**ADDENDUM 2 – WAGE ESCALATION FORMULA AND BACKGROUND**

The formula and the resulting wage escalation rates are for budget forecasting purposes only and are based on the most recent 10-Year Economic Projections issued by the Congressional Budget Office as of the date of this letter (the "Projections")[7]. The recommended wage escalation rates are calculated by adding projected inflation to 1%, which is a presumption that actual wage growth of University employees will outpace projected inflation.

The formula[8] to determine the recommended wage escalation rate is the sum of the projected inflation found in 1) and the 1% in 2) here:

1) Determine projected inflation for the project by using the Personal Consumption Expenditures (PCE) Price Index[9] projected calendar year annual percentage change rate published in the Projections (the "Percentage Change") as follows:
    a) For projects ending the same calendar year this letter is published, the projected inflation is the Percentage Change for the calendar year this letter was published rounded to the nearest tenth;
    b) For projects ending by or on December 31 of the fourth full calendar year after this letter is published, the projected inflation is the arithmetic average of the Percentage Changes[10] for each year beginning with the calendar year this letter was published and ending with the calendar year the project is expected to end, rounded to the nearest tenth;
    c) For projects ending after December 31 of the fourth full calendar year after this letter is published, the projected inflation is the arithmetic average of the Percentage Changes rounded to the nearest tenth for five years beginning with the Percentage Change for the calendar year this letter was published is the projected inflation.
2) 1% is added because the actual wage growth of University employees will likely outpace projected inflation.

For example, a project ending the year this letter is published would be subject to an escalation rate of 4.8%, which is comprised of the 3.8% projected inflation for 2023 plus 1% for presumed outpaced wage growth.

As an additional example, the wage escalation for a project ending the year after this letter is published is calculated as shown:
- Projected inflation for 2023 (**3.855%**) + Projected inflation for 2024 (**2.769%**) = **6.624%**
- **6.624%** ÷ 2 (the number of years of the project) = **3.312%**
- **3.312%** rounded to the nearest tenth = **3.3%**
- **3.3%** (average projected inflation over the project period) + **1%** (assumption of additional wage growth) = **4.3%**

Therefore, the calculated wage escalation for the project would be 4.3%.

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[7] See Note 3. Calendar year projections from the Projections are used, not the fiscal year projections.

[8] The formula was developed in consultation with faculty from UC Berkeley's Department of Economics.

[9] The PCE is used as the deflator index for this guidance because of its inclusive dataset, including gross domestic product and supplier reports, and it measures goods and services purchased by all U.S. households <u>and</u> nonprofits. The more commonly known Consumer Price Index (CPI) utilizes a smaller dataset focused on U.S. urban households, which is why CPI was not used.

[10] Prior to this guidance, campuses generally used a singular percentage for determining project budget escalation (e.g., 3%). However, using the same escalation estimate for an 18-month project and a five-year project in periods of volatile inflation would lead to outsized under- or over-recovery. However, it is impractical to ask campuses to apply year-by-year escalation rates (e.g., 3.7% for FY23, 3.2% for FY24, 2.7% for FY25) in multi-year projects that largely do not follow standard calendar or fiscal years. Therefore, this guidance relies on a tailored rate determined by an arithmetic average of specified years so campus administrators have a singular escalation rate to apply based on the project's end date.