

**City of Salina**  
**STAR Bond Project**  
**Discussion of Risk Factors**  
**and City Credit Support**

The following is a discussion of certain risks that could affect payments to be made with respect to proposed STAR Bonds for the City and the possible risks and impacts of City credit support for the bonds.

Both the complexity and the unpredictable nature of a significant downtown redevelopment Project makes it impossible to identify every possible circumstance which could present a certain risk to the City. Consequently, this discussion while thorough, is intended to be to create an awareness of possible risks but cannot, and is not intended to be, exhaustive and should not be considered as a complete description of all risks that could arise from the City's involvement in such a financing.

**The Security for the Bonds - Special, Limited Obligations**

**Pursuant to the Kansas STAR Bond Statute**

The proposed STAR Bonds and the interest thereon will be special, limited obligations of the City payable solely out of the incremental sales tax and transient guest tax revenues generated by new and established businesses within the District. Under the Kansas STAR Bond statute, the STAR Bonds and interest thereon shall not be deemed to constitute a debt or liability of the City, the State or any political subdivision thereof within the meaning of any state constitutional provision or statutory limitation and shall not constitute a pledge of the full faith and credit of the City, the State or any political subdivision thereof, but shall be payable solely from the pledged revenues. ***Unless the City expressly chooses to further obligate itself, the issuance of the STAR Bonds will not, directly, indirectly or contingently, obligate the City, the State, or any political subdivision thereof to levy any form or taxation therefor or to make any appropriation for their payment.*** The State shall not in any event be liable for the payment of the principal of, redemption premium, if any, or interest on the STAR Bonds or for the performance of any pledge, mortgage, obligation or agreement of any kind whatsoever which may be undertaken by the City. No breach by the City of any such pledge, mortgage, obligation or agreement may impose any liability, pecuniary or otherwise, upon the State or any charge upon the State or any charge upon its general credit or against its taxing power.

***In the event the City elects to lend credit support to the proposed bonds the City will incur a contingent liability equal to the amount of such credit support as long as the bonds are outstanding. Such credit support may only take the form of an annual appropriation commitment from City sales and transient guest tax revenues by the Commission to cover any shortfall in revenues needed to make principal and interest payments on the bonds up to the extent of said commitment.***

**Limited Sources of Debt Service and Factors Affecting Revenues**

**Overview.** The repayment of the STAR Bonds is dependent on the generation of sufficient Incremental Revenues to make the necessary principal of and interest on the Bonds. Based on financing structures

typical for such issues, the amount of Revenues generated will impact the amount of Bonds redeemed on each Interest Payment Date and the speed at which the bonds can be repaid.

***To the extent the City lends credit support to the repayment of the bonds, the City will incur a contingent liability which will obligate the City to annually appropriate City sales tax and transient guest tax funds if and to the extent the Incremental Project Revenues are insufficient to cover debt payments on the bonds in a given year.*** This commitment will exist according to the terms and conditions under which such credit support is pledged. For example, if the City pledges to fully support of the debt service on the bonds the City would incur a contingent liability for up to 100% of the debt service on the bonds if for any reason revenues for the project were insufficient to make such payments. Under this example, the City would be bound to make said payments as long as the bonds were outstanding.

**It should be noted that the Commission can elect to fully support the bonds, offer no credit support for the issue or offer a level of credit support which is somewhere between.**

## **CREDIT SUPPORT BY THE CITY – POTENTIAL IMPACTS**

### **City will be Required to Fund Shortfalls**

If the City elects to provide credit support for the bonds and revenues from the project are insufficient to fully cover payments on the bonds, the City will be required to fund such insufficiency from money in the City's current year budget. Such a commitment will impact the City in several ways. Money used to support a debt service insufficiency on the STAR Bonds will not be available to fund other City expenses. The City will be required to reduce expenditures in other areas or use reserves to cover the shortfall. The City Commission may be forced to delay or forego other projects or initiatives it considers important in order to meet such an obligation. Decisions to reduce spending in other areas to cover a shortfall may be difficult or controversial for a future Commission.

