

HENDRICKS & LEWIS

999 THIRD AVENUE, SUITE 2675
SEATTLE, WASHINGTON 98104

telephone (206) 624-1933
facsimile (206) 583-2716
www.hllaw.com

October 30, 2000

**CONFIDENTIAL
ATTORNEY/CLIENT PRIVILEGE**

(Approved by City Council for release)

Henry Miggins, City Manager
City of Spokane
808 West Spokane Falls Boulevard
Spokane, Washington 99201-3303

Dear Mr. Miggins:

As you have requested, this is my preliminary report as Special Counsel on certain aspects of the River Park Square ("RPS") controversy. This report is based primarily on documentary evidence, supplemented by my recollection of discussions with the City's Bond Counsel and various City Officials and staff.

As a preliminary report, it is neither comprehensive (in that it does not raise all of the important issues) nor complete. Consequently, as the case progresses, additional personal interviews and additional document review might result in significant changes to parts or all of the following analysis.

Principal Conclusion

THE PROPONENTS OF CITY SUPPORT FOR RPS USED THE PDA AND FOUNDATION TO FACILITATE A PLEDGE OF LOANS FROM PARKING METER REVENUES AND FROM THE CITY'S GENERAL FUNDS - WITHOUT A PUBLIC VOTE - TO EFFECTIVELY GUARANTEE PAYMENT OF DEBT SERVICE ON BONDS OF A PRIVATE FOUNDATION THAT WERE ISSUED TO ACQUIRE THE RPS PARKING GARAGE AT A HIGHLY INFLATED PRICE FROM THE RPS DEVELOPERS AND TO PAY HIGHLY INFLATED GROUND RENT TO THE RPS DEVELOPERS.

Findings

1. By no later than the first half of 1995, City Officials and the Developers of RPS were engaged in extensive communication over City contributions to the redevelopment of RPS. The Developers are Citizen's Realty Company, Lincoln Investment Company, River Park Square L.L.C., and R.P.S. II, L.L.C. (collectively herein referred to as "Developers").

2. A letter dated June 2, 1995, from Roy Koegen, the City's Bond Counsel to Duane Swinton, the Developers' attorney, described those discussions as follows:

Henry Miggins, City Manager
October 30, 2000
Page 2

You have advised the City that approximately 550 additional public parking spaces were *necessary in order to construct a new Nordstrom store* in downtown Spokane. In addition, you have advised that it will be necessary to improve the existing parking facilities currently owned and operated by RPS.

RPS has proposed that the City acquire its existing parking facilities, improve that structure and construct an approximately 550 space new public parking garage on the vacant parcel south of City Hall (the "District 81 Property") which would be integrated into the existing RPS facilities. You have also provided the City with excerpts of various feasibility analysis [sic] prepared by Ernst & Young LLP.

In order for the City to finance the Improvements, it will be necessary for it to own them. *RPS has offered to lease the underlying real property to the City for a term approximating the useful life of the Improvements for approximately \$320,000 per year and to sell the existing parking structure to the City. You have suggested that the sale price should be approximately \$4,800,000. You have further advised us that the existing parking structure requires approximately \$2,000,000 in structural improvements.*

If the City Council agrees to acquire and improve the existing RPS parking structure and to construct new public parking improvements, it will be required to issue parking revenue bonds. The amount of capital the City will be able to raise will be necessarily limited by the amount of revenue that the combined parking facilities will produce, minus the cost of normal maintenance and operation. Generally, the *Improvements must produce net revenue (gross revenue minus the costs of normal maintenance and operation) equal to 1.3 times the annual debt service on any parking revenue bonds that the City issues.* The amount of money which the City can raise is controlled by the amount of revenue that the Improvements will produce.

It will be necessary to pay interest on the bonds during construction (which is assumed to be capitalized for 30 months) and to commence principal payments within four years from the date of issue. The amount listed under the title "Net Operating Income" on the Ernst & Young LLP spreadsheet dated May 25, 1995, has been used in the analysis. You have suggested that the *Net Operating Income should support an approximate \$14,000,000 bond issue.*

Henry Miggins, City Manager
 October 30, 2000
 Page 3

The City has engaged Prudential Securities to provide advice with respect to a marketable structure and to provide interest rate assumptions. . . Their conclusions are summarized in the following table:

Scenario:	20 Year Issue	25 Year Issue	25 Year Issue
Net Operating Income:	Adjusted*	Adjusted*	Unadjusted
Bond Issue Size:	\$11,145,000	\$13,050,000	\$14,245,000
Proceeds Available for Construction:	\$9,919,200	\$11,558,400	\$12,624,000
Total Project Development Cost:	\$12,360,000	\$12,360,000	\$12,360,000
Funding (Shortfall)/Surplus:	(\$2,440,800)	(\$801,600)	\$264,000

*Adjusted Net Operating Income reflects NOI as calculated on 5/25/95 by Ernst & Young, less an annual lease payment of \$320,000 plus additional income of \$200,000 per year from the PBIA.

