

DEPARTMENT OF INDUSTRIAL RELATIONS

Christine Baker, Director

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To All Interested Parties:

Re: Public Works Case No. 2011-016

*Hotel Construction Project, Turtle Bay Exploration Park,
City of Redding*

By mutual agreement to resolve the petition for writ of mandate in *Turtle Bay Exploration Park v. Christine Baker*, Shasta County Superior Court Case No. 13-0176864, and in consideration of the unique facts of the case, the parties stipulate that the Coverage Determination and the Decision on Administrative Appeal are vacated.

STATE OF CALIFORNIA

DEPARTMENT OF INDUSTRIAL RELATIONS

DECISION ON ADMINISTRATIVE APPEAL

RE: PUBLIC WORKS CASE NO. 2011-016

**HOTEL CONSTRUCTION PROJECT
TURTLE BAY EXPLORATION PARK
CITY OF REDDING**

I. INTRODUCTION

On December 27, 2011, the Director of the Department of Industrial Relations (Department) issued a public works coverage determination (Determination) finding that the construction of a hotel and restaurant at Turtle Bay Exploration Park (the Project) is not a public work subject to prevailing wage requirements.

On January 26, 2012, Plumbers & Pipefitters Union, Local 228, International Brotherhood of Electrical Workers Union, Local 340, and Sheet Metal Workers Union, Local 162 (Unions) timely filed an administrative appeal. Unions, the City of Redding (City), Turtle Bay, and other interested parties have submitted position statements in support of and in opposition to the appeal.

Included in the submittals from Unions and Turtle Bay were expert declarations on the issues of whether the 1992 lease (the Lease) permitted construction of the Project and whether the construction will be paid for in whole or in part out of public funds. Because of differences in the opinions of the experts, the Department retained Gruen Gruen + Associates (Gruen) to review the expert declarations and other relevant materials and to render an opinion on the issue of whether the Project, as presently constituted, will generate sufficient net operating income to earn a risk-adjusted return on equity if required to pay land rent. Gruen issued its opinion-letter on June 19, 2012.

On July 19, 2012, Unions and interested party California State Building and Construction Trades Council requested that the Director conduct an investigative hearing

on the appeal pursuant to title 8, Cal. Code Regs., section 16002.5, subdivision (b). The Director granted the request and set a fact-finding hearing limited to the question of whether the construction of the hotel is paid for in whole or in part out of public funds. The parties submitted questions to Gruen in advance, and the hearing was held and transcribed on September 28, 2012. Thereafter, the parties submitted their final position statements.

All of the submissions, including the transcript of the hearing, have been carefully considered. For the reasons set forth in the Determination, which is incorporated herein by reference, and the additional reasons stated below, the appeal is granted, and the Determination is reversed.

II. DISCUSSION

A. The Determination Correctly Found That The 2010 Amendments Are The Benchmark Event And That Current Prevailing Wage Law Applies To The Project.

On appeal, Turtle Bay argues that the Determination was correct in finding that the Project is not a public work but incorrectly found that the for-profit lodging facility and restaurant were not a permitted use under the Lease. With regard to the latter issue, Turtle Bay argues that construction of these improvements was anticipated in the Redding Riverfront Specific Plan, and because they were not expressly prohibited by the terms of the lease, are a permitted use. The argument is not persuasive given the restrictions on use stated in the Lease and the conduct of the parties when the 2010 Amendments were negotiated.

The Permitted Uses provision in the Lease, Section 3.01, provides that the Premises shall be used “solely for the purpose of constructing and operating a Museum Park and *related* facilities and activities ...” (Italics added.) The Lease defines a Museum Park in Section 2.01 in relevant part to “consist of museums which shall be open to the public and dedicated to serve the public, and may include meeting rooms, food and banquet facilities, gift shops, educational and scientific research activities, and other facilities and activities which are normal and appropriate for museums.” The Lease restricts the right to sublease portions of the premises to “museums” and “for purposes

and uses which are incidental and normal to the use of museums, such as gift shops, and food service facilities.”

