To: Grow and Preserve NK
From: Tom Sgouros
Date: March 16, 2021
Re: TIFs: Who is on the hook?

Summary: Tax Increment Finance (TIF) bonds are a new form of finance in Rhode Island that allows a prospective real estate development project to borrow against future increases in property tax collections its construction will create. The promise is that issuing such bonds on behalf of such a development are a relatively risk-free way for a city or town to foster economic activity. Unfortunately, the perceived lack of risk is entirely dependent on whether or not the debt incurred will be considered a debt of the city or town that issues the debt. If the project fails, who is on the hook for the debt?

TIF finance documents say that if a project fails, the bonds will default without bondholders having recourse to the issuing municipality. To the contrary, recent developments in state law argue that TIF debt will be regarded as debt of the municipality that issues it by the legislature and by ratings agencies. Even though bond documents may be written to suggest otherwise, the practical reality is that municipalities should regard this debt as their own, with all the responsibility for due diligence that implies.

The question has arisen, relative to TIF bonds, whether the agreements behind those bonds can be written to absolve the municipality issuing the bonds from ultimate responsibility for the debt. If the real estate project fails, who is on the hook for the debt? Assertions that it is possible that such bonds will default without impact to the issuing municipality are an integral part of the debates over these bonds. It is my opinion that this is not possible, and that no municipality should proceed with issuing these bonds, except to the extent the governing body of that municipality accepts full responsibility for the debt.

Please find, attached to this memo, some excerpts from the 2010 38 Studios bond documents.[1] You will see that on the cover page, as well as on pages 2, 11, and 29, it says, in fairly clear language, in capital letters, that this debt is not and cannot be construed as a debt of the state. And yet, here we are, five years later, obligated to pay this debt, not out of charity, but out of fear of the consequences of not doing so.

Bond attorneys say there are what amount to between-the-lines contradictions of these clear statements to be found in other places around the bond document. For example, in the passage on page 29, you can see that the state is *allowed* to make appropriations to pay this debt. There is also general discussion elsewhere in the document about "moral obligation" debt and the bond structures that are usually considered to incur such obligations.[2] According to these attorneys,

[1] You can find the 38 Studios documents online at emma.msrb.org, using CUSIP numbers 762236DY0, 762236DX2, or 762236DW4.

[2] See pages A-67 and A-78, for example. These are reproduced and attached to this memo.

passages like these are signals to say that the government issuing the debt is not at arms-length, and can be considered to be involved with the transaction and thus on the hook for the debt. These signals imply that the clear warnings, like the ones highlighted in the pages attached to this memo, may be safely ignored. Ratings agencies and underwriters will consider the state to owe the debt in the event of the borrower's default, despite the capital letters and prominent placement of the warning disclaimers.

Of course, the warnings are not ignored during the pricing of the bonds. These same prominent disclaimers of obligation are taken to be reasons for borrowers to demand a relatively high interest rate. The 38 Studios bonds, being based on the finances of an unproven video game company (and being federally taxable bonds), had interest rates between 6% and 7.5% for terms of 5, 6, and 10 years. (There were actually three bond issues, one for each of those terms.) This is lower than the company would have gotten on its own, but had the state simply borrowed the money directly, it would have paid much less and avoided the payments for the bond insurance.[3] A $168M general obligation (GO) bond issued by the state just a few months after the $75 million 38 Studios bond paid only 3% on the portions with the same terms.[4] These were tax-free bonds, but using an estimated (and generous) 35% tax rate, the 38 Studios bonds were more than a third more expensive than the state would have paid had it simply borrowed the money directly.[5]

Another recent case is that of Central Falls, whose city council voted to initiate bankruptcy proceedings in early 2011. Among the primary reasons for the bankruptcy was a $6 million balloon payment coming due that November from a 1990 bond issue. (The city's total budget was approximately $16 million at the time.) An orderly bankruptcy would have allowed the city to skip, or at least restructure that looming bond payment.

However, a default by Central Falls could reflect badly on the bond rating of other Rhode Island municipalities. Perhaps this is true, and perhaps not; we will never know. It is widely perceived to be true, and that was enough. The state acted to prevent Central Falls from going into bankruptcy. The General Assembly passed a law making bond payments superior to all other municipal debts,[6] invented a new form of state receivership,[7] and appointed its own receiver to run the city. In the end, *all* Central Falls creditors, from commercial suppliers to retirees, took a haircut on the debt owed them, *except* the bondholders, who never lost a penny. The retirees saw their payments cut by 50%, the bondholders, 0%.

In both the 38 Studios and Central Falls cases, bond debt was paid that was not legally necessary to pay, in order not to poison the well for other agencies and municipalities who borrow in the

[3] The bonds were also insured. Rather than honoring the claim and making the bond payments on behalf of the defaulting agency, the insurance company sued the state to prevent a default.

[4] On emma.msrb.org, see CUSIP 76222RJK9. In fact, most of those GO bonds were bought at much higher prices than 100.0, resulting in much lower yields. At issue, the actual yields were in the range of 1.35-1.426% for the five-year terms. The 38 Studios bonds for the same term (762236DY0) sold at par at issue (100.0), resulting in yields of the stated 6%.

[5] Taxable economic development bonds were sold in May 2010, a few months before the 38 Studios sale, that paid only 4.663% for an 11-year term. See emma.msrb.org, CUSIP 76222RHN5.

[6] R.I.G.L. §45-12-1, see also 2011 P.L. 277, passed on the second-to-last day of the 2011 session. Also see http://www.wsj.com/articles/SB10001424053111903885604576486610528775994

[7] R.I.G.L. §45-9, see also 2011 P.L. 279 & 304

bond market. Since dependence on the bond market is universal and absolute among governments in Rhode Island, the legislature can be counted on to act in a similar fashion in the future when the threat of potential default looms for any municipality or agency. Any Rhode Island municipality or quasi-public agency must assume that all debts issued by that municipality are general obligation debt, even those that are specifically labeled conduit or revenue debt.

