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Making the Rooftop Do the Work

By Michael Hindus

Owners of big box stores, shopping malls and other buildings with large roof expanses have found a new way to generate income, improve their "green" image and save money on power bills. But even though these "solar development" deals can benefit both society and the bottom line, putting them together is complicated by tax laws, property rights, tenant relationships and financing constraints.

Deal Structure

Lightweight, flat photovoltaic panels convert sunlight directly into electric energy, but given the complexities of installing and maintaining the panels, owners often avoid purchasing them outright. Instead, they frequently contract with a solar developer. The solar developer may then agree to pay the roof owner both an option fee (*i.e.*, a fee for the exclusive right to evaluate a property, even though the solar developer may ultimately choose not to install solar at that location) and a license fee or rent for the use of the roof.

In exchange for assuming startup costs, the solar developer receives a commitment from the owner (and, sometimes, tenants) to purchase the electric energy produced by the photovoltaic panels. (Some roof owners, of course, may evaluate applicable federal and state tax incentives and decide to install the panels themselves, using one of the myriad solar contractors that have sprung up.)

These arrangements raise several issues, including the extent to which the owner grants access and/or property rights to the solar developer. These rights can be in the form of an easement, lease or license. An easement or lease provides the solar developer with a property right, but leaves the landlord in the tricky situation of trying to describe the location of the easement or leased premises.

A license, generally exclusive, is more common, and grants the solar developer the right to use the roof for installation of solar panels as well as the right to access the roof to maintain and repair the panels, while reserving to the owner all property rights to the roof and the right to use the roof for purposes that do not obstruct the solar use. This is particularly important where, over the life of the long-term license, the owner may make modifications to the roof for installation of satellite dishes, additional air conditioning and other uses.

With an easement, lease or license, the parties must clearly define the solar developer's maintenance obligations, when it may access the roof and the appropriate access points, as well as the owner's right to access the roof to maintain other rooftop facilities. In all cases, the agreement must provide for the ability for both roof owner and solar developer to carry out these functions in a manner that does not unduly interfere with the rights of the other party.

The photovoltaic panels must also be easily dismantled. The roof owner wants the roof to be in the same condition at the end of the license as it was at the beginning. Mandatory roof inspections at the beginning of the installation and at the end of the removal, preferably by an independent contractor, can be written into the contract as a way of assuring the roof owner that at the end of the contract there will be no damage to the roof attributable to the solar panels.

Payment Structure

A large-scale rooftop solar transaction will involve the sale of power to a single store, to a shopping center or to a tenant, usually at a slight discount from, or capped at, the utility rate. This power sale is facilitated in 38 states by the ability of solar power producers to "run against the meter." Literally, the power causes the utility meter to run backward.

While most other forms of self-generation are separately metered, running against the meter is a widely accepted

incentive for solar power. This provides several benefits to the customer. First, it is exceedingly simple and either eliminates the need for or reduces considerably the complexity of any interconnection agreement with the serving utility. Second, this arrangement does not degradate the reliability of the electric service, since the utility is still providing service to the customer. Third, this arrangement has economic benefit in those states where customers pay time-of-use rates, since solar power is generated at the time of the highest prices for power. The payment structure may need to be modified in the case of real estate investment trusts to meet the IRS requirements for that type of enterprise.

In order to obtain the revenue certainty the solar developer needs to finance its projects, the solar developer typically insists on a take-or-pay provision in the power purchase agreement—sometimes even requiring the roof owner to refrain from taking other energy-efficiency measures (including conservation and other forms of self-generation).

It is important for the roof owner to understand the relationship between a building's total power needs and the power that can be provided through the solar panels during daylight hours so that in the event the power purchase agreement includes such a take-or-pay provision, the roof owner does not pay for power it cannot use. Because solar production is related to the amount of square feet available for solar panels, the solar production may never exceed the building's consumption. Where tenants receive their power from an entity other than the landlord, the roof owner should measure solar production against consumption for common use.

The cache of having a green building with its own solar power facilities has significant appeal.

If the roof owner provides power to tenants, solar production can offset that consumption. Alternatively, the owner may agree to facilitate an introduction by the solar developer to tenants for the purpose of selling power to the tenants directly. In that case, the parties need to consider what happens in the event of a tenant default or vacancy in determining whether the owner becomes the backstop purchaser.

