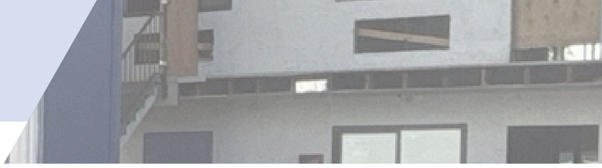


POLICY BRIEF | JULY 2024

AFFORDABLE HOUSING AT WHAT COST?

Some Private Entities Fail to Ensure Responsible Contracting in California

California faces a considerable housing crisis, with nearly 50% of the share of unsheltered people in the United States, and 28% of all people experiencing homelessness. California's Homekey program is one of the most substantial affordable housing programs in recent years, leveraging millions of dollars in state and federal funds to provide grants to local entities to purchase primarily hotel and motel property to be converted into low-income permanent housing.

Overview

Homekey heavily relies upon public-private partnerships, with the majority of projects (83%) having a private for-profit or non-profit developer as a co-applicant.

As owners, these private entities may have little experience overseeing public construction, and current CA law exempts private entities from many of the project transparency regulations designed to promote compliance on other public works.

This creates unique challenges for state labor and contracting regulators, especially in the residential sector where fewer public construction standards have historically applied, and where workers tend to be more vulnerable to wage theft and other exploitative practices.

As the state continues to invest taxpayer dollars in affordable housing while bringing in new private partners, strong oversight is needed to ensure responsible contracting.

The California Department of Industrial Relation's Labor Enforcement Task Force (LETF) found contractor violations on at least five Homekey projects awarded in Round 2, and CAL-OSHA identified violations on 4 Projects:

- **Four out of five Homekey projects** where contractors were issued Civil Wage and Penalty Assessments were owned by non-governmental agencies.
- **Eight contractors** on Homekey projects violated labor and public works laws.
- The assessments issued across these five projects totaled **$1,704,821** in wages and penalties, with contractors being held liable for **$1,176,893** in wages owed to aggrieved workers.
- Overall, **taxpayers contributed over $108,582,465** to fund these five projects.
- Between 2019 – 2024, contractors named on these CWPAs involving Homekey projects have performed work on a combined total of over **100 projects, amounting to $1.3 billion in taxpayer** dollars.
- **CAL-OSHA identified 13 violations** on 4 Homekey Projects. Each were led by private awarding bodies, and involved five different contractors who had been cited for 49 other violations in the preceding five years.

Compliance problems on projects with a private awarding agency is not limited to Homekey.

- Between 2021 and 2023, **$640,184 in wages and penalties** were assessed against nine contractors, based on referrals from just one Northern California compliance organization.

Legislation could help to ensure private entities awarding and overseeing taxpayer-funded projects are subject to the same level of public scrutiny as public agencies. One such measure, **AB 2439** would expand the list of entities subject to the CPRA to include owners, operators, or developers who receive public funding for a public works project.

NCIC
NORCAL CONSTRUCTION INDUSTRY COMPLIANCE

Background: Funding Responses to California's Housing Crisis

California faces a critical housing crisis, **with nearly 50% of the share of all unsheltered people and 28% of all people experiencing homelessness** in the United States. Homelessness in California has become more and more of an issue in recent decades, going up 31% since 2007. At least 181,399 people experienced homelessness in 2023, with 68% percent of those having no shelter at all.[1]

While the unhoused population continues to increase in California there has also been an increase in the number of people who have been able to access temporary shelter such as emergency shelters or transitional housing. This may be the result of public investment and other initiatives to expand temporary housing and shelter. Between 2018 and 2021 California allocated and spent **$5.5 billion on affordable housing initiatives, with $3.3 billion for housing and homelessness programs** in California's 2023-24 budget.[2] Policies have also been enacted to ease COVID-19-era restrictions to expand shelter capacity and speed-up lengthy development and purchasing processes.