This is especially true for new kinds of debt like TIF, an innovation in Rhode Island law that only dates to 2015, part of the package of economic development incentives included in the FY16 budget, on which Governor Raimondo has wagered her reputation.[8] Being a new invention that will allow poor cities to borrow without putting up any money, TIFs are very important to current state policy, both to the administration and the legislature. Beyond them, the pressure to preserve the possibility of TIF financing will be equally important to the cities in the state who hope to issue TIF bonds. Were any Rhode Island TIF project to fail, the pressure will be intense on the municipality through which it was issued to avoid default at any cost. As with Central Falls, it seems quite likely that either administration or Assembly would act to prevent a looming default by any city or town willing to contemplate it.

Even without a change in law, the responsibility for this debt is subject to question. In theory, TIF bonds are just conduit debt, passing specifically identified revenue (the increment of the tax collections in the redevelopment area) through the issuing municipality to repay the lenders on behalf of the borrower. According to that theory, if the revenue does not materialize due to some failure by the developer, the municipality issuing the debt does not owe the debt. The bond documents will be written to make it clear that the project owes the debt, not the city or town. But the 38 Studios bond documents are equally clear, and that clarity was for naught.

The reality is that the revenue to repay a TIF bond is collected taxes. The municipality will thus be intimately involved in the payment stream, hardly at arms-length. Involvement with the payment stream is precisely the same legal nexus that made the 38 Studios bonds a "moral obligation." The involvement in that case was in the management of a reserve fund, while the involvement of a TIF issuer is the provision of property tax revenue. These are obviously different, but both create a legal nexus between issuer and project likely to withstand legal and political challenge. Thus will TIF bonds be susceptible to precisely the same pressures brought to bear on the state over the discussion of whether to pay the 38 Studios bonds. The result: no TIF deal should be contemplated without assuming that this debt will be owed by the municipality itself.

Please let me know if you have any questions about TIF bonds, moral obligations, the ratings agencies, or anything else in this memo. I am happy to discuss with anyone, and can be reached at [redacted] or [redacted].

(The author works in the office of the RI General Treasurer, but this memo is his own opinion and nobody else's.)

[8] R.I.G.L. §42-64.21, 2015 P.L. 141, article 19. See http://sos.ri.gov/documents/archives/regdocs/released/pdf/RIEDC/8171.pdf

PRIVATE PLACEMENT MEMORANDUM DATED OCTOBER 22, 2010

NEW ISSUE – Book-Entry Only **Ratings: See "Ratings" herein.**

Interest on the 2010 Bonds is includible in income for federal income tax purposes. In the opinion of Moses & Afonso, Ltd., Bond Counsel, except for estate, inheritance, and gift taxes, the 2010 Bonds and the income (including gain from sale or exchange) therefrom shall at all times be free from taxation of every kind by the State of Rhode Island and its municipalities and political subdivisions, although income from the 2010 Bonds may be included in the measure of certain Rhode Island corporate and business taxes.

$75,000,000
RHODE ISLAND ECONOMIC DEVELOPMENT CORPORATION
Job Creation Guaranty Program
Taxable Revenue Bonds
(38 Studios, LLC Project), Series 2010

RIEDC Rhode Island Economic Development Corporation

Dated: Date of Delivery **Due: November 1, 2020**

The Rhode Island Economic Development Corporation Job Creation Guaranty Program Taxable Revenue Bonds (38 Studios, LLC Project), Series 2010 (the "2010 Bonds") are being issued by the Rhode Island Economic Development Corporation (the "Issuer") pursuant to Chapters 026/029 of the Rhode Island Public Laws of 2010 (the "Act"), the Rhode Island Economic Development Corporation Act, Title 42, Chapter 64 of the Rhode Island General Laws, as amended (the "Issuer Act"), the Loan and Trust Agreement (the "Agreement") dated as of November 1, 2010 by and among the Issuer, 38 Studios, LLC (the "Company") and The Bank of New York Mellon Trust Company, N.A., as trustee (the "Trustee"), and resolutions passed by the Issuer's board of directors on June 14, 2010 and July 26, 2010 authorizing the issuance of the 2010 Bonds (the "Resolutions").

The 2010 Bonds will only be issued as fully registered bonds under a book-entry only system. The 2010 Bonds will be registered initially in the name of Cede & Co., as nominee for The Depository Trust Company, New York, New York ("DTC"), which will act as securities depository for the 2010 Bonds. Purchases of beneficial interests in the 2010 Bonds will be made in book-entry only form, in minimum denominations of $100,000 and in increments of $5,000 in excess thereof. Purchasers will not receive certificates representing their interest in 2010 Bonds purchased by them. The 2010 Bonds will be dated the date of delivery. Interest on the 2010 Bonds will be payable on May 1, 2011 and semiannually thereafter on the 1st day of November and May of each year at the rates as shown in the maturity schedule on the inside cover. The 2010 Bonds are due November 1, 2020 and subject to mandatory sinking fund redemptions as provided herein. So long as DTC, or its nominee Cede & Co., is the owner, principal and semiannual interest payments will be made directly to such owner. Principal of and interest on the 2010 Bonds will be payable by The Bank of New York Mellon Trust Company, N.A., as Paying Agent (the "Paying Agent") to DTC. Interest is computed on the basis of a 360-day year consisting of twelve 30-day months. The scheduled payment of principal of and interest on the 2010 Bonds when due will be guaranteed under an insurance policy to be issued concurrently with the delivery of the 2010 Bonds by Assured Guaranty Municipal Corp. (formerly known as Financial Security Assurance Inc.). **The 2010 Bonds are subject to optional, mandatory and extraordinary redemptions as described herein.**

ASSURED GUARANTY MUNICIPAL

The 2010 Bonds are being issued by the Issuer under the Issuer Act and in connection with the Job Creation Guaranty Program created under the Act in order to promote the retention and expansion of businesses and the creation of jobs in the State of Rhode Island (the "State"). The proceeds of the 2010 Bonds will be loaned by the Issuer to the Company for the purpose of financing (i) the relocation of the Company's corporate headquarters and primary place of business to the State and (ii) the establishment and operation by the Company of a video gaming studio in the City of Providence, Rhode Island, including, but not limited to costs and expenses related to the development of assets associated with role playing video gaming and massively multiplayer games, and the development of specific products to be used for such purposes, (iii) the funding of the Capital Reserve Fund and the Capitalized Interest Fund as provided in the Agreement, and (iv) paying costs of issuance of the 2010 Bonds (the "Project").

