

DEPARTMENT OF INDUSTRIAL RELATIONS

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December 9, 2020

Claire Ervin Lee, Hearing Officer
Office of the Director – Legal Unit
Department of Industrial Relations
1515 Clay Street, Suite 701
Oakland, California 94612

Re: Public Works Case Nos. 2017-035 and 2018-005
SpringHill Suites – The Dunes at Monterey Bay
Fort Ord Reuse Authority

Dear Ms. Ervin Lee:

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 1773.5¹ 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 SpringHill Suites – The Dunes at Monterey Bay (Project) is a public work and therefore subject to prevailing wage requirements.

Facts

The "SpringHill Suites - The Dunes at Monterey Bay" is a hotel located on approximately 4.5 acres in the City of Marina. The four-story hotel, which opened on June 7, 2017, is 67,328 square feet with 106 rooms and includes a 1,750-square-foot meeting room. Revenue generated from the hotel was expected to have a ripple effect throughout Monterey County and it was estimated that the hotel would support 165 jobs and \$5.2 million of annual payroll countywide.

A. SpringHill Suites is located on former Fort Ord Military Base Property.

In 1991, the Fort Ord Military Base was closed, leaving 44 square miles of property to develop or repurpose for civilian use. The Fort Ord Reuse Authority (FORA) was created to transition the 44 square miles from military use to civilian use. (Gov. Code, § 67678.) FORA is governed by member representatives of Monterey County and eight cities, including the City. (Gov. Code, § 67660, subd. (a).) On or about March 14, 1994, FORA adopted a Master Resolution, which in part, dictates future land use of the former

¹ Unless otherwise indicated, all further statutory references are to the Labor Code.

Fort Ord property. Among the provisions of the Master Resolution, there was a requirement for prevailing wages on all “first generation construction.”²

FORA lists a number of different projects ranging from residential housing, hotels and resorts, Department of Defense facilities, California State University at Monterey Bay educational facilities, recreational projects, as well as commercial and retail developments. At least 11 projects fall within the City’s jurisdiction. Specifically, one of the City’s projects “The Dunes on Monterey Bay” is a mixed-use area consisting of 290 acres of retail, commercial (including a hotel), and residential space.

Pursuant to section 2905(b)(4) of the Base Closure Act, the 290 acres were transferred to the City’s then-existing Marina Redevelopment Agency³ by means of a No Cost Economic Development Conveyance for no monetary consideration. Development of the 290 acres is to be carried out in three phases pursuant to the May 31, 2005, Disposition and Development Agreement (DDA)⁴ described below.

B. The May 31, 2005, Disposition and Development Agreement.

On or about May 31, 2005, in accordance with the FORA Master Resolution, the Marina Redevelopment Agency entered into a DDA with Marina Community Partners, LLC (Developer).

The DDA requires development of the 290 acres to include up to: (1) 750,000 square feet of retail space; (2) 760,000 square feet of business park development; (3) 1237 residential units; and (4) hotels with up to an aggregate of 500 rooms, as well as public improvements, community amenities and infrastructure necessary to support the development. The area was to be developed in three phases, as well as “opportunity phases,” which could be undertaken by the Developer, if market conditions permitted.

The Developer would pay \$6,000,000 for Phase I property, which was 132 acres, \$15,300,000 for Phase II property, and \$26,700,000 for Phase III property. These figures were based on a “Reuse Valuation” conducted pursuant to section 33433 of the Health and Safety Code.

² Section 1.01.050 of the Master Resolution defines “First Generation Construction” as “construction performed during the development and completion of each parcel of real property contemplated in a disposition or development agreement at the time of transfer from each member agency to a developer(s) or other transferee(s) and until issuance of a certificate of occupancy by the initial owners or tenants of each parcel.”

³ Effective February 1, 2012, all redevelopment agencies, including the City’s Marina Redevelopment Agency were dissolved. (Heath & Saf. Code, § 34172.) However, the City assumed the former Agency’s rights and obligations.

⁴ The DDA has been amended by implementation agreements dated September 6, 2006, and August 5, 2008.

