Strategic Cost Considerations for Corporate Employers

Evolving Location Strategies in the COVID-19 Era

A Series Considering the Impact of COVID-19 on the Workforce Environment from CBRE Labor Analytics
The severity of COVID-19’s impact on industries, jobs and the workforce over the near and long term will depend on the duration of the pandemic and the medical solutions and government actions to combat the crisis.

Initial data already suggests which industries are being impacted the most and how the labor landscape might change over the long term. Corporations should be mindful of these impacts and thoughtful about how the shifting labor landscape informs their short- and long-term location strategies.

Through a series of articles, CBRE Labor Analytics will outline several key short- and long-term changes that likely will impact U.S. labor markets and the strategies employers can take in response to these changes.

Topics covered in this series include:
- Anticipating a Changing Landscape in the Workforce: Industry Impact on U.S. Labor Markets
- Location Strategy: Business Continuity and Operational Risk
- Location Strategy: Strategic Cost Considerations for Corporate Employers
- Sector Focus: Technology and E-commerce

For many companies, the pandemic has caused a fundamental shift from operational growth to contraction and/or rationalization. Although it is unclear how long this shift will last, the market disruption has been increasing and echoes many of the challenges faced during the Great Recession. Unique impacts of this pandemic-related downturn include uncertainty over future space requirements and evolving workplace strategies. In addition to business and operational risk assessment, employers are focusing on cost containment, driven by falling revenues for many industries. As a result, many companies are rationalizing their portfolios and modifying their location strategies to maximize cost savings.

In this report, CBRE Labor Analytics outlines location strategies for companies seeking to reduce costs in this decelerating economic environment.
**STRATEGIC COST CONSIDERATIONS FOR CORPORATE EMPLOYERS**

The economic disruption caused by COVID-19 has occurred at an unprecedented rate. In just eight weeks beginning in mid-March, the unemployment rate rose from a 50-year low of 3.5% to over 14.0%, with more than 38 million initial unemployment claims over nine weeks. The hospitality, restaurant and service sectors have been impacted the most. Figure 1.1 illustrates the sheer speed and depth of the pandemic’s impact on the job market relative to past recessions.

**Figure 1.1: Historical Recession Impact on the Workforce**

Many companies face extreme cost pressure as a result of social distancing measures put in place over the past few months. For many businesses, labor costs make up a large percentage of overall corporate costs—up to 85% for service and technology-oriented companies. As companies deal with tighter budgets and reevaluate their space needs, many are dusting off their location strategy playbooks from the Great Recession to find where they can access top-quality talent and location options for lower cost.
While reducing the real estate footprint is a common method for managing costs, moving jobs to lower-cost locations creates a much greater return on investment (ROI) over the long term. Consider this: Just a $1/hr. savings in labor costs is the equivalent of $16.64 per sq. ft. in real estate costs.¹

Bearing in mind that savings from reduced labor costs are much greater than from reduced real estate costs, many companies are evaluating how to reposition their talent portfolio. While there may be lower labor costs across most if not all markets, some will be better positioned than others due to their unique industry make-up, cost of living and minimum wage requirements.

**COST DRIVERS**

To understand the changing dynamics of the cost environment, a review of the primary drivers of labor cost is necessary.

![Diagram showing four cost drivers: Market Conditions, Industry Conditions, Talent Expectations, Legislation & Regulations.]

Many of these drivers are shifting as the pandemic continues to significantly alter labor conditions. This in turn likely will affect strategies and the approach of both employers and workers.

¹Assumes a utilization rate of 1 person per 125 square feet.
One of the biggest challenges for employees prior to the pandemic was the rapidly escalating cost of living in many of the hottest job markets. Cities like San Francisco, New York, Boston and Seattle have been the best markets to get a high-paying job, but also some of the most expensive in terms of cost of living. Surging competitive talent growth and increasing housing needs have caused similar conditions in other maturing markets, such as Denver, Portland and Dallas.

The pandemic has already significantly lowered millions of Americans’ incomes. One of the federal government’s initial measures to help relieve income loss was the Economic Impact Payment program, which provided up to $1,200 to individuals earning less than $100,000 per year. To illustrate the cost of living across major markets in the U.S., CBRE Labor Analytics has evaluated to what degree a $1,200 stimulus check covers the average monthly rent of a two-bedroom apartment.

As illustrated in Figure 2.1, dark green locations indicate where the stimulus created a significant surplus of income greater than rent. Locations in orange represent areas where the stimulus check does not account for even 50% of one month’s rent. Pacific Coast and Northeastern markets require higher incomes to affordably cover the average market rent.
Markets with lower housing costs, as noted in Figure 2.2, can attract top talent with a wage that provides more purchasing power. This in turn can boost morale, improve culture and reduce employee turnover—an often overlooked but costly expense.