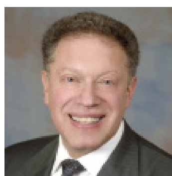
Final Considerations

Other considerations for the roof owner include obtaining guarantees for the costs of removal of the equipment at the end of the term. In addition, the technology for solar panels is changing rapidly. A roof owner signing a long-term contract (which the solar developer will require in order to get financing) may be concerned that the solar panels installed might become antiquated, out-of-date or less efficient. The roof owner should require the developer to commit to replacing outdated equipment, although this may be difficult to negotiate because the equipment itself may be subject to a sale and leaseback, reducing the developer's incentive to improve existing installations.

Finally, the interests of the roof owner are likely to conflict with the interests of the solar developer with respect to the deal structure. If the solar developer uses special purpose entities for each property, the roof owner should make sure there is an entity standing behind the solar panels with expertise for repair and maintenance and access to equipment. The roof owner may well want security, such as a letter of credit to cover the anticipated cost of maintenance and removal, which the solar developer may be reluctant to accept as a cost of doing business.

Although these are complicated issues that need to be worked through in any negotiation, the upside for the building owner is considerable. Not only is there the possibility of increased income through roof rent and lower costs through the purchase of electricity at a discount, but the cache of having a green building with its own solar power facilities has significant appeal as well, especially to big box stores seeking to either maintain or improve their green image.

Solar developer companies are increasingly sophisticated and well-capitalized, and solar panels are increasingly lightweight and more efficient. For buildings with flat roofs in the appropriate climates, photovoltaic solar, structured appropriately, may well become the standard.



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Green Hospitality

By Soha Mody and Kate Myers

The hotel industry continues to evolve based on consumer tastes. In the 1980s, the luxury hotel reinvented the definition of decadence. By the 1990s, the demand for a more personal, intimate hotel experience was satiated by the boutique hotel. More recently, consumer preferences have inspired the green hotel.

The greening of the hospitality industry, however, is more than a fleeting trend or a socially conscious endeavor. Rather, it presents novel, and sometimes challenging, issues for those individuals or companies that acquire, design and operate a hotel. Green hotel principles apply to both new construction as well as the retrofitting of existing buildings.

The Green Movement

In the past decade, the hospitality industry has developed new and more sustainable practices and is proving that "green" and "luxury" can go hand-in-hand. The green movement is propelled by the distinct recognition that green hospitality is a profitable enterprise. With U.S. hotels collectively spending nearly $4 billion a year on energy, according to the U.S. Environmental Protection Agency (EPA), hotels now are choosing to use renewable materials, earth-friendly supplies, energy-efficient technologies and management practices that reduce both environmental impact and operational costs.

Several hotel companies are trailblazers in this regard. In the early 1990s, Fairmont developed a Green Partnership Guide to help implement environmental goals; today, the Washington, D.C., Fairmont is committed to purchasing 10% of its annual electric load from wind-generated power. Starwood, in collaboration with Perseus Realty, has just launched 1 Hotels, which the company touts as a "five-star, eco-friendly international hotel brand." The debut of the new brand will occur in Washington, D.C., with one of the region's first eco-friendly luxury hotels, a property certified by the U.S. Green Building Council (USGBC) as part of its Leadership in Energy and Environmental Design (LEED) program, which will donate 1% of its profits to a local environmental organization. Other green pioneers include Accor, Kimpton Hotels and Saunders Hotel Group.

The green movement is also relevant to the rehabilitation of existing hotels. According to the National Trust for Historic Preservation, "[t]he conservation and improvement of our existing built resources, including re-use of historic and older buildings, greening the existing building stock, and reinvestment in older and historic communities, is crucial to combating climate change." As many preservationists point out, the greenest property is the one that's already built. Kimpton is a good example of a hotel group committed to green principles in its

The green movement is propelled by the distinct recognition that green hospitality is a profitable enterprise.

rehabilitation of historic properties. The company turned the former General Post Office Building in Washington, D.C., a National Historic Landmark that had fallen vacant for 10 years, into the luxury Monaco Hotel. More generally, Kimpton's Earthcare environmental program aims to use non-intrusive, high-quality, eco-friendly products and services at all of the group's hotels.

