STATE OF CALIFORNIA GAVIN NEWSOM, *Governor*

DEPARTMENT OF INDUSTRIAL RELATIONS
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November 28, 2022

Robert Allen Williams, III
District Council 16
International Union of Painters and Allied Trades
2705 Constitution Drive
Livermore, California 94551

Re: Public Works Case No. 2020-014
City Place Santa Clara / Related Santa Clara
City of Santa Clara

Dear Mr. Williams:

This constitutes the determination of the Director of Industrial Relations regarding coverage of the above-referenced project under California's prevailing wage laws, and it is made pursuant to Labor Code section 1773.5[1] and California Code of Regulations, title 8, section 16001, subdivision (a). Based on my review of the facts of this case and an analysis of the applicable law, it is my determination that the City Place Santa Clara / Related Santa Clara project (Project) in the City of Santa Clara (City) is subject to prevailing wage requirements.[2]

Department staff reviewed over *25,000 pages* of documents submitted in relation to the Project. Many of the documents described complex transactions, and were provided with little context and little indication as to their relevance to the issues raised in this determination. The Department also considered a total of nine letter briefs, comprising 80 pages of legal argument, from the City, the Developer, and International Union of Painters and Allied Trades, District Council 16 (DC 16), which requested the coverage determination. The parties insisted on filing several rounds of briefs, with each round discussing new issues not raised in previous rounds.

The scale of the record, the complexity of the business and financial agreements, and the multiple rounds of briefing go far beyond usual coverage determination requests.

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[1] Unless otherwise indicated, all further statutory references are to the California Labor Code and all subdivision references are to the subdivisions of section 1720.

[2] The City Place Santa Clara project is also referred to as the CityPlace Santa Clara project. By December of 2019, the name of the project was changed to Related Santa Clara.

Facts

The Project contemplates a mixed-use development of approximately 9.16 million square feet that includes up to 5.7 million square feet of office and 1.5 million square feet of retail/restaurant/entertainment uses, 700 hotel rooms, and up to 1,680 residential units, as well as public open space and parks.

The Project site is owned by the City and encompasses approximately 240 acres of land generally located north of Tasman Drive, east of Great America Parkway and San Tomas Aquino Creek, west of the Guadalupe River, and south of Great America Way and State Route 237, most of which was formerly occupied by a landfill.

The Project is a combination of what was originally two separate development proposals by two different developers. The two developers, Montana Property Group, LLC[3] (Montana) and Related, formed joint venture Related MPG JV, LLC to develop a portion of the Project Site, with the remainder to be developed solely by Related (Developer).[4] Relevant background on how the two separate developments were proposed and negotiated, and how they were later combined, is recounted below.

A. Proposals for the Development of the Tasman and City Landfill Parcels Were Submitted without Competitive Bidding.

On July 12, 2011, the City accepted an unsolicited proposal submitted by Montana in December of 2010 to enter into an exclusive negotiating agreement to develop two City-owned parcels adjacent to the San Francisco 49ers stadium project site. Although City staff recommended that the City solicit Requests for Qualifications/Requests for Proposals from Montana and other developers, the City declined to engage in a competitive bidding process.

On June 26, 2012, the City and Montana entered into an Exclusive Negotiating Rights Agreement for the development of a 9.48-acre property at 5120 Stars and Stripes Drive, located immediately south of the landfill and north of Tasman Drive on the east and west sides of Centennial Boulevard and a portion of another parcel located immediately northward of those other parcels (Tasman Parcels). At that time, the two vacant parcels were being used as staging areas for the construction of the City's adjacent Tasman Garage and the construction of the nearby Levi's Stadium, home of the San Francisco 49ers football team. Montana proposed to develop a luxury hotel, sports bar, upscale restaurant, retail and additional entertainment uses. As stated in the Exclusive Negotiating Rights Agreement: "The City intends to ground lease the Property for a fair market rent and no City general fund or enterprise funds will be used in or pledged to the development, financing or operation of the Project."

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[3] Montana Property Group, LLC is led by Joe Montana, who won four Super Bowl championships with the San Francisco 49ers professional football team.

[4] Unless otherwise indicated, "Developer" or "Related" refers to the entity or entities developing the project. Related Santa Clara, LLC self-identifies as the developer in its communications to the Department.

On April 9, 2013, the City and Related entered into an Exclusive Negotiating Rights Agreement (ENA) for the development of approximately 230 acres located at 5155 Stars and Stripes Drive, in the North of Bayshore area between Great America Parkway and Lafayette Street formerly occupied by the landfill (City Landfill Parcels). The proposed project contemplated the subdivision of the City Landfill Parcels into two sets of vertical parcels, with one parcel constituting the City's fee interest in the landfill (Landfill Parcels), and the other parcel constituting the City's fee interest in the airspace above the landfill (Airspace Parcels). The ENA provided a time frame for the parties to complete predevelopment efforts including extensive design, engineering, legal, environmental and California Environmental Quality Act (CEQA) scopes of work. Related proposed developing various mixed uses on the property, including retail, entertainment, residential,[5] and office uses. The development would be constructed on a platform over the former landfill.

The genesis of the City's ENA with Related is unclear, but the Revised Minutes of the City Planning Commission's meeting on June 8, 2016 noted that "Steve Eimer [for Related Santa Clara, LLC], the applicant, stated that they were invited by the City Council to look at this site and be a partner with the City." There is no evidence that the City pursued a competitive bidding process with respect to development of the City Landfill Parcels.

B. The City Entered into Term Sheets for the Development of the Tasman and City Landfill Parcels.

On February 11, 2014, the City entered into separate non-binding Term Sheets with Montana and Related for the development of the Tasman Parcels and City Landfill Parcels, respectively. The intent of the Term Sheets, and the later supplements to the Term Sheets, was to document the parties' negotiated commitments and obligations with respect to the proposed long-term lease of the parcels (Ground Leases).

1. <u>The City Entered into Term Sheets that Set Forth the Rent Structure for the Airspace Parcels.</u>

The Term Sheet between the City and Related identified several significant challenges with the development of the City Landfill Parcels, including "attaining the economic feasibility to provide the level of infrastructure and public benefits necessary to achieve the Project guidelines and goals."[6]

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[5] Residential development of the landfill is subject to the approval of State and local regulatory agencies. (See Cal. Code. Regs., tit. 27, §§ 20005-23014.)

[6] The Term Sheet between the City and Related made the following representation with regard to development fees: "An Exhibit to the DDA and/or DA would identify and quantify all City development fees that would pertain to the Project. It is expected that no City development fees, other than those identified in the exhibit, would be levied against the Project or its owners, that the values on which such development fees are based would be held constant or subject to a maximum annual adjustment set forth in the exhibit, and that the Project would benefit from any downward adjustments in

With regard to rent considerations, the parties stated that: “Rent to be paid to City would be intended to achieve a balance between City’s need to achieve a fair return for its property, the public policy objectives of the Project, and Developer’s need for a market return (with recognition of project component risks) on Project cost.” With regard to utility services, the parties agreed to “work cooperatively to assure that all necessary public and private utility services would be provided to the Property” and “work together to explore for key elements of the Project such discounts, rebates and related assistance from publicly owned utilities as may be available under the circumstances.”

