

DEPARTMENT OF INDUSTRIAL RELATIONS

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January 29, 2015

To All Interested Parties:

Re: Public Works Case No. 2013-004

Town Centrale Project, City of Hercules

By agreement to resolve this matter, the interested parties have stipulated to vacate the Coverage Determination in Public Works Case No. 2013-004, Town Centrale Project, City of Hercules. In consideration of the unique facts leading to the determination, the Department has agreed that the Coverage Determination is hereby vacated.

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December 27, 2013

Thomas A. Enslow  
Adams Broadwell Joseph & Cardozo  
520 Capitol Mall, Suite 350  
Sacramento, CA 95814

Jon Welner  
Jeffer Mangels Butler & Mitchell LLP  
Two Embarcadero Center, 5th Floor  
San Francisco, CA 94111

RE: Public Works Case No. 2013-004  
Town Centrale Project  
City of Hercules

Dear Messrs. Enslow and Welner:

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 California Code of Regulations, title 8, section 16001(a). Based on my review of the facts of this case and an analysis of the applicable law, it is my determination that the Town Centrale Project in the City of Hercules (Project) is not a public work subject to prevailing wage requirements.

#### Facts

Town Centrale is a mixed-use project currently under construction in the City of Hercules (City). When complete, it will consist of 147 apartment units and 10,000 square feet of retail space focused around a central plaza area. The Project's website describes the Project as "... the premier 'class A' apartment community in Hercules and on the 1-80 corridor north of the San Francisco Bay Bridge. Town Centrale provides a 'sense of place' for the Town Center district and a gathering place for the entire Hercules community."

The development is being constructed by UC-BNB (Developer). Prior to the inception of the Town Centrale Project, the project site was the location of Sycamore North, a project which was owned by of the City of Hercules Redevelopment Agency (Redevelopment Agency). All parties concur that Sycamore North was a public work that was paid for out of public funds. However, during the construction of Sycamore North, the City determined it did not have the necessary \$25 million that was needed to complete the project. The City declared Sycamore North to be a "failed

project” and decided to abandon the project and sell the property. Prior to this decision, the City had expended approximately \$35 million on the Sycamore North project.

### Sycamore North

On November 6, 2006, the City of Hercules Planning Commission approved a mixed-use commercial and residential development project that would come to be known as Sycamore North. The plan called for 30,104 square feet of commercial space and 104 residential units, including low income housing.

On August 6, 2007, the Community Development Director issued a notice that a “minor modification” to the Sycamore North project had been approved. The Sycamore North project was now planned to consist of 40,000 square feet of retail space and 96 residential units. The modification designated 75 of the units as affordable housing.

In 2009, the Redevelopment Agency, general contractor Oliver and Company, Inc., and the Contra Costa County Building & Construction Trades Council (Council) and its affiliate unions entered into a Project Labor Agreement for Sycamore North. Construction commenced shortly thereafter.

On August 23, 2011, the City Council adopted a Resolution No. 11-109, which stated that the “Sycamore North Project as Currently Conceived Is No Longer Feasible ....” The Resolution stated that the Redevelopment Agency had spent approximately \$35 million on Sycamore North, but neither the Agency nor the City would be able to provide the estimated \$25 million needed to complete construction. The Resolution directed the City Manager “to solicit additional proposals to sell or ground lease the Project to a developer for development of an alternative project ... ” Following adoption of the Resolution, the City hired real estate broker CBRE and attempted to sell the property.<sup>1</sup> After a nine month period, the City received twelve offers to buy the property, four of which were deemed to be from qualified buyers.

All of the “qualified” buyers offered to pay \$0 for the property in “as is” condition. UC-BNB was ultimately selected from among these four qualified buyers. On October 11, 2011, the City Council adopted Resolution No. 11-124, which authorized an expenditure of no more than \$420,000 to weather wrap the partially constructed Sycamore North project. On January 10, 2012, the City became the Successor Agency to the Redevelopment Agency.

On March 12, 2012, City Manager Steve-Quran submitted a Staff Report to the City Council. In his report, he urged the City Council to authorize execution of the Purchase and Sale Agreement with the Developer. Also, in that report the City Manager stated that the City considered several alternatives for selling the Project, including (1) “demolishing the [half finished] structure;” (2) “lopping off two stories”; or (3) “selling it to an affordable housing developer for a 100% low income project.” The City rejected all three options, apparently due to a desire to have the parcel developed by a private developer, resistance to authorizing a 100% low income project on the site,

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<sup>1</sup> In approximately October, 2011, City winterized the structure. The work included putting a roof on the structure and wrapping the structure with Tyvek. According to the City, the purpose of the work was to protect the structure from potential harm from winter weather and protect the building and the value of the building for the benefit of the City.

and a concern that tearing down the project would create a “(p)erception of lost dollars that have been sunk into project.”

