ProService | HAWAII

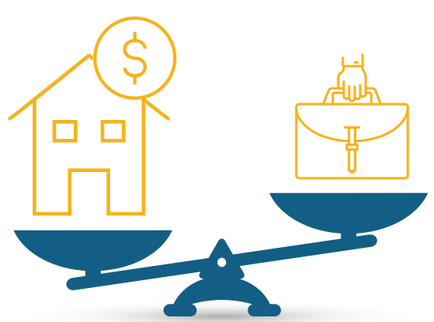
PARADISE TAX

The Cost of Doing Business in Hawaii



[Ben Welcome Message/Intro]

Sunny weather, beautiful landscapes and outdoor living make Hawaii one of the most sought after destinations in the world. But behind the beautiful landscape lies a harsh reality. The phenomenon commonly referred to as the “Paradise Tax” makes the cost of living and doing business in Hawaii significantly higher compared to most U.S. cities. **It’s the price we pay to live in paradise.**



So what is the price tag on paradise? Hawaii residents “pay” it everyday as we deal with low wages and a high cost of living. In fact, the gap between the two has gotten significantly worse over time as wages have grown at a much slower pace than cost of living. This “Paradise Tax” creates a “catch 22” that makes it increasingly difficult for employees to earn a living wage and employers to find and retain talent.

With this in mind, we set out to study the “Paradise Tax” by comparing Honolulu to other cities with a high cost of living, specifically San Francisco and New York City. We compared overall compensation and then broke it out by wages, taxes and benefits. We looked at historical data and analyzed how the landscape has changed over the last 35 years. We were hoping to discover trends and gain insight on the impact of the “Paradise Tax” and how other cities may have adjusted for a high cost of living.



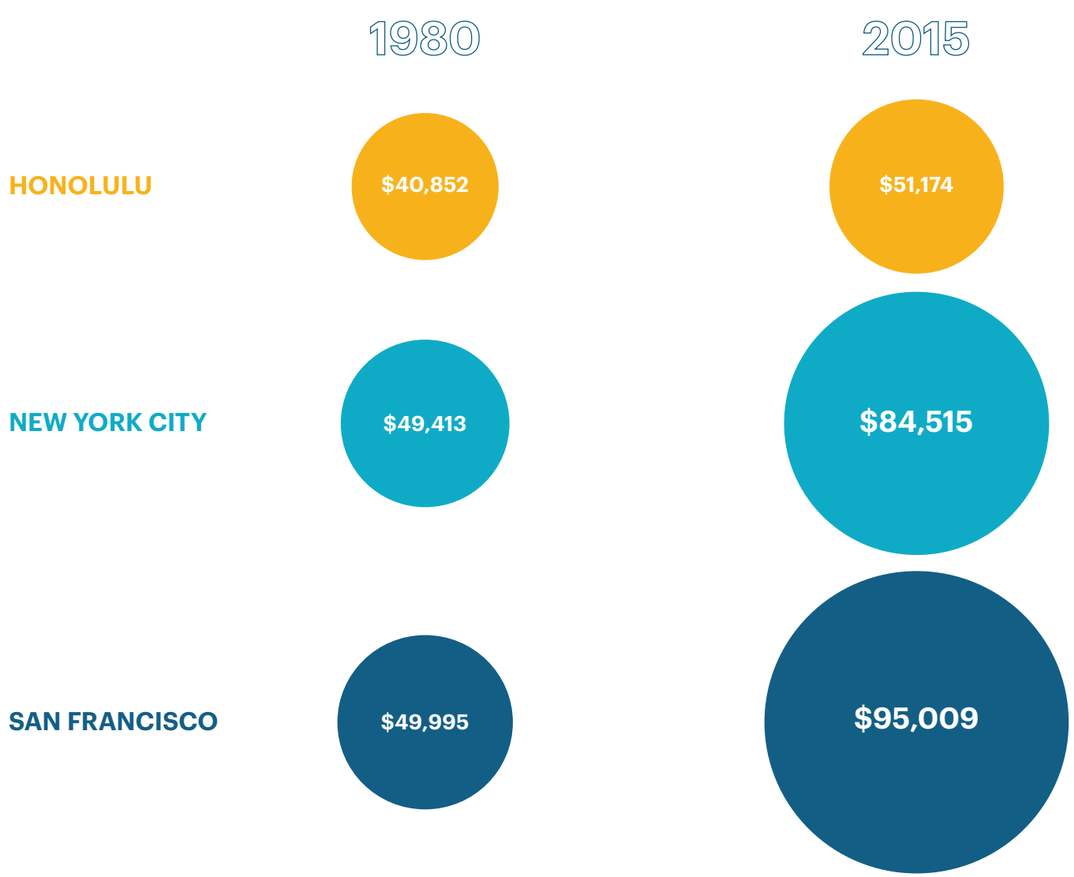
What we found was not only does the “Paradise Tax” exist, but it’s more extreme than we originally thought. While our research doesn’t paint an optimistic picture, it does put a spotlight on opportunities for local businesses to help ease the burden of the “Paradise Tax”. We hope this ebook sparks conversations within the Hawaii small business community and raises awareness for an issue that affects every employer and employee across the state of Hawaii.



