MEMORANDUM OF LAW

DATE: November 26, 2002

TO: Hank Cunningham, Community and Economic Development Director

FROM: City Attorney

SUBJECT: Effect of SB 975 Amendments on Prevailing Wage Requirements

INTRODUCTION

This memorandum is in response to your questions concerning the scope of amendments to the California Labor Code pursuant to the passage of Senate Bills 975 and 972. You had numerous questions as to the application of these revisions to certain City practices and programs, and requested an analysis of the effect of these changes. Because of their length, your questions, and our short responses, will not be set forth at the beginning of this memorandum, rather, they will be analyzed in sequence below.

BACKGROUND

A. Department of Industrial Relations

Pursuant to California Labor Code section 1720, *et seq*., all workers for public work projects must be paid prevailing wages. California Redevelopment Law, set forth in Health and Safety Code sections 33000 *et seq*., applies the prevailing wage requirement to redevelopment agencies. Prevailing wages are determined by the Department of Industrial Relations [DIR]. The DIR also has the authority to determine as to which projects are considered public projects subject to prevailing wage payments.

The DIR periodically issues precedential decisions which apply existing labor law to specific facts. Some of the recent DIR decisions reveal a more inclusive interpretation of the applicability of the prevailing wage requirement for redevelopment projects. In what appeared to be an attempt to preclude any possible court challenges to this trend, State legislators passed Senate Bill 975 [SB 975] in October 2001. Through SB975, amendments were made to Government Code section 63036 and Labor Code section 1720. These changes became effective as of January 1, 2002.

B. Changes to Existing Law

With the passage of SB 975 in October 2001 and Senate Bill 972 [SB 972] in September 2002, changes were made to both the Government Code and Labor Code sections dealing with prevailing wages. Government Code section 63036 now requires the payment of prevailing wages for any public work financed through the use of industrial development bonds. The changes to Labor Code section 1720, which mandates that prevailing wages are paid when construction is "paid for in whole or part out of public funds," are significant.

Prior to the passage of SB 975, it was possible to structure disposition and development agreements so that prevailing wages were not required for the private construction done by a developer, even though a Redevelopment Agency [Agency] paid prevailing wages for the related public improvements. With the amendments resulting from SB 975, the definition of "paid for in whole or part out of public funds" has been broadened so that it appears to include private projects that have any Agency assistance. Specifically, the following types of Agency assistance will trigger prevailing wages under a typical disposition and development Agreement:

Agency payments to a developer.
Agency construction or contribution to the construction of public improvements for or related to the project.
Agency transfer of property or any other asset to a developer for less than "fair market price."
Agency payment of or waiver of development fees or permit processing fees for a project.
Agency loans to a developer made at less than "fair market value."
Agency loans or advances where repayment is contingent or repayment will be forgiven based on the developer's performance.
Agency loans or advances where payments or repayments to the Agency are reduced by credits for income to the Agency such as tax increment generated by a project.

There are, however, certain exceptions to this broadened definition. In the following situations, prevailing wages will not be required:

When private residential projects are built on private property, without an agreement with the Agency.
When the Agency pays for public infrastructure needed for a private project so long as (1) the public infrastructure is required as a condition of the approvals for the developer; (2) the Agency construction is limited to the cost of the public infrastructure; (3) prevailing wages are paid for the construction of the public infrastructure; and (4) the Agency "maintains no proprietary interest in the overall project."
When the Agency's assistance, in the form of reimbursement of costs or subsidy, to a private development project is "de minimus in the context of the project."
When the Agency uses low and moderate-income housing fund monies for the construction or rehabilitation of affordable housing so long as the only other source of funding for the project is private funds.
For affordable housing projects financed with mortgage revenue bonds, receiving mortgage credit certificates or state or federal low income housing tax credits, as long as the project receives an allocation of bond capacity, mortgage credit, or tax

credits prior to December 31, 2003.
For projects receiving tax credits for specified types of industrial projects.

