

DEPARTMENT OF INDUSTRIAL RELATIONS
OFFICE OF THE DIRECTOR
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San Francisco, CA 94102
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April 8, 2010

Linda Schiltgen
Deputy County Counsel
Office of the County Counsel
County Administration Center
575 Administration Drive, Room 105A
Santa Rosa, CA 95403

Re: Public Works Case No. 2010-008
Southwest Community Health Center
Construction of Tenant Improvements at 3569 Round Hill Circle
County of Sonoma

Dear Ms. Schiltgen:

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 tenant improvements by Southwest Community Health Center ("Southwest") at 3569 Round Barn Circle in the City of Santa Rosa for use as a community health clinic (the "Project") is not a public work subject to the prevailing wage requirements of the California Labor Code.

Facts

Southwest is a nonprofit California public benefit corporation that operates seven health care facilities in the Santa Rosa area. The Project entails the purchase of an approximately 42,500 square foot building on 2.83 acres at 3569 Round Barn Circle (the "Property"), the construction of tenant improvements, and the equipping of the building for use as a new community health clinic. The clinic will serve the unmet health care needs of the community.

There are three sources of funding for the Project. One source is \$2.1 million in equity raised by Southwest from private donors. This money was raised through a \$2.5 million capital campaign to obtain financing.

The second source of funding is a tax-exempt revenue bond issuance (the "Bonds"). The Bonds are to be issued by the California Municipal Finance Authority ("Authority") in the amount of \$13.27 million pursuant to the Loan Agreement between Southwest and Authority. The proceeds from the sale of the Bonds will be deposited with a private trustee, U.S. Bank National Association ("Trustee"), and disbursed to Southwest pursuant to provisions of the Indenture between Authority and Trustee¹ and the Loan Agreement. The proceeds will be used to purchase the Property and to

¹Under the Indenture, Authority has assigned all of its rights to the Bond proceeds to Trustee.

construct the tenant improvements. Southwest is obligated to repay all principal and interest on the Bonds, with payments being made to Trustee. The Cal-Mortgage Loan Insurance Division of the Office of Statewide Health Planning and Development ("Office") has insured payment of the Bonds under the Contract of Insurance between Southwest, Office and Authority, for which Southwest has paid a one-time premium of \$824,866. The insurance is backed by the full faith and credit of the State of California.

The third source of funding is a grant of \$500,000 to Southwest pursuant to the Grant Agreement with the County of Sonoma ("County"). The grant was authorized by the County Board of Supervisors ("Board") under Government Code section 26227 to assist Southwest with the purchase of the Property. Board has determined that the clinic is necessary to meet the needs of low-income and medically underserved residents of County.

The Grant Agreement provides that the grant funds shall be used solely to purchase the Property for use as a primary care community health center. Southwest agrees that County funds will not be used for construction, improvements, alterations, repairs or preconstruction. In the event Southwest does not use the Property as a primary care community health center or discontinues use of the Property as a primary care community health center during the term of the Grant Agreement, Southwest will be required to return the grant funds to County. The term of the Grant Agreement is February 2, 2010, to December 31, 2019.

Discussion

Labor Code section 1771² generally requires the payment of prevailing wages to workers employed on public works. Section 1720, subdivision (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 ... "[C]onstruction" includes work performed during the design and preconstruction phases of construction" Subdivision (b)(1) includes within the definition of "paid for in whole or in part out of public funds" the payment of money by the state or a political subdivision "directly to or on behalf of the public works contractor, subcontractor, or developer."

The Project entails construction done under contract. The question is whether the construction is "paid for in whole or in part out of public funds."

It is clear that the Bond proceeds will pay for construction of the tenant improvements. Thus, it is necessary to determine whether the bond financing mechanism entails a payment out of public funds. The Department has previously analyzed the issue of bond financing where the proceeds are derived from the sale of "conduit bonds" and debt service on the conduit bonds is repaid from project revenue. That analysis is pertinent here.

²All further section references are to the California Labor Code unless otherwise indicated.

In PW 2004-016, *Rancho Santa Fe Village Senior Affordable Housing Project* (February 25, 2005) ("*Rancho Santa Fe*"), the "conduit bonds" used to finance an affordable housing project were described 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).

The bond financing here is in relevant part identical to the conduit bond financing described in *Rancho Santa Fe* because it does not involve the coffers of a public entity. For the reasons explained in that case, the bond financing does not entail the "the payment of money or the equivalent of money by the state or political subdivision" within the meaning of section 1720, subdivision (b) (1).³

Turning to the County grant, it is undisputed that the grant funds are public funds. Whether payment of the grant funds is for construction, however, requires further analysis, which begins with *McIntosh v. Aubry* (1993) 14 Cal.App.4th 1576.

