

Attachment #2

“The Casino Was Rigged”

---The U.S. Internal Revenue Service, Tax Exempt Bond Unit, June 22, 2004

The Evidence of Fraud, Conspiracy, Money Laundering, And Public Corruption in the River Park Square Transactions

The purpose of this report is to respond to U.S. Attorney James A. McDevitt’s public invitation to be presented with evidence of criminal wrongdoing and public corruption in the River Park Square fiasco. Given the abundance of documentary evidence and testimony compiled by Camas Magazine, the Internal Revenue Service, attorneys for garage bondholders, and the City of Spokane’s former special counsel, the burden is on Mr. McDevitt and the Justice Department to explain why no serious federal investigation of this matter has commenced. Given the accessibility of the evidence, it is simply baffling that, to the best of our knowledge, no grand jury has been impaneled or asked to evaluate, as grand juries commonly do, whether criminal charges should be brought against one or more individuals connected with the River Park Square debacle.

The burden is heightened, in this case, because Mr. McDevitt, the U.S. Attorney for the Eastern District of Washington, was directly involved as a lawyer in the Spokane office of Preston, Gates & Ellis, the law firm that represented both seller and buyer in the RPS garage transaction and failed to disclose this conflict of interest in a securities offering. As we’ve also shown in Attachment #1, deposition testimony and documents produced in discovery in the federal securities fraud action brought by garage bondholders clearly indicate Mr. McDevitt was deeply involved in the RPS garage transaction (along with his colleague Mike Ormsby) at the most sensitive time (July/August 1999). **[Exhibits #1, #2, #3].**

By now, journalists and litigants have pushed a lot of information about the River Park Square fraud into public view. Garage bondholders prevailed in their civil case against the City and other defendants (including Preston) because the top City official, then-Mayor Jim West, concluded the City was guilty of fraud and would likely lose at trial. Preston and the other settling co-defendants obviously felt they had similar exposure to the fraud claims. The IRS investigation, making use of the evidence that emerged in discovery in the bondholder case, reached its own withering conclusions based on the evidence. **[Exhibit #4].** To the best of our knowledge, none of the central evidence backing the IRS’s findings of law has been refuted and that, alone, begs the question as to why there’s no evidence that a federal grand jury has inquired into River Park Square.

As we’ll explain, the garage transaction was deeply connected to a related transaction--the \$22.65 loan (and accompanying \$1 million federal grant) from

the City of Spokane to River Park Square. The loan was backed by federal block grant funds the city receives, annually, to assist with basic necessities and economic development of its poorest neighborhoods.

CORRUPTION AND FRAUD IN THE RPS GARAGE TRANSACTION

The River Park Square garage transaction failed because Cowles Real Estate companies succeeded in persuading the Spokane City Council, in 1996/1997, to allow RPS to receive \$26 million (not counting a thoroughly contrived ground lease) for a garage the City's own consultant valued at less than \$11 million. **[Exhibit #5]**. As we'll explain elsewhere in this report, the overvaluation was accomplished through the use of a highly unusual appraisal method that pushed the paper value of the property far beyond its actual market value. The valuation schemes, and the efforts to hide their effects from the public and bondholders, are the heart of the RPS frauds.

The two elements of the overvaluation were deliberately inflated revenue projections, and the insidious use of the City's cost of funds interest rate to greatly enhance the value of the garage for the benefit of the seller, Cowles real estate companies.

The valuation methods and schemes used in the RPS garage transactions violated federal rules (12 CFR, Chapter 4, Part 34) adopted as part of the Federal Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). FIRREA was enacted into law to rectify abuses that Congress found in the wake of a national banking scandal. FIRREA should have applied to the garage appraisals because, as IRS concluded in its June 22, 2004 report "(t)he HUD loan was somewhat dependent on certain garage analyses."

To be more precise, 12 CFR Chapter 4, Section 34.44 requires that the FIRREA rules apply to all "federally-related transactions." The federal government had a clear stake in the garage transaction because 41% of the ground rent payments on the garage land were dedicated to repayment of the City's HUD-backed loan to RPS. Specifically, as page 10 of the City's January 13, 1999 loan contract with HUD specifies, the City was required to assign its share of the ground rent payments to HUD as part of HUD's security. That established the federal interest and it is why the bogus valuation methods used to determine the amount of the ground lease payments violated federal law. Of course, the FIRREA violation occurred for a reason, and that's because the valuation schemes used at RPS were part of a much broader fraud and money-laundering scheme. People who knew the garage and the land were grossly overvalued are many of the same people who organized and facilitated the transaction, and did so even when they knew, or should have known, that it wasn't going to work. So far as we know, none of them have been held criminally or even professionally accountable for their actions.

The Ormsby Letter

Exhibit #1, the August 12, 1999 memo from Mike Ormsby that lists Mr. McDevitt on the “bcc” line of the distribution list, is a key piece of evidence for a federal criminal inquiry. It was written at a moment in time, after the garage bonds had been sold by the Spokane Downtown Foundation (SDF), but before Cowles real estate companies (RPS) had been paid with the bond proceeds, when it was clear something had gone wrong. AMC Theatres, a major new RPS tenant, had been threatening to withdraw from the RPS development. Through an apparent miscommunication with RPS management, AMC believed that its movie patrons would not have to pay, or pay much, to park in the new RPS garage. On the other hand, RPS and the other parties involved in the garage transaction, had provided bondholders with revenue projects assuming that AMC customers would pay \$1.50 an hour to park.

When AMC learned what was expected of its customers, it balked, and eventually filed a notice of default on its lease with RPS. An impasse ensued and, remarkably, it was the new public agency formed to operate the garage--the Spokane Parking Public Development Authority (PDA)--that quietly framed a solution. It would only charge evening customers at the garage a flat rate of \$2. In other words, if an evening parker stayed in the garage four hours, he or she would pay \$2, not \$6. This is noteworthy because when this potential problem was recognized by a city consultant in January 1997, it was RPS president Betsy Cowles who publicly assured the Spokane City Council that her company would take responsibility.

“We have every intention to be part of that solution,” Ms. Cowles told the council. But the problem was never solved and it led to the crisis in the summer of 1999. Even though neither the PDA, the SDF, or the City of Spokane were in no way responsible for the dispute with AMC, it was the PDA that agreed to lower garage parking rates to try to solve what was really RPS’s problem to solve.

So, what was happening on August 12, 1999 is that the PDA was trying to get its numbers back in line. It thought it could do so by working through Preston’s Mike Ormsby who was (then) the lead counsel for the SDF, the non-profit set up by Cowles lawyers to purchase the garage “on behalf of” the City from Cowles real estate companies. In its first sentence, Mr. Ormsby’s memo references a letter from the PDA, and it’s the letter from the PDA that holds the information that implicates Preston and the other parties in securities fraud.

As the letter [**Exhibit #6**] from the PDA’s Terry Novak patiently explains, the change to a flat evening rate to help placate AMC caused the PDA to enlist a consultant to evaluate the change in revenue projections provided to bondholders. He reports that annual “revenues will be insufficient by approximately \$1,240,000” as early as 2001 and continuing into the future.

Clearly the purpose of the two letters (Novak’s and Ormsby’s) was to try to persuade Betsy Cowles to back off her demand to take \$26 million for the garage. As Mr. Ormsby points out in his letter, the purchase price was negotiated on the basis of revenue assumptions that were no longer valid. So what of that request? As Ms. Cowles confirmed in her April 2003 deposition in the securities fraud case, she flatly refused to consider taking less than \$26 million. In the face of Ms.

Cowles's refusal to back off her \$26 million demand the PDA and Preston and the Spokane Downtown Foundation did a remarkable thing. They agreed to pay her anyway, the full amount.