SB 972, approved by Governor Davis on September 28, 2002, further amended Labor Code section 1720 by excluding from the prevailing wage laws the construction, expansion, or rehabilitation of privately owned residential projects that are self-help housing projects, operated on a not-for-profit basis as housing for homeless persons, or that provide for housing assistance. Specifically, SB 972 provides that unless otherwise required by a public funding program, the construction or rehabilitation of privately owned residential projects is not subject to the requirements of prevailing wages if one or more of the following conditions are met:

a. The project is a self-help housing project with no fewer than 500 hours of construction work performed by the home-buyers.

b. The project consists of rehabilitation or expansion work associated with a facility operated on a not-for-profit basis as temporary or transitional housing for homeless persons with a total project cost of less than $25,000.

c. Assistance is provided to a household as either mortgage assistance, down payment assistance, or for the rehabilitation of a single-family home.

d. The project consists of new construction, or expansion, or rehabilitation work associated with a facility developed by a nonprofit organization to be operated on a not-for-profit basis to provide emergency or transitional shelter and ancillary services and assistance to homeless adults and children. The nonprofit organization operating the project shall provide, at no profit, not less than 50 percent of the total project cost from nonpublic sources, excluding real property that is transferred or leased. Total project cost includes the value of donated labor, materials, architectural, and engineering services.

e. Projects in which the public funding is a below-market interest loan, and at least 40 percent of the units are restricted for at least twenty years, and the household's income does not exceed the low-income level (80 percent of area median income).

SB 972 also provides that SB 975 does not preempt local ordinances requiring the payment of prevailing wages on housing projects.

ANALYSIS

The revisions to Labor Code section 1720 are untested at this juncture. Therefore, it is difficult to make generalizations as to how the changes will be applied. Whether prevailing wage rules apply to a particular project is a fact-driven analysis which will vary depending on whether the particular project meets the definition of a "public work," the type and amount of public funding involved, and whether the type of project would be classified as a "municipal affair" under the legal doctrine that allows charter cities to avoid the application of state statutes in certain situations.

I. IS THE PROJECT A "PUBLIC WORK" PROJECT FOR PURPOSES OF PREVAILING WAGE?

In order for prevailing wage to apply to a project, it must be a "public work," defined in Labor Code section 1720(a) as construction, demolition, installation, or repair work, including design and preconstruction phases of construction such as inspection and land surveying. This definition excludes contracts for services or procurement of goods from being subject to prevailing wages. However, the statute is ambiguous as to when this definition will apply to contracts which are not directly for construction but have an indirect effect of the contracting party performing construction activities. Labor Code section 1720(b) states that "paid for in whole or in part out of public funds" includes payments by a political subdivision "directly to or on behalf of the public works contractor." This implies that the payment must be made with the intention that it be used for construction for the statute to apply. One court ruling on this issue prior to the SB 975 amendments suggested that when construction is an indirect effect of a government contract, rather than the primary purpose of the contract, prevailing wages will not apply:

> We hold that paying public funds for public services does not make incidental construction work done by a private provider of those services "public works" under section 1720 subdivision (a). The statute requires payment for "construction"; to take that as meaning "services" would violate plain, unambiguous language, which we cannot do.

McIntosh v. Aubry, 14 Cal. App. 4th 1576, 1586 (1993).

Based on this language, City contracts which are primarily for purposes other than construction can be treated as exempt from prevailing wage, because they are not public works contracts. However, in the case of contracts which are primarily for the purpose of construction, such as facade improvement rebate contracts, in which the construction project is more than "incidental" to the contract, this argument will not be applicable, and those projects must be treated as public works projects for purposes of prevailing wage analysis.

II. IS THE PUBLIC SUBSIDY FOR THE PROJECT "DE MINIMUS"?

Another factual issue with the applicability of prevailing wage to projects is the amount of the public subsidy in the context of the whole project, and whether it could be argued that it is "de minimus," and therefore not subject to prevailing wage. Labor Code section 1720(b)(2)(B) provides:

> If the state or political subdivision reimburses a private developer for costs that would normally be borne by the public, or provides directly or indirectly a public subsidy to a private development project that is de minimus in the context of the project, an otherwise private development project shall not thereby become subject to the requirements of this chapter.

The statute does not define "de minimus," and it is unclear what percentage of a project cost will be treated as de minimus, therefore, this exception should be used with caution, and only for projects in which the City subsidy is a very small percentage of the total project cost.

III. IS THE PROJECT EXEMPT FROM PREVAILING WAGE AS A "MUNICIPAL AFFAIR" OF A CHARTER CITY?

Perhaps the most important consideration in determining whether the prevailing wage statutes apply to a particular project involving public funds is whether the project is exempt from the applicability of prevailing wage as a municipal affair of a charter city. Under Article XI, section 5(a) of the California Constitution, the City of San Diego, as a charter city, is autonomous with regard to purely "municipal affairs," and is not subject to state statutes regarding those subjects which are municipal affairs when those statutes conflict with the City's Charter. California courts have held that prevailing wage statutes generally do not apply to public works by charter cities for projects which are municipal affairs. *City of Pasadena v. Charleville*, 215 Cal. 384 389 (1932); *Vial v. City of San Diego*, 122 Cal. App. 3d 346 348 (1981). In the *Vial* case the court held that the prevailing wage statutes did not apply to public works by the City of San Diego which are municipal affairs, because those statutes conflict with the City Charter's requirement that public works contracts be awarded to the low bidder. *Id*. at 348.

