DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

WORK COPY

Spokane Downtown Foundation
1400 Seafirst Financial Center
601 West Riverside
Spokane, WA. 99201

Date:
June 22, 2004

Person to Contact:
Derek Knight
75-07593
Telephone Number:
720-956-4293

RECEIVED
JUN 28 2004
Randall & Danskin, P.S.

EIN: 91-1940922

Re: Proposed Adverse Determination (Final)
Spokane Downtown Foundation
$ 31,465,000 Parking Revenue Bonds 1998

This is to inform you that we have concluded our examination of the Bond Issue(s) named above (the "Bonds"). We have made a proposed determination that the interest paid to bondholders is not excludable from gross income under section 103 of the Internal Revenue Code. The enclosed agents report provides an explanation the facts, law, and analysis on which this proposed determination is based.

We encourage you to immediately contact the person named above to begin negotiations to resolve problems with the Bond Issue through a closing agreement. **This will be your last opportunity to conduct settlement negotiations with this office.**

If you choose to not pursue a closing agreement, you may formally respond to this proposed determination as follows:

1. **Request an administrative appeal of your case to the Office of Appeals of the IRS**. The Office of Appeals is separate and independent of the IRS office that made this proposed adverse determination with respect to the bonds. The administrative Appeals process is explained in Revenue Procedure 99-35, 1999-41 I.R.B. 501.

If you decide to request an Appeals review, you must submit your request in writing within 30 days of the date of this letter. Your request must include a **detailed written response** to this proposed adverse determination and include any further explanation of the Issuer's position regarding the issue(s) in dispute. The request for an appeal should be sent to the following address: IRS:TE/GE:TEB 7222, 56 Inverness Drive East, Englewood, CO. 80112

2. **You also have the right to contact the Office of the Taxpayer Advocate.** Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals processes. The Taxpayer Advocate is not able to reverse a legally correct tax determination. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. See the enclosed Notice 1214, Helpful Contacts for Notice of Deficiency, for Taxpayer Advocate telephone numbers and addresses.

If you do not respond in writing within 30 days of the date of this letter, you will forfeit your opportunity for Appeals review and our proposed determination becomes final. At such time, you should advise the appropriate paying agents to report the interest as taxable to the beneficial holders of the Bond Issue. Corrected information returns (Form 1099 (Corrected)) must also be filed with the Internal Revenue Service and issued to the bondholders as required under section 6049 of the Internal Revenue Code.

If you have any questions concerning this matter, please contact the person whose name and phone number are shown on this letter.

Thank you for your cooperation.

Sincerely,

Derek Knight
Manager TEB Group 7222

Enclosures:
Notice 1214

cc: Bradley S. Waterman
City of Spokane

TAX EXEMPT BOND EXAMINATION PROGRAM

Proposed Adverse Determination

BOND ISSUER: Spokane Downtown Foundation

BOND ISSUE: Parking Revenue Bonds, 1998 (River Park Square Project)

Facts

The Spokane Downtown Foundation (the "Issuer") was created and incorporated as a "Washington Non-Profit Corporation" on November 15th, 1996. The purposes and powers of the corporation include, among others, that the corporation will engage in activities and have powers consistent with a non-profit corporation described in Internal Revenue Code (IRC) §501(c)(3). The corporate documents, as filed, were deficient as to the required language to qualify the entity as a 501(c)(3), (i.e. dissolution clause was not in compliance with IRC §501(c)(3) requirements)[1].

The original incorporation indicated 1114, Inc. a Washington Corporation as the registered agent for the Foundation. Duane M. Swinton (the Developer's Attorney) signed as Vice President of 1114 Corporation.

The Articles of Incorporation were amended August 27th, 1998. The purposes of the corporation were expanded and continued to use the basic IRC §501(c)(3) language. The powers of the entity continued to be limited to IRC §501(c)(3) activities. The Article VIII limitations section was very specifically limited to 501(c)(3) activities and updated the dissolution clause to be in basic compliance with IRC §501(c)(3). This amendment also indicated a newly placed Board of Directors (Chris Schnug, Dave Broom, Tom White).

Per the amended Articles of Incorporation, 3 new Board Members/Directors were appointed[2]. The Board Members/Directors were selected by;

- R.W. (Bob) Robideaux---Citizens Realty Company & R.W. Robideaux Associates
- Duane Swinton---Developer's Attorney
- Betsy Cowles---Developer (Owner of Citizens Realty & Lincoln Investments)

The selection process was not based on qualifications; these were just people they knew.[3] The primary job of the Board was to work on financing the garage.[4] The new Board of Director's per the Amended Articles filed August 27th, 1998 was in place 3 days before the bonds were dated September 1, 1998.

Per the amended Articles of Incorporation PTSGE, a Washington Corporation is the registered Agent for the Foundation. Michael C. Ormsby (bond counsel) signed documents for PTSGE.

The entity never filed Form 1023 to request Tax Exempt Status under IRC §501(c)(3). For purposes of the bond issuance in question, the Spokane Downtown Foundation was purported to be an organization described in Revenue Ruling 63-20.

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[1] IRC § 501(c)(3) requires the dissolution clause state that assets will be distributed to other 501(c)(3) entities that have been in existence for certain periods of time.

[2] Per Betsy Cowles Testimony (Page 249-250)

[3] Per Betsy Cowles Testimony (Page 251) & Mike Ormsby Testimony (Page 422)

[4] Per Mike Ormsby's (Bond Counsel) Testimony (page 423)

In 1993 the City Planning Staff and Parking subcommittee, as part of a Central Business District Plan update, conducted a study of the parking situation in Spokane. This study indicated that the supply outweighed the demand. The study area had a 47% surplus of parking spaces while the core area had a 17% surplus in parking spaces. The study added that reducing parking costs is a priority in order to get people to come downtown[5].

In the downtown area there was a development known as River Park Square. Within this development was a parking garage that provided 750 spaces. The development was owned by Lincoln Investment Company and Citizens Realty Company (collectively the "Developer"). The development was the subject of a redevelopment plan that was to include a Nordstrom's, rentable retail spaces, 24-screen theater complex and retail atrium. An integral part of the redevelopment was to rehabilitate and expand the existing parking garage, originally built in 1973. The expansion would add approximately 554 spaces, for a total of 1,304.

In 1994 Ernst & Young looked at the value of the garage and concluded the value to be between $4 & $6 million dollars[6]. In 1995 there was a plan discussed and considered that would have the City buy the garage and renovate it. It was collectively determined at that time that the garage could support approximately $14 million in tax exempt debt (purchase price plus renovation).

The total renovation plan of River Park Square was estimated to cost approximately $100 million dollars. The Developer did not have the financial wherewithal to cover the redevelopment cost alone. The Developer was in a position where they had to raise money for the redevelopment or the existing tenants would move out of the downtown development to the suburbs. The City of Spokane (City) was desirous of revitalizing downtown, keeping sources of sales tax revenue in place, keeping property values up and encouraging redevelopment.

The Developer and the City explored various funding options for the redevelopment project in conjunction with tenants and others. These options included the sale of assets, government grants, etc. In this consideration it was determined that the Developer could expand and rehabilitate the parking garage and then sale it to the City.

Once it was determined that the Garage could be renovated and sold to the City as part of a funding mechanism for the rest of the project, a chain for events was put in place that appears to be designed to hide the true nature of the transaction. This is despite testimony that the transactions goal was always to buy the garage and provide excess monies to the developer to be used for the total redevelopment[7]. This is currently acknowledged as being understood by the City from the start.

On June 14, 1995 the City Council approved three resolutions. Resolution 95-75 provided for the vacation of Post Street from Spokane Falls Boulevard to Main Street. Resolution 95-74 authorized the City Manager and staff to proceed with the possible acquisition of a public parking garage facility. Resolution 95-73 approved the application of the HUD Section 108 loan (which would finance the Nordstrom store in the Project).

In a memo dated February 28, 1996, the Developer records that it "will spend approximately 2.5 million improving the structure and then sell the garage to the City for 9 million and, in addition,

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[5] Report Prepared by Spokane Unlimited, Inc. & Downtown Spokane Association

[6] Per Betsy Cowles Testimony (Page 34)

[7] Betsy Cowles Testimony (Page 122, 310) Duane Swinton Testimony (Pages 659-672) Mike Ormsby Testimony (Page 265)

lease the land to the city for approximately 20 years[8]. The parking garage will revert to River Park Square with the exercise of an option to purchase at the end of the lease."[9]

------Appraisal Reports

In April of 1996, at a public hearing, the City commissioned Walker Parking Consultants (Walker) to provide additional services of a feasibility study concerning the River Park Square parking garage. Walker submitted this report to the City in June of 1996.

Walker had previously done work for the Developer on this project prior to the City Contract. The work for the Developer consisted of preparing various financial projections relating to the garage.

The City commissioned two real estate appraisal firms – Daniel Barrett and Auble & Associates – to value the parking garage. The firms were required to value the garage on an investment value basis. The investment values and projections to be used were those embedded in the Walker report.

The Walker study was to place a value on the garage under the "investment valuation" method. The investment valuation method is not a fair market valuation. Walker was not engaged to do the appraisal, just to determine investment valuation. Investment valuation, in theory, is the value of a specific property to a specific investor based on the present value of a projected revenue stream. The projected revenue stream in these valuations is exceptionally important, the higher the revenue stream used the higher the value obtained. In this case, for each dollar of revenue used in the revenue stream, the theoretical value of the garage increased by $13.

Walker's study used unrealistic projections for the revenue stream. The dollars per hour charged, the length of stay, etc. were all overstated given history and economic climate of Spokane and the downtown area. Provisions for the value of the Developer's option to purchase the property at the end of the financing, for assumed validation programs, for the AMC default, for the 50/50 revenue split, for disincentives to use the garage after 6 PM and on weekends as a result of free street parking and other garages reduced rates, etc. were all ignored in the study. So it is clear that the Walker study was not a "fair market" (reasonable man willing buyer willing seller theory) valuation study, but was rather a concocted valuation based on unreasonable assumptions provided by the Developer.

