



Office of the Independent Budget Analyst

**Key Issues Related to
Requiring Payment of
Prevailing Wages on all City
Public Works Projects**

**Presentation for
City Council
July 30, 2013**



Overview

- On May 15, 2013, the Rules & Economic Development (R&ED) Committee considered a two paragraph memorandum from the Mayor requesting the City Council adopt an ordinance applying the State's prevailing wage laws to all City public works projects.
- Chair Lightner requested that the following be brought back to Committee on June 19, 2013:
 - a report prepared by City staff to address potential policy and cost implications of a prevailing wage requirement;
 - City Attorney asked to develop a draft an implementing ordinance and legal analysis regarding proposed Senate Bill 7;
 - IBA Report to review the resulting staff report, analyzing cost implications related to a prevailing wage requirement and discussing any related policy issues.



Overview

- The staff report presented to the R&ED Committee on June 19th cited the difficulty of evaluating the fiscal impact of a prevailing wage requirement and did not estimate the potential project cost implications associated with requiring prevailing wages on all City public works projects.
- In developing IBA Report 13-26 (Attachment 1) for the R&ED Committee, we reviewed numerous studies on project cost implications and discussed the proposed policy change with knowledgeable City staff and representatives from outside organizations.
- In response to Committee direction, our report estimated that prevailing wage requirements would increase total project costs by 5%.



Overview

- In making his presentation at the June 19th Committee meeting, the Assistant Chief Operating Officer disagreed with our estimate that total construction costs would increase by 5%.
- Other proponents of prevailing wages (i.e., Alex Littlehale of SmartCitiesPrevail.org) have similarly disagreed with our estimation approach.
- They generally suggest that requiring higher prevailing wages does not necessarily lead to higher labor costs on public works projects because more skilled workers will complete public works projects more efficiently.



IBA Comments

- Given limited data, the IBA acknowledges the difficulty in estimating the impact of prevailing wage requirements on total project costs.
- We have reviewed the literature/arguments of prevailing wage proponents and appreciate their feedback.
- Based on our assessment of literature/studies for and against prevailing wage requirements, our best judgment is that prevailing wages will increase total project costs for the City.
- The potential for increased total project costs is particularly important in light of the **high priority** the Council has assigned to addressing the City's infrastructure challenges, including a backlog in deferred capital for facilities, streets, and storm drains currently estimated at \$898 million.



IBA Comments

Submitted critiques of our analysis and estimation approach:

- Findings not supported by rigorous academic review.
- Ignored the preponderance of academic evidence.
- Overstated outlier findings showing significant costs associated with prevailing wages.
- Did not consider the potential offsetting impact of cost efficiencies on the increased cost of wages.
- Did not consider the possibilities of increased tax revenues and the associated multiplier effects.



Findings of Significant Benefit

- Staff Report 13-065 lists "Findings of Significant Benefits" derived from "academic literature, public testimony and expert opinions".
- The IBA questions whether the City's professional public works/engineering staff has been asked to weigh in or contribute their experience and expertise on these findings?
- Do we have local data from the City's prevailing wage projects to substantiate these findings?

Findings of Significant Benefits:

- Higher quality/less defective work
- Properly trained apprentices
- Fewer change orders/cost overruns
- Pre-bid conference with trade-specific subs
- More likely to finish on schedule
- Better and well-trained workforce



Summary of IBA Report 13-26

- Prevailing Wage law in California
- Arguments For and Against Prevailing Wage laws
- Challenges estimating fiscal and economic impacts
- Potential impacts to infrastructure programs
- Seven recommendations for Council Consideration



Estimating Fiscal Impacts

- Three Approaches to Estimate the Potential Fiscal Impact to Total Project Costs:
 1. IBA Report 13-26 – Developed an Estimation Approach
 2. City Manager's 2003 Report – Prior Research Conducted by Professional Engineering Staff
 3. RS Means – Current Tool for Estimating Construction Costs
- If there are increased project costs, what are the Potential Impacts to the City's Planned Infrastructure Programs?