Although the court decisions cited above regarding prevailing wages and the municipal affairs doctrine predate the SB 975 amendments, this Office has opined in a previous Memorandum of Law that the SB 975 amendments do not change the basic rule that prevailing wage statutes do not apply to City projects which are municipal affairs. MOL 2001-24 (Nov. 19, 2001). Although the amended language in Labor Code section 1720(a)(3) makes reference to work done under the direction or supervision of a charter city, the courts have held that while weight is given to the stated purpose of the Legislature in enacting general laws, the Legislature may not determine what is a municipal affair. *Bishop v. City of San Jose*, 1 Cal. 3d 56, 63 (1969); *Sonoma County Org. Of Pub. Employees v. County of Sonoma*, 23 Cal. 3d 296, 315-16 (1979).

The determination of whether a project is a "municipal affair" is generally made by courts on a case by case basis, because the California Constitution does not define the term "municipal affairs." The courts have articulated three factors to weigh in determining whether a project is a municipal affair: (1) the extent of non-municipal control over the project; (2) the source and control of the funds used for the project; and (3) the nature, purpose, and geographic scope of the project. *Southern California Roads Co. v. McGuire*, 2 Cal. 2d 115, 123 (1934). These factors are routinely cited by the DIR in determining whether prevailing wage requirements apply in a particular case.

It is also helpful to consider examples of matters that the courts have held to be municipal affairs, in contrast to those that have been held to be of statewide concern. The following are all examples of projects that have been determined to be municipal affairs:

> Construction of a City reservoir to serve the City's residents (*Williams v. Vallejo*, 36 Cal. App. 133 (1918)).
> Construction of a fence around a City reservoir (*City of Pasadena v. Charleville*, 215 Cal. 384 (1932)).
> Street and sewer work (*Loop Lumber Co. v. Van Loben Sels,* 173 Cal. 228 (1916).
> Street improvements (*Raisch v. Myers*, 27 Cal. 2d 773 (1946)); off street public parking (*Alexander v. Mitchell*, 119 Cal. App. 2d 816, 827 (1953)).
> Landscaping and maintenance of medians (*City of San Jose v. South*, 146 Cal. App. 3d 320 (1983).
> Creation of an improvement district (*Redwood City v. Moore,* 231 Cal. App. 2d

563 (1965)).

Examples of projects which have been held to be matters of statewide concern, rather than municipal affairs, include construction of a storm sewer system extending into another jurisdiction (*Gadd v. McGuire*, 69 Cal. App. 347 (1924)), improvements to a street which was part of a state highway system (*Southern California Roads v. McGuire,* 2 Cal 2d. 115 (1934)); and construction and maintenance of power lines (*Modesto Irrig. District v. Modesto,* 210 Cal. App. 2d 652 (1962)).

IV. APPLICATION OF CODE REVISIONS TO QUESTIONS PRESENTED

A. Will the code amendments apply to all contracts entered into as of January 1, 2002 (the effective date of the bill) or to all work commenced as of that date? If the latter, would it matter if various financing obligations, including the issuance of bonds, have been entered into based on prior law?

The changes in Labor Code section 1720 made by SB 975, apply to projects advertised for public bid on or after January 1, 2002. There are no "grandfather" provisions in the bill that exempt projects which do not involve advertisements for bids. However, the DIR has an unwritten policy that disposition and development agreements and owner participation agreements entered into and approved by the Agency and City Council before January 1, 2002, will be exempt, unless any portion of the project has been the subject of a coverage determination made by the DIR prior to January 1, 2002.

B. Does the new definition of "public works" include City contracts entered into with the intention of encouraging job creation, neighborhood revitalization, the provision of new business services, or other public goals, but which have the indirect effect of businesses engaging in "construction, alteration, demolition. . ." as set forth in Labor Code section 1720(a) (1)? Some examples are: the City's Storefront Improvement Program, the Business Cooperation Program, the reduction or reimbursement of City fees or taxes in consideration of a specified public goal, the rebate of real or personal property taxes pursuant to Revenue and Taxation Code sections 5108 and 51298, and the provision of tax credits and deductions as authorized by the State Enterprise Zone and Local Agency Military Base Reuse Act.