The Term Sheet set forth the financing plan as follows:

> Developer would be responsible for obtaining all necessary private financing, both debt and equity. City would work with Developer to explore sources of public financing for the Project, such as Mello Roos . . . Developer and City would work together to create landscape, lighting, and maintenance districts, in order to pay infrastructure capital and maintenance costs. The costs to establish such districts would be borne by Developer, and ongoing funding for each district would be borne by the constituent properties of that district. A final Financing Plan . . . would be negotiated by the Parties and attached to one or more of the Transaction Documents. The Financing Plan would include details regarding expected sources and timing of equity and debt, as well as anchor tenant identification and other evidence of financial and market feasibility of the Project.

On May 23, 2014, Montana filed a preliminary application for the development of the Tasman Parcels. Shortly thereafter, on June 9, 2014, Related filed a preliminary application for the development of the Airspace Parcels, which were subdivided from the City Landfill Parcels.

The Agenda Report dated June 27, 2014 from the Economic Development Officer/Assistant City Manager to the City Manager, prepared for the July 1, 2014 City Council meeting, provided the following context with regard to the lease valuation of the Project:

> Unlike typical parcels ready for development or redevelopment, the development of the former landfill requires a significant infrastructure investment prior to commencement of the construction of buildings. This infrastructure investment includes the need to build 1) a stable ground floor (or a platform) to accommodate the continued settlement of the landfill over time and 2) the necessary water, sewer, electric, storm, gas utilities and roadway systems to accommodate development over 215 acres of land. This infrastructure investment has been estimated at more than $800 million. Although the Developer will be required to make these infrastructure investments on behalf of the City, the City, will in effect, take on some of this responsibility through a reduction in rent in the earlier years of the lease.

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development fees made City-wide. It is intended that no subsidies, permit fee waivers, or other fee waivers will be requested or granted by City in connection with the Project.”

On July 1, 2014, the City and Related entered into a Term Sheet Supplement for the purposes of setting forth the negotiated rent structure for the Ground Leases and supplementing other provisions of the Term Sheet.[7] Per the July 1, 2014 Term Sheet Supplement, development of the Project is expected to take place over a total of seven Phases on a total of four parcels, and the parties will enter into a lease for each Phase using the form of lease attached in the Disposition and Development Agreement (DDA). As explained in the June 27, 2014 Agenda Report, the initial annual rent for each Phase would be as follows: Phase 1 - $1.5 million; Phase 2 - $500,000; for each of Phases 3 through 5 - $750,000; and for each of Phases 6 and 7 - $875,000. The Agenda Report summarized the proposed annual adjustment[8] to rent as follows:

> The initial rent shall be increased by 3% annually with the exception of Years 15, 25, 35, 53, 61, 80 and 90 in which the rent shall increase by 10% over the prior year. In addition, the City will receive two fair market rent adjustments in Years 45 and 70. Subject to a negotiated floor and cap, these fair market rent adjustments will be based on the then appraised value of the land as if it were vacant, less the agreed costs that Developer incurred to supply infrastructure that are above and beyond typical costs due to the unusual site, with the resulting value at 6.5% return to the City.

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[7] The Term Sheet Supplement stated that the Parties, having previously set forth a procedure for arriving at the proposed rent structure for the Ground Leases in the Term Sheet, have now completed that procedure with the assistance of outside consultants and have negotiated the rent structure and the related issues set forth in the Term Sheet Supplement.

[8] Exhibit D to the July 1, 2014 Term Sheet Supplement provided two examples of calculation of rent adjustments:

> Example of Lease Year 45 fair market value increase outlined in Section III (B)(2), subject to the minimum Rent increase provided for in Section III (B)(2)(a) and (b):
>
> (i) (fair market value of land [capped at $200 per Allowable Square Footage]) LESS (Premium Costs) = (adjusted land value)
>
> (ii) (adjusted land value) X (6.5% lease rate) = Ground Rent
>
> Example of Lease Year 70 fair market value increase outlined in Section III (B)(3), subject to the minimum Rent increase provided for in Section III (B)(3)(a):
>
> (i) (fair market value of land [capped at $350 per Allowable Square Footage]) LESS (Premium Costs) = (adjusted land value)
>
> (ii) (adjusted land value) X (6.5% lease rate) = Ground Rent

The June 27, 2014 Agenda Report explained that the maximum term of each ground lease will be 99 years, except that Phases 2 through 7 will be co-terminus with Phase 1, with the minimum term for any lease will be 89 years. All improvements will revert to the City at the end of the lease terms.

2. Development of the Tasman and City Landfill Parcels is Combined into a Single Project.

On August 5, 2014, Related filed an application to combine the two development proposals into a single project that would encompass up to 9.16 million gross square feet of office buildings, retail and entertainment facilities, residential units, and hotel rooms. On February 5, 2015, Montana and Related formed Related MPG JV, LLC, a joint venture to develop the "City Center" portion of the Project Site, with the remainder of the Project Site to be developed by Related.[9]

3. The City Entered into Term Sheets that Set Forth the Rent Structure for the Tasman Parcels.

On June 16, 2015, the City and Related entered into a Term Sheet Supplement No. 2 for the purposes of recognizing the inclusion of the Tasman Parcels within the Project and setting forth a proposed rent structure for the Tasman Ground Lease. As set forth in the June 10, 2015 Agenda Report from the Economic Development Officer/Assistant City Manager to the City Manager, prepared for the June 16, 2015 City Council meeting, the initial annual rent for the Tasman Parcels would be as follows: $750,000 at take down;[10] $1 million at project opening; $1.5 million at the fourth anniversary of opening. The Agenda Report noted that the rent structure for the balance of the Project remains unchanged. With regard to the annual adjustments to rent for the Tasman Parcels, the Agenda Report summarized:

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[9] Sometime after February 5, 2015, Related proposed a modification to the Original Project, referred to as the "Enhanced Open Space Variant" (the "EOS Variant") to reserve a portion of one of the parcels (APN 104-01-102) (designated as "Parcel 3" in the Master Community Plan) for parks and open space uses, with the office uses and associated parking that would otherwise have been developable on Parcel 3 being reallocated to other parts of the Project Site. As stated in City Resolution No. 16-8337 dated June 28, 2016, the EOS Variant was proposed after the publication of the Final Environmental Impact Report, and the City concluded that the EOS Variant would not result in any changes to the previously identified environmental impacts and would not result in any additional environmental impacts. According to the City, the EOS Variant was negotiated between the City and Related to address concerns raised during the public hearings and study sessions that the Project retain open space for public use.

[10] As defined in the Term Sheet Supplement, "take down" refers to the City and the Developer entering into a lease with respect to a particular Phase on the terms set forth in the Term Sheet Supplement.

> The initial rent shall be increased by 3% annually until Year 46 with the exception of Years 25 and 35 in which the rent shall be increase by 10% over the prior year. In Year 46 and continuing through the end of the Ground Lease term, the rent shall be increased annually by the lesser of 3% or the increase in CPI with the exception of Years 53, 61, 80 and 90 in which the rent shall increase by 10% over the prior year. In addition, the City will receive two [sic] fair market rent adjustments in Years 20, 45 and 70. Subject to a negotiated floor (and cap in Year 20 only), these fair market rent adjustments will be based on the then appraised value of the land as if it were vacant and zoned with a comparable use with the resulting value at 6.5% return to the City.

