

DEPARTMENT OF INDUSTRIAL RELATIONS
Office of the Director - Legal Unit
455 Golden Gate Avenue, Ste. 9516
San Francisco, CA 94102
Tel: (415) 703-4240
Fax: (415) 703-4277

MAILING ADDRESS:
P. O. Box 420603
San Francisco, CA
94142-0603



July 28, 2006

Terrance O'Malley, Hearing Officer
Office of the Director - Legal Unit
320 West 4th Street, Suite 600
Los Angeles, CA 90013

Re: Public Works Case No. 2003-042
East Campus Student Apartments
University of California, Irvine

Dear Mr. O'Malley:

This constitutes the determination of the Director of Industrial Relations regarding coverage of the above-referenced project under California's prevailing wage laws and is made pursuant to title 8, California Code of Regulations, section 16001(a). Based upon my review of the facts of this case and an analysis of the applicable law, it is my determination that the construction of the East Campus Student Apartments ("Project") is not a public work.

Facts

On December 5, 2000, the University of California, Irvine ("UC") issued a Request for Qualification and Proposal to Develop University of California, Irvine East Campus Student Apartments. The Project involves the construction of a 488-unit affordable student housing complex, undergraduate and graduate community buildings, a maintenance building, a community swimming pool and infrastructure including, parking spaces and sewer and water lines. Seventeen developers responded with packaged submissions. EAH-East Campus Apartments, LLC, a California Limited Liability Company whose general partner is EAH University Properties, Inc., a non-profit corporation (collectively "EAH"), was selected to develop the Project.

On December 1, 2002, EAH entered into a 40-year ground lease with UC ("Ground Lease"), leasing 27 acres of land ("Property") on which to build the Project and manage the rentals once the Project is completed. EAH is required to rent the apartments to UC students at below-market rental rates. The student rent is to be set no higher than 90 percent of market rate in order for it to be affordable, as determined by a rental survey.

Under the Ground Lease, EAH is to pay UC an initial rent of \$700,000 per year plus a one-time "System Fee" of \$505,000 and "123 Management Fee" of the greater of \$165,000 or \$0.33 times the gross square footage (collectively "one-time fees"). This initial rent is to be increased every five years by the percentage increase in the Consumer Price Index. After each 10-year period, EAH's rent is to be recalculated to provide UC with a 9 percent return based on the then-market value of the leased property.

In a letter dated February 13, 2006, Larry W. Heglar, a state-certified real estate appraiser with a Masters of Appraisal Institute ("MAI"), stated that in order to obtain the true fair market value of the Property, the fair market value should be reduced by the value of the student rent restrictions. According to Mr. Heglar, it should also be reduced by the off-site development costs because the comparable properties he considered in the appraisal discussed below "all involved sale of developable 'super pads' with offsite improvements already installed or paid for." Thus, according to Mr. Heglar, the "as is" value referred to in his appraisal represents the true fair market value of the Property.

In an appraisal dated October 30, 2000, Mr. Heglar determined that the highest and best use of the Property is apartment rentals. Calculating the rents at 90 percent of the market rate, the minimum restriction under the Ground Lease, the fair market value of the Property is \$11.35 million. Reducing the fair market value by the off-site development costs (\$3,326,660), Mr. Heglar determined the total "as is" value of the Property with student rent restrictions to be \$8,021,340.¹

In an appraisal dated December 3, 2004, James Brabant, a state-certified real estate appraiser with an MAI, determined that \$700,000 plus the one-time fees represents the fair market rent of the Property. He based this calculation on \$8,021,340, the "as is" or fair market value of the Property with student rent restrictions. Using that figure, Mr. Brabant determined that the \$700,000 rent plus one-time fees fell within the 8 to 10 percent expected market rate of return at 8.9 percent.

Construction is financed through a Loan Agreement dated December 1, 2002 between EAH and the California Statewide Communities Development Authority ("CSCDA" or "Issuer"), a joint powers authority organized under California law. Under the Loan

¹The correct "as is" figure is \$8,023,340. Mr. Heglar mistakenly subtracted \$3,328,660 in off-site development costs, instead of \$3,326,660.

