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HIGH-COST LOCATION SOLUTIONS

Runzheimer

Relocation and Living Cost Intelligence

Companies, both large and small alike, are often faced with these questions:

How can you fairly treat individuals who are relocating to high-cost areas within the U.S. and Canada? How should a Cost-of-Living Allowance (COLA) be administered? How long should allowances be paid out? Should additional benefits be offered in extreme high cost areas? While there is no singular solution that fits all situations, here are some ideas to consideration.

WHAT IS THE MOST COMMON APPROACH TO PROVIDING A COLA IN HIGH COST AREAS?

Companies commonly take the amount of the cost-of-living differential between the locations and provide a benefit, in a declining payout, over 3 years (100%-67%-33%). For example, an employee has a salary of $100,000. The cost-of-living differential is 15%. The company would then provide $15,000 of assistance in the first year, $10,000 in the second year, and $5,000 in the third year. There are many variations of payment schedules. This is the most common approach to paying allowances, especially in locations where the post-move worksite is higher than the pre-move worksite.

HOW IS A COLA TYPICALLY ADMINISTERED?

The most common way to provide this benefit is through payroll. The COLA is divided by the number of pay periods in a year and then paid out to the employee through payroll. It is important to show this as a separate line item from regular pay. This helps the employee understand that this is meant to help them adjust to the higher cost location and is not part of their salary. Additionally, your company should enact controls within payroll to decrease the benefit each year and remove it completely if the employee relocates again or when the benefit payout period comes to an end.

Another option is to provide the benefit in a single payment at the beginning of each year. The primary advantage of this method is that it is easier to administer. Additionally, the employee can use the COLA for expenses such as a down payment on a home. However, there is a risk that they will use it for unrelated expenses (e.g., vacations, paying off other debts) and not as intended.

A final, commonly used approach for homeowners is a mortgage subsidy. Most national relocation lenders offer this as an option for transferees moving to higher cost areas. The company would provide the first-year subsidy (or possibly the portion that is due until the end of the calendar year) to the lender. Each month, the lender then applies 1/12 of the annual subsidy to the transferee's mortgage and they are only responsible for the remaining monthly payment. In each of the following years, the lender would invoice the client for the declining amount and apply this to the transferee's monthly amount due. One of the primary benefits of this method is that it ensures the COLA is being used for what is typically the expense item that increases the most in high cost areas: housing. Check with any national relocation lender for additional benefits and requirements.

"THE COLA IS DIVIDED BY THE NUMBER OF PAY PERIODS IN A YEAR AND THEN PAID OUT TO THE EMPLOYEE THROUGH PAYROLL."

ARE THERE DIFFERENT APPROACHES IN EXTREME HIGH COST AREAS?

In short, yes. The nature of a COLA inherently provides larger allowances in higher cost areas with extreme high cost areas resulting in the highest allowances. However, many companies provide an additional benefit when the post-move location is considered “significantly higher” than the pre-move location.

The most common adjustment in such situations is to increase the number of years that the allowance will be paid out. A company might offer an extended length of benefit where the cost of living in the post-move location is more than, perhaps, 25% or 30% higher than the pre-move location. In such cases, they would pay, either through payroll or a subsidy, on a similar declining schedule a COLA for 5 years (100%-80%-60%-40%-20%) rather than 3 years (100%-67%-33%).

It is also becoming increasingly popular to provide an additional payment at the time of the relocation, or to “front-load” the COLA in “significantly higher” cost areas. The primary reason for this is simple. One of the largest obstacles to purchasing a home in extreme high cost areas is the required down payment.

In this option, a company would provide the transferee with the entire first year benefit (or multiple years) upfront for their down payment and then have a declining payout schedule. When considering this option, it is very important to ensure a solid payback agreement is in place, since a substantially large amount of funds are provided upfront.

> **MANY COMPANIES PROVIDE AN ADDITIONAL BENEFIT WHEN THE POST-MOVE LOCATION IS CONSIDERED “SIGNIFICANTLY HIGHER” THAN THE PRE-MOVE LOCATION.**

A last option, although not new, has been receiving more discussion as of late: a corporate second mortgage. If an employee qualifies at a certain threshold/ differential level, the company provides funds for a second mortgage at closing of perhaps 20%. The employee is still required to make a down payment (of at least 10%). But, by the company providing the second mortgage, the monthly payment obligation is greatly reduced for the transferee. Some of these are provided at a nominal or zero interest rate. The only stipulation? The employee must pay back the loan when either relocating again, when they sell their home or when they leave their employer (a type of “golden hand-cuff”). The company needs a significant amount of administration to put such a program in place. The cash outlay can be substantial and the employer is potentially at risk of a loss of their investment in cases of a declining housing market.

WHAT IF A TRANSFEREE DECIDES TO RENT IN AN EXTREME HIGH COST LOCATION BUT WAS PREVIOUSLY A HOMEOWNER?

The cost of living can vary, especially in extreme high cost areas. This also depends on whether a transferee is a homeowner or a renter. Not only will the cost to rent vs. own be different based on a location but additional cost elements can have a large impact on a COLA. These include property taxes, insurance and income tax deductions (e.g., mortgage interest, property taxes, etc.). Typically, in these extreme high cost locations, the cost for a homeowner is much higher than that of a renter.

An important consideration in looking at homeowner vs. renter COLA's is to make sure that employees are all being treated fairly. An individual may rent for a few months with the intention of buying but then, after looking at home prices, decide to rent on an ongoing basis. Considering that most COLA reports are run at the beginning of a move, it is important that a company's COLA reports be calculated using a consistent approach. Changing whether they decide to run the report as a homeowner or a renter would impact fairness companies strive to maintain with their employee population.

"NOT ONLY WILL THE COST TO RENT VS. OWN BE DIFFERENT BASED ON A LOCATION BUT ADDITIONAL COST ELEMENTS CAN HAVE A LARGE IMPACT ON A COLA SUCH AS PROPERTY TAXES, INSURANCE, AND INCOME TAX DEDUCTIONS."

Many companies have taken the approach of implementing a policy of "once a homeowner, always a homeowner." As most policies provide additional, enhanced or extended benefits to homeowners, many transferees feel the need to purchase a home every time they relocate. This prevents them from losing these benefits in future moves. The result is increased costs for their company. Allowing an employee to be considered eligible for homeowner benefits when relocating in the future oftentimes relieves the pressure to purchase homes. This is especially true in extreme high cost areas or when the employee will decide to rent, a win-win for both employee and employer.

With any of these solutions, it is important to understand the difference between compensation and relocation benefits. A cost-of-living allowance (COLA) is designed to facilitate a relocation into a higher cost location. This allowance is meant to assist an employee with the financial adjustment they need to make in order to live in a higher cost economy. This is something that locals have already done. It is not meant to replace a competitive salary. Companies must still ensure that their compensation structure is in line with the local labor market. If not, they risk losing key talent and the ROI they expected to realize as a result of the relocation.

Runzheimer is the premier relocation and living costs intelligence solution, powered by Motus. Understanding that today's workforce is driven by data, Runzheimer provides employers and their mobile workers with the actionable insights and tools needed for a successful move. Our world-class solutions support companies with everything from equitable compensation calculations between multiple locations to understanding relocation-related expenses and needs. With comprehensive data, Runzheimer empowers employers to win the war for talent while getting the most from their budget.

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