Section 7.9 of the DDA states that “to the extent prevailing wages are required to be paid either pursuant to Labor Code Sections 1720 et seq. or pursuant to the FORA Master Resolution, the developer shall and shall cause the contractor and subcontractors to pay prevailing wages in the construction of the development”

With respect to conveyances, transfers, and assigns by the Developer, the Developer was allowed to transfer land so long as it was “to be developed with hotel uses provided the hotel to be developed meets the quality standards [under the DDA].” Any future transfer of land by the Developer must be approved by the City.

C. The Developer conveys 4.5 acres to the Hotel Developer for the Construction of Springhill Suites.

As contemplated in the DDA, the City conveyed the land to the Developer via a quitclaim deed dated September 21, 2006. The quitclaim deed incorporated by reference the DDA, which was recorded in the official records of the Monterey County Recorder.

On December 26, 2014, the Developer sold 4.5 acres, known as Parcels 6 and 7, to the Monterey Peninsula Hotels Group LP, which is owned by the Dadwal Management Group, Inc., Harbhajan S. Dadwal, and Harwider K. Dadwal (collectively, “Hotel Developer”) for \$1,150,000, or \$5.84 per square foot. Part of Phase I property, Parcels 6 and 7 were located on 2nd Avenue and were described as having street, curb, and gutter improvements, as well as water and utilities at the lot line. According to comparable sales information obtained from Brigantino & Company, a real estate appraiser, Parcels 6 and 7 were compared to six other properties, five of which were within the jurisdiction of the City. Of those five properties, only one other property was described as having similar existing improvements. Like Parcels 6 and 7, this other property was on 2nd Avenue and had the same improvements, but sold on March 27, 2014, at \$10.49 per square foot.

1. The Operating Covenant and Agreement.

On March 31, 2014, the City signed an Operating Covenant and Agreement with the Hotel Developer. Pursuant to the DDA, the sale of Parcels 6 and 7 had to be previously reviewed and approved by the City. On December 26, 2014, the Developer conveyed the land to the Hotel Developer via a quitclaim deed. The quitclaim deed describes Parcels 6 and 7 as former Fort Ord property and expressly references and incorporates the DDA. Further, the Hotel Developer acknowledged and assumed all the responsibilities with regard to Parcels 6 and 7, which had been imposed on the land under the terms of the prior conveyances, beginning with FORA’s conveyance to the Marina Redevelopment Agency.⁵

⁵ Page 3 of the quitclaim deed states “The Grantee [Hotel Developer] hereby acknowledges and assumes all responsibilities with regard to the Property placed upon the Grantor under the terms of the aforesaid USA Deed and the FORA Deed and Grantor grants to Grantee all benefits with regard to the Property under the terms of the aforesaid USA Deed, FORA Deed and Agency Deed.

As an incentive for the Hotel Developer to select the former Fort Ord site, as well as an incentive to expedite the completion of the hotel, the Operating Covenant and Agreement deferred the Hotel Developer's payment of impact fees until the completion of the hotel so long as the Hotel Developer met certain conditions. One of the conditions was that the hotel be completed by July 30, 2016. The City expressly stated in Resolution No. 2013-0193, that it was deferring impact fees to assist the Hotel Developer with the construction costs of the hotel.

The Operating Covenant and Agreement also provided that if the conditions were met, the impact fees would be paid from transient occupancy tax (TOT) revenues generated by the hotel under a specified formula. The formula also offered the possibility for the hotel to receive a portion of the TOT revenue collected, if the TOT revenue exceeded a certain threshold. The option of applying TOT revenue toward owed impact fees was available only if the Hotel Developer finished construction by July 30, 2016.

2. Deferral of Impact Fees.

The Hotel Developer was not able to apply its future TOT revenues toward its owed impact fees because the hotel was not completed by July 30, 2016. However, an amended Operating Covenant and Agreement extended the opening day of the hotel to March 31, 2017, and the City continued to defer payment of the impact fees. In consideration for the extension of time, the Hotel Developer gave the City a \$100,000 promissory note, dated September 1, 2016 (Extension Fee Note). The Extension Fee Note includes the following clause:

This Note evidences the obligation of the Borrower [Hotel Developer] to Lender [City of Marina] to pay Lender the note [\$100,000] amount plus interest as consideration for the Lender extending the date of completion of the Hotel and deferral of Borrower's Impact Fees. . . ."