The 2010 Bonds are being issued in reliance upon exemptions contained in Regulation D to the Securities Act of 1933, as amended (the "1933 Act"). The 2010 Bonds are being offered by this Private Placement Memorandum to "accredited investors" within the meaning of Rule 501(a) of the 1933 Act. Each prospective purchaser of the 2010 Bonds is responsible for assessing the merits and risks of an investment in the 2010 Bonds and must be able to bear the economic risk of such investment in the 2010 Bonds. Moreover, each purchaser of the 2010 Bonds, by purchasing the 2010 Bonds agrees that (a) its purchase of the bonds is for its own account, or as a fiduciary for others, for the purposes of investment and not with a view to resale or other distribution, (b) the purchaser has received this Private Placement Memorandum, (c) the purchaser is sufficiently knowledgeable and experienced in financial and business matters so as to be capable of evaluating the merits and risks of the investment represented by the purchase of the 2010 Bonds, and is capable of making its own investigation of the Issuer, the Company and the 2010 Bonds, and (d) the purchaser will execute an investor letter in the form of Appendix E hereto.

The 2010 Bonds are special and limited obligations of the Issuer. The 2010 Bonds are payable from, and secured by, among other things, loan payments by the Company to the Issuer, certain property and interest in the Trust Estate, Gross Receipts of the Company, amounts on deposit in the Capital Reserve Account, Sinking Fund, Capitalized Interest Account and Program Account, and by certain appropriations made by the State, all as set forth in the Agreement.

THE 2010 BONDS AND THE INTEREST THEREON DO NOT CONSTITUTE A DEBT, LIABILITY OR OBLIGATION OF THE STATE OR ANY POLITICAL SUBDIVISION THEREOF (OTHER THAN A SPECIAL OR LIMITED OBLIGATION OF THE ISSUER) AND NEITHER THE FAITH AND CREDIT NOR THE TAKING OR TAXING POWER OF THE STATE OR ANY POLITICAL SUBDIVISION OR MUNICIPALITY THEREOF IS PLEDGED TO THE PAYMENT OF THE 2010 BONDS OR THE INTEREST THEREON. THE ISSUER HAS NO TAXING POWER. THE OBLIGATION OF THE STATE TO MAKE PAYMENTS FOR DEPOSIT INTO THE CAPITAL RESERVE FUND IS SUBJECT TO ANNUAL APPROPRIATION BY THE STATE GENERAL ASSEMBLY.

The 2010 Bonds are offered for delivery when, as, and if issued, subject to the final approving opinion of Moses & Afonso Ltd., Bond Counsel, Providence, Rhode Island, and to certain other conditions referred to herein. Certain legal matters in connection with the 2010 Bonds will be passed upon by Pannone Lopes Devereaux & West LLC, Providence, Rhode Island, as Counsel to the Placement Agents. Certain legal matters will be passed on for the State by its Disclosure Counsel, Taft & McSally LLP, Cranston, Rhode Island, for the Issuer by its General Counsel, Adler Pollock & Sheehan P.C., Providence, Rhode Island, for the Trustee by its counsel, Bernstein, Shur, Sawyer & Nelson, P.A., Portland, Maine, and for the Company by its counsel Edwards Angell Palmer & Dodge LLP. FirstSouthwest, Lincoln, Rhode Island, is serving as financial advisor for the Issuer on this transaction. It is expected that the 2010 Bonds in definitive form, will be available for delivery to DTC, New York, New York, on or about November 2, 2010.

Wells Fargo Securities **Barclays Capital**

Capitalized Interest Account shall be applied to the amounts necessary to pay interest on the 2010 Bonds for those interest payment dates commencing May 1, 2011 through and including November 1, 2012. Moneys deposited into the Capital Reserve Fund on the date of delivery shall be used in the event the Company defaults on its Loan Payments to the Issuer and the amounts on deposit in the Principal and Interest Account are not sufficient to pay principal and interest to owners of the 2010 Bonds when due. The Capital Reserve Fund shall be restored annually to the Minimum Capital Reserve Fund Requirement in accordance with the Agreement subject to appropriations made by the General Assembly of the State. See “SECURITY AND SOURCES OF PAYMENT FOR THE 2010 BONDS” herein.

The Act, the Issuer Act and the Agreement require the Issuer’s Executive Director to deliver by December 1st of each year to the Governor of the State a certificate stating the sum, if any, required to restore the Capital Reserve Fund to the Minimum Capital Reserve Fund Requirement. The Act requires the Governor to include such amount, if any, in his or her budget request for appropriation by the General Assembly. In addition, should the Company fail to make additional Loan Payments subsequent to the Executive Director’s delivery of the certificate on each December 1, the Executive Director is required to update, by amended certificate delivered to the Governor and the State budget office on the 15th day of each month thereafter, the additional sum needed to restore the Capital Reserve Fund. In the event any Loan Payments required to be made by the Company are not received by the Trustee subsequent to November 1 of each year, the Executive Director shall deliver a certificate to the Governor to request that the General Assembly make a supplemental budget appropriation for the full amount of the May 1 payment next due. Under the Agreement, the Issuer has covenanted to comply with the provisions of the Act and the Issuer Act relating to the making and delivery by the Executive Director of the requisite certificate to the Governor and to deposit any requested monies received from the State pursuant to the Act and the Issuer Act into the Capital Reserve Fund. See “SECURITY AND SOURCES OF PAYMENT FOR THE 2010 BONDS” herein.

THE 2010 BONDS AND THE INTEREST THEREON DO NOT CONSTITUTE A DEBT, LIABILITY OR OBLIGATION OF THE STATE OR ANY POLITICAL SUBDIVISION THEREOF (OTHER THAN A SPECIAL OR LIMITED OBLIGATION OF THE ISSUER) AND NEITHER THE FAITH AND CREDIT NOR THE TAKING OR TAXING POWER OF THE STATE OR ANY POLITICAL SUBDIVISION OR MUNICIPALITY THEREOF IS PLEDGED TO THE PAYMENT OF THE 2010 BONDS OR THE INTEREST THEREON. THE ISSUER HAS NO TAXING POWER. THE OBLIGATION OF THE STATE TO MAKE PAYMENTS FOR DEPOSIT INTO THE CAPITAL RESERVE FUND IS SUBJECT TO ANNUAL APPROPRIATION BY THE STATE GENERAL ASSEMBLY.

