

DEPARTMENT OF INDUSTRIAL RELATIONS

**Katrina S. Hagen, Director**

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January 26, 2021

Erik Caldwell  
Deputy Chief Operating Officer  
City of San Diego  
202 C Street  
San Diego, California 92101

Re: Public Works Case No. 2017-022  
Market Rate Residential Project – Hilltop & Euclid  
City of San Diego

Dear Mr. Caldwell:

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 Labor Code section 1773.5<sup>1</sup> 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 construction of the Market Rate Residential Project – Hilltop & Euclid in the City of San Diego is not subject to prevailing wage requirements.

### Facts

#### **A. Development at Hilltop Drive and Euclid Avenue.**

The City of San Diego (City) solicited proposals to develop a City-owned 8.5-acre site located at the intersection of Hilltop Drive and Euclid Avenue, and selected Affirmed Housing Group (Affirmed Housing) as the winning proposer. The proposal provided for "bifurcated development" of two primarily residential developments on the site – a so-called "Market Rate Development" on the west side of an arroyo that bisects the site, and a so-called "Affordable Development" on the eastern side of the arroyo.

The City entered into an Exclusive Negotiation Agreement with Affirmed Housing to negotiate the disposition and development of the site in line with Affirmed Housing's proposal. During the course of those negotiations, the City and Affirmed Housing agreed that the disposition and development of the site will occur under two agreements, a Purchase and Sale Agreement for the Market Rate Development (PSA) and a Disposition and Development Agreement (DDA) for the Affordable Development. The site was to be

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<sup>1</sup> Unless otherwise indicated, all further statutory references are to the Labor Code.

subdivided and sold separately to the developers of the Market Rate Development and the Affordable Development.

**B. The Affordable Development and the Disposition and Development Agreement.**

As contemplated in the Exclusive Negotiation Agreement and after obtaining the necessary votes and approvals from various boards and commissions, Affirmed Housing and the City entered into the DDA in June 2018. Under the DDA, Affirmed Housing was required to build the Affordable Development, which was described as including 113 rent restricted, multi-family apartments, approximately 8,300 square feet of commercial and retail space, a trail system, parks, and various amenities and public improvements. As an inducement to build the Affordable Development, the City would provide subsidies to Affirmed Housing, including a \$1.00 purchase price for the land and low-interest loans. Both the City and Affirmed Housing concede that these public subsidies constitute public funds for the purposes of the prevailing wage law. In addition, Affirmed Housing must use some of the low-interest loan proceeds for predevelopment work such mass grading of the entire site, arroyo restoration, and public street, sewer, and utility improvements, some of which also obviously benefit the property where the Market Rate Development will be built.

Shortly after the DDA was approved, San Diegans for Open Government, a non-profit taxpayer and voter organization, filed a complaint alleging improprieties in the approval process for the Affordable Development.<sup>2</sup> The case was subsequently settled in June 2019. Under the terms of the settlement agreement, the City would rescind the June 2018 DDA and allow for the resubmission and consideration of a new DDA. The new DDA, which is substantially similar to the old DDA, was signed in December 2019.<sup>3</sup>

**C. The Market Rate Development and the Purchase and Sale Agreement.**

Consistent with the “bifurcation” concept developed and agreed upon between the City and Affirmed Housing, the City selected Hilltop Encanto, LLC as the developer for the Market Rate Development and entered into the PSA with Hilltop Encanto. The PSA provides for the development of an approximately 66,142 square-foot market-rate, for-sale residential development of 47 homes, including 20 detached two-story single-family homes, and 27 attached three-bedroom townhomes, and includes related amenities and minimal public improvements. Unlike the DDA for the Affordable Development, the PSA does not place any restrictions on the sales price of the homes in the Market Rate

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<sup>2</sup> *San Diegans for Open Government v. City of San Diego, et al.* (Super. Ct. San Diego County, 2018, No. 37-2018-00040518-CU-MC-CTL) filed on August 13, 2018.

<sup>3</sup> Despite the interested parties’ “continuing duty” to provide related records, neither the settlement agreement nor any other document reflecting the case’s disposition was sent to the Department until October 2020, and only after the Department’s request. (Cal. Code Regs., tit. 8, § 16001, subd. (a)(3).) The interested parties also never provided the December 2019 DDA, although the Department was able to obtain a copy through its independent investigation.

