STATE OF CALIFORNIA EDMUND G. BROWN, JR., *Governor*

DEPARTMENT OF INDUSTRIAL RELATIONS
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To All Interested Parties:

Re: Public Works Case No. 2006-021
Hilton San Diego Convention Center Hotel
Port of San Diego Unified Port District

The Decision on Administrative Appeal, dated June 20, 2008, in PW 2006-021, *Hilton San Diego Convention Center Hotel*, was affirmed in a published Fourth District Court of Appeal opinion dated July 26, 2011. See *Hensel Phelps Construction Co. v. San Diego Unified Port District* (2011) 197 Cal.App.4th 1020.

STATE OF CALIFORNIA

DEPARTMENT OF INDUSTRIAL RELATIONS

DECISION ON ADMINISTRATIVE APPEAL

RE: PUBLIC WORKS CASE NO. 2006-021

HILTON SAN DIEGO CONVENTION CENTER HOTEL

PORT OF SAN DIEGO UNIFIED PORT DISTRICT

I. INTRODUCTION

On April 1, 2008, the Director of the Department of Industrial Relations ("Department") issued a public works coverage determination ("Determination") finding that the Hilton San Diego Convention Center Hotel and related construction ("Project") is a public work subject to prevailing wage requirements.

On April 23, 2008, Hensel Phelps Construction Co., Inc. and Phelps Portman San Diego, LLC ("Appellants") filed an administrative appeal and requested a hearing. The Department has also received position statements from other interested parties in support of and in opposition to the appeal. All of the submissions have been carefully considered. Except as noted below, the appeal raises no issues not already addressed in the Determination. For the reasons set forth in the Determination, which is incorporated herein by reference, and the additional reasons stated below, the appeal is denied and the Determination is affirmed.

II. DISCUSSION

A. No Hearing Is Required.

California Code of Regulations, title 8, section 16002.5(b) provides that the decision to hold a hearing is within the Director's sole discretion. Appellants do not present new facts in their appeal. The issues raised are predominantly legal, involving the

meaning and application of Labor Code section 1720(b)(4).[1] The material facts are undisputed. Accordingly, no hearing is necessary and the request is denied.

B. The Determination Correctly Found That The Project Was Paid For In Part Out Of Public Funds Within The Meaning Of Section 1720(b)(4).

As discussed in the Determination, the Port of San Diego Unified Port District ("District") has foregone up to $46.5 million in rent due for the first 11 years of its lease with One Park Boulevard, LLC ("Hilton"). District's forbearance is a payment in whole or in part out of public funds, and therefore, as the Determination concluded, the Project is a public work subject to prevailing wages.

Appellants raise three arguments in support of the appeal. First, they argue, as they did previously, that the rent credit in the lease between District and Hilton does not fall within section 1720(b)(4) because the lease contains a market value rent. Second, they argue that there can be no rent reduction without an already enforceable lease agreement. Third, they argue that the rent credit must have an "economic value," which they argue it does not. Appellants' arguments ignore the facts and are without support in either the statute or case law.

1. The Rent Credit Falls Within The Plain Meaning Of Section 1720(b)(4).

Section 1720(b)(4) includes within the meaning of "paid for in whole or in part out of public funds" the following:

> 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.

Appellants argue that only if rent is "charged at less than fair market value" does it fall with the provisions of section 1720(b)(4). That argument, however ignores the basic rules of statutory construction. In *McIntosh v. Aubry* (1993) 14 Cal.App.4th 1576, the court instructed: "'To determine the intent of legislation, we first consult the words themselves, giving them their usual and ordinary meaning. [Citations.]' [Citation]." *Id.* at p. 1588. The same court reasoned that "[t]here is nothing in the language of subdivision (b) which furnishes a basis for concluding that the Legislature intended to overthrow the

[1] Statutory references herein are to the California Labor Code unless otherwise specified.

