



The cost difference between California and Texas explained

With all the gain comes some pain for Austin



CEO Darrell Mervau, second from right, moved the company to Austin from Silicon Valley for many reasons, including increasing employees' quality of life. Arnold Wells / ABJ



By Kathryn Hardison – Staff Writer, Austin Business Journal - Jan 14, 2021

The writing on the wall was clear for Darrell Mervau in 2018 — he couldn't provide his employees the lives they wanted in Silicon Valley.

It took time for Mervau to find the right place to relocate his software company, FileTrail Inc., which was then based in San Jose and had grown California roots for 20 years. The short list was Phoenix, Nashville or Austin.

The decision to move to the Texas capital was an easy one, he remembered, adding it was shared with a team of employees in January 2020 over a round of beers at Lazarus Brewing Co. A few months later, the company would relocate its headquarters just half a mile away from that brewery in East Austin.

Of all the reasons companies have cited for leaving California in recent years — high taxes and burdensome business regulations, to name a few — Mervau said the driving factor for FileTrail was to find a city that could provide better opportunities for its people.

“My employees were constantly saying, ‘Look, my commute is horrible, and my rent is astronomical for what I’m getting,’” he said. “And to be perfectly honest, I also told them, ‘I’m not going to pay you \$400,000 a year so you can buy a house in Silicon Valley.’”

“So, we were really looking at improving their lives and moving somewhere where they could start accumulating assets.”

That, ultimately, has been the driving factor for many companies leaving Silicon Valley and looking to areas such as Austin, which remains a top market because of its business climate, comparatively low cost of living and its large talent pool, according to site selectors.

Texas has been a magnet for company relocations and expansions for some time. For eight straight years, the state has ruled supreme in the Governor's Cup rankings produced by Site Selection magazine for total capital investment by state. Now that trend appears to be accelerating because of cost concerns in coastal states as well as the sudden upheaval of the pandemic.

So, as companies trade in the beaches of California for the Texas Hill Country, it begs the question: What’s the actual cost difference between the two states? On a narrower level, what opportunities does Austin provide over Silicon Valley? And the crystal ball question: How can Austin manage its fast-paced growth so that it doesn’t become the next Silicon Valley in 10 years?

An era of cost-cutting

Businesses generally save 20% on overall costs by making the move from California to Texas, said John Boyd Jr., principal at site selection consulting firm The Boyd Co., based in New Jersey.

Taxes are obviously a big factor in this, but Boyd also pointed to the savings from operating costs such as leasing commercial real estate and payroll. Companies even save on utilities for an office space, with costs in Austin about half what businesses pay in San Francisco.

“Companies save tremendous amounts of money with taxes and operating costs in Austin versus the Bay Area in California, and also labor costs,” he said. For both states, the types of taxes and rates vary based on the business, which makes the complete tax picture a bit complex.

When it comes to income, combined federal and state corporate taxes total roughly 28% in California and 21% in Texas, thanks to the limited taxes in the Lone Star State, according to a report from The Tax Foundation. That’s not to say businesses don’t pay taxes in Texas — there’s a franchise tax, plus taxes for specific industries. California also has a franchise tax and an alternative minimum tax.

However, site selectors said the lack of personal income tax is huge for both businesses and their employees in Texas. It is important to note that property taxes are higher in cities across Texas — about 2.2% in Austin — to help make up for the lack of income tax to fund government services. Other booming markets, like Tennessee or Arizona, have average property tax rates lower than 1%.

To the dismay of many California CEOs, state lawmakers were considering another tax hike for millionaires by press time to help fund homelessness efforts — a move that Boyd said will accelerate the exodus from the West Coast.

“Every company with a major presence in California right now — it’s not even an overstatement to say this — their board of directors are, as a matter of due diligence, exploring options as a way to be accountable to their shareholders,” Boyd said.



John Boyd Jr., principal, The Boyd Company.

On average, an employer in the Bay Area can save about 15% to 20% in annual payroll costs by moving to Austin, Boyd said, though he warned that gap is beginning to narrow as more companies rush to Central Texas.

"The trend is clearly companies are reducing wages with these moves to lower cost markets with lower costs of living," he said. "The market is just on fire right now, and it's beginning to shrink labor cost savings."

Site selector Joseph Vranich — whose specialty is companies leaving California — said he expects to have a record amount of business in 2021 as companies leave the West Coast for several reasons, including proposed tax hikes. He said it ultimately comes down to politics.

