

Borrowing Alternatives for Illinois Non-Home Rule Cities and Villages

The purpose of this memorandum is to summarize the borrowing alternatives available to Illinois non-home rule cities and villages. Under current law, borrowings by such cities and villages are governed by the provisions of the following laws:

- (1) the Illinois Municipal Code, as amended (the "*Municipal Code*");
- (2) the Local Government Debt Reform Act of the State of Illinois, as amended (the "*Debt Reform Act*");
- (3) the Property Tax Extension Limitation Law of the State of Illinois, as amended (the "*Extension Limitation Law*");
- (4) the Bond Issue Notification Act of the State of Illinois, as amended (the "*BINA*");
- (5) the Property Tax Code of the State of Illinois, as amended (the "*Property Tax Code*");
- (6) the Tax Increment Allocation Redevelopment Act of the State of Illinois, as amended (the "*Tax Increment Act*");
- (7) the Local Government and Governmental Employees Tort Immunity Act of the State of Illinois, as amended (the "*Tort Immunity Act*");
- (8) the Tax Anticipation Note Act of the State of Illinois, as amended (the "*Tax Anticipation Note Act*");
- (9) the Revenue Anticipation Act of the State of Illinois, as amended (the "*Revenue Anticipation Act*"); and
- (10) the Internal Revenue Code of 1986, as amended (the "*Tax Code*"), and the arbitrage and rebate regulations promulgated thereunder (the "*Federal Regulations*").

Compliance with Illinois law is necessary for the borrowing to be valid and legally binding. Compliance with the Tax Code and the Federal Regulations is necessary for the interest on the borrowing to be exempt from federal income taxation.

General Provisions

Under Section 8-5-1 of the Municipal Code, the *debt limit* for non-home rule municipalities is 8.625% of the equalized assessed valuation of the municipality. General obligation bonds and installment contracts are generally subject to the debt limit. Tax anticipation warrants, general obligation warrants (except for refunding obligations issued pursuant to the Debt Reform Act), revenue anticipation notes, revenue bonds, tort judgment bonds, bonds that finance water or wastewater treatment facilities mandated by a compliance order and, except under certain circumstances, alternate bonds are not subject to the debt limit of a municipality.

Under Section 6 of the Debt Reform Act, whenever a municipality is authorized to issue bonds (defined in the Debt Reform Act to include any instrument evidencing the obligation to pay money) without referendum, it may add *issuance costs* (including underwriter's discount, bond insurance or other credit enhancement costs) to the estimated costs of the project and may pay such costs from bond proceeds.

Section 9 of the Debt Reform Act allows a municipality to use bond proceeds to pay *capitalized interest* on its bonds for a period not to exceed the greater of: (1) two years or (2) a period ending six months after the estimated date of (a) completion of the acquisition and construction of the project or (b) accomplishment of the purpose for which the bonds are issued. The corporate authorities may provide for such capitalized interest in the ordinance authorizing the bonds.

Section 10 of the Debt Reform Act permits municipalities to *sell bonds at a discount*. Whenever bonds are sold at a discount, the bonds must be sold at a price and bear interest at such rate or rates so that either the true interest cost (yield) or the net interest rate received upon the sale of the bonds does not exceed the maximum rate otherwise authorized by applicable law. There is no requirement that the sale of bonds by a municipality be competitive.

In many cases, the Municipal Code limits, by way of a formula or otherwise, the amount of bonds that a municipality may issue for a particular purpose. *Issuance costs*, *capitalized interest* and *underwriter's discount*, if financed out of bond proceeds, count against the limits imposed by applicable law and decrease the amount of proceeds available for a project.

The Debt Reform Act extends the time within which a *tax levy for general obligation or limited bonds* must be filed. Prior to the passage of the Debt Reform Act, a municipality was required to file any debt service levy with the county clerk on or before December 31 of a given year in order to have taxes extended for the payment of the bonds in the following year. Section 16 of the Debt Reform Act provides that municipalities are authorized to levy a tax for the payment of debt service on general obligation or limited bonds at any time prior to March 1 of the calendar year during which the tax will be collected. County clerks are required to accept the filing of such tax levy up to March 1 notwithstanding that such filings occur after the end of the calendar year during which the tax will be collected.

