



THE CITY OF SAN DIEGO

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## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Date Issued: July 26, 2013

IBA Report Number: 13-33

Council Meeting Date: July 30, 2013

Item Number: S500

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

## 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 projects that are "public works" within the meaning of the State prevailing wage law. The City currently requires compliance with federal labor wage laws for projects receiving federal funds and State prevailing wage laws for projects receiving State funds. Additionally, the City requires compliance with the State's prevailing wage laws on all water and/or sewer fund projects whose estimated construction costs exceed \$10 million.

In order to receive additional information on this important policy decision and address related policy considerations raised by the IBA and Committee members during this meeting, 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; an update of previous legal opinions, draft ordinance, and legal analysis provided by the Office of the City Attorney; and an IBA Report reviewing the staff report, analyzing cost implications related to a prevailing wage requirement and discussing any related policy issues.

The staff report presented to the R&ED Committee on June 19<sup>th</sup> 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%.

In making his presentation at the June 19<sup>th</sup> 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.

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. However, given our assessment of both 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 buildings/facilities, streets, and storm drains currently estimated at \$898 million.

In an effort to provide more balanced information to the City Council, IBA Report 13-26 additionally discussed: prevailing wages law in California; arguments in favor of and against prevailing wage laws; challenges in assessing the impact of prevailing wages on total project costs; potential impacts to City infrastructure programs; and other relevant policy considerations related to requiring prevailing wages. Finally, our report concluded with seven recommendations for Committee and City Council consideration if a decision was made to require prevailing wages.

After lengthy discussion and public comments, the Committee voted 3 to 2 in favor of forwarding the proposed ordinance to the full Council with the recommendation that City staff work with the City Attorney to clarify the applicability of the State's current prevailing wage laws to the City, address certain recommendations made in IBA Report 13-26 and prepare a draft implementing ordinance. The IBA has received and reviewed the new staff report issued on July 22, 2013. This report discusses key issues related to the proposed requirement to pay prevailing wages on all public works projects, including Findings of Significant Benefit; the estimated fiscal impact of the prevailing wage requirement; impacts to infrastructure programs if costs are higher; enforcement of the requirements; and other notable implications. The report also provides alternatives for Council consideration.

## FISCAL/POLICY DISCUSSION

### **Findings of Significant Benefit**

As stated in IBA Report 13-26, there is much controversy over laws requiring the payment of prevailing wages, and the debate is ongoing. Numerous studies exist on both sides of the issue and we believe each side has significant and valid points; however, it is important to recognize that neither side has a preponderance of evidence. While much attention has been focused on whether or not prevailing wages increase total project costs, less attention has been directed at substantiating some of the benefits attributed to prevailing wage requirements (notably: higher quality projects, fewer cost overruns, safer/better work sites, increased local tax revenue, etc.).

The Administration recently provided two staff reports on prevailing wage requirements for public works projects (Report 13-051 dated June 5, 2013 and Report 13-065 dated July 16, 2013)

which included arguments in favor of prevailing wages. However, the reports did not address arguments against prevailing wages and did not appear to include objective analysis rendered by the City's professional public works/engineering staff on the potential fiscal impacts of this requirement on public works projects. 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? If so, where is the information from the City's professional staff experts? Further, do we have local data from the City's prevailing wage projects to substantiate these findings? If the answer to either of these questions is no, we question why the Council is being asked to approve these findings in the ordinance that has been docketed for July 30<sup>th</sup>.

### **Estimated Fiscal Impact of the Prevailing Wage Requirement on Public Works Projects**

The IBA acknowledges that the City has limited project data which makes it challenging to evaluate the potential impact of a prevailing wage requirement on total project costs. However, despite this limitation, the R&ED Committee asked our office to estimate the potential cost implications. We have attempted to do that in a number of ways that are summarized below:

#### ***2003 Engineering Study***

The most recent study of the impacts of prevailing wage requirements on public works projects was a significant effort conducted by the City Engineer and professional staff in 2003. Utilizing certified payroll data from City projects, staff broke out the percentage of labor and applied prevailing wage rates to those projects where they were not required and non-prevailing wage rates to projects that had required prevailing wage rates. The Manager's Report (03-111), included as Attachment 2 to this report, concluded that requiring prevailing wage rates on all City construction contracts could increase the capital cost of projects because prevailing wage rates are higher than at-will labor rates paid by contractors, although the rate of increase depends on the type of project. For example, projects requiring a higher percentage of unskilled labor such as landscaping and slurry seal will be impacted more than a building project that requires a higher percentage of skilled labor. Specifically, the report 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.

#### ***Some New Data - Using the RS Means Construction Cost Estimator***

Updating the 2003 study would require both resources and time from professional staff, particularly because bids for capital projects do not break out labor costs. However, 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. RS Means is 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.

### ***IBA Report 13-26***

On pages 5 and 6 of our report, we discuss challenges of assessing the impact of prevailing wages on total project costs and suggest what we believe is a simple and reasonable estimation approach. We assume that: 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) all other potential fiscal impacts like tax multiplier benefits, potentially reduced contractor profit margins or increased administrative costs are not considered. Using these assumptions, 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.

