

DEPARTMENT OF INDUSTRIAL RELATIONS
OFFICE OF THE DIRECTOR
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October 1, 2009

Jim Baker, Labor Compliance Officer
SMWIA Local Union No. 206
4594 Mission Gorge Place
San Diego, CA 92120

Re: Public Works Case No. 2008-026
King/Chavez Preparatory Academy
City of San Diego

Dear Mr. Baker:

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 King/Chavez Preparatory Academy ("Project") is not a public work subject to the prevailing wage requirements of the California Labor Code.

Facts

The Project entails construction of a charter school facility for grades 6 through 8, consisting of a two-story 14,787 square foot building with a 3,710 square foot basement and surface 20-space parking lot. (City of San Diego, Report to the Planning Commission, Report No. PC-08-011, January 10, 2008.) Construction was pursuant to a contract between San Diego Charter School Development, LLC ("Developer") and Aerial Construction. On May 14, 2009, the completed facility was sold to King/Chavez Facilities, LLC ("Borrower"), an entity solely owned by King/Chavez Academy of Excellence ("Lessee"), a 501(c)(3) non-profit corporation. Lessee leases the facility from Borrower, and is the entity operating the school.

Construction financing came in the form of a \$4.435 million loan from Vectra Bank to Developer. Borrower purchased the facility with proceeds of tax-exempt revenue bonds in the amount of \$8.49 million and taxable revenue bonds in the amount of \$405,000, issued by the California Municipal Finance Authority ("Authority"). In a letter dated September 22, 2008, bond counsel Foley & Lardner LLP describes the bonds as "conduit revenue bonds." Pursuant to the Indenture, the proceeds are disbursed by, and repayment made to, Zions First National Bank ("Trustee"). Borrower and Authority entered into the Loan Agreement, under which Borrower agreed to assign to Trustee all of its rights, title and interest under and pursuant to the lease, including its right to receive rental payments from Lessee. Borrower will repay the loan on a monthly basis from such rental payments, and Trustee will use these revenues to satisfy its obligations to the bondholders. Lessee, in turn, is to pay the rent from state school funding.

The Limited Offering Memorandum ("Memorandum") for the bonds details the financing scheme. The Memorandum discloses a long list of risk factors making the bonds suitable for purchase only by a "Qualified Institutional Buyer." Among the risk factors is the fact that the only source of revenue with which to repay the bonds will be rents collected by Borrower.

Under the subheading "Dependence on State Aid Payments that are Subject to Annual Appropriation and Political Factors," the Memorandum states at page 5:

California charter schools ... may not charge tuition and have no taxing authority. *The primary source of revenue generated by charter schools is aid provided by the State for all public schools.* The amount of State aid received with respect to any individual school is based on a variety of factors, including the school's enrollment and average daily attendance. The amount of aid provided by the State in any year is subject to appropriation by the California Legislature. The Legislature bases its decisions about appropriations on many factors, including the State's economic performance. Further, because some public officials, their constituents, commentators and others have viewed charter schools as controversial, political factors may also come to bear on charter school funding.

As a result, *the Legislature may not appropriate funds, or may not appropriate funds in a sufficient amount, for the Corporation to generate sufficient revenue to meet its operating expenses and to meet its obligations under the Lease representing the debt service payments on the Series 2009 Bonds.* No liability would accrue to the State in such event, and the State would not be obligated or liable for any future payments or any damages. If the State were to withhold State aid payments for any reason, even for a reason that is ultimately determined to be invalid or unlawful, the Charter Schools could be forced to close. (Emphasis added.)

Under the subheading "Default under the Lease; No Assurance Regarding Subsequent Tenant," the Memorandum states at page 6:

If there is a default by the Borrower under the Loan Agreement attributable to a default by the Corporation under the Lease, the Borrower would very likely not have funds to satisfy its remaining obligation to make payments under the Loan Agreement. If the Corporation defaults under the Lease, there can be no assurance that the Borrower will be able to find a new tenant to generate any funds or funds in a sufficient amount to make payments under the Loan Agreement representing debt service on the Series 2009 funds.

The Memorandum provides further warnings of possible shortages of state funds to service the debt. Additionally, it cautions that "the Facilities are a build-to-suit property specifically designed as a middle school educational building and there would be significant conversion costs with respect to alternative uses."

Consistent with the stated risk factors, the tax-exempt bonds pay interest rates of 8 to 8.75 percent, depending on maturity date. The taxable bonds pay a rate of 10.25 percent.

Discussion

Labor Code section 1771¹ generally requires the payment of prevailing wages to workers employed on public works. There are two potential bases of coverage. One basis is under section 1720(a)(1), which 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(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.