Estimated 5% Cost Increase

- Our assumptions:
 1. labor costs comprise approximately 25% of a public works project;
 2. prevailing wage requirements will on average increase labor costs by 20% on City public works projects; and
 3. other potential fiscal impacts (like tax multiplier benefits, increased efficiencies, reduced contractor profit margins or increased administrative costs) are not considered.
- If a cost component which constitutes 25% of total project cost (labor) increases by 20% (due to higher wages for workers), then 20% of 25% equals a 5% estimated increase in total project costs.



Impacts to Infrastructure Programs

- Although the estimated percentage increases are relatively small, the resulting additional costs for construction contracts are significant.
- Given limited funds and competing priorities, this would reduce the number of projects that could be implemented.
- We estimated the following potential implications:
 - Cost of construction contracts to be awarded could increase from \$13 million to \$26 million.
 - Number of projects that could be addressed in the planned borrowing for the Deferred Capital Funding Plan could be decreased by approximately \$17 million or \$34 million.
 - Increase in cost of asphalt overlay projects by \$11-22 million could reduce miles of streets overlaid by 22-44 miles.



2003 Engineering Study

- The most recent study of the impacts of prevailing wage requirements on public works projects. The study was a significant effort conducted by the City Engineer and professional staff in 2003.
- The Manager's Report (03-111), found:
 - Buildings projects – Labor cost increase of 20% resulting in total construction cost increase of 7.5%. Note that this means labor force would have to be about 17%-20% more efficient to make up for additional costs.
 - Pipeline projects – Labor costs increase 20-40% resulting in increased total construction cost as high as 17%.
 - Road projects – Labor increases from 20-35% resulting in increase of 16% for total construction costs.



RS Means Construction Cost Estimator

- After consulting with professional staff we were able to compare 26 project line items applying both prevailing wages and non-prevailing wages using RS Means--a leading tool used by professional engineers to estimate construction costs (date labor, materials and overhead costs).
- We believe RS Means would provide some perspective on potential fiscal impacts of the proposed prevailing wage requirement because the database is developed using local information from winning bids and is updated quarterly.
- Based on our analysis of 26 line items from projects ranging from landscaping to sidewalk repairs to trench excavating and backfilling, we found the average percentage increase for total construction costs to be 12% when prevailing wages were applied and compared to line items when non-prevailing wages were applied.



Labor Compliance Program

- Adopting prevailing wage requirements for all public works projects will significantly grow the City's labor compliance monitoring responsibilities and associated administrative costs.
- Staff has not been able to inform the Council regarding the potential cost impacts of enforcement of this program nor have they fully assessed the additional resources needed for effective compliance.
- Roughly estimates the need for an additional 6.50 FTEs, but is likely understated because it does not address potential resources needed for M&R or service contracts. (currently \$17.7 million)




IBA Dual Bid Alternative Approach

- Contractors required to submit prevailing wage and non-prevailing wage bids for construction projects.
- City staff conducts usual process to evaluate the low bid in each category.
- City's policy would be to award to the lowest prevailing wage bidder so long as it does not exceed the lowest non-prevailing wage bidder by a pre-determined percentage to be decided by Council. For discussion, let's say 5%.



IBA Dual Bid Alternative Approach

Example 1	Contractor A	Contractor B	Contractor C
Prevailing Wage Bid	\$5 million	\$6.3 million	\$4.7 million 
Non-Prevailing Wage Bid	\$4.5 million	\$5.8 million	\$4.6 million

In Example 1, the lowest prevailing wage bid is *Contractor C's* bid of \$4.7 million and the lowest non-prevailing wage bid is *Contractor A's* bid of \$4.5 million.

➤ Since the prevailing wage bid of \$4.7 million is only 4.4% higher than the non-prevailing wage bid of \$4.5 million (which is less than the less than 5% cap), the project would be awarded on a prevailing wage basis to *Contractor C*.



IBA Dual Bid Alternative Approach

Example 2	Contractor A	Contractor B	Contractor C
Prevailing Wage Bid	\$3.3 million	\$3.0 million	\$2.8 million
Non-Prevailing Wage Bid	\$3.0 million	\$2.5 million ☆	\$2.6 million

In Example 2, the lowest prevailing wage bid is *Contractor C's* bid of \$2.8 million and the lowest non-prevailing wage bid is *Contractor B's* bid of \$2.5 million.

