

DEPARTMENT OF INDUSTRIAL RELATIONS  
OFFICE OF THE DIRECTOR  
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August 5, 2009

M.H. Sakata, Labor Compliance Officer  
South Bay Piping Industry Labor Management Trust  
400 Reed Street, Box 50832  
Santa Clara, CA 95052

Re: Public Works Case No. 2008-025  
Construction of Animal Community Center  
Humane Society Silicon Valley

Dear Mr. Sakata:

This constitutes the determination of the Director of Industrial Relations regarding coverage of the above-referenced project under California's prevailing wage laws and is made pursuant to California Code of Regulations, title 8, section 16001(a). Based on my review of the facts of this case and an analysis of the applicable law, it is my determination that the construction of the Humane Society Silicon Valley's ("HSSV") Animal Community Center ("Project") is not a public work subject to the prevailing wage requirements of the California Labor Code.

#### Facts

The Project consists of a 48,000 square foot facility being constructed on 4.8 acres of land at 901 Ames Avenue in the City of Milpitas. It will feature an adoption galleria with home-like habitats for dogs, cats and rabbits, a boarding facility, animal daycare, grooming center, dog park and training center, pet store, pet friendly café, education center, indoor presentation center, affordable spay/neuter medical center, and a veterinary hospital with a public viewing room.

HSSV is a nonprofit public benefit corporation organized under the laws of California whose stated mission is to save and enhance lives by connecting the community, people and animals. It accepts all incoming animals, regardless of health, temperament or age, and is open 24 hours a day, 365 days a year. HSSV currently has an annual operating budget of approximately \$7.97 million, and is supported by individual donations, program fees, foundation and corporate grants, and special events.

After operating for many years out of a small, aging facility in the City of Santa Clara, in 2001 HSSV acquired a site for a new Animal Community Center in Milpitas. HSSV broke ground on the new facility in September 2007. The total cost of the Project is estimated at approximately \$40.7 million. The Project is being financed in part with \$16 million from tax-exempt revenue bonds. The remaining funding for the Project comes from monies raised through HSSV's New Beginnings Campaign ("Campaign"), to which more than 600 private individuals and organizations have contributed. The Campaign, which has raised more than \$20 million to date, has also received a \$1 million Capital Payment from the City of Sunnyvale. HSSV expects to reach

its fundraising goal of \$25.5 million by June 30, 2010. Monies raised by the Campaign are deposited in the New Beginnings Fund.<sup>1</sup>

The revenue bonds were issued by the California Enterprise Development Authority ("CEDA"), a public entity established for the purpose of financing projects needed to implement economic development within the State of California. CEDA is a "conduit issuer" in that it is not a true party-in-interest to the transaction. Its sole function in the matter is to serve as the issuer of the bonds.

Simultaneously with issuing the bonds, CEDA entered into an agreement to lend the bond proceeds to HSSV ("Loan Agreement"). Pursuant to the Loan Agreement between CEDA and HSSV, the bond proceeds were loaned to HSSV at the governing market rate ("Bond Loan"). Interest on the bonds will be tax-exempt pursuant to Internal Revenue Code section 142. Pursuant to the Loan Agreement, the bond proceeds were deposited with a private trustee for the bondholders, Deutsche Bank National Trust Company ("Deutsche Bank"). Pursuant to a separate Trust Indenture, Deutsche Bank has made the bond proceeds available to HSSV to finance the Project. By virtue of the Loan Agreement and Trust Indenture, HSSV is contractually bound to make payments of interest and principal on the bonds to Deutsche Bank.

Most of the money in the New Beginnings Fund is being invested to produce earnings from which the Bond Loan will be repaid over the loan's 30 year repayment period.<sup>2</sup> Based on earnings projections, approximately 50 percent of the principal goal amount of \$25.5 million will remain after Project costs have been paid, including repayment of the Bond Loan.

The Capital Payment from Sunnyvale was made pursuant to an Animal Services Agreement between Sunnyvale and HSSV ("Agreement"), dated April 19, 2007, in which HSSV "has agreed to provide shelter and dead animal services in consideration for certain payments and promises" by Sunnyvale. The Agreement provides for a 20-year contract term to begin on the date HSSV moves into, and is operational, in the new facility. The Agreement provides for the following payments by Sunnyvale: (1) the \$1 million Capital Payment; (2) an annual "Host Fee" of \$40,000 with inflation adjustments; and (3) a "Live Animal Cost" (subsequently negotiated and set at \$163 per animal). With respect to the Capital Payment, section 8.a of the Agreement provides:

**Capital Payment:** CITY shall pay HUMANE SOCIETY One Million and no/100 Dollars (\$1,000,000.00) in cash upon groundbreaking for the Facility (the "Capital Payment"), which payment will be made by the CITY within ten business days of that event. The Capital Payment is a one time payment, and the CITY shall not be responsible for any design or construction cost overruns. The Capital Payment is subject to conditional reimbursement as set forth in Section 9.b.2 of this Agreement.