It was part of a larger pattern that the IRS thoroughly documented in its June 2004 report when it observed, "all parties involved appear to be struck by ostrich fever, a collective burying of heads in the sand. This is clearly what the [RPS] developer needed."

It's a good description except that federal law enforcement concerned with public corruption, as Mr. McDevitt says he is, must consider that "ostrich fever" is just a symptom of the powerful and corrupt influence of the Cowles family on Spokane government. In fact, the evidence trail dovetails at this point. In one direction is securities fraud, and the allegation (among many others) from garage bondholders that Preston and the others involved in the \$31,465,000 bond issue failed to disclose numerous "material facts" about conflicts of interests, inflated revenue projections, etc., that would have alerted them about the true risks involved in the garage bonds. The other direction the evidence runs is toward public corruption, the surreptitious efforts not only to lard River Park Square with public money but to go to great lengths to hide what was happening not only from the public, but from elected officials like Mrs. Rodgers who were critics or skeptics of the River Park Square project.

The bondholders got their money back and their attorneys fees paid. But what about the other victims? What about the taxpayers that Mrs. Rodgers was trying to represent in 1999 when, the evidence shows, top city officials, including elected officials, withheld all the information about the AMC fiasco and its consequences from her? The \$45 million in debt the City still faces to pay off the securities fraud case doesn't account for the millions of dollars in time and legal fees the City spent, over the years, to try to resolve the RPS mess. It was a debacle that could have been avoided if Mrs. Rodgers and public had only known, in time, what was really happening.

But they didn't. Documents that Mr. Connor (and former KXLY reporter Tom Grant) obtained via public records requests on the PDA show not only a conspiracy at the PDA to keep the AMC crisis a secret, they also include notes taken at an August 16th meeting of the Spokane Downtown Foundation. As noted in Attachment #1, the notes record that Ms. Cowles voiced her displeasure with Mr. Novak's letter and the fact that it had come from a public official and not a lawyer. Ms. Cowles is herself her lawyer, and one can reasonably infer that her request to keep the correspondence between lawyers was to try to keep them from being released via public records requests.

Another important symptom of the civic corruption involved is that the lead attorney for River Park Square, Duane Swinton, doubles as the lead attorney for Cowles media. He's the newspaper's lawyer. Newspaper lawyers are the ones that fight for information for journalists. But, in his capacity as RPS's lawyer, Mr. Swinton fought to keep information from journalists. In an effort to prevent public disclosure of the AMC crisis, Mr. Swinton sought and obtained a confidentiality agreement from the PDA's lawyer and the lawyer (again Preston's Mike Ormsby) for the Spokane Downtown Foundation committing them to withhold a "reimbursement agreement" that would have compensated the PDA if

the crisis boiled over and AMC withdrew, altogether, from the project. Because public disclosure of the reimbursement agreement would have led inquisitive journalists and skeptical public officials like Mrs. Rodgers to the problems in the garage transaction (including a drastic downward revision in expected garage revenues) it was considered deadly. If it got out, Ms. Cowles and River Park Square were probably not going to get the \$26 million they received with the garage deal finally closed in late September. The confidentiality agreement is not just an indication of public corruption. It's an irrefutable manifestation of it. **[Exhibit #7]** It obliges the signatories to resist valid public records requests for a contract with a public agency, in violation of Washington's Open Public Records law. Ironically, Mr. Swinton is a specialist at using the same law to pry information from agencies that Cowles media chooses to investigate. But the role of Cowles media was not to investigate RPS, but to promote it.

In summary, the clear evidence of corruption surrounding the secret resolution of the AMC crisis amid the closing of the River Park Square garage transaction (with its concomitant transfer of \$26 million to Cowles real estate companies) in the summer of 1999 is enough, by itself, to warrant a federal investigation/grand jury review. But it was not an isolated incident by any means. The River Park Square public/private partnership was a sophisticated white collar crime that began to take root, in earnest, in the spring of 1996 when Cowles real estate companies (a.k.a.the River Park Square developer) began to successfully pressure the City to pay much more for the River Park Square garage than it was really worth. Certainly, a key aspect of the complex scheme was the garage appraisal.

The Appraisal Fraud

The Spokane City Council adopted Resolution 95-74 at the request of Cowles real estate companies in June of 1995. The purpose of the resolution was for the city council to give its support for a plan to assist in the redevelopment of River Park Square by financing a new and expanded parking garage with City-backed revenue bonds "in an amount not to exceed \$15 million." **[Exhibit #8]** It's noteworthy how well Resolution 95-74 fits with the numbers in the parking consultants report presented to then Deputy City Manager Pete Fortin on September 1, 1998. **[Exhibit #5]** It shows that if the city simply held to its original intent to pay market value for the garage it could have done so with a \$15 million bond issue, not a \$31,465,000 bond issue.

So, what changed? The simplest answer is that Cowles real estate companies wanted much more money, and the first step to accomplishing that was to try to persuade the City to move off a market value transfer and agree to use an investment value appraisal method that was so rare that neither the City's real estate projects manager, nor its veteran bond counsel, had ever seen one. As Mr. Connor has reported, the guidance on how the City should apply the method came directly from Derek Zimmer, a River Park Square consultant. As City Real Estate Manager Dennis Beringer told Mr. Connor, Mr. Grant (KXLY-TV) and lawyers who deposed him, he vigorously opposed using the investment value method, but was overruled by more senior city officials. Among those who sided

with Mr. Beringer's objections were two senior independent appraisers in Spokane--John McFaddin and Mike Sprute--who raised objections to the method at a meeting in Spokane City Hall on April 9, 1996.

The pressure the City was facing from RPS to push up the garage price is evident in the hand-written notes of then acting-City Manager Bill Pupo who on July 29, 1996 listed a series of questions and points on a short memo that described a meeting, three days before, between City officials and Bob Robideaux, the RPS project manager. **[Exhibit #9]**

"\$26M-30M is where their @ for Purchase," Mr. Pupo wrote. "We're at \$20 million & we could build for \$13 million. Excludes land lease."

Mr. Pupo's telling note is just one of many documented indications that city officials were, as Mayor West later concluded, complicit in a fraud. They were helping (albeit grudgingly at times) to create millions of dollars of "equity" value for Cowles real estate companies above any reasonable value that would have derived from an honest, arms length transaction based on a market value appraisal. Perhaps the most stunning aspect of the fraud was the use of the City's access to tax-exempt securities (and the relatively low interest rates on those securities) to derive the "discount rate" used in Mr. Zimmer's complex investment value scheme. The low discount rate was a power boost to the investment value, and all this added value was to be harvested not by the City, but by the Cowleses. They would get the money. City taxpayers and bondholders would get the risks associated with it.

This is what Mr. McFaddin, a past president of the Inland Northwest Chapter of the Appraisal Institute, saw and so strenuously objected to. He didn't think a public entity like the City of Spokane should be using investment value appraisal methodology on public works projects.

The U. S. Government agrees with Mr. McFaddin. In response to the appraisal abuses that fueled the Savings and Loan banking crisis in the 1980s, Congress responded with a new law (FIRREA) that required the use of arms length, market value appraisals in transactions where federal funds were directly or indirectly involved.

Coopers and Lybrand, when it reviewed the garage transaction in 1997 as part of its contract with the City of Spokane, saw the problems with the appraisal methodology. Unfortunately, its criticisms were blunted and buried deep in a report delivered the same day the City Council adopted an emergency ordinance (C-31823) giving its backing to the parking garage plan. Clearly, neither Mrs. Rodgers (who would take office the next week) nor any other member of the public could possibly have had time to read and understand the Coopers report before the City Council authorized the garage transaction on January 27, 1997.