On April 11, 1996, the City sent the two appraisal companies instructions to use the revenue numbers from Walker's report[10]. A March 18, 1996 memo from Bob Robideaux states, "Scope of the Appraisal" to the appraisers. The March Memo states this is not a market value appraisal and lays out specific items to be followed to arrive at a value.

In a May 10, 1996 memo, Walker stated that if free parking were given to everyone who attends a movie, the revenues to the garage will be severely impacted. Free parking for movie customers is an industry standard which should have been used for the Walker report.

In June of 1996, the City Council adopted Resolution 96-77, which authorized the City Manager to meet with the Developer to prepare a report on the feasibility of acquiring the River Park Square parking garage.

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[8] Betsy Cowles Testimony (Page146-149) & Exhibit 549 to that Testimony

[9] Inurement is strictly forbidden by a Rev. Ruling 63-20 type of corporation. No consideration was paid to the Issuer/Foundation or Price reduction provided on the purchase of the garage for the value of this option. See "Ground Lease" documents

[10] April 11, 1996 Letter from Dennis Beringer, Real Estate Projects Manager to Appraiser detailing Scope of the Appraisals; & Betsy Cowles Testimony (Page 164); & Daniel Barrett Testimony (Pages 16-17)

The Auble & Associates report was dated July 11, 1996. The report stated that "if market value were estimated, the resulting value would be significantly lower". Auble questioned some assumptions in the Walker report. The parking revenue rate used was $1.50 while the current rate is $1.00. The average stay is estimated at 3 hours while it has been 1.2 hours over the last 5 years. The parking validation program is not considered so revenue is grossly overstated. Auble valued the garage at $34,300,000 using Walkers unreasonable assumptions, as directed.

Barrett submitted a report on July 8, 1996. The report notes that 40% of the revenues in the Walker report come from cinema patrons[11]. The report was highly skeptically of the data source it was forced to use. Barrett calculates the value of the garage using the Walker assumptions at $44,400,000. Barrett values the garage at $33,165,000 under a scenario where he reduces the cinema revenues by 25%. He calculates the value of the garage at $25,100,000 when he reduces the cinema revenues by 50%. Using the required numbers and assumptions it is clear the valuation was rigged to get to a number high enough to provide the developer with funds for the private portion of the project.

In spite of the negative comments from the appraisal reports, on July 15, 1996, the City Council approved Resolution 96-94 which gave the City staff approval to negotiate a ground lease and a purchase agreement relating to the garage.

An August 14, 1996 memo from the City's attorney to the developer describes a meeting between the City and the rating agencies. Both rating agencies were "incredulous" that there would be outside control over parking rates.

This apparently caused Walker to issue a revised report on September 3, 1996. A further result was in October of 1996, when the City commissioned Coopers & Lybrand to perform a review of the Walker feasibility study concerning the parking garage.

The Coopers & Lybrand report found numerous problems with the Walker study including:

- The Walker report does not assume any costs or lost revenues from a validation program, despite the fact that there already is a parking program in place.
- The Easy Pass Validation Program provides up to two free hours of parking, free parking after 6:00 PM and all day Sunday & a free transit ride.
- The Walker report assumes full parking lot fees from cinema patrons, estimated at $3.75 per car and 623,323 cars while historically, no theater in America charges its patrons for parking.
- The Coopers & Lybrand report stated that the tax exempt bond rate would increase the investment value of the improvements and would provide "Unrealized Equity" to the Developer.
- The private part of the report compares the Developer expense reimbursements of $11.02 per square foot to $6.95 per square foot for similar properties (provided by ULI's Dollars and Cents, a National Trade Magazine). The report also notes the operating income would provide for significant participating income to the lessor (Developer) and minimal participating income to the lessee.

[11] Barrett Appraisal (Page 43)

The Walker report was again revised in 1998 for Bob Robideaux. No work was ever performed for the foundation.

------Bond Counsel Activity

Mike Ormsby an attorney with the firm of Preston, Gates & Ellis, LLP ultimately issued the tax opinion with respect to the issuance of $31,465,000 Spokane Downtown Foundation Parking Revenue Bonds, 1998 (River Park Square Project). These bonds were issued to purchase the *parking garage facility (not the land it sits on).*

Mike Ormsby as Bond Counsel was in a position where he should have represented the Issuing Authority, Spokane Downtown Foundation. No formal engagement contract was established. Mr. Ormsby's activities in this deal are indicated to be the following;

- August 1996 a waiver request of the City is made in order for Mr. Ormsby to assist R.W. *Robideaux & Associates on behalf of the Developer* in conjunction with the bond financing, covenants, & revenue. Waiver was granted.
- On September 16, 1996 is last work completed for Developer.[12]
- On September 17, 1996 meeting with Mayor on financing[13]
- On October 1, 1996 Preston Gates formally withdraws from representation of the Developer and Prudential
- Preston Gates requested a waiver in order to represent Prudential Securities. Not Granted
- Mr. Ormsby wrote to Mr. Robideaux requesting a fee increase due to various events that had transpired.[14]

Mr. Ormsby originally was approached by Bob Robideaux, Duane Swinton and Betsy Cowles. Betsy Cowles owns the Developers and Mr. Robideaux and Mr. Swinton work for her in one capacity or another. They approached Mr. Ormsby as to his willingness to be involved in the financing and to be Bond Counsel to the Foundation.[15]

-----Bonds Issued

On December 15, 1996, the newspaper (which is owned & controlled by the Developer) printed an article which stated "a non-profit corporation formed by River Park Square's owners will issue bonds to buy the garage after it has been renovated and expanded[16]. A public development authority, formed by the city of Spokane, would then sublease the garage and the land beneath it from the non-profit corporation, *Spokane Downtown Foundation*".

On December 24, 1996, the Underwriter sent all parties involved a letter regarding the Bonds rating. The concerns the rating agency had included the parking meter revenues, the validation

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[12] Per Mike Ormsby's billing records

[13] Per Mike Ormsby's billing records .6 hours charged to foundation (*Foundation incorporated 11/15/96)*

[14] Increased fees associated with the bond issue would delay the date on which the developer would share in the 50/50 revenue split contemplated and written into the official bond documents. Mr. Robideaux's company is an affiliate of the Developers.

[15] Mike Ormsby Testimony (Page 429)

[16] Also stated in Duane Swinton Testimony (Page 38-39) Mike Ormsby Testimony (Page 428)

program, and the 50/50 split in remaining revenues (they wanted the City's share to be plowed back into the deal).

On January 13, 1997, the City Council passed Resolution 97-2 which approved the plan to have the Issuer purchase the garage and then lease it to the PDA.

At the January 27, 1997, City Council meeting the following events occurred;

> (1) A representative from Coopers & Lybrand summarized their findings, pointing out major flaws in the proposed purchase and lease of the Project. The results of the Coopers & Lybrand presentation was there was an undisclosed annual shortfall of $1.6 million.
>
> (2) A rival developer stated that "the parking structure itself has a fair market value considerably less. I think we all understand that. It is being used as a vehicle to get tax-free bond money to the developer, which will enable them and assist the proponents of the project to compete, we believe, unfairly with our facility in attempting to secure tenants.
>
> (3) the City Council adopted Ordinance C31823 which created the parking meter revenue fund. This pledged parking meter revenues to the PDA in the event parking revenues are insufficient to make ground lease payments and pay operating expenses.

It appears that the City, acting as the Issuer, participated in this structured transaction to aid in the development of the downtown area. The form of the structure is extremely flawed, as the substance show inurement/private benefit for the Developer. The flow of funds from the operations of the Garage were prioritized in the Official Statement in the "Sources of Payment and Security for the Bonds" section under "Flow of Funds" on page 15:

> "*First,* to pay Fixed Facility Rent[17];
>
> *Second,* to pay Fixed Ground Rent[18];
>
> *Third,* to pay Operating Expenses[19];
>
> *Fourth,* to pay Administrative Variable Ground Rent[20];
>
> *Fifth,* to pay Variable Ground Rent[21] (equal to 50% of the money in the Revenue Account remaining after payments made in First through Fourth above);
>
> *Sixth,* if the Authority has received a loan of Parking Meter Revenues from the City to pay Fixed Ground Rent or Operating Expenses, to repay amounts owed to the City[22];

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[17] Payment of Revenues to Bond Investors

[18] Represents payment of an encumbrance on the property. The ground under the garage was not sold and is owned by the developers. Payments were inflated via the feasibility study and reduce the value of the leasehold improvements. This reduction in value was not considered in the sale. These payments as well as priority #3 were secured by a pledge of parking meter revenue.

[19] Payment of the normal operating expenses of the facility is secured by a pledge of parking meter revenues.

[20] This payment of $45,000 per year was to compensate the Developer for a loss of income due to increased administrative costs of approximately $500,000.

[21] This provision provided a 50/50 revenue split between the City and the Developer.

[22] Repayment to the City for any Parking Meter Revenues tapped to pay Priority #2 and #3.

Seventh, to make payments into the Rate Stabilization Amount until the amount therein equals $2,000,000;

Eighth, to make payments into the Renewal and Replacement Account until the amount therein equals $1,5000,000;

Ninth, to pay Variable Facility Rent, which shall be used by the Foundation solely for the purpose of repaying, defeasing or otherwise paying all outstanding Bonds;

Tenth, to pay additional Variable Facility Rent (equal to 20% of the money in the Revenue Account remaining after payments made in First through Ninth above), so long as such additional Variable Facility Rent is used solely for lawful purposes under the Foundation nonprofit corporate statutes designed to benefit and improve the downtown neighborhood; and

Eleventh," for any lawful purpose of the Authority."

In September 1998 the Bonds were issued. The proceeds were escrowed and allowed to be used as collateral by the Developer for private construction loans associated with the entire redevelopment project[23].