.....

There appears to be a *significant shortfall, excluding consideration of any amount to acquire the existing RPS parking structure*. We would appreciate your review of both the assumptions and the exhibits and your thoughts with respect to the best utilization of the City's parking revenue bonding capacity and to *how the shortfall can be addressed*. Lastly, the City will need to retain a consultant to *independently* review revenues and expenses. I look forward to meeting with you on Monday.

(Emphasis added.)

3. On June 12, 1995, the City passed a resolution authorizing and directing the City Manager to develop a proposal for acquisition and development of a parking facility through the issuance of revenue bonds in an amount not to exceed \$15 million to be repaid exclusively from RPS Parking Garage revenues.

4. On June 26, 1995, the Spokane City Council authorized the City Manager to negotiate a contract for a financial feasibility study for the RPS Garage with Walker Parking Consultants/Engineers ("Walker"). Walker furnished most or all of the parking garage information, including estimated Garage revenue, that was presented in the Ernst & Young report.

Henry Miggins, City Manager
October 30, 2000
Page 4

5. In the summer of 1996, Bond Counsel advised the City Council by memo that, without a public vote, the City could not pledge its General Fund to finance the parking facility.

6. With respect to revenue bonds, Bond Counsel gave the following advice in a memo dated August 23, 1996:

The *primary benefits* of issuing revenue bonds are that they insulate the City's general fund (i.e., the City's general fund is not obligated to pay debt service on the bonds in the event of a default) and they *may be issued without a vote of the City's electors*. *City of Spokane v. Taxpayers of the City of Spokane*, 111 Wn.2d 91, 99 (1988). Nevertheless, potential investors will require that the revenues from the financed project be sufficient to pay debt service on the revenue bonds (see RCW 35.41.080 and 39.46.150(3)); and the bonds may be marketable only if the City covenants with the bondholders to maintain rent or user fees at a level sufficient to generate net revenues equal to at least 135 percent of the annual debt service payments on the bonds.⁴ Accordingly, revenue bonds are most appropriate for those projects that are self-supporting and perform essential services to their users, such as water and sewer systems.⁵

⁴ Net revenues are typically defined as operating revenues less operating expenses.

⁵ According to Moody's Investor's Service, Inc., "[t]he concept of 'benefit analysis' is . . . central to the evaluation of revenue bonds—assessing the ability to continue to provide the service and the benefit to be derived from that service, all in the context of fees and rates charged for that service. As a result, the essential nature of the enterprise and the elasticity of price become critical considerations." Moody's Investor's Service, Inc., *Moody's on Municipals* (8th Ed. 1991), p. 10.

(Emphasis added.)

7. In response to the foregoing advice and Bond Counsel's discussion with City Officials, Prudential Securities Incorporated, Lehman Brothers Inc., Moody's Investors Service, Standard & Poor's Ratings Group, MBIA and AMBAC Indemnity Corporation, and others, the Developers and City Officials agreed upon a proposal that was presented at a public hearing on October 17, 1996.

8. That plan, as explained at the public hearing, included the following elements:

- RPS Garage would be acquired and owned by the City as part of a *system* of City garages.
- City would issue \$29.8 million in City Parking *System* Revenue bonds.

Henry Miggins, City Manager

October 30, 2000

Page 5

- Off-street parking ordinance would provide that the bonds would be payable solely from parking revenue with a contingent pledge of money from parking meters only if there is a shortfall in Garage revenues.
- Tax dollars could not be used to pay debt service on bonds.
- Flow of funds:
 - (1) operation and maintenance expenses
 - (2) debt service on bonds
 - (3) ground lease payments to Developers
 - (4) debt service on Developers' note
 - (5) renewal and replacement
 - (6) any lawful City purpose
- Rate Covenant of 1.35 times annual net debt service
- Bond Insurance which is beneficial because it protects the bond purchasers against any adverse consequences from a default, lowers the City's borrowing costs and broadens the investor market by guaranteeing principal and interest payments on the bonds.