### **Bond Rating**

This is an important project for the City and may well justify the risk the City is undertaking to assure the project will occur. There is a very strong possibility the City's Moody's rating will be adversely impacted. The existence of a contingent liability of this magnitude will be credit negative for the City's Bond Rating. The Commission must decide if the potential benefits of a project of this scope and magnitude are significant enough justify this possible impact. We are not suggesting that the City should not undertake this initiative out of fear of bond rating repercussions. Bond ratings can change. Any rating the City might end up with would still be a very high rating. The cost to the City of a rating downgrade would not be drastic. While we work very hard to maintain and upgrade the City's bond rating at every chance we get, we also counsel our clients not to make decisions out of fear of a rating change. There are moments when the opportunity or the necessity of undertaking a project is more important than a short term rating impact. The Commission must decide if this is one of those moments.

### **Managing a Contingent Liability may impact Future Decisions**

A contingent liability of this magnitude justifies an increase in unencumbered cash reserves in the City's budget which would then be available to deal with unexpected events. At the same time, if the City is forced to use money from its current year budget to fund shortfalls it may be even more difficult for the City to build up those needed cash reserves.

Sales tax and transient guest tax collections can vary over time and are impacted by economic conditions and other events. A significant portion of a City's sales tax revenues are accordingly paired against annual expenses which can be adjusted if circumstances dictate (such as street maintenance and vehicle purchases). A smaller portion of the City's sales tax is typically budgeted for the payment of bonds. The amount of General Sales tax the City can safely pledge to support bond payments for other needed projects may be impacted by this commitment. The City's ability to make similar commitments to other development projects may also be limited.

### **Risks Generally – Overview of Project Risks**

Revenues available for repayment of the Bonds are contingent upon and the amount generated will be affected by a variety of factors, including the following: economic conditions within the Redevelopment Project Area and the surrounding area; timely completion of construction of the Project, including in particular the key revenue producing elements; competition from other retail businesses; rental rates and occupancy rates in the Redevelopment Project Area; suitability of the Redevelopment Project Area for the local market; local unemployment, availability of transportation, neighborhood changes, crime levels in the area, vandalism, and operating costs; and interruption or termination of operation of the key revenue producing businesses in the Redevelopment Project Area as a result of fire, natural disaster, strikes or similar events, among many other factors. Revenues are also contingent upon the then applicable tax rates, and timely collection and transfer of tax revenues. As a result, it is not possible to predict with certainty that amount of Revenues which will be available in any year to pay debt service on the STAR Bonds. The hotel, restaurant, entertainment and retail sales industries are highly competitive. Businesses outside of the Redevelopment Project Area, which are currently existing or which are developed after the Bonds are issued, will be competitive with retail businesses in the Redevelopment Project Area and could have an adverse impact on the available amount of Revenues generated within the Redevelopment Project Area.

***Certain Risks Related to Construction.*** Construction of the key revenue producing businesses in the Project has not yet commenced. The amount of Revenue generated in any year is dependent on the completion of construction of the Hotel, the Hotel Restaurant, the Alley, and other key revenue generators. Any significant delay in completion of or failure to complete an important phase of the Project, or any failure to obtain any required building permit, license or approval, or increased or unusual user requirements or circumstances, will impact the timing and availability of Revenues. Construction projects are subject to cost increases and delays due to a variety of causes, including, without limitation, delay in procurement of evacuation, demolition or building permits or other governmental approvals, weather, labor disputes, availability of materials or supplies, wind, fire or other casualty damages, unanticipated subsoil conditions or environmental problems, unanticipated construction difficulties and other "force majeure" occurrences or events or financial failure of or failure to perform by one or more contractor, a significant subcontractor or supplier.

New businesses to be located within the District may need to obtain construction loans to finance portions of the Project, with the closing of the construction loan expected to occur on or about the date that the STAR Bonds and the CID Bonds are issued. Although it is intended (through the use of TRANSFEREE AGREEMENTS) to be a condition for the issuance of the STAR Bonds and the CID Bonds that such construction loan be in place, there is no assurance that the construction lender will fully fund the

construction loan. While steps will be taken in the Transferee Agreements to mitigate these risks there can be no assurance that such steps will be fully effective.