In extending taxes for general obligation bonds, the county clerk must add to the levy for debt service on such bonds an amount sufficient, in view of all losses and delinquencies in tax collection, to produce tax receipts adequate for the prompt payment of such debt service.

Under Section 17.5 of the Debt Reform Act, whenever the authorization or the issuance of bonds is subject to either a *referendum* or a *backdoor referendum*, the approval, once obtained, remains (a) for

five years after the date of the referendum or (b) for three years after the end of the petition period for the backdoor referendum.

Section 7 of the Bond Authorization Act allows a municipality whose aggregate principal amount of bonds outstanding or proposed exceeds \$10,000,000 to enter into agreements for *interest rate swaps* and other interest rate risk management tools with respect to any issues of its bonds. The bonds must be identified to the interest rate swap. Net payments under swap agreements are treated as interest for the purpose of calculating the interest rate limit applicable to the bonds, provided that, for this purpose only, the bonds are deemed to bear interest at taxable rates. Swap agreements and the payments to be made thereunder do not count against the debt limit of the municipality.

A *credit rating* of a municipality's debt by one or more of the New York rating agencies, Fitch, Inc., Moody's Investors Service, Inc. or Standard & Poor's Ratings Services, is not legally required to issue bonds, but a favorable rating may reduce the interest rate to be paid. The rating agencies review the overall management, debt, economic and financial picture of the municipality, including recent audits and fund balances. *Bond insurance* may also reduce the interest rate paid by a municipality on its debt.

In connection with the issuance of its bonds, a municipality may enter into an agreement to provide additional security or liquidity, or both, for the bonds ("*Credit Agreement*"), including municipal bond insurance, letters of credit, lines of credit, standby bond purchase agreements and surety bonds. A municipality may also enter into an agreement for the purchase or remarketing of its bonds ("*Remarketing Agreement*") to provide a mechanism for remarketing bonds tendered for purchase. The term of the Credit Agreement or Remarketing Agreement may not exceed the term of the bonds, plus any time period necessary to cure any defaults under such agreements.

Under Section 265(b)(3) of the Tax Code, banks and certain other financial institutions are not allowed any deduction for interest expense attributable to tax-exempt debt acquired after August 7, 1986, unless the "*small issuer exception*" applies. If a municipality will not issue more than \$10,000,000 of tax-exempt debt during the calendar year and it designates the debt as a "qualified tax-exempt obligation" pursuant to said Section 265(b)(3), the restriction on the deduction for interest expense does not apply.

[Bond Issue Notification Act](#)

The BINA requires a corporate authority proposing to sell non-referendum general obligation bonds or limited bonds (other than refunding bonds) to hold at least one public hearing concerning the municipality's intent to sell such bonds. The municipal clerk must publish notice of the public hearing at least once in a newspaper of general circulation in the municipality not less than seven and not more than 30 days before the date of the public hearing and must post notice of the public hearing at the principal office of the corporate authorities at least 48 hours before the public hearing. Such notice must be continuously available to the public. Care must be taken to ensure that the notice appears above the name or title of the municipal clerk. At the public hearing, the corporate authorities must explain the reasons for the proposed bond issue and permit persons to present written or oral testimony. The corporate authorities must then wait at least seven days following the final adjournment of the public hearing before adopting an ordinance providing for the sale of the bonds.

Limited Bonds

Municipalities subject to the Extension Limitation Law and commonly referred to as being “tax-capped” are permitted to issue limited bonds. Limited bonds are issued in lieu of general obligation bonds that otherwise have been authorized by applicable law. They are payable from a separate property tax levy that is unlimited as to rate, but the amount of taxes that will be extended to pay the bonds is limited by the Extension Limitation Law. Limited bonds are payable from a municipality’s debt service extension base (the “Base”), which is an amount equal to that portion of the municipality’s extension for the applicable levy year (which depends on when the Extension Limitation Law was first applicable to the municipality) for the payment of non-referendum bonds (other than alternate bonds or refunding bonds issued to refund bonds initially issued pursuant to referendum), increased each year, beginning with the 2009 levy year, by the lesser of 5% or the percentage in the Consumer Price Index for All Urban Consumers during the 12-month calendar year preceding the levy year.

