

DEPARTMENT OF INDUSTRIAL RELATIONS

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December 17, 2018

Jon Welner

Member

Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.

44 Montgomery Street, 36th Floor

San Francisco, California 94104

Re: Public Works Case No. 2018-024
Multi-Family Residential Development
Glendale Unified School District

Dear Mr. Welner:

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 Labor Code section 1773.5¹ and California Code of Regulations, title 8, section 16001, subdivision (a). Based on my review of the facts of this case and the project documents and other materials submitted, and an analysis of the applicable law, it is my determination that the above-referenced project, if the project proceeds according to the terms of the proposed agreements among the parties that have been submitted to the Department of Industrial Relations, does not constitute a public work subject to prevailing wage requirements.

Facts

Glendale Unified School District (GUSD) and developer Jackson Street Apartments (LLC) (Developer) propose and intend to enter into an Exchange Agreement and Joint Escrow Instructions (Agreement), the terms of which have not yet been executed, but which are intended to be final, pursuant to which the parties will exchange multiple parcels of land in order to facilitate development of a multi-family residential housing project in the City of Glendale. In preparing the proposed Agreement, Developer and GUSD retained Certified General Real Estate Appraisers Peregrine Realty Partners ("Peregrine"), licensed by the California Department of Consumer Affairs, Bureau of Real Estate Appraisers, to appraise each property. Under the proposed Agreement, Developer will transfer to GUSD title to an approximately 116,505 square foot office building located at 425 East Colorado Street in Glendale, which has been appraised for \$29,000,000. In exchange, the proposed Agreement requires GUSD to transfer to Developer four separate properties, all also located within the City of Glendale: 1) a 21,099 square foot "Office Building A" located at 223 N. Jackson Street; 2) additional property also located at 223 N. Jackson Street containing a surface parking lot and a 32,233 square foot "Office Building B;" 3) a nine-unit

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

apartment building located at 241 N. Jackson Street; and 4) a 12,064 square foot, 16-unit apartment building located at 316 W. Palmer Avenue. Collectively, these four properties have been appraised at a value of \$20,500,000. The Agreement then requires GUSD to make a cash payment to Developer of \$8,300,000 to make up a portion of the \$8,500,000 difference in the valuation of the properties.

In addition to the exchange of properties listed above, the proposed Agreement contains several additional material terms: a leaseback provision, a right of entry provision, and two easements. The leaseback provision provides that, after the exchange, GUSD will continue to lease a portion of the properties at 223 and 241 N. Jackson Street for \$62,500.00 per month for up to sixteen months while GUSD transitions out of the property and into its new offices at 425 E. Colorado Street. The initial 12 months of lease payments (\$750,000.00) are due in a lump sum within five days of when the Developer pulls a building permit for development of the property, which has the effect of allowing the GUSD to avoid the lease payments for the initial year of the lease and instead to make a lump sum payment at the end of the lease. The monthly “base rent” lease payments do not commence until the 13th month of the lease. Consistent with the transition purposes of the lease, the proposed leaseback agreement also provides that over time, GUSD will transfer possession of portions of the leased back property over to Developer, and cede access to and possession of those portions of the property, which will allow Developer to commence work on the property.

The Agreement also grants Developer a Right of Entry to a three-foot corridor of GUSD property at the adjacent property, Allan F. Daily High School, throughout construction on the Jackson Street properties. In exchange, Developer will pay GUSD a “license fee” of \$100 per month. Finally, the Agreement grants Developer two easements: a Tieback System Easement, granting Developer permanent access to the Allan F. Daily High School property to excavate and maintain a tieback system for lateral and subjacent support of 223 North Jackson Street; and a No Build Easement, requiring the Allan F. Daily High School property to maintain a five foot undeveloped strip around its property for the benefit of 223 North Jackson Street. Although the Peregrine appraisals addressed these additional covenants in relation to potential impact on the value of the GUSD Jackson Street properties to be exchanged, there was no information provided as to the value of the easements themselves.

After the land exchange contemplated by the proposed Agreement above, Developer will privately develop a large multi-family residential development at 223 North Jackson Street. Developer will contract and pay for all costs of construction on the project.