But there, tucked in the middle of page 18, was the giveaway to the scam.

"It is important to note," the Coopers team reported, "that the excess investment value over market value of the improvements is created solely by the favorable bond financing rate resulting from the City's credit enhancement (pledging of parking meter revenues) and is not reflective of the contributory value of the land. Based on this argument, an even lower bond rate, which would increase the investment value of the improvements would provide additional 'Unrealized Equity' to the Developer." **(Exhibit #10)**

Granted, the Coopers & Lybrand accountants were displaying a dry sense of humor. But what's telling is that this deal was so corrupt that the City's own consultant was clearly mocking the absurd logic of using the investment value appraisal method for this type of public/private project.

All humor aside, what Coopers & Lybrand was saying is that the low discount rate that drove the millions in excess value for Cowles real estate companies [the "Developer"] was only possible with the City's backing. Without the City's backing, the low interest, tax-exempt bonds were simply not available. Moreover, without the City's willingness to pledge its parking meter revenues as a backup for rent and maintenance costs of the garage, the bonds would have been below investment grade. They would have been junk bonds. The RPS garage bonds would have either been unmarketable or marketable at such a higher interest rate as to drive the investment value down considerably. Again, it's important to recognize, as Coopers & Lybrand did, that it's the Cowles companies that are collecting ALL of the millions of dollars in the difference between investment value and market value. The City got exactly nothing for it, except *more* risk to its parking meter funds. The more garage revenues needed to pay off the purchase price, the less revenue would be available to pay ground rent (to the Cowleses) and maintenance—costs the City agreed to back with its parking meter funds. So, in a nutshell, what Coopers was saying is that the Cowles companies were directly, and hugely, benefiting from the risks the City was taking to support River Park Square.

The Bogus Land Value

The person who spoke with the most conviction about the legitimacy of the investment value appraisals, and the millions of dollars above market value she thought they should bring her, was Betsy Cowles. In late 1996 she seemed to deeply believe her real companies were entitled to receive close to \$30 million for the River Park Square garage. Just the garage. She intended to hold onto the land beneath the garage. And she would lease that land to the City.

But the City, which had once tried to limit its exposure to \$15 million, finally drew the line at \$26 million, provided that a non-profit organization (the SDF) sell the bonds. So, as Coopers & Lybrand noted in their report, Cowles would try to make up for the difference by trying to recover the missing millions in the ground lease. This is what Coopers was referring to with the phrase "unrealized equity" and why it mocked the "developers" explanation for it in its report to the City.

In a less cowed community, where powerful people don't get to demand that others remain silent while they redefine the world around them to try to obscure their lack of ethics and self-restraint, "unrealized equity" would likely be called "greed" if not "theft." It was a complicated way to coerce city officials to help create millions of dollars in property value, where none existed, and then seize that value for the benefit of Cowles real estate companies. In a truly arms length relationship, the notion that even after being handed double the market

value for the River Park Square garage, Cowles real estate companies would be demanding and receiving additional compensation through a ground lease on the same property simply made no sense. It was a fiction built on a fiction.

Assistant City Attorney Stan Schwartz saw it and was so upset about it that he wrote at least two memos to the file recording his objections to it, and recording the instructions he was given to ignore it. **[Exhibit #11]**.

Mrs. Rodgers wasn't shown those memos and they were withheld from Mr. Connor when he requested them via public records requests.* The obvious reason the City withheld the memos from Mr. Connor is that they undermined the City's defense in the River Park Square securities fraud litigation at a time when the City was pronouncing its innocence and trying to blame others, including the PDA, for the excesses of the garage transaction. In other words, the Schwartz memos expose the City's active participation in the fraudulent scheme that bondholders alleged.

*The City's repeated practice of withholding from Mr. Connor public records related to the River Park Square project (which ultimately led to two superior court verdicts against the City, and an additional \$299,000 out of court settlement) is part of the pattern of public corruption that federal law enforcement should have been concerned with and investigated.

What the IRS Saw

The IRS's Tax Exempt Bond Unit investigators recognized the fraudulent nature of the investment value appraisal method and how it was applied. They ultimately spent several pages in their June 22, 2004 report explaining its significance in relation to another part of the scam. This was the creation of a bogus non-profit front organization--the Spokane Downtown Foundation--that was actually created and controlled by the River Park Square developer. Preston (Mr. McDevitt's law firm) assisted with the creation and operation of the Foundation and became Foundation's attorneys and bond counsel. (See, for example, pages 3 thru 5, and 13 thru 18, of the IRS report).

And what did IRS conclude?

- "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 [Spokane Downtown 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." (page 17)

- "The terms of this transaction were not reasonable and not in the public's interest." (page 20).

- “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.” (page 18)

- “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.” (page 21)

- “The project was dependent from the start on the garage valuation. In this case, the garage was clearly overvalued. The overvaluation was a 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 the Bond Counsel [Preston] all ignored 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.” (page 21).

- “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.” (page 16).

- “(I)t 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 a 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. If the price went down, the lease went up.” (page 24)

- “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 Nordstrom’s portion of the project, which is owned by the Developer. The City will not obtain title to this property.” (Page 23)

- “The issuer 63-20 corporation [the Spokane Downtown Foundation] 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.” (page 14)

The IRS findings about the appraisal fraud and the use of the bogus non-profit organization to issue the bonds for the garage project are thorough. They expand on reporting that Mr. Grant and Mr. Connor did in 2000 (www.camasmagazine.com, see *Secret Deal* series), corroborate the findings of former city special counsel O. Yale Lewis, and clearly support the bondholder charges that led to the settlement of the RPS securities fraud case in 2005. As recounted in Attachment #1, pages 13 and 14 of the 6/22/04 IRS report provide a list of 15 specific facts and events that describe the conspiracy, money laundering and fraud.

Mr. McDevitt (as Preston's designated closer for the RPS garage transaction) either knew, or should have known, about the illegal activities that the IRS described in its report. For Mr. McDevitt to suggest, as he did on KGA radio on August 6th that IRS found no evidence of criminal wrong-doing, is just wrong. They did find and publish evidence. It just wasn't pursued. It's only use, so far as we're aware, was simply to support the IRS finding that interest on the bonds was not entitled to exemption from federal income tax. Law enforcement, at all levels, has ignored it and the most obvious explanation is that law enforcement didn't want to mess with a U.S. Attorney or the Cowles Family.

CORRUPTION AND FRAUD IN THE HUD 108 LOAN TRANSACTION

The IRS investigators, in their June 22, 2004 report, clearly indicated that the corruption involved in the RPS garage transaction carried over into the other stem of the River Park Square public/private partnership. This was the so-called HUD 108 loan of \$22.65 million (accompanied with a federal grant of \$1 million) directly to Cowles real estate companies.

After stating (page 21, 6/22/2004 report) that, because of the millions it funneled directly to Cowles real estate companies, the RPS garage project "explicitly violated" a federal tax rule written to prevent excess profit-taking by private developers the IRS reported the following:

This transaction, and the redevelopment project, from day one was dependent on being able to get enough financing in the developer/project owner's pocket to get it done. This initially was done via the renovation and sale of the garage and 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 the purposes of this report those irregularities will not be addressed.

Obviously, the IRS Tax Exempt Bond Unit didn't see that its purview extended to the HUD loan. But public corruption is public corruption, so we're going to pick up where IRS left off on the HUD loan to show the wrongdoing that, so far as we know, federal and state law enforcement has shown no interest in pursuing.