In November of 1998, two months after the bonds were issued, the River Park Square operator requested Walker to revise their assumptions.

On June 8th, 1999, AMC (owner/operator of the 24 theatre movie complex in the Project) discovered for the first time that they would not receive free parking for their patrons. AMC threatened to leave the mall or encourage their patrons to park elsewhere. The public was never informed of the AMC problems per various city council notes and council member statements.

On June 10, 1999, AMC sent a letter to the Developer that stated, "AMC has directed me to provide a formal notice to you of a potential default in landlord's obligation in regard to parking under the lease." The Developer had been required to represent to the Foundation that there were no potential events of default. The Bond Counsel verified that the Foundation would have had an argument to not close the sale of the garage due to this notice of default[24].

Walker prepared a revised report dated June 12, 1999, which projected that revenues would be insufficient by approximately $1.24 million per year due to the flat rate parking charges of $2.00 after 5 p.m. and on Sundays. The revenue projection for the 2000 year was $4.6 million, the revised revenues were $2.1 million. The garage had not yet been purchased even though the bonds had been issued. No adjustment to the purchase price was made as a result of this event or revised report.

On July 30, 1999, the Developer sent AMC a letter agreeing to pay them $400,000 to be applied toward validation and parking costs for AMC customers. On August 1, 1999 the developer made a payment of $400,000[25].

On August 2, 1999, AMC sent a letter to the Developer which was a notice of default[26]. The Issuer's counsel was not aware of this letter.

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[23] Coopers & Lybrand Analysis Page 22

[24] There was no significant event notice made of the default, the Developer certified in the purchase agreement that no significant event of default has occurred.

[25] This payment artificially propped the purchase price of the garage up. In addition, no analysis was made by bond counsel as to whether this payment represents a kickback, private payment, excess reserve fund or other. The payment may represent more than one of these items. No adjustment was made to purchase price for the default of the other 19 years of payments used in the feasibility study.

On August 13, 1999 the Issuer/Foundation attorney (Bond Counsel) wrote a letter to the Developer asking, since the purchase price is based on a revenue stream and the revenue stream has been revised downward shouldn't the purchase price have a corresponding downward adjustment. The Developer never responded and the attorney never followed up.

At a meeting of the PDA Executive Session on August 25, 1999, which included Spokane Council Member Roberta Greene and the City's attorney, a decision to not reveal the default of the bonds was made. The PDA is the Authority controlled by the City to oversee operations of the garage once the purchase is made. The Issuer/Foundation does not appear to have had a voice in this matter.

On September 24, 1999, the Developer signed a reimbursement agreement with the Issuer which provided the Issuer with the funds equal to any shortfall in revenue from AMC. The Issuer was required to keep this agreement confidential[27]. The Developer said it would provide any defense against any action taken to try to make this agreement public and pay any penalty assessed by the court.

On September 28, 1999, the Issuer purchased the garage for $26 million pursuant to the Garage Purchase and Sale Agreement signed on August 1, 1998.

On September 28, 1999, the Developer entered into a parking facility operator agreement with the PDA where the PDA agreed to operate the parking facility for a temporary period of time.

Changes to the validation system and rate changes in the fall of 1999 caused additional revenue shortfalls above and beyond those that were to be experienced by virtue of the excessive price paid for the garage. The PDA declined to be a permanent operator of the parking facility when it became apparent that the City would not use parking meter revenues to cover the shortfall.

On April 26, 2000 the City Council voted not to use parking meter revenue for operation and maintenance costs and ground rent.

On September 20, 2001 US Bank issued a significant event notice to the bondholders which advised of the default of the bonds. Prudential Securities, the underwriter, had previously determined the Bonds were unsuitable for their clients regardless of sophistication.

On January 28, 2004 an administrative ruling was issued by a United States District Judge with respect to various liability issues. It appears the ruling dealt with state law issues of liability as related to the Foundation as well as others. This ruling does not appear to consider requisite control and positions of influence with respect to the Foundation for purposes of federal tax law and tax administration. For federal tax law purposes the requisite control and positions of influence with respect to inurement and private benefit issues are different. The analysis under federal tax law will, therefore, be different from any analysis under State law and may reach a different conclusion.

LAW

Revenue Ruling 63-20 provides that obligations issued by a nonprofit corporation formed under the general nonprofit corporation law of a state for the purpose of stimulating industrial development within a political subdivision of the state will be considered issued "on behalf of" the

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[26] This significant event was not disclosed.

[27] Private payment for private use of the Garage, which indicates the issuance was a private activity bond. The use of a confidentiality clause for this agreement cannot be seen in any type of a positive manner, it was meant to conceal the source and reason for the payment, which in turn would keep the garage purchase price artificially propped up.

political subdivision, for purposes of §1.103-1 of the Income Tax Regulations, provided each of the following requirements is met;

- (1) the corporation must engage in activities which are essentially public in nature;
- (2) the corporation must be one which is not organized for profit (except to the extent of retiring indebtedness);
- (3) the corporate income must not inure to any private person;
- (4) the state or a political subdivision thereof must have a beneficial interest in the corporation while the indebtedness remains outstanding and it must obtain full legal title to the property of the corporation with respect to which the indebtedness was incurred upon retirement of such indebtedness; and
- (5) the corporation must have been approved by the state or a political subdivision thereof, either of which must also have approved the specific obligations issued by the corporation. Interest received from such obligations is excludable from gross income under the provisions of § 103(a)(1) of the Internal Revenue Code of 1954.

Internal Revenue Code (IRC) §141(a) provides the term "private activity bond" means any bond issued as part of an issue ---

(1) which meets----

(A) the private business use test of paragraph (1) of subsection (b), and

(B) the private security or payment test of paragraph (2) of subsection (b), or

(2) which meets the private loan financing test of subsection (c)

IRC §141(b)(1) provides the private business use test is met if more than 10% of the proceeds of an issue are to be used for any private business use.

IRC §141(b)(2) provides the private security or payment test is met if the payment of the principle of, or the interest on, more than 10% of the proceeds of such issue is directly or indirectly----

(A) secured by an interest in----

(i) property used or to be used for a private business use, or

(ii) payments in respect of such property, or

(B) to be derived from payments in respect of property, or borrowed money, used or to be used for a private business use.

IRC § 141(c) provides an issue meets the test of this subsection if the amount of the proceeds of the issue which are to be used to make or finance loans to persons other than governmental units exceeds the lesser of ....(A) 5% of such proceeds, or ...(B) $5,000,000.

Income Tax Regulation (ITR) §1.141 provides the reasonable expectations test must take into account reasonable expectations about events and actions over the entire stated term of the issue.

IRC §148(d) provides that reasonably required reserve or replacement funds shall not exceed 10%.

IRC §1.148-10(a)(4) provides the Anti-Abuse Rules and Authority of the Commissioner. It further provides that, "...an action overburdens the tax exempt bond market....if it results in issuing more

bonds, issuing bonds earlier, or allowing bonds to remain outstanding longer than is otherwise reasonably necessary ....".

IRC §1.148-10(a)(2) provides,"...any is an abusive arbitrage device if the action has the effect of ---(ii) overburdening the tax exempt bond market...".

Government's Position

Qualified Issuer?:

(1) Revenue Ruling 63-20---provides obligations issued by a nonprofit corporation formed under the general nonprofit corporation law of a state for the purpose of **"stimulating industrial development"** within a political subdivision will be considered issued "on behalf of" the political subdivision...

The bonds issued for this project were for the renovation of a parking garage (privately funded) then purchased with the bond proceeds. In addition, the bond was issued in an amount in excess of the fair market value purchase price of the garage, with renovations, to funnel or further fund the developer in the completion of the entire River Park Square project. The entire redevelopment project was estimated at $ 100 million and consisted of a retail store, movie complex and parking garage.

The redevelopment does not appear to fall within the meaning of "stimulating industrial development" as defined in Revenue Ruling 63-20. This is far from an industrial development.

(2) Revenue Ruling 63-20—provides that "...obligations issued by a nonprofit corporation ...will be considered issued "on behalf of" provided...the following requirement(s) is met: (1) the corporation must engage in activities which are **essentially public in nature**.....

The "corporation" as identified in Revenue Ruling 63-20 for this case is the Spokane Downtown Foundation ("Issuer" or "Issuer/Foundation" or "Foundation"). The Issuer did not engage in activities that are "essentially public in nature" as required by Revenue Ruling 63-20.

The term "essentially public in nature" has a basic meaning as stated and should be examined in the context of general nonprofit corporation powers and purposes as stated in the Issuers Articles of Incorporation and Amended Articles of Incorporation.

The Articles of Incorporation, filed November 14, 1996, state the purposes of the Foundation (Issuer) to be;

(1) To provide services which will aid general economic development in downtown Spokane including, but not limited to, owning & operating a parking facility in downtown Spokane so as to provide low-cost, short term parking for members of the public utilizing downtown facilities and amenities, including Riverfront Park, City Hall, the City Library and downtown retail stores;
(2) To engage in any other lawful activity which may hereafter be authorized from time to time by the Board of Directors; provided, however, that the purposes for which the corporation is formed shall at all times be consistent with §501(c)(3) of the Internal Revenue Code of 1986, ..., including within such purposes the making of distributions to organizations that qualify as exempt organizations under §501(c)(3) of the Code.

