

Every Penny Counts:

The impact of the minimum wage on the supply chain



David Egan

Americas Head of Industrial and Logistics Research

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- Across the U.S., minimum wages are on the rise. Many states and municipalities are proposing and passing legislation that pushes their minimum hourly wages above the federally mandated \$7.25 to as much as \$15.
 - Labor accounts for approximately 20% of total supply chain costs, so rising wages have a significant impact on the bottom line. For a fulfillment operation of 500 employees, a \$1 per hour wage increase can raise labor costs by approximately \$1 million per year.
 - A \$1 million increase in costs in a 500,000 sq. ft. facility equates to a rent increase of \$2.08 per sq. ft. - a substantial 37% over the \$5.65 per sq. ft. average warehouse lease rate.
 - Rising wages may encourage distribution users to seek new locations in neighboring municipalities or states with lower wage scales, or even to pursue automation alternatives in an attempt to control labor costs.

“Global trade and the continuing rise of e-commerce have increased demand for labor at warehouse and distribution facilities. As the minimum wage continues to trend higher, it will put added cost pressure on industrial occupiers. Every dollar increase in wages represents the equivalent of a 37% hike in rents for the operator of a typical big-box distribution facility.”

— Laura Sidney, CBRE Labor Analytics

Deemed unrealistic just a few years ago, the movement to increase minimum wages is making hourly wages as high as \$15 a reality in many cities across the U.S. Last summer, Los Angeles Mayor Eric Garcetti signed into law a bill that will raise the minimum wage from \$9 to \$15 per hour by 2020, making Los Angeles the largest U.S. city to enact a \$15 minimum wage.¹ The first increase, to \$10.50 per hour, is set to take place on July 1.² It's worth noting that, while the minimum wage legislation was passed, the city also decided to cut the business tax which will result in a 16% reduction over the next three years. This will save Los Angeles businesses approximately \$90 million and is expected to partially offset the effect of the wage increase. In the meantime, California's state minimum hourly wage increased from \$9 to \$10 on January 1, and a ballot initiative to further raise California's hourly minimum wage by \$1 each year, to \$15 by 2021, is headed to state voters in November.

Raising the minimum wage will have a significant impact on employers, who will need to reallocate revenue, raise prices or amend hiring practices to cover the additional cost. There is, of course, a social benefit to boosting minimum wages in some markets, especially given that overall U.S. wage growth amounted to 5% from 2010 to 2015, a marked slowdown from the 12.7% gain from 2004 to 2009, according to the U.S. Department of Labor.