The Loan Security Scam

The City of Spokane was approached by Cowles real estate companies in early 1995 for the purpose of supporting and facilitating a \$20-plus million loan to directly finance the redevelopment of River Park Square. The plan was for the loan to be made under the federal HUD Section 108 program, whereby the loan funds would actually come from the sale of federal debentures. HUD would make the loan to the City, and the City would be the conduit. It would make a second, pass-through loan to River Park Square.

The loan was ultimately approved by the City and HUD at \$22.65 million and came with a \$1 million Economic Development Initiative grant from HUD. The security for the primarily loan (from HUD to Spokane) the City of Spokane, was the City's annual Community Development Block Grant funds from the Department of Housing and Urban Development. The security for the second loan (from Spokane to River Park Square) was supposed to be--according to HUD guidelines--an unqualified letter of credit.

Only it wasn't. As Mr. Connor and Camas Magazine first documented in 2001 (See camasmagazine.com archives: *Inside Job*) the Cowles family refused to put up a letter of credit to secure the loan. Indeed, according to a "confidential" 1998 memo from developer Betsy Cowles (**Exhibit #12**) the Cowleses's strategy was to limit their liability in the RPS project to the modest assets of Cowles Publishing Company's two real estate subsidiaries, Citizens Realty and Lincoln Investment Company. As City Attorney James Sloane and Assistant City Attorney Stanley Schwartz pointed out in a "confidential" memo in late 1997, the City's appeals to Cowles negotiators for the family to put up a letter of credit, or similarly robust collateral, to secure the City's loan were "resisted and represented as impossible by the developer." (**Exhibit #13**)

When the City commissioned a HUD required credit analysis of Cowles companies under the terms insisted upon by the Cowleses, the first draft of the analysis made the mistake of reporting the truth. The truth was that, under the terms they insisted upon, the Cowles companies were a poor credit risk. This apparently infuriated the River Park Square project manager Bob Robideaux who termed it the "kiss of death" according to notes taken of a conference call with City officials. (**Exhibit #14**). Here, again, it's important to note that the City tried to cover this up and withheld the draft of the critical credit analysis from Mr. Connor in response to a lawful public records request. (The critical analysis was only obtained when, finally, a pro-RPS council member, Roberta Greene, produced it in discovery in Mr. Connor's public records suit against the City.)

The fierce reaction from RPS caused the report language to be changed, even though the loan was still not secured with a letter of credit. Another response was that Cowles attorney Duane Swinton tried to keep the city's newly elected mayor in the dark about the details of the documents being exchanged between the Cowles real estate companies and the City (**Exhibit #15**). This was at the same time the family newspaper was denouncing the Mayor as a "civic terrorist" for raising questions about the wisdom of the loan. The evidence of obstruction—including the paper's decision not to publish a leaked city memo warning about the lack of adequate Cowles collateral--is very clear. It is why the

Washington News Council recently concluded that the Cowles newspaper had “suppressed financial information of importance to decision-makers and the public at large.” (**Exhibit #16**, see page 22)

The lack of adequate security for the loan left the City in a very difficult situation that would play itself out years later when the City found itself forced to settle the RPS securities fraud claims. In a clear *quid pro quo* to protect its future HUD block grant money, the City voted (Mrs. Rodgers not included) to settle its claims against Cowles companies on terms that even those who voted for it admitted were unfair to City taxpayers.

The “confidential” internal warnings (that senior City officials and the Cowles newspaper had succeeded in suppressing back in 1997 and 1998) had come true. As Assistant Attorney Schwartz reported in his notes from a phone conversation with a HUD official in August 1997, the City’s loan to RPS could leave the City “holding the bag” even though HUD was protected because of its hold on Spokane’s block grant funds. After Mrs. Rodgers joined the City Council, such internal warnings bypassed her and the Mayor, and were shared only with project supporters on the City Council, specifically the City Council Finance Committee led by councilman and real estate developer Orville Barnes.

The sanitization of the City’s public records, in violation of Washington’s retention rules for official documents, is additional evidence of public corruption. At different times, Mrs. Rodgers and Mr. Connor sought access to the meeting minutes of the City Council’s Finance Committee during the period (1997 and 1998) when it made key decisions both about the RPS garage and the HUD 108 loan. No minutes were kept in 1997 and, in 1998, the minutes recorded no mention, whatsoever, of the committee’s discussions related to River Park Square.

One of the key warnings that bypassed the Mayor and Mrs. Rodgers came as the council prepared to vote to approve the loan documents in early 1998. This was a February 9, 1998 memo from Mr. Schwartz to the Finance Committee (**Exhibit #17**). In the memo (which was later illegally withheld from Mr. Connor) Mr. Schwartz not only updates the failed efforts to persuade Cowles negotiators to put up more collateral for the loan, but he reports the City “could find the developer is making a profit” off RPS while the City is losing its block grant funds because of how poorly the City’s loan is secured.

Surely, that information should have killed the deal. And it would have killed the loan if the loan terms had been made public before the City Council’s votes in March and July of 1998 to approve the loan. As the record shows (see *Inside Job*) when Mrs. Rodgers asked questions about the security for the loan in public meetings, she was given false information by Mr. Barnes and other city officials.

Some of the key evidence of this is preserved on video feed that can be viewed at the camasmagazine.com website, under *Scenes from the Inside Job #2*. The issue is whether the so-called “Cowles Publishing Company Guaranty” protected the city’s block grant funds in the event of a loan default. Mrs. Rodgers was told it would. That wasn’t true. In fact, the Cowles Publishing Co. Guaranty actually stipulated that all of the City’s available block grant funds would be consumed before the first dollar of Cowles money was touched. Mr. Schwartz’s

effort to at least get Cowles negotiators to agree to mix the money, so that the Cowleses shared the risk with the City, is recorded in Exhibit #17. It ends with the telling words: ***“This was rejected.”***

The full circle of corruption on the HUD loan was borne out in late 2004 when a majority of the Spokane City Council voted (Mrs. Rodgers voted against the resolution) to accept a settlement of the City’s claims against RPS in what remained of the federal securities fraud litigation. The City paid \$39 million, up front, to finance the settlement with bondholders. The sum was offset by relatively small settlements with Preston Gates and other parties to the bond issuance. To protect Spokane taxpayers, City officials said they would vigorously pursue claims against Cowles companies on whose behalf, after all, the fraudulent garage deal had been put together in the first place.

And yet the City Council--at the urging of its lawyers and Mayor West--agreed to settle the claims with Cowles companies for the receipt of merely \$2 million. The Cowles companies were even allowed to reclaim ownership of the garage they’d sold for \$26 million in 1999. In addition to the \$2 million in cash, the Cowles companies agreed to cover the repayment of the City’s loan to HUD for the HUD 108 loan. In other words, their main contribution to settle the RPS case was to fully secure the loan that they’d refused to secure in 1998. This was the *quid pro quo*. So, who paid the difference? Spokane taxpayers.

It’s notable that even councilman Al French (who publicly supported River Park Square and later served on the City’s mediation team) publicly denounced the settlement even before voting for it. Mr. French explained that he felt he was voting with “a gun to my head.”

Why would Mr. French and others on the council vote for a settlement that they felt was unfair to the City? Because Mr. Schwartz’s 1998 warnings were coming true. The City was losing its block grant money because the loan to River Park Square was going into default and HUD was taking the block grant funds as compensation. **(Exhibit #18)** To prevent further block grant losses, the City Council accepted a deal that Mr. French and others who voted for it publicly acknowledged as unfair for City taxpayers.