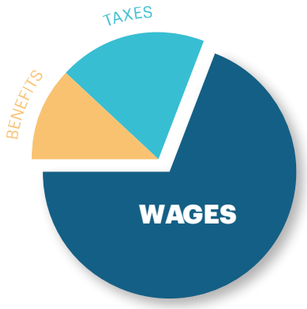
PART ONE

The Compensation Pie

Let’s start by taking a look at the whole compensation pies for Honolulu, San Francisco, and New York City in 1980 vs. 2015.

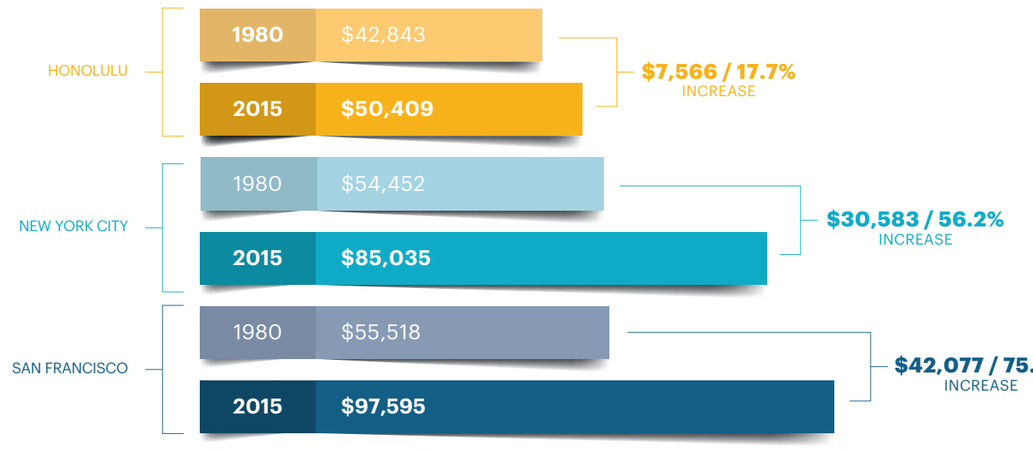


While the New York and San Francisco pies have grown significantly to keep up with the rising costs of living, the Honolulu pie looks almost the same as it did in 1980. Why? You may ask. Let’s cut the pie into slices and see what we discover.



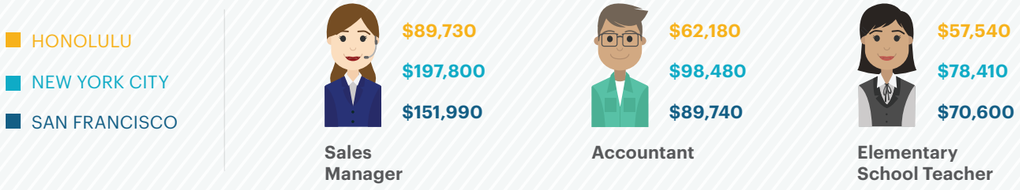
The compensation pie is composed of wages, taxes and benefits. Let's start by taking a look at the largest slice, **wages**.

Gross wages per employee: 1980 vs. 2015



As you can see from the graph above, in 1980, Honolulu ranked the lowest in total gross wages, 23% lower than San Francisco and 21% lower than New York City. Fast forward 35 years to 2015, you'll see that Honolulu is still the lowest, but the gap has widened significantly. Honolulu gross wages are now 48% lower than San Francisco and 41% lower than New York City. Over the last 35 years, Honolulu wages have only increased by $7,566 (a mere $200/year), whereas San Francisco increased by $42,077 and New York City by $30,583 during the same time frame.