How Green Is Your Hotel?

Despite the rapid movement toward green hospitality, there is no universal measurement or guideline to determine the "green-ness" of a hotel. The most recognized hotel certification programs in the United States are Energy Star and LEED.

Energy Star: Energy Star is a joint program between the EPA and the U.S. Department of Energy with the goal of facilitating more energy-efficient products and practices, most notably through providing resources to hoteliers seeking improved energy and financial performance. According to the Energy Star program, America's 47,000 hotels spend $2,196 per available room each year on energy. Energy Star-labeled buildings use an average of almost 40% less energy and emit 35% less carbon than comparable buildings. For example, Energy Star has recognized Marriott International Inc. ("Marriott") twice, most recently in 2007, for its sustained excellence, including nearly $7.8 million in savings on energy bills and a reduction in greenhouse gas emissions by more than 3% per available room since 2004.

LEED: Green building standards such as LEED have been implemented in many building industries and

include programs for sustainable site development, water savings, energy efficiency, materials selection and indoor environmental quality. In the past, LEED's Existing Buildings Rating was criticized for being less applicable in the hotel context, but the USGBC recently revised the LEED for Existing Building Rating System to make it more inclusive.

Although travel industry experts differ on which system most accurately and consistently measures the "greenness" of a hotel, each is gaining membership and usage, and more standards are being developed.

Advantages

Green hospitality reflects the hotel industry's commitment to the environment and the well-being of its customers, staff and communities. Studies have shown that green buildings have lower operating costs and can contribute to higher employee productivity and healthier guests. Further, green hotels have a powerful marketing tool, particularly in areas of eco-tourism, a word that may have once inspired visions of vacations into tropical jungles, but which now references an appeal to the environmentally and socially conscious traveler.

Cost Savings

Building green is not as expensive or complicated as developers once feared. According to the USGBC, the most significant green features add only 2-4% to a project's initial design and construction costs, but may substantially reduce construction times and noise interference between hotel rooms. According to Hospitality Sales and Marketing Association International's summer 2007 marketing review, "improved construction, technology,

and management can reduce electricity consumption by 20% in existing buildings and up to 50% in new ones."

Hotels can use a variety of methods to promote energy and water conservation, translating into reduced operational costs. Traditional approaches include waste management and recycling programs, installation of low-flow water appliances and amenities within the guest rooms, reduction of laundry and towel changes, and use of renewable resources (such as bamboo or cast-in-place concrete materials) in the hotel construction. Non-traditional methods include composting, using recycled water on landscaping and implementing an employee carpooling program. Many hotels increasingly use earth-friendly cleaning products; organic, natural fabrics for sheets and towels; and local, organic produce in their restaurants. One hotel chain even recycles its sheets and table linens into chef's aprons and table napkins. Creativity, cooperation and adaptation are the common hallmarks of the most successful programs.

A Natural Marketplace Advantage

Ernst & Young's *Hospitality Top 10 Thoughts for 2008* echoed the recent flurry of activity of hotels trying to "out-green" each other: "strong economics have resulted in a number of major hotel companies either developing green hotels or retrofitting existing properties, to become part of the green movement." The same publication cited a recent TripAdvisor survey suggesting that travelers may be willing to pay more to stay in an environmentally friendly hotel. Marriott, already a market leader, has used its innovative and environmentally friendly designs to build a platform for green initiatives, such as the Amazonas Sustainable Foundation, an innovative public-private partnership that seeks to reduce the impact of greenhouse gas emissions from deforestation through financial contributions.

Conclusion

In a world increasingly full of hybrid vehicles, fuel consciousness and dedicated recycling, the greening of the hospitality industry, one of the largest consumers of certain natural resources, is more than a passing trend. The movement toward eco-conscious hotel operations is one that hoteliers cannot afford to miss. By developing a comprehensive green strategy early in the acquisition or construction process, hoteliers will both help establish a green legacy and benefit their bottom line.