The full amount of the Extension Fee Note was due on the fifth anniversary of the opening date of the Hotel. Commencing on the date of the Extension Fee Note, interest on the loan was a variable per annum interest rate equal to the LIBOR index plus 3.75 percent.

Again, the Hotel Developer was unable to meet the opening date deadline. SpringHill Suites opened in June 2017. As a result of the Hotel Developer's delayed hotel opening, the full amount of the impact fees was due immediately.

The City confirmed that TOT generated by SpringHill Suites has not been credited toward the amount of impact fees due. Instead, the Hotel Developer gave the City a promissory note, dated September 25, 2017, for the full amount of impact fees owed – \$634,608 (Impact Fee Note). Under the terms of the Impact Fee Note, the Hotel Developer's first payment was not due until March 1, 2018, more than five months after executing the Impact Fee Note. The Hotel Developer was to pay the City \$5,000 per month commencing on March 1, 2018, and continuing until March 1, 2019. The interest on the loan is compounded annually at a rate of 3.25 percent, beginning September 25,

2017, the date the Impact Fee Note was executed. The full amount of the loan is due no later than March 1, 2025.

Both the Impact Fee Note and the Extension Fee Note are secured by deeds of trust subordinate to the Hotel Developer's lender.

D. Construction of SpringHill Suites.

To construct SpringHill Suites, the Hotel Developer sought various forms of financing, including small business loans from the Bay Area Employment Development Company and a private entity. The City was advised of such financing efforts because these small business loans would have adversely affected the City's rights. The small business loans resulted in a "Security Financing Interest" attaching to Parcels 6 and 7. In turn, the "Security Financing Interest" rendered the City's right to repurchase or revert rights subordinate to the small business loan's "Security Financing Interest." The City ultimately approved the Hotel Developer's financing and acknowledged that the "Security Financing Interest" would take precedence over the City's interest.

On or about December 4, 2014, the Hotel Developer entered into an agreement with a general contractor, Covenant Construction, Inc., to build SpringHill Suites. The contract was for \$12,134,311. Covenant Construction contracted with the Plumbing Company, which employed workers to perform plumbing work on the hotel. While Covenant Construction engaged subcontractors to perform work on the hotel's construction, it appears that some construction work was performed directly by Covenant Construction's own employees, such as drywall, lather, plaster, carpentry, and tiling.

The Parties' Positions

A. The Plumbing Company and Covenant Construction.

The Plumbing Company argues that the Master Resolution's requirement to pay prevailing wages on first generation construction is contractual in nature and that the Division of Labor Standards Enforcement (DLSE)⁶ has no authority to enforce the Master Resolution's requirement to pay prevailing wages.

The Plumbing Company further contends that Chapter 3 of the FORA Master Resolution applies only to purchases and capital contracts with FORA. Specifically, the Plumbing Company asserts "Section 3.03 of the FORA Master Resolution is entitled 'Public Works Contracts' and relates to public works contracted **with and only with FORA** [emphasis in original]."⁷

⁶ As authorized by section 1741, DLSE conducted an investigation and issued civil wage and penalty assessments against the contractors. After coverage of the work under the prevailing wage law was disputed in section 1742 proceedings to review the assessments, the matter was referred for a coverage determination.

⁷ It should be noted that the Master Resolution has been amended several times. The Plumbing Company states that section 3.03.100 of the Master Resolution was

Additionally, the Plumbing Company claims that its contract with Covenant Construction is not subject to the prevailing wage law because the SpringHill Suites project is purely a private venture and not one “under contract” with any public agency. The Plumbing Company argues that DLSE has not established that the project was awarded by the City nor has DLSE “shown that the property subject to any construction contract was, upon completion of the construction work, more than 50 percent of the assignable square feet of the property is leased to the state or political subdivision. Lab. Code § 1720.2.” Further, because the site of the hotel is privately-owned, which the Plumbing Company asserts was purchased at fair market value, the Hotel Developer “did not receive any public subsidies for the land.”