Estimated after tax wages & benefits for payroll employees: 1980 vs. 2015





How much does **income tax** take away from the wage slice of each compensation pie?

According to Bloomberg, The Best—and Worst—States to Avoid Income Taxes[1], the state of Hawaii ranks 2nd in highest average tax rate for single people, and 1st for married couples in the nation. So what happens when you combine Hawaii's high income tax burden with low wages? The already small wage slice gets even smaller.

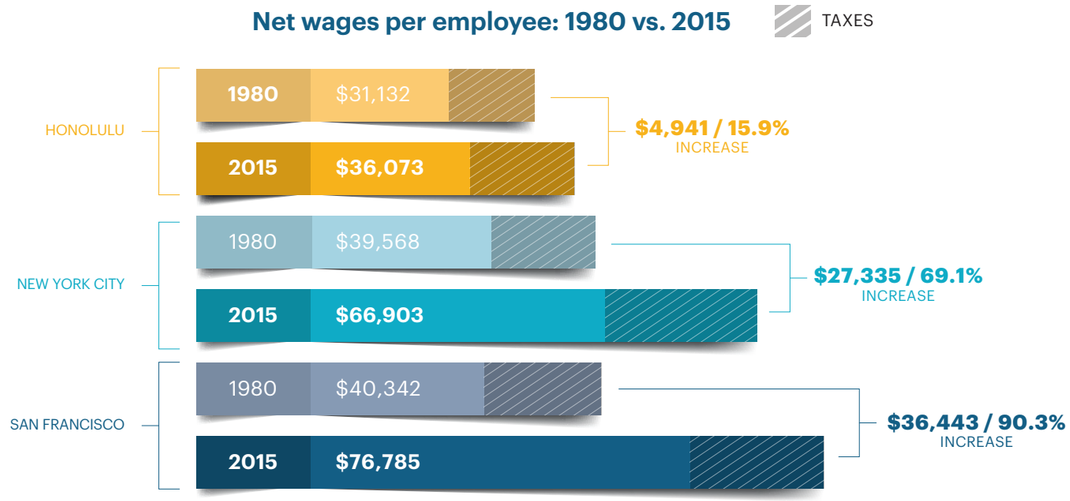
Unlike San Francisco and New York City, where wages have outpaced the gradual increase in average taxes, the lack of wage growth in Honolulu has made the tax burden significantly worse. In Honolulu from 1980 to 2015, income tax increased from 27% to 28% of average gross wages. In the same time period, in San Francisco and New York City, income tax decreased from 27% to 21% of average gross wages. Honolulu wages have failed to keep up with incremental tax increases, worsening the tax burden for local employees and reducing the take home pay they need to afford the high cost of living.

So what city does Honolulu look like in terms of wages?

While Honolulu's cost living is similar to that of San Francisco and New York City, the average wage growth (or lack thereof for that matter) over the past 35 years is most similar to none other than...Oklahoma City! Did you guess that right?

	Cost of Living Ranking 2015[2]	Per Capita Income Growth 1980-2015[3]
01	New York (Manhattan)	288 St. Joseph, MO-KS
02	New York (Brooklyn)	289 Janesville-Beloit, WI
03	Honolulu	290 Urban Honolulu, HI
04	San Francisco	291 Oklahoma City, OK
05	New York (Queens)	292 Texarkana, TX-AR