The amended Articles of incorporation filed August 27, 1998 (just days before issuance of the Bonds) changed the purposes of the Foundation to reflect;

(1) To combat community deterioration and to carry out community revitalization and community economic development by receiving and administering funds exclusively for educational and charitable purposes;
(2) To assist in the erection and maintenance of public buildings, monuments, facilities, or works to lessen the burdens of government, and to promote social welfare;
(3) To initiate and carry out activities to stimulate economic development in economically depressed areas of the City of Spokane and its environs and, in particular, to undertake activities which: a.) relieve poverty and lessen neighborhood tensions caused by a lack of jobs in deteriorated or depressed areas by providing training opportunities for the unemployed or the under employed and creating employment opportunities for minority and other disadvantaged groups; and (b) combat community deterioration and eliminate blight by undertaking activities which stimulate and guide the establishment of new businesses among minority and other disadvantaged groups and which rehabilitate and revive existing businesses operated by members of minority or other disadvantaged groups.
(4) To provide services which will aid general economic development in downtown Spokane including, but not limited to, owning and operating a parking facility in downtown Spokane so as to provide low-cost, short term parking for members of the public utilizing downtown facilities and amenities, including Riverfront Park, City Hall, the City Library and downtown retail stores;
(5) To aid, support, and assist by gifts, contributions or otherwise, other corporations, community chests, funds & foundations organized and operated exclusively for charitable, scientific, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carry on propaganda, or otherwise attempting to influence legislation; and
(6) To do any lawful activities which may be necessary, useful or desirable for the furtherance, accomplishment, fostering or attainment of the foregoing purposes, either directly or indirectly and either alone or in conjunction or cooperation with others, whether such others be persons or organizations of any kind or nature, such as corporations, firms, associations, trusts, institutions, foundations or governmental bureaus, departments or agencies.

The original Articles of Incorporation limit the purposes of the corporation to those purposes that are consistent with an organization/corporation described in IRC §501(c)(3). The Amended Articles of Incorporation recite in their entirety, at times verbatim, the purposes of a 501(c)(3)[28] organization/corporation. Some liberty is taken in the purpose section to wrap the parking garage up in IRC §501(c)(3) language.

The amended Articles of Incorporation "Article IV" indicate the powers of the corporation/Issuer. This section states in part, "The Corporation shall have the power to do all lawful acts or things necessary, appropriate, or desirable to carry out and in furtherance of its purposes described in Article III which are consistent with the Washington Nonprofit Corporation Act and § 501(c)(3) of the Code of the Internal Revenue Code of 1986, ...". The powers of the corporation/Issuer are clearly limited to activities and actions that are consistent with IRC §501(c)(3).

As a result of the stated purposes of the corporation, and the similarities in the stated rules of Revenue Ruling 63-20 and those of IRC §501(c)(3), it is useful to look to IRC §501(c)(3) and related regulations to define and clarify the rule "...corporation must engage in activities which are essentially public in nature".

[28] See IRC §501(c)(3) and related regulations

Under Treasury Regulation §1.501(c)(3)-1(c)(1), an organization is considered operated exclusively for exempt/public purposes only if it engages "primarily" in activities that further an exempt/public purpose. No more than "an insubstantial part of its activities" may be devoted to other purposes.

Treasury Regulation §1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized and operated exclusively for charitable/public purpose unless it **serves a public rather than private interest.**

Whether or not an organization satisfies these requirements is determined by examining the actual purpose of the organizations activities, not its statement of purpose[29]. An organizations purpose may be inferred from its manner of operating[30]. The organization has the burden of proving that it is operated exclusively for exempt/public purposes[31].

The organization/Issuer is incorporated as a Washington nonprofit corporation, purportedly to act as a Revenue Ruling 63-20 corporation for federal tax purposes, with purposes and powers limited to IRC §501(c)(3). In determining the issuers compliance with the tax law we must look to the term "exclusively" as has been applied to 501(c)(3) organizations and the term "essentially" as applied to Revenue Ruling 63-20 organizations. The terms as applied to each type of entity, and as both apply to this entity, are virtually identical and as such will demand parity of analysis.

Both terms require the activities of the respective corporations to serve public interest and engage in public activities. Both terms appear to allow some level of activity that may be directed to other than public interest.

According to the 501(c)(3) regulations it is necessary for an organization to establish that it is not organized and operated for the benefit of private interests. Given the Issuers Articles of Incorporation and the purported 63-20 status, it is reasonable to apply the standards outlined in the 501(c)(3) regulations as they relate to private benefit.

For 501(c)(3) organizations, if an organization serves a public interest and also serves a private interest other than incidentally, it is not entitled to exemption under IRC §501(c)(3)[32]. It stands to reason in this case that if a private interest is served more than "incidentally" by the purported 63-20 Issuer then the Issuer is not a "qualified on behalf of" Issuer.

Incidental or incidentally in this context has both a qualitative and quantitative connotation.

(1) Qualitative means the "incidental" private benefit must be a necessary concomitant of the activity which benefits the public at large; in other words, the benefits to the public cannot be achieved without necessarily benefiting certain private individuals[33].

(2) Quantitative means that if the purposes or operations of an organization are such that private individuals who are not members of a charitable class receive other than an insubstantial or indirect economic benefit therefrom, such activities are deemed repugnant to the idea of an exclusively public charitable purpose[34]. The result is the same even if the purposes and activities of the organization would be exclusively public were it not for the element of private benefit.

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[29] American Campaign Academy v. Commissioner, 92 T.C. 1053, 1064 (1989)
[30] Living Faith, Inc. v. Commissioner, 950 F.2d 365, 372 (7th Cir.1991)
[31] Tax Ct. R. 217(c)(2)(A); Church of Scientology, 832 F.2d at 1317
[32] G.C.M. 37166, G.C.M. 35701, Rev. Rule 69-545, 1969-2 C.B.117
[33] Example: Rev. Rule 70-186, 1970-1 C.B. 128
[34] Example: Rev. Rule 76-152, 1976-1 C.B. 151; G.C.M.35701

Private benefit arising from an organization's activities must be "incidental" in both qualitative and quantitative aspects in order to be entitled to exemption under IRC §501(c)(3). If they are not, the activities are deemed to serve other than a public purpose. The substantiality of the private benefit is measured in the context of the overall public benefit conferred by the activity[35].

Applying the principles discussed above to this case, it is clear there was substantial and excessive private benefit derived by private interests. The Issuer must engage in activities which are essentially public in nature in order to qualify as an "on behalf" of Issuer. The Issuer engaged in activities that, more than insubstantially, benefited private parties.

The Issuer was;

(1) Established by the developer; and
(2) The developer's Attorney established the corporation and served as registered agent of the corporation[36]; and
(3) The developer initially approached, engaged and essentially hired Bond Counsel; and
(4) The developer initially approached and hired the Board of Directors as listed in the Amended Articles of Incorporation[37]; and
(5) Via the original 501(c)(3) language in the Articles of Incorporation filed by the Developer's Attorney & the 501(c)(3) language in the Amended Articles of Incorporation did obfuscate the true nature of the corporation/Issuer; and
(6) Developer required a revenue stream analysis, provided a number of the assumptions for the analysis, used the analysis as an appraisal with the knowledge that the analysis substantially overstated the value of the garage; and
(7) Allowed the parking rates in the analysis to determine revenue stream to be up to double the rate in effect, the hours of stay to be double a reasonable number, ignored the validation programs, etc...all of which have the effect of overstating the value of the property which ultimately (if the financing is to be paid) demand the garage to set rates much higher than would be necessary were this a true arms length transaction[38]; higher parking rates is diametrically opposed to the purpose of the Issuer/corporation established by the developer; and
(8) The developer adjusted and set the land lease rates in opposition to the garage purchase price based on the Walker parking analysis study; and
(9) The developer benefited excessively from the land lease since it was predicated on the parking analysis study that was overstated and the revenue stream was discounted on a tax exempt bond financing rate; and
(10) The developer put in place prior to the sale of the garage a parking oversight committee (composed of the Developer & Developer's tenants) to set the hours of the garage, the pricing structure of the garage, and various other items that amount to special legal entitlements[39]; and
(11) The developer sought to conceal the AMC theatre default on the garage, prior to the sale of the garage, via confidentiality agreements and a payment to AMC to cover shortfalls in the garage revenue for the first year as a result of the default, thus keeping the purchase price of the garage artificially elevated; and
(12) The developer required the City to pledge parking meter revenues for fixed ground rent (payment to the developer for what appears to be an encumbrance on the property) and operating expenses, which increased the rating on the bonds and added to the overvaluation of the garage via discounting the revenue stream at the bonds interest rate; and

[35] Rev. Rule 75-286, 1975-2 C.B. 210; Rev. Rule 68-14, 1968-1 C.B. 243
[36] Duane Swinton Testimony (Pages 38-39) & Mike Ormsby Testimony (Page 428)
[37] Betsy Cowles Testimony (Pages 249-250)
[38] John Dorsett Testimony (Pages 139-140)
[39] Article 2.1 of Parking Agreement & John Dorsett Testimony (Page 139-140) & Parking Covenants

(13)The developer wrote into the bond documents, via Bond Counsel, the 4th priority payment of administrative variable ground rent which was designed to reimburse the developer for the administrative costs incurred by the City and the Issuer to get the financing (this is why bond counsel inquires of the developer to increase his fees because any administrative fee that comes out of proceeds reduces the developers overall take); and

(14)The developer wrote into the bond documents, via Bond Counsel, the 5th priority payment of "variable ground rent" more appropriately know as a 50/50 split of revenue/profits; and

(15)The developer wrote and entered the ground lease prior to the sale of the garage including a provision that allows the developer to purchase the garage at the end of the lease for it's then fair market value not it's "investment value" based on revenue stream that the developer is selling the garage to the Issuer for.

It is clear from the facts that a number of priorities were at work here. The City priority was clearly to keep that portion of downtown viable and ensure sales tax revenues. The developer's priorities were to keep that area of downtown viable and the retail shops in place to ensure continued lease revenue and property value protections. The developer owned that area of downtown known as River Park Square.

In order to accomplish these goals the River Park Square area had to be redeveloped. The developer did not have the financial wherewithal to go it alone on the estimated $100 million project. So a scheme was devised that would allow the developer to renovate and sale the garage to the City and in the process generate approximately $10 million in cash the developer would plow back into the "private" portion of the project. It is unreasonable from the facts of this case to conclude otherwise. It is unreasonable from the facts of this case, in their entirety, to conclude that this is an everyday willing buyer and willing seller at fair market value transaction. Given the facts it is unreasonable to conclude this is an arms length transaction. No reasonable person given the facts would have purchased this facility under these terms for the price paid.