Pillsbury continues to be a pioneer in the sustainability and hospitality industries, founding dedicated client and industry teams for climate change and sustainability issues. For more information, please see our website at www.pillsburylaw.com/climatechange.

Considerations in Greening a Hotel

In committing to develop or operate a green hotel, hoteliers should decide to "go green" early in the planning stages, allowing them to develop an integrated green strategy, as opposed to merely having *ad hoc* green policies. Key considerations include:

- Determine the scope of the hotel's green commitment. Will it have renewable energy sources? Recycle unused food, or donate old towels to charity? Support community conservation efforts? Educate guests about being green?
- Assemble the "green team" early, preferably one with green experience. Many architects are already LEED-certified professionals.
- Consider whether federal, state or local tax or other incentives are available. Most major cities now have green development initiatives that can shorten the permitting process, and provide tax incentives or other development perks.
- In choosing a site, consider if it is accessible by public transportation.
- Strategically implement cost and space savings programs. These include installation of energy-efficient appliances, fixtures and amenities.

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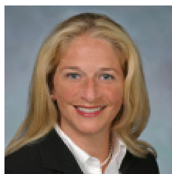

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China's Real Estate Industry:

The Effect of Recent Regulatory Developments on Foreign Investment

By Joseph Chan and William Ling

Property prices in China continue to soar. According to the latest figures of China's National Bureau of Statistics, property prices in 70 large and medium cities of China rose 10.9% in February 2008 year-on-year, with an 11.8% increase for new residential properties and a 10.3% increase for office buildings. This tremendous growth took place in spite of the Chinese government's macro-control measures to cool down the overheated real estate market. In 2008, we expect many foreign investors will continue to favor China's real estate market, for a number of reasons: China's phenomenally high economic growth likely will continue; appreciation of the Renminbi (RMB) is expected to persist; and the Beijing Olympic Games should boost the hotel and tourism industry.

However, as China seeks to limit the formation of a bubble in the overheated real estate market and ensure healthy, moderate development, the regulatory environment for foreign investment in the real estate sector has undergone significant changes in the last two years. This article aims to examine these regulatory changes and provide foreign investors with an overview of the current regulatory regime governing the Chinese real estate market.

Circular 171

Circular 171 was promulgated jointly by six government agencies on July 11, 2006; it was the bellwether of a series of recent real estate regulations on foreign investment issued since 2006. The most significant impact of Circular 171 is the introduction of the principle of "commercial presence," which requires foreign investors to establish a foreign-invested real estate enterprise (FIREE) in China before making any real estate investment. Heretofore, foreign investors commonly purchased real estate in China via an offshore investment vehicle. After the promulgation of Circular 171, foreign investors can no longer purchase and hold properties via an offshore structure; instead, a locally registered entity must be employed.

Circular 171 also prohibits foreign individuals from purchasing residential properties for self-use, unless such foreign individuals have been working or studying in China for more than one year. Residents of Hong Kong, Macau or Taiwan and overseas Chinese, however, are exempt from this rule.

Furthermore, Circular 171 makes it more challenging for foreign investors to finance real estate projects in China. The regulations impose a number of financing restrictions. A FIREE with a total investment amount (*i.e.*, the aggregate of debt and equity) of not less than US$10 million must have registered capital (*i.e.*, equity) of at least 50% of the total investment amount. Moreover, a FIREE is prohibited from obtaining loans, foreign or domestic, if (i) its registered capital has not been fully paid up; (ii) it has not obtained a "land use certificate" for the land; or (iii) the paid-in capital of the development project is less than 35% of the total investment amount of the project.

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Circular 50

In order to resolve certain issues relating to the implementation of Circular 171 and strengthen the administrative and operational procedures for the approval and supervision of foreign investment in real estate, the Ministry of Commerce (MOFCOM) and State Administration of Foreign Exchange (SAFE) jointly issued Circular 50 on May 23, 2007.

Since the issuance of Circular 50, foreign investors have been subject to more stringent approval requirements. Circular 50 requires prompt filing with central MOFCOM

of all locally approved FIREEs. In practice, such filing requirement effectively serves as an additional, and final, tier of the approval process for foreign real estate investments. Failure to comply with this filing requirement will render a FIREE unable to handle foreign exchange matters for its investments, including conversion of foreign currency funds to RMB for inbound capital contribution and conversion of RMB funds to foreign currency for outbound repatriation. Also, FIREEs that are improperly approved by local authorities may be investigated and "rectified" by MOFCOM.