This Private Placement Memorandum describes the terms of, security for, and guaranty of the 2010 Bonds and the use of the proceeds of the 2010 Bonds. Also included are summaries of certain provisions of the Agreement and provisions of the Act and the Issuer Act, as well as an overview of the Company and the Project. These descriptions and summaries do not purport to be comprehensive or definitive. All references herein to the Agreement are qualified in their entirety by reference to the definitive forms thereof, all references to the Act and the Issuer Act, are qualified their entirety by reference to the complete statutes, regulations and published interpretations by State officials, and all references to the 2010 Bonds are qualified by the forms thereof contained in the Agreement and are further qualified in their entirety by reference to laws and principles of equity relating to or affecting the enforceability of creditors’ rights. Copies of the Agreement may be obtained as set forth under “MISCELLANEOUS” herein.

All capitalized terms used in this Private Placement Memorandum and not otherwise defined herein have the meanings set forth in the Agreement. See “APPENDIX B – Summary of Certain Provisions of the Agreement” herein.

Capitalization of Assured Guaranty. At June 30, 2010, Assured Guaranty's consolidated policyholders' surplus and contingency reserves were approximately $2,264,680,337 and its total net unearned premium reserve was approximately $2,259,557,420, in each case, in accordance with statutory accounting principles.

Incorporation of Certain Documents by Reference. Portions of the following documents filed by AGL with the SEC that relate to Assured Guaranty are incorporated by reference into this Official Statement and shall be deemed to be a part hereof:

(i) The Annual Report on Form 10-K for the fiscal year ended December 31, 2009 (which was filed by AGL with the SEC on March 1, 2010);

(ii) The Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2010 (which was filed by AGL with the SEC on May 10, 2010); and

(iii) The Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2010 (which was filed by AGL with the SEC on August 9, 2010).

All information relating to Assured Guaranty included in, or as exhibits to, documents filed by AGL pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, after the filing of the last document referred to above and before the termination of the offering of the 2010 Bonds shall be deemed incorporated by reference into this Private Placement Memorandum and to be a part hereof from the respective dates of filing such documents. Copies of materials incorporated by reference are available over the internet at the SEC's website at http://www.sec.gov, at AGL's website at http://www.assuredguaranty.com, or will be provided upon request to Assured Guaranty Municipal Corp. (formerly known as Financial Security Assurance Inc.): 31 West 52nd Street, New York, New York 10019, Attention: Communications Department (telephone (212) 826-0100).

Any information regarding Assured Guaranty included herein under the caption "BOND INSURANCE – The Insurer" or included in a document incorporated by reference herein (collectively, the "Assured Guaranty Information") shall be modified or superseded to the extent that any subsequently included Assured Guaranty Information (either directly or through incorporation by reference) modifies or supersedes such previously included Assured Guaranty Information. Any Assured Guaranty Information so modified or superseded shall not constitute a part of this Private Placement Memorandum, except as so modified or superseded.

Assured Guaranty makes no representation regarding the 2010 Bonds or the advisability of investing in the 2010 Bonds. In addition, Assured Guaranty has not independently verified, makes no representation regarding, and does not accept any responsibility for the accuracy or completeness of this Private Placement Memorandum or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding Assured Guaranty supplied by Assured Guaranty and presented under the heading "BOND INSURANCE".

SECURITY AND SOURCES OF PAYMENT FOR THE 2010 BONDS

Nature and Obligations and Authority

Pursuant to the Act, the Issuer Act and the Agreement, the Issuer is authorized to issue the 2010 Bonds. The 2010 Bonds are special and limited obligations of the Issuer and are payable solely from, and secured by, among other things, Loan Payments by the Company to the Issuer, property and interests in the Trust Estate, Gross Receipts of the Company, amounts on deposit in the certain funds created by the Issuer, and certain appropriations made by the State, all as set forth by the Agreement. The 2010 Bonds and the payment of principal and interest thereon are not general obligations of the Issuer. The 2010 Bonds are not obligations, general, special or otherwise, of the State, do not constitute a debt of the State, are not enforceable against the State, nor shall payment thereof be enforceable out of any monies of the State.

THE 2010 BONDS AND THE INTEREST THEREON DO NOT CONSTITUTE A DEBT, LIABILITY OR OBLIGATION OF THE STATE OR ANY POLITICAL SUBDIVISION THEREOF (OTHER THAN A SPECIAL OR LIMITED OBLIGATION OF THE ISSUER) AND NEITHER THE FAITH AND CREDIT NOR THE TAKING OR TAXING POWER OF THE STATE OR ANY POLITICAL SUBDIVISION OR MUNICIPALITY THEREOF IS PLEDGED TO THE PAYMENT OF THE 2010 BONDS OR THE INTEREST THEREON. THE ISSUER HAS NO TAXING POWER. THE OBLIGATION OF THE STATE TO MAKE PAYMENTS FOR DEPOSIT INTO THE CAPITAL RESERVE FUND IS SUBJECT TO ANNUAL APPROPRIATION BY THE STATE GENERAL ASSEMBLY.

Loan Payments and Other Obligations of the Company

Under the Agreement, the Company is required to make certain loan payments to the Issuer which shall be the amount necessary to pay the interest, principal and redemption premiums, if any, due or coming due on the 2010 Bonds. To effectuate these loan payments, the Company is required (i) commencing on November 1, 2012, and on the first day of each month thereafter, to make a loan payment equal to one-sixth (1/6) of the interest due on the 2010 Bonds for the next succeeding interest payment date (i.e., May 1 and November 1) through maturity of the 2010 Bonds and (ii) commencing on November 1, 2013, and on the first day of each month thereafter, to make a loan payment equal to one-twelfth (1/12) of the principal due on the 2010 Bonds for the next succeeding principal payment date (i.e., November 1), into the Principal and Interest Account (as described below) (the “Loan Payments”).

In addition to the Loan Payments, the Company, at any time when any principal payment of the 2010 Bonds is overdue, shall also have a continuing obligation to pay to the Trustee for deposit into the Principal and Interest Account an amount equal to interest on the overdue principal but the installment payments shall not otherwise bear interest. If at any time when said loan payments are due the balance in the Principal and Interest Account available for said purpose is insufficient to make such loan payments, the Company will pay to the Trustee (in immediately available funds) any such deficiency. The Company is not required to make any Loan Payments to the extent its application would result in an excess in the Principal and Interest Account over the amounts necessary to meets its obligations when due and payable, plus any additional amounts then required to be maintained in the Sinking Fund.