The City now states (and claims to have stated all along) that part of the purchase price was designed to provide capital to the developer to assist in the overall project. Given the facts, as we now know them, this appears to be the case. The price was determined prior to the Issuer being created, subsequent events that affected the price were ignored, obviously incorrect revenue stream assumptions were ignored, validation programs were ignored, control contracts and issues were ignored, AMC default was concealed, developers ground rent was secured (parking meter revenues), etc..

The Issuer ultimately issued $ 31,465,000 in tax exempt bonds and paid $ 26,500,000 to the developer for the purchase of a garage whose fair market value at best was $15,000,000. Even today, current independent appraisals indicate the fair market value of the garage to be $ 14,000,000 maximum.

The Issuer 63-20 corporation is not a qualified "on behalf" of issuer because it has not engaged in activities which are essentially public in nature. Failure to negotiate a fair market value based on all the facts and subsequent events is not an activity which is essentially public in nature. This single fact will result in harm to the public through higher parking fees. Enriching the developer via the purchase by at least $10 million is not essentially public in nature. Providing special legal entitlements to the merchants (who are tenants of the developer) to set hours of operations and rates charged is not an activity essentially public in nature. In fact, almost none of the activities of the Issuer/Foundation were essentially public in nature. All of the activities were directed at getting the financing in place to provide funds to the developer to assist in the redevelopment of a private retail center. The private benefit is direct and indirect, is substantial and is both qualitative & quantitative.

(3) Revenue Ruling 63-20—provides that "...obligations issued by a nonprofit corporation...will be considered issued "on behalf of" provided...the following requirement(s) is met: (2) the corporation must be one that is **not organized for profit (except to the extent or retiring indebtedness)....**

To determine if the Issuer is organized for profit we must first look to the organizing documents. In this case the organizing documents indicate that the Issuer is Incorporated under the Washington Nonprofit Corporation Laws. The incorporation documents further state the Issuer is a corporation with purposes and powers consistent with IRC §501(c)(3). The basic organizing documents appear to be in compliance with Revenue Ruling 63-20.

The operational aspects of the Issuer must be explored to determine if the Issuer, in fact, operates, as stated on the organizational documents.

The Issuer, as noted above, issued bonds to purchase a garage from the developer. The purchase price was excessive. This was obvious and ignored. Events that occurred after the City agreed to the purchase price (prior to the Issuer being established) and the actual sale date were ignored. No price adjustment was made as a result of these events. No reasonable man would have purchased the facility, knowing all the facts, for the price paid. So the actual sale of the facility itself was designed to enrich the developer to help fund the private development portion of the project. Therefore, the Issuer actually operated for the developer to profit. The developer established the Issuer, appointed Bond Counsel, and the Board as was previously noted.

The parking oversight committee, established by the developer, has special legal entitlements to set the garage hours of operation, establish the parking rates and determine validation programs to be used. The oversight committee is comprised of merchants of the River Park Square, all tenants of the developer and the Developer. Allowing the garage to operate for the benefit & profit of the tenants and developer also constitutes private use under IRC §141 (see discussion in this report on private use and payments in respect of use). In addition, this operation as a whole conveys private benefit/inurement upon the developer (see discussions on engaging in activities "essentially" public in nature and discussion on inurement).

The garage generates revenue from its operation. This revenue is pledged to pay 11 items by priority. The second priority is to pay "fixed ground rent". This payment is made to the developer as a lease payment for the land the garage sits on. Due to the obvious irregularities in the parking analysis done by Walker, and subsequent appraisals (as directed), the garage purchase price was excessive. The ground rent is based on these obviously improper valuations that the Board of the Issuer chose to ignore. The ground rent is an entirely fictitious valuation.

The ground rent was designed to give the Developer a ten percent return on the value of the land, increasing every three years by 10%[40]. Based on the underlying value of the land of $6.7 million this would reflect an initial ground rent payment of $ 670,000[41]. The negotiated term of the base ground rent only, results in excess payments of and profit to the developer in excess of $ 1.5 million over the 20 year term of the lease[42].

The developer has indicated the base ground rent and participation feature (4th priority) were designed to compensate the developer for "Unrealized Equity", the difference between the appraised investment value (excess & non-reflective of FMV) and the sale price of the garage ($ 26 million)[43]. The excess of investment value over market value of the garage with improvements is created solely by the favorable bond financing rate resulting from the City's

[40] Coopers & Lybrand Parking Garage Analysis (Page 17)
[41] Coopers & Lybrand Parking Garage Analysis (Page 17)
[42] Coopers & Lybrand Parking Garage Analysis (Page 17)
[43] Coopers & Lybrand Parking Garage Analysis (Page 18)

pledge of parking meter revenues and is not reflective of the contributory value of the land[44]. The pledge of parking meter revenues is only for the benefit of the developer as it serves as a sort of credit enhancement reducing the bond financing rate. That rate is used to discount cash flow to determine the investment value (lower the rate the higher the value created). In addition, if the bond defaults from lack of revenue, as they did, the ground rent (2nd priority) gets paid regardless because the parking meter revenue pledge is for ground rent and operating expenses only. The developer was insulated from any risk of loss, leaving investors (1st priority) hanging in the wind.

The developer has an option to purchase the garage at fair market value[45]. This is substantially less than the investment value used to sell the facility to the Issuer. Basically, once the bonds are paid by the Issuer, the City receives title to the improvements (garage) unencumbered by debt, but still subject to the ground lease[46]. In effect, the City is entitled to use the improvements for a maximum of 25 years at which time the developer may purchase the property for fair market value[36].

The 4th priority payment of the revenue generated by the garage is "administrative variable ground rent". This rent is to reimburse the developer for the administrative costs incurred by the City in the issuance of the Bonds. These payments represent a preferential return to the developer for loss of income resulting from increased debt service payments as a result of bonds being issued to cover the administrative costs incurred by the City. Basically, the increased debt service of the administrative cost portion of the bond issue will reduce monies available for the 50/50 revenue split (5th priority) or may increase the wait time to get to the 50/50 split. These payments clearly increase the overall excess profit the developer realized on the date of sale. This payment was put in the bond documents as a payment of "administrative variable ground rent" basically to conceal the true nature of the expense. This clause organizationally and operationally is for the developer's profit.

The 5th priority payment is for "variable ground rent". This payment is equal to 50% of the money in the Revenue Account. Basically, after priorities 1 thru 4 are paid the developer shares in an equal 50/50 split of the revenues/net income of the facility. Clearly, this profit sharing arrangement with the developer is an operation for the benefit and profit of the developer.

Clearly, given the facts in this case, the Issuer/Foundation despite being incorporated under the nonprofit laws of the State of Washington and despite the fact that the Articles of Incorporation & Amended Articles of Incorporation indicate the Issuer to be described in, and conduct activities of, a 501(c)(3) public entity, it is operated for the profit of the developer. It is unreasonable to believe the aspects of this transaction were negotiated in an arms length environment. In an arms length environment no reasonable person would have purchased this facility under the terms used.

The Issuer/Foundation has argued that the price of the purchase was negotiated by the City. This was three years before the actual purchase occurred. The Foundation when established (by the developer as previously noted) did nothing to exercise its apparent right to renegotiate the purchase price as the result of items that affect the value of the leasehold improvement whether using investment value or fair market value. Clearly, the value of the land lease should have been determined as all arms length ground leases are, on the fair market value basis which will accurately reflect the contributory value of the land in this type of arrangement[47]. In addition, the pledge of parking meter revenue, the administrative variable ground rent (preferential payment $ 45,000), the 50/50 revenue split, the option for the developer to purchase the improvements at fair market value, the right of private interests to control prices, hours of operation and select private operators, and the AMC theater default (discussed below) all reduce the value of the

[44] Coopers & Lybrand Parking Garage Analysis (Page 18)
[45] See Ground Lease Agreement
[46] Coopers & Lybrand Parking Garage Analysis (Page 19) & See Ground Lease Agreement

[47] Land lease is overstated because City's discount rate was applied to cash flows C&L Analysis (Page 11)

leasehold improvements to the Issuer/Foundation. A true arms length negotiation would have resulted in significant reductions in the price paid for the facility under both the investment valuation method used and any fair market valuation method. Most of the items noted above were known and ignored in order to unjustly enrich and profit the developer.

(4) Revenue Ruling 63-20—provides that "...obligations issued by a nonprofit corporation...will be considered issued "on behalf of" provided...the following requirement(s) is met: (3) **the corporate income must not inure to any private person...**

As discussed above in Part (2) of the **Government's Position** regarding the Issuer/Foundation (corporation) engaging in activities which are essentially public in nature, it was shown that if an organization is engaging in activities which provide substantial private benefit, it is not, then considered to be engaging in activities of a public nature.

For purposes of Part (2) the private benefit must be substantial. For purposes of this section, Revenue Ruling 63-20, identical to IRC §501(c)(3), *provides an absolute prohibition* on inurement. The relationship between inurement and private benefit was clarified in American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). The court explained that, "while the prohibitions against private benefit and private inurement share common and overlapping elements, the two are distinct requirements which must be independently satisfied." The court stated that the presence of private inurement violates both prohibitions, but the absence of inurement does not mean the absence of private benefit. Inurement, then, may be viewed as a subset of private benefit.

The proscription against inurement generally applies to a distinct class of private interests, typically persons who, because of a particular relationship with an organization, have an opportunity to control or influence its activities[48]. Therefore, regulations interpreting 501(a) of the Code (where inurement has generally been dealt with) make clear the words "private shareholder or individual" in §501(c)(3) refer to persons having a personal and private interest in the activities of the organization, as opposed to members of the general public.

In this case, the Issuer/Foundation purports to be described in IRC §501(c)(3), although it never formally applied for recognition, and purports to be a 63-20 corporation/Issuer. Under Revenue Ruling 63-20 we believe the term "private person" has the same connotation and meaning as the term "private shareholder or individual" in IRC §501 and related rulings.