McIntosh ordinary meaning approach to determining what qualifies as 'paid for in whole or in part out of public funds.'" *State Building and Construction Trades Council of California v. Duncan* (2008) ___ Cal.Rptr.3d ___, 162 Cal.App.4th 289, 2008 WL 1812973 (April 23, 2008) at p. *13. ("*Trades Council.*")

Subsection (b)(4) is written in the alternative. Giving the word "or" its usual and ordinary meaning, "or" is used to indicate "(1) an alternative between different or unlike things, states or actions." (Webster's 3d New Internat. Dict. (2002) p. 1585.) Contrary to Appellants' argument, there is no overarching requirement that rent which is "reduced ... waived, or forgiven" also be at less than fair market value. The Director cannot write such a requirement into the statute. As such, rent is a payment of public funds under subsection (b)(4) if it is "paid" *or* "reduced" *or* "charged at less than fair market value" *or* "waived" *or* "forgiven" by District.

Here, the lease contains both minimum rents and standard percentage rents charged by District for its hotel properties. There is no dispute that the total rent credit reduces by up to $46.5 million the rent that Hilton would otherwise pay under these provisions over the first eleven years of the lease. As Karen Weymann, District's Assistant Director for Real Estate Development, advised the District's Board of Commissioners ("Board") in August 2003:

> **The [lease] provides for the $26.5 million subsidy to be taken in the form of rent credits, equal to 60% of rent due**, until $46.5 million ... has been received or 11 years, which ever occurs first.[2]

All parties understood that that the rent credit reduced Project costs, and, thereby, made the Project financially feasible. Appellants' appraiser acknowledges that due to the restructured rent credit in 2005, which provided "rent concessions in the early years,"[3]

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[2] Agenda Sheet for Agenda Item 3, dated August 6, 2002, page 5 (emphasis added). As noted in the Determination, Hilton initially proposed two alternative means by which District would "financially support" the Project: by paying all parking garage revenues to Hilton or by contributing a $26.5 million cash subsidy to the Project. Instead, District and Hilton agreed to spread over the first 11 years of the lease in the form of a rent credit the *present value* of a $26.5 million cash contribution.

[3] Market Rent Analysis and Self-Contained Appraisal Report of the Leasehold Interest prepared by Jones Lang LaSalle Hotels, dated June 7, 2007. ("JLL Report"), page 5.

together with the "deferrals of rent in years one through 10, ... the subject hotel became (financially) feasible."[4]

The parties' appraisers agree that the rent credit reduces the amount of rent District would otherwise receive. Appellants' appraiser calculates that the rent credit will reduce by approximately 3.3 percent the estimated $1.4 billion in rent that Hilton would otherwise pay over the life of the lease.[5] The Carpenters/Contractors Cooperation Committee's appraiser estimates that the rent credit is equal to a reduction in the first 11 years of the lease of more than 63 percent of the rent that would be otherwise payable.[6]

Thus, by operation of the rent credit, Hilton's rent was eliminated for the first three years of its lease and reduced by 60 percent for eight years thereafter. This is foregone rent that otherwise would have been payable to District under the lease's minimum and percentage rent structure. Whether characterized as a reduction, waiver or forgiveness of rent, each of which the rent credit is, the undisputed facts show that the rent credit falls within the plain meaning of section 1720(b)(4). With the rent credit, District has "foregone" rent compensation with an estimated present cash value of $26.5 million. As stated in *Trades Council*, rent that is "foregone" constitutes the "payment" of "public funds." (*Trades Council, supra,* at p. *20.)

2. Section 1720(b)(4) Does Not Require A Pre-Existing Enforceable Lease Agreement.

Appellants' argument that section 1720(b)(4) requires a pre-existing enforceable lease agreement finds no support in either the statute or case law. To the contrary, subsection (b)(4) requires only that rent, which normally would be required in a lease transaction, be foregone by being paid, reduced, charged at less than fair market value, waived or forgiven. Appellants provide no authority for the requirement of a pre-existing lease.

In *McIntosh v. Aubry*, *supra,* 14 Cal.App 4th 1576, the court addressed the issue of whether rent "forbearance" constitutes the payment of public funds under then section 1720(a). In that case, the County entered into a sublease with Helicon, Inc. ("Helicon"),

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4 JLL Report, page 26.