One step to be taken to mitigate the Developer risk is to require Guaranteed Max Price Contracts with completion date commitments. Under Guaranteed Maximum Price Contracts, the Contractor typically covenants to construct the project for the respective guaranteed maximum prices by the respective guaranteed completion deadlines set forth therein.

Under the Guaranteed Maximum Price Contracts, each such guaranteed completion deadline may be subject to extension if the applicable component of the Project is delayed by changes in the work agreed to or ordered by the Developer, with approvals of, as applicable, the Construction Lender or the City. In determining the respective completion deadlines, each Guaranteed Maximum Price Contract typically provides for an agreed upon number of built in "bad weather" days. Any change in the applicable completion deadline must be pursuant to a change order approved by the Developer, and the Contractor must demonstrate to the reasonable satisfaction of the Developer that the delay was not due to the fault of the Contractor.

Any extension of the applicable guaranteed completion deadline may cause the Developer to fail to have the Project open by the time set forth in the projections. In a circumstance involving property leased by the Developer to an outside retailer, it may in turn permit the applicable retailer to terminate its lease agreement with the Developer.

Like the guaranteed completion deadlines set forth in the Guaranteed Maximum Price Contracts, each guaranteed maximum price is subject to certain limitations. Delays may entitle the Contractor to additional compensation for the delay. In addition, additional costs incurred for changes in the work requested or agreed to by the Developer will entitle the Contractor to additional compensation. Finally, latent, concealed or physical subsurface conditions which differ from the conditions the Contractor reasonably anticipated may also give rise to additional compensation to the Contractor. If the amount to be paid to the Contractor under the applicable contract exceeds the applicable guaranteed maximum price, the Developer must absorb such cost overrun, which increases the likelihood that the Project will not be constructed within the amount of proceeds of the public financing and private funds available therefor to the Developer. In addition, if the Contractor incurs cost overruns for which it is not entitled to additional compensation, and the Contractor lacks the financial resources or the will to absorb such cost overruns, a delay in completing or a failure to complete a project could result.

Under the Guaranteed Maximum Price Contracts, the Contractor is required to obtain surety bonds securing the completion of construction and the payment of the various subcontractors and suppliers providing goods and services with respect to the project, should the Contractor fail to do so. Such surety bonds are subject to a number of legal limitations and customary contractual limitations, including, for example, the right of the surety to refuse to honor the performance bond to the extent the Developer has paid the Contractor more than the Contractor was contractually entitled. In addition, if the Contractor fails to complete the Project and a claim on the performance bond is made, the hiring of a new general contractor to complete the Project will likely entail delays and additional unbudgeted costs, which may or may not be covered by such bond. Finally, as with any surety instrument, the security offered by the performance and payment bonds is dependent on the claims paying ability of the surety.

The City is not obligated to issue Additional STAR Bonds to pay any additional cost of completing such projects and has limited ability to issue Additional STAR Bonds under the STAR Bond Act and the Indenture.

**Project Success Influenced by Surrounding Area** - Even if the primary Project components such as the Hotel, Alley, Car Museum and Field House are completed, there is no assurance that the redevelopment of additional retail activity in the Downtown area will occur.

Although the Revenue Study indicates that certain Revenues can be expected from already identified Projects including the Hotel, Hotel Restaurant, Alley, and Grocery which will provide an anticipated level of support for debt service on the Bonds, a lack of redevelopment of the remainder of the area surrounding these improvements may have a significant adverse impact upon the Project area generally and over time.

**Financial Feasibility.** The financial feasibility of the Project depends in part upon completion of private financing, construction, leasing, operation and retention of key revenue generating businesses. These businesses must achieve and maintain substantial retail sales throughout the term of the STAR Bonds. While attempts will be made to reduce construction risk, there is no guarantee that the key revenue generating businesses will open, continue to occupy and remain open within the Redevelopment Project Area for the entire term of the Bonds. Any covenants by retailers or others to open or operate within the Redevelopment Project Area may not be enforceable or may be dependent on other tenants who fail to open. Failure of any one or more of the key Revenue generating businesses remain open and remain viable for the entire term of the bonds could impair the availability of needed STAR Bond Revenues to repay the debt.