The Company is also required to make certain additional payments under the Agreement. First, the Company is required to pay the Issuer for reimbursement of any and all, costs, expenses and liabilities reasonably paid or incurred by the Issuer in satisfaction of any obligations of the Company not performed by the Company as required under the Agreement. Second, the Company is required to pay the Issuer on the date of delivery a “commitment fee” of $375,000 (0.50% of the principal amount of the 2010 Bonds). On each May 1, and on the same date each year thereafter, the Company is required to pay an Annual Guaranty Fee equal to 1.50% per annum of the average amount of the 2010 Bonds that are then outstanding for the applicable period in arrears (and deducting any amount in the Prepayment Account) for so long as the 2010 Bonds are outstanding (the “Annual Guaranty Fee”). Third, the Company is required to pay the Issuer for reimbursement or prepayment of any and all costs, expenses and liabilities paid for and incurred by the Issuer with respect to the 2010 Bonds or the Project. Fourth, the Company is required to pay the Issuer on each June 30 starting in 2014 a “deferred fee” equal to twenty-five percent (25%) of the Company’s Excess Operating Income (as defined in the Agreement) based upon the Company’s audited financial statements for the prior year up to an amount not to exceed $5.0 million per year (the “Deferred Fee”) until an aggregate Deferred Fee amount of $15,250,000 has been paid (the “Aggregate Deferred Fee Amount”), and up to $18,800,000 in the event the Aggregate Deferred Fee Amount is not achieved by 2017. In the event the Deferred Fee has not been paid in full when the bonds become due in full, then the unpaid balance of the Deferred Fee shall be due when the bonds become due regardless of the company’s Excess Operating Income. Lastly, the Company is required to pay the Trustee on

(ii) An additional 175 Full-Time Jobs in the State with an average annual wage of not less than $67,500 per year within twenty-four (24) months of the date of delivery;

(iii) An additional 150 Full-Time Jobs in the State with an average annual wage of not less than $67,500 per year within thirty-six (36) months of the date of delivery.

In the event the Company fails to meet any of the Full-Time Jobs requirements, the Company will be required to pay the Issuer annually, commencing March 31, 2012 in accordance with the Agreement, an amount equal to $7,500 per year for each Full-Time Job with an average wage of $67,500 not so added during the applicable year until such shortfall is cured.

INVESTMENT CONSIDERATIONS

The Issuer's ability to pay principal of and interest on the 2010 Bonds depends upon numerous factors, many of which are not subject to the control of the Issuer. Described below are certain factors that could affect the ability of the Company to pay debt service on the 2010 Bonds.

Special and Limited Obligations. The 2010 Bonds are special and limited obligations of the Issuer payable solely from, and secured by, among other things, Loan Payments by the Company to the Issuer, amounts on deposit in the Capital Reserve Fund, Capitalized Interest Fund, Sinking Fund and Project Fund, and by certain appropriations which may be made by the State from time to time, through the General Assembly, all as set forth by the Act, the Issuer Act and the Agreement. The 2010 Bonds and the payment of principal and interest thereon are not general obligations of the Issuer. The payment of the 2010 Bonds is not payable out of any monies of the Issuer other than the Sinking Fund, Capital Reserve Fund, Capitalized Interest Fund and Prepayment Fund established under the Agreement. The 2010 Bonds are not obligations, general, special or otherwise, of the State, do not constitute a legal debt of the State, are not enforceable against the State, nor shall payment thereof be made out of any monies of the State, except monies annually appropriated therefore, if any, by the General Assembly. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2010 BONDS" and APPENDIX B – "SUMMARY OF CERTAIN PROVISIONS OF THE AGREEMENT."

Development Stage Business. The Company is a development stage video game and entertainment company with no revenues from product sales, except those projected by the Company over the next several years. The company is currently considered "pre-revenue" and no guarantee can be made that the Company will meet its Loan Payment obligations under the Agreement or that the Company will continue to be in business now or in the future. On July 6, 2010, the Company's auditor, PricewaterhouseCoopers LLP issued a "going concern" opinion in connection with the Company's most recent audited financial statements stating that the Company will require additional financing to fund future operations and raising substantial doubt about the Company's ability to continue as a going concern. To the extent that the Company is unable to meet its Loan Payment or other obligations under the Agreement, the Capital Reserve Fund may be drawn upon, and appropriations from the General Assembly of the State will be requested, to make the principal and interest payments to owners of the 2010 Bonds when due. The General Assembly may appropriate such moneys but is not obligated to do so.

Product Development Risks. There can be no assurance that the games under development by the Company will be released on schedule, or ever, or that, if released, they will meet with market acceptance. Nor is there any assurance that any products of the Company will produce significant revenues or earnings for the Company.

Key Personnel. The success of the Company's business will be significantly dependent upon the skills and continued commitment of the Company's visionaries and of key Company personnel. The loss of any one of them could diminish the success of the Company's games and their ability to attract an audience and following.

- **Moral obligations** The following pages from the 38 Studios bond documents show how the concept of "moral obligation" is couched. There is nowhere in the documents where such an obligation is explicitly assumed. The issue of a reserve fund is identified because it carries the implication that the government controlling the reserve fund is a party to the transaction. The elliptical constructions and circumlocutions of these passages are presumed by the underwriters, the bond insurers, and the ratings agencies, to override the clear declaration of the highlighted passages shown above that appear earlier in the bond document.

above the authorization shall not be deemed or counted toward the authorized but unissued debt of the State. Since December 31, 1991, the State has extinguished a total of $66,275,387, which was previously reflected in the above table. In addition, there is $1,552,805 of authorized debt which will not be issued due to premium received by the State in connection with its sale of $123,255,000 Consolidated Capital Development Loan of 2007, Series A Bonds being allocated to benefit the projects relating to such Bonds. This authorization has been removed from the balance of debt which can be issued.

Obligations Carrying Moral Obligation of State. Certain agencies of the State have the ability to issue bonds which are also secured by a capital reserve fund. If at any time the capital reserve fund falls below its funding requirement, the agency is authorized to request the General Assembly to appropriate the amount of the deficiency. The General Assembly may, but is not obligated to, appropriate the amount of the deficiency. See "Rhode Island Economic Development Corporation" and "Rhode Island Housing and Mortgage Finance Corporation" below.