It is clear from the facts of this case, the developer had, and continues to have, a particular relationship with the City of Spokane and the Issuer/Foundation such that it was in a position to control or influence its activities. The relationship with the City was one of essentially mutual goals in the accomplishment of the redevelopment project for different ends. The relationship with the Issuer/Foundation was one of creation, establishment, appointment of directors a few days before issuance, etc.

It is clear that the developer would meet the definition of private person for purposes of the inurement proscription. Although not a board member or employee, a close working relationship existed and services were performed for the Issuer/Foundation. To that extent the developer would possess the requisite relationship to find inurement, similar to the relationships outlined in G.C.M. 39498 and G.C.M. 39670. Given the facts, to conclude otherwise is unreasonable.

Even though the developer is subject to the inurement proscription, it does not mean there can be no economic dealings between the parties. The inurement proscription does not prevent the payment of "**reasonable compensation**" for goods or services.

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[48] G.C.M. 39862

There are a number of different arrangements in this case that give rise to, and result in, inurement. These arrangements emanate from the actual sale of the garage and the resulting contractual obligations. The sale of the garage was to the Issuer/Foundation created and established by the developer. The method to get to a purchase price was purported to be negotiated with the City. The purchase price was based on an analysis performed by Walker Parking Consultants in which the developer provided most if not all of the underlying assumptions to be used. The analysis notes that this is not a fair market value valuation but is rather an analysis given specific assumptions. After the analysis was complete, two appraisers were hired to do investment valuation appraisal and were directed to use the numbers in the Walker Analysis[49]. This was despite the fact that the City of Spokane had throughout its entire existence always used the fair market value valuation method.

Coopers & Lybrand, as well as both appraisers, pointed out that the assumptions in the Walker report were excessive[50]. The excessiveness was in the assumed length of stay, rates per hour, disregarded parking validation programs, disregarded disincentives to use garage after 6 and on Sundays due to free parking in the area, etc. Walker did no local market analysis of rates in this market and what it would bear. The developer provided assumptions used as well as others. The appraisers were told to discount the cash flows for purposes of the investment value at the City's presumed discount rate (credit rate). Coopers & Lybrand presentation to the City, as noted previously, pointed out a revenue shortfall of $ 1.6 million the first year. This is both significant and material, and was ignored.

In the Walker report approximately 52% of all cars parked in the garage will come from cinema patrons. Given that the Walker report does not take the disincentives into account after 6 and on weekends, and the fact that they believe they know of only one cinema in the country that does not provide for free parking or validated parking, approximately 50% of the total revenue stream used in the report represented by the cinema patrons, is a gross valuation overstatement.

In addition, parking rates after 6 PM and on weekends were reduced significantly prior to the purchase of the garage by the Issuer/Foundation. This rate reduction resulted in a $1.24 million shortfall in projected revenue for the first year alone. The change in parking rates and resulting revenue shortfalls were ignored by the Issuer/Foundation and did not result in any negotiations to adjust the purchase price of the facility. A reasonable person would have negotiated the price significantly under any valuation method.

While the appraisals and studies were done with significant disclosures embedded, the City and developer for purposes of the transaction ignored the information. All assumptions to be used by the appraisers were dictated to them. The appraisals in reality were nothing more than a notch in post of public deception.

The purchase price of the property was purportedly decided in 1996. The bonds were issued in 1998 and the sale took place in 1999. In that time frame, Coopers & Lybrand was contracted to accomplish a Parking Garage Analysis, or more specifically a due diligence study for the City. This report was relatively critical of the Walker study as well as pointing out the flaws the appraisers had pointed out. The study did not address whether the proposed financing could be supported by the assumed revenues but did clearly state that a significant valuation problem existed here. The report also points out that the City reduced the purchase valuation by reducing the cinema patron revenue in the projection by 43%. Therefore, the cinema patron revenue which accounted for approx. 50% of the total revenue was reduced by 43% thus reducing the total revenue stream used for the investment valuation method by approximately 20%. No other adjustments were made. This reduction resulted in an offsetting increase in the cost/value of the ground lease.

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[49] Betsy Cowles Testimony (Page164) & Daniel Barrett Testimony (Pages 16-17) & April 11, 1996 Letter from City to Appraisers

[50] See Coopers & Lybrand Parking Garage Analysis January 27, 1997

No adjustments were made with respect to the purchase price;

- As a result of the parking charges being lowered after 6 and on weekends in the summer of 1999. This reduction in rates occurred before the sale;
- As a result of the developers right of first refusal on the purchase of the property if another party made an offer to buy;
- As a result of the developers option to buy the property at fair market value at the end of the ground lease;
- As a result of the obvious and apparent overstatements embedded in the Walker report;
- As a result of the increase in the ground lease (encumbrance) payment and obvious overstatement of the contributory value of the land via the investment valuation method (2nd priority of payments from project revenues);
- As a result of the administrative variable ground rent payment clause (4th priority on project revenues)
- As a result of the variable ground rent payment (5th priority on revenues) representing a 50/50 split of revenue/income of the project;
- As a result of the developer's parking oversight committee private interests had operational control of the facility for setting rates, hours of operation and selection of private operator;
- Nor as a result of the AMC Cinema's default (*)

(*) AMC Default--AMC was notified June 8, 1999 that their patrons are not to receive free parking at the garage. These patrons accounted for approximately 50% of the revenue stream purportedly used to determine a purchase valuation. AMC indicated a default on the lease to the developer. AMC indicated they were seeking free parking at another garage or would move out of the development and into the suburbs. This fact (AMC would not get free parking) was obviously hidden from AMC and the public from 1996 until just before the sale was to occur, but after the bonds were issued. It is standard and customary for theatres to get free parking for their patrons throughout the country[51]. The City, Issuer/Foundation and the developer all knew this yet hid the fact that AMC would not get free parking from AMC until June of 1999.

To cure the AMC default the developer entered into a confidentiality agreement with the Foundation (signed by Mr. Ormsby who was Bond Counsel to the Issuer/Foundation). As noted above Mr. Ormsby was initially approached by the Developer to participate as Bond Counsel in this deal for the Issuer/Foundation the Developer created. This agreement noted that if it became public significant damage to the developer may result. The developer at this point is two months from the sale of the garage to the Issuer/Foundation for a price that will result in approximately $10 million in gain. The $10 million or so is an amount the City had been trying to get to the developer in order to help finance the entire $100 million redevelopment. The redevelopment however, was a private project that did not follow public contracting rules and was designed for the benefit of the developer, not the public. The confidentiality agreement sought to keep hidden the fact that AMC filed a default on the lease and as a result the developer agreed to put up $400,000 to cover lost revenues from an AMC validation program for the 1st year.

A couple of problems are present here. First, the $400,000 payment, and concealment of that payment, resulted in the purchase price of the garage not being adjusted downward given that half the revenue the purchase price was based on was non-existent. In addition, the payment was only for the 1st year and ignored the next 19 years. No reasonable person would have purchased this garage for the prices suggested given any of the facts, much less this one alone. There was no arms length transaction. The payment of the $400,000 and concealment of the facts served to artificially hold up the already excessively inflated price of the garage. This resulted in direct benefit to the developer of approximately $10 million dollars or more given that the fair market value for the garage as was repeatedly indicated to be $10 to 15 million.

[51] John Dorsett Testimony (Pages 143-146)

Payment of the $400,000 to be used for garage shortfalls, as a result of the AMC theatre default, will be discussed further below as to whether this creates an additional debt service reserve fund (thus disqualifying the bonds), represents a kickback, supports an overissuance arbitrage issue or represents all these things.

The direct result of the payment, the concealment (confidentiality agreement) and the certification by the developer on the purchase agreement directly and unjustly enriched the developer with $10 million or more dollars of the Issuer/Foundations assets.

It is clear that the developer is a "private person" for purposes of the proscription on inurement under both Revenue Ruling 63-20 and IRC §501(c)(3). It is also clear that significant inurement was bestowed upon the developer, as well as private benefit, that indicates the Issuer/Foundation is engaging in activities substantially other than those essentially public in nature.

Whether the purchase price was negotiated in an arms length methodology with full and fair disclosure is not really relevant for this analysis. It unreasonable to believe this was an arms length transaction in light of all the facts to the contrary. The important facts of this analysis are all the obvious and repeated "reds flags" raised in the process of this transaction and the consistent "disregard" for common sense required of those red flags. Exercising common sense in this transaction would have been an activity in the publics benefit. To meet the arm-length standard at a minimum it must be between parties of equal bargaining power and result in reasonable terms. The terms of this transaction were not reasonable and not in the publics interest.

The concealment, via confidentiality agreement, with the Issuer/Foundation regarding the AMC default, and the commitment & payment made by the developer to protect the purchase price ($10 million profit) and the fact that the payment was for only one of the 20 years the revenue stream was based on, gives clear indication of private interest being served as well as direct private inurement on the date of sale of the garage.

The establishment of the parking oversight committee, where all the power was ceded to select the private operator of the garage, set the operational hours of the garage and to set the rates charged by the garage all indicate non public purposes are being served and inurement. This arrangement forecloses the power of any public authority. This arrangement is at odds with, and creates a substantial conflict between, the fiduciary duty requiring the facility to be operated and engaged in activities essentially public in nature and the natural desires of Nordstroms and the Developer to further their pecuniary interests. The surrender of effective control and profits (5th priority payment) reflect adversely on the Issuer/Foundations own public purposes in having its sole activity managed by private parties that stand to profit (oversight committee).

The developer is paid several fees from the revenue generated from the operation of the garage. The various ground rents that are described in the priority of payments and the 5th priority payment is a 50/50 revenue split. This is a direct sharing in the revenue/income of the facility that the developer and Nordstroms have complete operational control over. Whether or not payments have been made yet is not the issue with this clause since this situation exists for 20 years. It is an enforceable clause on the date of issue of the bonds and represents a private interest as well as inurement of income and assets to a private person.