**Competition.** The Project faces competition for sales (which, in turn, generate sales tax revenues) from other shopping centers, strip centers, and freestanding retailers located in the City and the region. Other centers in the market area may be possible competitors of the Redevelopment Project Area and new competitors may be developed. In addition, competition between retailers within the Redevelopment Project Area could cause the failure of other retailers within the Redevelopment Project Area. Such competition within and without the Redevelopment Project Area could adversely affect the ability of the Redevelopment Project Area to generate Revenues in each year in amounts sufficient to pay principal of and interest on the outstanding STAR Bonds on a timely basis or at all. Revenue generators that are currently located within the City could move into the District and current sales tax revenues that the City receives would be diverted to pay the STAR Bonds.

**Changes to State and Local Tax Rates.** The Kansas legislature has the authority to amend the provisions of State law governing the sales and use taxes imposed within the Redevelopment Project Area. As indicated under the State sales and use tax rate has been amended several times since the inception thereof. The local sales and use taxes may be amended or repealed by the Issuer, the county or voter referendum. Changes to the tax base and exemptions could affect the amount of Revenues available for payment of the Outstanding STAR Bonds. Any change in the current system of collection and distribution of sales taxes in the State, including without limitation the reduction or elimination of any such tax, judicial action concerning any such tax or voter initiative, referendum or action with respect to any such tax, would likely affect the amount of Revenues generated in any year and could adversely affect the ability of Revenues in any year in amounts sufficient to pay the principal of and interest on the Outstanding STAR Bonds. There can be no assurance that they current system of collection and distribution of sales taxes

will not be changed by any competent authority having jurisdiction to do so, including without limitation the State, the Issuer, the courts or the voters.

**Damage or Destruction of the Retail Businesses.** The partial or complete destruction of any retail business within the Redevelopment Project Area as a result of fire, natural disaster or similar casualty event, or the temporary or permanent closing of one or more retail businesses due to strikes or business failure, would adversely affect the amount of Revenues generated within the Redevelopment Project Area in years affected. Due to the concentration of Revenues projected to be generated by large taxpayers within the Redevelopment Project Area the damage or destruction of such retail businesses, even for a short amount of time, could have a substantial impact on the amount of Revenues generated during the affected time period.

**Changes in Economic and Demographic Conditions.** Sales tax revenues historically have been sensitive to changes in local, regional and national economic conditions. For example, sales tax revenues have historically declined during economic recessions, when high unemployment adversely affects consumption. Demographic changes in the population of the market area for the Redevelopment Project may adversely affect the level of sales tax revenues. A decline in population, or reductions in the level of tourism in the market area, could reduce the number and value of taxable transactions and thus reduce the amount of sales tax revenues. It is not possible to predict whether or to what extent any such changes in economic conditions, demographic characteristics, population or commercial and industrial activity will occur, and what impact any such changes would have on Revenues.

**Change to Plans.** The Redevelopment Project Plan, the Development Agreement, the plans and specifications for the Project, the Guaranteed Maximum Price Contracts and other documents contemplate the construction of the Project. However, in the event of circumstances not presently anticipated, including but not limited to such things as an economic downturn, a bankruptcy of one or more of the key revenue generating businesses, a loss of construction financing and other events which result in the current plans not being commercially feasible, there may be significant modifications to the plans for the Project and resultant changes to the anticipated Revenues projected to be available to pay debt service on the STAR Bonds.

### **Retail Sales Tax Report and Development Strategies Projections**

The projected annual Revenues contained in the Retail Sales Tax Report are based on various assumptions concerning facts and events over which the Issuer has no control. **No representation or warranty is or can be made about the amount or timing of any future income, loss, occupancy, valuation, increased assessment or revenues, or that actual results will be consistent with the Retail Sales Tax Report or with the Revenue projections contained therein. The information in the Retail Sales Tax Report is based on various assumptions, estimates and opinions. There is no assurance that actual events will correspond with the projections or the assumptions, estimates and opinions on which they are based.**

The Retail Sales Tax Report is forward-looking and involves certain assumptions and judgements regarding future events. Although, the Retail Sales Tax Report is based on currently available information, it is also based on assumptions about the future state of the national and regional economy and the local real estate markets as well as assumptions about future actions by various parties, which cannot be assured or guaranteed. The Retail Sales Tax Report is not a prediction or assurance that a certain level of performance will be achieved or that certain events will occur. The actual results will vary from the Retail

Sales Tax Report, and the variations may be material. Commissioners should read the Retail Sales Tax Report carefully and form their own opinions about the validity and reasonableness of such assumptions.

