

DEPARTMENT OF INDUSTRIAL RELATIONS

Christine Baker, Director

Office of the Director

1515 Clay Street, 17th Floor

Oakland, CA 94612

Tel: (510) 286-7087 Fax: (510) 622-3265



To All Interested Parties:

Re: Public Works Case No. 2011-016

*Hotel Construction Project, Turtle Bay Exploration Park,
City of Redding*

By mutual agreement to resolve the petition for writ of mandate in *Turtle Bay Exploration Park v. Christine Baker*, Shasta County Superior Court Case No. 13-0176864, and in consideration of the unique facts of the case, the parties stipulate that the Coverage Determination and the Decision on Administrative Appeal are vacated.

DEPARTMENT OF INDUSTRIAL RELATIONS
Office of the Director – Legal Unit
455 Golden Gate Avenue, Ste. 9516
San Francisco, CA 94102
Tel: (415) 703-4240
Fax: (415) 703-4277

MAILING ADDRESS:
P. O. Box 420603
San Francisco, CA 94142-0603



December 27, 2011

Barry E. DeWalt
Assistant City Attorney
Office of the City Attorney
777 Cypress Avenue
Redding, California 96049-6071

Re: PW 2011-016
Hotel Construction Project
Turtle Bay Exploration Park
City of Redding

Dear Mr. DeWalt:

This constitutes the determination of the Director of Industrial Relations regarding coverage of the above-referenced project under California's prevailing wage laws (CPWL) and is made pursuant to section 16001(a) of title 8 of the California Code of Regulations. 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 hotel and restaurant at Turtle Bay Exploration Park is not a public work subject to prevailing wage requirements.

Facts

The City of Redding (City) in 1992 leased a 60-acre site (the Premises) to Alliance of Redding Museums (now Turtle Bay Exploration Park (Turtle Bay)), a private non-profit entity organized for charitable purposes (the Lease). The term of the Lease is for fifty-five (55) years with an option granted to Turtle Bay to renew the Lease for an additional fifty-five (55) years. Turtle Bay pays no rent. As consideration for the Lease and as "rent," Turtle Bay agreed to construct and to operate a Museum Park on the Premises, consisting of "museums which shall be open to the public and dedicated to serve the public," and which may include related facilities and activities "which are normal and appropriate for museums."

The Lease was amended in 1995 to add an area for additional parking and in 2005 to reduce the area of the leasehold in order to accommodate highway widening by the California Department of Transportation.

The Lease was amended for a third time effective June 30, 2010 (the Third Addendum), and for a fourth time effective November 23, 2010 (the Fourth Addendum). The Third Addendum dealt with a proposed "change of use" of a portion of the Premises to permit the construction and operation of a for-profit hotel. In the Fourth Addendum, the Premises were subdivided to create an approximately five-acre "Hospitality Parcel" so that Turtle Bay could sublease that portion of the

Premises to a third party and so that the sublessee could construct "a hotel, restaurant, related hospitality facilities and necessary improvements," use its subleasehold interest as collateral to finance the construction, and operate the hotel and related facilities.¹ Under the Third and Fourth Addenda (hereafter, the 2010 Amendments), Turtle Bay continues to pay no rent to City.

The Lease neither expressly prohibits nor expressly permits the construction of for-profit lodging facilities. When the issue of whether to approve the Third Addendum was before the City Council (Council), the Council was advised in a June 4, 2010, Staff Report prepared by the Assistant to the City Manager that, "A decision to not amend the lease would effectively halt the project as it would be deemed incompatible with the terms of the lease."² At a public hearing of the Council on June 15, 2010, to consider approval of the Third Addendum, the City Manager acknowledged that, "The lease as it exists today does not contemplate a hotel as a potential use."

Turtle Bay has formed a for-profit corporation, SSR Ventures, Inc. (SSR), in which it is the principal shareholder. SSR will sublease the Hospitality Parcel from Turtle Bay and develop the property with a full-service 130-room Sheraton Hotel with restaurant, lounge, outdoor pool and whirlpool, exercise room, and gift shop (the Project). SSR will pay rent to Turtle Bay estimated to be between \$343,000 per year in 2015 and \$450,000 per year in 2022. Under the 2010 Amendments, "net revenues" received by Turtle Bay or any subsidiary or affiliate of Turtle Bay from such commercial uses of the Hospitality Parcel must be used "solely for the maintenance, operation, development or payments to the endowment of the Museum Park."³

The approximately \$21 million Project will be privately-financed with loans from North Valley Bank (NVB), two non-profit, private foundations, the Turtle Bay Private Endowment and the hotel operator. SRS plans to put out bids in December 2011 and to begin construction in February 2012. The hotel is scheduled to open in January 2013.