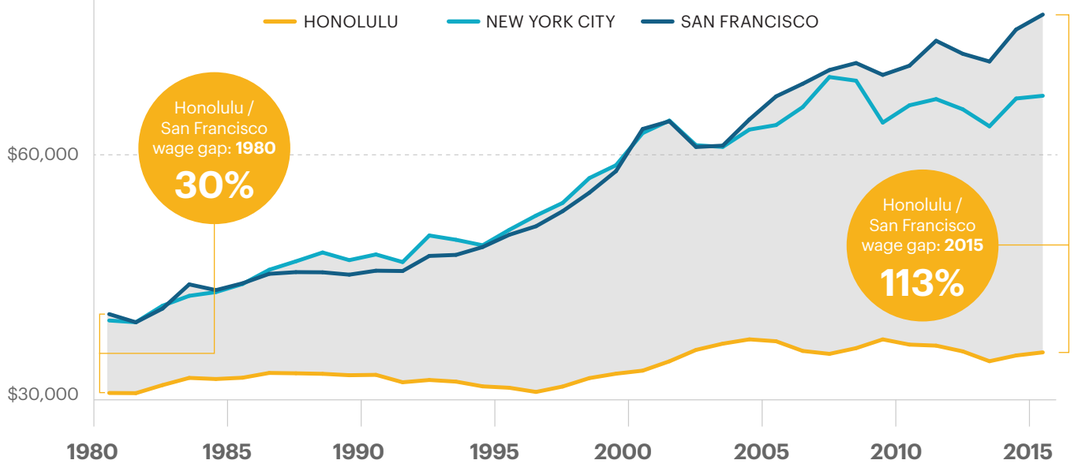
Net wages per employee: 1980 vs. 2015



In 1980, the average take home for Honolulu residents was $31,132, compared to $40,342 and $39,568 in San Francisco and New York City respectively. In 2015, the average take home for Honolulu residents was $36,073. That means, **Honolulu's average net income has only grown by 16% in 35 years, compared to San Francisco's growth at 90% and New York City's at 69%.**

Net wages per employee: 1980 vs. 2015

Adjusted for inflation



To demonstrate just how much the wage gap has widened over the past 35 years, **the difference in average take home income between Honolulu and San Francisco grew from 30% to 113%!**

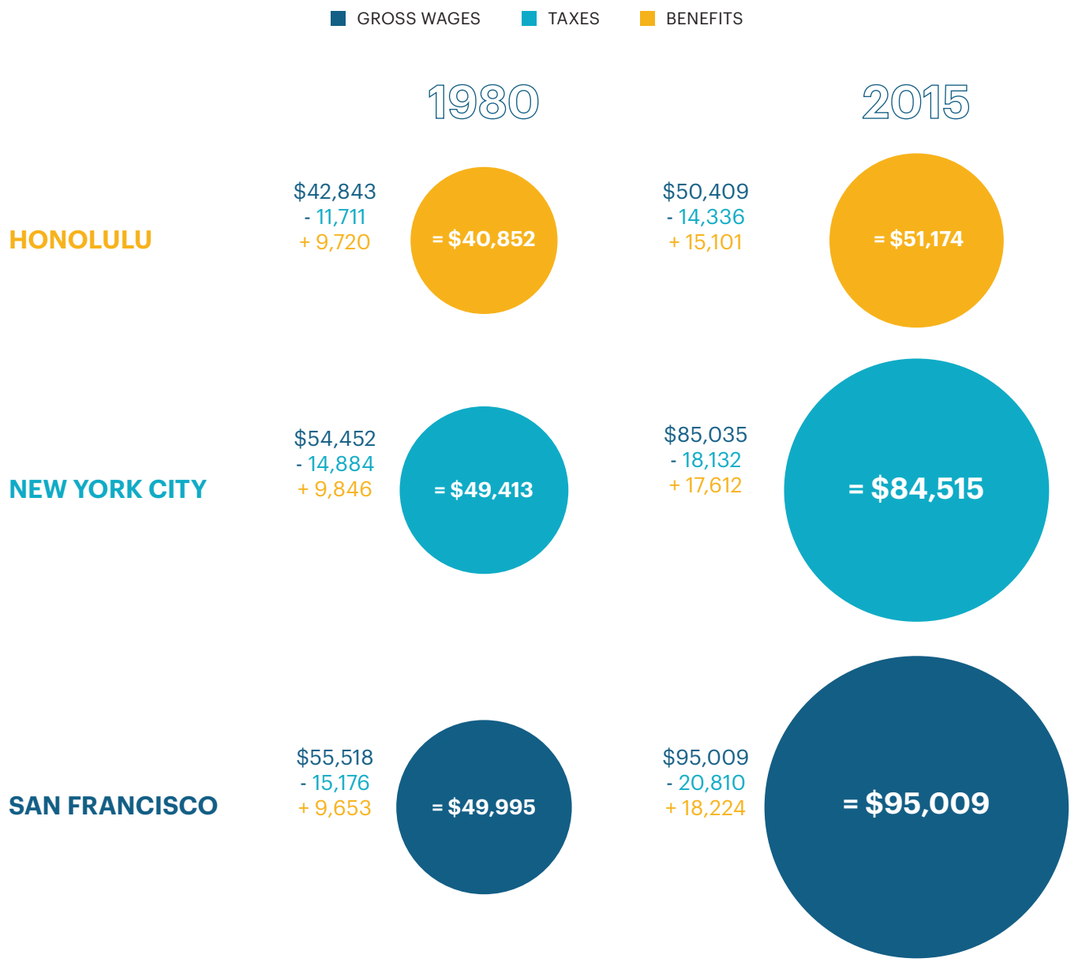
The growth rate (or lack thereof) for wages in Honolulu is eye-opening on its own, but when compared to the other cities, it's frightening.