Another potential basis for coverage is under section 1720.2. It provides that:

For the limited purposes of Article 2 (commencing with Section 1770) of this chapter, "public works" also means any construction work done under private contract when all of the following conditions exist:

(a) The construction contract is between private persons.

(b) The property subject to the construction contract is privately owned, but upon completion of the construction work, more than 50 percent of the assignable square feet of the property is leased to the state or a political subdivision for its use.

(c) Either of the following conditions exist:

(1) The lease agreement between the lessor and the state or political subdivision, as lessee, was entered into prior to the construction contract.

(2) The construction work is performed according to plans, specifications, or criteria furnished by the state or political subdivision, and the lease agreement

¹Subsequent statutory references are to the Labor Code unless otherwise indicated.

between the lessor and the state or political subdivision, as lessee, is entered into during, or upon completion of, the construction work.

The question of coverage under section 1720.2 is easily answered. The construction contract is between private persons, Developer and Aerial Construction, and the property subject to the construction contract is privately owned. Thus, section 1720.2 would apply if Lessee is “the state or a political subdivision.” Education Code section 17604, subdivisions (a) and (b), however, “permit a charter school to operate as a non-profit benefit corporation, with the school district granting the charter entitled to one representative on the board of directors.” *Wilson v. State Board of Education* (1999) 75 Cal.App.4th 1125, 1132. As explained in *Wells v. One2One Learning Foundation, Inc.* (2006) 39 Cal.4th 1164, 1200-1201:

Though charter schools are deemed part of the system of public schools for purposes of academics and state funding eligibility, and are subject to some oversight by public school officials (see *Wilson, supra*, 75 Cal.App.4th 1125, 1136-1142, 89 Cal.Rptr.2d 745), the charter schools here are *operated*, not by the public school system, but by distinct outside entities—which the parties characterize as non-profit corporations—that are given substantial freedom to achieve academic results free of interference by the public educational bureaucracy. The sole relationship between the charter school operators and the chartering districts in this case is through the charters governing the schools’ operation. Except in specified respects, charter schools are “exempt from the laws governing school districts.” (Ed. Code, § 47610.)

The status of Lessee is no different than the status of the entities described in *Wells*. Lessee is a non-profit corporation distinct from the public school district within which it operates. Section 1720.2 by its terms is limited to property that is “leased to the state or a political subdivision for its use.” Section 1721 provides that: “‘Political subdivision’ includes any county, city, district, public housing authority, or public agency of the state, and assessment or improvement districts.” It is significant that non-profit corporations are not mentioned either in section 1720.2 or in the definition of “political subdivision” set forth in section 1721. The latter section lacks language such as “includes but is not limited to,” which would suggest that the entities listed were not intended to be exhaustive. See *State Building and Construction Trades Council of California v. Duncan* (2008) 162 Cal.App.4th 289, 319. It is a “familiar rule of construction that where a statute enumerates things upon which it is to operate it is to be construed as excluding from its effect all those not expressly mentioned.” *Capistrano School Dist. v. Capistrano Beach Acreage Co.* (1961) 188 Cal.App.2d 612, 617. Thus, it must be concluded that as a non-profit corporation, Lessee is neither the state nor a political subdivision, and section 1720.2 does not apply.

Therefore, whether the Project is a public work turns on the applicability of section 1720(a)(1). The Project clearly entails construction done under contract. The issue is whether that construction is “paid for in whole or in part out of public funds.”

Developer has been paid with the proceeds of “conduit bonds.” The issue of conduit bond financing has previously 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*"), which involved "conduit bonds" similar to those involved here, 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 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).

Because the conduit bond financing here does not involve the coffers of a public entity, the Project is not paid for in whole or in part out of public funds for the same reasons explained in *Rancho Santa Fe*.²

Whether this Project was paid for out of public funds requires additional analysis, however, because the bonds are being repaid with rental income derived from state school funding. The question is whether this funding arrangement entails a "payment of money ... by the state or political subdivision directly to or on behalf of the public works ... developer." (§ 1720(b)(1).)

The answer to this question is no. Developer is in the business of financing and building school facilities, and then selling the completed facilities. Developer already has sold the facility at issue to Borrower. Borrower paid the purchase price from the proceeds of the bonds. The transaction having been completed, Developer is no longer in the picture. Developer does not receive, directly or indirectly, any of the public funds paid by Lessee to Borrower in the form of rent payments. Therefore, this funding arrangement does not involved a payment "on behalf of the public works ... developer" within the meaning of section 1720(b)(1).

²This Department recently applied the same analysis in PW 2008-025, *Construction of Animal Community Center, Humane Society Silicon Valley* (August 5, 2009).