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<sup>1</sup> HSSV established the New Beginnings Fund in 1999 for the organization's long term investment and financial growth. Proceeds of this account are unrestricted, and can be used for any purpose of the organization, including overhead, administration, animal supplies, medical equipment, and other operating expenses.

<sup>2</sup> If there is any shortfall in earnings (dividends, interest and capital gains), the difference will be paid from a variety of sources, including revenues from operations, donations received for repayment of the bonds, and the New Beginnings Fund principal.

CITY acknowledges that funds paid toward the Facility do not entitle CITY to any ownership rights in the Facility and that complete discretion as to building site, design and all other aspects with respect to the Facility rests with HUMANE SOCIETY.

Section 9.b.2 of the Agreement provides that in the event of termination of the Agreement by either party under the circumstances specified therein, HSSV is to return a portion of the Capital Payment in accordance with the following schedule:

|        |     |                   |     |
|--------|-----|-------------------|-----|
| Year 1 | 75% | Year 5            | 35% |
| Year 2 | 65% | Year 6            | 25% |
| Year 3 | 55% | Year 7            | 15% |
| Year 4 | 45% | Year 8 (or later) | 0%  |

Sunnyvale's staff describes this provision as follows: "If HSSV or the City of Sunnyvale terminates the agreement within seven years of completion of the new facility project, Sunnyvale will be compensated for their [sic] portion of the paid construction costs at the following rate ... ." *Report to Mayor and Council, No.: 07-106, March 27, 2007, at p. 7.*

With regard to the fiscal impact of the Agreement, the staff states: "If Council terminates the [existing] agreement with [Palo Alto Animal Services] and authorizes the City Manager to sign a Long Term Agreement with HSSV, the recommended FY 2007/2008 Budget will reflect the project for the City's \$1 million capital payment for the new HSSV facility and the adjusted operating budget." *Ibid.*

Section 8.b of the Agreement provides for the payment of the Host Fee, stating in part:

Beginning on the Start Date, CITY shall pay HUMANE SOCIETY an annual fee of Forty Thousand and no/100 Dollars (\$40,000.00) for the provision of the Animal Services (the "Host Fee"). The Host Fee shall be paid at the beginning of each fiscal year and increased or decreased at a rate equal to the percentage increase or decrease, as the case may be, from year to year in the Consumer Price Index for the San Francisco Bay Area Consolidated Metropolitan Statistical Area ... as compiled by the Bureau of Labor Statistics (the "CPI").

Section 8.c of the Agreement provides for the payment of the Live Animal Cost, stating in part:

**Cost Per Live Stray Animal (Domestic or Wild):** Before the Start Date, the Parties will negotiate a fee per live stray animal sheltered or treated by HUMANE SOCIETY that CITY shall pay HUMANE SOCIETY in providing the Animal Services (the "Live Animal Cost"). The Live Animal Cost is in addition to the Host Fee. ... The Live Animal Cost shall be increased on an annual basis in an amount equal to the greater of four percent (4%) or the percentage increase, if any, in the CPI.

Discussion

Labor Code section 1771<sup>3</sup> 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 ... ." The Project clearly will entail construction work done under contract. At issue here is whether the 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 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.

Section 1720(c)(3), however, provides that:

(c) Notwithstanding subdivision (b): . . .

(3) If the state or a political subdivision . . . 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 project shall not thereby become subject to the requirements of this chapter.

Regarding the bond proceeds, the issue of tax-exempt bond financing has been analyzed by this Department in the context of multifamily affordable housing projects. PW 2004-016, *Rancho Santa Fe Village Senior Affordable Housing Project* (February 25, 2005) ("*Rancho Santa Fe*") involved "conduit bonds" similar to those involved here and described the bonds as follows:

A "conduit issuer" . . . 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

<sup>3</sup> Subsequent statutory references are to the Labor Code unless otherwise indicated.

private party ("Borrower") to assist in financing the project. 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.

Because it assigns all of its rights to a bond trustee, Issuer never has possession of either the bond proceeds or the loan repayments that are made by Borrower directly to the bond trustee.

....

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).

Although the Project at issue here involves housing for animals rather than people, the same reasoning applies. As explained above, the bond proceeds involved here do not constitute payment in whole or in part out of public funds within the meaning of section 1720(b)(1). Additionally, the fact that the bond proceeds fund the Bond Loan does not mean that a public entity is making a loan at a below-market interest rate for purposes of section 1720(b)(4).