1. Storefront Improvement Program.

The City's Storefront Improvement Program currently provides grants of up to $5000 for businesses constructing approved storefront improvements, for the purpose of beautifying and revitalizing neighborhoods and increasing business in the districts. The grants are funded with Small Business Enhancement Program funds, which come from a portion of the business tax certificate fees levied by the City on small businesses. The contracts for the provision of these grants would constitute "public works" contracts for purposes of the prevailing wage statute because they are for the primary purpose of funding construction, alteration, and repair of storefronts. Further, the construction is paid for in part by public funds, and the amount of funding would probably not be considered to be "de minimus," because the grants are for one-third of the cost of construction, up to $5000.

Although, although these projects may appear to meet the criteria for the application of the prevailing wage statute, a strong argument exists that these projects are "municipal affairs," and therefore not subject to prevailing wages. There is no control over these projects by any government agency other than the City, the funds used are City funds, and the projects are small projects wholly within the geographical boundaries of the City. Therefore, a court would probably find that they are municipal affairs projects not subject to prevailing wage requirements.

2. Business and Industry Incentive Program.

The City's Business and Industry Incentive Program, outlined in Council Policy 900-12, provides business and industry incentives, including permit assistance, reduced permit fees, credits toward City business license taxes or development fees for State sales or use taxes paid by the business, reduction of sewer and water capacity charges, rebate of all or part of the City's portion of real and personal property taxes, and provision of tax exempt bond financing. These incentives are provided in consideration for a demonstration by the business that it meets certain criteria, including providing significant revenue or jobs to the City's economy, promoting stability or growth of City taxes or other revenues; encouraging new business or development in older parts of the City, and preventing businesses from relocating to other jurisdictions.

It is unclear whether the City's contracts for the provision of these business incentives are contracts for "public works" for prevailing wage purposes. Although construction of new business facilities or alteration of facilities are often the reason for a business's application for these incentives, the incentives provided by the City are not strictly for construction or renovation, but are consideration for a demonstration that the business provides certain economic benefits to the City. Some of these projects may not involve any construction or renovation of facilities at all, and would not meet the definition of public works. Whether or not an incentive agreement could be classified as a "public works" agreement will depend on the particular circumstances of the agreement and will need to be analyzed on a case by case basis. Additionally, whether or not the value of the incentives provided is "de minimus" in the context of the overall project will also have to be determined on a case by case basis. Finally, whether an incentive agreement would constitute a municipal affair will depend on the facts of the particular agreement. In the case of a business receiving only water and sewer capacity reductions under an incentive agreement, there may be an argument that the deal is purely a municipal affair. On the other hand, in a situation involving the procurement of tax exempt financing for the business from a state agency, the involvement of the state would probably result in the agreement being a matter of statewide concern. For all of these reasons, no general rule can be stated with regard to the applicability of prevailing wages to this program.

3. Reduction or Reimbursement of City Fees.

The reduction or reimbursement of City fees or taxes for a public goal is subject to the same uncertainty in the applicability of prevailing wages as outlined above for the Business and Industry Incentive Program. Projects receiving subsidies are clearly intended by the Legislature to be within the definition of projects "paid for in whole or in part out of public funds" under the SB 975 amendments, which include in that definition obligations which are "paid, reduced, charged at less than fair market value, waived or forgiven." Labor Code section 1720(b). The application of prevailing wages would only potentially apply to such a subsidy if the subsidy

were being provided in conjunction with a project meeting the definition of a public works project for prevailing wage purposes. In such cases, the amount of the subsidy in the context of the project, and the nature of the project and whether it would constitute a municipal affair would need to be considered in order to determine if prevailing wage requirements may apply.

The SB 975 amendment includes language exempting certain projects involving tax credits from being subject to prevailing wages. Projects that include tax credits pursuant to section 17053.49 or 23649 of the Revenue and Taxation Code are exempt from prevailing wage pursuant to section 1720(c)(4). These code sections refer specifically to tax credits provided by a local agency for the construction, reconstruction or acquisition of equipment used in certain types of manufacturing.

There are a number of other similar tax credits and rebates which local agencies are authorized to provide pursuant to state law in addition to those cited above which have not been given the same exemption from prevailing wage requirements by the SB 975 amendments. Examples of similar tax benefits not included in this exemption are tax rebates pursuant to Revenue and Taxation Code section 5180 and Government Code section 51298 (property tax rebates for placing manufacturing equipment into service which is also qualified for tax credits under sections 17053.49 and 23649), Government Code section 51298 (rebate of property tax revenue gained by the local agency based on establishment of a qualified manufacturing facility); and tax benefits for establishing businesses which result in job creation in Enterprise Zones and Local Agency Military Base Recovery Areas pursuant to Revenue and Taxation Code sections 17276.1 and 17268. All of these tax benefits have been established for a similar purpose of stimulating investment in communities and the attraction and retention of manufacturing activity and businesses that create jobs. However, not all of these programs are provided the same relief from prevailing wage requirements by the SB 975 amendments.