A number of factors could alter the results of this simple estimation approach up or down:

- Labor could constitute a higher or lower percentage of total project costs.
- Wage increases could be higher or lower than 20%.
- Higher wages could attract better workers who might be able to work more efficiently thereby fully or partially offsetting the higher wage costs, or not.

Based on our research and conversations with public works professionals, we believe our assumptions and the resulting estimate of a 5% increase in total project costs are reasonable, if not conservative for public works projects that require less skilled labor (i.e., road or landscaping projects). Obviously, if one assumes prevailing wages do not increase total project costs, there are no implications to be illustrated. Our report also illustrated the implications of a 10% increase in total project costs.

### **Impacts to Infrastructure Programs if Total Project Costs are Higher**

Addressing infrastructure issues is clearly one of the highest priorities for the City, particularly given the estimated \$898 million backlog of deferred capital for buildings/facilities, streets, and storm drains. Further, the backlog is anticipated to significantly increase as information is collected in FY 2014 on the condition of City facilities, sidewalks, and park assets. Our office believes it is fiscally responsible to estimate and understand the potential impact of prevailing wage requirements on the City's ability to fund needed infrastructure projects.

The recent staff reports indicate that there will not be a fiscal impact on infrastructure programs. However, our office continues to believe that prevailing wage requirements will increase project labor costs and, to a lesser extent, total costs for public works projects. Although some economic benefits may potentially be realized (i.e., increased local taxes attributable to a higher proportion of local contractors and local workers), these benefits are difficult to measure and it is unlikely that they will significantly offset increased total project costs.

IBA Report 13-26 made an effort to evaluate the potential impacts to the City's infrastructure programs. As noted above, we believe it is reasonable to **estimate** that prevailing wage requirements will increase total project costs by 5%. As this estimate may be considered by some to be conservative, we also illustrate the impact of a 10% increase on total project costs. 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 by the City. We estimated the following impacts:

- Cost of construction contracts to be awarded (identified in the FY 2014 CIP budget) 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.

### **Enforcing a Prevailing Wage Requirement: 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. For example, additional staff will be needed to review certified payroll reports and interview employees at jobsites to verify actual wages paid. There will also be a need for staff to train and educate contractors about the City's new prevailing wage requirements.

The staff report notes that an added cost of about \$250,000 will be charged to public works projects for labor compliance for every \$100 million. This rule of thumb is helpful, but staff has not made the effort 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. If prevailing wages were to be implemented during FY 2014, a mid-year appropriation would need to be made. Additionally, new positions will have to be evaluated and classified by the Personnel Department. The hiring process can take significant time and needs to be factored into plans to significantly ramp up EOC's Labor Compliance Program. Staff would also need to be trained.

The Mayor's EOC Program Manager estimates the need for one compliance officer for every 10 construction projects; however, this is not addressed in the staff report. He roughly estimates the need for an additional 6.50 FTEs, but acknowledges this will depend on the number/types of public works projects that are subject to prevailing wage monitoring. Additional staff can either be reimbursed from CIP project funds (adding to overall project costs) or funded by the General Fund for non-CIP projects. IBA Report 13-26 indicated that adding 1.00 Supervising Management Analyst and 5.00 Associate Management Analysts to perform the additional labor compliance work would have an annual cost of approximately \$714,000. This cost estimate may be understated because, for example, it only includes staff needed to enforce compliance with CIP projects. It does not address the potential resources needed for Maintenance & Repair (M&R) or service contracts. This is important information for the Council to know and consider as part of their decision.

## **Other Notable Implications**

***SLBE Projects*** - The City currently sizes some public works projects to be under \$500,000 in order to attract and provide contracting opportunities to Small Local Business Enterprises (SLBEs). Additionally, there are SLBE bid incentives for contracts under \$1 million. Although these efforts are designed to encourage SLBE participation in City construction projects, prevailing wage requirements and associated administrative costs may be a disincentive for SLBEs that lack resources or administrative staff familiar with prevailing wage law. The IBA agrees with staff report comments about the importance of educating contractors, especially SLBEs. If SLBE participation in City construction projects is to be maintained at high levels, it will be important to provide training and information to SLBE contractors in advance of the effective date of the requirement to pay prevailing wages on all projects and so that they are prepared to comply with the new requirements.

***Smaller Community Projects*** - Increased labor costs attributable to prevailing wage requirements could also create fiscal challenges for small cost-sensitive community projects (landscaping projects, tot lots, community signs, etc.) that tend to be labor intensive. In an effort to avoid these unintended consequences, the IBA recommends the Council consider specified exemptions or a project cost threshold beneath which prevailing wage requirements, if adopted, would not apply.

***Public Facilities Financing Plans and Developer Fees*** - The City has 42 Public Facilities Financing Plans (PFFP) which include the infrastructure and public facilities needed to serve the community and identifies priorities and funding sources. The cost estimates for projects in the PFFPs are based on non-prevailing wage. If the cost of public works projects increases, as is likely the case, the plans will not accurately reflect project costs and, importantly, the City will not be collecting sufficient fees to cover these costs.

