STATE OF CALIFORNIA

DEPARTMENT OF INDUSTRIAL RELATIONS

DECISION ON ADMINISTRATIVE APPEAL

RE: PUBLIC WORKS CASE NO. 2006-020

HEBER FAMILY APARTMENTS, COUNTY OF IMPERIAL

I. INTRODUCTION AND PROCEDURAL HISTORY

On November 6, 2006, the Acting Director of the Department of Industrial Relations ("Director") issued a public works coverage determination ("Determination") pursuant to California Code of Regulations, title 8, section 16001(a), finding that the construction of the Heber Family Apartments ("Project") was a public work subject to the prevailing wage requirements of the California Labor Code. The determination was based on representations by the County of Imperial ("County") that Project was to be financed in part by a loan from County out of HOME funds ("HOME Loan") at a one percent simple interest rate, and that pursuant to a regulatory agreement ("HOME Regulatory Agreement") occupancy of 24 of the 81 units in Project would be restricted for a period of 55 years to tenants earning no more than 80 percent of the Area Median Income ("AMI"). Based on these representations, the Determination concluded that Project would be paid for in part out of public funds because the interest rate of County loan was less than fair market value within the meaning of Labor Code section 1720(b)(4),[1] and because the occupancy restrictions did not satisfy the requirements for the exemption set forth in section 1720(c)(6)(E).

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[1] Subsequent statutory references are to the Labor Code unless otherwise indicated.

On November 27, 2006, Heber Family, L.P., a California limited partnership ("Owner") timely filed an administrative appeal of the Determination,[2] along with supporting documentation showing that Project was subject to additional regulatory agreements satisfying the conditions of the section 1720(c)(6)(E) exemption. On December 7, 2006, Department staff sent a letter to County inviting it to submit a response to the appeal. County has filed no response, and the facts asserted by Owner and supported by the additional documentation therefore are taken as true and undisputed. For the reasons set forth below, the appeal is granted, and the Determination is reversed.

II. RELEVANT FACTS

Project entails the construction of a privately-owned low-income housing development that is being financed by (1) the HOME Loan; (2) a loan ("Bond Loan") funded by proceeds of the sale of tax-exempt bonds in the aggregate amount of $6.95 million issued by the California Statewide Communities Development Authority ("Issuer") under Section 142 of the U.S. Internal Revenue Code ("IRC");[3] (3) an equity investment from a limited partner, which will receive federal Low Income Housing Tax Credits ("LIHTCs") under IRC section 42, allocated by the Tax Credit Allocation Committee ("TCAC"); (4) a loan from the California Department of Housing and Community Development under the Joe Serna, Jr. Farmworker Housing Grant Program ("Serna Loan"); and (5) a loan of Affordable Housing Program funds ("AHP Loan") from the Mississippi Valley Life Insurance Company to Owner's general partner.

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[2] Although Owner's letter is styled a request for reconsideration, it is in essence a notice of appeal pursuant to California Code of Regulations, title 8, section 16002.5, and is treated as such herein.

[3] The Bond Loan is the subject of a Loan Agreement between Owner and U.S. Bank National Association. On the basis of information provided by County, the Determination stated that permanent financing was provided by loans from U.S. Bank. Apparently this was in fact a reference to the Bond Loan.

Pursuant to a regulatory agreement between Issuer and Owner recorded on Project on December 16, 2005 ("Bond Regulatory Agreement"), occupancy of at least 80 of the 81 units in Project is restricted for a period of 55 years to tenants earning no more than 60 percent of the AMI. Additionally, pursuant to a regulatory agreement between TCAC and Owner recorded on Project on November 1, 2006 ("TCAC Regulatory Agreement"), occupancy of at least 80 of the 81 units is restricted for a period of 55 years to tenants earning no more than 60 percent of the AMI.[4]

III. DISCUSSION

Section 1771 generally requires the payment of prevailing wages to workers employed on public works. Section 1720(a)(1) defines public works to include: "Construction, alteration, demolition, installation, or repair work done under contract and paid for in whole or in part out of public funds ... ." This Project clearly entails construction work done under contract. At issue here is whether Project is "paid for in whole or in part out of public funds." Section 1720(b) provides in pertinent part:

> (b) For purposes of this section, "paid for in whole or in part out of public funds" means all of the following:
> (1) The payment of money or the equivalent of money by the state or political subdivision directly to or on behalf of the public works contractor, subcontractor, or developer.
> (2) Performance of construction work by the state or political subdivision in execution of the project.
> (3) Transfer by the state or political subdivision of an asset of value for less than fair market price.
> (4) Fees, costs, rents, insurance or bond premiums, loans, interest rates, or other obligations that would normally be required in the execution of

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[4] County did not disclose the existence of either of these regulatory agreements to this Department at any time. Among the facts asserted and evidence submitted by Owner, and not disputed by County, is that after County's communications with this Department, Owner informed County of the occupancy restrictions set forth in the TCAC Regulatory Agreement. Owner further provided County with a copy of that regulatory agreement and requested that County submit it to this Department. County failed to do so. In this regard, it should be noted that California Code of Regulations, title 8, section 16001(a)(3) provides in part: "All parties to the coverage determination request shall have a continuing duty to provide the Director or his/her duly authorized representative ... with relevant documents in their possession or control, until a determination is made." County violated this regulation, and in so doing, failed to disclose critical facts to this Department.

the contract, that are paid, reduced, charged at less than fair market value, waived, or forgiven by the state or political subdivision.

(5) Money loaned by the state or political subdivision that is to be repaid on a contingent basis.

(6) Credits that are applied by the state or political subdivision against repayment obligations to the state or political subdivision.

However, section 1720(c) provides that:

(c) Notwithstanding subdivision (b):

. . .

(6) Unless otherwise required by a public funding program, the construction or rehabilitation of privately owned residential projects is not subject to the requirements of this chapter if one or more of the following conditions are met:

. . .

(E) The public participation in the project that would otherwise meet the criteria of subdivision (b) is public funding in the form of below-market interest rate loans for a project in which occupancy of at least 40 percent of the units is restricted for at least 20 years, by deed or regulatory agreement, to individuals or families earning no more than 80 percent of the area median income.

As stated in the Determination, the HOME Loan is being made by a political subdivision of the state, and its one percent simple interest rate is clearly less than fair market value within the meaning of section 1720(b)(4). Owner has not provided details regarding the interest rate on the Serna Loan, which is being made by the state, but assumes, without conceding, that it is below market. Thus, both of these loans meet section 1720(b)(4)'s definition of "paid for in whole or in part out of public funds" because the interest rates are "charged at less than fair market value." Both the Bond Regulatory Agreement and the TCAC Regulatory Agreement, however, impose occupancy restrictions in excess of those required by section 1720(c)(6)(E), and therefore the exemption set forth therein applies with respect to these loans.[5]

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[5] These loans do not lose the exemption because they are subject to their own regulatory agreements imposing restrictions less than the minimum required by section 1720(c)(6)(E). The existence of any

The Bond Loan and the federal LIHTCs were not disclosed by County in its determination request, and accordingly were not discussed in the Determination. Regarding the Bond Loan, there are two basic structures for tax-exempt low-income housing revenue bonds: Publicly-offered and privately-placed.[6] PW 2004-016, *Rancho Santa Fe Village Senior Affordable Housing Project* (February 25, 2005) ("*Rancho Santa Fe*"), which involved the use of publicly-offered bonds, described the "conduit bond" financing mechanism as follows:

> A "conduit issuer" (in this case, CSCDA) issues and sells bonds and, simultaneously with their issuance, assigns all of its rights to the bond proceeds to a private trustee for the bondholders. The bond trustee advances the proceeds to a developer or other private party (the "Borrower") to assist in financing the project. The borrower is contractually bound to make payments to the bond trustee from revenues generated by the project on payment terms that exactly match the terms of repayment of the bonds.
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> Because it assigns all of its rights to a bond trustee, the Issuer never has possession of either the bond proceeds or the loan repayments that are made by the borrower directly to the bond trustee.
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> . . .
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> This Department has previously determined that money collected for, or in the coffers of, a public entity is "public funds" within the meaning of section 1720. PW 93-054, Tustin Fire Station (June 28, 1994). Here neither the conduit bond revenues nor the loan repayments ever enter the coffers of a public entity, nor are they collected for the public entity. Since none of the money flows into or out of public coffers, the conduit bond financing is not "the payment of money or the equivalent of money by the state or political subdivision" within the meaning of section 1720(b)(1).