Two of the most significant programs in California that have helped to provide shelter for unhoused people are **Project Roomkey and Project Homekey**. Launched at the beginning of the COVID-19 pandemic in April 2020, Project Roomkey was a Federal Emergency Management Agency (FEMA) funded homeless relief program to provide motel and hotel rooms to individuals experiencing homelessness, especially those over the age of 65 and with an underlying medical condition. One-time funds of $62 million from California's Disaster Response Emergency Operations Account were allocated to counties late in 2020 to ensure folks remained sheltered.[3] The project was soon expanded to provide more permanent housing through Project Homekey, a program administered by the California Department of Housing and Community Development (HCD), whose main purpose is to "provide grant capital to help public entities purchase underutilized buildings and convert them into housing for people experiencing or at risk of homelessness."[4] As of January 17, 2024, **Homekey has funded 245 projects and over 15,000 homes**. Homekey funding has been awarded in three rounds, with nearly $2 billion in funds awarded for Round 2, and over $600 million in Round 3.

PUBLIC-PRIVATE PARTNERSHIPS IN CALIFORNIA'S AFFORDABLE HOUSING MARKET

Homekey leverages both state and federal funds to provide grants to local entities, who may also provide matching funds that increase grant funding, to purchase primarily hotel and motel property to be converted into low-income housing. Though public entities must be an applicant to receive funding awards, they are encouraged to collaborate with private co-applicants, typically for-profit or non-profit developers. Public-private partnerships between state funding sources, local public agencies, and private developers are widespread in the affordable housing market.

Based on data provided on the HCD's Homekey Dashboard, **83% of co-applicants are private developers**.[5] Moreover, **at least 57%** of 60 Northern California projects registered on the Department of Industrial Relations online database of public projects identify a private entity operating as the awarding agency, or the agency overseeing the project. In short, **private developers play a central role on most of these publicly funded, affordable housing projects.**

To be sure, public-private partnerships in affordable housing may benefit both parties. Local public entities can help address the ongoing housing crisis by securing state funding for the development of new housing units, while transferring the cost and responsibility of construction oversight and administration, ongoing maintenance, and management to private entities.

This dynamic makes Homekey projects unique in the public construction sector. Whereas most public projects are "owned" by public bodies—such as school boards, utility districts, or municipal governments—who award bids to contractors and construction firms, **Homekey projects can often have non-public entities making critical decisions about public dollars.**

Overseeing Contractor Compliance on CA Public Works Projects

Beyond awarding contracts, the public works project owner also oversees the construction process, especially contractor compliance with California labor and public works laws. As this brief will detail, the private ownership of public works projects—a common dynamic within Project Homekey projects—can create unique challenges with respect to ensuring compliance with state labor and contracting rules. **Private entities may not have experience overseeing public projects, or lack understanding of their or the contractors' obligations.**

A significant contractor obligation on public works projects is the requirement to pay their workers prevailing wages—a minimum pay rate that reflects the local labor market—and to support new workforce development through the utilization of apprentices.[6] **Public works contractors must adhere to high transparency standards to encourage compliance with labor law** as well as to help enforcement agencies, labor compliance groups, and other entities ensure contractors are acting responsibly. Public works contractors in California must submit monthly electronic certified payroll records to the California Department of Industrial Relations (DIR) and register as a public works contractor prior to bidding and/or performing work (as well as hold the appropriate license for the work performed).

These records are all open to public inspection and covered under California's Public Records Act, unless the owner of the records (in this case a developer), is a private entity.[7] Awarding agencies must also register the majority of public works projects on the DIR's online database in order to convey project award information and improve project monitoring.

To keep contractors in compliance with public works laws, awarding bodies, or the entity who awards a public works contract, are required to take cognizance of any violations of public works laws, and "promptly report any suspected violations to the Labor Commissioner." [8]

Effectively, awarding bodies are directly accountable for ensuring responsible contracting and protection of taxpayer dollars. While contractors are legally obligated to adhere to these regulations, violations by non-responsible and bad actors persist. This is particularly concerning in California's public sector. In 2023 alone, there were 48,784 public works projects that were awarded and registered on the California public works database, over half of which were valued between $50,000 and $5,000,000. **Overall, state and local public construction in California totaled nearly $44.8 billion in taxpayer dollars in 2022,[9] with nearly ten thousand contractors registered to perform public works**. [10]

Prior Research and News Details Challenges of Public Subsidy to Private Developers

According to a 2022 report by The California Employment Development Department's Joint Enforcement Strike Force (JESF), a "high proportion of noncompliance allegations that are received" are in the construction industry. It's not surprising then, that the Contractor's State Licensing Board (CSLB) participated in the "second most JESF inspections each year."