Development. Hilltop Encanto is responsible for performing grading, landscaping, and public improvements specific to the Market Rate Development.

Under the PSA, the City will sell the subdivided property to Hilltop Encanto for the price of \$2,201,250. A Summary Report prepared pursuant to Health and Safety Code section 33433 found that the estimated fair market value of the property at its highest and best use is \$2,200,000. (See Health & Saf. Code, § 33433, subd. (a)(2)(B)(ii).) The PSA does not identify any public funding for the Market Rate Development.

### Discussion

All workers employed on public works projects must be paid at least the applicable prevailing wage rates. (§ 1771.) Section 1720, subdivision (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.

The construction of the Affordable Development constitutes public work, as it will be done under contract and paid for out of public funds in the form of the low-interest loans and the below-market value transfer of property. Affirmed Housing and the City concede that prevailing wage requirements apply because the Affordable Development receives public funding within the meaning of the prevailing wage law. (§ 1720, subd. (b).)

The Market Rate Development indisputably involves construction work done under contract, as Hilltop Encanto will be engaging contractors and subcontractors to perform the work called for in the PSA. The issue under section 1720, subdivision (a)(1) is whether the Market Rate Development is paid for out of public funds. Hilltop Encanto and the City insist that no public subsidies fund the Market Rate Development. However, because the Affordable Development is paid for out of public funds, the Market Rate Development would be deemed to be paid for “*in part* of out of public funds” if the two developments were considered part of a single project. (§ 1720, subd. (a)(1), italics added.)

#### **A. Determination of Whether There is a Single Project Requires An Examination of the Totality of the Facts.**

Appellate decisions have set forth the framework for analyzing whether components form a “complete integrated object.” (*Oxbow Carbon & Minerals, LLC v. Department of Industrial Relations* (2011) 194 Cal.App.4th 538, 549 (*Oxbow*).) The determination of what constitutes a single, integrated project requires an examination of the “totality of the facts.” (*Cinema West, LLC v. Baker* (2017) 13 Cal.App.5th 194, 212 (*Cinema West*).) Because the focus is on the totality of the facts, a brief description of the factual circumstances in those appellate decisions serves as a useful guide for the project analysis in this case.

At issue in *Cinema West* was whether a “theater, parking lot and related amenities were part of a ‘complete integrated object’ and thus constituted the ‘construction’ done under contract, which, if ‘paid for in whole or in part out of public funds,’ constitutes a public work subject to the [prevailing wage law].” (*Id.* at p. 215.) The evidence included numerous public records that referred to the parking lot as being “necessary” to the

theater. The disposition and development agreement, which governed the construction and operation of the theater, specifically called for the parking lot to be built with funding from the City of Hesperia. There was further evidence that the theater and parking lot were constructed together at the same time and on the same vacant parcel of land. (*Id.* at pp. 212-213.) Considering the totality of the facts, *Cinema West* found that the theater and parking lot were both components of a single, integrated project. (*Id.* at p. 215.)

In *Oxbow*, an amended air quality rule required open-air petroleum coke<sup>4</sup> facilities to be enclosed. To comply with the rule, the lessee of the coke facility planned to build a roof over it. However, the roof would render the existing conveyor system obsolete, so a new system had to be built. The City of Long Beach agreed to reimburse the lessee for the cost of constructing the new conveyor system, but the roof was built by a different contractor through a separate construction contract and was paid for with private funds. Taking into account the totality of the underlying facts, the *Oxbow* court declined to rely solely on the fact that there were separate construction contracts and held that the roof and conveyor system were part of a “complete integrated object” and prevailing wage requirements applied to the entire project. (*Oxbow, supra*, 194 Cal.App.4th at p. 549.)

## **B. The Affordable Development and Market Rate Development Are Separate Projects.**

As the *Cinema West* and *Oxbow* decisions show, determination of what constitutes a single, integrated project is often fact-intensive, and always fact-specific. In this case, the Affordable Development and the Market Rate Development share certain similarities with the projects in *Cinema West* and *Oxbow*. The developments here will be performed under separate contracts with different contractors. Like in those projects, the land on which the developments will be built was originally a single 8.5-acre site, although the site was later subdivided to accommodate the two developments.