Mr. French’s statement about feeling like he was voting with a gun to his head didn’t make the *Spokesman-Review*. In addition to suppressing the important financial details and story lines of the RPS fiasco (e.g. the Coopers & Lybrand warnings, the huge loophole in the Cowles Publishing Company Guaranty) the reporting and editing process at the paper can always be relied upon to shield the Cowles family from pointed criticism from the public square. The newspaper’s readers have to go elsewhere to learn anything meaningful about Cowles business practices and how they effect the civic and political environment in Spokane. It’s hard for voters to hold public officials accountable when the dominant press institution in the community remains complicit in the secrecy and corruption that public officials have been engaged in.

But that doesn’t excuse the U.S. Attorney and federal law enforcement. Federal investigators are surely smart and shrewd enough to ask what honest city government in its right mind would allow itself to risk grant funds for its poorest neighborhood to help a wealthy family with a high risk real estate project? The

answer is that none would. The fact that Spokane officials went along with this is a solid indication of public corruption--one involving federal grant and loan funds--that calls out for a federal investigation.

Paying HUD with Bogus Ground Rent

Garage bondholders were informed that the \$26 million purchase price of the River Park Square garage was based on “two MAI Appraisals” (see September 15, 1998 Official Statement page 25). This is not true. In fact, as IRS corroborated, the garage purchase price was based on appraisal reports whose methodology and key inputs were pre-determined by others. This abuse violates appraisal ethics, specifically Canon 3 of the Appraisal Institute and its prohibition against allowing the work of a member (an “MAI”) to be used in ways that results in biased or fraudulent outcomes.

As appraiser veteran Spokane appraiser John McFaddin told Mr. Connor in May 2000: “The appraisal was a problem. But the misuse of the appraisal was a bigger problem.”

Moreover, both the appraisers whose work was used to set the garage values in the transaction have expressed misgivings (both in interviews and in deposition testimony) with the way their work was used.

That should matter to federal investigators because federal funds (the HUD 108 loan, the \$1 million EDI grant) were involved and the Federal Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) should have applied. If it had applied the garage and garage land rent would have been set at market value, using a standard MAI appraisal adhering to Appraisal Institute ethics and USPAP guidelines. It’s baffling that no federal agency (other than the IRS Tax Exempt Bond Unit when it found the appraisals were a notch in the post of “public deception”) has moved to address this abuse and sanction the participants.

In this section we’re going to look exclusively at the garage ground rent because this is what connects the garage fraud to the HUD loan fraud. To begin with, as IRS noted repeatedly, the ground beneath the garage should have transferred with the garage. Because the land didn’t transfer, the two key private entities (the RPS developer and Nordstrom) were able to use the land lead (a.k.a. the ground lease) to insert conditions and profit-taking clauses that bound the City, the Spokane Downtown Foundation and the Spokane Parking Public Development Authority. This, by itself, violated federal tax rules for “on behalf” of transactions like this one under IRS Revenue Ruling 63-20.

Former City special counsel O. Yale Lewis recognized this problem in his October 30, 2000 report to the Spokane City Council:

“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.”

Mr. Lewis specifically warned about the “highly inflated ground rent that goes to the RPS Developer and the 41% of ground rent that is pledged to

repayment of the HUD loan” which, he said, “has not been examined but might be significant.” **(Exhibit #19)**

In terms of the HUD 108 fraud it turns out to be very significant. City records show that Cowles negotiators stubbornly resisted appeals from the City to have multiple sources of RPS revenue dedicated for repayment of the HUD-backed loan. So there were only three sources of funds: the Nordstrom lease payments including “base” rent and a percentage on sales receipts above \$40 million, a \$500,000 annual payment from Cowles real estate companies, and, As Mr. Lewis indicated, a share (41%) of the garage ground rent.

There are at least two reasons why this is significant.

1) Under the terms of Ordinance C-31823, the City agreed to loan its parking meter funds to the operators of the RPS garage if garage revenues (after payment of bond debt service) were inadequate to pay maintenance and ground rent obligations. Thus, an overvaluation of the land to benefit Cowles companies clearly increased the risk that the City would be asked to lend its parking meter funds so that the garage operator could pay rent to Cowles companies. In other words, the Cowleses would be using a loan from the City to repay the City’s HUD-backed loan.

2) The land on which the River Park Square garage sits was appraised by Auble & Associates in July of 1996 to be worth \$60 a square foot or \$6.7 million by March of 1999, upon the anticipated completion of the River Park Square renovation. **(Exhibit #20)**. Without even bothering to explain why, the City and the RPS developer agreed to add nearly \$1.6 million to that number, so that annual base rent payments started not at \$670,000 a year, but \$765,000 a year. In reality, the land had little if any value because the Cowleses had already mined the property for their \$26 million garage check, leaving the property (building and land) \$48 million in debt, not counting the operating costs of the garage.

The transaction was bogus, in part, because of a crucial discrepancy in the land appraisal used to derive the \$6.7 million land value. The appraisal instructions from City real estate manager Dennis Beringer on April 11, 1996 were to value the land with the “understanding that both parking structures must remain.” **(Exhibit #21)**. Mr. Beringer reiterated the specific condition on which the ground lease was to be valued in a subsequent letter, less than three weeks before the appraisal reports were due. The ground lease was to be valued, he specified, “for use as a parking structure.” **(Exhibit #22)**

But the Auble land appraisal removed the garages (on paper at least) and, instead, estimated “the prospective future “Market Value” of the fee simple interest of the land ***as vacant and available*** for development to its Highest and Best Use as of March 1, 1999. (Exhibit #20, p. 2, emphasis added).

But clearly it was not “vacant and available” for development. This inexplicable act of making the superstructure of the RPS garage (with its upper and lower portions) disappear from the land appraisal is stunning because the

whole RPS renovation project was premised on garage structures being on the property. The garage renovation and expansion was financed with \$48 million of bond debt that had to be paid off with garage parking revenues. As importantly, the first priority and obligation of the garage owners and operators, according to leases signed between Cowles companies, the Spokane Downtown Foundation, and the PDA, was to pay off the bonds. **(Exhibit #23)**. Only if anything was left over after debt service payments, could any parking revenue get to the land beneath the garage.

USPAP appraisal rules clearly require that such encumbrances and liens against a property's revenue be identified and accounted for in the valuation process. But despite Mr. Beringer's written instructions the enormous debt encumbrance attached to the garage sitting on the property wasn't accounted for in the Auble land appraisal.

This may be extremely complicated for the public to understand. But it shouldn't be complicated for white collar crime investigators at FBI who are doubtless qualified to make sense of such schemes. After all, \$18 million is \$18 million, whether it is lifted from a safe by people with dynamite and black ski masks, or removed with winks and a few keystrokes. In point of fact, no one has been able to offer any coherent explanation of how the RPS garage can be worth \$26 million, at the same time the land it sits on is worth \$6.7 million, accounting for the garage liabilities, including bond debt service.

This was black magic. For purposes of setting the land rent that the public would be on the hook for, the River Park Square garage was simply made to vanish. It was made to disappear by valuing the land as if it were clear and open for the highest and best commercial use available.

As if this weren't enough of a scam, the ground lease schedule called for even more money--above the grossly inflated value of the Auble land appraisal--to be paid to Cowles real estate companies.

"It is our understanding," the Coopers & Lybrand reviewers wrote in their January 27, 1997 garage report, "that the terms of the ground lease were designed to give the Developer (Lessor) a ten percent return on the value of the land, increasing every three years by ten percent. Based on the estimated value of the land underlying the RPS Garage of \$6.7 million, this would reflect an initial ground rent payment of \$670,000. The current negotiated terms of the agreement relating to base rent only, **result in additional lease payments totaling approximately \$1.59 million over the 20 year term of the lease.**" **(Exhibit #24, p. 17, emphasis added)**. The explanation for just slapping \$1.6 million onto land lease payments? According to Coopers & Lybrand it was "Unrealized Equity"—the demand from Cowles real estate companies that it be compensated through the ground lease for not getting everything Betsy Cowles wanted in the garage purchase price. This was illegal under FIRREA standards that should have applied because of the ground lease's direct connection to the HUD 108 loan repayment. But it's also a darkly humorous indication of just how corrupt the deal was. It's not as though \$1.6 million just falls out of the City's money tree and lands on the bed of a *Spokesman-Review* delivery truck.