The last piece of the compensation pie is **benefits**.

In 2015, employers in Honolulu spent an average of $15,101 per employee on benefits, compared to $17,612 in New York City and $18,224 in San Francisco. While Honolulu doesn't look too far off from the other cities as far as spend, this accounts for 30% of the compensation pie, compared to 21% in New York City and 19% in San Francisco. Benefits are taking a bigger slice of the compensation pie in Honolulu whereas in NY and SF they are growing proportionately with taxes and wages.

The Compensation Pie (Wages-taxes+benefits)



When you bring it all together, San Francisco and New York City's overall compensation pies have gotten significantly larger while Honolulu's has barely grown at all. Additionally, taxes in Honolulu have increased as a percentage of gross wages, leaving less for take home pay. Lastly, benefits are eating up a disproportionate share of the compensation pie.



So how do people afford to live and work in Honolulu when wages can't keep up with the cost of living?



PART TWO

The Price of Paradise



When people think about living in Hawaii, they picture pristine beaches, Aloha spirit, surfing, and living on "island time". For residents, we know this only tells half the story. As wages struggle to keep up with the cost of living, Hawaii businesses and residents alike are struggling to get by.

Paradise Tax Billed to Employers

The employer "Paradise Tax" is the combination of a complex regulatory environment and a limited labor pool that creates inefficiencies and decreases productivity; ultimately increasing the overall cost of doing business. According to an annual CNBC study[4], Hawaii consistently ranks as America's Bottom State for Business. Why?



Non-Labor Costs

Let's first state the obvious. Hawaii is an island, or rather a chain of islands. That means limited land capacity and everything must be imported and exported. This is extremely costly as a business owner when you consider the cost of leasing space, materials and shipping. Shipping is especially expensive due to The Jones Act, which "requires vessels that transport cargo or passengers between two U.S. ports to be U.S. flagged, U.S. crewed, U.S. owned and U.S. built. This means foreign carriers cannot compete, thus driving up the cost of shipping and the overall cost of living."[5]

In addition, utility bills and office rent in Hawaii are some of the highest in the nation. It explains why tourists are shocked when they visit McDonalds and see that it's twice as expensive as the mainland. It's not the food, it's the cost of shipping it to the island and pricy land underneath the restaurants that drive prices up.

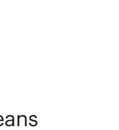


Labor Costs

Business owners must also account for the cost of labor. As we saw in the previous section, benefits in Honolulu account for 30% of total gross wages, much higher than San Francisco and New York City. This is mostly attributed to the state's mandated health care, the Hawaii Prepaid Health Care Act (PHCA), which requires employers to offer coverage to employees working at least 20 hours per week. In addition, strict workers compensation requirements, state mandated short-term disability insurance, and no "right-to-work-law" make employing people very expensive.

And the bills keep piling up. Dr. Paul Brewbaker, Principal of TZ Economics, describes the hardships business owners face when it comes to providing generous benefits.

> When you realize the growth rates of benefits have increased approximately three times as fast as wages in the past 30 years, it reflects a disproportionate burden placed on the business.
>
> Dr. Paul Brewbaker | Principal, TZ Economics





Labor Productivity

The last thing to consider is Hawaii's limited labor pool, adoption of technology and its impact on productivity. While the costs of living are similar, how does the productivity of Honolulu match up to its counterparts, New York City and San Francisco?

GDP per capita in 2013

HONOLULU	$**54,921**[6]
NEW YORK CITY	$**69,074**
SAN FRANCISCO	$**78,844**

It doesn't. Just look at the gross domestic product per capita. We're not comparing apples to apples; the higher wages in San Francisco and New York City are justified by higher productivity. Simply put, in order to pay more, you have to generate more. Honolulu may never be an economic powerhouse like San Francisco or New York City, but there are plenty of opportunities from adopting new technologies to investing in employee training that can help the workforce be more productive.