Other similarities with the projects in *Cinema West* and *Oxbow* include the coordination between the two developments, as Affirmed Housing will be using public funds to perform public improvements that benefit both developments.<sup>5</sup> The fact that the two developments are physically adjacent to each other further ensures that there will be coordination. The City maintains an overarching role over the two developments, and each developer must adhere to certain standards dictated by the City. All these facts weigh in favor of finding a single project.

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<sup>4</sup> Petroleum coke is “a by-product of the oil-refining process.” (*Oxbow, supra*, 194 Cal.App.4th at p. 542.)

<sup>5</sup> The records submitted to the Department do not disclose whether the improvements were done before or after the sale of the market rate half of the property to Hilltop Encanto. The Health and Safety Code section 33433 Summary Report also does not explain whether the market rate valuation includes the value of the publicly-funded improvements or whether the valuation assumes a completely unimproved lot.

Despite this coordination, there are other facts that militate against finding a single, integrated project. The land was subdivided into two halves for the two developments, which are governed by separate agreements and are being developed by two different, unrelated developers independently: the DDA and Affirmed Housing for the Affordable Development; the PSA and Hilltop Encanto for the Market Rate Development. Due to the different development agreements governing each development, and the fact that there are two different developers, the construction will supposedly run on separate tracks, as the work presumably will be performed by different contractors. Each half will be built at its own pace and with its own style. The Affordable Development combines commercial and retail components with residential, which will be in the form of apartments only, while the Market Rate Development consists exclusively of single-family homes. In its applications for low-income housing tax credits and conduit revenue bond funding, Affirmed Housing describes the Affordable Development as a fully affordable project separate from the Market Rate Development.<sup>6</sup> Finally, according to the DDA and PSA, construction will begin and complete on different schedules, suggesting that coordination between the two developments has its limits.

Under the specific factual circumstances here, it is not clear that there is a single, integrated project. While there are multiple facts suggesting that the two developments are coordinated and complement each other, there are other equally compelling facts described above that point to two separate projects.<sup>7</sup> On balance it appears that the overall purpose, once the City accepted Affirmed Housing's proposal, was to develop two separate projects. In this specific case, where there are no clear indicia of a single, integrated project, the two developments can be characterized as being two discrete projects. This determination is based on the facts presented. "If the assumed facts concerning this project change, a different result may obtain." (PW 2003-014, *Phase II Residential Development Victoria Gardens – City of Rancho Cucamonga* (July 20, 2005).)

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<sup>6</sup> Because there are minimum set-asides for low-income units to qualify for these types of tax credits and bond funding (see, e.g., 26 U.S.C. §§ 42(g), 142(d)), Affirmed Housing's description in its applications is potentially self-serving, since treating the Market Rate Development (and its 47 market-rate units) as part of a single project in its applications could lower or eliminate the low-income housing tax credits and bonds Affirmed Housing receives.

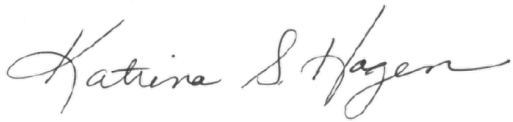
<sup>7</sup> As with separate construction contracts, it must be noted that the existence of separate developers and separate governing agreements alone is not dispositive. If the Department agreed that merely having separate governing agreements and developers was sufficient to transform two components of one project into separate projects, "it would encourage parties to contract around the prevailing wage law by breaking up individual tasks into separate [] contracts." (*Oxbow, supra*, 194 Cal.App.4th at p. 550.)

**Conclusion**

For the foregoing reasons, the Market Rate Residential Project – Hilltop & Euclid in the City of San Diego is not subject to prevailing wage requirements.

I hope this determination satisfactorily answers your inquiry.

Sincerely,

A handwritten signature in cursive script that reads "Katrina S. Hagen". The signature is written in black ink and is positioned above the printed name and title.

Katrina S. Hagen  
Director of Industrial Relations