In 2022, CSLB conducted over 500 inspections and issued 1,065 legal actions, of which 577 were administrative licensee citations. Workers in the construction industry, particularly the residential sector (which tends to be privately funded), are highly vulnerable to wage theft, often through misclassification and being paid under the table.[11] These workers are also employed on a contingent or on-call basis, with employers failing to report their hours.

In fact, one study estimated that 16 percent of wage and salary construction jobs in California are unreported. Day laborers, workers who are hired on a short-term daily basis, are highly concentrated in residential construction.[12] Not surprisingly, **Construction is one of the top five industries worked among wage claimants in California.**[13]

When contractors engage in illegal activity such as wage theft or misclassification, it not only directly hurts the workers, but can also increase burdens on the state's public welfare system while generating millions in lost taxes, referred to as the "tax gap." One study estimated that

wage theft in 2012 contributed to nearly $775 million in "tax gaps" in California

(a figure that does not include the cost of delivering increased public welfare services to underpaid workers).[14] Because of their public funding, affordable housing projects may provide opportunities for greater oversight to prevent the imposition of these public costs, as well as to deliver higher earnings and safer conditions for workers, and greater utilization of apprentices to expand the labor supply pool and career pathways for the construction industry.

However, the project owner is on the front lines of enforcement, obligated to ensure responsible contracting. And, unlike public bodies, **private development companies are made up of privately selected personnel,** with little to no public accountability to taxpayers, whose dollars they are spending on projects they are monitoring.

Indeed, private developers who can begin collecting rents from tenants once projects are completed may have an incentive to ensure projects are performed quickly, potentially at the expense of contractor standards enforcement. Ultimately, as one researcher noted, the use of private developers may contribute to workplace fissuring, or the diffusion of responsibility across actors, potentially leading to more instances in labor violations.[15] As Jake Schwitzer and Lucas Franco explain in their study of publicly-funded...

...construction projects where labor exploitation is rampant, "downward cost pressure imposed by developers seeking to maximize profits" may encourage contractors to "offload responsibility through the use of multi-tier subcontracts and so-called independent contractors who are often nothing more than labor brokers."[16] What's more, research shows that in the private sector, **limited and ineffective regulations not only limit worker protections, but even create incentives for contractors to cheat if the profits can outweigh the consequences of getting caught.**[17]

Aware that private developers may not be as familiar with public works construction laws, the DIR has issued multiple reminders that contractors on Homekey projects must pay workers prevailing wages and abide by California public works laws. Despite these reminders, one Los Angeles-based developer—**Shangri-La Industries—has recently been found to have "defaulted on private loans in seven Homekey-funded motel conversion projects** across the state, three of which are already housing homeless residents."[18]

Calaveras Quarters Homekey Project | Photo by Kristyn Pair, NCIC

According to a notice of violations issued by the Department of Housing and Community Development, Shangri-La has committed "numerous failures to comply with contractual and regulatory obligations, including, but are not limited to, a lack of communication on status of projects, failure to meet performance milestones, failure to record affordability covenants, and serious violations of the Standard Agreements including taking unilateral actions."[19]

Contractors on many of these projects have also alleged that they were not paid.

Though this developer made media headlines because they defaulted on loans, which halted construction, a number of contractors on other projects have quietly committed wage violations and required workers to perform work in unsafe environments, as detailed below.

Compliance Problems: When Private Entities Fail to take Cognizance on Homekey

To combat labor abuses, labor compliance organizations work closely with state enforcement agencies to target and investigate non-compliant and bad-acting contractors. Through investigations and complaints to the DLSE, the labor commissioner will conduct a statutory process to enforce its claims for unpaid wages and penalties.