Covenant Construction asserted the same defenses and arguments as stated by the Plumbing Company. Without providing details, it also argues that DLSE improperly issued the Civil Wage Penalty Assessment against Covenant Construction.

B. Carpenters Local 5050 and the Northern California Carpenters Regional Council.

Carpenters Local 5050 and the Northern California Carpenters Regional Council (collectively the “Union”) assert that the Hotel Developer purchased the property from the Developer at “Reuse Value,” which is not equal to fair market value.

Further, the Union asserts that the Developer bought Phase I property (including Parcels 6 and 7) at fair reuse value, and implies the Hotel Developer acquired the property at fair reuse value because the property has a history of prior transfers at fair reuse value. The Union also argues the DDA is binding on successors and is a covenant that runs with the land.

The Union also urges the Department to view “the Dunes Tract” - all 290 acres which were allocated for retail, commercial, hotel, and residential space - as one project. The Union relies on PW 2016-042, *Historic Chapel at Fort Ord – County of Monterey* (Dec. 29, 2017) (*Historic Chapel*), in which the Department concluded subsequent developers of former Ford Ord property step into the shoes of the initial developer and, thus, acquired the benefits of a public subsidy as well as obligations under an DDA. However, no evidence was presented regarding how the other 285.5 acres were disposed of. In addition, it is likely that the remaining acres were or will likely be sold to different developers, for various uses, and presumably under different agreements.

Finally, the Union also urges the Department to issue an “across-the-board” decision enforcing prevailing wages on all “First Generation Construction” under the DDA.

repealed and therefore “it [] cannot serve as the basis for prevailing wages as contended by the DLSE.” Former section 3.03.100, titled “Developers of Property Pursuant to Agreements with FORA,” was repealed on March 9, 2007. However, section 3.03.090, which directly addresses prevailing wage requirements, has not been repealed.

C. Division of Labor Standards Enforcement.

DLSE contends the SpringHill Suites construction is a public works project because the property was acquired by the Hotel Developer via a quitclaim deed and, therefore, it was acquired at less than fair market value. However, DLSE did not present any supporting argument nor explain why a transfer via quitclaim deed automatically means the property was transferred at below fair market value. Additionally, DLSE argues that the City deferred payment of impact fees, which constitutes a form of public subsidy.

Discussion

Pursuant to Labor Code section 1773.5, the Director is authorized to issue coverage determinations on whether specific projects or certain types of work are “public works” under the Labor Code. The FORA Master Resolution and the DDA were reviewed and considered to the extent they indicated whether the construction of SpringHill Suites was “paid for in whole or in part of public funds” as defined under the Labor Code.⁸

All workers employed on public works projects must be paid at least the prevailing wage rates applicable to their work. (§ 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.

For purposes of section 1720, the term “public funds” is not limited to a direct payment of money from a public entity to a contractor. Instead, “public funds” includes subsidies such as transfers of property for less than fair market price; below-market interest rate loans; or waivers of fees that would normally be required in the execution of the public works contract. (See § 1720, subd. (b).)

There is no dispute that construction work was performed on SpringHill Suites. The Plumbing Company argues that this work was neither “done under contract” nor “paid for in whole or in part out of public funds,” within the meaning of the statute, and for those reasons, asserts that the construction of SpringHill Suites does not constitute “public works” subject to prevailing wage requirements.

A. The Construction is Done Under Contract.

The Plumbing Company contends that the work is not subject to prevailing wage requirements because the work was performed under a contract between itself and Covenant Construction - two private entities and not “under contract” with FORA, or the City. In making this argument, the Plumbing Company misconstrues the “under contract” language in section 1720, subdivision (a)(1), which only requires that the work be done

⁸ Because this coverage determination is limited to whether this project is public works project under Labor Code section 1720 et seq., it does not address the Union’s request that the Department enforce the requirement of prevailing wage for all “First Generation Construction” under the Master Resolution or the DDA, nor does it address the extent of DLSE’s enforcement powers or the alleged impropriety of the CWPA issued against the Plumbing Company or Covenant Construction.

under contract, not that the contract be awarded by a public entity or awarding body. (See PW 2013-015, *Decision on Administrative Appeal, Central Valley Next Generation Broadband Infrastructure Project – Central Valley Infrastructure Network* (Jan. 14, 2015) (*Central Valley*).)