Tax-capped municipalities may only issue non-referendum general obligation bonds as limited bonds. To the extent that a municipality, under current law, does not have a Base that would otherwise enable it to levy taxes to pay debt service on non-referendum bonds for the size and scope of a project the municipality wants to undertake, the municipality may establish or increase a Base pursuant to referendum in accordance with the Extension Limitation Law.

The balance of this memorandum describes numerous non-referendum financing alternatives that initially were not available to tax-capped municipalities under the Extension Limitation Law. Those obligations now may be issued as limited bonds upon compliance with applicable law.

Borrowing Alternatives for Capital Projects

Federal Regulations generally permit the proceeds of borrowings for capital projects to be invested without any restriction as to yield for three years after the issuance of the bonds, so long as the municipality reasonably expects to expend the proceeds with due diligence within such three-year period. In addition, the municipality must enter into a substantially binding commitment to spend at least 5% of the bond proceeds within six months after the issuance of the bonds and must proceed with due diligence to complete the project.

Federal Regulations restrict the ability of a municipality to use bond proceeds to reimburse itself for expenditures incurred prior to the issuance date of the bonds, unless the municipality, in compliance with the Federal Regulations, formally declares its intent to reimburse itself for such expenditures with the bond proceeds. Preliminary expenditures (*e.g.*, architectural, engineering, surveying, soil testing and similar costs, but not including land acquisition or site preparation costs) may be reimbursed without a formal declaration of intent so long as such preliminary expenditures do not exceed 20% of the bond proceeds.

Section 148(f) of the Tax Code requires municipalities to rebate to the United States Treasury an amount equal to the sum of (A) the excess of (i) the amount earned on bond proceeds over (ii) the amount which would have been earned if such proceeds had been invested at the bond yield, plus (B) any income attributable to such excess. If this rebate requirement is not met, the bonds will be arbitrage bonds and the interest on the bonds will not be tax-exempt. However, arbitrage earnings need not be rebated to the United States Treasury if the expenditure of bond proceeds meets certain spend-down requirements or if

the municipality does not issue more than \$5,000,000 of tax-exempt bonds in the calendar year in which the bonds are issued.

General Obligation Bonds. Section 8-4-1 of the Municipal Code requires that general obligation bonds secured by a direct unlimited ad valorem property tax be approved by voters. This referendum requirement has many exceptions. The Municipal Code provides that certain general obligation bonds, including the following, may be issued without referendum:

- Bonds to refund existing indebtedness;
- Bonds to fund or refund judgment indebtedness;
- Working cash fund bonds;
- Bonds issued by a municipality when ordered to abate pollution under the Environmental Protection Act;
- Bonds issued for the acquisition, construction, or improvement of water or wastewater treatment facilities mandated by a compliance order issued by the United States Environmental Protection Agency or the Illinois Pollution Control Board; and
- Bonds issued under Section 8-5-16 of the Municipal Code so long as such bonds, together with the other bonds issued and outstanding under that Section, do not exceed 0.5% of the equalized assessed value of the taxable property within the municipality.

Such bonds are full faith and credit general obligations payable from an ad valorem property tax unlimited as to rate or amount. However, a municipality subject to the Extension Limitation Law may issue such bonds as limited bonds.

Revenue Bonds. Revenue bonds are obligations of a municipality payable solely from the net revenue derived from the financed project or facilities. The full faith and credit of the municipality is not pledged to the payment of the bonds. In order for non-home rule municipalities to issue revenue bonds, the revenue source must be related to the purpose for which the bonds are being issued and there must be a specific statutory grant of power for the issuance of the bonds.

The Municipal Code authorizes the issuance of revenue bonds for numerous revenue producing projects including, but not limited to, conservation plan areas (Section 11-12.1), hospitals (Section 11-22-1), cultural centers (Section 11-45.1), parking (Section 11-71-1), redevelopment (Section 11-74.2), housing (Section 11-74.5), various recreational facilities (Section 11-92), airports (Section 11-101), public utilities (water, sewer, gas, electric) (Section 11-117-1), subways and street railways (Section 11-80). Bonds for each such facility are issued under specific sections of the Municipal Code.

If revenue bonds are to be issued for a specifically authorized purpose, there is no statutory limit on the dollar amount of revenue bonds which may be issued. The amount of revenues available to pay the bonds may, however, limit the feasibility of the size of an issue. In addition, revenue bonds are not included in any computations of indebtedness for the purposes of constitutional or statutory limitations.

