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IRS Says $26.5M of Bonds for Statler Hilton Redevelopment Project in Dallas are Taxable.

WASHINGTON – The Internal Revenue Service has preliminarily concluded that $26.5 million of zero coupon bonds issued by a Wisconsin authority for a project to redevelop the old Statler Hilton Hotel in Dallas are taxable.

A material event notice posted on the Municipal Securities Rulemaking Board's EMMA website says the issuer — the Public Finance Authority in Wisconsin — received a Notice of Proposed Issue from the IRS on July 17 stating its initial finding is that the bonds are taxable.

The notice doesn't give the basis for the IRS finding, but says the issuer "disagrees with the legal conclusion set forth in the Notice and intends to engage in discussions with the IRS."

The IRS began auditing the bonds in January, less than five months after they were issued. Local newspapers in Dallas published articles quoting sources raising questions about the unusually complex financing and the incentives being provided to the developer – Commerce Statler Development, LLC, according to the official statements for the bonds. That company was created by Mehrdad Moayedi, an Iranian who reportedly came to the U.S. in the late 1970's and became a U.S. citizen n the early 1980's.

"For the IRS to jump into something that quickly is unusual," said Mark Scott, former head of the tax-exempt bond office at the IRS.

The quick action on the audit seems to suggest that the IRS had problems with the structure of the deal, rather than post-issuance compliance.

There are some curious aspects about the financing. First, the bonds were issued by the Public Finance Authority in Wisconsin, which can sometimes mean that transaction participants are trying to avoid state or local restrictions where the project is located.

The event notice said the IRS is not calling into question whether the issuer can issue tax exempt debt inside or outside the state of Wisconsin. The PFA is a governmental entity established under Wisconsin law and authorized to issue tax-exempt, taxable and tax credit conduit bonds for public and private entities throughout all 50 states, according to its website.

Also, questions have been raised about the developer. According to the OS, Moayedi's company Centurion American and various subsidiaries are involved in roughly 70 master planned residential community projects in Texas valued at about $2 billion (at build out). Roughly 40% of those projects have been developed using funding by various entities associated with United Development Funding, a large sponsor of real estate investment trusts based in Grapevine, Texas.

UDF's headquarters was raided by the FBI in February 2016 following allegations by Kyle Bass, who runs Dallas-based hedge fund Hayman Capital Management and bet against one of UDF's fund's shares, that that UDF involved in a Ponzi scheme. Bass alleged that UDF was using new investor money to repay earlier investors.

UDF claimed in May 2016 that a law firm it hired to investigate the allegations found no evidence of fraud or misconduct.

The OS for the Statler Hilton bonds says UDF is not associated with the funding of the project.

But it also says the developer and authority cannot predict the results of the FBI investigation and its effect, if any, on the developer or its ability to continue or complete project funding.

Finally, the structure of the financing is very complex and difficult to grasp, but it shows a lot of money flowing to Moayedi from both the city of Dallas and the bond financing. The structure involves a slew of companies connected to Moaydei.

And the public offering for the project consisted entirely of capital appreciation or zero coupon bonds, which pay no interest until maturity.

Moaydei's plan was to develop the former Statler Hilton Hotel, which has been vacant since 2001 as well as the old Dallas Central Library on Main Street into a luxury residential tower with restaurants, offices and a move theatre, according to the website of the development company, Centurion American, for which Moayedi is president and CEO, and statements Moayedi made back in April 2014.

Construction of the project was slated to start in 2015 and to be completed in 2017.

In 2014, the Dallas city council approved $46.5 million in tax increment financing for the project.

The $26.5 million of tax increment finance grant revenue bonds were issued August 2016 "to provide funds to finance the cost of the acquisition of a portion of the Economic Development Tax Increment Financing Grant" made by the city of Dallas, according to the official statement for the offering.

The OS says the developer planned to transfer the TIF grant funds to Ctmgt, LLC, another company owned by Moayedi, "on behalf of the developer to be treated as a non-shareholder contribution to capital."

A detailed description of the funding plan in the OS says that initial funding for the project was to be comprised of loans and contributions.

Statler 1900 Commerce, LLC, owned by Moayedi, committed to up to $85 million pursuant to a loan agreement secured by a deed of trust on the property and by a personal guarantee from Moayedi.

According to the OS, $50 million of the loan was released and $35 million was put into escrow.

Another equity contribution of $10.7 million was made to the developer by 1914 Commerce GM, LLC,
also owned by Moayedi.

In addition, 1914 Commerce Investments, Inc., a company registered by Moayedi, received a $29.13 million state housing tax credit bridge loan from Octagon, a company not described in the OS.

And loans were to be made to 1914 Commerce Investments in connection with two federal housing tax credit bridge loans from Octagon, one for $15 million and one for $7.5 million.

The OS says the developer was to receive a fee of more than $17 million, but deferred it. That's almost 8% of the estimated project cost in the OS of $221.59 million.

The OS, which was dated Aug. 16, 2016, then states that as of July 31, 2016, the supplemental budget is anticipated to be funded by several modified or additional amounts, including a deferred developer fee of $4.4 million.

A sources and uses table in the OS shows that of the almost $221.59 million cost of the project, almost $22.9 million is for land costs, $135.6 million is for construction and hard costs, and $63.1 million is for soft costs.

The OS states the bonds are to be paid in part by the Economic Development Tax Increment Financing Grant that was provided to the developer by the city and interest and other income from investments.

The bonds were underwritten by Jefferies. Orrick, Herrington & Sutcliffe was bond counsel and counsel to the authority. Underwriter's council was Winstead PC.

Sarah Dodd, a spokeswoman for Centurion American, one of Moayedi's companies, which she said is developer of he project, said: "We sold our rights to a portion of the TIFF. The Wisconsin Public Finance Authority and its legal counsel Orrick made determinations on all tax matters. We will follow whatever ruling is ultimately decided by the IRS. But, at this time the WPFA and Orrick are protesting the preliminary ruling of the IRS on this matter. They expect this to be a six to twelve month process to reach resolution."

Neither Orrick's lawyers, a spokeswoman for one of Moayedi companies, or staff of the Public Finance Authority could be reached for comment.

The Bond Buyer

By Lynn Hume

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