

The Impact of Minimum Wage Increases in California

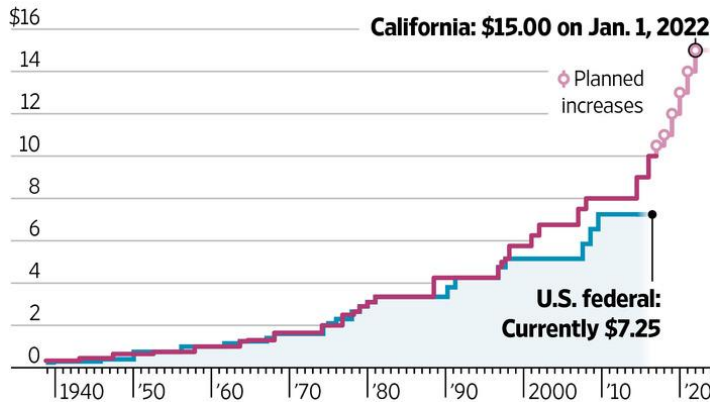
An analysis of the SB-3 legislation and its potential impact on Seniors Housing and Skilled Nursing Facilities

By: Humair Sabir

Possibly because this is an election year, there has been significant misinformation and confusion circulating around the scheduled minimum wage increases in California. We, as an organization, are currently in the process of acquiring senior housing facilities in California, and have been debating the impact of the SB-3 legislation to those facilities. I thought it would be useful to summarize my findings on the topic, and my opinions on the impact it will have on the seniors housing and skilled nursing industry in California.

Recent History/Background

For some background, California has been fairly proactive in raising its minimum wage, especially when compared with the federal government. Even in the midst of an economic downturn, on January 1, 2008, California increased its hourly minimum wage from \$7.50 to \$8.00. It was further increased to \$9.00 on July 1, 2014 and \$10.00 effective January 1, 2016, which currently remains in effect.



By comparison, the federal minimum hourly wage is currently \$7.25 and has not changed since July 2009. The spread between California and the federal minimum wage is expected to increase sharply, as shown in the above chart¹, unless the federal government institutes a drastic increase. This is unlikely in the new Trump administration and Republican controlled Congress.

Senate Bill No. 3 ("SB-3")

On April 4, 2016, Governor Jerry Brown signed legislation that made California the first state in the country to commit to a \$15 minimum wage for its hourly employees. This legislation,

called Senate Bill No. 3 or SB-3, mandates an increase in the state minimum wage over the next few years based on the following schedule:

Calendar Year	26 Employees or More	25 Employees or Less
2016	\$ 10.00	\$ 10.00
2017	\$ 10.50	\$ 10.00
2018	\$ 11.00	\$ 10.50
2019	\$ 12.00	\$ 11.00
2020	\$ 13.00	\$ 12.00
2021	\$ 14.00	\$ 13.00
2022	\$ 15.00	\$ 14.00
2023	\$ 15.00	\$ 15.00

Thereafter, starting 2024, and once the state hourly minimum wage reaches \$15 for all businesses, it will be indexed annually for inflation (national CPI) with a floor of 0.0% (i.e. no decreases) and a ceiling of 3.5%.

Since SB-3 is intended to increase the minimum wage consistent with economic expansion, it provides the Governor with safety valves or "off-ramps" to suspend wage increases if economic or budgetary concerns emerge. The Governor can act by September 1st of each year to pause the next year's wage increase for one year if there is a forecasted budget deficit (of more than one percent of annual revenue) or poor economic conditions (negative job growth and retail sales).

It is also important to note that SB-3 is only related to the state of California's minimum wage. Local entities (counties and cities) are free to enact their own minimum wages that are higher than the state minimum. Employers are required to follow the stricter standard (i.e. the one that is the most beneficial to the employee).

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So far, at least seventeen (17) local bodies in California have adopted timelines to \$15/hour that are more aggressive than the state, including the cities of San Francisco, San Jose, and Los Angeles².

