



Betsy's Choice

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Behind the scenes in the River Park Square garage transaction, a hidden battle raged about whether it could be done legally. New documents show how the lawyers faced a fateful decision. And how developer Betsy Cowles dealt with it.

FOR MONTHS AFTER the city council approved the public purchase of the River Park Square garage, a battle was raging out of sight. Unbeknownst to the citizens of Spokane and future bond buyers, the bond lawyers involved with the deal were trying hard to change it or stop it.

The battle was fought over a fundamental question upon which tens of millions of dollars were being wagered. Was the renovated garage going to be a public facility as both state and federal law required? Or was it to be a private facility beholden to the demands of anchor tenant Nordstrom?

Documents recently released through discovery in the federal RPS securities fraud case show that developer Betsy Cowles knew of the lawyers' warnings. Even Nordstrom was worried about the public financing plan. The Seattle-based retailer applied pressure to resolve the issue swiftly and in a way that protected Nordstrom's private interests.

Cowles had a choice to make.

A summary of the key cast of characters in the drama is as follows:

Betsy Cowles, the developer, Cowles Publishing Co. executive and head of Cowles real estate companies

David Johansen, Attorney with Lane, Powell, Spears, Lubersky, representing Nordstrom.

David Mackie, Nordstrom vice president in charge of real estate.

Duane Swinton, Cowles attorney with Witherspoon Kelley Davenport & Toole

Stan Schultz, another attorney representing Cowles interests with Witherspoon Kelley

Roy Koegen, Spokane's bond counsel, with international law firm Perkins Coie

William Mantle, tax specialist with Preston Gates & Ellis.

David Thompson, attorney and municipal finance specialist with Preston Gates.

THE STRUGGLES AMONG THE LAWYERS began months before the

controversial garage purchase was brought before the Spokane city council.

On July 29, 1996 city bond counsel Roy Koegen wrote to Stan Schultz, a Cowles attorney, to reiterate objections they'd been raising with RPS "for the last six weeks." Koegen wrote that he and senior city officials had looked at the Nordstrom contracts the RPS developer wanted to enforce at the garage and concluded the city could not be a party to them, because "they establish too much private involvement in municipal decision-making and control."

At the time Cowles was asking \$29.8 million for the garage, which she hoped would be purchased with city-backed revenue bonds. The council, however, balked at a direct purchase and, in an effort to move the transaction forward, an alternative plan was proposed. It was known as "63-20" financing, in reference to a federal rule through which a non-profit corporation could buy the garage with tax-exempt bonds "on behalf of" the city.

On October 25, 1996, Koegen sent a long memo to Mayor Jack Geraghty and the Spokane city council, briefing them on the "63-20" plan. Nearly all of the memo focused, in detail, on the IRS requirements. (The IRS would later invoke these same rules in its opinions that the transaction violated federal law.) Moreover, Koegen noted on the first page of the memo that the IRS "has stated a willingness to render advance rulings" on whether such plans conform to IRS rules. But the RPS garage financing plan was never submitted to IRS.

Cowles addressed the prospect of the new plan in a "Confidential Memorandum" to a select group of her supporters on November 8, 1996.

"One alternative to the original plan [for direct purchase by the city]," she wrote, "is something called a 63-20. Under the 63-20, a non-profit, not the city, would purchase the garage. To pay for the garage, the non-profit would issue tax exempt bonds which would be repaid with revenue generated by the garage."

"The non-profit concept," Cowles explained in the memo, "solves some of the political and legal issues with which we have been struggling, but we are having difficulty making it work financially. The basic problem is that the only asset the non-profit has is the garage itself. This could mean that bonds may have to be sold at a junk bond rate. The higher interest means the non-profit could not afford to issue a sufficient amount of bonds for River Park Square to get adequate value out of the garage."

The specter of junk bonds was a new problem -- one created by the city not directly backing the bonds. Junk bonds would have meant higher interest payments -- money taken out of garage cash flows that would otherwise be collected by Cowles companies.

The worrisome "junk bond" problem was solved by getting the city to indirectly back the bonds with its January 27, 1997 pledge of parking meter revenues. Although Spokane didn't put itself directly on the hook for debt service on the bonds, its pledge of parking meter "loans" to help cover rent and operations costs at the garage was received by the bond markets as a "credit enhancement." It was just enough to get the bonds rated BBB- by Standard & Poors, a notch above junk bond status. Still, the BBB- rating, gave the bonds investment grade status and, in a flash, preserved millions of dollars in the garage's so-called "investment value" -- not for the city, but for Cowles.