### Town Centrale

On March 27, 2012, the City and UC-BNB executed a Real Property Purchase and Sale Agreement (PSA), transferring the property “as is” from the City to UC-BNB. The purchase price was \$425,000, plus possible additional future payments based on an earn-out formula. The Purchase Agreement dropped the City's initial bid requirement to provide affordable housing units. In addition, Developer committed in the Purchase Agreement to either convert up to 10% of the residential units to below market rate units or to provide additional payments to the City if the Project was initially more profitable than estimated, based on an “earn-out formula.” The “earn-out formula” would be based on whether dividing total Net Operating Income by the actual total project costs would provide an additional return of over 8.5%. Developer, however, has indicated that it “does not expect any additional amounts to be due to the seller based upon this Earn-Out Formula.”

On November 13, 2012, the City Council passed Resolution No. 473, adopting the Development Agreement between the City and UC-BNB and granting approval to the Developer to proceed with the project, which was now called Town Centrale. Under the Development Agreement, the new Project consisted of 12,777 square feet of commercial space and 147 residential units.

The Development Agreement provides that Developer shall be deemed to have paid the City development impact fees, and shall not be responsible for paying any further development impact fees or other charges for or related to development of the Project. It also provides that Developer shall receive fee credits against all Third Party Fees required of the Project in an amount equal to the Third Party Fees previously paid for the Project when it was owned by the City.

Developer submitted two appraisals for the Project. The first appraisal is dated June 29, 2012 and was performed by CBRE Valuation and Advisory Services for UC-BNB Partners LLC (CBRE Appraisal). The second appraisal was dated January 18, 2013 and was performed by Joseph J. Blake and Associates Inc. for Wells Fargo Bank (Blake Appraisal). Each appraisal report included multiple value opinions, including market value of the land as vacant; hypothetical market value of the property as if construction were complete and at stabilized occupancy; and market value of the property in as-is condition. On June 29, 2012, the CBRE Appraisal found that the current fair market value of the Project property “as is”, assuming the project would be completed based on the current project/approvals, is \$460,000. The CBRE Appraisal also estimated that the fair market value of the property, if it was vacant without any improvements, would be \$2,000,000.

The Blake Appraisal found that the current fair reuse value of the Project property “as is”, assuming the Project would be completed based on the current project approvals, is \$425,000. The Blake Appraisal estimated that the fair market value of the property, if it was vacant without any improvements, would be \$3,770,000.

On May 17, 2013, at the request of Council, R & B Equipment, Inc., a California licensed General Engineering Contractor and C21 Demolition contractor, provided a bid estimate for the cost to demolish all existing site improvements on the subject property and to restore the site to a vacant,

level condition for \$1,375,000.55. Council engaged the services of California certified appraisers Norman C. Hulberg and Neil A. Lefmann to review the CBRE Appraisal, the Blake Appraisal and the R & B Equipment, Inc. demolition bid. Based upon this review, Hulberg and Lefmann provided a professional opinion, dated May 30, 2013, that the highest and best use of the Project property would be to remove all existing site improvements and restore the site to a vacant, level condition ("Hulberg Appraisal Opinion"). The Hulberg Appraisal Opinion, concluded that if the CBRE Appraisal was accurate, then the as-is market value of the subject property in the CBRE Appraisal would have been \$700,000 based on the R & B Equipment, Inc. demolition bid. The Hulberg Appraisal Opinion also concluded that if the Blake Appraisal was accurate, then the as-is market value of the subject property in the Blake Appraisal would have been \$2,470,000 based on the R & B Equipment, Inc. demolition bid.

On November 25, 2013, Developer submitted a bid for the demolition of existing improvements. The bid of \$3,264,338 includes the demolition and disposal of existing improvements and the importing of soil to restore the property to its initial condition.

On December 23, 2013, Developer submitted a statement that it will amend the PSA to increase the purchase price to \$700,000 or more. It will also eliminate the provisions regarding the Earn-Out Formula.

#### Discussion

Labor Code section 1771<sup>2</sup> generally requires the payment of prevailing wages to workers employed on public works. Section 1720, subdivision (a)(1) defines "public works" generally under a three pronged definition: (c)onstruction, alteration, demolition, installation, or repair work done under contract, and paid for in whole or in part out of public funds ... ." Section 1720(b) states: "(f)or purposes of this section, paid for in whole or in part out of public funds" includes the "[t]ransfer by the state or political subdivision of an asset of value for less than fair market price."

It is undisputed that the Project meets the first and second requirements for public works coverage, in that it constitutes "construction, alteration, demolition, installation, or repair work" and it is "done under contract." The last requirement, that the Project be "paid for in whole or in part out of public funds" is the one at issue in this case.