Why did this happen? Why did top city officials overrule Mr. Beringer's objection to the investment valuation scheme, and then overrule Mr. Fortin when he had advised paying no more than \$18 million for the garage? One plausible explanation is that in the perverse logic of the City's subservient relationship to the Cowles family, the City actually thought it was getting a piece of the action on this clever but absurd scheme. The higher the ground rent, the more money the City would get (through the 41% ground rent dedication) to repay the HUD loan. And it really needed that money because, as Mr. Schwartz secretly reported to the City Council Finance Committee, the Cowleses refused to make additional revenue streams available. The City officials who understood this scheme in 1997 didn't care if the money coming back to repay the City was money that the City had loaned to the garage. What mattered to them is that the deal get done.

If federal criminal investigators don't want to accept the IRS Tax Exempt Bond Unit's dark take on how the Cowleses used the garage valuation schemes to get what they wanted, then they should look at what others, who were directly involved, have to say. How about Councilwoman Roberta Greene, an RPS supporter on the city council and a PDA board member at the time the deal was cut.

Here's what Mrs. Greene said in her March 19, 2003 deposition when asked about what happened when the City Council, at Mr. Fortin's advice, tried to draw the line at \$18 million:

Roberta Greene: "As I remember, we asked him to convey that message to the developer."

Q. And what did you learn back from Mr. Fortin?"

Mrs. Greene: "That that was not acceptable."

Q. Did he indicate why the developer had said it was not acceptable?

Mrs. Greene: "My, I'm thinking that it was like the deal is dead or something like that with that kind of a number."

What clearly astonished the Coopers & Lybrand team (and deeply upset Mr. Schwartz, see Exhibit #11) is that Cowles companies wanted even more money and top city officials were willing to give it to them. As Coopers & Lybrand explained, the Cowleses thought they'd gotten shorted on the garage; that it was worth *more* than the \$26 million they were paid. So they insisted on amending the ground lease terms to recover their "unrealized equity" through additional profit taking provisions. As the deal was concluded, the City agreed to give the "unrealized equity" compensation through what was termed "administrative variable ground rent," and "variable ground rent." If the garage had money left over after operating expenses, the Cowleses would get the first call on what was left, even before any money was made available to pay back any loans the City would have made to pay "fixed" ground rent and maintenance.

THE FRAUDULENT SCHEME IN MOTION

The garage fraud and its connection the HUD loan fraud emerge when events are set in a chronology. Documentation of all the quotes and references in this section are available on request from Mrs. Rodgers and Mr. Connor.

•**May 17, 1995:** Walker Parking consultants sends parking revenue projections for a new River Park Square garage to RPS project manager Bob Robideaux. For the years 2000 through 2005, the projections forecast revenues of between \$1.9 million an \$2.3 million. The 1995 projections turn out to have been a very accurate forecast.

•**June 1, 1995:** Cowles attorney Duane Swinton writes City bond counsel Roy Koegen and proposes that the City pay \$12 million to build and renovate an expanded River Park Square garage, and agree to pay \$320,000 to \$350,000 in annual ground rent on the land beneath the garage structures.

•**June 12, 1995:** The City essentially ratifies the Cowles proposal with Resolution 95-74, agreeing to issue revenue bonds “in an amount not to exceed \$15 million” and the lease the land beneath the garage from the Cowleses at an unspecified amount.

•**June 12, 1995:** A resolution to vacate the city’s Post Street property and sell it to Cowles real estate companies is adopted and later confirmed by ordinance. The Post Street vacation transfers 22,500 square feet to Cowles companies at a cost of \$474,648, or \$21 per square foot. This parcel becomes part of the land beneath the newly expanded River Park Square garage. With Ordinance C-31823, the City agrees to a land lease that requires “fixed” annual ground rent payments based on a land value of \$76.5 per square foot. As the IRS Tax Exempt Bond Unit later concludes, the only purpose for this extraordinary transfer of land value is to provide a hidden subsidy to Cowles real estate companies.

•**Winter/Spring 1996:** City of Spokane real estate manager Dennis Beringer and other City officials come under pressure by Cowles real estate companies to commission new garage appraisals using the “investment approach to value.” Despite objections from Mr. Beringer and private appraisers like John McFaddin, the city council overrules the objections and decides to go forward with the appraisals using a method that is forbidden under the Federal Institutions Reform, Recovery and Enforcement Act of 1989 which requires “market value” appraisals on projects where federal funds are involved.

•**May 1996:** Walker Parking consultants prepares new revenue projections for the River Park Square garage, this time for the City of Spokane. But now, incredibly, Walker’s forecast for the 2000 to 2005 period ranges

between \$4.3 million and \$5.1 million—more than double its earlier projections. A big reason for the new, rosy numbers is that Walker has simply removed the cost of the generous parking validation program (that subsidizes parking in the garage) to assume someone will pay for it. Then the contract appraisers were instructed to use the unadulterated 1996 Walker numbers in estimating the investment value of the new garage. Under those terms, Spokane appraiser John McFaddin was so upset he refused to bid on the project. “I don’t see why they needed an appraiser,” Mr. McFaddin told Mr. Connor in 2000. “If you are dictating income and a capitalization rate, you could do that with simply a calculator.”

•July 8th and 11th 1996: The garage appraisal reports from Daniel Barrett and Auble & Associates are provided to the City. When questioned about the legitimacy of the \$26 million purchase price, RPS developer Betsy Cowles would invoke these reports. Mr. Barrett saw a “best case” investment value of \$30,820,000 and a “worst case” investment value of \$22,240,000. Auble and its appraiser John Evans put the investment value at \$34,300,000. Both reports raised questions about the assumptions the appraisers were instructed to use. Deep inside his report (page 74), Mr. Barrett estimated the market value of the new and expanded garage at a mere \$12 million and its replacement cost at \$16 million. Auble submits a “market value” land appraisal, that values the land beneath the garage at nearly \$60 a square foot, or \$6.7 million. Despite instructions to value the land with the garage on it, the appraisal report values the land as vacant and available for “highest and best use” development. The \$6.7 million is converted into an initial land lease schedule beginning at \$670,000 a year. By the time the bonds are sold, the beginning annual land lease payment has jumped to \$765,000 a year, for no apparent reason.

•July 26/29, 1996: City staff notes reveal extraordinary pressure from Cowles agents not only on the purchase price of the garage but other demands, such as demanding City participation in a parking subsidy program and allowing Cowles companies to dictate important terms of the bond sale. This is the point at which then-Acting City Manager Bill Pupo writes, on a city memo, “\$26M-30M is where their @ for Purchase,” Pupo wrote. “We’re at \$20 million & we could build for \$13 million. Excludes land lease.”

•August 1996: City Finance Director Pete Fortin privately recommends to the City Council that the City pay no more than \$18 million for the garage. The City Council sends him to Cowles negotiators with that position. Not only is it rejected, but Mr. Fortin is then removed from any further role in negotiating the purchase price. By this time, City real estate manager Dennis Beringer has already voiced his objection to the appraisal method, and he is removed from further involvement in the project.

•August 1996: Preston Gates and its attorney Mike Ormsby are hired by RPS to advise RPS on the garage transaction.

•**October 1996:** Public reaction to the proposed \$29 million purchase price of the garage causes the city council to back away from the project.