9. Following that hearing, the plan for City revenue bonds was abandoned without explanation.

10. By early November 1996, City Officials and the Developers were contemplating that the Spokane Parking Public Development Authority ("PDA") would issue revenue bonds to acquire the Developers' parking garage. According to another memo from Bond Counsel, the City would be expected to pledge its Parking Meter Revenue to (1) satisfy any debt service coverage requirement (presumably 1.35) on the bonds and (2) replenish the debt reserve fund, as necessary. However, according to Bond Counsel the PDA board would not agree to the \$26 million transfer price, so the Developers' attorney established the Spokane Downtown Foundation ("Foundation") to effectuate the undertaking at that price.

11. The foregoing statement seems to be inconsistent with Mr. Swinton's statement that Mr. Kocgen is responsible for the Foundation approach and with Mr. Novak's unsolicited statement to you that the PDA board was not assembled until after the enactment of Ordinance No. C 31823 and that by the time he became involved the "deal was done."

12. In any event, by mid-January 1997, a four-party structure (City to PDA to Foundation to Developers) had been agreed upon that placed two limited-liability entities between the City and the Developers. Ostensibly, that enabled the City to deal only with the PDA (a public agency). The PDA, in turn, dealt with a private non-profit foundation created by the Developers which, in turn, contracted with both the Developers and the bondholders that purchased the Foundation's bonds so that the Foundation could transfer \$26 million to the Developers for actual construction costs of approximately half that amount, plus or minus several million dollars. A letter dated January 4, 1997, from the City Bond Counsel to Mr. Swinton states that if the City "is legally precluded from pledging or otherwise using its parking meter revenue in support of ground rent payments or operating expenses of the Public Development Authority, that it will have no obligations, economic or otherwise, under any agreement pertaining to the River Park Parking Garage." There is no documentary evidence that the City and Developers ever reached a contrary understanding.

13. Early drafts of Section 9 of Ordinance C 31823 differ dramatically from the enacted version. For example, a draft ordinance contemplated for enactment in early January, 1997 provided that "in the event parking revenues are insufficient to make Ground Lease Payments and Pay Operating Expenses, the city shall *transfer* money from the Parking Meter Revenue Fund . . ." Substitution of "shall loan" in the enacted Ordinance for "shall transfer" in the earlier draft, supports the view that the Council intended to limit the City's liability under Section 9 of Ordinance C 31823 to transfers that could be repaid.

Other changes were not so felicitous of the City's interests. For example, the earlier version - which contained "shall transfer" - expressly disclaimed any City pledge to "maintain parking meter fees and charges at levels sufficient to pay Ground Lease Payments or Operating Expenses." In contrast, Section 9 of the enacted Ordinance provides as follows:

The City covenants to maintain parking meter rates at a level to produce an amount each year that, together with other legally available money loaned to the Parking Meter Fund, will equal Ground Lease Payments and Operating Expenses budgeted for that year.

Thus, the enacted Ordinance converted the disclaimer of the prior draft into a pledge and for the first time introduced the concept that the City's General Fund was a potential source of funds for the City's loan pledge.

14. On January 27, 1997, the City Council passed Ordinance C 31823 committing the City, if Parking Garage revenues are inadequate, to loan to the PDA each year, from Parking Meter Revenue and other legally available funds, sufficient money to enable the PDA to maintain and operate the garage and pay its Ground Lease with the Developers. According to Bond Counsel the "other legally available funds" would be loans from other City funds to the Parking Meter Revenue Fund. Section 9 expressly did not "pledge any assets of the City to the

Henry Miggins, City Manager
October 30, 2000
Page 7

payment of principal of or interest on the Foundation Bonds." Consequently, when Ordinance C 31823 was enacted, any "transfers" of "other" City funds would be limited to "loans" to pay Ground Lease rent payments and Operating Expenses.

15. Consistent therewith, PDA Resolution 97-1, which was adopted in May 1997, approved a Parking Garage Lease Agreement dated June 1, 1997, between the PDA and the Foundation that included a flow of funds covenant that *did not commit* loans of City Parking Meter Revenue or other City loans to the payment of debt service or anything else. The PDA did, however, covenant with the Foundation to "charge and collect Parking Revenues in an amount not less than 1.35 times the amount of Fixed Facility Rent [debt service] for that calendar year."