Between March 10, 2016 and June 7, 2016, the City Council and the City's Planning Commission held five study sessions for the Project. The Minutes of the City Council's June 7, 2016 meeting referred to the Project as a public/private partnership.[11] On June 8, 2016, after the completion of the study sessions, the Planning Commission adopted a resolution recommending that the City Council approve the Development Agreement (DA) associated with the Project.

C. The City Approved the Project with a Finding that the Transaction Will Provide the City with Fair Market Value.

On June 28, 2016, the City Council approved the Project. Specifically, the City Council adopted five resolutions and passed two ordinances concerning the Project. The general effect of these resolutions was to ensure all the necessary formal action was taken for the Project to comply with certain laws, such as CEQA, to make amendments to ensure appropriate rezoning of the area consistent with the Project's uses, to formally approve the DDA for the Project, and to make a finding that the terms in the DDA and the Ground Leases provided the City with fair market value, "taking into account the development and market risk, extraordinary up-front costs, and reasonable private development return expectations."[12] Adopted on July 12, 2016, Ordinance Nos. 1956 and 1957 formally approved the DA, and allowed leases up to 99 years in length within the CityPlace Santa Clara Master Community Plan area.

D. The Disposition and Development Agreement Sets Forth the Terms of the Ground Lease Rent Structure.

The DDA is dated August 12, 2016. Section 1.1 of the DDA is titled "Overview" and states:

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[11] However, the August 12, 2016 Development Agreement states that the Project is a private development, except for that portion to be devoted to public improvements to be constructed by Developer in accordance with the Disposition and Development Agreement and the Project Documents.

[12] See Resolution Nos. 16-8337, 16-8338, 16-8339, 16-8340, and 16-8341.

> This Agreement contemplates development of the Project, which will entail Developer entering into ground leases of the Development Parcels from the City on a phased basis for the purposes of: (i) constructing Infrastructure to support the Project, such as rods, utilities and geotechnical improvements required for development on the Landfill (e.g. a structural slab on which other Improvements will be constructed); (ii) constructing and improving certain public parks and open spaces; and (iii) constructing and operating Buildings within each ground lease premises, all in accordance with the Project Approvals, Subsequent Project Approvals and the Schedule of Performance to the extent applicable, as more particularly described in this Agreement.

Section 29.36 of the DDA is titled “Wages and Working Conditions” and states:

> The Parties acknowledge that the development of the Project will necessitate many extraordinary and unusual additional on-site and off-site development costs to be incurred by Master Developer and any Phase Developer, including costs on account of the Landfill, the lack of customary infrastructure on the Project Site, and the need to acquire necessary rights and access to Phases 2 through 7 of the Project Site. Given the extraordinary up-front costs, in approving this Agreement, the City Council made findings that the Project Documents, including this Agreement and the Ground Leases, provide the City with fair market value, taking into account the development and market risk, extraordinary up-front costs and reasonable private development return expectations. The rent structure as set forth in this Agreement and the form of Ground Lease includes an initial Base Rent, periodic rent adjustments and fair market value adjustments in years 45 and 70, taking into account the extraordinary and significant up-front costs required of Developer to position the Property as a developable site. As such, the rent structure under the Lease does not involve any fees, costs, rents, loans or other obligations that would normally be paid under the Ground Lease that are reduced, waived or otherwise charged at less than fair market value by the City or otherwise trigger California’s Prevailing Wage Law (Cal. Labor Code, §§ 1720 et seq.).

According to the DDA, after the City approves the Development Area Plan (DAP) for a Phase, the City and Related will enter into a Ground Lease for that Phase. The form of the Phase 1 Ground Lease is attached to the DDA as Exhibit G-1, and applies to the Tasman Parcels.

1. <u>Rent Structure for the Tasman Parcels (Phase 1).</u>

The Ground Lease form for Phase 1 (Tasman Parcels) states that the base rent for the first Lease Year is $750,000, and that the base rent increases each year by 3% until the end of the 44th Project Lease Year. Commencing on the Opening Date, defined as the date that at least 50% of all buildings depicted within the approved DAP(s) for all of Phase 1 are constructed and open for business, the base rent will increase to $1 million. Commencing on the 4th anniversary of the Opening Date, the base rent will increase to

$1.5 million. The Phase 1 Ground Lease contains a floor and ceiling for the rent adjustment for Project Lease Year 20. The Project Lease Year 20 base rent is the amount equal to the Tasman Parcels Fee Fair Market Value multiplied by 6.5%, but in no event less than $3 million or more than $3.5 million.[13] For Project Lease Years 45 and 70, the base rent amount is the greater of: (i) the Tasman Parcels Fee Fair Market Value multiplied by 6.5% (using the same valuation method as for Year 20); and (ii) the base rent for the immediately preceding lease year multiplied by 110%. After the 45th Project Lease Year, the base rent is the amount equal to the base rent for the immediately preceding year multiplied by the lesser of: (i) the sum of 100% plus the CPI (Consumer Price Index) Increase and (ii) 103%.

2. <u>Rent Structure for the Airspace Parcels (Phases 2-7).</u>

The form of the Ground Lease for Phases 2 through 7 is attached to the DDA as Exhibit G-2, and applies to the Airspace Parcels, which were subdivided from the City Landfill Parcels. Section 6.1.8 of the DDA listed the following initial base rents: Phase 2 - $1,500,000; Phase 2A (EOS Variant) - $750,000; Phase 3 - $500,000; Phase 4 - $750,000; Phase 5 - $750,000; Phase 6 - $875,000; and Phase 7 - $875,000. There is no explanation why these amounts differ from the amounts in the Term Sheet Supplement with regard to Phases 1, 2, 2A, and 3.[14] The Ground Lease form for Phases 2 through 7 roughly follows the rent structure set forth in the Term Sheet Supplement with regard to annual rent increases of 3% and 10%. However, the rent adjustments in Project Lease Years 45 and 70 for Phases 2 through 7 are calculated differently from the rent adjustments in Phase 1. For Project Lease Year 45, the rent adjustment is the greatest of:

1. (Fair market value of land [capped at $200 per Allowed Square Footage]) less Premium Costs,[15] multiplied by a 6.5.% lease rate;[16]

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[13] It is unclear how the parties arrived at the 6.5% rate, or the $3 million floor and $3.5 million cap on rent for Project Lease Year 20. The "Tasman Parcels Fee Fair Market Value" is obtained through the valuation process set forth in Section 3.4 of the Phase 1 Ground Lease, using appraisal instructions described in Exhibit H of the DDA.

[14] The Parties carved out Phase 2A, the EOS Variant, from the 99-year term of the Ground Leases. As set forth in section 4.8.1(d) of the DDA, the Phase 2A Ground Lease will terminate no later than 24 months after its effective date.

[15] Similar to the definition in the Term Sheet Supplement, the DDA defines "Premium Costs" as the categories of development costs set forth in Exhibit N of the DDA and associated with development of Phases 2 through 7. Exhibit N of the DDA estimated over $634 million in preliminary premium costs, in the following categories: (1) premium off site large development; (2) premium on site large development; (3) premium landfill; (4) premium engineering; and (5) miscellaneous.

[16] Section 3.4 of the Phase 2 through 7 Ground Lease form sets forth the valuation process for the Airspace Parcels Fee Fair Market Value, and Exhibit H to the Phase 2 through 7 Ground Lease form sets forth the appraisal instructions. These provisions are similar to those in the Phase 1 Ground Lease form. (*Ante*, fn. 14.)

