STATE OF CALIFORNIA

Arnold Schwarzenegger, *Governor*

DEPARTMENT OF INDUSTRIAL RELATIONS
OFFICE OF THE DIRECTOR
455 Golden Gate Avenue
San Francisco, CA 94102
(415) 703-5050

February 25, 2005

Paul R. Schrecongost, Esq.
Pillsbury Winthrop LLP
50 Fremont Street
San Francisco, CA 94105

Re: Public Works Case No. 2004-016
Rancho Santa Fe Village Senior Affordable Housing Project

Dear Mr. Schrecongost:

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 title 8, California Code of Regulations, 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 Rancho Santa Fe Village Senior Affordable Housing Project ("Project") is not a public work, and therefore is not subject to prevailing wage requirements.[1]

Facts

The Project entails construction of 120 units of affordable housing in the City of San Marcos. Pursuant to a regulatory agreement, occupancy of 100 percent of the units will be restricted, for a period of 55 years, to tenants earning no more than 60 percent of the area median income. The Project will be financed in part from a loan of low-income housing bond funds allocated by the California Debt Limit Allocation Committee ("CDLAC"). RSF Village Partners L.P. ("Owner") anticipates that it will also qualify for federal low-income housing tax credits pursuant to section 42 of the Internal Revenue Code of 1986. Each of these funding mechanisms is explained in greater detail below.

[1] You have disclosed that the City of San Marcos has committed to give Owner a grant in the amount of $700,000, which Owner will accept only in the event that the Project is determined to be subject to prevailing wage requirements, and that Owner will decline the grant if it is determined that the Project is not subject to such requirements. This determination therefore assumes that the grant will be declined. Acceptance of the grant would trigger prevailing wage requirements.

Discussion

Labor Code section 1771[2] generally requires the payment of prevailing wages to workers employed on public works. Section 1720(a)(1) defines public works to include: "Construction, alternation, demolition, installation, or repair work done under contract and paid for in whole or in part out of public funds …."

Section 1720 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.
>
> . . .
>
> (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.
>
> . . .
>
> (6) Credits that are applied by the state or political subdivision against repayment obligations to the state or political subdivision.
>
> (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

---

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

> 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.
>
> (d) Notwithstanding any provision of this section to the contrary, the following projects shall not, solely by reason of this Section, be subject to the requirements of this chapter:
>
> (1) Qualified residential rental projects, as defined by Section 142(d) of the Internal Revenue Code, financed in whole or in part through the issuance of bonds that receive allocation of a portion of the state ceiling pursuant to Chapter 11.8 of Division 1 (commencing with Section 8869.80) of the Government Code on or before December 31, 2003.
>
> . . .
>
> (3) Low-income housing projects that are allocated federal or state low-income housing tax credits pursuant to Section 42 of the Internal Revenue Code, Chapter 3.6 of Division 31 (commencing with Section 50199.4) of the Health and Safety Code, or Section 12206, 17058, or 23610.5 of the Revenue and Taxation Code, on or before December 31, 2003.

Clearly, the Project is construction that will be done under contract. At issue is whether one or both of the financing mechanisms renders the Project "paid for in whole or in part out of public funds."

Federal Tax Credits

The federal Low-Income Housing Tax Credit ("LIHTC") program was created by legislation enacted by Congress in 1986 to provide an incentive to private entities for owning affordable housing. The owner of an affordable housing development receives the credit and may use it to offset the amount of income tax owed to the federal government. The credit reduces, dollar-for-dollar, the amount of tax owed, and may be used annually for up to 10 years. It is available to the taxpayer only if the housing is rented to low-income households at rents that are affordable to those households. The credit is based on the cost of constructing the units to be operated as affordable housing. If the housing is not rented to low-income households at affordable rents, the

credit cannot be used and past credits received are subject to recapture.

The LIHTC program is administered at the federal level by the Department of Treasury and the Internal Revenue Service and at the state level by the California Tax Credit Allocation Committee ("TCAC"). Federal law authorizes the annual allocation of tax credits in an amount equal to $1.80 per state resident. The federal government allocates federal tax credits to each state in proportion to that state's population. The states in turn allocate the credits to low-income housing projects. The owners[3] of projects receiving federal tax credits use them to offset their federal tax liability.[4]

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 neither the state nor a political subdivision is making any payment to the Owner. Moreover, a tax 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).

Section 1720(b)(4) includes as payment out of public funds:

> 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.

---

[3] The owner of a multifamily affordable housing development is, as here, typically, though not necessarily, a limited partnership, with the limited partner investing private capital in the project. In return, the limited partner receives the tax credits allocated to the project.

[4] The above explanation is based on a letter from Goldfarb & Lipman, dated March 31, 2004, on behalf of the California Coalition for Affordable Housing ("CCAH"). No party has disputed the accuracy of the description of the program set forth therein. It should be noted that the TCAC also administers a program for state tax credits, which are not at issue here and, accordingly, are not addressed in this determination.

Federal tax credits do not entail any such action by the state or a political subdivision. While the tax credits may reduce Owner'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, Owner. Similarly, the tax credits are not "applied by the state or political subdivision against repayment obligations to the state or political subdivision" within the meaning of Section 1720(b)(6).