16. Consistent with that arrangement, there is documentary evidence that the previous City Manager intended to set aside annually at least \$2 million for PDA loans, although there is no documentary evidence that the City Council was advised of that plan.

17. On August 10, 1998, Standard & Poor's promulgated a *New Issue Review* of the Spokane Downtown Foundation bonds that included a "flow of funds" analysis that described a PDA commitment of City loans to the payment of debt service (if Parking Garage revenues were inadequate) as a first priority, ahead of Operating Expenses and Ground Lease rent payments.

18. On August 21, 1998 apparently in response to a press release by Mayor Talbott, five members of the City Council issued a strong endorsement of the City's participation in the RPS redevelopment. Included with that release was a statement that:

A cost benefit analysis for bond insurance performed by Prudential Securities indicates that the benefits in terms of decreased debt service is marginal and therefore the Developer indicates that bond insurance will not be purchased.

With respect to that statement, it is not clear why the Developers rather than some other entity would "indicate that bond insurance will not be purchased." After all, the bonds were to be issued by the Foundation "on behalf of the City." However, the antecedents to that answer can be found in the summary of an earlier meeting on July 26, 1996, among Pete Fortin, Roy Koegen, Bob Robideaux and Stan Schwartz to discuss an earlier option. Notes of that meeting include the following:

1. Nordstrom demanding all agreements signed before September.
2. Nordstrom has pulled architects off project until agreements signed.
3. City to have restricted ability to use revenues from garage as part of system, main concern is raising rates in this garage to subsidize other garages.

Henry Miggins, City Manager
October 30, 2000
Page 8

4. Nordstrom must be participant in garage operations (cleanliness, rates, general operation).
5. City must participate in parking validation program.
6. Developer will determine value of lease purchase of garage which will be non-negotiable.
7. City should use parking meter revenue for debt service or parking validation.
8. *Developer will determine maximum coverage requirements on bonds.*

(Emphasis added.)

The relationship between this last point and the Council Member's statement that "the Developer indicates that bond insurance will not be purchased" is highlighted by Bond Counsel's August 23, 1996 advice to the City Council that:

"bond insurers will require net revenues of the parking facility, on an annual basis, to be at least 135 percent of the annual debt service on revenue bonds issued to finance the Parking Facility."

19. On August 31, 1998, at a City Council hearing relating to the proposed bonds, Bond Counsel once again assured the City Council that the possibility of any call on the City's loan pledge was remote.

20. On September 2, 1998, the "flow of funds" analysis (including the application of City loans to debt service) that first appeared in the *New Issue Review* of Standard & Poor's dated August 10, 1998, also appeared in the Preliminary Official Statement of the Foundation's bonds.

21. On September 14, 1998, Bond Counsel assured the Mayor and City Council by letter that the "transaction has been carefully thought out and prudently structured based upon conservative estimates" and that "the current plan is to market the bonds tomorrow" [September 15, 1998].

22. On September 18, 1998, the PDA by Resolution 98-1—which was referred to in the previously issued Official Statement—approved a revised Parking Facility Lease Agreement between the PDA and Foundation dated August 1, 1998, that, *inter alia*, revised the flow of funds covenant in the 1997 draft lease to provide that the first priority of "City loans proceeds and Parking Meter Revenues loaned by the City" would be for debt service on the Foundation's bonds. The revised lease also reduces the PDA's coverage covenant from 1.35 to 1.25 but,

Henry Miggins, City Manager
October 30, 2000
Page 9

seems to commit the PDA to raising two times the amount of its Operating Expenses and Ground Lease rent payments.

23. That amendment to the Parking Facility Lease Agreement—which may have been essential to the sale of the Foundation's bonds—was not approved by the City Council or as far as the record shows, ever explained to either the City Council or the PDA Board.

24. The steps leading to the \$26 million transfer price for the RPS Garage are summarized in the Amended Complaint in *Spokane v. Walker* and chronicled in substantial detail in the *Camas* reports. Therefore, this report will not address that issue further, except to note that in the summer of 1996, Bond Counsel advised the City Council that City Parking Meter Revenue of approximately \$1.6 million per year could support debt service on approximately \$31 million of bonds, the proceeds of which could be used to pay approximately \$29 million for the parking facility. Prior to that advice, Walker had estimated the costs of renovating and expanding the garage to be approximately \$8.6 million in 1998 dollars. Thereafter, estimated construction costs for 550 new spaces more than tripled, causing the total estimated costs to approach \$21 million.