2. $30 million multiplied by a fraction, the numerator of which is the Allowed Square Footage allocated to the Premises and the denominator of which is the Aggregate Project Allowed Square Footage; and

3. The Base Rent for Project Lease Year 44.

The Allowed Square Footage appears to be defined in section 10.1 of the DDA as "the maximum total amount of Gross Square Footage for Buildings that can be constructed within each Phase based on the reasonably anticipated maximum amount of square footage for each Phase or Partial Phase, taking into account the total density and mix of uses permitted under the MCP [Master Community Plan] and the economic viability of constructing, leasing and operating the same in light of site constraints, but not based upon market viability." The Aggregate Project Allowed Square Footage is defined in the Ground Lease form for Phases 2 through 7 as the aggregate Allowed Square Footage allocated to the Project Site.

Both Ground Lease forms contain the same Exhibit I, titled "Examples of Calculations of Base Rent Escalations."[17] Exhibit I indicates that the Allowed Square Footage is 1,419,800 square feet for Phases 2, 3, and 4, 1,440,000 square feet for Phase 5, and 1,296,000 square feet for Phases 6 and 7. Exhibit I also states that the Aggregate Project Allowed Square Footage is 8,291,400 square feet. Exhibit I allocates Premium Costs as follows: $175 million to Phases 2 and 3, $150 million to Phase 4, and $100 million to Phases 6 and 7. Using the numbers in Exhibit I, the following is an illustration of the three alternative rent adjustment calculations for Phase 2 in Project Lease Year 45 (the greatest of the three sets the rent in Project Lease Year 45):

1. Taking the capped fair market value of $200 per Allowed Square Footage of 1,419,800 square feet, less $175 million in Premium Costs, and multiplied by the 6.5% lease rate, yields $7,074,600.

2. $30 million multiplied by the fraction consisting of a numerator of 1,419,800 and a denominator of 8,291,400 equals $5,137,130.04.

3. The third alternative is based on the Phase 2 Base Rent Amount for Project Lease Year 44, which cannot be precisely determined at this time, as it is unknown how many annual increases of 3% and 10% will accrue by the 44th Project Lease Year. The Project Lease Year begins with the Commencement Date of the Phase 1 Ground Lease. Because none of the Ground Leases have been executed, it is unknown when Phase 2 will begin in relation to Phase 1. However, assuming that the Phase 2 take down occurs 5 years after the Phase 1 take down, the application of 3% annual increases to the initial Phase 2 rent

[17] Exhibit I illustrates the calculation of annual rent based on the rent structure set forth in the Ground Lease forms. Exhibit I shows that while the Ground Leases for each Phase are projected to begin in different years, the annual rent increases referenced in the Ground Lease form are aligned with the Project Lease Year beginning on the Commencement Date of the first Ground Lease.

of $1,500,000, as set forth in the DDA, from Project Lease Year 5 to Project Lease Year 39 equals $4,750,540.46.

After the 45th Project Lease Year, the base rent is the amount equal to the base rent for the immediately preceding year multiplied by the lesser of: (i) the sum of 100% plus the CPI (Consumer Price Index) Increase and (ii) 103%. For Project Lease Year 70, the rent adjustment is the greater of:

1. (Fair market value of land [capped at $350 per Allowable Square Footage]) less Premium Costs, multiplied by a 6.5% lease rate; and

2. The Base Rent for Project Lease Year 69 multiplied by 110%.

The Ground Lease form for Phases 2 through 7 leaves blank the base rent amount for the first Lease Year. Presumably the Parties intend to follow the initial rent amounts identified in the DDA.

E. The Development Agreement Describes How Various Impact Fees are Imposed on the Project, as well as the City's Obligation to Construct an Electrical Substation.

Like the DDA, the Development Agreement (DA) is also dated August 12, 2016. Section 2.2 of the DA makes clear that future changes to City ordinances, laws, rules, regulations, plans or policies adopted after the Effective Date of the DA shall not apply to the Project.[18] Section 3.3 of the DA includes a number of provisions regarding development fees, and the specific development fees applicable to the Project are listed in Exhibit C to the DA:[19]

- Section 3.3.1 freezes the Development Fees for the Project for 7 years after the City's approval of the first DAP for the Project (Development Fee Vested Period): "there shall be no increase in any Existing Development Fees, and no new

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[18] Section 1.3 provides that the DA will be effective upon its execution by all parties following the effective date of the Enacting Ordinance. City Ordinance 1956, which approved the DA, was adopted on July 12, 2016. The Parties have not provided Department staff with a fully executed copy of the DA.

[19] Exhibit C makes the following statement with regard to development fees: "In according with Section 3 of the Development Agreement, the only Development Fees currently applicable to the Project are the Development fees listed in this Exhibit C (the "Existing Development Fees"). The Existing Development Fees shall be payable at the rates set forth in this Exhibit C, and unless otherwise specified herein, any future increase in Existing Development Fees and any new Development Fees set forth in this Exhibit C shall be subject to the limitations set forth in Section 3.3 of the Development Agreement. Exhibit C contemplates future credits for Sanitary Sewer Connection Charges, future reductions for Sanitary Sewer Outlet Charges, and future credits for Storm Drainage Outlet Charges."

Development Fees shall be applicable to any Improvements within the Project Site."

- Section 3.4.1 caps Traffic Impact Fees until the later of the expiration of the Development Fee Vested Period or the date by which building permits have been issued for 3,000,000 square feet of office space (Traffic Impact Fee Vested Period).[20] Section 3.4.2 caps, for the Term of the DA, Traffic Impact Fee for office uses on the Project Site at $2.25 per square foot and caps Traffic Impact Fee for hotel uses on the Project Site at $900 per hotel room.

- Section 3.5 fixes Regional Traffic Fees at $1 per square foot of Office and Retail uses, and $0.50 per square foot for residential uses, for the Term of the DA.

- Section 4.3.4 of the DA requires Related to pay the Dwelling Unit Tax subject to the limitation on rate increases as provided in Section 3.3. However, section 4.3.4 requires the City to credit the full amount of the Dwelling Unit Tax toward costs owed to the City.

- Section 4.6 of the DA discusses the Multimodal Improvement Plan (MIP) addressing various transportation needs in the general area of the Project that are associated with development of the Project. Although Sections 4.6.3.1 and 4.6.3.2 require Related to fund the MIP, Section 4.6.3.3 indicates that the City will fund Related's obligations using the following funds in order of priority:

  (a) All Regional Traffic Fees to be paid to the City in connection with the Project;

  (b) All Traffic Impact Fees to be paid to the City in connection with the Project;

  (c) Equal monetary contributions by Developer and the City, up to a total lump sum of Eight Million Dollars ($8,000,000.00) (i.e., a maximum of $4,000,000 for each Party); and

  (d) City funds.

- Section 5.1 of the DA freezes the Engineering Plan Check Fees applicable to the Project during the Development Fee Vested Period.

Section 4.7 of the DA acknowledges that the Project will require certain increased and/or special electric service facilities to be provided by Silicon Valley Power (SVP), the City's electric utility provider. According to Section 4.7:

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[20] As noted in the Planning Commission Minutes of June 6, 2016, the static traffic fees "is to incentivize the developer to take down parcels and build which would bring rental income to the City sooner."