Under the rules of statutory interpretation the expression of certain things in a statute necessarily involves exclusion of other things not expressed. *Henderson v. Mann Theatres Corp.*, 65 Cal. App. 3d 397 403 (1976). There is a strong argument under this principle of that the Legislature intended to exempt from prevailing wage requirements only the tax credits specifically cited in the statute, and that the exemption was not intended to apply to other similar tax credits or rebates not mentioned in the amendment.

Therefore, in the case of tax credits and benefits for business activities not specifically exempted from the prevailing wage requirements, these projects should be analyzed in order to determine whether they are exempt from prevailing wage requirements for other reasons, such as the project not being a public works project, the public subsidy being de minimus in the context of the project, or the project being a municipal affair. It should be noted, however, that it may be difficult to argue that projects related to enterprise zones or military base recovery areas are municipal affairs, based on the state's involvement in designating the zones and oversight over the program.

Additionally, because of the inconsistency of some tax credits being exempted in the prevailing wage statute, and other similar tax credits not being exempted, this is an area where the City may want to recommend amendments to the statute to add other tax credit programs to the exemption.

C. If the amendments apply to indirect contracts in which businesses engage in "construction, alteration, demolition. . .," do the prevailing wage obligations apply only to construction and related activities, or do they apply to the company's own employees?

For projects which have been determined to be subject to prevailing wage, only those "workers employed on public works" are required to be paid prevailing wage. Labor Code section 1771. In making a determination regarding whether an engineer for a particular project was entitled to prevailing wages, the Attorney General opined that the engineer was entitled to prevailing wage only with respect to those duties that qualified as a public work. 70 Ops. Cal. Atty. Gen. 92 (1987). Therefore, only those employees whose duties meet the definition of "public work" in Labor Code section 1720(a), including construction, alteration, demolition, installation or repair work, and design and preconstruction work, are entitled to prevailing wages.

D. Does a "public work" done for "improvement districts," include business improvement districts in which assessments are levied on the business, pursuant to Streets and Highway Code section 36500, and those in which assessments are levied on the property, pursuant to Streets and Highway Code section 36600?

Although the definition of "public works" in Labor Code section 1720(a)(2) includes the language "work done for . . . improvement districts," the term "improvement districts" is not defined, and it is unclear whether the Legislature intended this provision to apply to work done for business improvement districts (BIDs) established pursuant to Streets and Highways Code sections 36500-36551 and 36600-36651. In the absence of any clarifying authority on this issue, individual projects for BIDs should be analyzed on a case by case basis to determine if prevailing wages are required. Some of the projects are purely for services, and will not be subject to prevailing wages because they are not public works projects. Other projects may involve a "de minimus" amount of public subsidy in the context of an entire project. Additionally, for those BID projects which are public works, such as streetscape projects, or the installation of banners, a strong argument exists that they are municipal affairs not subject to prevailing wage, because they are a matter of purely localized concern, benefit only a particular business district wholly within the City, and they are generally not subject to control or oversight by other agencies.

E. Do the amendments apply to circumstances where the City provides funding out of its General Fund to community-based nonprofit corporations to conduct design and preconstruction phases of construction, as well as maintenance, such as the Parking Meter District funding to the Uptown Partnership?

The City sometimes provides General Fund money generated by parking meter districts to fund construction related activities associated with the creation of new parking facilities. The primary issue in the applicability of prevailing wages to these projects will be whether the projects are municipal affairs, as it appears that these type of projects would meet the definition of "public works," and that the amount of subsidy in these cases is more than de minimus. There are several factors which may provide an argument that some of these projects are municipal affairs, including the exclusive use of City funds, the lack of involvement or oversight of other agencies or jurisdictions in the projects, and the location of the projects within the City boundaries. Additionally, courts have found in other cases that the construction of off street parking facilities is a municipal affair. *Alexander v. Mitchell*, 119 Cal. App. 2d 816, 827 (1953) (holding that public off street parking lots were "primarily of local interest just as street and

sewer projects are").

F. Would the transfer of property at fair market reuse value, pursuant to redevelopment law, trigger application of the prevailing wage requirement Based on the amendment definition of "paid for in whole or in part out of public funds," to include the "transfer of an asset of value for less than fair market price?" Would the manner in which the redevelopment project is selected make a difference?