Contrary to the assurances Cowles provided in her November 8, 1996 memo, however, the serious legal problems with tax-exempt financing remained.

The "63-20" required a new non-profit corporation to issue the bonds instead of the city. The Spokane Downtown Foundation was hastily created by Cowles lawyers, and it came with its own lawyers and tax specialists. It ultimately would rely on Seattle's oldest law firm and the state's highest-profile legal team in the field of public finance -- Preston, Gates & Ellis.

Just days after the Spokane city council voted to approve the garage transaction, Cowles attorney Duane Swinton wrote a long January 31, 1997 letter to David Thompson, a municipal finance specialist in Preston Gates's Seattle office. Preston Gates had reached the same conclusion as Koegen had earlier -- that the parking covenants presented an illegal encumbrance for a public financing. And that position, wrote Swinton, "is creating some difficulty concerning our discussion with Nordstrom."

"Nordstrom has an expectation," Swinton reported, "that, if it is going to commit to downtown Spokane, once the City takes title to the parking facility, it will agree to be bound by those covenants and agreements." He concluded the letter by reminding Thompson: "This is a very critical issue with regard to Nordstrom's commitment to the project."

On June 25, 1997 Swinton wrote to David Mackie, a Nordstrom vice president. Swinton and Preston Gates were desperate to resolve the legal roadblocks. In the letter, Swinton informs Nordstrom that the developer and Preston Gates had approached the reputed mastermind behind the controversial Pacific Place garage transaction in Seattle, John Finke. (Finke is credited for putting together the deal where the City of Seattle, according to a *Seattle Times* investigation, funneled \$23 million worth of excessive leasing fees to a private developer.) Swinton's letter reports that Finke and his nonprofit -- the National Development Council -- were asked if they would become involved in the Spokane garage transaction but told by Finke that he wasn't interested.

"In addition," Swinton continued, "both Preston Gates and our firm have previously reviewed the prospects of having Spokane Downtown Foundation qualify as a 501(c)(3), which would be necessary in order to undertake non-profit financing through the Washington State Housing Finance Commission. Both Preston Gates and our firm believe that, given the structure of the Spokane transaction, it would not be possible to qualify Spokane Downtown Foundation as a 501(c)(3)."

This passage in Swinton's letter reveals, in new detail, how thoroughly the RPS developer and Preston Gates were using the non-profit SDF simply as a front for Cowles development interests. (As IRS has noted in its investigation, the SDF should have been under the control of the city and acting in an arms-length relationship with RPS.)

Preston Gates reiterated its unwelcome assessment in an August 1997 letter. Going with an "on behalf of" financing using federal revenue rule 63-20 wouldn't work, wrote Preston Gates tax specialist William Mantle to Koegen, because the Nordstrom parking contracts constitute an "encumbrance" on a publicly financed facility in violation of the federal rules.

The impasse threatened to ruin everything. By the fall of 1997 Cowles and her lawyers were looking seriously at doing what Nordstrom would have preferred -- abandoning the tax-exempt gambit and financing the garage privately. Cowles real estate companies prepared a 75-page "Request for Financing" that was distributed to potential lenders on a confidential basis. The proposal sought \$26 million in the form of a construction loan or "permanent loan."

Cowles explained the initiative to her brother (*Spokesman-Review* publisher) Stacey and her uncle James Cowles in a confidential September 24, 1997 memo. One of the prospective private lenders Cowles had approached was the Compass Group, a union pension fund lender that had already agreed to a \$20 million construction loan that was to be repaid by the bond proceeds.

Compass has refused to respond to Camas inquiries.

"Our exposure here is about \$6 million," Cowles reported. "Compass has no problem funding the construction of the garage [at \$20 million], but they have not yet completed their analysis of the permanent financing [\$26 million]. If we cannot issue bonds and Compass is not able to get from \$20 to \$26 million, we will be \$6 million short. That \$6 million is going back into the project to create enough equity to make Seafirst happy on the retail and entertainment side."

(Cowles's use of \$20 million to represent garage construction is a much higher number than appears in RPS budget reconciliations compiled after garage construction was concluded.)

Nordstrom was clearly unsettled by the insistence of the RPS developer to try to go ahead with the tax-exempt financing.

David Mackie, a Nordstrom vice-president, is reported to have become "very concerned" in late 1997 about the direction Cowles wanted to go.