> Prior to approval of the DAP for Phase 1, Developer shall enter into a separate agreement with the City to address the rights and obligations of the parties with respect to providing interim electrical capacity and service at full build-out. The agreement will address such matters as the construction obligations for the City for additional substation and off-site distribution facilities, electrical service requirements to be provided by the City, construction and payment obligations of Developer, the granting of easements or other property rights and mutual cooperation as reasonably necessary to accommodate the electric service needs of the Project.

On December 3, 2019, the City, which owns and operates municipal electric utility SVP, and Related entered into the Esperança Substation Agreement to provide new electric capacity and power transmission facilities to Related for the Project. In this regard, the City agreed to allocate 27 MVA (Mega Volt-Amp) of the new substation's 60 MVA capacity to the Project. As stated in the Agenda Report to the City Council dated December 3, 2019:

> As part of th[e] Development Agreement, the City has agreed to provide new electric capacity and power transmission facilities to Related for City Place. The City Place development will require certain increased and/or special electric service facilities that will be provided by the City's electric utility provider, Silicon Valley Power (SVP). The City and Related have negotiated a Substation Service Agreement to address the rights and obligations of the parties with respect to providing interim electric capacity and service at full build-out. This Substation Service Agreement addresses such matters as the construction obligations of the City for the additional substation and off-site distribution facilities, electrical service requirements to be provided by the City, construction and payment obligations of Related, and the granting of easements or other property rights.

According to the December 3, 2019 Agenda Report, SVP will design, procure, construct, test and commission all substation equipment necessary and required per SVP's specifications to provide electric service to the Project, and Related will be responsible for paying the actual prorated costs related to the design, procurement, installation, construction, fabrication, inspection, and testing of the Esperança Substation at an estimated cost of $9,079,794. The Agenda Report further noted that the completed Esperança Substation will be owned, operated, and maintained by SVP at SVP's sole cost and expense.[21] The Agenda Report also noted that the Esperança Substation falls under an EIR adopted by the City Council on September 14, 1999 with regard to the SVP's Northern Receiving Station, which suggests that the construction of the new substation was contemplated at that time.[22]

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[21] A public utility is required to provide service to customers, and SVP is obligated to provide service to its customers. (See Santa Clara Mun. Code, §§ 13.05.010 et seq.)

[22] A June 21, 2010 Agenda Report indicated that SVP proposed to install a new Esperança Substation at the City's existing Northern Receiving Station to replace the older Tasman Substation located adjacent to the Great America parking lot. The Tasman

On March 24, 2020, the City Council adopted Resolution 20-8825 approving the DAP for Phase 1 of the Project. On July 13, 2020, the City Council adopted Resolution 20-8873 approving the DAP for Phase 2 of the Project. No fully executed Ground Lease for the Project has been provided to Department staff.

The construction financing for the Project is unknown.

Position of the Parties

DC 16 alleges three possible sources of public funding for the Project. DC 16 contends that the rent adjustment in years 45 and 70 for Phases 2 through 7 that deducts Related's Premium Costs both reduces rent and causes rent to be charged at less than fair market value under section 1720, subdivision (b)(4) (hereafter section 1720(b)(4)). DC 16 also contends that the City's responsibility to maintain public streets within the Project, the City's purported estimate of public works infrastructure costs for the Project, as well as the City's agreement to construct the Esperança Substation to supply electricity to the Project, constitute the performance of construction work in execution of the project under section 1720, subdivision (b)(2) (hereafter section 1720(b)(2)). Finally, DC 16 contends that the freezing of development fees, including a local impact traffic fee, dwelling unit tax, utility fees, street lighting fees, street improvement fees, sewer fees, and plan check fees, constitutes a reduction in fees under section 1720(b)(4).

Related disputes that the rent is reduced or discounted, disputes that the City will perform any construction work for the Project, disputes that the City's construction of the Esperança Substation constitutes a public subsidy to the Project, and disputes that the freezing of development fees constitutes a discount. Related also contends that a number of statutory exceptions are applicable, namely the exceptions set forth in section 1720, subdivision (c)(2) (hereafter section 1720(c)(2)) with regard construction as a condition of regulatory approval and section 1720, subdivision (c)(3) (hereafter section 1720(c)(3)) with regard to de minimis public subsidies.

The City worked closely with Related in responding to the various requests for information. The City rejects the claim that the Project is a public work. The City relies on the City Council's Resolution 16-8340 finding that the Project Documents, including the Disposition and Development Agreement and the Ground Leases, will provide the City with fair market value, taking into account the development and market risk, extraordinary up-front costs, and reasonable private development return expectations.

Substation would be removed from service and the land made available for use as parking or other development. The Northern Receiving Station is located south of Levi's Stadium. The Agenda Report noted that new substation project is part of a significant capital construction program for electric transmission, substation and distribution facilities in the next several years, necessary to meet customer demand for increased electric load and to ensure ongoing reliability of the electric system.

Discussion

All workers employed on public works projects must be paid at least the applicable prevailing wage rates. (§ 1771.) Section 1720, subdivision (a)(1) (hereafter section 1720(a)(1)) defines "public works" to mean construction, alteration, demolition, installation, or repair work done under contract and paid for in whole or in part out of public funds. "There are three basic elements to a 'public work' under section 1720(a)(1): (1) 'construction, alteration, demolition, installation, or repair work'; (2) that is done under contract; and (3) is paid for in whole or in part out of public funds." (*Busker v. Wabtec Corporation* (2021) 11 Cal.5th 1147, 1157.) It is undisputed that the construction of the Project meets the first and second elements for public works coverage under section 1720(a)(1), in that it constitutes "construction" that is "done under contract." Thus, the only issue presented is whether the Project is "paid for in whole or in part out of public funds."

Public funds in this context are not limited to a direct payment of money from a public entity to a contractor. Instead, section 1720, subdivision (b) provides in relevant part that "paid for in whole or in part out of public funds" also means:

> . . .
>
> (2) Performance of construction work by the state or political subdivision in execution of the project.
>
> . . .
>
> (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.
>
> . . .
>
> (§ 1720, subd. (b).)

A. The Rent for the Project is Both Reduced and Charged at Less Than Fair Market Value.

The rent structure for the Project is set forth in the Term Sheet Supplements and in the Ground Lease forms attached to the DDA. The initial annual rent for each Phase is a stated amount that is subject to either 3% or 10% annual increases, except for certain years (Years 45 and 70 for the Airspace Parcels, and Years 20, 45, and 70 for the Tasman Parcels) when the rent is adjusted according to the applicable formulas as set forth in the Ground Lease forms. The parties focus their arguments on the nature of the fair market rent adjustments in Years 45, and 70 for Phases 2 through 7 (Airspace Parcels). The parties do not seem to dispute the valuation of the initial rent of the parcels.

Under the prevailing wage law, a payment of public funds can occur when a public entity either reduces rent or charges rent at less than fair market value. (§ 1720, subd. (b)(4); *Hensel Phelps Construction Co. v. San Diego Unified Port Dist.* (2011) 197 Cal.App.4th 1020, 1039 (*Hensel Phelps*).)