Other Obligations Subject to Annual Appropriation. The State has entered into certain contractual agreements which, although of a long-term nature, are subject to annual appropriation by the General Assembly. Certain of these obligations are contractual agreements with State Agencies or Authorities (See "State Agencies and Authorities"). A brief description of the most significant of other such commitments for which the State has or may appropriate funds is provided below.

In December 1995, the State entered into a lease agreement with a financial institution which issued $4,500,000 in certificates of participation to finance acquisition and renovation of an office building to house the Office of the Attorney General. $775,000 of these certificates of participation were defeased in June 2002 from the proceeds of the securitization of revenues from the State's tobacco master settlement. All of the remaining certificates of participation were defeased through the issuance on December 13, 2007 of the $2,230,000 Lease Participation Certificates (Attorney General's Building – 2007 Refunding Series G). As of June 30, 2009, $2,030,000 of these certificates were outstanding.

The State has also entered into a lease agreement with a financial institution that issued $33,000,000 in certificates of participation to finance construction of an Intake Center for the Department of Corrections. These certificates were refunded in January 1997. As of June 30, 2009, $2,775,000 was outstanding.

The State also entered into a lease agreement with a financial institution which issued $24.0 million in certificates of participation in January 1997 to finance the renovation of a group of buildings at the State-owned John O. Pastore Center, formerly known as Howard Center in Cranston for use as an office facility for the Department of Labor and Training. These remaining certificates of participation were defeased through the issuance on December 13, 2007 of the $13,375,000 Lease Participation Certificates (Howard Center Improvements – 2007 Refunding Series E). As of June 30, 2009, $12,630,000 of such certificates were outstanding.

In November 1994 the State entered into a lease agreement with the Economic Development Corporation which issued $34.1 million in long-term bonds for the renovation of the Shepard Building. During August 1997, the State of Rhode Island issued $34,805,000 in certificates of participation that were used to defease the Economic Development Corporation bonds. These remaining certificates of participation were defeased through the issuance on December 13, 2007 of the $21,420,000 Lease Participation Certificates (Shepard's Building – 2007 Refunding Series F). As of June 30, 2009, $19,155,000 in certificates of participation were outstanding.

In January 1998, the Economic Development Corporation issued revenue bonds in the amount of $11,825,000 to finance improvements to McCoy Stadium in Pawtucket. These bonds are supported by State lease payments subject to annual appropriations. As of June 30, 2009, $2,220,000 was outstanding.

On June 29, 2000, the State entered into a lease agreement with a financial institution, which issued $9,525,000 in certificates of participation for the purchase and installation of telecommunications equipment, furnishings and vehicles and rolling stock. The State also privately placed $318,000 of taxable certificates at that time. In June 2001, the State financed an additional $3,150,000 of vehicles and rolling stock in this manner. In December 2002, the State financed an additional $3,890,000 of vehicles and rolling stock. In June 2005, the State financed an additional $6,950,000. In June 2006, the State financed an additional $6,000,000. In June 2007, the State financed an additional $9,100,000. As of June 30, 2009, $9,400,000 in certificates were outstanding.

In addition, the State has provided for credits if certain targeted new job goals are met. No expenditures have been made to date. At June 30, 2009, the outstanding balance was $9,180,000.

Bonds secured by the Corporation's capital reserve fund (including bonds for Fidelity Management Resources and Fleet National Bank described above) carry a moral obligation of the State. If at any time, certain reserve funds of the Corporation pledged fall below their funding requirements, a request will be made to the General Assembly to appropriate the amount of the deficiency. The General Assembly may, but it is not obligated to, appropriate the amount of the deficiency.

In January 1998, the Corporation issued revenue bonds in the amount of $11,825,000 to finance improvements to McCoy Stadium in Pawtucket. These bonds are supported by State lease payments subject to annual appropriations. At June 30, 2009, the outstanding balance was $2,220,000.

In May 2000, the Corporation issued revenue note obligations in the amount of $40,820,000 to finance a portion of the costs of the Providence Place Mall. Such financing will be supported by two-thirds of the sales taxes generated at the mall (up to a cap of $3.68 million in years 1-5, and $3.56 million in years 6-20) as provided in the Mall Act (R.I.G.L. § 42-63.5-1 et. seq.) enacted by the General Assembly in 1996 and by Public Investment and HOV Agreement. It is expected that sales tax revenues generated at the Mall will be sufficient to fully support the revenue note obligations. Sales tax generated at the Mall is recorded as general revenues. The State is not obligated to fund the note payments if the sales tax generated is not sufficient.

In November 2003, Rhode Island entered into a payment agreement with the Rhode Island Economic Development Corporation relating to the issuance of $53,030,000 of Motor Fuel Tax Revenue Bonds to provide funds for the State match for certain major Transportation projects funded by GARVEE bonds also issued by the Corporation. The Motor Fuel Tax Revenue Bonds are secured by two cents of the motor fuel tax dedicated to the Department of Transportation, subject to annual appropriation. In March 2006, a second series of bonds totaling $42,815,000 was sold. In April 2009, a third series was issued totaling $12,410,000. As of June 30, 2009, $81,125,000 was outstanding.

The GARVEE bonds issued through the Corporation, which are secured by federal funds made available to the Department of Transportation, are not considered part of the State's net tax supported debt. As of June 30, 2009 there was $394,280,000 outstanding which were supported by federal revenues.

In July 2007, the Rhode Island Economic Development Corporation provided $14 million to an affiliate of Sage Hospitality, the developer of the old Masonic Temple located in Providence in the form of a 40 year loan, at an interest rate of ½ of one per cent, in exchange for the extinguishment of no less than $24 million in Rhode Island Historic Preservation Tax Credits that have not yet been issued on the project to redevelop the old Masonic Temple into a Renaissance Hotel. The Corporation borrowed funds for the transaction from Bank of America and the Governor agreed to request that the General Assembly appropriate each fiscal year funds sufficient to repay the obligation of the Corporation during FY 2008 through FY 2010. It is anticipated that the net savings to the State would be approximately $8,000,000 over the period of time those tax credits may otherwise have been used.