25. The Foundation bonds in the amount of \$31.5 million were eventually sold and then downgraded by the rating agencies because of low or insufficient Garage revenue; the City declined to lend money to the PDA that couldn't be repaid; litigation ensued; and the rating of the City bonds was downgraded.

26. The PDA is currently in default to the Foundation under its coverage requirements and to the Developers under its Ground Lease rent payment obligations. If the City had not recently extended the PDA's obligation to repay the City's 1999 loan, it would soon be in default under that agreement. Based upon the Keyser Marston Study and a year of operating experience, it also seems unlikely that the PDA could ever repay any City loans and without the transfer of substantial City funds, the PDA cannot function.

27. Current Parking Garage Revenue does not cover current debt service on the Foundation's already downgraded bonds, even with the benefit of a \$200,000 annual City subsidy through the PBIA. Next year, monthly debt service will increase to approximately 2.5 times its current level. Ground Lease rent payments also increase steadily, as will operating costs if parking demand improves significantly. Therefore, based upon the Keyser Marston Study and a year's operating history, it seems unlikely that, over the next few years, Parking Garage revenue will even cover debt service much less provide for Ground Lease rent payments and Operating Expenses.

28. Accordingly, unless the "deal" is radically restructured, the PDA cannot survive financially, even if City subsidies through the PBIA and loans from the City's General Fund and Parking Meter Revenue Fund fully cover the PDA's Ground Lease rent payments and Operating Expenses because, under the revised PDA—Foundation Lease, City loans will be applied first to debt service, then to Ground Lease rent payments and only then to the costs of operating and maintaining the garage. Depending upon the magnitude of debt service deficiencies, the amount

Henry Miggins, City Manager
 October 30, 2000
 Page 10

of residual City loans after debt service payments might not be enough to pay the Ground Lease rent payments.

29. In that case, the Developers, who claim that the HUD loan is non-recourse, may claim an inability or in fact not be able to make payments on the HUD loan to which 41% of the Ground Lease rent payments are pledged.

30. If that occurs, the City which has pledged future federal grants as security for the Developers' loan, might be denied some or all of those grants.

31. The irony of the foregoing is that as a result of its participation in the RPS redevelopment, the City is now in a situation in which it may be required to transfer money from its General Fund to the RPS Developers in order to avoid future reductions in federal grants. Alternatively, the City might be required to transfer money from its General Fund to the PDA in order to enable the PDA to maintain and operate the garage.

32. With respect to this particular issue, compare the \$320,000 annual ground rent the Developers proposed in 1995, with the ground rent required by the ground lease between the Foundation and RPS Developers that was assigned to the PDA and which the RPS Developers claim is guaranteed by Section 9 of Ordinance C 31823:

<u>Year</u>	<u>Fixed Ground Rent</u>
1999	\$ 765,000
2000	\$ 765,000
2001	\$ 790,000
2002	\$ 815,000
2003	\$ 840,000
2004	\$ 865,000
2005	\$ 885,000
2006	\$ 905,000
2007	\$ 925,000
2008	\$ 945,000
2009	\$ 965,000
2010	\$ 985,000
2011	\$1,015,000
2012	\$1,035,000
2013	\$1,050,000
2014	\$1,065,000
2015	\$1,080,000
2016	\$1,105,000
2017	\$1,120,000
2018	\$1,135,000
2019	\$1,150,000

33. It also seems highly improbable that there is any source of funds other than additional City funds for any renewal and repair of the garage that becomes necessary. Without such additional funds it might not be possible to maintain the garage in proper condition for the next twenty years. Consequently, without additional City investments, it is not clear that the garage will have any significant value in 2020, which was considered by the Developers to be the end of the useful life of the facility. *See* paragraph 2, *supra*.

34. On a related point, all interested parties contemplated that bonds issued by the Foundation would meet the requirements of Revenue Ruling 63-20. Under Revenue Ruling 63-20 and I.R.C. § 103, interest on bonds issued "on behalf of" a municipality will not be exempt from federal taxation if bond proceeds inure to the benefit of a private party, for example, through the use of an other-than-fair-market-value sales price for a property, or use of an inflated lease payment. Substance prevails over form for purposes of federal taxation analysis. The sale price of the RPS facility and the terms of the Ground Lease and Fixed Facility Lease payments appear to significantly exceed any reasonable definition of fair market value, as that term has been defined in federal tax cases.