In *Hensel Phelps*, the San Diego Unified Port District leased a waterfront parcel to a developer for the development of a hotel. The lease provided for $46.5 million in rent credits. In arguing that this rent credit was not a reduction or waiver under section 1720(b)(4), the developer claimed that prior to signing the lease, there was never any obligation to pay any amount of rent and there could not be a reduction, waiver, or forgiveness of rent that is not yet owed. The Court of Appeal rejected this argument, finding "no indication in the statute that a *preexisting* legal contract to pay rent must exist before a public agency can agree to a reduction or waiver of rent within the meaning of section 1720, subdivision (b)(4)." (*Hensel Phelps, supra,* 197 Cal.App.4th at p. 1038, original italics.) Instead, the court explained that the lease itself established the baseline rent amounts, and that "[t]he rent credit therefore constitutes a reduction in the rent from the baseline set forth in the Lease." (*Ibid*.) The developer in *Hensel Phelps* also argued that there could be no reduction in rent under section 1720(b)(4) unless the total amount of rent the public agency receives during the entire lease term is less than fair market value. The *Hensel Phelps* court rejected this argument as well:

> We find no support for Petitioners' proposed approach to the text of section 1720, subdivision (b)(4). In fact, the opposite is the case. The statute refers, *in the alternative*, to "rents . . . that are paid, reduced, charged at less than fair market value, waived, *or* forgiven by the state or political subdivision." Therefore, a public agency may pay for construction out of public funds either by reducing rent *or* by charging rent at less than fair market value. There is no requirement that both conditions be present.

(*Id.*, at p. 1039, original italics, citation omitted.) In this case, while both conditions are not required for the Project to be deemed a public works, it appears that both conditions are met: the rent can be characterized as being reduced and the limited evidence in the record addressing the fair market value of the rent suggests that the rent was charged for less than fair market value.

First, the rent adjustments in Lease Years 45 and 70 for the Airspace Parcels constitute a reduction in rent within the meaning of section 1720(b)(4). According to the Developer, these rent adjustments or "rent resets" are meant to reset the rent to "allow for a potentially larger rent increase in those years if the fair market value of the City's land has substantially risen." The rent adjustment formula for Lease Year 45 sets the rent amount at the greatest of three alternatives. The first alternative not only caps the appraised fair market value[23] at $200 per Allowed Square Footage, it also deducts Premium Costs, before it applies a 6.5% lease rate. The second alternative caps the rent amount at $30 million, multiplied by the fraction of Allowed Square Footage over

[23] Subject to the appraisal process outlined in Section 3.4 of the Phase 2 through 7 Ground Lease form and appraisal instructions set forth in Exhibit H to the Ground Lease form.

Aggregate Project Allowed Square Footage. The third alternative caps the rent amount at the same amount as the prior year. The rent adjustment for Lease Year 70 uses a similar formula and sets the rent amount at the greater of two alternatives. The first alternative caps the appraised fair market value at $350 per Allowed Square Footage, then deducts the Premium Costs, before applying a 6.5% lease rate. The second alternative sets the rent amount at 110% of the rent for the preceding year.

If the rent adjustments are meant to capture changes in the fair market value and fair market rental value of what the City owns, as the Developer and the City seem to be urging, then the rent adjustment formula should reflect the fair market value of only the property that the City owns. As the Developer points out, the City "is leasing the land 'as is' because that is all the City has to lease," and that land, vacant and unimproved, should be the land appraised for purposes of determining the fair market value – and fair market *rental* value – during the rent resets in Lease Years 45 and 70. According to the appraisal instructions set forth in Exhibit H to the Phase 2 through 7 Ground Lease form, for the Project Lease Year 45 and 70 rent adjustments, the parties' respective appraisers are required to calculate fair market value as if the parcels were vacant and unimproved. These appraisal instructions appear to be consistent with the rationale behind the rent adjustment or rent reset to value the land that the City owns – which is essentially an unimproved landfill without any improvements or infrastructure. However, the rent adjustment inexplicably caps the appraised fair market value at $200 per Allowed Square Footage for Lease Year 45, and $350 per Allowed Square Footage for Lease Year 70, a practice the City asserts is "typical" of leases. Premium Costs are then deducted from the capped fair market value, before the 6.5% lease rate is applied. The 6.5% lease rate applied to the fair market value of land presumably yields the fair market *rental* value, but this ultimately is conjecture, because there is no explanation of why 6.5% was chosen or how 6.5% represents fair market rental value.[24]

Setting aside any issues with the other terms of rent adjustment (such as the artificial caps on the fair market value, which also appear to constitute a rent reduction), the deduction for Premium Costs itself constitutes a rent reduction. Because the fair market value of the parcels is to be appraised as if vacant and unimproved, the fair market value is already based on the parcels' "as is" condition, without any of the Developer's infrastructure improvements. It would therefore be unnecessary to deduct the Premium Costs, which did not figure, and should not have figured, into the fair market value of vacant and unimproved parcels in the first instance. Yet by deducting the Premium Costs from the capped fair market value of the parcels, the City will in effect be partially reimbursing or crediting the Developer for its infrastructure development costs. If the Premium Costs were not factored into value of the "as-is" condition of the vacant and unimproved land, why would those costs then be deducted from the value of the land? There may be a plausible rationale for this deduction, but neither the Developer nor the City has presented a cogent explanation.

While the terms of this rent reduction are not identical to the facts in *Hensel Phelps*, the baseline for rent in Lease Years 45 and 70 is set at 6.5% of the fair market

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[24] There may be evidence that the rent was charged at fair market value or that there was no reduction in rent, but such evidence has not been presented.

value of the parcels. The baseline is reduced through the deduction for Premium Costs, which artificially lowers the fair market value, and concomitantly reduces the rent. This reduction not only affects Lease Years 45 and 70, but also the years following, as the rents for the following years are based on the rents in Lease Years 45 and 70, that were reset and reduced, respectively.[25]

The City and the Developer may argue that this rent adjustment formula *is* the rent negotiated, and there is no reduction because the Developer's "only obligation under the Lease was to pay a specific net amount of rent each year." (*Hensel Phelps, supra,* 197 Cal.App.4th at p. 1038, fn. 16.) But as the court in *Hensel Phelps* pointed out, "[t]here are legal consequences from the way a document is drafted and the plain meaning of the words that the parties choose to constitute their agreements" and the parties are bound by those consequences. (*Ibid.*) Perhaps the City and the Developer could have devised a formula that accomplished the same rent adjustment without deducting Premium Costs, but that is not what happened here.

Furthermore, even if there were no reduction from baseline rent, *Hensel Phelps* did not limit the application of section 1720(b)(4) to leases with a baseline rent. In fact, the *Hensel Phelps* court would have examined the parties' negotiating history had it not been apparent from the terms of lease itself that the port district was granting a rent reduction. (*Hensel Phelps, supra,* 197 Cal.App.4th at p. 1039, fn. 5 ["Although CCCC advocates that we examine the parties' negotiating history to determine whether the Port District agreed to a reduction in rent, because the terms of the Lease set forth a clear baseline rent, from which OPB is granted a reduction, we need not look to the parties' negotiating history."]) Just as in *Hensel Phelps*, it is not necessary to examine the parties' negotiating history in this case. Public statements made by the City reveal that the parties intended for a rent reduction to subsidize the development of the Project.

The City acknowledged in its June 27, 2014 Agenda Report that it would "take on some of this responsibility [of Related's significant infrastructure development costs] through a reduction in rent in the earlier years of the lease." While the rent reduction may or may not have happened in the earlier years of the lease, the City specifically contemplated reducing rent to account for Related's Premium Costs. This reduction, however it was clothed, "serve[s] to reduce a developer's project costs" and therefore constitutes a public subsidy under section 1720(b)(4). (*Hensel Phelps*, *supra,* 197 Cal.App.4th at p. 1034.)

