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# White Paper in Critical Updates to the San Francisco Chapter 14B LBE Ordinance

To Support the Growth & Development of Small Businesses in the Construction Industry

## **ABSTRACT**

The San Francisco Chapter 14B Local Business Enterprise Ordinance or “LBE program” was specifically created to level the playing field for small businesses to compete against prime contractors on public contracts, by creating a more equitable business environment. That level playing field has consistently been challenged in San Francisco where the cost of doing business continues to escalate year after year, making it harder for small businesses to thrive. Those small businesses that have been fortunate enough to maneuver the annual cost escalations from all angles in San Francisco, and experience growth; hit a complete wall within the LBE program when it comes to the economic thresholds (average gross receipts in prior three years) that they cannot exceed. Because while their costs increase annually, the economic thresholds within the LBE program, are subject to change only through an enormous time expenditure and effort, of a coalition of small businesses owners, community leaders and the political will of a few elected leaders.

This lack of an automated internal process for updating the economic thresholds to reflect the business environment of San Francisco has adversely affected small businesses across all categories, and gone against the spirit of the program, which intends to support small businesses, and enhance the economic diversity and economic vitality of San Francisco. Particularly for the Public Works/Construction category, one of the largest job providers across all the small business categories in the LBE program, costs have increased by roughly 123% (non-residential building costs), but economic thresholds which have not been updated since 2014, have stayed the same (Zarenski, par. 22).<sup>i</sup>

Therefore, we have outlined critical updates to the LBE program for the Public Works/Construction category, for not only proposed increases to the economic thresholds and the small business size standard measurement, but other areas that will support LBE’s to grow, develop and thrive in San Francisco’s current business environment.

## **BACKGROUND**

The San Francisco Chapter 14B LBE Ordinance was created in 1984 to course correct the City’s active and passive participation in discriminating against women and minority owned businesses in contracting for goods & services (Chapter 14.B.1.5 Local Business Enterprise Utilization and Non-Discrimination in Contracting Ordinance, 2).<sup>ii</sup> As the program has evolved, the City found “...that the public interest is served well if the city is self- sustaining. Stimulating the expansion of small firms or development of new enterprises fosters economic growth and independence for San Francisco and its taxpayers. This expansion of local small businesses advances the public interest, contributes to the economic well-being of all San Franciscans, and tends to minimize the burden on the General Fund to provide for general welfare” (14.B.1.6, 2).<sup>iii</sup> Since the creation of Chapter 14B there have been updates to the code via various ordinances passed by the Board of Supervisors (BOS), to ensure that it maintains the spirit of its foundation- to support the economic vitality of small business, small women-owned business and small minority owned businesses in San Francisco-by keeping up with the overall business environment in San Francisco.

Turner & Townsend found that one of the main drivers for the sharp rise in construction costs is the technology industry's demand for space across San Francisco (Slowely, par.2).<sup>iv</sup> In a separate article for *The San Francisco Chronicle*, Roland Li, a real estate reporter said "...Tech companies grow at a staggering pace in San Francisco and the Bay Area. Facebook's 756,000-square-foot deal in May (2018)...was not only San Francisco's biggest deal of the year, but the biggest in the city's history"(Li, par.9).<sup>v</sup> Perhaps most interestingly though, is that the article also noted that non-tech companies and professional service firms have shifted growth outside of the San Francisco/Bay Area, are occupying less space and/or moving back-office workers out of the expensive market (par.17).<sup>vi</sup> These observations all speak to the impacts that "big tech" are having on the San Francisco market in terms of driving up costs, and driving other businesses out. As office space inventory continues to constrict, it is even beginning to pose an issue for other big technology companies, who are having to lease major portions of new buildings well in advance of developers even breaking ground (par.21).<sup>vii</sup> **So, if big technology companies are running into challenges competing with one another in San Francisco, imagine what non-tech small businesses experience trying to also compete in the same market...Typically, they are leaving San Francisco.**

In continuing to consider the current business environment in San Francisco: San Francisco is the most expensive city in the world to build. At the end of 2018, construction costs in San Francisco were also the highest in the world, at an average of \$416 per square foot. The second most expensive city to build was New York City at \$368 per square foot, \$48 dollars less than San Francisco. And third most expensive to build was London at \$352 per square feet, \$64 less than San Francisco. A major cost driver in each of these markets, including San Francisco? The cost of skilled labor (due to shortages) and the rising cost of materials. By the end of 2019, construction costs are expected to rise another 6% in San Francisco alone (par.21).<sup>viii</sup>

