STATE OF CALIFORNIA GAVIN NEWSOM, *Governor*

DEPARTMENT OF INDUSTRIAL RELATIONS
Victoria Hassid, Chief Deputy Director
Office of the Director
1515 Clay Street, 17th Floor
Oakland, CA 94612
Tel: (510) 286-7087 Fax: (510) 622-3265

November 25, 2019

Ceci Doty
Executive Vice President
East Hotel, LLC
2750 Womble Road, Suite 200
San Diego, California 92106

Re: Public Works Case No. 2018-027
Former Naval Training Center Development Hotel Project
City of San Diego

Dear Ms. Doty:

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 1773.5[1] and California Code of Regulations, title 8, section 16001, subdivision (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 hotels on lots 3 and 4 of Map Area 8 at the former Naval Training Center in San Diego (Project) is not a public work and is therefore not subject to prevailing wage requirements.

Facts

On June 26, 2000, the Redevelopment Agency (RDA) for the City of San Diego (City) and McMillin-NTC, LLC (Developer) filed a Disposition and Development Agreement (DDA) with the City Clerk for the City of San Diego. The DDA provided for the redevelopment of the former Naval Training Center located near San Diego International Airport. Under the DDA, the RDA would acquire title to the site from the United States Navy and then sell and lease portions of the site to Developer for specific residential, commercial, and entertainment purposes. This DDA entered into in 2000 remains in effect to this day for the property at issue.

Under the June 2000 DDA, an area known as "Map Area 8," was to be leased by the RDA to Developer for the purpose of building one or more hotel and conference centers containing between 500 to 650 guest rooms. In exchange, Developer would pay the RDA the sum of one dollar per year plus 50 percent of the remaining revenue from

[1] Unless otherwise indicated, all further statutory references are to the Labor Code and all subdivision references are to the subdivisions of section 1720.

the site after the Developer deducted costs and took a cut equivalent to 12 percent of gross revenue. The DDA contained, as an exhibit, a form lease with terms to which all leases under the DDA must comply.

On January 1, 2002, Senate Bill 975 took effect, which deemed the charging of rents, and the transfer of an asset, for less than fair market value to be a payment of public funds under Labor Code section 1720, subdivisions (b)(3) and (b)(4). Developer admits that, under the version of the law that took effect January 1, 2002, and which remains in effect, the lease terms above would constitute public funding under the prevailing wage law.

On April 26, 2002, the RDA and Developer executed a ground lease on terms identical to those contained in the DDA's lease template, which conveyed a leasehold in Map Area 8 to Developer for a period of 66 years for a payment of one dollar plus 50 percent of the profits as calculated above. The lease contained a provision permitting the assignment of rights under the lease provided the assignee also complied with Developer's duties under the DDA.

No development proceeded on Map Area 8 for a period of nearly 10 years, during which time Developer and the RSA complied with the terms of the 66-year below-market rate lease from 2002. On December 6, 2011, the City[2] and Developer agreed to operate the lot as an airport parking lot until such time as the hotel development could proceed, and to split the profits of the parking lot equally.

On February 1, 2012, the RDA was dissolved and the City became the successor agency to the RDA, vested with all rights and authority of the former RDA under both the DDA and the ground lease for Map Area 8 when acting as a successor agency. On November 22, 2013, Developer incorporated a wholly-owned affiliate known as East Hotel, LLC for the purpose of developing hotels on Map Area 8. On June 3, 2015, Developer assigned its rights and obligations under the Map Area 8 ground lease and under the DDA, insofar as they relate to Map Area 8, to East Hotel, LLC. On September 2, 2016, the City as Successor Agency finished unwinding the RDA's position in the DDA and transferred its interest as landlord under the Map Area 8 lease to itself pursuant to a property management plan approved by the California Department of Finance.