### **Concentration of Revenues – Largest Taxpayers**

The Retail Sales Tax Report projects that certain retailers will be among the largest taxpayers of Revenues within the Redevelopment Project Area throughout the term of the STAR Bonds. The Retail Space in which these projected retailers will be located has not yet been constructed and only one of these retailers is currently open for business. The concentration of a substantial portion of the actual and projected sales activity in the Redevelopment Project Area in a small number of businesses increases the risk from events which may impact the construction, operations or sales activity of the largest taxpayers. The damage or destruction, closing of business, changes in business operations, and many other factors which adversely affect sales of a retail business, could impact one or more large taxpayers and would have a substantial adverse impact on the availability of Revenues in the years impacted.

### **Limited Collateral: No Pledge of any Portion of the Project**

The payment of the STAR Bonds is not secured by an encumbrance, mortgage, security interest or other pledge of any of the property in the Redevelopment Project Area or any other property of the Developer. Therefore, in the event of a default, the Trustee will not have the ability to sell the Project or any portion thereof to retire the STAR Bonds nor look to the Developer or to any other asset or collateral to secure repayment of the STAR Bonds. ***The only other source of repayment for the STAR Bonds would be an appropriation from the current year budget of the City of Salina, should the City elect to further secure the STAR Bonds with a pledge of such revenues.***

### **Priority Fees**

Pursuant to a Tax Distribution Agreement, certain fees of the Trustee, Dissemination Agents, Rebate Analyst and any third party monitor that provides support services to the Dissemination Agent are typically payable from the Revenues prior to payment of the Outstanding Bonds. While the extent of such fees is typically known in advance and not material in amount, it should be made clear that such expenses are typically a first priority on STAR Bond Revenues.

### **Legal Matters; Future Changes in the Law**

Various state and federal regulations and constitutional provisions apply to the obligations created by the STAR Bonds. There is no assurance that there will not be any change in, interpretation of, or addition to such applicable laws, provisions and regulations which would have a material effect either directly or indirectly, on the Issuer or the STAR Bonds.

There can be no assurance that the Kansas state legislature will not enact legislation that will amend the laws governing the imposition of sales and compensating use taxes and the applicable tax rates or other laws or the Constitution of the State of Kansas resulting in a reduction of sales tax revenues, and consequently, an adverse effect on the Revenues otherwise available to pay the debt service on the STAR Bonds.

### **Forward-Looking Statements**

Certain statements made by the various parties involved in this STAR Bond effort or included in or incorporated by reference in the Revenue Report or the Official Statement which will eventually be drafted for the STAR Bonds that are not purely historical are or may be “forward-looking statements” within the meaning of the United States Private Securities Litigation Reform Act of 1995, Section 21E of the United States Securities Exchange Act of 1934, as amended and Section 27A of the United States Securities Act of 1933, as amended, and reflect current expectations, hopes, intentions or strategies regarding the future. Such statements may be identifiable by the terminology used such as “project,” “plan,” “expect,” “estimate,” “budget,” “intend,” “anticipate” or other similar words.

