

Bonds sold to purchase the River Park Square garage are not tax-exempt because the groups involved in the deal did not follow federal law, paid an unreasonably high amount for the facility and gave too much money to the mall's private developer, an Internal Revenue Service report says.

A final Proposed Adverse Determination report, received this week by the city of Spokane from an IRS supervisor in Denver, is scathingly critical of the deal that involved the city, affiliates of Cowles Publishing Co. that renovated the downtown mall, and a foundation that sold bonds to buy the garage for \$26.5 million. It says one part of the project "raises troubling aspects of potential fraud" and refers to some of the complicated financing as "smoke and mirrors."

"The terms of this transaction were not reasonable and not in the public's interest," says a 27-page report that accompanies the letter from IRS Manager Derek Knight. "The bonds are taxable, private activity bonds."

If that ruling holds up under appeal, a tax liability estimated at \$1.7 million would be borne by someone, depending on the terms of a settlement being sought in a massive tangle of garage litigation. The foundation that issued the bonds has 30 days to appeal the ruling.

City Councilwoman Cherie Rodgers, a longtime critic of the city's involvement in the mall, said the strongly worded report "nails" the city, the mall developer and the legal advisers connected to the \$110 million downtown project.

But an attorney for the developer said the report was filled with "significant errors."

"We don't think it's factual," said Les Weatherhead. "We never had an opportunity for input."

For example, one of the major complaints leveled by the IRS is that the developer paid \$400,000 – the report calls it "nothing more than a kickback" – in the summer of 1999 to hide an imminent default by one of the mall's main tenants, AMC, which was disputing terms of its lease and threatening not to open the multiplex theater.

No such payment – which the report labeled as potential fraud – was ever made, Weatherhead said. The developer did give the foundation a confidential pledge to cover parking revenue losses if AMC pulled out of the mall; but that never happened because the mall and the theater chain eventually settled the dispute.

Betsy Cowles, president of the development companies, said the report was riddled with errors, but is not something that directly affects the developer because it didn't issue the bonds. The mall is a success, she added.

"These sorts of witch hunts are unfortunate," Cowles said. "I think at the end of the day, whenever this gets resolved, the public will come to understand that this was an open process, and, looking back, that it was the right thing to do."

Laurel Siddoway, the city's special attorney for River Park Square matters, also challenged some of the IRS agents' contentions regarding the city. For example, the report criticizes the city as deliberately overpaying for the garage.

But the city was basing its decisions on advice from Walker Parking Consultants, a nationally recognized firm that said the garage would cover its costs, Siddoway said.

"We concede that an excess amount was paid, in retrospect," she said. "Walker's projections were so far off, but the city had a number of experts and everyone always acknowledged that Walker was the pre-eminent parking consultant."

The IRS saw it differently, however. Agents noted that other consultants raised "red flags" about the value of the garage.

"The city, the developer and bond counsel all ignored the obvious overstatements as detailed in all the reports on the project provided," the report contends. "All parties involved appear to be struck by ostrich fever, a collective burying of heads in the sand."

The mall renovation project was proposed in the mid-1990s as a way to revitalize downtown Spokane's declining retail district. The project involved a new Nordstrom, a near doubling of the capacity of the 20-year-old parking garage, a multiplex theater and an atrium of shops and restaurants. The mall is owned by affiliates of Cowles Publishing, which also owns The Spokesman-Review.

When the mall developer was unable to finance the renovation on its own, it entered into a complicated public-private partnership with the city. Over time, part of that partnership evolved so that the developer would build the expanded garage and sell it to the nonprofit Spokane Downtown Foundation, which sold bonds to cover the price negotiated by the city and the developer.

When the bonds were paid off in 2019 with garage revenues, the city would receive title to the parking facility.

Under certain conditions, federal law allows nonprofit foundations to sell tax-exempt bonds, which are less expensive to repay and attractive to certain investors. The foundation sold \$31.4 million in tax-exempt bonds in 1998, and purchased the garage in the fall of 1999, after the first phase of the mall renovation was completed.

The IRS says, however, that the way the deal was structured doesn't meet federal tax law for tax-exempt bonds. The report says the developer gets too much financial benefit from the deal, and has too much control. It says the garage is worth no more than \$15 million in fair market value, so the \$26 million paid for the garage includes more than \$10 million in benefit to the developer, the report concludes.

The developer has said the garage addition cost almost \$20 million to build, and the existing garage cost more than \$7 million in 1974, so there was no unfair benefit. The price was not set on a fair market value, but on an investment value that took into account the garage's potential to make money and the cost of borrowing money to build it.

The IRS was highly critical of that investment-value approach, particularly when the price of the garage wasn't adjusted downward to reflect lower revenues that were certain to follow a reduction in evening parking rates. The report said the appraisers used assumptions that were dictated to them, which "were nothing more than a notch in (a) post of public deception."

"A reasonable person would have (re)negotiated the price significantly under any valuation method," the report charged.

An attorney for the foundation did propose renegotiating the price, in August 1999, but that was dropped after the developer pledged to make up any shortfall in revenue if AMC re-refused to open the theaters. In making that pledge, the developer required a confidentiality agreement from members of the foundation and city officials who were told about it. It also promised to pay any fines the city's parking agency faced for possible violations of the state's public records law.

The IRS report said that confidentiality agreement amounted to "concealment" that private interests were being served.

Weatherhead said Thursday the agreement was to keep from giving AMC an unfair advantage in the ongoing negotiations.

The developer's attorney also disputed several items in the report which he said agents could have easily checked and discovered they were wrong. For example, the report says the foundation board was appointed only days before the bonds were sold in late 1998; in fact, they were appointed in early 1997. The report also says that a committee of mall tenants and the developer control parking rates and garage operations; the Parking Oversight Committee has only advisory authority under the terms of the parking agreement.

The parking authority sets the rates, and its members are appointed by the city, Weatherhead noted.

Neither Knight, the IRS manager, nor attorneys for the foundation returned calls requesting a comment on the report.

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