## **ALTERNATIVES FOR CONSIDERATION**

### **IBA Recommended Alternative Approach to Implementing Prevailing Wage Requirements**

The lack of good information about the costs and benefits associated with prevailing wage requirements makes it challenging for the City Council to make a fiscally sound policy decision. If prevailing wages result in increased project costs, then the Council should know by how much and how these additional costs will impact their top priority of reducing the City's growing backlog of deferred capital projects. Understanding the Council may be interested in pursuing a prevailing wage policy, the IBA suggests an alternative approach to implementing prevailing wages be considered.

The IBA recommends that the City Council adopt a policy requiring contractors to dual bid construction projects. Contractors would be required to submit a prevailing wage bid and a non-prevailing wage bid. City staff would conduct their usual process to evaluate the low bid in each category. The City's policy would then be to award the project to the lowest prevailing wage bidder so long as the low prevailing wage bid did not exceed the lowest non-prevailing wage bid by a pre-determined percentage, to be determined by Council (for discussion purposes, let's say 5%). So long as the low prevailing wage bidder does not exceed the low non-prevailing wage bidder by more than 5%, the City will always award the contract to the low prevailing wage

bidder. In other words, a policy decision is being made that the City is willing to pay for increased costs of up to 5% for prevailing wages.

There are several reasons to consider this approach:

1. It enables Council to proceed with a prevailing wage policy that caps their cost exposure if prevailing wages significantly increase total construction project costs.
2. It allows Council to set a maximum price (in the example above 5%) on the benefits they believe are associated with a prevailing wage requirement.
3. It allows City staff to develop an excellent apples-to-apples database to be re-evaluated in the future which would be beneficial not only to our City but to other states and municipalities grappling with this issue. Future policy can be better shaped using this data.
4. This approach will provide solid information for estimating construction costs and budgeting for projects. This policy approach could be used for all City construction projects, a subset of projects or be trialed as a pilot program.

The IBA has discussed the feasibility of this approach with public works staff and they generally believe it is workable. We do not believe this will create too much of an extra burden for contractors who already develop their bids both ways for different agencies. Contractors, used to submitting non-prevailing wage bids, would be additionally asked to augment their bids to reflect the provision of prevailing wages. The planned implementation of PlanetBids software will make this process easier for contractors and City staff evaluating the bids, and we believe implementation of this software is a key component of our recommended dual bid approach.

If the City Council elects to pursue this recommendation in whole or in part, the Office of the City Attorney will need to amend the ordinance that is before you.

### **Other Potential Alternatives**

#### ***Charter Amendment***

One of the ordinances the Council will be asked to approve on July 30<sup>th</sup> asks the City Council to make a number of significant benefit findings. For example, the following WHEREAS clause is found in the docketed ordinance:

“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;**”

The IBA questions whether the Council has been provided sufficient data from the City’s professional public works and engineering staff to make these findings. Based on the research we have conducted to date, our office could not make these findings. If Councilmembers have difficulty in making these findings in order to implement prevailing wages, an alternative

approach would be to seek a Charter amendment to allow for prevailing wages. However, this alternative would require additional time, expense and voter approval.

***Hire a Consultant to Study Prevailing Wage Impacts***

The City could hire a qualified consultant to review the City’s historical project data (for both prevailing wage and non-prevailing wage projects) in order to make determinations about the associated benefits and costs of prevailing wage requirements. This alternative would involve expense and require some time for a consultant to be hired and perform the analysis.

***If the Prevailing Wage Ordinance is to be Adopted, Consider the Suggestions Found on Pages 10 and 11 of IBA Report 13-26***

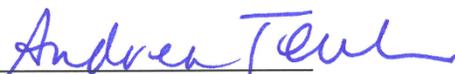
If the City Council elects to adopt the proposed prevailing wage ordinance, the IBA recommends consideration be given to the seven suggestions presented on pages 10 and 11 of IBA Report 13-26 which is attached. These suggestions were made to: 1) clarify if there are to be any exemptions (such as maintenance and repair contracts) to the State’s prevailing wage law as written; 2) ensure that prevailing wage requirements do not conflict or work against other Council priorities; and 3) request that staff collect data and report back to Council so that prevailing wage impacts can be better understood in the future.

**CONCLUSION**

As we noted in our report (IBA-13-26), there is much controversy over laws requiring the payment of prevailing wages and the debate is ongoing. Numerous studies exist on both sides of the issue and we believe each side has significant and valid points, and it is important to recognize that neither side has a preponderance of evidence. While the IBA recognizes the potential socio-economic benefits and understands this is a policy decision for the Mayor and Council, we also 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. We also believe it is the Mayor’s responsibility to provide Council with more complete information on such significant policy matters including substantive input from the City’s public works and engineering professionals and cost estimates for enforcement. Our goal in developing this report was to provide balanced information and recommendations for Committee and City Council consideration.

  
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**Attachments:**

- 1. IBA Report 13-26
- 2. City Manager’s Report 03-111