Discussion

All workers employed on public works projects must be paid at least the prevailing wage rates applicable to their work. (§ 1771.) Section 1720, subdivision (a)(1) defines “public works” to mean, *inter alia*: “construction, alteration, demolition, installation, or repair work done under contract and paid for in whole or in part out of public funds,” The work to be performed here is clearly construction done under contract. The question thus presented is whether the project will be “paid for in whole or in part out of public funds.” Further, since Developer will pay for all of the costs of construction, the question is whether there is any payment of public funds, within the meaning of the statute, through the transfers of land, funds, leaseback provisions, and easements given pursuant to the Agreement described above.

The statute defines a payment of public funds as including, *inter alia*, a “[t]ransfer by the state or political subdivision of an asset of value for less than fair market price.” (§ 1720, subd. (b)(3).) A transfer of land or an interest in land at fair market value, however, does not constitute public funding requiring public works coverage. (See § 1720, subd. (b)(3); see also *State Building & Construction Trades Council of California v. Duncan* (2008) 162 Cal.App.4th 289, 311.) In the present case, Developer has obtained appraisals of each property that will be part of the exchange contemplated by the Agreement with GUSD. These appraisals are thorough and detailed, do not appear to contain any unwarranted or inaccurate assumptions, and the comparable properties referenced and relied upon appear to be appropriate.

The building at 425 E. Colorado Street is a large (approximately 116,505 sq. ft.) office building in the heart of downtown Glendale, and its \$29,000,000 valuation appears consistent with local real estate pricing. The GUSD properties also appear to have been appropriately valued. The GUSD property at 315 W. Palmer St. is already a multi-unit apartment building with long-term tenants, and its \$4,000,000 valuation appears appropriate given the income from existing leases and comparable apartment building pricing. The GUSD building at 241 N. Jackson is a multi-unit apartment building that is subject to an agreement requiring that seven of nine of its units be let to low-income tenants. Its current income and lease restrictions justify its \$1,000,000 valuation. The appraisal for “Office Building A,” located at 223 N. Jackson, originally constructed in 1939, values the property at \$3,500,000. There is no apparent grounds to question this valuation.

Lastly, the materials submitted include an appraisal for the remaining property owned by GUSD at 223 N. Jackson to be transferred to Developer in the exchange. This 1.95 acre property currently consists of a surface parking lot and “Office Building B.” The appraisal does not address the value of Office Building B, and instead indicates that the appraisers were instructed to assume that Office Building B would be demolished, and to appraise the property as vacant. Accordingly, the appraisal does not include any value or deduction for Office Building B. The appraisal also determined the highest and best use of the property based on the assumption, as instructed, that the property would be vacant. Based on that assumption, the appraisal determined that the highest and best use of the site, as vacant, would be the development of a multifamily apartment project, and that the value of the property was \$12 million.

Although this appraisal did not determine the fair market value of this particular property to be conveyed by GUSD based on its current use and condition (i.e., containing Office Building B), it is possible to infer and to conclude from the materials submitted that the resulting appraisal assigned a *higher* fair market value to the property than would have resulted from an appraisal of the existing Office Building B (i.e., without the assumption of vacant land). The adjacent Office Building A, albeit a smaller building containing approximately 10,000 fewer square feet, appraised at only \$3.5 million, whereas the lot containing Office Building B, when assumed as vacant and approved for multifamily residential development, appraised at \$12 million. For purposes of analysis under Labor Code section 1720, subdivision (b)(3), the issue is whether public property has been transferred at *less* than fair market value, thereby constituting a payment of public funds within the meaning of the statute. Here, the assumption in the appraisal that the property was vacant appears to have facilitated the transfer at a higher fair market value, and as such does not implicate a payment of public funds.

Thus, the \$29,000,000 valuation for Developer’s property and the \$20,500,000 combined valuation for all GUSD properties, as expressed in the Agreement, appears justified. As a result,

the exchange of these properties, along with the \$8,300,000 cash payment to be made by GUSD to Developer, does not constitute a payment of public funds because GUSD will receive property worth \$200,000 more than the assets GUSD will provide to Developer. (See § 1720, subd. (b)(3); see also *State Building & Construction Trades Council of California, supra*, 162 Cal.App.4th at p. 311.)