The lack of skilled labor, and rising labor costs have also had a significant impact on Public Works/Construction LBE's, as there has been a squeeze on California's labor supply, that has been acutely felt in San Francisco. In fact, scarcity of workers has been found to be a major factor in the Bay Area's rising construction costs and the shortage of affordable housing. "According to a 2018 report by the UC Berkeley Turner Center for Housing Innovation regarding the drivers of housing construction costs in San Francisco, the number of workers in relation to the number of units being built is below the historical average, meaning that the demand for housing is outpacing the ability to fulfill construction demands" (Zagub & Chou, par.2).<sup>ix</sup> Also, because of the housing crisis in California, where only 80,000 homes of the 180,000 homes that need to be built annually, to address the crisis; workers often live far away from the construction sites in order to save money. While some companies do their best to offset commuter impacts by offering housing that is near the construction sites, there are limited options due to state rules & regulations (Berardi, par.2).<sup>x</sup> And for the few Public Works/Construction LBE's that are invested in local hiring, they are making personal investments in local communities to implement training programs to attempt at creating a labor pipeline.

**So with rising rent costs due to technology, increasing construction costs and decreasing access to skilled labor (driving up the cost of skilled labor); Public**

**Works/Construction LBE's are facing a uniquely costly business environment, culminating in San Francisco being the most expensive place in the world to build.**

**PROBLEM?**

The current economic threshold for Public Works/Construction is set at \$10 million for Micro-LBE's, \$20 million for Small-LBE's and \$33.5 million for SBA-LBE's. While the economic thresholds for Micro LBE's and Small LBE's in the Public Works/Construction category were increased in 2014, it has never been increased for SBA-LBE's since it was added to Chapter 14B in 2010 (Administrative Code – 14B Local Business Enterprise, 16).<sup>xi</sup> Utilizing a Consumer Price Index calculator for San Francisco, based on rates from the U.S. Bureau of Labor Statistics; the \$33.5 million that was designated to SBA-LBE's in 2010 when the category was added to the LBE program, would be \$43.1 million in 2019 (U.S. Dollar Inflation Calculator)<sup>xii</sup>. As the cost of construction has continued to skyrocket in San Francisco, and more pressure has been placed on SBA-LBE's by Primes & 1<sup>st</sup> tier subcontractors to create job opportunities, hire locally and invest in their local communities; many high performing small businesses are looking for ways to limit their potential sales to stay in the LBE program, in fear of graduating out and losing a significant percentage of their overall business.

Construction companies that would be considered 1<sup>st</sup> tier subcontractors, are operating at a three-year average gross receipts of \$100 million to \$200 million, their average gross receipts almost three to six times the current average gross receipts of SBA-LBE's at \$33.5 million. Making the prospect of graduating out of the LBE program for SBA-LBE's, that much more daunting. For the few that do graduate out-because the economic threshold has not been adequately adjusted over time to keep up with construction industry costs-when compared to their new competitors (companies they previously relied upon to be their 1<sup>st</sup> tier subcontractors) they are much smaller, with less resources and staff. The 1<sup>st</sup> tier subcontractors also lose valuable LBE partners, with no assurance of their replacement.

Public Works/Construction SBA-LBE's typically employ between 25 to 300 people at any given time during a single year (a combination of full-time office staff and field workers), paying all their staff weekly. Often 2<sup>nd</sup> or 3<sup>rd</sup> tier subcontractors on city-contracts, SBA-LBE's are relied upon by Primes and 1<sup>st</sup> tier subcontractors to finance all costs on new construction projects for up to 120 days. These costs include labor, materials, bonds, etc., and can be anywhere from \$25,000 to \$1,000,000 depending on the size of the project(s). These 2<sup>nd</sup> or 3<sup>rd</sup> tier SBA-LBE subcontractors are also only paid after Primes pay 1<sup>st</sup> tier subcontractors, which is usually on a net 60 payment cycle. Meaning SBA-LBE's, Small LBE's or Micro LBE's are then paid net 60 or 90 by the 1<sup>st</sup> tier subcontractors. Then, upon completion of projects, 10% of the payment is withheld, in a practice widely known within the construction industry as, Retention. Regardless of when the construction SBA-LBE or LBE's time on the job is complete, the final 10% is not paid until the entire construction project is in fact done (which in some cases can be years later).

Public Works/Construction SBA-LBE's specifically, are often times needed to create, finance, implement and execute upon training programs in partnership with City departments and unions; to ensure local hiring goals are met for their Primes on projects, in addition to giving

back to their local communities through various sponsorships. And while these opportunities are critical to fostering employment in San Francisco, these programs are extremely costly for construction SBA-LBE's.