The above requirement effectively prolongs the approval process of foreign-invested real estate projects. That translates into additional time, cost and uncertainty in obtaining regulatory approval.

Circular 130

On July 10, 2007, SAFE issued Circular 130, which, technically speaking, is an internal departmental guideline but, in practice, has the same legal impact as a regulation, as it has been implemented by the various branch offices of SAFE.

Besides the release of the list of the first batch of foreign-invested real estate projects that have been filed with MOFCOM, SAFE has ordered its local branches not to register or settle foreign exchange loans for locally approved FIREEs that have not submitted filings to MOFCOM before June 1, 2007. As a result, offshore investment funds behind these FIREEs may only enter China in the form of equity, as opposed to foreign debt.

Although FIREEs may in theory borrow from domestic financial institutions, there are stringent requirements for such borrowings, including, as a prerequisite, receipt of the so-called "four certificates" in connection with real estate development projects in China—*i.e.*, a Land Use Right Certificate, Construction Land Planning Permit, Construction Project Planning Permit and Construction Permit. As China currently has been tightening its credit policy, including raising the deposit reserve ratio requirement for domestic lenders to a record high, borrowing from domestic lenders, if feasible at all, may be time consuming and cost ineffective.

The implementation of Circular 130 poses difficulties in financing for FIREEs, although the practical impact on small- and medium-sized foreign developers may be more significant as compared to large-scale developers and institutional investors.

2007 Catalogue

The newly revised 2007 Catalogue was jointly issued on October 31, 2007, by the National Development and Reform Commission (NDRC) and MOFCOM. This is the fourth revision since the Catalogue's first promulgation in 1995. Under the 2007 Catalogue, China reclassified its economy under the four foreign investment categories —encouraged, permitted, restricted and prohibited—in line with its national economic development policies. We note below the following changes in the 2007 Catalogue that are germane to the real estate industry:

- Trading on the secondary market and operation of property agency/brokerage firms, previously permitted, are now restricted;
- Golf course developments, previously restricted, are now prohibited;
- Ordinary residential developments are no longer encouraged; and
- Development and operation of high-end hotels, villas, high-end office buildings and international convention centers remain restricted.

Conclusion

China's real estate sector is a fast-growing and attractive market. Many investors expect to see continued strong growth in this area in 2008, amidst the recent downturn of the U.S. economy and global stock markets.

However, China's real estate market is relatively immature as compared to the U.S. and other developed markets. Foreign investors should be mindful of the constantly changing regulatory regime and the practices of the local authorities. We expect that China will continue to closely monitor and regulate real estate investment and development in accordance with its national policy priorities.

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Reliance on Certificates of Insurance:

A Trap for the Unwary

By Scott Barat and James Bobotek

When negotiating and entering into a commercial contract (whether a construction contract, a professional services agreement or a lease), most building owners know they need to require each contractor, consultant and tenant (for purposes of this article, we will refer to each as a "contractor") to obtain and maintain proper insurance. Few of them, however, focus on how to be sure insurance requirements have been satisfied—either upon execution of the contract or throughout its term.

Owners not only require certain types of insurance and limits of coverage, but also often mandate that they (and, if applicable, their lenders) be named as additional insureds under the contractor's liability insurance policies (other than any professional errors and omissions liability policy), and that certain policies include a waiver of subrogation (that is, a waiver of claims that are covered by insurance) in the owner's favor.

None of these requirements provides any benefit to the owner, however, if the proper coverage never existed or is permitted to lapse. Too many owners rely only on certificates of insurance provided by contractors to evidence that, in fact, the contractors have obtained all insurance and that the insurance possesses all the required characteristics. For several reasons, however, relying on these certificates is extremely risky.