It is also my determination that the leaseback provisions under the Agreement do not give rise to public funding. A lease for fair market value does not constitute a payment of public funds. (See *Hensel Phelps Construction Co. v. San Diego Unified Port Dist.* (2011) 197 Cal.App.4th 1020, 1040-1041.) Here, although no information was submitted specifically addressing the fair market value of the leaseback provisions, it is possible to deduce that information from the documents provided. The appraisal for Office Building A determines a market rent estimate for the building of \$19.00 per square foot per year. It is reasonable to conclude that the same or a very similar value would be assigned for the adjacent Office Building B. The total square footage of Office Buildings A and B to be leased back by GUSD is approximately 53,332. Thus, market rent for these two properties would be \$1,013,308.00 per year, or \$84,442.00 per month. The leaseback agreement requires lease payments to be made by GUSD to Developer of \$62,500.00 per month. Because the leaseback payments to be made by the public entity appear to be below what would otherwise constitute market rate, this aspect of the parties' agreement does not constitute a payment of public funds on the project by GUSD.

Although the parties' proposed Agreement values the land, easements, and lease appropriately as they relate to the properties that are part of the exchange, it does not consider the burden of the easements on the resulting value of the GUSD property at Allan F. Daily High School. The tieback and no-build easements granted to the Developer are burdens on the Allan F. Daily High School land and are given free of charge. The transfer of an interest in land, including an easement, for free, assuming such interest has some value, is a transfer for less than fair market value and thus constitutes public funding. (§ 1720, subd. (b)(3).) Thus, GUSD has provided some payment of public funds equivalent to the value of those easements.

Nevertheless, under an exception in the statute, a public subsidy to an otherwise private development project that is "de minimis" in the context of the overall project will not result in the project's coverage under the prevailing wage laws. (§ 1720, subd. (c)(3).) The estimated cost of this multifamily residential development project is \$98,000,000. While de minimis is not defined in the statute, past determinations have held public subsidies to be de minimis when the "amount of public funds is proportionately small enough in relation to the overall cost of the Project, such that the availability of the subsidy does not significantly affect the economic viability of this Project." (PW 2011-033, *Blue Diamond Agricultural Processing Facility – City of Turlock* (May 9, 2012).) The subsidy at issue in *Blue Diamond* was 1.75 percent of the overall project cost and was found to be de minimis. To constitute a 1.75 percent subsidy in the present case, the minor easements discussed above would need to have a value of at least \$1,715,000. Under the circumstances, and even in the absence of an actual appraisal or valuation, there is no basis to conclude that these minor encumbrances would have a value in the range of \$1.7 million.²

² A survey of the valuation of tieback easements found that they routinely appraise at up to 1% of the value of the encumbered property. (See Smith, et al., *Over and Under: A Practical Guide to the Condemnation of Aerial Guideway Easements and Tunnel Easements*, (2006) SL049 ALI-ABA 565, 587 n.18.) A no-build or "setback" easement at the edge of the property that minimally effects

Moreover, on its face, the public subsidy here, which amounts to certain use rights on the grounds of a public high school, is simply not significant enough to affect the economic viability of the project. As a result, I conclude that any public subsidy, in this instance, is de minimis within the context of the overall costs of the Project.

Conclusion

For the foregoing reasons, the Multi-Family Residential Development is not public works and therefore not subject to prevailing wage requirements.

I hope this determination satisfactorily answers your inquiry.

Sincerely,



André Schoorl
Acting Director

the use or enjoyment of the land would be worth between 0 and 10% of the value of the parcel. (See Sherwood, *The Valuation of Easements: a reference guide to establishing the impact on the remainder*, Right of Way (November/December 2014) at p. 38.) Assuming, in the absence of an appraisal, that the Allan F. Daily High School lot is also worth \$12 million (since it is similar in size and improvements to the 223 N. Jackson Street lot), the tieback and no-build easements would be worth a maximum of \$1.3 million (1% of 12 million plus 10% of 12 million). Even this maximum valuation for the easements would result in a de minimis subsidy for this project.