Pursuant to Labor Code section 1720, the definition of "paid for in whole or part out of public funds," includes the transfer of property from the Agency to the developer for less than "fair market price." There have been no recent DIR decisions that address this particular issue, so there is little guidance at this point as to whether the transfer of property at fair reuse value will bring the project under the prevailing wage requirement. Assuming that there are no other triggering factors, an argument could be made that the fair reuse value of property, which includes the covenants and conditions the Agency imposes on a developer, is, in fact, the "fair market price." This type of sale represents the fair market value or price given Agency requirements that reduce the value of the property. It may be advantageous to include this type of language in appraisal reports and related documents, subject to the approval of the experts involved. There is nothing to indicate that the method of property selection is a consideration in making this determination.

Further, the DIR decisions prior to the passage of SB 975 on what constitutes the payment of public funds for a redevelopment project are informative. The DIR issued the *Vacaville* decision on October 20, 2000 (Public Works Case No. 2000-15). On this project, as an inducement for the developer, the Agency agreed to pay certain city fees normally paid by property owners. The question presented was whether the agency's payment of these fees constituted payment of public funds for the construction. The Agency's argument against the prevailing wage requirement was based on its belief that due to the close relationship of the city and the Agency, the payment of the fees was simply a forbearance. As such, based on the court's ruling in *McIntosh v. Aubrey*, 14 Cal. App. 4th 1576 (1992), these payments would not be considered public funds to be used for construction. The DIR disagreed with this argument, finding that the Agency was a separate and distinct entity from the city, and therefore the Agency was actually paying public funds to the city. The DIR found the project to be a public works project, subject to the prevailing wage requirement.

In the November 30, 2000, *Huntington Beach* decision (Public Works Case No. 1999-079), the DIR found that the redevelopment agency's promise to reimburse the private developer for certain infrastructure and relocation costs associated with the project constituted the payment of public funds for construction. As a result, the entire multi-phased project was subject to the prevailing wage requirement.

In the matter considered in the *King City* decision (Public Works Case No. 2000-011) issued on December 11, 2000, the Agency sold property to a developer and took back a promissory note. The Agency also agreed to pay certain site assembly costs for the acquisition of the property. As a participant in the city's "Performance Incentive Program," the developer was entitled to credits which offset the cost of the land. The credits received by the developer as a result of this program would offset the full amount of the promissory note held by the Agency. The DIR found that the Agency's payment of site assembly costs and the gift of free

land to the developer via the incentive program constituted a payment of public funds for construction. Prevailing wages were required for the entire project.

In the *Pittsburg* decision (Public Works Case No. 1999-082) issued on December 18, 2000, the infrastructure for this project, involving the construction of 120 private homes and a public park, was to be funded in part by an Agency credit related to the purchase of the property. The DIR found public funds were to be used for the project because (1) the Agency was to be reimbursed for a portion of its infrastructure costs from assessment district funds, which are public funds and (2) the credit received by the developer against the purchase price of the property was actually a payment of public funds.

On January 23, 2001, the DIR issued the *Sacramento* decision (Public Works Case No. 2000-043). This project involved the construction of town homes. Part of the funding for the developer was provided by the Agency in the form of no-interest loans from affordable housing tax increment funds. A percentage of these loans were forgiven with the sale of each town home in the project. When all of the town homes were sold, the balances of the loans were to be forgiven, the loans terminated, and the property conveyed to the developer. The DIR determined that this loan agreement constituted a payment of public funds because no repayment was ever contemplated, rather the land was given to the developer by way of the loan forgiveness. Therefore, prevailing wages were required for the project.

G. If tax increment proceeds are used to fund public improvements, and prevailing wages are paid, where the public improvements indirectly benefit the private development project, will the prevailing wage requirement apply to a private development?

This question is virtually impossible to respond to without additional facts as to the nature of the improvements, the relationship between them, and the type of benefit given to the private improvement. If the public and private improvements are completely separate in nature, not arising from a common agreement nor simply separate components of a single project, there would be no requirement for prevailing wages to be paid for the purely private project. Otherwise, the question can only be answered on a case by case basis.