The insurance certificate may be incorrect or reflect insurance that does not exist. Most certificates of insurance are prepared using the industry-standard ACORD Form 25, a preprinted form that includes placeholders to fill in the name of the entity purchasing the listed policies (the "named insured"), the name of each insurer, the types and amounts of coverage, and the effective dates of the policies. It is fairly common for a contractor simply to ask its insurance agent over the telephone for a certificate of insurance naming the owner as an additional insured under the relevant liability policies, while providing the agent with little information other than the owner's name and address. Many of the contractual insurance requirements for which the owner has bargained, therefore, will not be reflected in that insurance certificate.

The agent then sends the certificate to the contractor, who forwards it without review to the owner. All too often, the owner's busy employee tasked with completing a checklist of the contract's requirements will receive the contractor's certificate of insurance and file it after performing only a cursory review of the certificate. The result frequently is insurance coverage that does not meet the owner's contractually mandated requirements.

Just as serious, we know of occasions when the agent has filled out and signed an insurance certificate stating that all required insurance terms exist, without confirming or arranging for endorsements satisfying such requirements. Under this scenario, when the unwary owner tenders a claim to the insurance company, the insurer will raise the defense, many times successfully, that no coverage exists for the owner as an additional insured because the agent exceeded its authority to issue the certificate and/or never requested that the insurer actually amend the coverage to conform to contractually mandated requirements.

> *Too many owners rely only on certificates of insurance provided by contractors to evidence that, in fact, the contractors have obtained all insurance.*

The certificate of insurance may also be misleading. For example, the certificate may indicate the owner indeed is an additional insured under the contractor's policy, but the certificate does not inform the owner of the specifics of the additional insured status.

Additional insured endorsements vary greatly in the breadth of coverage provided. Some do not include coverage for damage occurring after work is completed, while others limit coverage only to claims made based on the additional insured's fault (leaving no protection for the owner who is wrongfully sued based on the acts of the contractor). Because of the variances in cover-

ages provided by additional insured endorsements, the prudent owner not only requires provision of copies of policies and/or endorsements along with a certificate of insurance, but also includes in its contract or lease the specific endorsement(s) under which the additional insured coverage is to be provided.

Accepting an incorrect certificate of insurance may waive a contract's insurance requirements. Some courts have held that an owner's receipt and acceptance of a certificate of insurance bearing incorrect information or information that does not satisfy the requisite contractual requirements, without demanding that the contractor provide a corrected certificate, operates as a waiver of the requirements set forth in the contract. This is even more reason to review carefully all insurance information that the contractor provides.

The certificate of insurance is not legally binding. Many cases have been brought where the actual insurance policies do not provide the coverage required to be maintained, even though the certificate of insurance states that conforming insurance has been obtained. Courts have repeatedly found the disclaimers placed in the ACORD form to be a clear indication that one should not rely on the certificate alone, particularly with respect to additional insured status, waivers of subrogation, and applicable policy exclusions and limitations. For instance, the upper right hand corner of the ACORD form states:

This certificate is issued as a matter of information only and confers no rights upon the certificate holder. This certificate does not amend, extend or alter the coverage afforded by the policies below.

Additional language appears on the ACORD form expressly stating that, notwithstanding any other document, the insurance provided is subject to all terms, conditions and exclusions set forth in the relevant policy. Many courts also rely on language placed on the second page of the ACORD form stating that (i) the certificate of insurance is not a contract, (ii) the actual policies must be endorsed to provide additional insured coverage and waivers of subrogation, and (iii) the certificate of insurance confers no rights absent such endorsements.

Thus, courts have stated that the ACORD form is so replete with express disclaimers that it is simply not reasonable to rely on one, even if properly completed, as evidence of anything other than the mere fact that the contractor has obtained the policies listed on the certificate.

To add insult to injury, a commercial general liability policy provides coverage for the insured's contractual indemnification obligations, but not for the insured's breach of a promise to obtain additional insured coverage. Thus, the owner who does not properly confirm that additional insured coverage has in fact been obtained on its behalf will not only be deprived of such coverage, but will also find that the contractor does not have insurance coverage for damages caused by its failure to obtain the contractually required coverages. The contractor who fails to make the owner an additional insured may have few or no assets, leaving the owner with little recourse if a loss occurs, but the bargained-for insurance does not exist.