In June 2009, the Corporation issued revenue bonds in the amount of $150,000,000 to provide funds to reimburse the State for Historic Structures Tax Credits from time to time presented by taxpayers. These revenue bonds are supported by a payment agreement with the State subject to annual appropriation. As of June 30, 2009, there was $150,000,000 of such revenue bonds outstanding.

Rhode Island Airport Corporation. RIAC was created by the Rhode Island Economic Development Corporation (EDC) on December 9, 1992 as a public corporation, governmental agency and public instrumentality, having a distinct legal existence from the State and the EDC, and having many of the same powers and purposes as EDC. RIAC is a component unit of the EDC, which is a component unit of the State. RIAC is empowered, pursuant to its Articles of Incorporation and Rhode Island law, to undertake the planning, development, management, acquisition, ownership, operation, repair, construction, reconstruction, rehabilitation, renovation, improvement, maintenance, development, sale, lease, or other disposition of any "airport facility", as defined in Title 42, Chapter 64 of the Rhode Island General Laws. "Airport facility" is defined in part as "developments consisting of runways, hangers, control towers, ramps, wharves, bulkheads, buildings, structures, parking areas, improvements, facilities, or other real or

Primary Government

	Balance July 1	Additions	Reductions	Balance June 30	Amounts Due Within One Year	Amounts Due Thereafter
Governmental activities						
General obligation bonds payable:						
Current interest bonds	$ 997,079	$ 107,820	$ (68,710)	$ 1,036,189	$ 63,494	$ 972,695
Capital appreciation bonds	9		(9)			
Accreted interest on capital appreciation bonds	310		(310)			
Premium and deferred amount on refunding	31,121	1,011	(3,637)	28,495		28,495
	1,028,519	108,831	(72,666)	1,064,684	63,494	1,001,190
RIEDC Grant Anticipation Bonds	285,505	169,395	(27,475)	427,425	26,910	400,515
Premium	17,236	6,786	(3,235)	20,787		20,787
RIEDC Rhode Island Motor Fuel Tax Revenue Bonds	72,560	12,410	(3,845)	81,125	3,480	77,645
Premium	1,377	204	(121)	1,460		1,460
Revenue bonds - RIRBA	24,235		(18,195)	6,040	6,040	
Net premium/discount and deferred amount on refunding	(286)		197	(89)		(89)
Tobacco Settlement Asset-Backed Bonds	843,541		(21,100)	822,441		822,441
Accreted interest on TSFC bonds	11,153	12,724		23,877		23,877
Net premium/discount	(26,329)		1,365	(24,964)		(24,964)
Historic Tax Credit Bonds		150,000		150,000	14,805	135,195
Bonds payable	2,257,511	460,350	(145,075)	2,572,786	114,729	2,458,057
Certificates of Participation (COP)	236,060	54,610	(21,330)	269,340	24,535	244,805
Net premium/discount	6,101	35	(783)	5,353		5,353
Obligations under capital leases	242,161	54,645	(22,113)	274,693	24,535	250,158
Compensated absences	67,436	57,024	(62,456)	62,004	58,480	3,524
Net OPEB Obligation	16,112	4,613		20,725		20,725
Notes Payable	2,276		(2,276)			
Other long-term liabilities						
Special obligation notes	18,152		(4,973)	13,179	4,729	8,450
Arbitrage rebate	6,167		(2,769)	3,398		3,398
Tax refunds payable	17,905			17,905		17,905
Masonic Temple Tax Credit	9,775		(4,745)	5,030	5,030	
Station Fire Settlement	10,000			10,000	10,000	
Other General Fund liabilities	2,248		(1,077)	1,171		1,171
ISTEA Fund liabilities	17,844		(2,387)	15,457		15,457
GARVEE Fund liabilities	908	937		1,845		1,845
Pollution Remediation	11,201	5,930		17,131	1,786	15,345
Other	140		(68)	72	51	21
Other long-term liabilities	94,340	6,867	(16,019)	85,188	21,596	63,592
	$ 2,679,836	$ 583,499	$ (247,939)	$ 3,015,396	$ 219,340	$ 2,796,056
Business type activities						
Revenue bonds	$ 270,960	$ 71,220	$ (66,370)	$ 275,810	$ 7,530	$ 268,280
Add: bond premium	3,905		(356)	3,549		3,549
Less: issuance discounts	(633)	(1,945)	241	(2,337)		(2,337)
Deferred amounts on refunding	(5,907)	(11,031)	3,620	(13,318)		(13,318)
Bonds payable	268,325	58,244	(62,865)	263,704	7,530	256,174
Other long-term liabilities	1,171		(141)	1,030	235	795
	$ 269,496	$ 58,244	$ (63,006)	$ 264,734	$ 7,765	$ 256,969

H. Defeased Debt

In prior years, the State and its component units defeased certain general obligation bonds and revenue bonds by placing the proceeds of the new bonds or other sources, in irrevocable trusts to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liabilities for the defeased bonds are not included in the basic financial statements. On June 30, 2009, the following bonds outstanding (expressed in thousands) are considered defeased:

State of Rhode Island and Providence Plantations
Notes to Basic Financial Statements
June 30, 2009

	Amount
Primary government:	
General Obligation Bonds	$ 194,899
Certificates of Participation	20,045
R.I. Convention Center Authority	33,375
Component Units:	
R.I. Depositors Economic Protection Corporation (ceased operations during FY04)	264,955
R.I. Economic Development Corporation	61,320
R.I. Turnpike and Bridge Authority	32,300

I. Conduit Debt

The R.I. Industrial Facilities Corporation, the R.I. Health and Educational Building Corporation and the R.I. Economic Development Corporation issue revenue bonds, equipment acquisition notes, and construction loan notes to finance various capital expenditures for Rhode Island business entities. The bonds and notes issued by the corporations are not general obligations of the corporations and are payable solely from the revenues derived from the related projects. They neither constitute nor give rise to a pecuniary liability for the corporations nor do they represent a charge against their general credit. Under the terms of the various indentures and related loan and lease agreements, the business entities make loan and lease payments directly to the trustees of the related bond and note issues in amounts equal to interest and principal payments due on the respective issues. The payments are not shown as receipts and disbursements of the corporations, nor are the related assets and obligations included in the financial statements. The amount of conduit debt outstanding on June 30, 2009 was $102,000,000, $2,600,179,582 and $1,169,000,000 respectively. Certain issues of conduit debt are moral obligations of the State and the current amounts outstanding are disclosed in Note 12.