The City, as stated above, now claims in testimony that part of the reason for this Bond issue was to help provide financing to the overall project. As evidence of this, it was disclosed to Coopers & Lybrand that the Bonds were to be used to "take down" the construction financing upon completion of the garage **and** completion of the Nordstrom and theatre portions of the project[52].

[52] Coopers & Lybrand Parking Garage Analysis (page 22)

The Bonds were to be issued prior to the start of construction and held in escrow until completion. The Bond proceeds were used as pledged collateral for the construction financing. This disclosure is clear that the bond proceeds were to be used for the private portion of the facility. This results in direct inurement to the developer.

In the "Privileged & Confidential" section of the Coopers & Lybrand report an analysis of the internal rate of return to the developer was conducted. The cash flows from the base ground rent only were analyzed. The cash flow analysis for the garage, as prepared by Walker, indicated significant participating income to the Developer. For purposes of this calculation, models prepared by the Developer were relied on. In effect, the developer included an amount in the calculation for the "contributory value of land" for the parcel underlying the Nordstroms store. This indicates that Nordstroms is not paying lease payments for the underlying land. So in the Nordstrom case, the land underlying it is of no contributory value to the leasehold improvements, but the land underlying the garage (which partially underlies Nordstrom) is of great contributory value as indicated by the excessive ground lease payments. This is smoke and mirrors. The value of the property was pumped up by the Walker Parking Report using the investment value analysis, relying on the Developer for assumptions and ignoring all the items that reduce the value of the property. Then from that figure getting to an allocation point that put cash in the Developers pocket and the rest being deemed a ground lease. In effect, the ground lease is a created and arbitrary number. At the rates paid, the ground rent for the garage and Nordstrom and possibly others, is more than covered and is secured by a pledge of parking meter revenue, a pledge of security the investor/Bondholders do not have. Since the developer has been able to shift the burden of ground rent to the Issuer/Foundation it has increased its bargaining power with the private tenants in terms of lease of the improvements.

There is an absolute prohibition on inurement for a 63-20 corporation to qualify as an "on behalf" of issuer. This same prohibition is equally applicable to IRC §501(c)(3) non profit corporations. It is clear, from the facts, that this prohibition has been explicitly violated. This transaction, and the redevelopment project, from day one was dependent on being able to get enough financing in the developer/project owners pocket to get it done. This initially was to be done via the renovation and sale of the garage and the use of a HUD loan. The HUD loan was somewhat dependent on certain garage analyses and some irregularities in that process have been noted. For purposes of this report those irregularities will not be addressed.

The Project was dependent from the start on the garage valuation. In this case, the garage was clearly overvalued. The overvaluation was the result of the method dictated by the City and the assumptions used as provided by the Developer (as shown throughout this report). In addition, the City, the Developer and Bond Counsel all ignored the obvious overstatements as detailed in all the reports on the project provided. All parties involved appear to be struck by ostrich fever, a collective burying of heads in the sand. This is clearly what the developer needed.

As a result, the Issuer/Foundation purchased the garage for at least $ 10 million more than the fair market value of the garage then and now. The $ 10 million is direct inurement to the Developer. A ground lease was entered that provides direct inurement to the developer in the created excess's of the payments over fair market value. This amounts to several million dollars over the life of the lease. The ground lease provides for a right of first refusal to purchase, at **fair market value**, the facility, should a buyer appear during the term of the lease. The ground lease also provides an option for the Developer to purchase the property at **fair market value** at the end of the lease. Neither the Issuer/Foundation nor the City were compensated for the value of these options directly or via a reduced purchase price for the facility or via a ground lease reduction. It was not in the equation for the ground lease or the purchase price, although under the structure of the purchase and the lease, the values were created values and reducing these items for the option values would still have not removed the direct inurement from the transaction.

The AMC Theater default which occurred after the bonds were issued but prior to the sale of the garage and resulting confidentiality agreement (concealment), lack of any negotiation on the

issue, or price adjustment on the leasehold improvement (garage) further supports a finding of inurement. It is unreasonable to believe this transaction at any stage was an arms length negotiated transaction. When 50% of the revenue that supports an investment value valuation is in jeopardy or non existent (as in this case) what reasonable person or entity engaged in an arms length transaction would sign confidentiality agreements to conceal that fact and then pay full price for the facility? The $400,000 payment to cover lost revenues is nothing more than a kickback of Bond proceeds to make it appear there are no lost revenues as a result of AMC's default. This portion of the transaction represents affirmative acts engaged in by the Developer, Bond Counsel, the Issuer/Foundation and the City to the detriment of the public and for the direct and private benefit of the developer, inurement. This portion of the transaction raises troubling aspects of potential fraud.

Revenue from the garage will be paid for priority items as noted previously. The ground lease, priority 2, is inurement in that it is a created value to funnel money to the developer. The administrative variable ground rent, priority 4, is inurement in that it is a preferential payment to the Developer intended to compensate for the administrative costs incurred by the City for the bond issuance that were paid out of Bond proceeds. These administrative costs would have delayed the start of payments under the 5th priority and resulted in the City and the Developer sharing in the issuance costs. The variable ground rent, priority 5, is a 50/50 revenue/income split of the garage revenues between the Issuer and the Developer. This is inurement and indicates the garaged is being operated for profit.

All the items noted in this "inurement" section, Section 4 of the Government's Position also constitute "private benefit" under Section 2 of the Governments Position. This is because inurement is a subset of private benefit. The Bonds are taxable private activity bonds.

(5) Revenue Ruling 63-20—provides that "...obligations issued by a nonprofit corporation...will be considered issued "on behalf of" provided...the following requirement(s) is met: (4) **the state or political subdivision thereof must have a beneficial interest in the corporation while the indebtedness remains outstanding and it must obtain full legal title to the property of the corporation with respect to which the indebtedness was incurred upon retirement of such indebtedness...**

It is clear from the facts of this case that the indebtedness (Bonds Issued) was incurred to purchase a leasehold improvement, the garage, and provide money to the developer for completion of additional "private" parts of the overall project. In addition, the indebtedness was incurred prior to the start of construction in order to allow the developer to use the proceeds as collateral to secure financing for the garage portion as well as other portions of the project.

Whether the State or political subdivision has a beneficial interest in the Issuer/Foundation (corporation) while the indebtedness is outstanding is unclear. The Issuer/Foundation, as previously noted established the foundation and essentially appointed the Board and hired the Bond Counsel. The City Parking Development Authority is charged with overseeing the garage operations. The Developer & Nordstroms, via the parking oversight committee have the right to select the private garage operator, set rates and set hours of operation. Since the City and the Issuer/Foundation have no real control of any of the operations of the garage, it appears there are no real beneficial interests. The written interests appear to be for appearance purposes only, not within the spirit and intent of the law, and perform no other function than to help conceal the true private nature of this financing to the detriment of the public.

The City must obtain full legal title to the property of the Issuer/Foundation with respect to which the Bonds are issued. Although it is stated that the City will have full title to the garage upon retirement of indebtedness, it is subject to a number of conditions. The ground underneath the garage is owned and will be owned by the Developer. The ground is subject to a ground lease

payment made by the owners of the garage. The Developer has an option to purchase the garage at fair market value for which the City was not compensated. As structured it appears the land and associated ground lease constitute an encumbrance on the property.

In addition, the intent of the transaction was to get funds to the developer to help in the financing of the overall project. The fact that it was done through a methodology that essentially attempted to conceal this fact does not change the outcome. The Bond proceeds while escrowed were used as collateral, by the Developer, for construction loans. These loans were for the garage and the Nordstroms portion of the project. Upon the sale the loans were paid off. The true nature of the use of the Bond proceeds was concealed in the valuation situation. The indebtedness was used not only for the garage but also for the Nordstroms portion of the project which is owned by the Developer. The City will not obtain title to this property.

It is clear from the facts of this case that the Spokane Downtown Foundation **is not a qualified "on behalf" of issuer** under Revenue Ruling 63-20. It is also clear that the Spokane Downtown Foundation is not an organization described in IRC § 501(c)(3) as generally alluded to in the Articles of Incorporation. The Bonds are taxable private activity bonds.

Qualified Bonds?:

In addition to the qualified issuer question addressed above, these bonds had to be qualified under the Internal Revenue Code for tax exemption.

(1) IRC §141(a) provides the term "private activity bond" means any bond issue as part of an issue—(1) which meets—

(A) the private business use test of paragraph (1) of subsection (b), and

(B) the private security or payment test of paragraph (2) of subsection (b), or

The private business use test is met if more than 10% of the proceeds of an issue are to be used for any private business use.

The private security or payment test is met if the payment of the principle of, or the interest on, more than 10% of the proceeds of an issue is (under the terms of such issue or any underlying arrangement) directly or indirectly—(A) secured by any interest in—(i) property to be used for private business use, or (ii) payments in respect of such property, or (B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Income Tax Regulation §1.141-3(b)(2),(3)(4) & (7) provide definitions of types of private business use arrangements.

- ITR 1.141-3(b)(2) states that ownership by a nongovernmental person of financed property is private business use of the property
- ITR 1.141-3(b)(3) states that a lease of financed property to a nongovernmental person is private use...to determine the arrangements proper characterization it is necessary to consider all the facts....(i) degree of control exercised over the property by nongovernmental person; and (ii) whether the nongovernmental person bears risk of loss....
- ITR 1.141-3(b)(4) states a management contract with respect to financed property generally results in private business use of

that property if the contract provides for compensation for services rendered.....based in whole or in part on a share of net profits

- ITR 1.141-3(b)(7) states any other arrangement that conveys special legal entitlements for beneficial use of bond proceeds or of financed property that are comparable to special legal entitlements....result in private business use.