The California Supreme Court analyzed the meaning of “work done under contract” in *Bishop v. City of San Jose* (1969) 1 Cal.3d 56, 63-64 (*Bishop*). *Bishop* concluded that, by using the “under contract” language, the Legislature intended to exclude the situation where the public agency was using its own employees to carry out the construction. The Legislature later codified the *Bishop* decision by amending section 1771 to expressly exclude “work carried out by a public agency with its own forces.” (Stats.1974, ch. 1202, § 1); (see also *Azusa Land Partners, LLC v. Department of Industrial Relations* (2010) 191 Cal.App.4th 1, 20 [statutory requirement means that work only must be done “under contract (i.e., not by the public entity’s own employees)”) and *O.G. Sansone Co. v. Dept. of Transportation* (1976) 55 Cal.App.3d 434, 459, fn. 5.)

The Department has followed Supreme Court precedent and explained the meaning of “under contract” in several coverage determinations. (See, e.g., *Central Valley*, PW 2005-025, *Canyon Lake Dredging Project – Lake Elsinore and San Jacinto Watersheds Authority* (June 26, 2007) (*Canyon Lake Dredging*) and PW 98-005, *Goleta Amtrak Station* (Nov. 23, 1998).) As was observed in *Canyon Lake Dredging*, section 1720, subdivision (a)(1) “only requires that the [work] be done under contract, not that the contract be awarded by any public entity.” Accordingly, the issue in this case is whether the Project was “paid for in whole or in part out of public funds.” (§ 1720, subd. (b).)

B. The City’s Deferral of Impact Fees and Below-Market Rate Interest Impact Fee Note Constitute Public Subsidies.

As an incentive for the construction of SpringHill Suites, the City provided “public funds” by deferring impact fees owed by the Hotel Developer. Development fees, also known as impact fees or development impact fees, are fees imposed by local agencies on development projects as a result of impacts generated by a specific project and for cumulative impacts of a development within the community. (See Gov. Code, § 66000 et seq.; *Nollan v. California Coastal Com’n* (1987) 483 U.S. 825, 863.) Impact fees reflect the fact that new development imposes costs on the community, such as costs for additional services, expansion of capital facilities, cultural facilities, or facilities replacement. (Subdivision Law and Growth Mgmt. (2d ed.) § 6:31 “Fees—Impact fees”.)

Although other fees (planning and permit fees) were required to be paid at the time the Hotel Developer submitted the plans and applications, the City deferred the payment of \$634,608 in impact fees expressly for the purpose of assisting the Hotel Developer with the construction costs of the hotel. In providing this deferral, the City essentially granted an interest-free loan, until September 1, 2016, when the Hotel Developer signed the Extension Fee Note for \$100,000 to extend the time to complete the hotel and continue deferral of the impact fees. (See § 1720, subd. (b)(4) [“loans, interest rates, or other obligations . . . that are . . . waived, or forgiven.”]) Significantly, neither the Extension Fee Note nor the Impact Fee Note negates the fact that for several years prior to these notes, the City provided a public subsidy by deferring impact fees at no cost to the Hotel

Developer. The Hotel Developer reaped the benefits of this years-long deferral, and the benefit is measured by the monies the City forewent, i.e. interest on a loan of \$634,608. This no-cost deferral was specifically intended to subsidize construction of the Project and “serve[s] to reduce a developer’s project costs” (*Hensel Phelps Construction Co. v. San Diego Unified Port Dist.* (2011) 197 Cal.App.4th 1020, 1034).

The Hotel Developer also received a public subsidy in the form of the Impact Fee Note, which was a below market interest loan. (§ 1720, subd. (b)(4).) The Impact Fee Note provided 3.25 percent interest in September 2017. According to JP Morgan’s online historical data of prime rates in June 2017, interest rates were 4.25 percent. (See PW 2015-008, *Kings Rehabilitation Center – City of Hanford* (Aug. 31, 2015).)