➤ Since the prevailing wage bid of \$2.8 million is 12% higher than the non-prevailing wage bid of \$2.5 million (which is more than the less than 5% cap), the project would be awarded on a non-prevailing wage basis to *Contractor C*.



Other Potential Alternatives

- Amend City Charter
- Hire a Consultant to Study Prevailing Wage Impacts
- If the decision is to adopt Prevailing Wage ordinance, consider Suggestions on Pages 10 and 11 of IBA Report 13-26 which were offered to:
 - Clarify if there are any exemptions (such as M&R and service-related contracts)
 - Ensure that prevailing wages requirements do not conflict or work against other Council priorities (SLBE)
 - Gather relevant data and report back to Council so the resulting impacts of Prevailing Wages are better understood in the future



Conclusions

- The IBA was asked to estimate, not to empirically certify, the potential annual cost implications of adopting a prevailing wage ordinance.
- After much research and discussions with professional staff, our best judgment is that net of any potential offsetting benefits, a prevailing wage requirement will increase total construction project costs for the City.
- If we are correct, a prevailing wage requirement will necessarily slow the pace of high-priority public infrastructure programs.



Conclusions

- The IBA does not oppose prevailing wage requirements ; however, we believe Council should 1) have sound fiscal impact information and analysis before making major policy decisions and 2) understand the potential tradeoffs between competing policy objectives.
- We do not believe the Council received balanced or well developed fiscal/administrative analysis for this important policy decision.

We believe it is fiscally responsible to understand and consider the likely trade off in the form of higher capital project costs and the resulting impact to infrastructure programs which are a high priority for the City.



Conclusions

- The IBA is concerned that the Council is being asked to make certain findings in the prevailing wage ordinance without sufficient evidence:

“WHEREAS, compliance with state prevailing wage laws on municipal affair projects will provide certain benefits to the projects, including but not limited to higher quality and lower cost through the use of a skilled labor force, a safer jobsite, projects completed on schedule, bidders who have the quality, fitness and capacity to satisfactorily complete the project, allowing all contractors to compete on an even playing field, and that the public benefit from requiring compliance with state prevailing wage laws will outweigh any potential increase in costs;”



Conclusions

- Given these concerns and understanding the Council may wish to adopt a prevailing wage ordinance, the IBA has suggested alternatives for the City Council to consider.
- Of those alternatives, the IBA strongly recommends a dual bid requirement be implemented to cap project cost exposure and develop good comparative project cost data going forward.



QUESTIONS ?

City Council Meeting
July 30, 2013



IBA Suggestions

1. Extend the effective date of the ordinance to FY 2015 to allow additional time to prepare and plan in the normal budget cycle.
2. Establish a \$1 million project cost threshold beneath which prevailing wage requirements would not apply to assist Small Local Business Enterprises (SLBEs) and maintain the financial feasibility of small cost-sensitive community projects.
3. Request the Assistant Chief Operating Officer work with the Office of the City Attorney to clarify the applicability of the State's current prevailing wage laws to the City to create targeted exemptions so as not to interfere with other policy objectives and priorities.



IBA Suggestions

4. Ask Development Services Department staff to evaluate the impact of potential project cost increases on 1) the City's 42 Public Facilities Financing Plans (with a focus on FBA funded plans) and 2) existing developer reimbursement agreements.
5. Ask Purchasing & Contracting Department to report on their plans for gearing up the Labor Compliance Program (LCP) to properly enforce the prevailing wage ordinance. Request the department develop and present an annual report discussing the activities and results of the LCP (as was done for the Living Wage Ordinance).



IBA Suggestions

6. Request that staff return to Council one year after the effective date of the prevailing wage ordinance with a report from the Public Works and Purchasing & Contracting departments on their successes and challenges in administering/monitoring for contractor compliance. Perhaps also solicit feedback from construction contractors doing business with the City or endeavoring to do work for the City.
7. Request that staff return to Council one year after the effective date of the prevailing wage ordinance with an analysis of the fiscal impact of requiring prevailing wages on the cost of public works construction contracts. Request that staff acquire and maintain data on an ongoing basis to help facilitate this analysis.