STATE OF CALIFORNIA Arnold Schwarzenegger, *Governor*

DEPARTMENT OF INDUSTRIAL RELATIONS
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February 25, 2005

Dennis B. Cook, Esq.
COOK BROWN LLP
555 Capitol Mall, Suite 425
Sacramento, CA 95814

Re: Public Works Case No. 2004-030
Casa Loma Family Apartments/CL Investors, a California Limited Partnership

Dear Mr. Cook:

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 Casa Loma Family Apartments Project ("Project") is not a public work, and therefore is not subject to prevailing wage requirements.

Facts

CL Investors, A California Limited Partnership ("CL Investors" or "Owner"), is developing a new 113 unit apartment complex in Bakersfield. One hundred percent of the units will be rented to residents whose income is 60 percent or less of the area's median gross income. The administrative general partner will be CL Family Housing, LLC. The Community Revitalization and Development Corporation, a nonprofit public benefit corporation, will act as the managing general partner.

All funding for the construction of the Project will come from private sources. Construction financing in the amount of $9,600,000 will be provided through First Bank & Trust. Paramount Financial Group, Inc. ("PFG") will contribute additional capital in the amount of $13,163,847 as equity contributions over a period of three years. PFG is an investment partnership which has agreed to acquire 99.99 percent of CL Investors in exchange for its capital contribution. PFG is providing the funding based upon a series of conditions set forth in a Partnership Agreement between itself and CL Investors. One such condition is that the Project qualifies for $1,521,832 in annual federal tax credits over a 10-year period for a total of $15,218,832. Profits, losses and tax credits from the operation of the apartment complex will be distributed 99.99 percent to PFG.

Through a preliminary reservation letter dated June 16, 2004, the California Tax Allocation Committee ("TCAC") reserved for the Project 2004 Low-Income Housing Federal Tax Credits in the amount of $1,521,984 per year for 10 years. These credits were provided pursuant to Internal Revenue Code section 42. No state tax credits were allocated to the Project.

Discussion

Labor Code section 1771[1] generally requires the payment of prevailing wages to workers employed on public works. Section 1730(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... .

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.
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> ...
>
> (3) Transfer by the state or political subdivision of an asset of value for less than fair market price.
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> (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.
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> ...
>
> (6) Credits that are applied by the state or political subdivision against repayment obligations to the state or political subdivision.
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> ...
>
> (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] Subsequent statutory references are to the Labor Code unless otherwise indicated.

> (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 the financing mechanisms render the Project "paid for in whole or in part out of public funds."

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 TCAC. Federal law authorizes the annual allocation of tax credits in an amount equal to $1.80 per state resident. The federal government allocation 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[2] of projects receiving federal tax credits use them to offset their federal tax liability.[3]

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[2] 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 allocation to the project.

[3] 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.

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 1730(b)(4) defines payment out of public funds to include:

> 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.

Federal tax credits do not entail any such action by the state or a political subdivision. While the tax credits may reduce the 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, the 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,[4] the federal tax credits do not constitute payment in whole or in part out of public funds.

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[4] The State Building and Construction Trades Council of California, AFL-CIO 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 tax credits.

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.

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).

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