C. Parcels 6 and 7 were Transferred for Less than Fair Market Value.

Parcels 6 and 7, on which SpringHill Suites was built, were acquired at below fair market value through a sequence of conveyances. Initially, Phase I of the Dunes on Monterey Bay, which was comprised of approximately 132 acres, was conveyed to the Developer at a fair reuse value of \$6 million, which was below fair market value. The term “fair reuse value” is not interchangeable with the term “fair market value.” Fair market value is “the value of the land at its highest and best use as determined by a bona fide appraisal.” (PW 2004-035, *Santa Ana Transit Village/City of Santa Ana* at p. 5 (Dec. 5, 2005).) Fair reuse value is a term used in connection with redevelopment projects. The fair reuse value is less than fair market value as fair reuse value takes into account the added burdens assumed by developers in having to comply with covenants and conditions imposed by disposition and development agreements for redevelopment projects. (See Health & Saf. Code, § 33433, subd. (b)(2).) The public policy underlying disposition and development agreements and redevelopment projects is to provide a remedy with public assistance to those communities plagued by blight. (Health & Saf. Code, § 33037, subd. (a).) The intent of revitalizing blighted areas is to restore productive use of property and indirectly improve employment prospects, as well as develop affordable housing. (PW 2016-042, *supra*, *Historic Chapel*.) The DDA demonstrates that the 132 acres of Phase I property were transferred at the fair reuse value of \$6 million (roughly \$0.95 per square foot) and was below fair market value, thus constituting public funding under section 1720, subdivision (b).

Parcels 6 and 7 were subsequently transferred by the Developer to the Hotel Developer for \$1.15 million. While the Plumbing Company asserts that the Hotel Developer acquired the property at fair market value, neither the Plumbing Company nor any other party provided an appraisal demonstrating that the sale of Parcels 6 and 7 sold at fair market value as determined by competitive market forces. On the contrary, comparable sales of nearby properties at around the same time period indicate Parcels 6 and 7 sold at below fair market value.

At the time the Hotel Developer purchased the land, the property had street, curb, and gutter improvements, and water access at the lot line. The Hotel Developer paid \$5.84 per square foot. Price per square footage of a comparable property in the same vicinity with similar existing improvements was purchased within several months for

\$10.49 per square foot, which is \$4.65 more per square foot than what the Hotel Developer paid. No credible evidence was provided to dispute these facts.

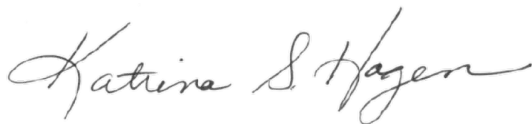
Further, a transfer of property between two private parties is not determinative of a project's status as a public work. If that were the case, parties could simply convey property initially valued at fair reuse to another private entity at less than fair market value thereby circumventing prevailing wage law requirements. This scenario was also addressed in *Historic Chapel*, in which a former Fort Ord parcel was conveyed by the Redevelopment Agency of the County of Monterey to a developer at fair reuse value. The land was subsequently purchased by a second developer at auction. The Department found that the second developer was a direct beneficiary of the Redevelopment Agency's initial sale for less than fair market value and that the second developer assumed the duties, rights, and obligations of the initial developer. As was the case in *Historic Chapel*, the Hotel Developer acquired Parcels 6 and 7 expressly agreeing to comply with the obligations of the DDA. The Hotel Developer assumed the rights and obligations as a vertical developer under the DDA between the Developer and the Agency and City. As such, the Hotel Developer stepped into the shoes of the Developer. Further, the Hotel Developer reaped the benefits of the property's status as a former Fort Ord parcel by purchasing it at below fair market value from the Developer, who had also benefited from a below fair market value purchase. Thus, although two private entities are involved in the transfer of this former Fort Ord property, the initial and subsequent below fair market value transfers constitute a form of public funds. Accordingly, the construction of Springhill Suites was a public work under section 1720.⁹

Conclusion

For the foregoing reasons, the construction of SpringHill Suites – The Dunes at Monterey Bay is public work subject to prevailing wage requirements.

I hope this determination satisfactorily answers your inquiry.

Sincerely,



Katrina S. Hagen
Director of Industrial Relations

⁹ Because of this conclusion, any discussion of The Plumbing Company's section 1720.2 argument is unnecessary.