Second, there is no evidence that the parcels are leased at fair market value. As a general matter, the Department 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. (PW 2004-035, *Santa Ana Transit Village – City of Santa Ana* (Dec. 5, 2005/June 25, 2007) (*Santa Ana Transit Village*); see also PW 2004-034, *Lake Piru Recreation Area Concessionaire Improvements – United Water Conservation District* (Mar. 15, 2005) (*Lake Piru*).) Here, there is no appraisal, bona fide

[25] This "chain reaction" of reductions in rent for the years following Project Lease Years 45 and 70 further supports DC 16's claim that rent was charged at less than fair market value.

or otherwise. There is no evidence of the fair market value of the parcels to be developed or any explanation as to the determination of the initial base rents, the annual increases of 3%, 10% or CPI, the rent adjustments in Lease Years 20, 45, and 70, and more specifically, why the percentages and caps used in the rent adjustment formulas represent fair market rental value.[26] Instead, the record suggests that rent is not being charged at fair market value. The "rent resets" in Project Lease Years 45 and 70, as the Developer describes it, are to "allow for a potentially larger rent increase in those years if the fair market value of the City's land has substantially risen." But if the fair market value of the land in those years is capped or otherwise artificially limited, the rent, a percentage of the land's value as calculated under the rent reset provisions, would also appear to be lower than fair market value. (See also *Eltinge & Graziadio Dev. Co. v. Childs* (1975) 49 Cal.App.3d 294, 298–299 [in leases where rent is based on a percentage of the fair market value of the property, the fair market value is generally based on its highest and best use as if vacant.]) As noted previously, the rent that follows the rent resets also suggest that rent in those future years is charged at less than fair market value. Furthermore, throughout the negotiations the parties expressed an interest in balancing the City's interest in a fair return for its property with the Developer's needs and the City has done so through reducing rent and charging less than fair market rent.

B. The Freezing and Capping of Fees, Along With Credits for Certain Fees, Constitute a Public Subsidy.

In addition to the favorable rent terms for the Developer, the DA contemplates the "freezing" of Development Fees for 7 years after approval of the first DAP of the Project, which occurred on March 24, 2020. Development Fees are defined broadly as any monetary fee or assessment charged in connection with any permit, approval, agreement, or entitlement for infrastructure related to the Project. A list of thirteen different Development Fees was included with the DA. The DA states that Development Fees will not be increased during the period between the "Effective Date" and 7 years after the first DAP is approved. The exact Effective Date is not clear but appears to be August 12, 2016, the date listed on the unsigned DA provided to the Department. Because the first DAP was approved on March 24, 2020, Development Fees are not charged under the normal rates until March 24, 2027.[27]

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[26] The Developer provided a memo dated July 21, 2022, from Economic & Planning Systems, Inc., a third party real estate economics consulting firm, that opined that the process by which the City negotiated the ground leases was consistent with best practices for this type of transaction. Notably, the memo did not offer any opinion as to whether the terms of the ground leases reflected fair market value.

[27] The DA also contemplates credits for Sanitary Sewer Connection Charges, future reductions for Sanitary Sewer Outlet Charges, and future credits for Storm Drainage Outlet Charges, as well as the freezing of these Development Fees until March 24, 2027. (Santa Clara City Code, § 17.15.220, subds. (b)-(e).) It is not entirely clear how the "credits" and reductions for these charges operate, and whether such credits and reductions constitute public subsidies under section 1720(b)(4). Engineering Plan Check Fees is another category of fees subject to the freeze.

1. Dwelling Unit Tax Credit.

For "freezing" purposes, Development Fees include the dwelling unit tax. "Every person constructing any structure containing a dwelling unit" in the City of Santa Clara must pay a dwelling unit tax, as specified. (Santa Clara City Code, § 3.15.020.) As with other Development Fees, the DA imposes a freeze on increases in the dwelling unit tax until March 24, 2027. Although, as of the date of this determination, the dwelling unit tax has not increased from the rates since the DA was executed, the DA *credits* "the full amount of the Dwelling Unit Tax actually paid toward any City Costs owing to the City." This is a credit towards an existing obligation owed to the City or also constitutes an obligation "forgiven" by the City. (§ 1720, subds. (b)(4), (b)(6).) While the dwelling unit tax credit is a modest amount, the credit is still considered a public subsidy. [28]

2. Caps and Freeze on Local Traffic Impact Fees.

Local traffic impact fees are also considered a category of Development Fees under the DA. The City has declared that new development has a significant impact on traffic congestion and that it is therefore necessary that developers pay traffic impact fees to offset that impact. (Santa Clara City Code, § 17.15.330, subds. (a)(8)-(9).) Under the Santa Clara City Code, the Developer is required to pay traffic impact fees as the fees "are hereby imposed upon every person . . . who causes new development" for any number of uses, including the mixed uses proposed for the Project. (Santa Clara City Code, § 17.15.330, subd. (c)(1).)

With respect to local traffic impact fees in particular, the DA freezes them under a different method and also places a limit on how high they can be charged to the Developer. The DA states that traffic impact fees shall not be increased between the Effective Date and the later of either (1) 7 years after the first DAP is approved or (2) "the date by which building permits have been issued for at least three million (3,000,000) square feet of office space on the Project Site." Because the first DAP was approved on March 24, 2020, the earliest date that traffic impact fees can return to their normal fee schedule is March 24, 2027, almost eleven years from when the DA became effective. Furthermore, if building permits are not issued for at least three million square feet of office space by March 24, 2027, the "unfreeze" date can be pushed even further.

Even after the freeze ends, whether in 2027 or later, the traffic impact fees are capped at $2.25 per square foot for office space and $900 per hotel room, for the entire term of the DA. As of the date of this determination, traffic impact fees have increased well beyond the fee schedule prescribed in the DA. According to the City's fee schedule for Fiscal Year 2021/2022, traffic impact fees have risen from $400 per room to $772.21

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[28] This credit is being provided ostensibly because "Developer is undertaking construction of public park improvements within the Project above and beyond the requirements of City Code." However, this does not change the fact that the credit is a public subsidy. The Developer chose to go "above and beyond" presumably because doing so provides the Developer with some added benefit. While the City should not discourage such acts, the subsidy has implications for whether the Project is a public works.

per room. It is not inconceivable that the traffic impact fees for hotels will exceed the $900 per room cap that the DA has set.

The Developer and the City argue that state law provides that development fees are fixed at the time of the execution of the development agreement. (See Gov. Code, § 65866; *North Murrieta Community, LLC v. City of Murrieta* (2020) 50 Cal.App.5th 31, 41 (*North Murrieta)* [“entering a development agreement allows a builder to rely on the regulations, conditions, and fees that exist at the planning stage when assessing the economics of completing a development that may take years or even decades to complete.”]) DC 16 counters that *North Murrieta* merely held that municipalities were restricted from imposing new generally applicable fees, and did not concern whether higher amounts of existing types of fees could be imposed. (*North Murrieta, supra,* 50 Cal.App.5th at pp. 34-35.)

DC 16’s reading of *North Murrieta* and the Development Agreement Statute is too narrow. The Development Agreement statute “allows a developer to make long-term plans for development without risking future changes in the municipality’s land use rules, regulations, and policies.” (*Mammoth Lakes Land Acquisition, LLC v. Town of Mammoth Lakes* (2010) 191 Cal.App.4th 435, 442 (*Mammoth Lakes*).) In this way, it acts to “strengthen the public planning process, encourage private participation in comprehensive planning, and reduce the economic costs of development.” (Gov. Code, § 65864, subd. (b).)