¹ The Wall Street Journal, "California Moves Toward \$15-an-Hour Minimum Wage", March 27, 2016

² The Economic Policy Institute, Minimum Wage Tracker, http://www.epi.org/minimum-wage-tracker/#/min_wage/California

Impact to the Seniors Housing and Skilled Nursing Sector

There are approximately 7.0 million hourly workers in California, of which almost 2.2 million are currently paid minimum wage³. It is estimated that 5.6 million Californians will be impacted either directly or indirectly by SB-3, 8% or 440,000 of those are related to the healthcare industry⁴.

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While it is unclear as to how many senior housing and skilled nursing employees these increases will directly impact, it is clear that the effects will be greatest amongst lower-skilled, but extremely critical roles, such as nurses' assistants and caregivers. Also, when the wage floor rises, all categories close to

the floor tend to rise as well, therefore indirectly impacting the entire labor force.

From an operating stand-point, the most immediate and hardest hit will be the larger operator/managers, not just because they have the largest payrolls, but also because the minimum wage increases occur a year earlier for them. Mom and Pop operators with one-off facilities typically tend to have fewer than 25 employees and therefore will have a year to plan for the increase in labor costs. However, smaller operators will start seeing the indirect effects of wage increases much earlier than expected.

Location of the facilities will also be a key factor, as most of the major metropolitan areas in California have local ordinances mandating a higher minimum wage than the state. For example, in May 2015, the Los Angeles City Council approved a proposal for a gradual establishment of a citywide minimum wage of \$15.00 per hour by July 1, 2020, far earlier than the state requirement. San Francisco has an even more aggressive timeline and is scheduled to jump to \$15 per hour starting July 1, 2018.

Navigating the Storm

Eventually, private-pay operators will have to figure out how to pass these increased wage costs to consumers in the form of rate increases. This will likely have to take place over time and will depend on the competitiveness of each facility. During this transitional period, we should all expect significant margin compression.

Theoretically speaking, facilities that depend on the government, should expect reimbursement to grow and catch up to the increased labor costs. However, practically speaking, we can all expect reimbursement to significantly lag behind expense increases.

In the meantime, while economists continue to endlessly debate the merits of raising the minimum wage, healthcare providers will have to look for ways to improve productivity in order to stay in business. Seniors housing and skilled nursing operators are already engaged in efforts to increase the quality of the care they provide while lowering costs. Increasing the productivity of their labor at every level of their organization is crucial to that effort. Operators with outdated operating models will leave the industry and efficient care providers will gain valuable market share.

Conclusion

There is no doubt that increases in the minimum wage will cause some pain in the short-term, but, in the long-run, it will benefit organizations that streamline their operations to provide the highest quality of care in the lowest cost setting.

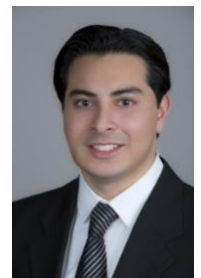
Further Resources

The Economic Policy Institute, a non-profit and non-partisan think tank, tracks the minimum wage by state and local entities. It can be accessed on their website at <http://www.epi.org/minimum-wage-tracker/>.

A fact sheet on the new legislation from the Office of the Governor can be found under https://www.gov.ca.gov/docs/Fact_Sheet_Boosting_Californias_Minimum_Wage.pdf.

For full text of SB-3, visit: <http://leginfo.legislature.ca.gov>.

The author, Humair Sabir, currently serves as Vice President of Acquisitions at Granite Investment Group. He has been involved in reviewing and closing billions of dollars in seniors housing and skilled nursing transactions. For any comments, inquiries, or questions, please call 949.477.5800 or email hsabir@graniteinvestment.com.



³ Office of the Governor, "Governor Brown Signs Landmark Legislation to Raise California's Minimum Wage", 2016

⁴ Center for Labor Research and Education, University of California Berkeley, "Who would be affected by the Proposal to raise California's minimum wage?", 2016