In July 2011, NVB commissioned a Summary Appraisal Report (Appraisal) by HVS Consulting and Valuation Services (HVS)⁴ of the market value of the leasehold interest of Turtle Bay. The Appraisal, dated September 23, 2011, concludes that the Project "is not financially feasible at this time," that the highest and best use of the property is "to hold for future development," and that the "as is" market value of the leasehold interest as of August 22, 2011, is "\$0 (ZERO DOLLARS)".⁵

¹ The Lease was amended for a fifth time effective June 14, 2011, to modify the boundaries of the Hospitality Parcel to accommodate slight modifications in the design of the proposed hotel.

² Similarly, an April 14, 2010, Staff Report to the City Council recommending that the City Attorney be directed to negotiate the Third Addendum advised the Council that, "The [hotel/restaurant] project would be deemed to be incompatible with the terms of the lease."

³ The April 14, 2010, Staff Report notes that the goal for the Project is to achieve "a steady source of income to support the museum."

⁴ HVS is a Division of MSR Valuation Services, Inc.

⁵ In January 2011, U.S. Bank commissioned a Summary Appraisal Report by HVS of the market value of Turtle Bay's leasehold interest. That appraisal, dated February 2011, which reaches the same conclusions, determined that the "as is" market value of the leasehold interest as of February 9, 2011 was "\$0 (ZERO DOLLARS)".

Discussion

Labor Code section 1771⁶ generally requires the payment of prevailing wages to workers employed on public works. 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 ..." Section 1720, subdivision (b) provides in relevant part that "paid for in whole or in part out of public funds" means all of the following:

...

- (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.

...

What is now section 1720, subdivision (b) became effective January 1, 2002, as part of Senate Bill 975 (SB 975) (Chapter 938 of the Statutes of 2001). Prior to that date, section 1720, subdivision (a) merely stated that "public works" meant "Construction ... work done under contract and paid for in whole or in part out of public funds."

It is not disputed that the Project involves construction. The principal issues to be decided are which law applies, pre-SB 975 or SB 975, and whether, under the applicable law, the construction is paid for in part out of public funds.⁷

In determining which prevailing wage law applies, the Director looks to the "benchmark event." In general, this is the agreement, contract or lease which establishes the essential character of the project relative to its status as a public work. See, e.g., PW 2004-019, *Strand Redevelopment Project, Redevelopment Agency of the City of Huntington Beach* (June 20, 2005).

Plumbers and Pipefitters Union, Local 28 (Union), argues that the 2010 Amendments are the "benchmark event" because the Lease did not permit the construction of the Project, that SB 975

⁶ All statutory references are to the California Labor Code unless otherwise indicated.

⁷ City also argues that the construction is not done "under contract" because the 2010 Amendments do not require construction, citing *Hensel Phelps Construction Co. v. San Diego Unified Port District* (2011) 197 Cal.App.4th 1020. Because I find that the construction here is not paid for in part out of public funds whichever law applies, it is not necessary to reach that issue in this case. However, the Director has consistently held that "under contract" means only that the work is contracted for as opposed to being performed by a public agency with its own forces. This application of the statute was affirmed in *Azuza Land Partners v. Department of Industrial Relations* (2011) 191 Cal.App.4th 1, 20.

applies, and that the construction is paid for in part out of public funds under section 1720, subdivisions (b)(3) and (4).⁸

City contends that the Lease implicitly permits the construction of the Project as part of the Museum complex, and that, therefore, the Lease is the appropriate benchmark. Thus, the case is governed by the law at the time the Lease was entered into, namely, that "construction ... aided by credits against rent" did not make a project a public work. *McIntosh v. Aubry* (1993) 14 Cal.App.4th 1576. City argues in the alternative that even if SB 975 applies, there is no payment of public funds for construction.