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Agreement, Issuer agrees to issue CSCDA Student Housing Revenue Bonds in the aggregate amount of \$104.5 million. Under an Indenture Agreement between Issuer and Wachovia Bank, a private financial institution ("Trustee"), Issuer's rights to the bond proceeds and its secured interest in the Project revenues and in the physical buildings are assigned to Trustee. The bond proceeds are deposited directly with Trustee by Banc One Capitol Markets, Inc., the bank underwriting the bond sales. Trustee is to loan EAH the bond proceeds in installments as specified in the Loan Agreement. In turn, EAH is to deposit all of the gross revenues from the student rentals in a specified bank account and turn the account funds over to Trustee on a weekly basis. Trustee is given a secured interest in the EAH bank account. Issuer never has possession of either the bond proceeds deposited directly with Trustee and paid to EAH or the loan repayments made by EAH to Trustee.

The bonds were sold to private investors in two series. Series 2002A Bonds were issued in the amount of \$104.23 million. Proceeds from the sale of these bonds are to pay for construction costs, debt service and a portion of the issuance costs. Interest on the 2002A Bonds is tax exempt under federal law. Series 2002B Bonds were issued in the amount of \$270,000. Proceeds from the sale of these bonds are to pay for the remainder of the issuance costs, insurance and debt service. Interest on these bonds is tax exempt under California law, but not federal law.

Trustee is required to pay all bondholders out of the trust funds. Bondholders' only recourse is against the trust fund accounts or the security provided for repayment of the bonds (i.e., Project revenues and physical buildings). Under the Indenture:

The Bonds together with the interest thereon, shall be special, limited and not general obligations of the Issuer giving rise to no pecuniary liability of the Issuer The Bonds shall be limited obligations of the Issuer as provided therein payable solely from the revenues and collateral pledged The Bonds are payable solely from the Trust estate. The Bonds ... shall never constitute the debt or indebtedness of the State, The [UC], the [City of Irvine], or any other agency thereof Neither the faith and credit nor the taxing power of the State, The [UC] or the [City of Irvine] is pledged to the payment of the principal ... or interest on the Bonds, nor is the State, The [UC], or the [City of Irvine] ... obligated to make any appropriation for payment

On December 1, 2002, EAH entered into a construction contract with Benchmark Contractors, Inc. for \$60,360,457 to build the East Campus Student Apartments.

Discussion

Labor Code section 1771² generally requires the payment of prevailing wages to workers employed on public works. Section 1720(a)(1) defines public works to include: "Construction, alteration, demolition, installation, or repair work done under contract and paid for in whole or part out of public funds ..."

Section 1720 provides in pertinent part:

(b) For purposes of this section, "paid for in whole or in part out of public funds" means all of the following:

(1) The payment of money or the equivalent of money by the state or political subdivision directly to or on behalf of the public works contractor, subcontractor, or developer.

(4) Fees, costs, rents, insurance or bond premiums, loans, interest rates, or other obligations that would normally be required in the execution of the contract, that are paid, reduced, charged at less than fair market value, waived, or forgiven by the state or political subdivision.

Clearly, the Project is construction that is done under contract. At issue is whether the rent charged to EAH by UC and/or the bond financing renders the Project "paid for in whole or in part out of public funds."

Rent Charged to EAH by UC

The first question is whether the rent charged to EAH by UC under the Ground Lease is a payment of public funds. Under section 1720(b)(4), payment of public funds includes rent charged at less than fair market value. Mr. Brabant's December 3, 2004 appraisal states that the rent of \$700,000 plus the one-time fees under the

²Subsequent statutory references are to the Labor Code unless otherwise indicated.