**Figure 2.2: Percent of Income Spent on Housing**

**MARKETS WITH THE HIGHEST % INCOME SPENT ON HOUSING**

<table>
<thead>
<tr>
<th>Rank</th>
<th>City</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>1</td>
<td>Los Angeles</td>
<td>44.9%</td>
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<td>2</td>
<td>San Francisco</td>
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<td>3</td>
<td>San Jose</td>
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<td>New York</td>
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<td>Sacramento</td>
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<tr>
<td>7</td>
<td>Riverside</td>
<td>27.6%</td>
</tr>
<tr>
<td>8</td>
<td>Boston</td>
<td>26.7%</td>
</tr>
<tr>
<td>9</td>
<td>Seattle</td>
<td>26.2%</td>
</tr>
<tr>
<td>10</td>
<td>Portland</td>
<td>25.4%</td>
</tr>
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</table>

**MARKETS WITH THE LOWEST % INCOME SPENT ON HOUSING**

<table>
<thead>
<tr>
<th>Rank</th>
<th>City</th>
<th>Percentage</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Pittsburgh</td>
<td>13.5%</td>
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<tr>
<td>2</td>
<td>Indianapolis</td>
<td>14.5%</td>
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<tr>
<td>3</td>
<td>Detroit</td>
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<tr>
<td>4</td>
<td>Houston</td>
<td>14.8%</td>
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<tr>
<td>5</td>
<td>San Antonio</td>
<td>15.3%</td>
</tr>
<tr>
<td>6</td>
<td>Kansas City</td>
<td>15.3%</td>
</tr>
<tr>
<td>7</td>
<td>Dallas-Ft. Worth</td>
<td>15.4%</td>
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<tr>
<td>8</td>
<td>Cleveland</td>
<td>15.6%</td>
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<tr>
<td>9</td>
<td>Cincinnati</td>
<td>15.6%</td>
</tr>
<tr>
<td>10</td>
<td>St. Louis</td>
<td>15.6%</td>
</tr>
</tbody>
</table>

Note: Excludes MSAs with populations below 750,000.

Source: ESRI, Median Household Income and Median Home Value 2019, CBRE Labor Analytics Research.

Companies seeking to reduce operating costs by relocating to lower-cost markets may be pleasantly surprised by greater availability of talent. The combination of cost-of-living concerns and increased adoption of remote working may create new migration patterns to these lower-cost markets. Preliminary data from Redfin may be an early indication of this trend.
The 10 metro areas with the greatest in-migration of Redfin users in Q2 2020 were all second-tier markets that had a lower cost of living relative to their primary feeder markets: Los Angeles, New York and San Francisco (See Figure 2.3).

**Figure 2.3: Top 10 Markets – Inflow Migration – Redfin Users 2Q 2020**

Note: The migration analysis is based on a sample of more than 1 million Redfin.com users who moved (inflow) to cities outside of their existing market in the second quarter of 2019 & 2020.

Source: Redfin, Q2 2020, CBRE Labor Analytics Research.

The higher cost of living in coastal cities is one of the primary reasons for migration to low-cost markets that offer the benefits of large-city infrastructure (Figure 2.4). This in turn boosts the supply of various skill sets and talent, offering more opportunity for employers to reduce costs or be more competitive. As seen by historic migration patterns, this is not a new trend and likely will accelerate.

**Figure 2.4: Coastal City Migration 2010–2019**

Note: Natural increase refers to the net gain or loss when considering births and deaths in a population.

LEGISLATION & REGULATION: A NEW WAGE ENVIRONMENT

As labor markets across the U.S. tightened over the past several years, employers increased wages to attract and retain top talent. As market conditions change and wage pressures ease, markets that provide employers with more flexibility in pay rates may have an advantage.

Minimum wage requirements have always been a consideration for employers, particularly those with entry-level, high-headcount operations. In today’s economic environment, legislation affecting wage levels may become more important than ever. During the past economic expansion, tightening labor markets forced employers to raise wages. In some cases, employers had to raise wages regardless of minimum wage requirements. However, as market conditions have changed and wage pressures eased, those markets that provide greater wage flexibility (i.e., a lower floor) may gain a near-term advantage in attracting new jobs, particularly for distribution, manufacturing and entry-level service or back-office operations.

Figure 3.1: Minimum Wage Rates – Continental United States

Many Pacific Coast and Northeast states and cities have minimum wages as high as $16 an hour (Figure 3.1). Meanwhile, several states in the South and Midwest, where the cost of living is generally lower, have minimum wages at or near the federal level of $7.25. As companies seek to cut costs—particularly for entry-level jobs—these lower-cost states provide a distinct operating advantage amid a declining economic environment. States proximate to those with the highest minimum wages, like Nevada and Idaho in the West and Pennsylvania in the Northeast, may be net beneficiaries of corporate relocations from nearby states with relatively higher minimum wages.

Minimum wage legislation likely will continue to influence corporate site selection, but federal stimulus legislation may also play an important role in the near-term cost strategies of employers. If an additional round of federal stimulus under consideration (as of September 2020) mirrors the rates and terms of the last round, it could influence how soon unemployed workers in some markets return to work, potentially constraining near-term labor supply or wage levels for employers looking to fill entry-level positions.

The increased $600-per-week unemployment benefit from the initial stimulus roughly equated to a base hourly wage of $15 or an annual salary of $31,200. This rate is higher than several high-volume, entry-level jobs across the country and well above most minimum wage requirements.