35. At various points throughout the negotiations, it appears that Bond Counsel and others genuinely attempted to make the "deal" less onerous and risky for the City. However, according to Bond Counsel, those efforts were consistently rejected by City Officials with whom Ms. Cowles and Mr. Robideaux frequently communicated directly.

36. Part of the Developers' explanation of why—despite the foregoing—the City's contribution to RPS is good for the City are assertions that (a) downtown Spokane was dying in the 1990's; (b) the City needed more off-street parking; (c) Nordstrom would have left downtown without a \$100 million RPS remodel and garage expansion; and (d) the RPS redevelopment has greatly increased the City's tax revenue. However, none of these claims are supported by documentary evidence.

37. For example, summaries of sales tax revenues from the RPS area that were prepared by City staff from information supplied by the State indicate that retail sales in the RPS area rose steadily throughout the 1990's until the RPS redevelopment got under way and have only recently returned to their 1995 levels.

38. Similarly, a 1993 parking survey by the City's planning department identified that area as an area of relatively high surplus parking spaces.

39. With respect to Nordstrom's intentions, press from 1993 indicates that Nordstrom was seeking only a modest remodel.

40. Finally, other information also compiled by City staff suggest that the increased fees and taxes that the City has realized from the entire RPS redevelopment have been relatively modest.

Henry Miggins, City Manager
October 30, 2000
Page 12

41. From the documentary evidence it is not clear who, if anyone, other than Bond Counsel, Mr. Robideaux and Mr. Swinton understood the full sweep of the strategy outlined in this report.

42. In discussions between Mr. Swinton and me, he has asserted vigorously that the City always knew exactly what to expect and that there have been no surprises. When pressed, it has seemed that "City" usually meant Mr. Koegen. At other times it meant the City's lawyers and executives. Occasionally, it meant the City Council or members thereof.

43. Mr. Koegen in turn has assured me that he kept the City Council fully informed. When pressed, he has identified "Orville Barnes" or "Barnes and the Mayor" or the "finance committee."

44. In addition to those individuals, a document review suggests that Jim Sloane and Pete Fortin were usually in the loop as were—to a lesser extent—Bill Pupo, Stanley Schwartz and the Foundation's legal counsel.

45. No one has acknowledged that they were aware of the earlier 1995 Walker study and Messrs. Sloane and Koegen have expressly disclaimed any knowledge of it and of any awareness that there was a prior relationship between Walker and Robideaux.

46. To this day no City Official, employee or outside professional has expressed any reaction, other than amazement at how far off the Walker figures turned out to be and everyone with whom I have spoken except Ms. Holmes has said they would not have supported the deal if they had been aware of how far off the Walker projections have turned out to be.

47. Ms. Holmes has said she would have supported "SOME" City subsidy if it had been explained to her at the time that "it is not uncommon for other municipalities of our size to dedicate parking revenues from meters, off-street parking and fines to subsidize parking garages." Nonetheless, she is not "willing to accept the degree of miscalculation that occurred" in this instance.

Conclusions

1. Both the \$26 million transfer price for the RPS Garage and the Ground Lease rent were deliberately inflated in order to provide the maximum possible subsidy for the RPS Developers.

2. Avoidance of a public vote was a driving factor for the extraordinarily complex strategy that facilitated the Foundation's sale of \$31.5 million of bonds.

Henry Miggins, City Manager

October 30, 2000

Page 13

3. No explanation has been articulated that satisfactorily reconciles the City Council's (1) abandonment of the plan presented at the October 17, 1996 public hearing for the issuance of City bonds; (2) rejection of the November 1996 option of the PDA bonds; and (3) approval of the plan presented at the hearing of January 27, 1997 for Foundation bonds—all of which were intended to provide \$26 million to the Developers. Bond Counsel's explanation is that the City Council and PDA followed his advice that \$26 million was too much to pay for the parking garage, but the Foundation was not his client. However, that explanation leaves too many questions unresolved and ultimately is not plausible, especially given the convoluted process and many important revisions that lead to Ordinance C 31823 and PDA Resolution 98-1 as ultimately approved by the City Council and the PDA's governing body, respectively.