While a direct referendum is not required, the issuance of revenue bonds is typically subject to a backdoor referendum. For example, Division 139 of the Municipal Code authorizes a municipality to issue and sell

revenue bonds for the purpose of “defraying the cost of acquiring, constructing, extending, or improving a combined waterworks and sewerage system or any part thereof.” The bonds are payable solely from the revenues derived from the operation of the combined waterworks and sewerage system. Division 139 also specifies the backdoor referendum petition procedure. If within 30 days after the publication of the authorizing ordinance, 10% or more of the number of registered voters in the municipality sign a petition requesting a referendum, the question of issuing the revenue bonds must be submitted to the voters.

Alternate Bonds. Section 15 of the Debt Reform Act permits municipalities to issue alternate or “double-barrelled” bonds. Alternate bonds are general obligation bonds payable from enterprise revenues or from a revenue source, or both, with the general obligation of the municipality acting as backup security for the bonds. Once issued, and until paid or defeased, alternate bonds are a general obligation of the municipality, for the payment of which the municipality pledges its full faith and credit. Such bonds are payable from the levy of ad valorem property taxes upon all taxable property in the municipality without limitation as to rate or amount. The intent of the Debt Reform Act is for the enterprise revenues or the revenue source to be sufficient to pay the debt service on the alternate bonds so that taxes need not be extended for such payment. Alternate bonds do not constitute debt for the purpose of any statutory provision or limitation unless taxes (other than a designated revenue source) are extended to pay them. In the event taxes are extended, the outstanding alternate bonds will count against the municipality’s debt limit until the municipality’s audit shows that the alternate bonds have been paid from the pledged enterprise revenues or revenue source for a complete fiscal year.

Several conditions must be met before alternate bonds may be issued. First, alternate bonds must be issued for a lawful corporate purpose. If issued in lieu of revenue bonds, then the revenue bonds must have been authorized under applicable law (including satisfying any backdoor referendum requirements) and the alternate bonds must be issued for the purpose for which the revenue bonds were authorized. If issued payable from a revenue source limited in its purposes or applications, then the alternate bonds must be issued only for such limited purposes or applications.

Second, alternate bonds are subject to a backdoor referendum. Except as provided in the following paragraph, the issuance of alternate bonds must be submitted to referendum if, within 30 days after publication of the authorizing ordinance and notice of intent to issue the alternate bonds, a petition is filed with the municipal clerk. The petition must be signed by the greater of (i) 7.5% of the registered voters of the municipality or (ii) the lesser of 200 of the registered voters or 15% of the registered voters, asking that the issuance of the alternate bonds be submitted to referendum. Backdoor referendum proceedings for revenue bonds and for alternate bonds to be issued in lieu of revenue bonds may be conducted at the same time.

Different rules for a backdoor referendum apply to municipalities with fewer than 500,000 inhabitants which propose to issue alternate bonds payable solely from enterprise revenues, except for alternate bonds that finance or refinance projects concerning public utilities, public streets and roads or public safety facilities, and related infrastructure and equipment. In this instance, the issuance of alternate bonds must be submitted to referendum if, within 45 days after publication of the authorizing ordinance and notice of intent to issue the alternate bonds, a petition is filed with the municipal clerk. For a municipality with more than 4,000 registered voters, the petition must be signed by the lesser of (i) 5% of the registered voters or (ii) 5,000 registered voters. For a municipality with 4,000 or fewer registered voters, the petition must be signed by the lesser of (i) 15% of the registered voters or (ii) 200 registered voters.

Third, the municipality must demonstrate that the enterprise revenues are, or that the revenue source is, sufficient to meet the requirements of the Debt Reform Act. If enterprise revenues are pledged as security for the alternate bonds, the municipality must demonstrate that such revenues are sufficient in each year to pay all of the following:

- (a) costs of operation and maintenance of the utility or enterprise, excluding depreciation;
- (b) debt service on all outstanding revenue bonds payable from such enterprise revenues;
- (c) all amounts required to meet any fund or account requirements with respect to such outstanding revenue bonds;
- (d) other contractual or tort liability obligations, if any, payable from such enterprise revenues; and
- (e) in each year, an amount not less than 1.25 times debt service on all:
 - (i) outstanding alternate bonds payable from such enterprise revenues; and
 - (ii) the alternate bonds proposed to be issued.