In *McIntosh*, the County of Riverside ("Riverside") entered into a 30-year sublease with Helicon, Inc., a nonprofit corporation, for 5.65 acres of undeveloped land in which Riverside held a ground lease. Under the sublease, Helicon was required to use the land "for constructing, operating and maintaining a residential shelter care facility for residents of [Riverside] who are emotionally

³This Department has recently applied the same analysis in PW 2008-026, *King/Chavez Preparatory Academy, City of San Diego* (October 1, 2009) and PW 2008-026, *Construction of Animal Community Center, Humane Society Silicon Valley* (August 5, 2009). In the present case, however, there is one caveat. Payment of principal and interest on the Bonds is insured by Office and backed by the full faith and credit of the State. In the event of default by Southwest, the Bonds may be repaid in whole or in part out of public funds, either from a pool of insurance premiums collected by Office and deposited with the State Treasurer or from general funds in the State Treasury. If a default occurs, public works status could attach to the Project, and, depending on the specific facts, prevailing wages might be owed for all or part of the work performed.

disturbed minors.” That *use* was consideration for the first 20 years, during which time Helicon would pay no rent. (*Id.* at p. 1580.) In a memorandum of understanding incorporated into the sublease, Riverside agreed to place minors in the facility using AFDC-FC funds, which the court described as “undisputedly public funds,” to pay for their care and treatment. (*Id.* at p. 1586.) *McIntosh* held that construction of the facility was not a public work under section 1720 as it then read.

The *McIntosh* court found that both in contracting for services and in “offering” the sublease and rent forbearance, Riverside was acting under the authority of Government Code section 26227,⁴ as County is here. It held that the AFDC-FC payments were “payments for later services” and not for construction and, therefore, did not make the construction a public work. (*Id.* at p. 1586.) The court held further that rent forbearance was not payment out of public funds and observed that it might be “more accurate” to view the uncharged rent “as an on-going subsidy of contracted-for *services* rather than initial *construction*.” Thus, the court concluded that “the forbearance of rent here ... does not fit comfortably into the idea of ‘construction’ ‘paid for ... out of public funds.’” (*Id.* at p. 1588 (italics in original).)

Particularly relevant to this case is *McIntosh*’s discussion of Government Code section 26227.⁵ The court noted it is “arguably inconsistent” for counties to encourage private development of projects to provide public services of a type specified in that section and then to “subject such development to the financial disincentive of public works status.” (*Id.* at p. 1587.) The court concluded that the prevailing wage law “in its present form” excludes from “public works” “private construction needed to provide the services for which the public entity has contracted.” (*Ibid.*)

In Senate Bill 975 (stats. 2001, chapter 938), effective January 1, 2002, the Legislature overturned parts of *McIntosh*. For example, section 1720 now provides that rent forbearance and other rent subsidies constitute payment out of public funds for construction. (§ 1720, subd. (b)(4).) The

⁴A recital in the sublease states that the Board of Supervisors of Riverside, pursuant to Government Code section 26227, “deems that the development of a residential shelter care facility ... is necessary to meet the social needs of certain residents of [Riverside] as it relates to health and welfare, and is willing to make certain property available to [Helicon] to carry out such development.”

⁵Government Code section 26227 provides, in pertinent part, the following: “The board of supervisors of any county may appropriate and expend money from the general fund of the county to establish county programs or to fund other programs deemed by the board of supervisors to be necessary to meet the social needs of the population of the county, including but not limited to, the areas of health, law enforcement, public safety, rehabilitation, welfare, education, and legal services, and the needs of physically, mentally and financially handicapped persons and aged persons. The board of supervisors may contract with other public agencies or private agencies or individuals to operate those programs which the board of supervisors determines will serve public purposes. In the furtherance of those programs, the board of supervisors may make available to a public agency, nonprofit corporation, or nonprofit association any real property of the county which is not and, during the time of possession, will not be needed for county purposes, to be used to carry out the programs, upon terms and conditions determined by the board of supervisors to be in the best interests of the county and the general public, and the board of supervisors may finance or assist in the financing of the acquisition or improvement of real property and furnishings to be owned or operated by any public agency, nonprofit corporation, or nonprofit association to carry out the programs, through a lease, installment sale, or other transaction, in either case without complying with any other provisions of this code relating to acquiring, improving, leasing, or granting the use of or otherwise disposing of county property.”

Letter to Linda Schiltgen
Re: Public Works Case No. 2010-008
Page 5

Legislature did not expressly overturn the holding in *McIntosh* that payment of public funds for public services for which a county has contracted under Government Code section 26227 does not make incidental construction by a private provider of those services "public works."

Applying *McIntosh* to the facts of this case, the Grant Agreement is a contract for the provision of public services under Government Code section 26227. The grant funds are being paid to purchase the Property for use as a primary care community health center. Thus, it must be concluded that the County grant to Southwest is payment for public health services and not for construction.

For the foregoing reasons, the Project is not a public work subject to California's prevailing wage laws.

I hope this satisfactorily answers 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".

John C. Duncan
Director