> There are all these other changes yet to come from automation and the penetration of IT in places we haven't even begun to scratch the surface of, and there's real potential (in Hawaii) to raise productivity.
>
> Dr. Paul Brewbaker | Principal, TZ Economics



Paradise Tax Billed to Employees

For those living and working in the "Aloha State," the amazing locale comes with a hefty price tag. According to an article from Honolulu Civil Beat[7], the household happiness threshold, how much money a household needs to bring in each year to have a good shot at happiness, Hawaii tops the nation at $122,175. The "Paradise Tax" for employees comes in the form of low wages and an increasingly high cost of living that makes Hawaii a challenging place to thrive.

High cost of living that keeps climbing higher

Hawaii's housing market is the main culprit behind the rising cost of living. Median prices for single family homes have climbed up to $755,000 on Oahu (as of March 2017), the highest in the United States.[8]

The islands' real estate market will always be limited by available land and the state's ability to approve new construction. In order to keep up with normal population growth, 3,500 new housing units are needed per year in Oahu. However, Honolulu county approves, at most, 1,500 units per year for new development. This discrepancy in supply and demand is creating a perpetual housing shortage.



> In the rent versus buy debate, our culture here in Hawaii understands pretty clearly that you're better off if you can own something versus renting it. Especially because the value goes up so consistently, and by so much.
>
> Carl Worthy | Real Estate Expert, Locations Hawaii



Renters are even worse off. Single family home rent rates doubled in the last 10 years, twice the national average[9]. In 2015, Hawaii ranked 2nd highest in the nation of renters spending 35% or more of household income on rent, 5.7% higher than the U.S. average. According to a study conducted by the National Low Income Housing Coalition, the state of Hawaii ranks worst in the nation as far as highest housing wage, meaning one would have to make $35.20/hr to afford rent on a 2 bedroom home. Compare that to the state of Kentucky at $13.95/hr.[10]

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To solve for the high cost of housing, many people have opted for longer commutes from more affordable communities such as Kapolei, Mililani, or Waianae, but transportation in Hawaii is also the most expensive in the country. In Honolulu, residents spend an average of 16% of their income on transportation, compared to 11% in San Francisco, and 9% in New York City[8]. In addition, gas prices are currently averaging $3.054/gallon[12], the highest in the nation.

And what about basic necessities like groceries? How much does it cost to feed a family? According to the U.S. Department of Agriculture[13], a "thrifty food plan" in Hawaii for a family of four costs $1,161 a month. That is roughly $520 more than what the same food plan would cost on the mainland. **The same gallon of milk that costs $8.99 in Oahu is priced at $2.39 in New York City.[13]**



Lastly, how do taxes impact the cost of living? As a percentage of total income, Hawaii has the 2nd highest tax burden in the U.S., which includes property taxes, individual income taxes, and sales & excise taxes.[14] While the state of Hawaii doesn't have a sales tax per se, consumers still get "taxed" though the General Excise Tax (GET). GET is a 4% (4.5% for Oahu) tax placed on businesses for the privilege of doing business in Hawaii. Most businesses pass on the GET to their customers which ultimately increases the cost of goods and services for consumers in Hawaii.

Finding ways to pay the "Paradise Tax"

Hawaii's unemployment rate[15] in 2015 was 3.7% (national average: 5.3%) and its labor underutilization rate was 9.7% (national average: 10.4%), both below national averages. At the surface level, you would think these low rates indicate a thriving employment market.

In reality, it's quite the opposite. There are too many qualified employees and not enough jobs. Adrienne LaFrance from Honolulu Civil Beat explains, "Hawaii's unemployment rate doesn't reveal how many people have to work multiple part-time jobs to make ends meet even though they really want one full-time gig."

How do residents in Honolulu pay the bills when average employee wages can't cover the rising cost of living?

Multiple Employment

Individuals who hold more than one job. In 2015, Hawaii ranked 18th in the nation for the number of workers holding down more than one job. Multiple jobholders as a percentage of total employment in Hawaii was 5.7% compared to the national average of 4.9%.[16]

Underemployed
Highly skilled workers accepting low paying jobs, low skill jobs, and/or part-time workers who would prefer to be full time. In 2015, Hawaii had the highest unemployment to labor underutilization ratio in the nation (2.62% compared to the national average of 1.96%)[17] which indicates a large number of marginally attached workers or people working part time for economic reasons.