Moreover, the public funds paid to Lessee by the state cannot be deemed payment for construction within the meaning of section 1720(a)(1) because the purpose of such payments is the education of children, not the construction of the school facility. This can be discerned from the language of Education Code section 47601, which declares the Legislature's intent in enacting the Charter Schools Act of 1992 (Stats. 1992, c. 781):

It is the intent of the Legislature, in enacting this part, to provide opportunities for teachers, parents, pupils, and community members to establish and maintain schools that operate independently from the existing school district structure, as a method to accomplish all of the following:

- (a) Improve pupil learning.
- (b) Increase learning opportunities for all pupils, with special emphasis on expanded learning experiences for pupils who are identified as academically low achieving.
- (c) Encourage the use of different and innovative teaching methods.
- (d) Create new professional opportunities for teachers, including the opportunity to be responsible for the learning program at the schoolsite.
- (e) Provide parents and pupils with expanded choices in the types of educational opportunities that are available within the public school system.
- (f) Hold the schools established under this part accountable for meeting measurable pupil outcomes, and provide the schools with a method to change from rule-based to performance-based accountability systems.
- (g) Provide vigorous competition within the public school system to stimulate continual improvements in all public schools.

Conspicuously absent from the above language is any mention of construction of facilities for charter schools. Moreover, Education Code section 47630(a) declares that: "It is the intent of the Legislature that each charter school be provided with *operational* funding that is equal to the total funding that would be available to a similar school district serving a similar pupil population" (Emphasis supplied.) The components of charter school funding include: (i) general purpose apportionment (block grant) funds provided in an amount per unit of average daily attendance in specified grade level spans (Ed. Code, § 47633); and (ii) charter school categorical block grant funding, which is provided in lieu of separate funding for specific categorical programs, and also allocated in an amount per unit of average daily attendance, supplemented with additional funds provided to charter schools that serve economically disadvantaged students and students who are English learners (see Ed. Code, § 47634.1). Both of these components are distributed to charter schools through the state's apportionment process and are available for any lawful use as determined by a charter school's governing board. Thus, the state would be paying the same amount to Lessee irrespective of its rent obligation, and regardless of whether the school was operating out of an established facility or this newly constructed facility.³

³Of necessity, the above is an abbreviated discussion of the highly complicated subject of education funding. Charter schools may obtain funding from additional sources, but this fact does not affect the analysis herein.

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. It held:

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(a) have overturned certain other aspects of *McIntosh*, the above holding remains good law, as noted recently in PW 2008-025, *Construction of Animal Community Center, Humane Society Silicon Valley, supra*. Thus, it must be concluded that the public funds received by Lessee are for the service of educating pupils, and not for construction.

On several occasions, the Legislature has enacted innovative approaches to school construction, and in so doing has made explicit reference to the Labor Code’s prevailing wage requirements. For example, Education Code section 17060(a) et seq. authorizes school districts to enter into joint ventures for the purpose of school facilities construction, specifying that: “This article does not affect any requirement of a school district to comply with the prevailing wage requirements of Article 2 (commencing with Section 1770) of Chapter 2 of Part 7 of Division 2 of the Labor Code with respect to the school facilities portion of a joint venture project under this article.” (Ed. Code, § 17066.) Similarly, Education Code section 17250.10 et seq. authorizes school districts to use the design-build procurement process for constructing and modernizing school facilities, and section 17250.30(d) thereof requires certain procedures for the enforcement of the Labor Code’s prevailing wage requirements. Substantially identical authorization for community college districts is set forth in Education Code section 81700 et seq., and section 81704(d) thereof mandates procedures for the enforcement of the Labor Code’s prevailing wage requirements.

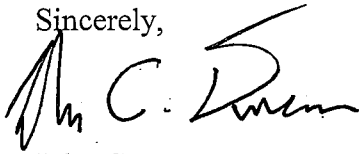
In stark contrast to these explicit references to prevailing wage requirements, in authorizing the establishment of charter schools, the Legislature made no reference to prevailing wages, nor did it amend section 1720.2 to include charter schools within its coverage.⁴ As stated in *McIntosh, supra*, 14 Cal.App.4th at p. 1589: “Courts will liberally construe prevailing wage statutes ... but they cannot interfere where the Legislature has demonstrated the ability to make its intent clear and chosen not to act” Similarly, this Department cannot read into the Labor Code provisions the Legislature could have enacted, but did not.

⁴Conversely, the Legislature did not exempt charter school construction from prevailing wage requirements where such construction is paid for out of public funds within the meaning of section 1720(a)(1). Accordingly, coverage of charter school construction depends upon the facts of the particular project.

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For the foregoing reasons, the Project is not a public work subject to the prevailing wage requirements. I hope this letter satisfactorily responds to your inquiry.

Sincerely,

A handwritten signature in black ink, appearing to read "John C. Duncan". The signature is written in a cursive style with a large, stylized initial "J" and "C".

John C. Duncan
Director