**THE ACHIEVEMENT OF CERTAIN RESULTS OR OTHER EXPECTATIONS CONTAINED IN SUCH FORWARD-LOOKING STATEMENTS INVOLVE KNOWN AND UNKNOWN RISKS, UNCERTAINTIES AND OTHER FACTORS WHICH MAY CAUSE ACTUAL RESULT, PERFORMANCE OR ACHEIVEMENTS DESCRIBED TO BE MATERIALLY DIFFERENT FROM ANY FUTURE RESULTS, PERFORMANCE OR ACHIEVEMENTS EXPRESSED OR IMPLIED BY SUCH FORWARD-LOOKING STATEMENTS, INCLUDED IN SUCH RISKS AND UNCERTAINTIES ARE (1) THOSE RELATING TO THE POSSIBLE INVALIDITY OF THE UNDERLYING ASSUMPTIONS AND ESTIMATES, (II) POSSIBLE CHANGES OR DEVELOPMENTS IN SOCIAL, ECONOMIC, BUSINESS, INDUSTRY, MARKET, LEGAL AND REGULATORY CIRCUMSTANCES, AND (III) CONDITIONS AND ACTIONS TAKEN OR OMITTED TO BE TAKEN BY THIRD PARTIES, INCLUDING CUSTOMERS, SUPPLIERS, USERS, BUSINESS PARTNERS AND COMPETITORS, AND LEGISLATIVE, JUDICIAL AND OTHER GOVERNMENTAL AUTHORITIES AND OFFICIALS. ASSUMPTIONS RELATED TO THE FOREGOING ECONOMIC, COMPETITIVE, AND MARKET CONDITIONS AND FUTURE BUSINESS DECISIONS, ALL OF WHICH ARE DIFFICULT OR IMPOSSIBLE TO PREDICT ACCURATELY. FOR THESE REASONS, THERE CAN BE NO ASSURANCE THAT THE FORWARD-LOOKING STATEMENTS INCLUDED IN THE REVENUE STUDY OR THE REPRESENTATIONS OF THE DEVELOPER OR ANY OTHER PERSON OR ENTITY MAKING SUCH STATEMENTS WILL PROVE TO ACCURATE.**

**UNDUE RELIANCE SHOULD NOT BE PLACED ON FORWAD-LOOKING STATEMENTS. ALL FORWARD-LOOKING STATEMENTS ARE BASED ON INFORMATION AVAILABLE AT THE TIME AND THE PERSPECTIVE OF THE ENTITY MAKING SAID STATEMENTS.**

**THERE IS NO OBLIGATION TO UPDATE ANY SUCH FORWARD-LOOKING STATEMENTS IF OR WHEN EVENTS, CONDITIONS OR CIRCUMSTANCES ON WHICH SUCH STATEMENTS ARE BASED OCCUR OR FAIL TO OCCUR.**

#### **Availability of Debt Service Reserve Fund**

At the time of issuance of the STAR Bonds, a Debt Service Reserve Fund may be funded from proceeds of the STAR Bonds in the amount of the Debt Service Reserve Requirement. There can be no assurance that the amount on deposit in the Debt Service Reserve Fund, if needed for payment of the STAR Bonds, will be available in the full amount of the Debt Service Reserve Requirement for the STAR Bonds, because (1) the market value of the securities in which such funds are invested may have declined or (2) funds may previously have been transferred from the Debt Service Reserve Fund to fund a prior year insufficiency; and in any such case sufficient amounts may not be available in the Reserve Fund to replenish the Debt Service Reserve Fund to the Debt Service Reserve Requirement for the Bonds.

#### **Tax-Exempt Status of the STAR Bonds**

The exclusion from federal gross income of interest on the STAR Bonds will be based on the continued compliance by the Issuer with certain covenants relating generally to restriction on use of the STAR Bond Projects financed with proceeds of the Series 2012 STAR Bonds, arbitrage limitations, and rebate of certain excess investment earnings to the federal government. Failure to comply with such covenants could cause interest on the STAR Bonds to become subject to federal income taxation retroactive to the date of issuance.

### **Enforceability of Remedies**

The remedies available to the Trustee, the Issuer and the holders of the STAR Bonds upon a revenue insufficiency or other event of default under the Indenture are in many respects dependent upon judicial actions that are often subject to discretion and delay. Under existing constitutional and statutory law and judicial decisions, including specifically the United States Bankruptcy Code, the remedies specified by the Indenture may not be readily available or may be limited. The various legal opinions to be delivered concurrently with the delivery of the STAR Bonds will be qualified as to the enforceability of the various legal instruments by limitations imposed by principles of equity and by bankruptcy, reorganization, insolvency, moratorium or other similar laws affecting the rights of creditors generally.