"Can it get any better? I've tried to be an optimist ... but when it comes to California I can't be," said Vranich, consultant with Spectrum Location Solutions in Pennsylvania.

Vranich said his clients typically save 15% to 30% on taxes by moving to Texas. Other cost savings also vary based on what city a company chooses in the Austin metro and the company's business model. Meaning, a company looking for space in downtown Austin might not see the same savings as those looking in Round Rock, and those that are labor-intensive will see more savings in salary costs.

Those have been the most apparent savings for FileTrail so far, said Mervau. After less than a year in Austin, he's already doubled his employee count to 40 people — and the company has still reduced its salary costs by 25%. FileTrail hasn't finished its first tax cycle yet, but Mervau expects those costs to also be in the company's favor.

Seeking greater quality of life

Austin is known for its nightlife and live music, but those aren't the biggest factors weighing on executives considering how to improve employees' quality of life.

Instead, it's that housing expenses in Austin are more than cut in half compared with San Francisco, and employees spend less time in their cars to get to their jobs. And it's the lack of income tax and the ability to start saving money, site selectors said.

For comparison, the typical home value in San Francisco is \$1.38 million and the average apartment rent is more than \$3,000 a month, according to data from Zillow and RentCafe.com. In the city of Austin, the typical home value is closer to \$438,000 and monthly rent is roughly \$1,400.

"Corporate income taxes are important, but really, personal income taxes play a major role in site selection decisions today, because companies are only as good as the people," Boyd said.

At FileTrail, Mervau said his employees have described the move to Austin as a substantial raise because their take-home pay is much higher in comparison. Since moving here last spring, several of his employees have purchased their first home — a milestone nearly impossible back in Silicon Valley.

The housing affordability crisis in California is the main reason that the Golden State's population has actually started to shrink, said Wendell Cox, principal of St. Louis-based international public policy firm Demographia. According to the U.S. Census Bureau's 2020 population estimates, Texas added the most residents of any state last year, while California's population lost an estimated 69,532 residents — the first negative population change for the West Coast state since at least 1900, the earliest available data.

Cox said California's rising housing prices mean many people who work in the Bay Area live in communities an hour or more away, where housing still costs 1.5 times as much as in Austin, and twice as much as in Dallas or Houston. Just to be able to qualify for a typical loan on a house in San Jose, that household would have to be well into the top 20% of income earners, Cox said.

City planners also have a role to play in how the housing market evolves. Cox said costs have been driven up in California and West Coast cities such as Portland by urban growth boundaries — a tool used to control urban sprawl by mandating what areas can be used for urban development — and other restrictions.

"The basic problem is, when you draw a line around the city and say you shall not develop beyond this line, you force prices up," Cox said. "Texas should run and hide if such restrictions are ever proposed there."

Managing Austin's growth

"Austin will continue to find itself on the radar screen because of the overall positive state business climate," Boyd said. "The intellectual capital and skill sets that are in Austin — you have some of the highest in-migration rates of tech talent around the globe."

As remote workforce trends prove themselves and corporate cost savings become more of a priority than ever during the pandemic, this has only quickened the pace of companies and CEOs leaving Silicon Valley, Boyd said. Take Oracle Corp.'s recent headquarters move to Austin as an example, plus personal moves to Texas by Tesla Inc. CEO Elon Musk and Dropbox CEO Drew Houston.

With a massive influx of people, the pressure is on to keep Austin competitive and affordable — and to not repeat history by garnering high taxes and high costs of living like California.

"With the number of people moving here, it's going to create the demand for talent, resources — everything. Hopefully it will keep its soul and manage the growth," Mervau said of Austin.

Area chambers of commerce have prioritized economic development tools for the upcoming legislative session to continue to bring companies here while also creating an environment that helps local businesses prosper. That includes maintaining the state's low taxes and continuing to focus on educational opportunities to keep the talent pool stocked.

Laura Huffman, president and CEO of the Greater Austin Chamber of Commerce, said managing Austin's growth will require both newcomers and longtime Austinites to be engaged in the community, adding it's less about studying the fails of California and more about charting a unique course for Austin.

"The question is, will we grow with grace? It takes all hands on deck to make sure that you do that appropriately, and that you protect those things that are most important to those of us that are living here," Huffman said. "The fact that people are still drawing a line from where they are today to Austin tells you that we get it right a lot of the time."