4. According to correspondence between Bond Counsel and Swinton, the overriding purpose of the garage expansion was to serve Nordstrom. Therefore, provision of additional off-street parking for visitors to municipal facilities was a pretext. Moreover, there was no sound basis for any assumptions that there would be adequate demand for the expanded facility. In fact, Spokane participants in the RPS strategy must have known or should have known that the demand for off-street parking in downtown Spokane is highly price elastic. Consequently, project participants must have realized that without substantial increases in on-street parking meters and rates, each of which has already been increased by approximately 33%, coupled with an extraordinarily high parking validation participation by RPS tenants—to which the City already commits \$200,000 per year—Parking Garage revenues would be anemic for a long time regardless of the economic success of the RPS retail facilities.

5. Consequently, there was no sound basis for ever assuming that net Parking Garage revenue would amount to 1.35 of the debt service on the facility's bonds. To paraphrase the statement in Moody's Investor's Service, Inc., *Moody's On Municipals* (8th Ed. 1991), p. 10, which is quoted in Bond Counsel's letter that is set out in paragraph 6, *supra*, additional off-street parking facilities in a surplus parking area is not an "essential" service and the price elasticity of the rates that could be charged for those additional spaces is extremely high. In addition, there is no evidence that anyone ever attempted to reconcile the 1995 Ernst & Young parking garage analysis that was furnished to Bond Counsel by the Developers in 1995, with the Walker studies of 1996 through 1998. These factors, coupled with the difficulty the participants appear to have experienced in obtaining an investment grade bond rating on the Foundation's bond should have caused the reevaluation of the entire undertaking.

6. For all these reasons, the professionals involved must have realized from the outset that the City's guarantee of debt service would or at least might be necessary to sell the required bonds—regardless of whether those bonds were issued by the City, the PDA or the Foundation. Consequently, it seems highly probable that Section 9 of Ordinance C 31823 was drafted to facilitate that eventuality, and the 1998 revisions in the flow of fund provisions of the PDA—Foundation Lease were essential to the Standard & Poor's bond rating and the eventual sale of the bonds.

Henry Miggins, City Manager
October 30, 2000
Page 14

7. Bond Counsel argues that the flow of funds described in Standard & Poor's *New Issue Review* of August 10, 1998, the September 15, 1998, Official Statement and the conforming revisions in PDA Resolution 98-1 of September 18, 1998, and the PDA/Foundation Lease does not commit either City loan proceeds or loans from the Parking Meter Revenue Fund to the payment of debt service on the Foundation's bonds. However, if Parking Garage Revenue does not cover debt service on the Foundation's bonds, any other interpretation is, at best, difficult even though—as Bond Counsel points out—other parts of the Official Statement state that:

City parking meter revenues are not pledged to and may not be applied to pay Fixed Facility Rent or otherwise to pay debt service on the Bonds.

The City has not pledged its full faith, credit and resources, or money in the City's General Fund to the payment of Fixed Ground Rent or Operating Expenses, nor are any of the City's assets or funds pledged to the payment of principal of or interest on the Bonds.

8. Predictably, net Parking Garage revenue does not cover debt service on the Foundation's bonds. Consequently, all of the net revenue of the City's Parking Meter Revenue Fund and significant amounts of the City's General Funds are clearly at risk as are the federal grants pledged by the City as security for the integrally related HUD loan.

9. The relationship, if any, between the highly inflated ground rent that goes to the RPS Developers and the 41% of ground rent that is pledged to the repayment of the HUD loan has not been examined but might be significant. It seems likely that if the loan pledge is enforced, City funds—through Section 9 of Ordinance C 31823—will be used to repay the HUD loan.

10. The "on behalf of" financing of the RPS project by the Foundation is subject to challenge on the grounds that it violated Revenue Ruling 63-20 by funneling funds significantly in excess of fair market value to the Developers.

11. There is no evidence that a majority of the City Council ever understood either the intricacies or the inevitable consequences of the RPS strategy. There is also no evidence that the Council, as a whole, was even aware of the 1998 revisions to the PDA—Foundation Agreement that committed City loan proceeds—as a first priority—to debt service on \$31.5 million worth of Foundation bonds. Nevertheless, the Council is subject to criticism that the Council did know or should have known that both the transfer price and ground rent were far beyond market values and that consequently the City's participation placed both its General Fund and federal grants at risk.

Henry Miggins, City Manager
October 31, 2000
Page 15

12. This is an unusually complicated controversy that should be resolved through negotiations and/or mediation.

Sincerely,

HENDRICKS & LEWIS



O. Yale Lewis, Jr.

cc: John Talbott, Mayor
City Council