Turning to the payments from Sunnyvale under the Agreement, there are three potential sources of public funds payments for the Project. Regarding the annual \$40,000 Host Fee and the \$163 per-animal Live Animal Cost, by the express terms of sections 8.b and 8.c of the Agreement, both are payments for services, not for construction. *McIntosh v. Aubry* (1993) 14 Cal.App.4th 1576, 1586 ("*McIntosh*") addressed a similar situation in connection with government assistance payments for the care and treatment of disturbed and abused minors:

By a memorandum of understanding incorporated in the sublease, the County "commits" to placing minors in the finished facility and using what are undisputedly public funds to pay for their care and treatment there .... However, that is payment for later services, not preliminary construction. We hold that paying public funds for public services does not make incidental construction work done by a private provider of those services "public works" under section 1720, subdivision (a). The statute requires payment for "construction"; to take that as meaning "services" would violate plain, unambiguous language, which we cannot do.

While subsequent amendments to section 1720 have overturned certain other aspects of *McIntosh*, the above holding remains good law. The Host Fee and the Live Animal Cost are both payments for services. They are not among the types of payments included in section 1720.

Regarding the Capital Payment, HSSV argues that it too is not a payment for construction, noting that the Agreement between HSSV and Sunnyvale is one for services. Additionally, it asserts that nothing in the Agreement requires HSSV to use the Capital Payment for construction of the Project, or even to complete such construction.

Unlike the Host Fee and the Live Animal Cost, which fall clearly within the *McIntosh* holding quoted above as payments for services rather than for construction, the Capital Payment presents a closer question. *Report to Mayor and Council, No: 07-106* describes the reimbursement at termination of the Agreement as compensation for a portion of the "paid construction costs." As such, arguably the Capital Payment renders the Project paid for, in part, out of public funds.

Even assuming the Capital Payment was for construction, however, the Project would nonetheless be exempt from prevailing wage requirements under section 1720(c)(3). The exemption in section 1720(c)(3) applies where "the state or a political subdivision ... provides directly or indirectly a public subsidy to a private development project that is de minimis in the context of the project ...." De minimis means "trifling, minimal ... or insignificant ... ." (Black's Law Dictionary (7th ed. 1999) at p. 443.)

The Capital Payment became part of the New Beginnings Fund, most of which is being invested to produce income from which the Bond Loan will be repaid. HSSV expects to reach its goal of raising \$25.5 million in the Campaign by June 30, 2010, and that approximately 50 percent of this total will remain in the New Beginnings Fund at the end of the 30-year Bond Loan repayment period. Based on this projection, no more than 50 percent, or \$500,000, of the Capital Payment could be considered as being used to pay for the Project. That would amount to approximately 1.23 percent of total Project costs.

It is especially important to note that before the Agreement between HSSV and Sunnyvale was negotiated, the land acquisition and the design and approval processes for the Project had already been completed and the Project was proceeding toward construction. The Agreement did not necessitate any design changes because the existing design for the Animal Community Center already provided for sufficient capacity to provide the services required by Sunnyvale. The Project would have gone forward with or without the Capital Payment, some of which may be returned should Sunnyvale decide to terminate the Agreement. With or without receipt of Sunnyvale's Capital Payment, HSSV already had sufficient financing in place to build exactly the facility it is building.

As stated above, section 1720(c)(3) exempts from prevailing wages private development projects that receive a public subsidy that is de minimis in the context of the project. The public subsidy for construction of the Animal Community Center amounts to only 1.23 percent of total Project costs. Under the unique facts of this case, this amount is deemed a trifle, minimal or insignificant and, therefore, "de minimis in the context of the project" within the meaning of section 1720(c)(3).

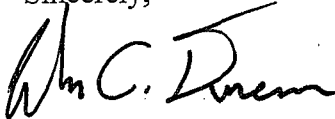
The analysis herein is consistent with prior public works coverage determinations in that the present Project entails a public subsidy within the percentage range found to be de minimis in PW 2004-024, *New Mitsubishi Auto Dealership, Victorville Redevelopment Agency* (March 18, 2004) [1.6 percent]; PW 2007-012, *Sand City Design Center, Sand City Redevelopment Agency* (May 15,

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2008) [1.4 percent]; PW 2008-010, *Sewer Line Construction – City of Corona* (August 4, 2008) [0.4 percent]; and PW 2008-037, *The Commons at Elk Grove – City of Elk Grove* (January 2, 2009) [1.1 percent].

For the foregoing reasons, the Project is not a public work subject to the prevailing wage requirements by operation of the exemption for private development projects receiving de minimis public subsidies under section 1720(c)(3). I hope this letter satisfactorily responds to your inquiry.

Sincerely,



John C. Duncan  
Director