The Struggle is Real

As we discovered in this section, employers' ability to pay "fair" wages in Hawaii is limited by the high cost of doing business, the cost of mandated benefits, taxes, and limited productivity. This, combined with the high cost of living perpetuates both livability issues for employees and profitability issues for employers.

In fact, according to the 2017 "Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index", Hawaii finds itself near the bottom in the nation when it comes to economic outlook and still falling, dropping from 42nd in 2016 to 43rd this year.[18] The research points to Hawaii's negative domestic migration (-43,856 in 2015) year after year as a driving factor for its poor rankings.

So who is leaving Hawaii and why?

As Aisha Price from 'ike summarized, "This drain of the State's exceptional talent is attributed to Hawaii's limited supply of high value jobs, lower compensation, and our high cost of living." These conditions lead to many of the youngest, highest performing, and skilled employees leaving the islands, also known as a the "Brain Drain." Evidence of this can be seen in Hawaii's rapidly aging population.

As economist Paul Brewbaker points out, **"In 1959, there were more than 30 persons of working age for each person age 65 and over. Today there are four working age persons for each person 65 and over, and in twenty five years there will be two."**



Hawaii is a tough place to earn a living, especially when you're first starting out. Hawaii has the highest sales tax burden, the 8th highest marginal personal income tax rate, ranks 3rd in overall cost of living among all cities, and has some of the highest rent prices in the nation. This environment, coupled with the fact that you can earn much more for the same job on the mainland, and it's easy to see why so many young professionals are moving off island.

If the gap between wages and cost of living continues to widen, young professionals will keep looking to the mainland for a more affordable standard of living and career opportunities. And as the workforce leaves the island and continues to age, employers will have a harder time finding the young talent they need to keep their business running long-term.

As the "Paradise Tax" increases, how can local businesses continue to thrive while attracting and retaining top talent?



PART THREE

Making Paradise Affordable



We've raised a lot of issues in the first two sections. Honolulu employers must deal with the high cost of doing business on a remote island, while finding a way to pay employees a living wage. At the same time, employees must find a way to afford a New York City/San Francisco level cost of living on Oklahoma City level wages.

So how we can ease the burden of the "Paradise Tax"?

1

Talk About It
Our mission at ProService Hawaii is to empower employers in Hawaii to succeed. By educating business owners of the challenges that we all face, we hope to ignite the conversation within the business community.

99% of companies in Hawaii are small businesses.[19] The small business community has both a huge responsibility and opportunity to shape the future of Hawaii.

- Talk to other small business owners and raise awareness
- Get involved in local organizations (Chamber of Commerce and Small Business Association)
- Be proactive; it can be something as ambitious as lobbying for legislation or as simple as educating your employees.

The more attention the Hawaii small business community can bring to the issue of "Paradise Tax", the likelier we will find mutually beneficial solutions. We need to create awareness around these issues in order to increase our ability to influence state policies that support the Hawaii small business community.

2

Invest in Your Workforce
In order to attract and retain the best talent, you have to be willing to pay for it. Small businesses can compete for the brightest minds by paying in the top quartile for Honolulu. Remember, top quartile in Honolulu isn't as costly as you think, especially when compared to San Francisco and New York City.

At ProService, we utilize online resources and tools to baseline wages for our local market, specific to roles, years of experience and scope of responsibilities. We are able to use this information to be competitive in the market to attract and retain the best of the best.

In addition, simply offering excellent benefits isn't enough. It's crucial for employers to educate employees on how to take advantage of the benefits available to them; employees, especially Millennials, often aren't aware of all of their options or how to leverage them.

At ProService, we specifically tailor our benefits to the type of talent we want to attract. For example, we offer student loan assistance and tuition reimbursement to attract Millennials. The combination of competitive pay and superior benefits helps us attract and retain the best employees.

> You need to start with a competitive base salary and add benefits over time, as the company grows. It really is important to be competitive at that base level and to have a richer portfolio of benefits than the competition.
>
> Brian Donahue | CFO, Pacific Allied Products

3

Put Culture First
Become the company people want to work for by treating your employees right. Fostering a great workplace culture that makes your employees feel valued is key to garnering employee buy-in, productivity and loyalty.

At ProService, culture is paramount. We hire based on core values that are deeply ingrained in everything we do. We foster this environment by aligning the company around common goals, bringing them alive through themed activities that culminate in an annual company-wide weekend retreat. The ProService culture is reinforced through activities ranging from daily team huddles, to peer-to-peer recognition to free breakfast Fridays.