Regardless of what the Legislature intended in enacting the Development Agreement statute, the Department ultimately does not need to decide this issue. Assuming, without deciding, development agreements may freeze development fees, these agreements are still voluntarily entered into and are, at base, contracts. (*Mammoth Lakes, supra,* 191 Cal.App.4th at p. 442; see Gov. Code, § 65866 [development agreement *may* apply the “rules, regulations, and official policies in force at the time of execution of the agreement”; however, the agreement is not *required* to by the Development Agreement statute to “freeze” any rules, regulations, or policies.]) Just as municipalities may “extract promises from the developers concerning financing and construction of necessary infrastructure,” so too can developers obtain concessions through entering into a development agreement. (*Id.* at p. 444.) Here, by negotiating a development agreement with the City, the developer has obtained the benefit of a cap on generally applicable development fees.

The Santa Clara City Code establishes the traffic impact fees that must be paid, and the City’s adopted fee schedule sets the baseline fee obligation. The cap in the DA, as well as the multi-year freeze in the fees, “therefore constitute[] a reduction in the [fees] from the baseline set forth in the” City Code. (*Hensel Phelps, supra,* 197 Cal.App.4th at p. 1038.)

C. Section 1720, Subdivision (c)(3) Does Not Apply.

Even if the Project receives public subsidies, the Developer contends that the so-called de miminis exception under section 1720(c)(3) applies.[29] For the reasons explained below, section 1720(c)(3) does not apply.

Section 1720(c)(3), which contains the so-called de minimis exception, provides:

> If the state or a 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 minimis in the context of the project, an otherwise private development shall not thereby become subject to this chapter.

In 2020, the Legislature adopted Assembly Bill (A.B.) 2231 (2020), which amended section 1720(c)(3) to define a de minimis subsidy as one that is "both less than six hundred thousand dollars ($600,000) and less than 2 percent of the total project cost." (§ 1720, subd. (c)(3)(i).) By its own terms, A.B. 2231 was inapplicable to projects advertised for bid before July 1, 2021. (§ 1720, subd. (c)(3)(ii).) The parties appear to agree that the pre-A.B. 2231 version of section 1720(c)(3) applies.

Under the prior version of the statute, de minimis was not defined and there was no fixed amount or percentage under which a subsidy would be deemed de minimis. (former § 1720, subd (c)(3).) However, past coverage determinations found public subsidies to be de minimis when "the amount of public funds is proportionately small enough in relation to the overall cost of the Project, such that availability of the subsidy does not significantly affect the economic viability of this Project." (PW 2011-033, *Blue Diamond Agricultural Processing Facility – City of Turlock* (May 9, 2012) (*Blue Diamond*).) The subsidy at issue in *Blue Diamond* was 1.75 percent of the overall project cost.

The Developer claims that the cost of Project development will be more than $8 billion, "not including the lease payments as rent for the land." Taking the City's $8 million contribution to build the substation, the Developer claims that the public subsidy is de minimis because it would only constitute 0.10% of the Project costs.

Assuming that the Project costs are $8 billion as the Developer claims, a percentage-based de minimis subsidy in the manner of *Blue Diamond* could be up to *$140 million* in public dollars (1.75 percent of $8 billion). In all the determinations, save one, where the Department found a public subsidy to be de minimis, the subsidies involved only thousands of dollars.[30] The only exception is the *Blue Diamond*

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[29] The Developer also contends that the exception under section 1720(c)(3) for otherwise private development projects apply. As explained below, it is unnecessary to address this exception.

[30] See, e.g., PW 2004-024, *New Mitsubishi Auto Dealership, Victorville Redevelopment Agency* (March 18, 2005) [$65,710; 1.64 percent]; PW 2007-012, *Sand City Design Center, Sand City Redevelopment Agency* (May 15, 2008) [$317,330.80; 1.4

determination, and even there, the subsidy only reached $1.66 million. Here, the value of the subsidies to the Project is at least $8 million, and is likely well in excess of that. As DC 16 points out, it is unclear how much the rent has been reduced or charged at less than fair market value, and how much in public funds has been provided to the Project through the freezing, capping, and crediting of certain fees. All these subsidies "serve to reduce a developer's project costs." (*Hensel Phelps, supra*, 197 Cal.App.4th at p. 1034.) An infusion of millions of dollars to subsidize a Project, even if the Project brings numerous benefits to the City, is unlikely to be "proportionately small enough in relation to the overall cost of the Project, such that availability of the subsidy does not significantly affect the economic viability" of the Project. The Developer is banking on the rent structures negotiated with the City for the Project to move forward, and in many public documents, the City has expressed its desire to provide financial assistance to the development of the Project. Given these circumstances, and the fact that there has not been evidence of the fair market rental value to even approximate the amount of the public subsidies to the Project, the Department cannot find that the public subsidies to be de minimis.

<u>The Remaining Arguments Need Not Be Addressed.</u>

Given the conclusion reached in this determination, it is unnecessary to address DC 16's remaining arguments, such as those that relate to the funding for and the construction of the substation, park, and other infrastructure improvements. And because those arguments are not being addressed, it is also unnecessary to address the section 1720(c)(2) exception for otherwise private development projects, which requires a private developer to perform public improvement work. (§ 1720, subd. (c)(2).)

It must be emphasized that the conclusions in this determination are based solely on the facts available to the Department at this time. Evidence showing no reduction in rent or that any subsidy is de minimis could be relevant. "[I]f evidence is brought forth that differs from the facts you have presented to the Director including but not limited to proof that the rent is being charged at [] fair market value, a different determination might be made with respect to public works coverage." (*Lake Piru, supra*, PW 2004-034; see also PW 2003-014, *Phase II Residential Development Victoria Gardens – City of Rancho Cucamonga* (July 20, 2005) ["If the assumed facts concerning this project change, a different result may obtain."])

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percent]; PW 2008-010, *Sewer Line Construction, City of Corona* (Aug. 4, 2008) [$123,300.67; 0.4 percent]; PW 2008-037, *The Commons at Elk Grove, City of Elk Grove* (Jan. 2, 2009) [$202,337;1.1 percent]; PW 2008-038, *Solar Photovoltaic Distributed Generation Facility, Santa Cruz School District* (Apr. 10, 2010) [$23,475; 0.99 percent]; PW 2009-005 *Solar Photovoltaic Distributed Generation Facility - West County Wastewater District* (Apr. 21, 2010) [$96,553.20; 1.2 percent]; PW Case 2015-028, *St. John's Pleasant Valley Hospital - City of Camarillo* (Aug. 1, 2016) [$500,000; 0.65 percent]; PW 2016-033, *Mayfield Place Housing Project –City of Palo Alto* (Oct. 18, 2017) [$138,600; 0.384 percent]; PW 2018-003, *Hotel Development Project - City of Indian Wells* (Sept. 23, 2019) [$11,515; 0.00825 percent].

Conclusion

For the foregoing reasons, the City Place Santa Clara project is subject to prevailing wage requirements.

I hope this determination satisfactorily answers your inquiry.

Sincerely,

Katrina S. Hagen

Katrina S. Hagen
Director of Industrial Relations