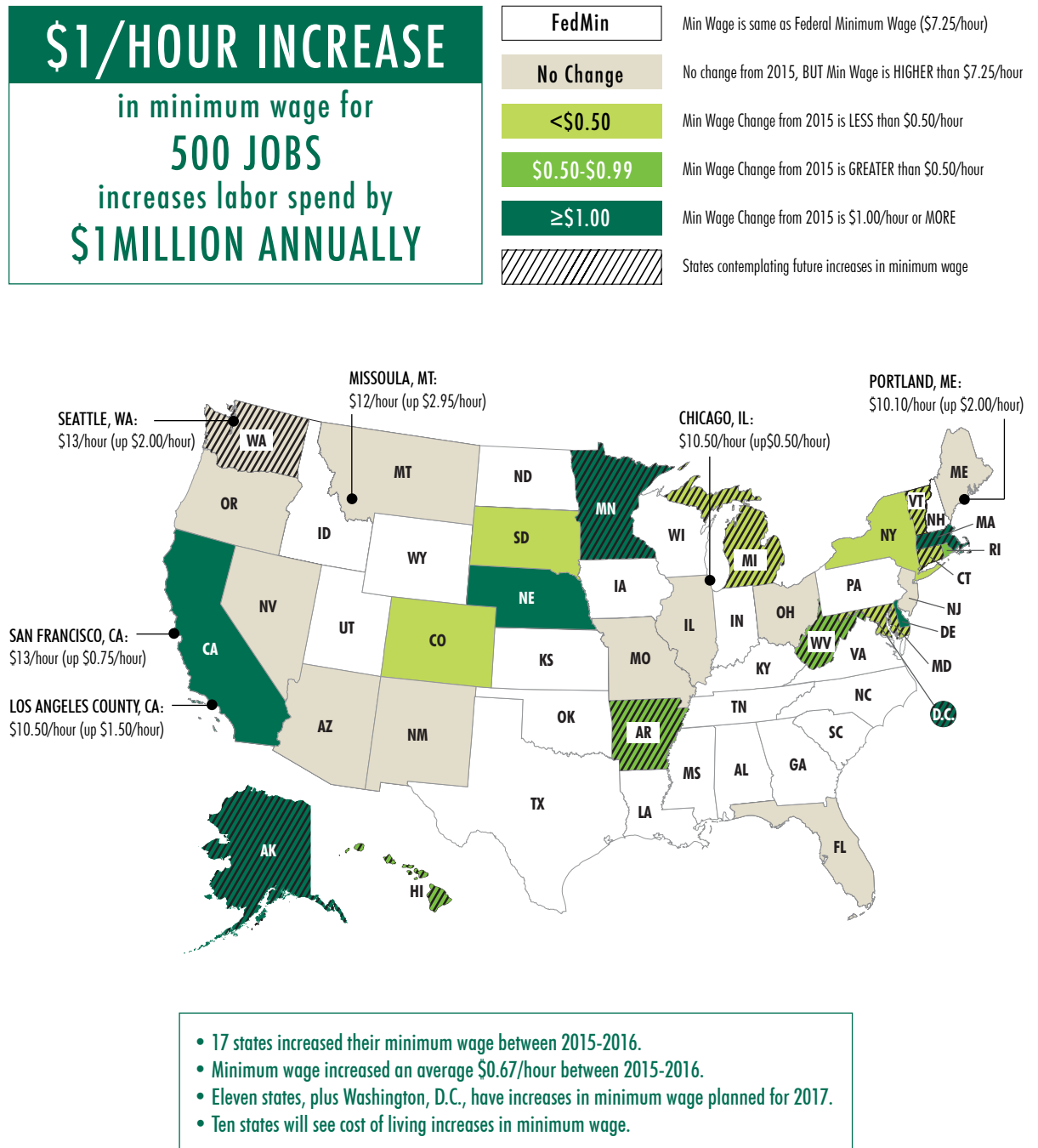
With the future minimum wage approaching the current average warehouse wage in some municipalities and states, industrial occupiers should understand and begin to plan for these changes.

Currently, 28 states and Washington, D.C. have minimum wages that exceed the federally mandated minimum of \$7.25 per hour. In many municipalities across the country, minimum wages are even higher; across the 23 cities or counties whose wages exceed respective state minimums, the average is \$10.50 per hour. The largest of such difference is in SeaTac, Washington, a town that surrounds the Seattle-Tacoma Airport.

1. Luckerson, Victor. "Here's Every City in America Getting a \$15 Minimum Wage" Time. 23 Jul 2015.

2. "Minimum Wage Tracker" The Economic Policy Institute. Updated 3 Feb 2016.