#### The Project Is Not a Public Work Because the City Is Selling the Project Property to Developer for a Fair Market Price

The Project is not a public work because Developer is paying fair market value for the Project property. All of the appraisers, whether those working for the Developer (CBRE and Blake) or Council (Norman Hulberg and Neil Lefmann) found that the fair market value of the property would be between \$700,000 and \$3,770,000, based on the highest and best use of the property,

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<sup>2</sup> All citations are to the California Labor Code; all subdivision references are to the subdivisions of Section 1720 unless otherwise specified.

being removal of the existing half-built improvements and sale as vacant land.<sup>3</sup> Developer bases its claim of fair market price on the as-is market value findings of the CBRE and Blake Appraisals. The CBRE Appraisal finds that the as-is market value of the property is \$460,000. The Blake Appraisals finds that the as-is market value of the property is \$425,000. The as-is market value, however, is not determinative of the value of the land.<sup>4</sup>

All the appraisals appear to agree that the highest and best use of the site and, therefore, the fair market value of the Project property would be to remove all existing site improvements and restore the site to a vacant, level condition. Because the “as-is” market value of the Project property as vacant is greater than then “as-is” market value of the Project property assuming the Project is to be built as proposed, the fair market price for purposes of determining the applicability of prevailing wages is the market value of the Project property as vacant. Based upon the information in the appraisals and the bid estimate for demolition and site restoration, the “as-is” market value of the Project property is somewhere between \$700,000 and \$2,470,000.<sup>5</sup>

Council argues that Developer is actually purchasing the Project property for less than fair market price because, according to the CBRE Appraisal, the \$425,000 purchase offer by Developer “was effectively a reimbursement for the city to agree to weather-wrap and roof the project, thereby saving Developer the cost of doing this work.” City, however, would likely have winterized the Project to protect its investment regardless of the PSA with Developer. In the event the PSA fell through, City would have sought another buyer for the Project and therefore, the cost of weather-proofing the Project should not be subtracted from the final purchase price. Accordingly, the City's sale of the Project property for \$700,000 does not constitute a “(t)ransfer by the state or political subdivision of an asset of value for less than fair market price.” This project is not a public works project because the land transfer is for fair market price.

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<sup>3</sup> In determining the fair market value of land, DIR has consistently held that fair market value shall be determined by the “highest and best use” of the land, not by the market value of the proposed project. DIR has determined that this is the case even where the proposed project is the only allowable use of the land per the terms of the sale or a disposition and development agreement. Where the transfer of real property is involved, “fair market price” is “synonymous with fair market value.” (Public Works Case No. 2003-040, Sierra Business Park/City of Fontana (January 23, 2004), p. 3.) Fair market value is defined as “the value of the land at its highest and best use as determined by a bona fide appraisal.” (Public Works Case No. 2004-035, Santa Ana Transit Village/City of Santa Ana (December 5, 2005), p. 2.) In contrast, “fair reuse value” is “a term unique to redevelopment projects ... [and] assumes the proposed restrictions in the disposition and development agreement on the use of the property, and thereby distorts the property's value such that a market-based appraisal is not possible.” (Id. at p. 5.) In the context of public works coverage determinations, “fair reuse value” is not mentioned anywhere in the Labor Code. (Ibid.)

<sup>4</sup> In PW 2012-041; Volkswagen of Palm Springs; City of Cathedral City (May 1, 2013), the Cathedral City Redevelopment Agency argued that the fair market price of the transfer of land from the City to M&M Property Company was zero dollars because of the agreed-upon restrictions that required use of the property for a car dealership specific project. A report prepared pursuant to Health & Safety Code section 33433 found that the fair market value of the Land at its highest and best use is \$1,077,000 and a subsequent appraisal found that land's fair market value “as vacant and available for sale” to be \$1,700,000. The Director found that the fair market value of the land as vacant was the highest and best use and that this value was the applicable fair market value for determining the applicability of prevailing wages, not the value of the land if used for the car dealership project.

<sup>5</sup> Developer submitted a \$3.2 million estimate for the demolition cost. Because the determination finds that the purchase price of \$700,000 constitutes a fair market value for the land, it is not necessary to address whether Developer is correct that its bid for the demolition work is more accurate than Council's bid.

For the foregoing reasons, the Towne Centrale Project in the City of Hercules is not a public work within the meaning of section 1720.<sup>6</sup>

I hope this letter satisfactorily answers your inquiry.

Sincerely,



Christine Baker  
Director

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<sup>6</sup> Council also argues that prevailing wages apply to the Project because City through its predecessor entity paid both City and "third party" fees for the Project and that the prior Redevelopment Agency Contribution of \$35 million is a payment on behalf of UC-BNB. It is undisputed that the failed Sycamore North project received public funding. Here, however, under the unique facts of this case, Developer is purchasing the land in "as-is" condition with an existing partially completed structure. According to the appraisals, the "as-is" condition of the property has less value than if the City or Developer demolished the existing structure. Developer's purchase of the property for at least \$700,000 constitutes a fair market value transaction at the property's highest and best use. As such, Developer will not receive any payment of public funds nor will City make any payments on Developer's behalf under section 1720, subdivision (b), in exchange for Developer's receipt of the existing structure.