

DEPARTMENT OF INDUSTRIAL RELATIONS
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May 13, 2009

Brian A. Pierek, Esq.
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2310 East Ponderosa Dr., Ste. 25
Camarillo, CA 93010-4747

Re: Public Works Case No. 2009-001
Colony Square
City of Atascadero

Dear Mr. Pierek:

You have requested a public works coverage determination as to whether a loan guaranty provided to a private developer for a development project by your client, the Community Redevelopment Agency of the City of Atascadero ("Agency"), would trigger the application of California's prevailing wage laws. You have offered a rough description of a multi-phased commercial development called Colony Square as an example of the type of development that would benefit from the availability of such a loan guaranty. Coverage determinations are made with regard to "either a specific project or type of work to be performed." Cal. Code Regs., tit. 8, § 16001(a)(1). Because Colony Square is still in the planning stages, your request lacks the information necessary to enable the Department to first identify the scope of the project or projects at issue and all public funding sources, and then determine coverage. Under the circumstances, a coverage determination cannot issue. As to the narrow question of whether Agency's proposed loan guaranty for construction of a theater and retail building in the Colony Square development would be a consideration in the public funds portion of the coverage analysis, based on the facts presented and an analysis of the applicable law, it is my conclusion that such a loan guaranty would not entail a payment in whole or in part out of public funds.

Facts

Agency is planning to assist an unidentified private developer ("Developer") in financing the construction of a theater and retail building on vacant land in downtown Atascadero as part of the Colony Square development.¹ The assistance proposed by Agency would take the form of a loan guaranty. Broadly speaking, a loan guaranty is a tool that facilitates the extension of credit by a private commercial lender. The guarantor promises to use its assets to repay a loan should the borrower default on its obligation. In this way, the guarantor and the lender share the risk that the borrower may not fulfill its promise to repay the loan.

Under the facts here, Agency's loan guaranty would work as follows: Developer requires a loan of about \$9 million to undertake the theater and retail building construction. In the current economic climate, and applying conventional underwriting standards, the private lender, Mission

¹The construction of additional buildings to house a restaurant and commercial retail operations is encompassed in a second phase yet to be planned.

Community Bank ("Bank"), is unable to lend Developer more than \$7.5 million, leaving a funding gap of \$1.5 million or 17 percent of total project costs. To close this gap, Agency intends to pledge as security \$1.5 million of Agency funds, enabling Bank to extend a fully collateralized loan of \$9 million.

Agency is proposing to charge Developer a 2 percent up-front fee for the guaranty as well as an annual servicing fee of 0.494 percent. Agency will maintain the \$1.5 million that is allocated for the loan guaranty in its reserves, segregated from other Agency funds in a separate account. Those funds cannot be expended for any other purpose until the guaranty is released. The guaranty will be released when Developer repays the first \$1.5 million of the loan to Bank. A default by Developer would not result in Agency acquiring any interest in the Colony Square development.

Discussion

Labor Code section 1771² requires that prevailing wages be paid to workers employed on public works projects. Section 1720(a)(1) defines "public works" as "[c]onstruction, alteration, demolition, installation, or repair work done under contract and paid for in whole or in part out of public funds" Section 1720(b) defines "paid for in whole or in part out of public funds" to mean:

- (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.

There is no dispute that the Colony Square development involves construction done under contract within the meaning of section 1720(a)(1). At issue here is whether Agency's loan guaranty constitutes a payment of public funds within the meaning of section 1720(b). In this regard, we are aided by a recent and authoritative treatment of section 1720(b) in *State Building & Construction Trades Council of California v. Duncan, et al.* (2008) 162 Cal.App.4th 289, 294

²All statutory references are to the California Labor Code, unless otherwise indicated.

(“*Trades Council*”). In that decision, the Court held that the provision of tax credits to the developer of a low-income housing development was not a public funds payment. The Court’s decision was based on a close analysis of the legislative history of the current version of section 1720, as well as a review of the decisional law that construed former versions of the statute. Under the Court’s interpretation, a payment of public funds is signified by a delivery or transfer of money or its equivalent. *Id.* at p. 311. The Court stressed that the language of section 1720(b) encompasses an element of tangibility and contemplates a transaction that actually diminishes the state’s economic resources. The allocation of tax credits was characterized as nothing “more than a promise or an administrative assignment, the mere movement of figures from one column to another.” *Id.* at p. 318.

Following *Trades Council*, we turn to the issue of whether Agency’s loan guaranty might be considered a payment out of public funds under subdivisions (b)(1) through (b)(6) of section 1720(b). The Court in *Trades Council* reasoned that a given transaction would be considered a payment of public funds only if it were to come within one of these enumerated categories. *Id.* at p. 319. It follows that section 1720(b) should not be construed to reach the range of financial arrangements outside these definitional provisions. The only two subdivisions potentially implicated under the facts of this case are subdivisions (b)(1) and (b)(4), discussed separately below.