ITR 1.141-3(f) example 5 states;

Rights to control use of property treated as private business use—parking lot. Corporation C and City D enter into a plan to finance the construction of a parking lot adjacent to C's factory. *Pursuant to* the plan, C conveys the site for the parking lot to D for a nominal amount, subject to a covenant running with the land that the property be used *only for a parking* lot. In addition, D agrees that C will have the right to approve rates charged by D for use of the parking lot. D issues bonds to finance construction of the parking lot on the site. The parking lot will be available for use by the general public on the basis of rates that are generally applicable and uniformly applied. The issue meets the private business use test because nongovernmental person has special legal entitlements for beneficial use of the financed facility that are comparable to an ownership interest.

In this case, a parking oversight committee was established consisting of Nordstroms, the Garage Owner, a Retail Owner and one other Occupant of the Retail Center. Since the committee was established prior to the sale of the garage, the term "Garage Owner" is unclear as to whether it was the Developer and then the Issuer/Foundation or whether it referred to the Developer only. In any event, the balance of power of the committee rests with the private sector. This committee was given the power to determine hours of operation and set rates. These powers are special legal entitlements for beneficial use of the financed facility that are comparable to an ownership interest.

In addition, Nordstroms and the Developer retain the power to select the private operator of the facility. With these provisions the power of any public authority was removed from the operation of the garage. These provisions are special legal entitlements that cause this bond issuance to meet the private use test of IRC §141.

The developer had the right to use the Bond proceeds as collateral for private loans for the garage and Nordstroms construction between date of issue and date of sale. Exclusive use of Bond proceeds for the entire period.

ITR §1.141-4(d) makes it clear that property used or to be used for a private business use and payments in respect of that property are treated as private security if any interest in that property or payments secures the payment of debt service on the bonds. Therefore, in this case the *revenues generated* by the facility (operation of the garage) will pay debt service on the bonds. This is the only source for debt service on the Bonds aside from reserve *accounts funded* with bond proceeds and a direct $400,000 payment made by the Developer.

Clearly the bonds meet the private payment and security tests of IRC § 141 and are not qualified tax exempt obligations. The Bonds are taxable private activity bonds.

Additionally, as discussed above in the qualified issuer section, it was the intent of the bond issue to provide financing to the Developer for private portions of the project, exclusive of the garage portion. This intent is shown by the way the entire transaction was handled in ignoring all the significant and material items that otherwise would have caused a reasonable person, in an arms length negotiation, to conclude the value of the garage is significantly lower and cause renegotiation or walking on the part of the reasonable person. The fact of this matter is the casino

was rigged. Any adjustment in the purchase price resulted in an adjustment of the ground lease[53]. If the price went down, the lease went up.

In any event, the developer profited unfairly to the tune of at least $10 million dollars. The Developer also made a $400,000 payment to cover the first year shortfall in revenues as a result of the AMC theater default. This payment was made by the developer in order to conceal the default thus protecting the excess valuation of the garage and $ 10 plus million in excess monies funneled to the developer to pay construction loans and other aspects (private aspects) of the project. One material item the valuation ignored was a validation program. A validation program was in place at the garage and every other garage in the area. This essentially results in the Developer being provided excess funding via the Bond issuance used for the Nordstroms construction as well as other aspects. The $ 400,000 payment, as a result of the AMC default, is in respect of those monies. Any validation *program* that requires merchants to pay any amount (reduced or otherwise) will result in additional private payments. It was clear on date of issue that some validation program will have to be put in place. It was even clearer on the date of sale. It is clear the expectations on both date of issue and sale were unreasonable. It is also clear that the $ 400,000 payment for the 1st year only, coupled with the valet parking and reserved spaces for various business's and the clear expectation of a validation program, that the private use and payment tests are met with respect to the excess valuation payment to the Developer. The Bonds are taxable private activity bonds. All items discussed above also constitute items that result in private inurement/benefit and result in the corporation not qualifying as a qualified "on behalf" of issuer as discussed in the Qualified Issuer § of this report.

(2) IRC §141(c) provides **an issue meets the test of this subsection if the amount of the proceeds of the issue which are to be used to make or finance loans to persons other than governmental units exceeds the lesser of ....(A) 5% of such proceeds, or ...(B) $5,000,000**

In this case at least $ 10,000,000 dollars in monies were passed to the Developer as part of a purported arms length purchase of the garage. As noted above, the Developer and other tenants of the project have special legal entitlements to the garage. Those rights, as well as others, make it clear the garage is used for private use, and the payments on the bonds are in respect of that private use. The excess valuation of the garage was used for Nordstrom construction and other private aspects of the project. The payments in respect of that private use are also from the garage revenues. The Developers who borrowed this excess valuation amount controls the garage per the special legal entitlements. That control generates revenue with which the Developer is able to repay the excess amounts (private loan). The private loan financing test of IRC §141(c), is met with respect to these bonds. The Bonds are taxable private activity Bonds.

(3) Income Tax Regulation (ITR) §1.141 provides the **reasonable expectations test must take *into account* reasonable expectations about events and actions over the entire stated term of the issue.**

It is clear from the facts that the reasonable expectations test of ITR §1.141 were not met. If the expectations were reasonable for the issuance of this debt, a lot less debt would have been issued and a lot greater public benefit would have been derived.

Reasonable expectations would have demanded that all significant material aspects of the deal be explored prior to the expenditure of the funds. Reasonable expectations and common sense tell us that if you want cheaper parking downtown you don't overpay for a garage. Reasonable expectations tell us that when a parking analysis report, at least two subsequent appraisal reports (although directed by the City as to what the outcome would be), and another parking analysis study point out repeatedly, numerous and substantial material items affecting the clear

[53] Duane Swinton Testimony (Pages 267, 601-603)

overvaluation of the garage, that someone would check into these items. Reasonable expectations demand that when a material default on the revenue stream the valuation was based on occurs only months from the expenditure of the funds that someone would put the brakes on the deal rather than enter into a confidentiality agreement to hide that fact and the cure that was put in place. Reasonable expectations would have resulted in someone noting that the cure for the deal was for only one year, not the 20 years the bonds will be outstanding, and putting the brakes on the deal until the revenue stream could be assured for a number of years in the future or the purchase price adjusted downward. Reasonable expectations would have resulted in real appraisals performed by the appraisers rather than the values derived from assumptions dictated to the appraisers that would result in a predetermined outcome. Reasonable expectations would have resulted in the City using the same fair market appraisal valuation criteria it had always used in the past, which is much less susceptible to manipulation and trickery, and would have resulted in a fair valuation. Reasonable expectations would demand that the garage operations be in the hands of a public entity rather than in the hands of a committee representing the Developer and various tenants of the project.

In this case, given the facts, it is unreasonable to believe or argue that the Issuer/Foundation or the City had anything that resembled a reasonable expectation. The Bond issue from the start was clearly for the substantial private benefit of the developer, to the detriment of the public. The Bonds are taxable private activity bonds.

(4) IRC §148(d) provides that **reasonably required reserve or replacement funds shall not exceed 10%**

On the date of issue a reserve fund to pay debt service was established. The fund was 10% of the proceeds. Payment of the $ 400,000 to cure the AMC default by the developer created a fund to pay debt service on the bonds. This fund, with the initial 10% deposit of bond proceeds and the $ 400,000 payment puts the reasonably required reserve or replacement funds at approximately 11.2% in violation of IRC §148. The $ 400,000 reserve was established by the Developer while the bond funds were invested and being used as collateral for private loans. It also was established just before the sale of the garage was made. The money, in effect, represents a kick-back of bond proceeds paid to the developer, in the transaction. The $400,00 payment protected the developer's interest, to the detriment of the general public. The Bonds are taxable private activity bonds under IRC §148.

(5) IRC §1.148-10(a)(4) provides the Anti-Abuse Rules and Authority of the Commissioner. It further provides that, **"...an action overburdens the tax exempt bond market....if it results in issuing more bonds, issuing bonds earlier, or allowing bonds to remain outstanding longer than is otherwise reasonably necessary ...."**.

IRC §1.148-10(a)(2) provides,"...any action is an abusive arbitrage device if the action has the effect of ----(ii) overburdening the tax exempt bond market..."

An abusive arbitrage device is defined in IRC §1.148-10 as any action that has the effect of (ii) overburdening the tax exempt market. In this case the Issuer/Foundation issued more bonds than was reasonably necessary for the purchase of a parking garage. The bonds were issued to among other things enable the developer to use the proceeds as collateral for construction loans on the garage as well as private portions of the project such as the Nordstroms renovation. More bonds were issued than necessary to achieve the purported governmental purpose here. In addition, the facts support a conclusion that the purpose of the issue was also to provide funds directly to the Developer to help fund the entire project. Again, more bonds were issued than necessary to accomplish the purported governmental purpose of the bonds. The actions by the issuer allowed the Developer to exploit the difference between taxable and tax exempt rates to obtain a material financial advantage and gain. The bond issuance is an abusive arbitrage device and the bonds are taxable.

Conclusion:

The Spokane Downtown Foundation is not a qualified "on behalf" of issuer for purposes of Revenue Ruling 63-20 and the bonds do not qualify for tax exemption as a result. The Bonds are taxable private activity bonds.

The Spokane Downtown Foundation is not a qualified 501(c)(3) organization and is not exempt from taxation under the Code. The bonds are not qualified private activity bonds under IRC §145. This is addressed solely because the organizing documents purport that this corporation is essentially described in 501(c)(3) of the Code. It is not. The Bonds are taxable private activity bonds.

The Spokane Downtown Foundation Parking Revenue Bonds, 1998 (River Park Square Project) are private activity bonds. The bonds meet the private use and payment tests, and the private loan financing test. The bonds also fail to meet the reasonable expectations test by failing to take into account the reasonable expectations about events and actions over the entire life of the bonds. The reasonably required reserve or replacement fund exceeded 10% of bond proceeds. More bonds were issued than necessary for the governmental purpose of the issue. The Bonds are taxable private activity bonds.

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Greensboro, NC 27401
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Portland, OR 97204
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466
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Salt Lake City, UT 84111
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Burlington, VT 05401
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