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[2] Assembly Bill 1X 26 (2011), the RDA dissolution measure, originally set October 1, 2011 as the dissolution date. A number of local agencies challenged A.B. 1X 26's constitutionality, and on August 17, 2011, the California Supreme Court stayed A.B. 1X 26 to prevent RDAs from being dissolved during the pendency of the challenge. (*California Redevelopment Assn. v. Matosantos* (2011) 53 Cal.4th 231, 252.) After upholding A.B. 1X 26, the California Supreme Court reformed the legislation and extended the dissolution date to February 1, 2012. (*Id.* at p. 257.) The parties do not explain why the City was involved in this transaction after the original dissolution date but before California Supreme Court's reformed dissolution date. At any rate, the fact that the City made an agreement concerning the RDA-owned lot before the RDA's formal dissolution does not affect the analysis in any way.

In October 2017, the City and East Hotel, LLC agreed to split Map Area 8 into five separate lots to accommodate the different planned hotel developments, and to allow for separate ownership and financing of each of the projects. On October 19, 2017, the City and East Hotel, LLC executed new lease agreements for the five new lots, which were largely identical to the DDA form lease and the April 26, 2002 Map Area 8 ground lease.

However, the October 19, 2017 ground leases differed in the following ways from the previous leases. First, while the original rent terms remained the same (one dollar per year plus 50 percent of all revenue after East Hotel, LLC deducts costs and payment equivalent to 12 percent of gross revenue), the new lease acknowledged that Developer had already paid the full $66.00 in advance. Second, the parties were now the City and East Hotel, LLC, rather than the RDA and Developer. Third, rather than enter into a new 66-year lease term, the leases acknowledged that the lease term began April 26, 2002 and would proceed the original 66 years, or until December 31, 2068. Fourth, the leases decreased the number of permissible guest rooms for each lot lease so the total guest rooms for all of former Map Area 8 still matched the 650 rooms contemplated by the DDA. Fifth, the lease recorded the transfers of interest from the original parties to show how the current signors received their interest in the lot.

Finally, the October 19, 2017 ground lease also required East Hotel, LLC to pay prevailing wage on any development on the lot, and to indemnify the City from any prevailing wage violations with respect to the property, unless East Hotel, LLC could obtain a determination from the Department of Industrial Relations that any development project was not covered by the prevailing wage law.

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. It is undisputed that the construction of the Project meets the first and second requirements for public works coverage, in that it constitutes "construction" that is "done under contract." Thus, the only issue presented is whether the Project is "paid for in whole or in part out of public funds."

The City has not expressly stated a position as to whether the Project is a public work, but it did submit documentation and staff reports showing that the City is not making any direct payment to the Project and expects no fiscal impact on the City from the development (not even a waiver of development fees). East Hotel, LLC submitted documentation reflecting that the construction on the Project will be directly financed through private bank loans obtained by East Hotel, LLC.

The sole apparent source of potential public funding for the Project is the below-market-rate lease between East Hotel, LLC and the City. Under current section 1720, subdivision (b), which has been in effect since January 1, 2002, a below-market-rate lease is considered public funding. (§ 1720, subds. (b)(3)-(4); see also *Hensel Phelps Construction Co. v. San Diego Unified Port Dist.* (2011) 197 Cal.App.4th 1020, 1039 ["a

public agency may pay for construction out of public funds either by reducing rent *or* by charging rent at less than fair market value," original italics.]) East Hotel, LLC admits that under current law the below-market rate lease would result in coverage for the Project.

However, under the version of the statute effective prior to January 1, 2002, a below-market rate lease on a property was not considered public funding. (*McIntosh v. Aubry* (1993) 14 Cal.App.4th 1576, 1588.) East Hotel, LLC contends that the prior version of the statute applies because the Project has a "benchmark date" of June 26, 2000. Accordingly, under the prior version of the statute as construed by *McIntosh,* East Hotel, LLC argues that the Project is not publicly funded.