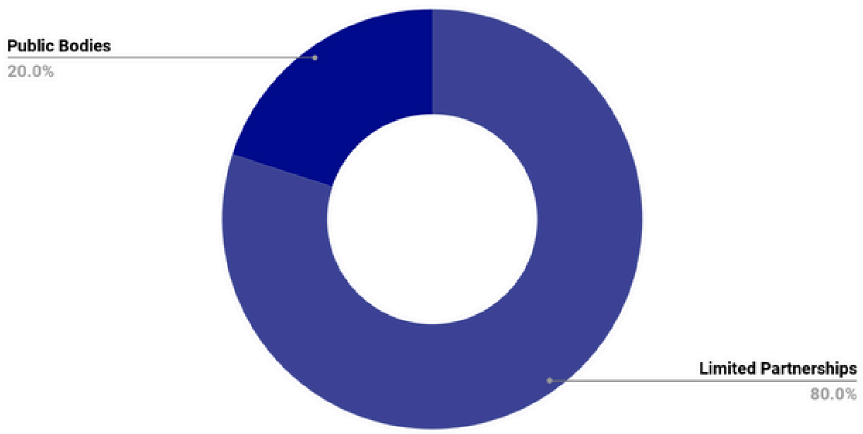
One such division that has been particularly important for enforcement in the affordable housing space is the DIR's Labor Enforcement Task Force (LETF). Initiated in 2012, **LETF is a coalition of California governmental agencies who work in collaboration to share information and strategies to locate non-compliant actors and conduct inspections.**

While LETF conducts investigations of employers covering a range of industries, the rapid and steady growth of affordable housing, particularly in the aftermath of the COVID-19 pandemic, has demanded greater attention. As the affordable housing sector has expanded, LETF has made enforcement over these projects, and especially the Homekey program, part of their key strategic enforcement initiatives.[20]

In 2023 LETF conducted numerous investigations involving contractors performing work on Homekey projects. By the end of the year, CWPAs were issued on five projects, with penalties assessed for eight different contractors. **Of these five projects, four owners were non-governmental entities, with only one being a public agency (Figure 1).**

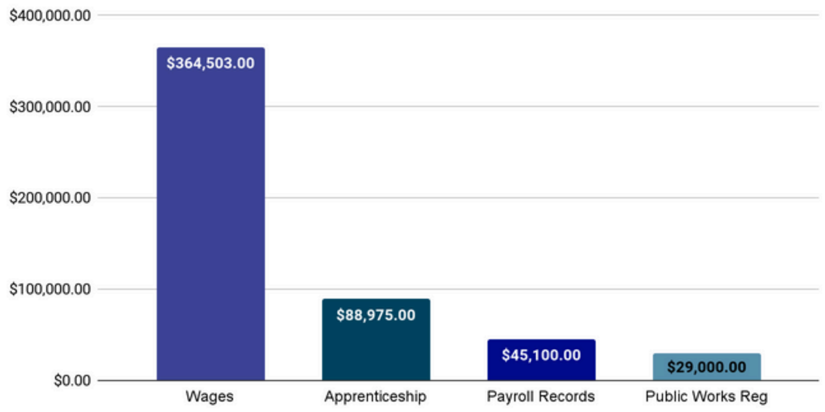
Though the onus to follow the law may be primarily on contractors, awarding agencies must play a key role in providing oversight. The fact that the majority of Homekey project CWPAs issued were on projects with private entity owners raises questions about whether these entities are doing their due diligence to take cognizance of contractor performance.

Figure 1: Homekey CWPAs by Awarding Body Type



The assessments issued across these five projects totaled $1,704,821.05. **Contractors were held liable for $1,176,893.05 in wages owed to aggrieved workers, and were further penalized $364,503 for violating wage laws.** Contractors were found to have committed violations across a range of labor requirements.

Figure 2: Homekey Penalty Assessments by Violation Type



On all five of these projects, contractors and subcontractors either **failed to pay workers the prevailing wage rate outright**, or otherwise misclassified workers in ways that left them with lower pay than they should earn. Subcontractors on three projects also **failed to register as a public works contractor** prior to performing work, a violation that prime contractors may also penalized for.

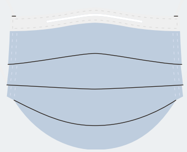
*Overall, taxpayers contributed over **$108,582,465** to fund these five projects. Potentially more concerning is the significant amount of work these contractors have performed on other public projects.*

Between 2019 and 2024, contractors named on CWPAs involving work performed on these Homekey projects have performed work on a combined total of over 100 projects, amounting to $1.3 billion in taxpayer dollars.