If the benefit received by the private developer is the result of the construction of public infrastructure for the project, the Labor Code section contains a specific exemption. Pursuant to Labor Code section 1720, prevailing wages are not required when the Agency pays for public infrastructure needed for a private project if (1) the public infrastructure is required as a condition of the approvals for the developer; (2) the Agency construction is limited to the cost of the public infrastructure; (3) prevailing wages are paid for the construction of the public infrastructure; and (4) the Agency "maintains no proprietary interest in the overall project." The key to this exception is the Agency's lack of proprietary interest in the entire project. However, at this point, this concept remains vague. The use of this phrase seems to indicate that if the project did not generate significant income for the Agency and if the developer did not repay the Agency for costs related to the improvements or infrastructure, then the Agency would not maintain a proprietary interest. This exception will apply whether the resulting infrastructure directly or indirectly benefits the new private project.

A review of the DIR decisions which were the impetus behind the 2001 amendments is instructive as to the expected application of the revised code sections to this question. The

decisions issued in the *Santa Rosa*, *Huntington Beach* and *Pittsburg* matters reveal a trend toward the integration of public and private improvements into a single project. For the DIR, this is a pivotal question in determining to what extent the prevailing wage requirement will apply for a project. Pursuant to the DIR's interpretation of Labor Code section 1720(a), if public funds are paid on a single project, then the prevailing wage requirement applies to the entire project. However, if the project is found to be multiple projects, prevailing wages may only apply to the construction of certain improvements and not others. In its analysis of this issue, the DIR considers five factors: (1) the manner in which the construction is organized (bids, contracts, workforce); (2) the physical layout of the project; (3) the direction, supervision and oversight of the project; (4) the financing and fund administration and (5) the interrelationship of the certain construction aspects.

The *Santa Rosa* decision (Public Works Case No. 2000-016) was issued by the DIR on October 16, 2000. The subject project involved the construction of a hotel, with associated amenities and a conference center. The redevelopment agency owned the land intended for the site and agreed to lease it to the developer. Additionally, the Agency was to contribute bond proceeds to be used for the construction of the conference center. It was the Agency's position that prevailing wages were not required in the hotel portion of the project because no public funds were to be used. In support of its decision that the project was indeed a single project subject to prevailing wages, the DIR noted that the strongest evidence of such was the manner in which the project was organized and its physical layout. This evidence was found in the resolution language, which stated, that the public improvements were so interwoven with the private improvements that it was not feasible to construct them as separate projects.

The project considered by the DIR in the *Huntington Beach* decision, discussed earlier, included a 517-room resort hotel and conference room, a second hotel and 177 residential units. Pursuant to the disposition and development agreement, the developer was responsible for all costs related to the construction of these improvements, subject to the Agency's reimbursement of certain infrastructure and relocation costs. The Agency's position was that the hotel project was not a public work because it was privately financed, and the use of public funds was limited to very specific items, completely separate from the hotel construction. The DIR disagreed with this argument, finding that this was a single project because: (1) it was governed by one agreement, (2) the phases of the development would be physically integrated and would accompany the public improvements, (3) the Agency had significant approval and oversight for the project, (4) the cost reimbursements by the Agency were integral to the deal, and (5) there was an interrelationship of the activities to be done by the developer and the Agency. In addition, the DIR found that the Agency's reimbursement of certain costs constituted payment of public funds, thereby making the entire project subject to the prevailing wage requirement.

In the *Pittsburg* decision the project involved the construction of 120 private homes and a public park. The infrastructure was funded in part by an Agency credit related to the purchase of the property. Although the public and private improvements were to be bid and constructed separately, the DIR found that this was a single project. In its decision, the DIR based this finding on the fact that both the homes and infrastructure were to be built by the same contractor, under a single agreement. Because the DIR also determined that public funds were to be used for the infrastructure and the park, prevailing wages were required on the entire project.

H. How can the exemption for private redevelopment projects that receive tax

increment funds to complete a public improvement be incorporated into Disposition and Development Agreements and Owner Participation Agreements?

The subject amendments to the Labor Code create an exception to the prevailing wage requirement for private developers who receive a reimbursement from the Agency for costs normally borne by the public. At this point, the scope of this exception is unclear. However, one way to incorporate this exception would be for the Agency to request that the developer undertake work that the Agency would normally require to be done. The Agency then could reimburse the developer for the cost of this work. Another possible approach would be to make it the Agency's policy to bear certain costs for all the redevelopment projects. Then it could be argued that these are expenses normally borne by the public and can be incorporated into the Disposition and Development Agreements and Owner Participation Agreements. In addition, if the Agency has a policy to waive certain fees for affordable housing developments, this waiver could constitute reimbursement for costs normally borne by the Agency. However, these two approaches can be used only if it is an established policy of the Agency to bear certain costs for all similarly situated redevelopment projects.