Neither City nor Turtle Bay presented evidence that in 1992, a for-profit hotel and full-service restaurant were considered to be facilities or activities that were incidental or normal to the use of museums. Moreover, there is no evidence that at the time the 2010 Amendments were negotiated, the parties considered this to be a permitted use of the premises under the Lease. To the contrary, the evidence shows City believed that the Project was “incompatible” with the terms of the Lease. There is no evidence that Turtle Bay, at that time, believed otherwise.

For example, a Report to the City Council dated April 14, 2010, from Greg Clark, Assistant to the City Manager, advises the Council not only that the hotel project “would be deemed to be incompatible with the terms of the lease,” but also that the Council must approve the amendment “to allow the proposed use,” and that “[a] decision not to amend the lease would effectively halt the project.” A copy of the Report was sent to Michael Warren, President and Chief Executive Officer of Turtle Bay. No evidence was presented to show that at the time either Warren or Turtle Bay disagreed with City’s assessment.

Further, as the Clark Report states, because the hotel project is incompatible with the Lease, City Council could have declined to approve the amendments. In the alternative, the Council could have directed that City require the payment of rent as consideration for approval of the amendments. It did not, and, as shown, the 2010 Amendments permitting construction of the Project and facilitating its financing were approved without requiring that Turtle Bay pay any rent, even though, as shown below, it was anticipated at the time that the Project would generate rent of up to \$250,000 per year.

Accordingly, based on the facts of this case, I affirm the finding in the Determination that the 2010 Amendments are the benchmark event and that Senate Bill 975 (SB 975) applies to the Project.

B. The Project is Subject To The Prevailing Wage Requirements Of The California Labor Code.

California's prevailing wage law generally requires the payment of prevailing wages to workers employed on public works. Labor Code section 1720, subdivision (a)(1)¹ defines "public works" to mean "Construction, alteration, demolition, installation, or repair work done under contract and paid for in whole or in part out of public funds ...". Section 1720, subdivision (b)(4) provides in relevant part that "paid for in whole or in part out of public funds" means "Fees, costs, rents ... 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."

In this case, it is clear that the purpose of the 2010 Amendments to the Lease was to facilitate construction of a hotel and restaurant on the leased premises in order to provide Turtle Bay with a new revenue stream. At the time City negotiated these amendments, it understood that these enterprises would generate not only rent but a profit for the for-profit entity formed by Turtle Bay to sublease the newly-created Hospitality parcel and to build the hotel. For example, in an April 26, 2010, email from Gregg Clark to City's General Manager, Kurt Starman, Clark provides "updated numbers from the pro forma" that show that Turtle Bay would charge annual rent at the outset of \$125,000, which would increase by \$25,000 per year to a maximum of \$250,000. In addition, the email notes that Turtle Bay projected a profit of between \$300,000 and \$500,000 per year. Starman responded in part that any profit from the operation of the hotel should be used to support museum operations, a provision that City ultimately required be included in the 2010 Amendments. However, City did not demand or require as consideration for the right to build the hotel that Turtle Bay pay any rent.²

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

² Unions' expert, Maurice Robinson, testified, without contradiction, that rent of between 4 and 7 percent of total revenues for hotel ground leases are common in California. The HVS Appraisal dated September 23, 2011, at page 115 concluded that "[T]he economic rent for hotels such as the proposed subject property typically range from approximately four to six percent of total revenue, averaging 5.3 percent of total revenue."

Turtle Bay argues on appeal that due to “significant increases in the cost of the Project,” the hotel will not generate enough revenue to pay rent. There is broad agreement among the parties’ experts and Gruen that given the cost to build the Project as currently constituted, it is not economically feasible. However, as Unions argue, it was Turtle Bay’s decision to build a four-star Sheraton hotel instead of a less expensive alternative.