Mackie's concerns are conveyed in a November 19, 1997 letter from David Johansen, a Seattle lawyer representing Nordstrom, to Cowles attorney Swinton. In the letter, Johansen informs Swinton that Nordstrom was giving RPS just 12 days to solve the explosive problem that was threatening to kill the whole redevelopment plan.

"Dave [Mackie] is very concerned about the status of your solution to the parking covenant issue," Johansen warned Swinton. "You have indicated in the past that you would either arrange to have the parking covenants be fully enforceable against the City and its successors in interest, or would have the garage financed by a private lender. The last time we spoke, however, you did not know if you could arrange for the covenants to be enforceable and you had not yet heard from your potential lender with respect to its loan commitment."

But Cowles had pursued the private funding option with Compass, and she wasn't pleased with what the lender was demanding. She addressed the issue again in a follow-up memo to her brother and uncle on January 12, 1998. This time she reported that RPS project manager Bob Robideaux had, in fact, "negotiated a \$26 million long-term loan with Compass, should we need it."

There was, however, a problem with what Compass wanted.

"The deal here is not very attractive," Cowles added, "because they

are asking for a guarantee from Cowles Publishing Co. for 50% of the loan amount (\$13 million). I have told Bob that we will not go that route because of the guarantee, but will issue bonds."

In other words, Cowles was telling her brother and uncle that she had decided against the private garage financing plan and had chosen to stick to the "63-20" plan to issue tax-exempt bonds. Going ahead with bonds, she reported, involved two other problems. One was the challenge "to reduce the fees and extras" -- an apparent reference to the mushrooming legal fees the city and the SDF were running up as various lawyers took turns at trying to mold the transaction into shape.

"The other issue," she added, was the problem "with a document called 'Parking Covenants,' which outline how the garage will be run. "In order for the bonds to be tax-exempt, she explained, "this 'encumbrance' cannot be imposed."

Ironically, this is exactly what Koegen, Mantle and others had been telling Swinton, Cowles's lawyer, for a year and a half.

The bond lawyers would eventually give in and put aside their objections. The mystery is still why they relented and, by doing so, set the stage for the IRS investigation that, thus far, is finding lots of reasons why the bond lawyers had it right the first time.

The resulting transaction was layered with contradictions. For example, when SDF filed articles of incorporation with the state, it emphasized it would conduct its affairs "in such a manner that the Corporation would qualify as an exempt organization under Section 501(c)(3)" of the IRS code. Yet, according to IRS records, the SDF never even bothered to file an application for federal tax-exempt status. One reason: RPS lawyers and Preston Gates had concluded that the IRS would reject the application. (Remarkably, under Washington's lax rules governing non-profit corporations, the SDF was still allowed to issue \$31.5 million in tax-exempt bonds.)

One longstanding criticism of the role of municipal bond lawyers is that their compensation is almost wholly dependent on whether bond sales go forward, and that this creates an incentive to say yes to deals when the right answer for all involved is either no, or not yet. In this case, Roy Koegen was prepared to fight for his fees and, in doing so, took personal credit for getting Preston Gates to say yes.

Five months after Cowles reported her decision to proceed with the bond financing, Koegen wrote to city councilman Orville Barnes. Barnes, apparently at the behest of RPS, had become personally involved in the dispute over the size of Koegen's fees that were slated to be paid out of bond proceeds. RPS wanted them reduced, with Swinton arguing, among other things, that Preston Gates had supplanted Koegen's firm as bond counsel when the city decided not to buy the garage directly. In his letter to Barnes, Koegen argued that he'd earned the money.

"Throughout this process," Koegen explained to Barnes in a July 1, 1998 letter, "it became clear that it was going to be impractical for the City to issue the bonds, primarily due to political pressure. The transaction was then restructured to include the Spokane Public Development Authority as the bond issuer. Then, due primarily to the purchase price of the garage and public sentiment, the transaction was restructured a third time to create the Spokane Downtown Foundation and have it be the bond issuer. We were asked to do research and convince Preston that the bonds issued by the Foundation would be tax exempt. We were successful in

doing so."

Seven weeks after his letter to Barnes, Koegen wrote city attorney Jim Sloane to report that, based upon Barnes's request, his firm (Perkins Coie) would agree to drop its RPS fees from \$300,000 to \$250,000. The \$50,000 reduction was conditioned on the city agreeing to a five-year extension of Perkins Coie's special services contract when it expired in November 1998. The city approved the extension.

THE END

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