SBA-LBE's, Small-LBE's & Micro-LBE's in the construction industry are critical to the lifecycle of projects. From beginning to end; their ability to hire (locally), sometimes initially finance and put people to work is what facilitates the completion of successful construction projects in San Francisco. **Therefore, Public Works/Construction SBA-LBE's, Small-LBE's & Micro-LBE's; should have their economic thresholds adjusted to stay in line with the cost of doing business in San Francisco.**

**Proposed Changes**

**1. Increasing Construction Thresholds (Micro-\$13M, Small- \$26M) to stay in line with the cost of doing business in San Francisco. Final figures to be determined by CPI.**

*Note: The Chapter 14B LBE Ordinance is set up so that the "Micro" category is always 50% of the Small-LBE economic Threshold. The SBA-LBE economic thresholds, are set based on other factors.*

<b>CURRENT LBE PROGRAM ECONOMIC THRESHOLDS</b>				
	"Micro"	"Small"	"SBA"	
Public Works/Construction	\$10,000,000.00	\$20,000,000.00	\$33,500,000.00	
<b>SUGGESTED LBE PROGRAM ECONOMIC THRESHOLDS &amp; EMPLOYEES</b>				
	"Micro"	"Small"	"SBA"	"SBA" – Employees
Public Works/Construction	\$13,000,000	\$26,000,000.00	N/A	350

**2. Implementing a small business size standard measurement by employee count, only. Public Works/Construction SBA-LBE's will be given up to 350 employees, tied to the 30% local hiring goal, as stipulated by OEWD.**

- For eligible SBA's, participation will be counted at 70%
- SBA-LBEs that engage in a mentor/protégé program with a micro-business, will be counted at 90%
- The SBA-LBE program will function as a legacy LBE program, therefore those businesses who have not been a part of the LBE program, cannot be certified as SBA-LBEs

SBA-LBEs in the Public Works/Construction category will have to file certified payroll and/or confirm their number of city build placements. If they fail to meet the 30% local hiring

goals, and fall within a 25% to 30% range; SBA-LBEs will immediately be required to work with OEWD and CMD staff, to implement an action plan or custom program, to increase their local hiring percentage. If SBA-LBEs fall within a 25% to 20% local hiring range, they will be subject to OEWD's City Build, disciplinary actions. If SBA-LBEs fall below a 20% local hiring percentage, they will be kicked out of the LBE program for one year at a minimum, and then will have to re-apply when they have a higher local hiring percentage.

*Note: Only SBA-LBEs who have had a local hiring percentage between 20% to 30% for three years consecutively or non-consecutively within the last 10 years (2010 to 2020) will be eligible for this SBA-LBE program. Office staff will be counted towards local hire requirements.*

**3. At least 10% of LBE requirements for city contracts must include Micro-LBEs**

- If a Micro-LBE is bidding against an LBE, the Micro-LBE should have a preference
- If a Micro-LBE is bidding as a General Contractor, their micro status must fulfill the Micro-LBE Requirement

**4. The Threshold for Micro-Set-Aside Contracts should be increased to \$1,500,000**

- Micro LBE truckers must be used on Micro LBE Set Aside Contracts

**5. Underserved SF communities, like District 10, Chinatown or the Western Addition, should have a Certificate of Preference (COP). This should follow existing housing COP legislation.**

**6. An automated Internal process between CMD, LBEAC and the City Administrator should be identified for reviewing the Economic Thresholds and/or Employee Size Standards for the LBE Program.**

**7. Contract Managers should utilize non-cost criteria to determine rating bonuses (i.e. Training and Mentoring Program, Track Record of Local Hiring, Workforce Development Initiatives).**

**8. Measuring LBE Participation by LBE Primes on a three-year average and applying preference to LBE Primes that are utilizing other LBEs or Micro-LBEs above the set LBE or Micro-LBE requirement on the project.**

**9. City contracts must include a 50% LBE requirement for Trucking.**

## **UNINTENDED CAUSES**

We believe that it is important to evaluate the solutions we have put forth, and review any "unintended causes," to ensure that we are not creating a business environment that will have adverse-effects on the way LBE's run their business in San Francisco.

- 1. Will the economic threshold increases or size standards by employee count, allow larger firms to now be classified as small businesses and compete against longstanding LBE's potentially taking their contracting opportunities?**

- a. The current proposed increased economic thresholds do not represent levels at which medium or big businesses will be able to enter the LBE program, compete on city contracts and remove opportunities from established LBE's, but instead are representative of the appropriate economic upward adjustments needed to support unencumbered growth for small businesses.
- b. Utilizing employee count particularly for the construction categories, will allow businesses to worry less about stifling their potential sales and focus on creating jobs and additional opportunities for their employees.

## **CONCLUSION**

The proposed changes to the Chapter 14B LBEA Ordinance as laid out in this white paper, have wide support from the San Francisco LBE, small business community, community leaders and union groups, and therefore we believe that the Board of Supervisor should move forward to adopt the aforementioned changes.

## REFERENCES

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**Thank You for Your  
Consideration.**