Loans of proceeds from privately-placed bonds were determined not to be payments out of public funds in PW 2006-005, *Central Village Apartments* (July 12, 2006):

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regulatory agreement meeting the statutory requisites is sufficient, and there is no requirement of a direct nexus between the loan and the regulatory agreement.

6 J. Cooper, *Multifamily Rental Housing: Financing with Tax-Exempt Bonds* (Orrick, Herrington & Sutcliffe LLP, 2003) at p. 13.

> A private placement ... is in substance a real-estate loan by the bondholder, here the Bank: "The Borrower/Developer essentially borrows money from a bank or other lender, just as it would if no bonds were issued, but the debt takes the form of a bond transaction in which the lender holds the bonds."[7] The Bonds are issued by a governmental Issuer (here LAHD), and the proceeds are loaned by the bondholder to the Borrower/Developer.[8] The Borrower/Developer repays the bondholder pursuant to a loan document.
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> In such a private placement, the Issuer never has possession of either the bond proceeds or the loan repayments that are made by the borrower to the bondholder.[9]

With regard to the Bond Loan, regardless of whether the bonds for this Project are publicly-offered or privately-placed, the same result attaches. Consistent with the reasoning in *Rancho Santa Fe* and *Central Village Apartments*, neither the bond revenues nor the loan repayments flow into or out of public coffers and thus do not constitute a payment of money or the equivalent of money under section 1720(b)(1). Additionally, the fact that the Bond Loan is funded by tax-exempt bond proceeds does not mean that a public entity is making a loan at a below-market interest rate for purposes of section 1720(b)(4). Even if the Bond Loan were deemed to be a below-market interest rate loan by a public entity, it would not trigger prevailing wage requirements because the requirements for the section 1720(c)(6)(E) exemption are satisfied. *Rancho Santa Fe, supra.*

Regarding the federal LIHTCs, as discussed above, section 1720(b)(1) provides that "payment of money or the equivalent of money by the state or political subdivision" constitutes payment out of public funds. Here the federal tax credits do not entail any payment to the Developer by either the state or a political subdivision. Moreover, a tax

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7 Cooper, *supra,* at p. 21.

8 *Id.* at p. 22.

9 *Ibid.* In PW 2004-016, *supra*, the same conclusion was reached with respect to publicly-offered "conduit" bonds. While there are structural differences in the two types of bond issues, they are essentially similar insofar as the public entity has no involvement in the cash flow.

credit "involves no expenditure of public moneys received or held ... but merely reduces the taxpayer's liability for total tax due." *Center for Public Interest Law v. Fair Political Practices Commission* (1989) 210 Cal.App.3d 1476. Accordingly, the allocation of federal tax credits is not a payment of money or the equivalent of money within the meaning of section 1720(b)(1).

Additionally, the federal LIHTCs do not entail any action by the state or a political subdivision under section 1720(b)(4). While they may reduce the Developer's federal income tax obligations, these are not "obligations that would normally be required in the execution of the contract." The execution of the contract entails expenditures by, not income to, the Developer. The tax credits therefore would reduce tax obligations, if any, on income derived from activities other than construction of the housing.[10] As no other provision of section 1720(b) is germane, the federal tax credits do not constitute payment in whole or in part out of public funds.[11]

Finally, the AHP Loan involves private funds loaned by a private financial institution, and likewise is not a payment out of public funds within the meaning of section 1720(b).

In sum, the only sources of public funds involved here are the HOME and Serna Loans, and they each constitute a payment in whole or in part out of public funds in the form of below market interest rate loans within the meaning of section 1720(b)(4). Pursuant to the Bond and TCAC regulatory agreements recorded on Project, more than 98 percent of the units are restricted for 55 years to individuals or families earning no more than 60 percent of the AMI, and these restrictions exceed those required by section

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10 *Rancho Santa Fe, supra.*

11 *Ibid.*

1720(c)(6)(E). The two public funds payments therefore fall within the safe harbor of the section 1720(c)(6)(E) exemption.

IV. CONCLUSION

For the foregoing reasons, Owner's appeal is granted and the November 6, 2006 Determination is reversed. Project is not a public work subject to prevailing wage requirements.

Dated: 5 April 07

John M. Rea, Acting Director