J. Short term borrowing

The table below summarizes General Fund short-term borrowing (expressed in thousands) for the fiscal year ended June 30, 2009:

	Balance July 1, 2008	Additions	Reductions	Balance June 30, 2009
General Obligation Tax Anticipation Notes	$ 0	$ 350,000	$ 350,000	$ 0
RI Temporary Disability Insurance Fund	0	25,000	25,000	0
RI Capital Plan Fund	63,721	83,500	45,273	101,948
Total Short Term Borrowing	$ 63,721	$ 458,500	$ 420,273	$ 101,948

All of the borrowings were used to provide short term working capital.

In addition, R.I. Housing & Mortgage Corporation had outstanding balances of $37,000,000 on two lines of credit that are payable on demand and accrue interest at rates ranging from .48875% to 2.06813%.

Lottery

The Lottery's master contracts with its video lottery facility operators contain revenue protection provisions in the event that existing video lottery facility operators incur revenue losses caused by new gaming ventures within the State.

In March 2008, UTGR, Inc., the owner and operator of Twin River, one of the two licensed video lottery facilities of the State, defaulted on loan payments to its lenders who provided a $565.0 million loan package to UTGR, Inc. and its parent companies to buy and expand the Twin River facility. As a result of defaulting on loan payments, UTGR entered into a forbearance agreement with its lenders. In September 2008, both Standard & Poor's and Moody's Investors Service downgraded their rating of the company that owns Twin River, and Moody's issued a statement warning of a "high probability of bankruptcy". The forbearance agreement expired on January 31, 2009 and was not extended.

In June 2009, UTGR, Inc. d/b/a Twin River, BLB Management Services, Inc, and BLB Worldwide Holdings, Inc. (collectively, the "Debtors") commenced a Chapter 11 bankruptcy proceeding by filing voluntary petitions for relief in the United States Bankruptcy Court for the District of Rhode Island. The filing was made when – after months of discussions and negotiations - the Debtors, their lenders and the State reached an agreement in principle with respect to a consensual reorganization plan, which plan is subject to approval of the Bankruptcy Court. The consensual plan contemplates, among other things, that the lenders will remove approximately $290.0 million of the approximately $590.0 million of debt on the balance sheet of the facility and, subject to the State's regulatory approval process, the lenders shall become the new owners of the facility and search for a new operator for the facility to replace the Debtors. The State is represented in the bankruptcy proceedings by outside legal counsel. Progress has been made toward a successful restructuring of the companies. Since the filing, the Debtors have continued in the management and operation of the business as debtors in possession pursuant to sections 1107 and 1108 of the Bankruptcy Code and Twin River has continued to remain open as usual.

In January 2010 the debtors filed their Second Amended Disclosure Statement and Second Amended Plan with respect to the reorganization, which has the support of the key stakeholders. The debtors have already received approval of their Second Amended Disclosure Statement. In addition, the debtors have been granted the authority to begin soliciting votes on the Second Amended Plan. Although the plan provides for the State to make additional investments in the marketing and management for the facility, it is not anticipated that the bankruptcy will have a significant impact on the lottery revenues the State expects to continue to receive from the facility. The lenders and/or debtors intend to have legislation introduced to statutorily achieve certain requirements of the restructuring, including but not limited to, the elimination of the requirement that the debtors offer live greyhound racing as a condition for operating video lottery terminals at the facility. The Rhode Island Lottery continues to control and regulate the video lottery operations at the facility, including cash receipts, cash transfers and cash deposits. The cash management process continues to be carried out with a high degree of physical security and financial integrity.

State of Rhode Island and Providence Plantations
Notes to Basic Financial Statements
June 30, 2009

The Department of Revenue, Division of Lotteries, and the Department of Business Regulation continue to closely monitor the situation. Any proposal to have a new operator of the facility and/or any proposal to transfer ownership of the facility would need regulatory approval. Certain applications for licensure have been submitted by the lenders to the Department of Business Regulation and these applications are currently under review. It should also be noted that the possible opening of new gaming sites in Massachusetts may significantly reduce revenues of Twin River since such sites are likely to reduce the number of out-of-state patrons visiting Twin River.

Federal Grants

The State receives significant amounts of federal financial assistance under grant agreements which specify the purpose of the grant and conditions under which the funds may be used. Generally, these grants are subject to audit.

The Single Audit for the State of Rhode Island for the fiscal year ended June 30, 2008 was issued in June 2009. That report identified approximately $14.2 million in questioned costs relating to the primary government. In addition, a number of findings had potentially significant but unknown or unquantifiable questioned costs. The ultimate disposition of these findings rests with the federal grantor agencies and in most cases, resolution is still in progress. Adjustments are made to the financial statements when costs have been specifically disallowed by the federal government or sanctions have been imposed upon the State and the issue is not being appealed or the right of appeal has been exhausted. The fiscal 2009 Single Audit is in progress. It is anticipated that there will be additional questioned costs identified in that audit. The State's management believes that any disallowances of federal funding received by the State will not have a material impact on the State's financial statements.

Moral Obligation Bonds

Some component units issue bonds with bond indentures requiring capital reserve funds. Moneys in the capital reserve fund are to be utilized by the trustee in the event scheduled payments of principal and interest by the component unit are insufficient to pay the bond holder(s). These bonds are considered "moral obligations" of the State when the General Laws require the executive director to submit to the Governor the amount needed to restore each capital reserve fund to its minimum funding requirement and the Governor is required to include the amount in the annual budget. At June 30, 2009 the R.I. Housing and Mortgage Finance Corporation and the R.I. Economic Development Corporation (RIEDC) had $285,257,986 and $39,907,829 respectively, in "moral obligation" bonds outstanding. Certain of the RIEDC bonds are economic development revenue bonds whereby the State will assume the debt if the employer reaches and maintains a specified level of full-time equivalent employees. The participating employers have certified that the employment level has been exceeded, thereby triggering credits toward the debt. As a result, the State anticipates paying approximately $3,201,500 of the debt on the related economic development revenue bonds in fiscal year 2010.