•**October 1996:** In further response to public opposition to the RPS project, the Spokane City Council decides to seek an independent financial evaluation from Coopers & Lybrand.

•**October/November 1996:** The proposed solution to the October impasse is to lower the purchase price to \$26 million, but to finance the transaction with revenue bonds issued by a non-profit corporation (the Spokane Downtown Foundation). The SDF would buy the garage “on behalf of” the City. The purpose is to avoid exposure to the City’s general fund, but still allow the garage to be financed with tax-exempt bonds, the effect of which (in the investment value appraisal scheme that Mr. Beringer and others opposed) is to more than double the value of the garage--to the Cowleses.

•**November 14, 1996:** The Spokane Downtown Foundation is created by two lawyers with Witherspoon, Kelley, the law firm used by Cowles companies. The SDF registers with the Washington Secretary of State as a Washington non-profit corporation. Its registered agent is Cowles lawyer Duane Swinton, a fact that won’t be disclosed in the official offering statement for the RPS garage revenue bonds that the SDF will issue in 1998. Within days after the SDF has been registered, Preston’s Mike Ormsby is approached to see if he will serve as the Foundation’s lawyer. He accepts and begins working on Foundation business even before the Foundation board is appointed.

•**November 15, 1996:** Mr. Swinton writes the City of Spokane requesting that the “parties” to the Coopers & Lybrand review sign a confidentiality agreement. Coopers refuses, but the City agrees to sign.

•**January 24, 1997:** According to a City memo, Betsy Cowles took exception to the draft report Coopers & Lybrand was planning to present to the City Council in preparation for the council’s 1/27/97 meeting. In a private meeting with Coopers & Lybrand and city staff, Cowles insisted the report be rewritten to remove information she regarded as confidential. When the report was presented to the Council three days later, it included a “confidential” section that revealed a “tenant allowance” payment to Nordstrom of \$22,750,000, a sum that exceeded the entire amount of the \$22.65 million federally-backed loan the City had agreed to make to Cowles companies.

•**January 27, 1997:** The City Council approves emergency ordinance, C-31823, approving the River Park Square garage project. The council’s unanimous approval came despite the warnings of the Coopers & Lybrand team leader, Mike Wenzell, that the parking revenue projections for the garage were inflated because they did not account for the cost of a parking validation program. It was

clear to Coopers & Lybrand that subsidized parking in the garage would be necessary to draw customers in the numbers that were projected by Walker. To extend the existing parking validation program (on which the parking demand study was predicated) would cost over \$2 million, Mr. Wenzell noted, and “the question is, where does that balance come from?” No one could answer Mr. Wenzell’s question. But Betsy Cowles, following him to the podium, assured the council that she recognized the concern and “there’s a lot of ways to solve that problem and we have every intention of being part of that solution.”

•**November 20, 1997:** After months of fruitless negotiating on the HUD 108 loan security, City Attorney James Sloane and Assistant Attorney Stanley Schwartz privately warn the city council that there are major unresolved problems with the planned loan to River Park Square. They report their efforts to solve those problems by seeking a letter of credit or other additional security from the Cowleses “has been resisted and represented as impossible” by Cowles negotiators. But the main objective is to make sure none of their warning get out to the agitated public that has just elected a new mayor, John Talbott, who opposes the loan to RPS. “This memorandum,” they write, “contains material which is deemed to be proprietary and confidential to the developer as well as our thoughts and impressions communicated to you through our attorney client privilege. This privilege, recognized in state law, allows us to keep this communication private and exempt from public disclosure.”

•**February 2, 1998:** The City Council Finance Committee (made up entirely of RPS project supporters) gets some startling news from Paul Webster, a top HUD official, in a conference call. Mr. Webster criticizes the City’s loan documents with RPS and observes, according to notes taken by Stan Schwartz, that if “the promissory note [with the Cowleses] is payable only if there are sufficient revenues, then Mr. Webster considers this a ‘loophole.’” Webster also informs the group that because there is no letter of credit on the city’s note, HUD is going to require more collateral in order to go ahead with the loan, and that “the gap will be filled by the developer delivering a letter of credit or other form of security.” HUD’s need for more loan security is because the City hasn’t properly secured its pass through loan. And the resulting security document—the Cowles Publishing Company Guaranty—has a clause that stipulates that *all* the City’s block grant money has to be consumed before the first dollar of Cowles money is touched. Mr. Schwartz circulates the 2/2/98 notes via a memo, but Mrs. Rodgers and the new mayor, John Talbott, are not on the distribution list.

•**February 3, 1998:** Nordstrom finalizes and signs its lease with River Park Square. While Duane Swinton, the lawyer who works for both RPS and the *Spokesman-Review* fiercely defends the confidentiality of the lease, the public is completely in the dark about the poison pills built into it for the City. The lease, for example, forces the City to go along with private parking agreements negotiated between RPS and Nordstrom. These agreements are illegal “encumbrances” under federal tax rules that pertain to projects—like the RPS

garage transaction—that are funded with tax exempt bonds. Under Section 8.4 of the lease, entitled “Enforceability of Parking Agreements, Abatement of Rent,” Nordstrom will be entitled to a huge cut in its annual base rent (from \$1.3 million down to \$520,000 per year) if the parking agreements aren’t enforced. That would seem to be a big problem for RPS but, no, RPS has actually pledged all of Nordstrom’s rent for the next twenty years to repay the City’s loan. And it’s a non-recourse note, which means that if Nordstrom can reduce its rent from \$1.3 million to \$520,000 a year, RPS doesn’t have any obligation to make up the difference. So, if the City wants to do the right thing and obey the law, it risks losing close to \$1 million a year.

•**February 9, 1998:** Assistant City Attorney Stan Schwartz reports back to the Finance Committee about his efforts to resolve the “loophole” that HUD’s Paul Webster warned about the week before. But Cowles negotiators won’t budge. At least not for the City. But HUD has a bit more clout and Cowles negotiators agree to fill the collateral “gap” not with a letter of credit that the City could use, but a special Cowles Publishing Co. Guaranty. It sounds impressive, but it’s not. It would only be activated in the event that Congress reduces the federal block grant program to a degree that it jeopardizes the City’s ability to repay the HUD 108 loan, if RPS defaults, with its federal block grant money. Moreover, the Cowles Publishing Guaranty requires that before the first dollar of Cowles money is touched, all the City’s available block grant money must be consumed for repayment of the HUD 108 loan. As the Washington News Council pointed out in its May 2007 report, this information was never shared with readers of the *Spokesman-Review* newspaper.

•**March 29, 1998:** For the second time in three months, *Spokesman-Review* editor Chris Peck uses his Sunday column to attack Mayor John Talbott for “civic terrorism” because of Mr. Talbott’s opposition to, and questioning of, the \$22.65 million HUD-backed loan the City is planning to make to River Park Square.

•**March 30, 1998 and July 27, 1998:** The City Council casts its votes to approve the \$22.65 million loan to RPS. On both occasions in response to the questions of Mrs. Rodgers and Mayor Talbott, other City officials (privy to the discussions with HUD) misrepresented the Cowles Publishing Guaranty by suggesting, erroneously, that it would protect the City’s block grants funds. On both occasions the City Council voted to approve the loan documents.

•**August 25, 1998:** Assistant City Attorney Stan Schwartz, clearly distressed by the excesses of the RPS garage transaction writes a memo to the file. In a meeting with Deputy City Manager Pete Fortin, City Attorney Jim Sloane, and City bond counsel Roy Koegen, Schwartz wrote, “I stated it did not make sense to me that variable ground rent would be paid to the Developer above and beyond the purchase price. This seemed to be an unnecessary payment in that the Developer is realizing its profit through the purchase price and should not be allowed to obtain any additional funds.” Mr. Schwartz then reports he was

told that “this matter had already been brought before Finance and had been negotiated by [council member] Orville [Barnes] with concurrence of the City Council.”