Much of the evidence and argument on appeal, including the expert testimony and Gruen opinion, deals with the question of whether by permitting construction of the Project, City transferred or gave up an asset of monetary value. Unions argue it did; Turtle Bay and City argue it did not. In *Hensel Phelps Const. Co. v. San Diego Unified Port Dist.* (2011) 197 Cal.App.4th 1020 (*Hensel Phelps*), however, the Court of Appeal held that it was not necessary in applying section 1720, subdivision (b)(4), in that case to a rent reduction/waiver, to determine whether the reduction in rent had realizable monetary value to the tenant/developer; the fact that rent had been waived or reduced was sufficient to constitute payment out of public funds for construction. Thus, the expert opinions here, including Gruen, are not pertinent to the underlying issue concerning whether there was a waiver of rent under section 1720, subdivision (b)(4). The holding of the court in *Hensel Phelps* is dispositive of the issues in this case.

In *Hensel Phelps*, the Port District entered into a ground lease that required construction of a four-star quality hotel. Developer and general contractor (Petitioners) argued that because the lease was of undeveloped land, building the hotel did not constitute construction “under contract.” The court rejected the argument finding that the lease required that the hotel be constructed, and, moreover, that the purpose of entering into the lease was to obtain construction of a hotel on the Port property. (*Id.*, at p. 1033). On the issue of whether the hotel was paid for in whole or in part out of public funds, the court held that section 1720, as amended by SB 975, does not require that the payment of public funds be applied to the actual costs of construction. Further, after noting that there is no case law interpreting the phrase “rents ... that are ... reduced, ... waived, or forgiven” in section 1720, subdivision (b)(4), the court held that, “Under a commonsense

meaning, rents are *waived* or *forgiven* when a party agrees not to impose or demand rents.” (*Id.*, at p. 1038; italics in original.)

Finally, the *Hensel Phelps* court rejected Petitioners’ argument based on *State Building & Construction Trades Council of California v. Duncan* (2008) 162 Cal.App.4th 289, that the lease did not provide for a reduction or waiver of rent because the Port District did not give up a tangible economic asset or anything of economic value. The court concluded that such analysis was not required under section 1720, subdivision (b)(4).

We agree that *State Building’s* focus on whether LIHTC’s had a “realizable monetary worth” ... was relevant to resolving the issues in that case of whether the LIHTC’s constituted “[t]he payment of ... the *equivalent of money*” (§ 1720, subd. (b)(3), italics added) or a “[t]ransfer ... of *an asset of value* for less than fair market price” (§ 1720, subd. (b)(3), italics added). Indeed, both of those issues incorporate concepts of value and worth. But we need not conduct such an analysis in this case. The Legislature indicated by enacting section 1720, subdivision (b)(4) that *a reduction, waiver or forgiveness of rent* constitutes a payment of public funds, *regardless* of any further inquiry into whether the rent reduction has a realizable monetary worth. Thus, we need not undertake Petitioners’ proposed inquiry into whether the Port District “[g]ave up any tangible economic asset when it agreed to The ‘rent reduction.’”

(*Id.*, at p. 1040, case cite omitted, italics in original except as noted by the court.)

In this case, the parties entered into the 2010 Amendments for the express purpose of permitting the construction of a for-profit hotel and restaurant on the leased premises and facilitating financing of the construction. At the time, both parties understood that the Project would generate a new income stream for Turtle Bay sufficient to pay rent to City. Applying *Hensel Phelp’s* “commonsense meaning” of section 1720, subdivision (b)(4), City waived or forgave rents when it agreed not to impose or demand rents of Turtle Bay when it negotiated the 2010 Amendments. As the court recognized in *Hensel Phelps*, the waiver, reduction, or forgiveness of rent reduces the developer’s project costs, which, as a practical matter, is one purpose for such public subsidies to construction projects. (*Id.*, at p. 1034.) The construction of the Project is, therefore, paid for in whole

or in part out of public funds and the Project constitutes a public work subject to prevailing wage requirements.³

III. CONCLUSION

For the reasons set forth in the Determination and in this Decision on Administrative Appeal, the appeal is granted and the Determination is reversed. This Decision constitutes the final administrative action in this matter.