While the initial stimulus didn’t appear to heavily influence labor costs, it provided insight to how large of a wage increase some occupations may face if minimum wages are increased. Figure 3.2 illustrates several occupations that could have significant pay gains if minimum wages are increased at the local or national level to meet the equivalent of the enhanced unemployment benefit.

Figure 3.2: Unemployment Pay (Initial Stimulus) vs. Entry-Level Pay Averages

<table>
<thead>
<tr>
<th></th>
<th>CALL CENTER REPRESENTATIVE</th>
<th>RETAIL SALES ASSOCIATE</th>
<th>FAST-FOOD COOK</th>
<th>WAREHOUSE WORKER</th>
<th>MANUFACTURING WORKER</th>
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</thead>
<tbody>
<tr>
<td>$ BELOW INITIAL STIMULUS WAGE</td>
<td>$2.33</td>
<td>$3.52</td>
<td>$4.34</td>
<td>$0.65</td>
<td>$1.14</td>
</tr>
<tr>
<td>% BELOW INITIAL STIMULUS WAGE</td>
<td>-15.5%</td>
<td>-23.5%</td>
<td>-28.9%</td>
<td>-4.3%</td>
<td>-7.6%</td>
</tr>
</tbody>
</table>

Source: Economic Research Institute, Q3 2020, CBRE Labor Analytics Research.
THE LABOR COST SAVINGS IMPACT

Labor costs can account for as much as 85% of a company’s operating costs. So as companies seek ways to reduce costs, relocating jobs to low-cost environments can have a significant impact. Markets in Asia, Eastern Europe and Latin America may continue to provide some of the greatest cost savings opportunities—up to 70% in labor costs in some cases. However, unique vulnerabilities produced by the pandemic, combined with increasing political pressure and the need for more specialized skills, will continue to push employers to retain jobs in the U.S.

Figure 4.1 illustrates the significant potential cost savings of relocating jobs from high-cost established markets to lower-cost emerging markets within the U.S. for software engineering skills. The priority for any location decision should be the supply and availability of talent and skills. But once the depth of the market has been determined, lower-cost locations can be a powerful and effective strategy for reducing operating costs over time.²

Figure 4.1: Median Software Engineer Salary

Source: Economic Research Institute, Q3 2020, CBRE Labor Analytics Research.

Moving software engineering positions from an established market like San Francisco to an emerging market like New Orleans saves $24,000 per job per year (Figure 4.1). Moving 250 of those positions saves $6 million per year or $60 million over 10 years.

The shifting economic conditions caused by COVID-19 likely will put cost considerations front and center again in corporate location strategies. While the duration of the pandemic is uncertain, companies seeking opportunities to reduce costs would be smart to make a clean assessment of their location strategy. Not only can significant cost savings be achieved, but market disruption and new migration patterns may align to increase the talent pools in lower-cost locations.

²In Figure 4.1, Established Markets are considered higher-cost, mature Tech Talent markets such as San Francisco, Seattle, New York and Boston. Expanding Markets are those with significant growth over the past 5–8 years with increasing competitive footprints and costs such as Denver, Dallas and Portland. Emerging Markets are lower-cost growth markets with increased interest and growing talent base such as New Orleans, Nashville and Madison.
Those companies that consider expanding and emerging markets for a cost containment advantage may reap the benefits in the form of both lower costs and talent retention due to less local competition.

**ESTABLISHED, EXPANDING AND EMERGING MARKETS TO WATCH**

While each corporate employer has its own unique strategy to navigate the path ahead, cost considerations will be high on the list. Every market has its own strengths and weaknesses in costs, talent base, competitive presence and scalability to meet corporate requirements for competitive and cost advantages. All should be evaluated through a customized portfolio optimization and location strategy process.

Figure 5.1 provides a sample of markets across the established, expanding and emerging spectrum that may provide various talent and cost advantages, depending on skill set and operational requirements.

**Figure 5.1: Established, Expanding & Emerging Talent Markets**

### ESTABLISHED
- Highly experienced and well-educated
- Competitive and most expensive markets
- Top talent goes to the highest payers
- Most compelling career paths

### EXPANDING
- Strong population growth
- Expanding economies
- Strong educational institutions
- Talent is migrating to these markets
- Strong quality of life, lower costs of living, less traffic, unique cultural offerings

### EMERGING
- Niche markets - specialized skill sets
- Less competition and lower costs = preferred employer positioning
- Less scalable niche plays
- Not meant for large hubs

Source: CBRE Labor Analytics Research.
Whether to offset losses by containing costs, to access top talent through wage positioning, to avoid potential wage pressures in the future or to take advantage of emerging markets, employers will have a keen eye on these wage/cost drivers and how they correlate to their overall talent strategy.
METHODOLOGY

Labor Analytics understands that there are multiple drivers factored into location strategy. This report outlines additional location strategies that could be considered amid the COVID-19 pandemic. Building owners, investors and corporate tenants might have different processes in finding the perfect site for their facilities; however, their objective is the same: to locate a property that will attract a qualified tenant and stable workforce. For office-based industries, access to quality labor markets remains the driving force in site selection.

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