If one or more revenue sources are pledged as security for the alternate bonds, the municipality must demonstrate that such revenue sources are sufficient in each year to provide not less than 1.25 times (1.10 times if the revenue source is a governmental revenue source) debt service on all outstanding alternate bonds payable from such revenue source and on the alternate bonds proposed to be issued. A municipality need not meet the test described in this paragraph for the amount of debt service set aside at closing from bond proceeds or other moneys.

Installment Contracts. Two separate provisions of the Municipal Code and Section 17(b) of the Debt Reform Act authorize municipalities to purchase real or personal property pursuant to installment contracts. Under Division 76.1 of the Municipal Code, a municipality may enter into an installment contract not to exceed 20 years. The installment contract is payable from the levy of a direct, unlimited ad valorem property tax sufficient to pay the installments. Accordingly, a municipality subject to the Extension Limitation Law must be authorized by a direct referendum to enter into a Division 76.1 installment contract.

A Division 76.1 installment contract entered into by a municipality that is not subject to the Extension Limitation Law is subject to a backdoor referendum. The ordinance providing for the installment contract must be published at least twice within 30 days after its passage. If, within 30 days after the second publication, at least 10% of the registered voters in the municipality file a petition requesting a referendum, the question of whether the ordinance authorizing the installment contract should become effective will be submitted to the voters.

A municipality which is authorized to enter into an installment contract under Division 76.1 may issue debt certificates in lieu of or as evidence of the amounts payable under the installment contract. The ability to issue such certificates adds flexibility to the municipality's marketing of its installment contract obligations.

Section 11-61-3 of the Municipal Code also permits a municipality to purchase real or personal property pursuant to an installment contract. This form of installment contract differs from an installment contract entered into pursuant to Division 76.1 in the following respects:

- The installment payments of principal and interest are payable solely from the general funds of the municipality; there is no separate tax levy to support the installment payments;

- The municipality is not permitted to issue its own certificates evidencing the installment payments due under the contract; and
- No backdoor referendum is required in order to enter into the installment contract.

Section 17(b) of the Debt Reform Act also authorizes municipalities to purchase real or personal property pursuant to an installment contract with a maximum term of 20 years. Municipalities are authorized to issue debt certificates evidencing the indebtedness incurred under such an installment contract. The payment obligation under such an installment contract and on such certificates constitutes a binding and enforceable promise to pay the amount borrowed plus the interest thereon. The municipality is expected to agree to annually appropriate amounts sufficient to pay the principal and interest on the installment contract and the debt certificates. There is no separate tax levy available for the purpose of making such payments.

Leases. Municipalities may lease real or personal property for a term not exceeding 20 years under Section 17(b) of the Debt Reform Act. A municipality is authorized to issue debt certificates evidencing the indebtedness incurred under the lease. As with installment contract financings, the payment obligation under a lease is a binding and enforceable promise to pay, for which the municipality agrees to appropriate sufficient funds on an annual basis.

Special Service Areas. When special services are provided to a particular contiguous area within a municipality, in addition to the services generally provided throughout the municipality, a municipality may create a special service area. The cost of the special services may be paid from taxes levied upon the taxable real property within the area, and such taxes may be levied in the special service area at a rate or amount sufficient to produce revenues required to provide the special services.

Pursuant to Section 27-45 of the Property Tax Code, bonds secured by the full faith and credit of the special service area territory may be issued for the purpose of providing special services. Such bonds are paid from the levy of taxes unlimited as to rate or amount against the taxable real property in the special service area. The county clerk will annually extend taxes against all of the taxable real property in the area in amounts sufficient to pay the principal and interest on the bonds. Such bonds are exempt from both the BINA and the Extension Limitation Law.

Prior to the first levy of taxes in the special service area and at least 60 days after the adoption of the ordinance proposing the establishment of the special service area, the municipality is required to hold a public hearing and to publish and mail notice of such hearing. At the public hearing, any interested person may file written objections and/or give oral statements with respect to the establishment of the special service area and the levy of taxes therein. As a result of the hearing, the municipality may delete areas from the special service area as long as the remaining area is contiguous.