I. Because a private development that receives a de minimus reimbursement is exempt from the prevailing wage requirements, how can this exception be incorporated into Disposition and Development Agreements, Owner Participation Agreements, and business development incentive agreements?

Agency assistance to a private project that is "de minimus in the context of the project" will not trigger prevailing wages for that project. However, the code section fails to define "de minimus," and "context of the project." De minimus is a shortened form of the Latin axiom, "de minimus non curat lex," meaning the law does not concern itself with trifles. Until there is more direction from either the DIR or the courts, it would be imprudent to depend upon this exception to the prevailing wage requirement.

J. Could the local agency increase its contribution to the affordable housing fund and provide these funds in lieu of other assistance in order to take advantage of the Low and Moderate Income Fund exception to the prevailing wage requirement?

Pursuant to Labor Code 1720, a project is exempt from the prevailing wage requirement when the Agency's assistance is for the construction or rehabilitation of affordable housing, if the assistance is from the Agency's Low and Moderate Income Housing Fund, and the only other source of funding is private funds. This exception would not apply if the project received additional government funds from any source other than redevelopment housing funds. Based solely on these guidelines, there appears to be nothing to prevent the Agency from increasing its contribution to the affordable housing fund and offering such as a direct subsidy to a redevelopment project developer in place of any other assistance. As long as the redevelopment monies are the sole source of any governmental funding for the affordable housing project, the prevailing wage exemption will apply.

K. Under the amendments, will the City be obligated to monitor prevailing wage rate compliance on contracts for traditional public works improvements? Will this same obligation exist if the new definition of "public works," includes businesses receiving economic development incentives, business improvement districts and non-

profit corporations receiving public funds to engage in planning, design, preconstruction, and maintenance work?

The City will be required to continue monitoring prevailing wages on State or Federal contracts which require the monitoring. Also, the monitoring will be as to contractors, land surveying, and inspection work. This is based upon the amended Labor Code section 1720. Traditional activities considered as "white collar" professional activities such as architecture and engineering will not be included as prevailing wage requirements and will not be monitored for prevailing wages . For details please see MOL 2001-24 (Nov 9, 2001), entitled "Prevailing Wage and Applicability after Labor Code Amendment."

L. If the City is responsible for additional compliance obligations, does the increased costs to do so constitute a state mandate subject to reimbursement from the State?

Whenever the legislature or any state government agency mandates a new program or higher level of services for an existing program, the State must reimburse local government for the costs to implement these changes. California Constitution, Article XIIIB, 6. The courts have defined mandated programs as those which provide services to the public or which impose unique requirements on local governments. Programs or higher level services arising from laws which apply generally to all state residents or local entities are not subject to reimbursement by the State. *County of Los Angeles v. State of California*, 43 Cal. 3d 46, 50 (1987). Additionally, in the drafting process for any bill, the legislature makes a determination as to whether the bill contains such a state mandated local program. Pursuant to the Legislative Counsel digest SB 975 was not designated as a state-mandated program. SB 975 does not appear to meet the requirements of a state mandated program as set forth in *County of Los Angeles v. State of California*. However, it is possible for a local government to challenge the legislature's designation by filing a test claim with the Commission on State Mandates. *See*, Government Code 17552. To date, there has been no such challenge to this amendment.

RECOMMENDATIONS

In the absence of further clarification from the DIR on the application of the amendments, interpretation of the amendments by the courts, or amendment to the statute, there will continue to be a lack of clarity about the applicability of prevailing wage requirements to the programs and projects discussed in this memorandum, and projects will need to be analyzed on a case-by-case basis.

The City and/or the Redevelopment Agency can seek advice from the DIR on the application of prevailing wages to a project or to a type of project. This process can be time consuming (the California Chamber of Commerce website states that it can take up to eight months) and could result in unfavorable rulings. In the alternative, the City and/or the Redevelopment Agency could propose clarifying amendments to the statute, either on their own, or as a part of an organized effort with other agencies, or through the League of Cities.

Finally, for any projects which appear to be at risk of having a determination made at a later date that they are subject to prevailing wage requirements, we recommend the City or the Agency include a provision in the agreement with the contractor or developer addressing that

contingency, and setting forth the intention of the parties regarding how that contingency will be addressed. In some projects, it may be appropriate to allow the application of prevailing wages to the project to be a ground for termination of the contract. In other projects, it may be appropriate for one or more of the parties to agree to be responsible for the additional cost of such a determination.

This office will continue to monitor any developments in this area of law, and will keep you informed about any significant developments which will affect the application of prevailing wages to City and Redevelopment Agency projects.

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