Living Wage Legislation

Elected officials are at it again, grossly miscalculating the impact.

Two weeks ago, I had lunch with one of New York City's high-ranking elected officials and the topic of the Kingsbridge Armory arose (a favorite topic of mine, as my frequent readers know). The official described what happened in the Bronx as a "gross miscalculation on our part of the impact of the living-wage compensation requirement on the project." No kidding! A living-wage requirement was imposed on the developer of the project to ensure that not only the contractors doing the construction, but all tenants leasing space in the project would pay employees a living wage. The developer, unable to get tenants to commit to pay this scale, pulled out, $310 million of private investment evaporated, and the building sits there today, a white-elephant reminder of a gross miscalculation.

Remarkably, several elected officials claimed that they would "rather have no jobs than jobs that pay an inadequate amount." They may be happy, but the people who could have received 1,000 construction jobs and 1,200 full-time retail positions, which would have been created at the site, are probably not so happy.

A living wage is a defined by the U.S. Department of Labor as "a wage sufficiently high to permit a worker to keep a given standard of living." As of 2011, federal and state minimum wage is $7.25 per hour while the living-wage totals were $11.50 per hour, comprising an hourly rate of $10.00 per hour and the health benefit supplement of $1.50 per hour. This living wage is also indexed to inflation. The living wage is, therefore, 59 percent higher than the minimum wage.

Many, including myself, would argue that higher-wage-paying jobs would be a good thing for the city. However, you could also argue that these jobs should be created by a thriving private-sector economy as opposed to mandated higher wages. Many reports have shown that living-wage mandates historically do not create or sustain jobs.

Notwithstanding this fact and the reality of the Kingsbridge debacle, bills have been drafted to institutionalize this living-wage mandate on projects receiving non-as-of-right public benefits. The first draft, 251-A, was shot down and a more "business-friendly" version, 251-B, was proposed. This legislation would require living wages to be paid by any "financial assistance recipient" receiving more than $1 million of benefits in the form of cash payments, grants, bond financing, tax abatements and exemptions, energy cost reductions, environmental remediation costs, or any additional itemized items that may be negotiated. One million dollars may sound like a lot but over a 25-year period, this amounts to just $40,000 per annum. The legislation also applies to all tenants, subtenants, leaseholders, fee holders and other condominium owners in a project and some contractors and subcontractors.

251-B has attempted to soften the impact of the initial iteration that was heavily criticized for containing too many job-killing components. However, even with the incorporated modifications, the living-wage bill retains job-killing ingredients that will hurt the very workers it seeks to help. If some elected officials still believe "no jobs are better than jobs that pay an inadequate wage," they may just get the "no jobs" they are willing to accept. Below are some job-killing aspects of the proposed legislation.

It would perpetuate the "Kingsbridge Armory" debacle throughout the five boroughs. This is particularly true in the outer boroughs, which have been historically underretailed, had rates of unemployment higher than Manhattan's and could benefit most from the additional economic activity and employment created by publicly supported projects.

The legislation would make it more difficult to create a range of affordable housing options—one of this city's chief priorities—at a time when the city's massive efforts to build or incentivize new housing are challenged by a difficult economy and a historically tough lending market. Generally, the feasibility of affordable housing developments is dependent upon a viable retail component. Given the administrative, compliance and additional cost burdens associated with this legislation, creating a viable retail component becomes even more challenging. Why would a retailer move into a project receiving benefits when they could simply open across the street and save significantly on their overhead?

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The legislation imposes additional burdens, financial, administrative and otherwise, on many of the city's cultural and social service institutions, impacting alternative revenue streams they have developed to remain afloat in an environment of diminishing public resources. While nonprofits are directly exempt from the living-wage requirements, any subtenants of theirs or long-term contractors must comply and the nonprofit is responsible for oversight of the employment practices of these parties.

This legislation virtually guarantees that franchise businesses like Subway, McDonald's, Burger King, Dunkin' Donuts and dozens of others would never open in a development that has received benefits. Many of these franchises are opened by immigrant residents who are looking to pour blood, sweat and tears into a business operation. Because the revenue of all "parent company" operations is included, overhead costs would make these operations unable to compete with a similar operation across the street.

251-B puts in place a disincentive for small businesses to grow since even modest growth in their revenues may subject them to exponential jumps in cost and bureaucracy if they secured certain types of government funding or occupied space in a publicly supported project. In fact, at the margin, a smaller business may find it financially beneficial to ensure that revenue comes in below $5 million to avoid the variety of burdens imposed by this legislation.

The last two factors are perhaps the most important considerations illustrating why this legislation would be harmful to the city's economic development projects.

The first is that the legislation would likely prevent private-sector investment in economic-development projects by creating a risk that a successful project could, years after opening, be subject to millions of dollars of penalty charges as a result of a subtenant's employment practices. Does a private developer (who would be the "financial assistance recipient") want to invest in a project that is only feasible based upon public assistance and then have that assistance "pulled" when a tenant, for whatever reason, knowingly or otherwise, fails to comply with the law? Not to mention the repayment of benefits received to date on that project. Why take on all of that risk and be subject to hurdles that competitors do not have to deal with?