•**September 1, 1998:** Working Parking Consultants sends City Deputy City Manager Pete Fortin a memo reporting that the assessed market value of the new River Park Square garage, with renovation and expansion, is \$8.8 million and that the assessed market value of the land is \$2.1 million.

•**September 24, 1998:** The RPS Parking Garage Bonds are sold. In addition to the \$26 million purchase price, the land lease payments reported to bondholders shows that Cowles real estate companies will receive a minimum of \$19.4 million in land lease payments from 1999 to 2019. Thus, under the terms of the bond sale and associated lease agreements, the Cowles companies expect (at a minimum) to receive \$45 million for a garage and land valued at \$11 million by the city’s consultant.

•**July 30, 1999:** A hidden crisis threatens the closing of the River Park Square garage transaction. Transfer of the garage to the Spokane Downtown Foundation (and payment to Cowles companies of \$26 million in bond proceeds) is scheduled for August 20, 1999. But on July 30th, acting Spokane City Manager Pete Fortin makes an “emergency phone call” to Preston Gates lawyer Mike Ormsby regarding “a problem.” A major new RPS tenant, AMC Theatres, is furious upon learning that its customers will not be able to park free at the River Park Square garage. In effect, this is Coopers & Lybrands’ Mike Wenzell’s warning to the City Council from January 27, 1997 (about the unaccounted for \$2 million in unbudgeted parking subsidies) coming home to threaten the whole project. Mr. Wenzell had asked, “where does that balance come from?” It’s still a question no one has bothered to answer.

•**August 1999:** A series of negotiations ensues to try to prevent AMC Theatres from withdrawing from the RPS development. The Spokane Parking Public Development Authority (PDA), the agency that will operate the new “public” garage, decides to cut its evening parking rates by more than half, even though the PDA is in no way responsible for the fight between AMC and RPS. The main objective, though, is secrecy. Notes from a Spokane Downtown Foundation board meeting and a PDA executive session record RPS developer Betsy Cowles, Councilwoman Roberta Greene, and city bond counsel Roy Koegen expressing concern about public disclosure of the crisis. The object is to clearly keep critics like Spokane lawyer Steve Eugster and Councilwoman Cherie Rodgers in the dark about what’s happening.

From the PDA executive session notes on August 25, 1999: “Mike concerned about pressure not to proceed by council. Roberta [Greene] commented that council really wasn’t aware of all that was going on. Roberta asked whether lres [sic] between PDA & Swinton are public doc. TMK [attorney

Tom Kingen] thinks they are. RJK's [city bond counsel Roy Koegen] concern is about things going public. "

If the deal blows up, the bond lawyers don't get paid. And neither would Betsy Cowles.

•August 13, 1999: The answer to who is paying for the AMC debacle is presented in a letter from PDA president Terry Novak to Preston's Mike Ormsby. To try to calm the waters with AMC, the PDA is cutting its evening parking rates by more than half and, as Mr. Novak reports, this results in an immediate and continuing annual revenue loss of \$1.2 million. That's a real problem, Mr. Novak reports, and "unless a solution is found to this matter [the PDA board] is of the view that it will need to meet with the city council; and that, due to these unexpected changes, it will be unable to lease the Facility."

•August 13, 1999: In a clearly choreographed move, Mr. Novak's letter is attached to a letter that Mr. Ormsby sends, the same day, to Cowles attorney Duane Swinton. Mr. Ormsby's letter gingerly approaches the real problem—Betsy Cowles is getting way too much money for a garage that's not worth anywhere near \$26 million.

"We certainly do not want to be presumptuous in suggesting to you or your client how these issues might be resolved," Mr. Ormsby wrote, "but in addition to the suggestions made by the Authority in its letter, there is at least one more option to consider. Since the purchase price of the Facility was based on the revenue stream expected to be generated by the Facility, it may be appropriate to consider adjusting that purchase price to reflect the revised revenue stream."

It seems like a reasonable request, given that Ms. Cowles constantly invoked a revenue based appraisal to defend her check. So, how did she respond to Mr. Ormsby's letter, and specifically the request that she take less money for the garage based on the new cash flow projections?

Ms. Cowles's one word answer is recorded in her April 24, 2003 deposition.

"No."

•September 28, 1999: The game of chicken between the PDA and Betsy Cowles was resolved in the following way. Ms. Cowles would get her full \$26 million check, and the PDA would agree to shut up about it. The first part of the agreement was a "reimbursement agreement" that only agreed to compensate the PDA in the event that AMC Theatres pulled out of the project. It did nothing to compensate the PDA for the rate concessions it had made (successfully it turned out) to keep AMC at River Park Square. Because the reimbursement contract disclosed the conflict between AMC and Cowles real estate companies, it was accompanied by a confidentiality agreement. The confidentiality agreement stated that the reimbursement agreement had to be kept secret, even though it is an agency contract and therefore a public record under state law. Nevertheless, the PDA's attorney, Roy Koegen, signed the confidentiality agreement at the request of Cowles attorney Duane Swinton. Among other things, it required the PDA not to produce the contract in response to a public record request. If the

PDA were sued and penalized as a result, River Park Square would pay the cost and penalties.

•**January 2000:** Just four months after closing of the garage transaction, Terry Novak, the president of the Spokane Parking Development Authority (PDA) reports to his board on the prospects of the PDA meeting its financial obligations in February 2000. “NO WAY.” A default on the parking garage bonds occurs 20 months later.

•**April 2004:** After Mayor Jim West determines, from the evidence, that city officials were knowledgeable and complicit in the fraudulent activities alleged by garage bondholders, he recommends settling the case. The city council agrees and funds the settlement by borrowing up to \$39 million. By doing so, the City acquired the bondholders’ evidence and case against the remaining defendants, including Cowles real estate companies.

•**May 2004:** Spokane citizens learn that because of the garage financial and political meltdown, coupled with lower than expected sales at Nordstrom, a default on the City’s loan to River Park Square is looming. In anticipation of losing \$1.5 million in block grant funds to loan repayment in 2005, the City’s Community Development Board recommends cutbacks in 15 housing, building and paving projects. When the loan default occurs in 2005, the Cowles Publishing Company Guaranty remains untouched.

•**December 11, 2004:** An agonized Spokane City Council votes to accept the terms of a \$2 million settlement with Cowles real estate companies to resolve all claims related to the RPS securities fraud case. Even those, like councilman Al French (who represented the council in efforts to mediate the garage dispute) indicate they believe it is an unfair settlement.

“I feel like I have a gun to my head,” Mr. French said. The problem, as he and others who supported the settlement explained, was not only that the Cowles family was threatening to bankrupt its real estate companies, but the City had no way to address the defaults on the HUD-backed loan with the garage litigation. Thus, even if it could get more than \$2 million from Cowles companies, it could still lose several million dollars in block grant funds because of the lack of a letter of credit on the non-recourse loan made to RPS. With the settlement, the Cowles companies agreed (finally) to take full responsibility for repaying the HUD-108 loan.

Not counting millions of dollars in attorney fees, that still left the City with some \$45 million in debt because of the garage debacle. This does not include the \$6 million in parking meter revenues it agreed to forfeit to Cowles companies in the settlement. Under the terms of the settlement, Ms. Cowles got the garage back.

“Quite frankly,” Mr. French explained to the public on December 11, 2004, “I think I’ve failed you. This is not a fair deal. This is not an equitable deal. But it’s probably the best deal we’re going to get.”