As a result, the question of coverage for this Project will be determined by the appropriate "benchmark date." The Department has historically used a "benchmark date" to enforce the settled expectations and contractual rights of the parties at the start of the project. (See *City of Long Beach v. Department of Industrial Relations* (2004) 34 Cal.4th 942, 952-953.) In a traditional design-bid-build public procurement process, the "benchmark date" is typically the date the project is advertised for bid. (See, e.g., PW 2013-027, *Los Angeles Community College District Furniture Contracts, Los Angeles Community College District* (*LACCD*) (Nov. 5, 2014) at p. 7; see also PW 2005-017, *Western Contract Services, Assembly and Disassembly of Free-Standing Modular Furniture* (Dec. 16, 2005) at p. 3.) Using the bid advertisement date allows the public agency and the bidding contractors to commit to pricing based on the law as it exists when the bids are formulated. (See *LACCD*, *supra*, at p. 7.)

However, in nontraditional procurement processes, such as those involving RDAs where the pricing and costs are worked out significantly earlier than the bid advertisement date, it may be necessary to identify an earlier "benchmark date." (See PW 2004-019, *Strand Redevelopment Project, Redevelopment Agency of the City of Huntington Beach* (June 20, 2005) (*Strand*) at p. 7-8.) In cases involving redevelopment agencies, the benchmark date has often been based on the date of a DDA that established the basic terms of future development for a large and long term project. (*Ibid.*) Despite modification or amendment to the DDA over time, if the agreement remains in effect, the original DDA date has been applied as the relevant benchmark date for determining which version of Labor Code section 1720 applied to a given project. (See *id*; see also PW 2004-037, *Bella Terra Entertainment Lifestyle Center, Redevelopment Agency of the City of Huntington Beach* at p. 2 [DDA date is date of which all parties are aware and over which parties have complete control]; PW 2005-002, *Golf Course Site, Northwest Golf Course Community, City of Oxnard* (Aug. 7, 2006) at p. 2 n.3 [benchmark date is the date of the formative agreement]; PW 2005-039, *Kiwi Substation, Orange County Water District* (Apr. 25, 2007) at p. 2 [same]; see also *Greystone Homes, Inc. v. Cake* (2005) 135 Cal.App.4th 1, 7 [court looks to version of the law in effect on the date DDA was executed].)

One recognized exception to the use of the DDA date as the benchmark date in RDA cases is where "the modification to an existing agreement changes the project's character as a 'public work,' such as by introducing or removing the payment of public funds." (*Strand*, *supra*, at p. 8.) In such circumstances, it would "be appropriate to determine coverage according to applicable law at the time of such modification." (*Ibid.*)

Here, although the original DDA was entered into almost 20 years ago in 2000, and although the parties to that agreement have changed in light of the dissolution of redevelopment agencies, the DDA remains in effect for this property and continues to govern the terms of development at the site. Likewise, although the below-market-rate lease has been reiterated several times, none of the permutations of the document altered the basic nature of the public participation in the Project. The public entity (first the RDA and then the City) was always providing the same 66-year lease at one dollar per year plus 50 percent of profits. The October 2017 amendments, even coming nearly 18 years after the execution of the original DDA, did not change the public participation arrangement.

Under these facts, the parties appear to have simply been executing documents to verify their relationships in light of the dissolution of the RDAs and the reorganization of Developer's company. As a result, the "benchmark date" for this project, deriving from the original DDA, will apply, and accordingly, based on the law that was in effect at that time, the below market rate lease is not considered a public subsidy.

Conclusion

For the foregoing reasons, the construction of the hotels on lots 3 and 4 of Map Area 8 at the former Naval Training Center in San Diego is not a public work subject to prevailing wage requirements.

I hope this determination satisfactorily answers your inquiry.

Sincerely,

/s/ Victoria Hassid
Victoria Hassid
Chief Deputy Director[3]

[3] See Gov. Code, §§ 7, 11200.4.