> The culture at ProService is energetic and never boring. We're not only co-workers here, we're friends. It's probably why we're consistently one of the Best Places to Work in Hawaii.
>
> Shawn Ibara | Benefits Analyst Manager, ProService Hawaii

4

Get More to Give More
In order pay higher wages, businesses need to create more value and drive greater productivity. To generate more output and maximize efficiencies, small business in Hawaii should consider outsourcing non-value add tasks and investing in automation and technology. On average, small business owners spend 35% of their time on HR administration. Automating administrative processes and paperwork can save your company money and free up time to focus on growth instead of compliance. Technology and automation are critical to small businesses, it's how you do more with less.

> There's more that can be done to keep employer costs down. We're probably not taking advantage of technology that can make everything better for everybody and get [us] to a less burdensome environment.
>
> Dr. Paul Brewbaker | Principal, TZ Economics

5

Be Proactive
Figure out what's important to your employees. There are always trade-offs; when you say yes to one thing, such as richer benefits, it means you're saying no to another, like higher wages. If you can figure out what's important to your employees, what they value and what will keep them around, you can better manage your overall compensation spend and tailor it to their specific needs.

> In our industry, I'd say that over 75% of our competitors do not offer their employees many fringe benefits, such as medical coverage, paid time off for vacation, or sick leave. They will almost never be offered retirement plans such as 401k, profit sharing, or safe harbor matching plans. In order to retain our top full-time employees, we offer all of these benefits and see firsthand that employees that value long term benefits stay on to work harder and truly appreciate the company for being as generous as we have it set up to be. To us, that's called ohana.
>
> Tommy Silva | CEO, T&T Tinting Specialists

Building a Better Business Community

Now is the time for the small business community to come together to address and lessen the burden of the “Paradise Tax”. If we don’t start now, the wage gap in Honolulu will continue to widen and the cost of running a business will continue to rise. If these conditions persist, Hawaii will find itself in a precarious position as the population continues to age and the labor pool of talented, young individuals seek opportunities elsewhere.



We must treat “Paradise Tax” as business critical if we hope to retain and grow our talent pool and improve the economic environment, small business sustainability, and livelihood of people living in Hawaii. Now is the time for the small business community to come together and work towards solutions for the future viability and sustainability of Hawaii.

[1] wallethub.com/edu/states-with-highest-lowest-tax-burden/20494
[2] www.cnbc.com/2015/06/24/worst-state-for-business-hawaii-is-americas-paradise-lost.html
[3] www.opendatanetwork.com/entity/310M200US46520/Urban_Honolulu_Metro_Area_HI/economy.gdp.per_capita_gdp?year=2013
[4] Trulia - www.trulia.com/home_prices
[5] Locations Hawaii - www.slideshare.net/KeithMann4/rent-prices-hawaii
[6] Dbebt: dbedt.hawaii.gov/economic/ranks
[7] National Low Income Housing Coalition: nlihc.org/oor
[8] htaindex.cnt.org
[9] www.gasbuddy.com/USA
[10] Hawaii News Now: www.hawaiinewsnow.com/story/33043272/new-federal-figures-underscore-high-price-of-groceries-in-hawaii
[11] www.bls.gov/oes/current/oessrcma.htm#H
[12] www.bls.gov/opub/mlr/2015/article/multiple-jobholding-over-the-past-two-decades.htm
[13] U-6 unemployment from BLS www.bls.gov/opub/ted/2016/u-3-and-u-6-unemployment-by-state-2015.htm
[14] U-3 unemployment from BLS www.bls.gov/opub/ted/2016/u-3-and-u-6-unemployment-by-state-2015.htm
[15] www.bizjournals.com/pacific/news/2017/04/18/hawaii-near-the-bottom-in-terms-of-economic.html?surround=etf&u=xUPeStqXnu4og4qxefd0lg-0440c47a&t=1497300715&j=78000551
[16] www.sba.gov/sites/default/files/advocacy/Hawaii_1.pdf

ProService HAWAII

ProService Hawaii is the state’s largest and most experienced provider of HR management services.

For the past 23 years, we have been partnering with local businesses to manage their HR needs efficiently and cost-effectively. Our company offers a comprehensive HR bundle which include payroll, workers’ compensation, employee healthcare and benefits management, HR compliance and administrative services. We believe in hiring the best people to be part of our team in order to provide the best HR for our 2,000 local businesses clients representing 32,000 employees statewide.

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