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Ground Lease is fair market rent. Mr. Brabant's evaluation is based on Mr. Heglar's October 30, 2000 appraisal stating that the "as is" or fair market value of the Property with student rent restrictions is \$8,021,340.³ Using that figure, Mr. Brabant determined that the rent charged to EAH by UC fell within the 8 to 10 percent expected market rate of return at 8.9 percent.⁴

In light of the facts as presented, the Director will accept a bona fide appraisal performed by an independent and certified appraiser as determinative of fair market value unless credible evidence to the contrary is presented. See, e.g., PW 2004-035, *Santa Ana Transit Village, City of Santa Ana* (December 5, 2005); PW 2003-040, *Sierra Business Park, City of Fontana* (January 23, 2004). Here, the appraisals were performed using accepted methodologies by state certified appraisers with an MAI and therefore are considered bona fide appraisals. No evidence to the contrary has been presented and therefore the appraisals are hereby accepted as establishing the fair market value of the rent.

In sum, the rent charged to EAH by UC under the Ground Lease is not charged at less than fair market value within the meaning of section 1720(b)(4). Therefore, the rent does not constitute a payment of public funds.

Bond Financing

The second question is whether the bond financing involves a payment of public funds. As described above, CSCDA is a "conduit issuer" of the bonds. A conduit bond issuer issues and sells bonds and, simultaneously with their issuance, assigns all of its rights to the bond proceeds to a private trustee for all bondholders. See PW 2004-016, *Rancho Santa Fe Village Senior Affordable Housing Project* (February 25, 2005) for a description of conduit bond funding. That is precisely what occurred in this case.

³According to Mr. Heglar's February 13, 2006 letter, the comparable properties used in his October 30, 2000 appraisal all involved sale of "super pads" with off-site infrastructure already installed or paid for. Because Property was not improved with any off-site infrastructure, the cost of building such improvements was taken into account in arriving at the true fair market value of the Property, which Mr. Heglar refers to as the "as is" value.

⁴As noted above, Mr. Brabant mistakenly reduced the fair market value of the Property by \$2,000 in his arithmetic calculations. The \$2,000 difference, however, does not alter the conclusion reached herein that UC is not charging EAH below-market rent. Using the correct fair market value of the Property of \$8,023,340 instead of \$8,021,340, the market rate of return on rent of \$700,000 plus one-time fees would still fall within the 8 to 10 percent expected market rate of return at approximately 8.8 percent.

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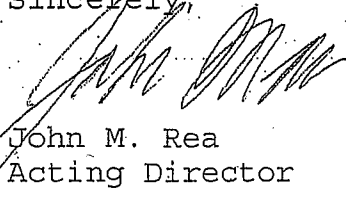
CSCDA issued the bonds. The bond proceeds were deposited with Trustee. Trustee advanced the proceeds to EAH as loan installments. EAH is contractually bound to repay the loan to Trustee from revenues generated by the Project. Because it assigns all of its rights to Trustee, Issuer never has possession of either the bond proceeds or the loan repayments. Moreover, Issuer has no pecuniary liability to repay the bond debt. In fact, the bondholders' only recourse is against the trust fund accounts or the security provided for repayment of the bonds.

The Department has previously determined that money collected for, or in the coffers of, a public entity is "public funds" within the meaning of section 1720. See, e.g., PW 2004-016, *Rancho Santa Fe Village Senior Affordable Housing Project* (February 25, 2005); PW 93-054, *Tustin Fire Station* (June 28, 1994). Here, neither the bond proceeds nor the loan repayments ever enter the coffers of a public entity, nor are they collected for a public entity. Because none of the money flows into or out of public coffers, the bond financing is not "the payment of money or the equivalent of money by the state or political subdivision" within the meaning of section 1720(b)(1). Therefore, the bond financing does not constitute a payment of public funds.

Based on the foregoing, neither the rent charged to EAH by UC under the Ground Lease nor the bond financing constitutes a payment of public funds. Therefore, the Project is not a public work and is not subject to prevailing wage requirements.⁵

I hope this determination satisfactorily answers your inquiry.

Sincerely,



John M. Rea
Acting Director

⁵Given the conclusion reached herein that Project is not a public work, there is no need to address whether the "internal university affairs" doctrine under article IX, section 9(a) of the California Constitution relating to the University of California would otherwise exempt Project from application of state prevailing wage requirements.