As no other provision of Section 1720(b) is applicable,[5] the federal tax credits do not constitute payment in whole or in part out of public funds.[6]

State Building and Construction Trades Council of California, AFL-CIO ("SBCTC") argues that, if federal tax credits were not intended to be included within the definition of public funds in Section 1720(b), there would have been no need for the prevailing wage exemption for federal or state low-income housing tax credits set forth in Section 1720(d)(3). That argument would be persuasive only if there were an independent basis for construing Section 1720(b) to include such credits. The language of the latter statutory section, however, is plain and unambiguous, and the credits do not fall within such language. Therefore, their inclusion cannot be inferred from the language of the exemption. This is particularly true since the language of Section 1720(b) was amended after Section 1720(d)(3) was enacted.

Further, Owner, Issuer and CCAH argue that the purpose for the exemptions set forth in Section 1720(d)(1) and (3) was to provide a transition period for affordable projects "already in the pipeline" that received funding from multiple sources. Such sources may include fee waivers and other public subsidies that would not have been considered payments of public funds prior to the enactment of Senate Bill 975.

---

[5] SBCTC argues that the tax credits are payment of public funds under Section 1720(b)(3) as a transfer of an asset of value for less than fair market price because they are economically equivalent to a cash grant from the public. This argument is rejected, first, because the tax credits are federal, and therefore not transferable by the state or a political subdivision of the state. Further, tax credits have no independent value and are not freely transferable upon receipt. *Rainbow Apartments v. The Illinois Property Tax Appeal Board*, 762 N.E.2d 534, 537 (Ill.App.Ct. 2001). Thus a fair market price cannot be assigned to them.

[6] Consistent with this determination, the discussion of the public funds status of federal tax credits set forth in PW 2002-070, *1010 Pacific Apartments/City of Santa Cruz* (June 30, 2003) is hereby overruled.

The legislative history does not disclose the intent of the exemptions set forth in Section 1720(d). However, it is significant that the subdivision states that "the following *projects* shall not, solely by reason of this Section, be subject to the *requirements of this chapter* … ." (Emphasis supplied.) Thus, Section 1720(d) does not simply exempt certain funding sources from the definition of "paid for in whole or in part out of public funds" set forth in Section 1720(b). Rather, it exempts *projects* receiving funding from such sources from all requirements of the Prevailing Wage Law, even if they also receive types of public funding expressly included in Section 1720(b) and not mentioned in Section 1720(d).

Tax-Exempt Conduit Bonds

The Project will also receive a CDLAC private activity bond volume cap allocation that will allow the California Statewide Communities Development Authority ("CSCDA" or "Issuer") to issue low-income housing "conduit" bonds and loan the bond proceeds to Owner to finance the Project. The interest on these bonds will be tax-exempt pursuant to Internal Revenue Code section 142. The bond proceeds will be loaned to Owner at an interest rate equal to the rate payable on the bonds plus an annual fee. Pursuant to an indenture of trust for the bonds, the bondholders will have no recourse against Issuer for payments of principal, interest or any other money with respect to the Bonds. The bondholders' sole recourse will be against Owner and the Project.

This type of financing is widely used for multifamily housing projects. 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 ("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. In this case the bonds would be subject to the provisions of Health & Safety Code section 52037, which limits the conduit issuer's payment obligations to "revenues and receipts derived from or with respect to the home mortgages …." That statute further provides that: "[T]he bonds shall not

constitute an indebtedness of the issuing city or county or a loan of credit thereof within the meaning of any constitutional or statutory provision, nor shall the bonds be construed to create any moral obligation on the part of the issuing city or county or any subdivision thereof with respect to the payment of such bonds." A statement to this effect is typically included on the face of the bonds themselves.

In a letter dated June 21, 2004, Orrick, on behalf of Issuer, further explained this funding mechanism:

> The conduit issuer is referred to as such because it is not a true party-in-interest to the transaction. Its only function is to serve – in form – as the issuer of the bonds and as lender of the bond proceeds to the borrower. [F]ederal tax law recognizes the form of a transaction over its substance to grant the bonds tax-exempt status based on the public entity nature of the issuer, even though the issuer is not the true obligor on the bonds.

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).

SBCTC suggests that the use of tax-exempt bond financing constitutes a loan at below-market interest rates and therefore is covered under Section 1720(b)(4). It cannot, however, be assumed that the interest rate is below-market merely because the bonds are tax-exempt. There are separate markets for tax-exempt and taxable bonds.[7] Moreover, tax status is only one of several variables influencing interest rates on bonds. Other important variables include the duration of the bonds and the

[7] This analysis is limited to the specific context of bond markets. The Department will not assume the existence of separate markets in other factual contexts.

creditworthiness of the issuer. In any case, the loan to Owner is made by the bond trustee, so even if the interest rate were below-market, neither the state nor a political subdivision thereof is charging interest at less than fair market value.[8]

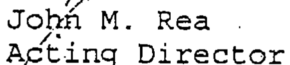
Finally, even if the conduit bonds were deemed to be a below-market interest rate loan by a public entity, they would not trigger prevailing wage requirements. By regulatory agreement, occupancy of all of the units will be restricted, for a period of 55 years, to tenants earning no more than 60 percent of the area median income. Because these restrictions exceed the requirements of Section 1720(c)(6)(E), the exemption set forth therein would apply.

Conclusion

For the foregoing reasons, the Project is not subject to prevailing wage requirements.

I hope this letter satisfactorily answers your inquiry.

Sincerely,



John M. Rea
Acting Director

[8] In fact, because the loan is made by the bond trustee, no public entity, either federal, state or local, is charging below-market interest rates within the meaning of Section 1720(b)(4), which refers to "loans [or] interest rates… that are … charged at less than fair market value … *by the state or political subdivision*." (Emphasis supplied.)