Dated: 1/27/2013



Christine Baker, Director

³ The Unions also argue that City's failure to require the payment of other unidentified fees or costs constitutes the payment of public funds. However, this argument must fail in the absence of any evidence of a fee or other cost "that would normally be required in the execution of the contract" that was paid, reduced, charged at less than fair market value or forgiven by City.

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PROOF OF SERVICE

(Code Civ. Proc. §§ 1011, 1013, 1013a, 2015.5)

Case Name: Hotel Construction Project, Turtle Bay Exploration Park, City of Redding

Public Works Case No.: 2011-016

1. At the time of service I was over 18 years of age and not a party to this action.

2. My business address is 1515 Clay Street, Suite 701, Oakland, CA 94612.

3. On **January 29, 2013** I served the **Decision on Administrative Appeal** on the persons listed below by placing true copies thereof in sealed envelopes addressed as shown below for service as designated below:

(A) **By personal service.** I personally delivered the documents to the persons at the addresses listed below. For a party represented by an attorney, delivery was made to the attorney or at the attorney's office by leaving the documents in an envelope or package clearly labeled to identify the attorney being served with a receptionist or an individual in charge of the office.

(B) **By United States mail.** I enclosed the documents in a sealed envelope or package addressed to the persons at the address below and:

(1) deposited the sealed envelope with the United States Postal Service, with the postage fully prepaid.

(a) and the sealed envelope was prepared for Certified Mail, Return Receipt Requested, with appropriate fees for such service fully prepaid.

(b) and the sealed envelope was prepared for Registered Mail, with appropriate fees for such service fully prepaid.

(2) placed the envelope for collection and mailing, following our ordinary business practices. I am readily familiar with this business's practice for collecting and processing correspondence for mailing. On the same day that correspondence is placed for collection and mailing, it is deposited in the ordinary course of business with the United States Postal Service, in a sealed envelope with postage fully prepaid.

(a) and the sealed envelope was prepared for Certified Mail, Return Receipt Requested, with appropriate fees for such service fully prepaid.

(b) and the sealed envelope was prepared for Registered Mail, with appropriate fees for such service fully prepaid.

I am a resident or employed in the county where the mailing occurred. The envelope or package was placed in the mail at Oakland, California.

(C) **By overnight delivery:**

(1) I enclosed the documents in an envelope or package provided by an overnight delivery carrier and addressed to the persons at the addresses below. I placed the envelope or package for collection and overnight delivery at an office or a regularly utilized drop box of the overnight delivery carrier.

(2) The documents were delivered to an authorized courier or driver authorized to receive documents by an overnight delivery carrier, in an envelope or package designated by the carrier with delivery fees

1 paid or provided for, addressed to the person to whom it is to be served, at the office address as last
2 given by that person on the document filed in the cause and served on the party making service.

3 (D) **By fax transmission.** Based on an agreement of the parties to accept service by fax transmission, I
4 faxed the documents to the persons at the fax numbers listed below. No error was reported by the fax machine
5 that I used. A copy of the record of the fax transmission, which I printed out, is attached.

6 (E) **By e-mail or electronic transmission.** Based on a court order or an agreement of the parties to
7 accept service by e-mail or electronic transmission, I caused the documents to be sent to the persons at the e-mail
8 addresses listed below. I did not receive, within a reasonable time after transmission, any electronic message or
9 other indication that the transmission was unsuccessful.

10 (F) **By messenger service.** I served the documents by placing them in an envelope or package addressed
11 to the persons at the addresses listed below and providing them to a professional messenger service. (A
12 declaration by the messenger service is attached.)

<u>TYPE OF SERVICE</u>	<u>ADDRESS/FAX NO. (IF APPLICABLE)</u>
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I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Date: **January 29, 2013**


Janette Balais, Declarant