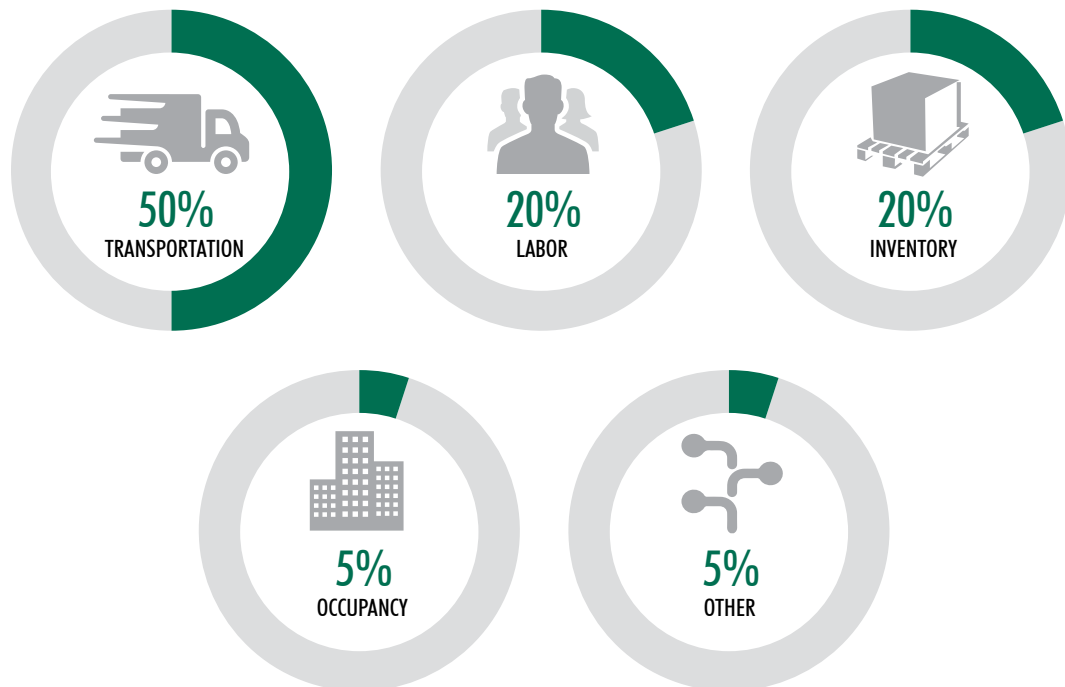
Figure 1: Minimum Wage Changes by State (2015-2016)



Source: National Conference of State Legislatures, February 1, 2016.

While Washington's minimum wage is \$9.47 per hour, SeaTac's minimum wage is set 58% higher—at \$15. Among the nation's largest cities, New York, San Francisco and Washington, D.C. have all recently passed measures to join Los Angeles and SeaTac in gradually increasing their minimum wages to \$15 per hour by 2021. Seventeen states and Washington, D.C. have seen minimum wage hikes take effect in 2016, with an average increase of 67 cents per hour. With 11 more states set to increase minimum wages over the next five years, and with the issue gaining popularity among voters, industrial real estate occupiers need to be aware of the impact of higher wages on labor and overall occupancy costs, since labor can represent up to 20% of total supply chain costs.

Figure 2: Total Supply Chain Costs



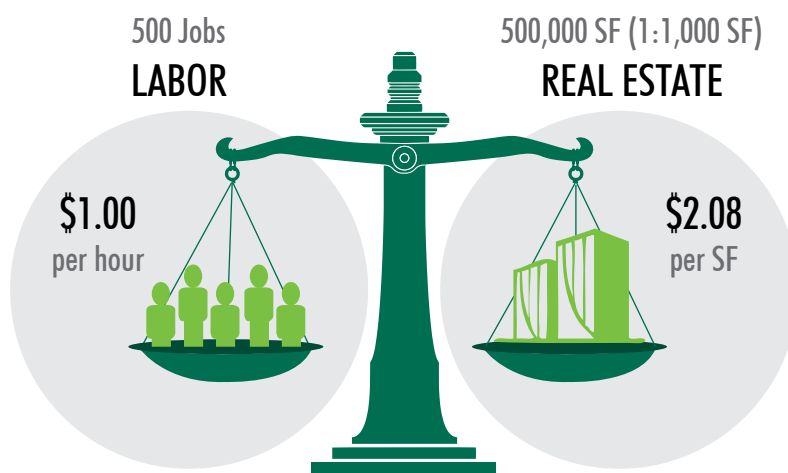
Source: Chainalytics, November 2015.

“Supply chain management is a constant balancing act of cost and service, and this minimum wage conversation has massive implications on that balance. In order to remain competitive in this challenging E-commerce reality, occupiers are now forced to find savings by reshaping inventory levels or further optimizing their transportation network.”

— Scott Marshall, Americas Industrial & Logistics Services

A CBRE analysis of minimum wage hikes across the U.S. shows that a small increase in the minimum wage can have significant implications for industrial occupiers. For a typical 500 employee operation, a \$1 increase in the average hourly wage raises its annual labor costs by \$1.04 million.³ This increase is equivalent to a \$2.08 per sq. ft. per year increase in rent for the 500,000 sq. ft. distribution center that might house this operation (assuming a density of one employee per 1,000 sq. ft.). To put this in perspective, a \$2.08 increase would represent a 37% mark up over the average U.S. industrial rent of \$5.65 per sq. ft., an enormous increase for a typical distribution center. The potential impact on more labor-intensive operations like e-commerce—where employee density can be twice as high under normal circumstances and three to four times as high during seasonal surges—is substantial.