The second is the impact this legislation would have on green grocers, another focus of city officials, and other low-margin businesses. This legislation would effectively eviscerate the FRESH (Food Retail Expansion in Support of Health) program, which has been a duly much-heralded initiative of this mayoral administration and City Council, thus depriving New Yorkers, particularly in the outer boroughs, of additional employment and greater food choices.

Let's take a closer look at the FRESH program to fully understand the impact this legislation would have. There are presently 14 businesses operating within this program throughout the city. The average FRESH grocery store is 28,475 square feet and employs an average of 73 full-time-equivalent employees. The average hourly wage of these employees is $9.73. It is estimated that 60 percent of grocery store workers are paid the minimum wage of $7.25 per hour. While an increase to $10.50, or $3.25 per hour, might not sound like a lot, the aggregate implications for the industry are tremendous, and devastating.

In the grocery business, the average profit margin is about 1 percent of gross revenue. If we assume that the $7.25 workers are increased to $10.50, costs would clearly rise but not just for these employees. "Creep" in wages would occur as a more senior employee who was making a certain amount more than the minimum-wage worker would have to receive a raise as well to keep relative compensation in line. Therefore, it is likely that a $3.25 wage increase would impact almost all employees.

For illustrative purposes, we will not include this inevitable creep in our example. Presently, there are 1,027 employees of FRESH participants. If we use the 60 percent minimum-wage assumption, 616 of these employees are earning minimum wage. An increase of $3.25 per hour in their wages would yield increased costs of $2,002 per hour in the aggregate, or additional costs of $16,016 per day assuming an eight-hour shift. Working five days a week and being paid for 52 weeks a year would mean additional payroll expenses of $4,164,160 per annum. In a business that has a profit margin of 1 percent, the gross revenue of the stores would need to increase by over $400 million per year to cover theses increased costs. Today, it is estimated that the 14 FRESH participants gross approximately $200 million if aggressive assumptions are made. Tripling gross revenue is an outrageous assumption.

An analysis of the 14 FRESH participants shows that if the living-wage legislation were to be applied to them, 12 would be out of

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business. If that is not job-killing, what is?

Moreover, what is actually most frightening about this bill is what we don't know. As drafted, this legislation will affect any entity that receives over $1 million in financial assistance that is negotiated or awarded by the city, even if the funding comes from the state or federal government. It would also apply to existing projects whenever their agreements are modified or renewed.

Has the city administration done an analysis of how many entities would be swept up under this legislation, if it were assumed that the legislation applied to current recipients of government monies? The analysis of the legislation's impact on the FRESH program is enlightening but it would be even more interesting to review a full analysis of all the entities that would be subject to this legislation so that the public can have a full understanding of the wide-ranging sweep of the bill.

Additionally, the manner in which the legislation was drafted raises a series of serious questions as to how this legislation would be applied.

For instance, the legislation defines a "small business" as having gross revenue of less than $5 million, inclusive of parent and subsidiary income, and regardless of business expenses. Was it the bill's sponsor's intent to capture a business, for example, like a high-volume green grocer located in a high-rent location? The legislation requires exempt entities to recertify their status each year. If a small business were to have revenues over $5 million for just one year, would it permanently lose its exemption? If that business didn't pay its employees the living wage that year, would the building owner owe the city millions in restitution?

Manufacturers are purportedly exempt. Does that include all manufacturing processes? Are ancillary, on-site businesses also exempt? How would the legislation address wholesale and retail operations on site? Would the legislation apply to a manufacturer operating within a mixed-use project? Will small or manufacturing businesses be willing to lease space in economic-development projects if they are required to file proprietary business records each year with the comptroller?

Regarding affordable housing, it seems like this legislation is a death knell for projects involving a mix of incomes and uses. For example, was it the intent of the legislation to impose new requirements on a project that blends supportive housing and middle-income housing?

When this legislation was created, did the sponsors contemplate that projects may be unable to obtain financing based upon the risk that a project could, years later, be subject to millions of dollars of penalty charges as a result of a subtenant's employment practices? This would burden yet another party with the oversight responsibility to make sure that employment practices of perhaps dozens of tenants will comply. Underwriting is dependent upon these projects receiving benefits and, without them, the projects are not feasible. Lack of compliance would create financial burdens for these developments that would completely change their financial picture. Banks will be reluctant to lend with such financial uncertainty.

If a nonprofit social service organization receives financial assistance to develop its property, it would presumably be exempt both as a covered employer and as a financial assistance recipient. Yet it appears that its subtenants would be subject to living-wage requirements. Who would oversee this? Are these organizations in a position to deal with these obligations?

Lastly, at a time when municipalities, including New York City, are facing budget deficits and are looking to trim costs where they can, are additional costs for the city to administer this program appropriate? What are the additional costs to the city for implementing this legislation, particularly with regard to the increased demands on the comptroller's staff who would now be charged with audit and oversight of the thousands of private businesses that are tenants in financially assisted projects?

In these very difficult economic times, when unemployment in our city far exceeds any acceptable level, does anyone believe that this legislation will, in any manner, create the new private-sector jobs that this city so desperately needs? Unfortunately, it is likely that only those who prefer "no jobs" to "inadequately paying" jobs will be happy if this legislation passes.

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