I find on the facts of this case that the 2010 Amendments are the benchmark event. As City officials acknowledged in public meetings at the time the City Council was asked to approve the Third Addendum, the Project is incompatible with the Lease, which did not contemplate a for-profit lodging facility and restaurant as a permitted use. Permitting the subdivision of the Premises and the sublease of a parcel for construction of the Project fundamentally changes the nature of the leasehold interest from its current use as a non-profit cultural and scientific center. Accordingly, SB 975 applies to the Project.

The Legislature did not provide that SB 975 was to be given retroactive effect. Therefore, the fact that there was an agreement in 1992 to waive rent as consideration for construction of the Museum cannot be considered as a basis for finding a public subsidy for construction of the Project.⁹ For the Project to be subject to the CPWL, there must be new consideration flowing from City to Turtle Bay or its sublessee that constitutes the payment of public funds for construction under SB 975.

On this issue, Union makes two arguments based on the premise that the Lease does not permit the construction of a for-profit lodging facility and restaurant and that this use of the leasehold premises was reserved by City (the reserved use). First, Union contends that the reserved use is a valuable asset and when City transferred the right to Turtle Bay to construct the Project without receiving any consideration in return, City transferred an asset of value for less than its fair market price, thus triggering prevailing wage requirements under section 1720, subdivision (b)(3). Second, Union makes the related argument that when City agreed to amend the Lease to permit the construction, it failed to charge fair market rent; thus triggering prevailing wage requirements under section 1720, subdivision (b)(4). Neither of these contentions has merit.

In *State Building and Construction Trades Council v. Duncan* (2008) 162 Cal.App.4th 289, the court held that subdivision (b)(3) requires that the public entity part with something of current value. Union presents no evidence that the reserved use has current value to City. Indeed, because City has transferred possession of the Premises to Turtle Bay potentially for another 91 years, City

⁸ Union also argues the current law applies based on a provision in the Lease that the "law in force at the time" the need for interpretation arises is to be applied to interpret the Lease. However, to apply statutory prevailing wage obligations that became effective in January 2002 retroactively to an agreement entered into in 1992 would be contrary to the way in which the Director and the courts have applied the CPWL. See, e.g., *City of Long Beach v. Department of Industrial Relations* (2004) 34, Cal.4th 942, 946-947.

⁹ City is correct that *McIntosh* was the landmark case in this area pre-SB 975. The court in that case held that the waiver or forgiveness of rent did not constitute the payment of public funds. That portion of the court's decision was abrogated by SB 975.

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cannot itself build a hotel on the Premises. Thus, the reserved use, even if considered an asset of City, has value only to the tenant, Turtle Bay.

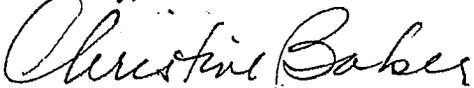
This brings us to the second argument Union makes – that the agreement by City to permit construction of the Project increased the fair market value of the leasehold interest. Again, Union presents no evidence that this is the case. To the contrary, the only evidence of value presented is the HVS appraisals, which show that the transfer did not increase the fair market value of the leasehold interest. Thus, it would be entirely speculative to assume that if City withheld permission to build the Project, it could and would have negotiated a “market rent.” It seems equally or more likely in light of the appraised market value of the leasehold interest being \$0 that had City attempted to do so, it simply would have killed the Project.

As a general matter, the Director 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. Here, the bank appraisals are the only evidence presented on the fair market value of the leasehold interest. Based thereon, it is clear that the 2010 Amendments did not increase the fair market value of Turtle Bay’s leasehold interest. Therefore, City has not transferred an asset of current value to City at less than its fair market price, and City has not waived or forgiven rent or leased the property at less than its fair market value.¹⁰

For the foregoing reasons, the Project is not subject to the prevailing wage requirements of the California Labor Code.

I hope this letter satisfactorily responds to your inquiry.

Sincerely,



Christine Baker
Director

¹⁰ City has submitted a Legislative Counsel Opinion (LCO) which concludes in part that “a court could find foregone rent [under 1720(b)(3)] if it were to determine that the authorization to build the hotel was not an allowable use under the original lease ... [and] that the authorization to construct a hotel granted by the 2010 amendments would normally be granted for consideration in the form of additional rents, and that the failure to charge those additional rents constituted a payment of public funds for a hotel project.” However, no evidence has been presented that rent would “normally be required” under the circumstances of this case. The appraisals, which are not referenced in the LCO, are substantial evidence that it would not.