In addition to these violations, LETF also worked with Cal-OSHA to investigate safety practices on Homekey projects. Cal-OSHA ultimately identified violations on four Homekey projects, all owned by a private developer or limited partnership. **Penalties assessed across 13 violations against five contractors, two of which are considered serious violations, totaled $11,475.** Violations included:

Failure to provide up-to-date first aid kit

Improper COVID-19 procedures



No Heat Illness Prevention Plan

Faulty fire extinguishers

Lack of safe stairways and ladders

Two contractors were also cited for exposing workers to exposed protruding reinforcing steel, a serious violation that can be fatal if not corrected.

Of note, seven of the eight contractors working on Homekey projects who received OSHA violations had been issued violations in the past. In fact, **over the last five years these contractors racked up a cumulative total of 49 violations.** The evidence is clear that more education and oversight is needed when private entities are able to function as owners of public projects.

PRIVATE ENTITY OVERSIGHT EXTENDS BEYOND HOMEKEY

The challenge of ensuring compliance by private entities on publicly subsidized construction projects is not limited project Homekey. For example, NorCal Construction Industry Compliance (NCIC), one of several California-based non-profit construction compliance organizations, filed complaints with the DLSE Public Works Unit between 2021 and 2023 alleging violations of California Labor Code against **14 contractors performing work across 22 affordable housing projects where the awarding body was a private entity,** which are currently under investigation.

NCIC referred eight of these 22 projects **to LETF, which resulted in 27 OSHA violations and cumulative penalties of $13,875.00.** Two contractors were found to have exposed workers to serious health and safety risks, including unsafe exposure to respirable crystalline silica, which can lead to fatal lung and kidney disease.

Public works violations on projects owned by a private entity **extends beyond affordable housing projects to other types of public projects.** Between 2021 and 2023 NCIC filed complaints against nine contractors performing work on five public projects where the awarding body was a private entity, resulting in CWPAs.

$640,184 in penalties and wages due were assessed by the DLSE on these five projects with private entity owners.

The taxpayer value of these five projects alone was over $130.9 million. In the last five years, **these nine contractors have been awarded over 250 projects, valued at more than $2.5 billion in taxpayer funded projects**.

Despite violating labor laws, these contractors have continued to work on public works construction projects in California, highlighting the need for agencies to actively and closely monitor contractor activity. Failure to identify contractor violations promptly can result in misuse of public funds.

CONCLUSION

While private entities may have experience as developers in the affordable housing market, their lack of experience as public works project owners may result in poor oversight of contractors. This includes ensuring that contractors are properly monitoring subcontractor activity and helps to explain why the DIR has issued multiple statements reminding Homekey employers to pay prevailing wages on publicly funded projects.

Issues with contractor compliance on public works projects with a private entity owner raises important questions about how to ensure that both taxpayer dollars and workers are protected when private companies begin taking on the role of public agencies.

Especially given the high rates of worker exploitation in private residential construction work, more systematic and in-depth research is needed to explore rates of contractor noncompliance on projects of this nature.

Enforcing both contractor and awarding body compliance is especially challenging when private entities function as awarding bodies because private entities are exempt from the California Public Records Act (CPRA).

In other words, many project documents like a subcontractor list, inspector log, or copies of payrolls are not available for public review in the same way as they are for public works.

LOOKING AHEAD

One way to potentially address this concern of transparency for private entities, is through an expansion of the California Public Records Act to hold private owners or developers functioning as public works awarding bodies to the same standards of transparency as other public agencies.

The California legislature is set to consider such as measure, known as AB 2439, in its 2024 Legislative session.

More research is clearly needed to understand and address challenges associated with private entities functioning as public awarding bodies. While it is clear that such arrangements can reduce the costs and burdens faced by public agencies—particularly in the effort to expand access to affordable housing--it need not come at a cost of ensuring taxpayer dollars are being spent responsibly.

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ABOUT NCIC

NorCal Construction Industry Compliance (NCIC) is a joint labor management organization committed to paving the way to a level playing field for contractor and workers by promoting equitable contracting, and ensuring compliance with all applicable state and federal labor laws governing the construction industry. Learn more at norcalcic.org.

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