In light of all of the risks inherent in relying solely on contractor-provided insurance certificates, we recommend that owners require not only an insurance certificate, but also delivery of a copy of the applicable insurance policies or, at a minimum, a copy of the endorsements to those policies evidencing the proper insurance coverage, additional insured status and waiver of subrogation.

Requiring the contractor to provide copies of insurance policies and/or applicable endorsements along with certificates of insurance prior to performing work or occupying premises, and then performing a diligent review of the information provided, will greatly diminish, if not remove, the anguish, costs and lost time suffered when the owner discovers, after a claim is made, that the putative coverage identified on the certificate of insurance is not what the actual policies provide and not what was required under the owner's contract with the contractor.

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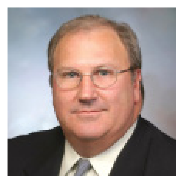

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The Wages of Subsidy

Prevailing Wages as the Cost of Public Assistance to Development Projects in California

By Jon Goetz

California developers who obtain public funding for their projects may be in for a rude surprise—that assistance may trigger prevailing wages, labor requirements that often make the project much more expensive, perhaps costing even more than the value of the public assistance itself.

Until recent years, "prevailing wages" were required only in connection with government construction projects in California, such as a city storm drain project. Prevailing wages, adopted by regulation of the California Department of Industrial Relations (DIR) for a wide variety of construction trades, are pay rates roughly equivalent to union-scale wages and benefits. Starting in 2002, however, prevailing wage requirements became applicable to many otherwise private construction projects receiving government financial assistance. Prevailing wages can be significantly higher than non-union wage rates for certain types of construction, and a prevailing wage requirement can make otherwise feasible projects financially impossible to build.

When an otherwise private development project is "paid for in whole or in part out of public funds," prevailing wages are required for the project. Senate Bill 975, adopted with the strong support of trade union groups, changed the law to broadly define "paid for in whole or in part out of public funds" to include public agency payments to or on behalf of a contractor or developer, public agency construction of a project, transfer of property for less than its "fair market price," reduced or waived fees, below-market loans, and forgiveness of or credits against outstanding loans. The sweeping new definitions incorporate most types of public assistance that might be provided to a development project. For the most part, public assistance to a project now triggers a prevailing wage requirement unless one of the statutory exemptions to prevailing wages applies.

One of the most important exceptions for commercial projects is for public agency subsidies for public works "required as a condition of regulatory approval." Prevailing wages must be paid on the public works portion of the project, but not on the private portion of the project.

A common form of public assistance to a large project is the issuance of tax-exempt bonds through a Mello-Roos or Community Facilities District (CFD), which finances the costs of required public works. The DIR has found that the use of CFD bond funds constitutes the use of public funds for the project, triggering the prevailing wage requirement for the public works, but not for the private portion of the project. Finding the public works exception applicable, the DIR will then examine the project to determine whether the public works and other portions of the project constitute a "single, integrated and interdependent project." If prevailing wages are required for the public works portion of the project, and the public works are found to be integrated with the remainder of the project, the DIR will find that prevailing wages are required for the entire project.

One such project involved a vertically integrated development, in which a hotel, restaurants and retail buildings were constructed above a public parking structure. In that instance, the DIR found that the physical connection of the commercial improvements to the public parking structure was so complete that prevailing wages were payable on the entire project. In other projects with more horizontal spacing between the public works and the private improvements, the DIR has found the prevailing wages requirement only applicable to the public works and not the private development. These projects include a 2,100-home residential development using CFD financing for required infrastructure, where individual parcels were sold to merchant builders for the construction of homes, and a 207-acre business park within an existing CFD, where assistance was provided for the public works, but not the private buildings.

The DIR also has found that public agency assistance did not trigger a prevailing wage requirement in the case of a public agency's assistance to an auto dealership that amounted to less than 2% of the project costs, which was found to be *de minimis*; a public agency's sale of real property to a developer for its appraised fair market value; and construction of "pad" buildings in a publicly assisted shopping center, where the pad developer acquired the land at a fair market price and independently constructed the improvements.

Because of the complexity and recency of California's prevailing wage rules, developers who seek public assistance must seek sophisticated legal advice as to whether the public funding will trigger a prevailing wage requirement, and if so, whether there might be an alternative way to structure such assistance in order to avoid that costly outcome.

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