The Court’s analysis in *Trades Council* is instructive in determining whether Agency’s proposed loan guaranty is a “payment” of money or the equivalent of money within the meaning of subdivision (b)(1). Agency’s proposed loan guaranty involves the reservation of funds, which cannot be used for other purposes until the Developer repays the first \$1.5 million of the Bank loan and the guaranty is released.³ Agency’s proposed loan guaranty is akin to the administrative allocation of tax credits at issue in *Trades Council*, which the Court found not to constitute the payment of money or the equivalent of money under subdivision (b)(1). Because the loan guaranty entails the reservation, rather than expenditure, of Agency’s money, the proposed guaranty does not actually diminish the funds in Agency’s coffers.⁴ As such, under the reasoning of *Trades Council*, Agency’s guaranty does not constitute the payment of money or the equivalent of money within the meaning of subdivision (b)(1).

To the extent the proposed guaranty could be characterized as a fee, cost, rent, insurance or bond premium, loan, interest rate, or other obligation that would normally be required in the execution of the contract under subdivision (b)(4), the loan guaranty is not being paid, reduced, waived or forgiven by Agency. As to whether the loan guaranty is being charged at less than fair market value, Developer argues that Agency’s loan guaranty is comparable to loan guaranties offered by other public entities. Under the loan guaranty program administered by the federal Small Business Administration (“SBA”), SBA authorizes guaranties for small businesses and start-ups of up to 85 percent of the value of the loan. The maximum SBA guaranty is \$1.5 million. Normally, SBA charges an up-front fee on a sliding scale from 2 to 3.75 percent of the

³This determination assumes that Developer will repay the loan and Agency will make no payment of public funds. If Agency makes a payment of the guaranteed amount on account of a default on the loan by Developer, public works status could attach and, depending on the specific facts involved, prevailing wages might be owed for all or part of the work performed.

⁴Agency’s administrative costs are covered by the annual servicing fee.

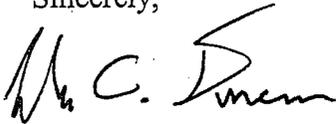
guaranteed portion of the loan and an annual servicing fee of 0.494 percent.⁵ Loan guaranties are also made available to small businesses from the Small Business Loan Guarantee Program ("SBLGP") of the State of California. In the Atascadero area, SBLGP is administered by the California Coastal Rural Development Corporation. SGLGP criteria permit a guaranty of up to 90 percent of the value of the loan, with a maximum of \$500,000 per project. SGLGP collects an up-front fee of 2.25 percent of the guaranteed portion of the loan. SGLCP does not charge an annual servicing fee but does charge a flat \$250 loan documentation fee.

The Department's investigation has discovered no private-sector financial institutions offering loan guaranty programs like those run by the federal SBA or the state SBLGP. Strictly speaking, then, there exists no open and competitive market that might produce a fair market value for this type of financing mechanism. To the extent these public sector loan guaranty programs can be used as a basis to establish fair market value for purposes of applying subdivision (b)(4), however, there are no facts to suggest Agency's proposed loan guaranty is below market. Although Agency's guaranty would cover a far smaller percentage of the value of Bank's loan (17 percent) than the ceiling included in the SBA program (85 percent), the actual dollar amount of Agency's proposed guaranty does not exceed the maximum set by SBA (\$1.5 million). Agency's charge of a 2 percent up-front fee is comparable to SBLGP's charge of 2.25 percent, and is within the range set by SBA. Agency's annual servicing fee will be identical to SBA's annual fee.⁶ By referring to the SBA program and SBLGP for comparison, it appears that Agency's proposed loan guaranty would not be "charged at less than fair market value" within the meaning of subdivision (b)(4).

For the foregoing reasons, I conclude that Agency's proposed loan guaranty for Colony Square would not entail a payment in whole or in part out of public funds and, on that basis alone, would not trigger coverage under California's prevailing wage laws.

I hope this determination satisfactorily answers your inquiry.

Sincerely,



John C. Duncan
Director

⁵ Under the American Recovery and Reinvestment Act of 2009, however, SBA's up-front fees have been temporarily discontinued.

⁶ Agency also presented alternative terms for the proposed loan guaranty. Under the alternative terms, Agency would waive the up-front fee for the loan guaranty, per current SBA practice; and it would waive the annual servicing fee, following SBLGP policy. The waiver of either one or both of these fees would come within the plain language of subdivision (b)(4), which provides that fee waivers are to be considered the payment of public funds, regardless of whether the fees themselves might be reflective of fair market value.