5 JLL Report, page 33.

6 Appraisal consulting report of Integra Realty Resources, dated September 17, 2007, page 4.

the successful bidder for the construction of a shelter care facility, which was "a negotiated version of the first [request for proposals] alternative." (*Id.* at p. 1580.) The sublease provided that Helicon would use the leased land for the construction, operation and maintenance of the facility. That use would be consideration for the first 20 years of the sublease, during which time no rent would be paid. After 20 years, Helicon would pay rent at fair market value. The court found that the "forbearance of rent," while "valuable as a negotiating tool," did not constitute payment "out of public funds" under the statute as then written. (*Id.* at p. 1588.) The court also found that cost waivers were not public funds but added:

> Legislators could easily express an intent to bring waived costs (or rent) within the concept of payment with "public funds" but have not done so. A holding that waived inspection costs are partial payments from public funds could make public works of any project where a county has used cost waivers as incentives to development, even though the project may serve purely private needs. The statute gives no warning that this result was intended.

(*Id.* at p. 1590.)

In partial response to *McIntosh*, the Legislature did give such "warning" by enacting section 1720(b)(4). In the recent case of *Trades Council*, the *McIntosh* court acknowledges that in section 1720(b)(4), the Legislature abrogated its earlier decision that rent forbearance does not constitute the "payment of public funds." (*Trades Council, supra*, at p. *20.) Yet *McIntosh* remains instructive in describing the type of public subsidy the Legislature intended to include in section 1720(b)(4). Critical to this discussion is the fact that, as here, there was no pre-existing enforceable lease. The forbearance in *McIntosh* was negotiated amongst the parties and memorialized in the original lease agreement. The court found rent forbearance despite the fact that there was no pre-existing lease agreement. While the *McIntosh* court also found they were without statutory authority to find a payment of public funds, the authority now exists in section 1720(b)(4). To find that section 1720(b)(4) requires a pre-existing lease agreement would not only be inconsistent with the rule of statutory construction that plain meaning controls, but, just as important, it would violate the spirit of *McIntosh*.

Moreover, as the *McIntosh* court noted, the forbearance of rent may be a valuable *negotiating* tool that provides an incentive to development. That is what occurred here. The rent credit was negotiated with the purpose and intent of providing economic incentive to the development of the Project.[7]

3. Appellants' View That The Analysis Whether The Rent Credit Falls Within Section 1720(b)(4) Entails An Independent Evaluation Of The Rent Credit's "Economic Value" Is Incorrect.

Appellants argue that District has neither given up anything of "economic value" nor transferred anything of "economic value" to Hilton, and that this concept of "economic value" is material to the issue presented. Appellants rely on *Trades Council* for this proposition. Appellants' reliance on *Trades Council* is misplaced. The specific issue decided in *Trades Council* is whether an allocation of state tax credits to facilitate the construction of low-income housing comes within the definition of "paid for in whole or in part out of public funds" within the provisions of section 1720(b)(1) or (b)(3).

In discussing section 1720(b) generally, the court instructed that the "statutory emphasis is very much upon the tangibility and form of the payment." (*Trades Council, supra*, at p. *13.) Here, "tangibility" of the rent credit is shown by the extensive record documenting that Hilton required a specific amount of money from District to do the Project. That amount is $26.5 million in present cash value. Unlike the tax credits in *Trade Council*, the "form of payment" here falls within the plain meaning of section 1720(b)(4). The form of payment is a rent credit, which whether viewed as a reduction, forgiveness or waiver, provides up to $46.5 million in real dollars to Hilton over the first 11 years of the lease. The rent credit has a tangible, calculable value. Under the plain meaning of section 1720(b), nothing more is required.

III. CONCLUSION

The up to $46.5 million in rent credit by District constitutes the "payment" of "public funds" within the plain meaning of section 1720(b)(4). Nothing in *Trades Council* changes this straightforward result. Accordingly, the Project is a public work subject to the requirements of the prevailing wage laws.

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[7] In a February 2003 Financing Memorandum, Secured Capital Corp., Hilton's advisor in arranging construction financing and equity capital for the Project, characterized the rent credit as a "development incentive unprecedented for hotel development in downtown San Diego ... ."

For the reasons set forth in the Determination and in this Decision on Administrative Appeal, the appeal is denied and the Determination is affirmed. This Decision constitutes the final administrative action in this matter.

Dated: 6/20/08

John C. Duncan, Director