Figure 3: The Strategic Cost of Industrial Labor



Source: CBRE Labor Analytics, January 2016.

3. A \$1/hour wage increase for 500 jobs = \$1.04 million/year, assuming 2,080 hours/employee/year (\$1/hour x 500 employees x 2,080 hours/employee/year). A facility that houses 500 employees at 1,000 SF per employee = 500,000 SF (\$1.04 million / 500,000 SF = \$2.08/SF/year price increase)

It's important to note that, while the average minimum wage is on the rise across much of the U.S., the immediate impact on labor costs for warehouse operators is minimal. The average wage for a warehouse worker in the U.S. is \$11.82 per hour—well above the average national minimum wage. However, in key distribution locations, such as Southern California, the gap between the average warehouse wage and the local minimum wage is rapidly shrinking. In metropolitan Los Angeles and the Inland Empire (the Riverside/San Bernardino/Ontario metro area), average warehouse wages are \$12.22 per hour and \$12.13 per hour, respectively—approximately 20% above the current municipal minimum wages. By 2021, when the minimum wage in Los Angeles (and perhaps the entire state) reaches \$15 per hour, the warehouse and distribution industry will be faced with millions of dollars in additional labor costs, which will force some hard decisions.

What options do occupiers of warehouse and distribution centers have when their labor costs rise suddenly? Passing the extra cost along to the customer is not optimal; users will prefer to cut other costs to mitigate rising labor expenses. Raising operations efficiency with greater automation will likely become a priority. At the moment, robots that can move items from racks into the fulfillment stream are generally more expensive and less efficient than humans doing the same job. As the equipment improves and becomes less expensive, however, adopting these cutting-edge technologies may slow the rise of labor costs while increasing throughput. In the near term, as these technologies remain out of reach for many distribution and fulfillment users, the alternative might be to seek a new location with lower labor costs.

Where transportation infrastructure or a certain customer ties a distribution operation to a specific area, making a large move quite difficult, a neighboring municipality that is less ideal but features a lower minimum wage may become competitive. Operations that are more regional in scope, and less tied to a particular location, might cast a wider net—relocating to an adjacent state that offers a more favorable wage scale. Using Southern California as an example, operations that are dependent on the Ports of Los Angeles and Long Beach may find it impossible to move a great distance when the Los Angeles minimum wage increase puts pressure on their labor costs. If the California state minimum wage does not rise at the same rate as the Los Angeles wage, these users may seek to locate outside but near Los Angeles, allowing them to continue business at approximately the same cost. Regional users may look even further, to states such as Arizona and Nevada, where there have been little or no changes to the minimum wage since 2015 and which are less expensive than California. Ultimately, the overall effect of rising wages will likely be the reexamination of the entire supply chain network which will force innovation in the distribution process and demand a greater variety of viable distribution locations.

FOR MORE INFORMATION, PLEASE CONTACT:**Scott Marshall**

Executive Managing Director
Industrial & Logistics Services, Americas
+1 630 573 7026
scott.marshall@cbre.com
Follow Scott on Twitter: [@S_R_Marshall](#)

Adam Mullen

Managing Director, Supply Chain Services
Industrial & Logistics Services, Americas
+1 404 923 1414
adam.mullen@cbre.com

Laura Sidney

Director, Client Strategy
CBRE Labor Analytics
+1 602 735 5564
laura.sidney@cbre.com

Kristin Sexton

Managing Director, Consulting
CBRE Labor Analytics
+1 602 735 5247
kristin.sexton@cbre.com

Spencer G. Levy

Americas Head of Research
+1 617 912 5236
spencer.levy@cbre.com
Follow Spencer on Twitter: [@SpencerGLevy](#)

David Egan

Americas Head of Industrial & Logistics Research
+1 312 935 1892
david.egan@cbre.com
Follow David on Twitter: [@Egan2David](#)

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