Prior to the issuance of special service area bonds, the municipality must give published and mailed notice and hold a hearing at which any interested person may file written objections and/or give oral statements with respect to the issuance of the bonds. The questions of the creation of the special service area, the levy of a tax on such area and the issuance of special service area bonds may all be considered at the same hearing.

The creation of the special service area, the levy of a tax within the area and the issuance of bonds for the provision of special services to the area are subject to a petition process. If, within 60 days after the

adjournment of the public hearing, a petition signed by not less than 51% of the electors residing within the special service area and 51% of the owners of record of land located within the special service area is filed with the municipal clerk objecting to the creation of the special service area, the levy of a tax or the issuance of bonds, then the area may not be created, the tax may not be levied and the bonds may not be issued. If such a petition is filed, the subject matter of the petition may not be proposed relative to any of the signatories within the next two years. If no such petition is filed with the municipal clerk, the municipality may proceed to adopt an ordinance establishing the special service area, which must be timely filed with the county recorder and the county clerk.

Special Assessments. Similar to service area financings, a special assessment is a method of financing used when a municipal improvement benefits a particular area to a greater extent than it benefits the entire municipality. The cost of such improvement is assessed against individual properties in amounts approximately equal to the value of the benefit to the properties assessed. Each assessment is a lien on the property and is payable in annual installments, with interest. Except for the public benefit portion of the special assessment, special assessment debt does not count against the statutory municipal debt limit. Article 9 of the Municipal Code grants certain municipalities the authority to make local improvements by special assessment and sets forth the municipal and court procedures for doing so.

In general, municipalities may finance special assessment projects by selling (usually at a discount) the vouchers issued for services in lieu of payment or by exchanging all such vouchers with special assessment bonds. In addition, municipalities may issue, subject to BINA and the Extension Limitation Law, judgment funding bonds to pay their public benefit portion of the assessment. Finally, the Special Assessment Supplemental Bond and Procedures Act provides supplemental authority regarding the procedures for the making of local improvements and the issuance and sale of obligations payable from special assessments.

Tax Increment Financing. Tax increment financing provides a means for municipalities, after the approval of a “redevelopment plan and project,” to redevelop blighted, conservation or industrial park conservation areas. The Tax Increment Act allows incremental property taxes to be used to pay certain redevelopment project costs and to pay debt service with respect to tax increment bonds issued to pay redevelopment project costs. The municipality is authorized to issue tax increment bonds payable from, and secured by, incremental property tax revenues expected to be generated in the redevelopment project area. Incremental property tax revenues are derived from the increase in the current equalized assessed valuation of the real property within the redevelopment project area over and above the certified initial equalized assessed valuation for such redevelopment project area.

Pursuant to Section 11-74.4-5 of the Tax Increment Act, before adopting the necessary ordinances to designate a redevelopment project area, a municipality must hold a public hearing and convene a joint review board to consider the proposal. At the public hearing, any interested person or taxing district may file written objections and may give oral statements with respect to the proposed financing. After the municipality has considered all comments made by the public and the joint review board, it may adopt the necessary ordinances to designate a redevelopment project area.

Tax increment bonds may be secured by the full faith and credit of the municipality. The issuance of general obligation tax increment bonds is subject to a backdoor, rather than a direct, referendum. Once a municipality has authorized the issuance of tax increment obligations secured by its full faith and credit, the ordinance authorizing the issuance must be published in a newspaper of general circulation in the

municipality. In response, voters may petition to request that the question of issuing obligations using the full faith and credit of the municipality as security to pay for redevelopment project costs be submitted to the electors of the municipality. If, within 30 days after the publication, 10% of the registered voters of the municipality sign such a petition, the question of whether to issue tax increment bonds secured by the municipality's full faith and credit must be approved by the voters pursuant to referendum.

Tax increment revenues may also be treated as a revenue source and be pledged to the payment of alternate bonds under Section 15 of the Debt Reform Act.

Short-Term Borrowing Alternatives to Meet Operating Expenses

The following discussion addresses the ways in which a municipality can borrow to meet cash flow needs. Federal Regulations require an analysis of a municipality's cash flow needs if the obligations are to be issued on a tax-exempt basis. Federal Regulations provide that such needs are determined by preparing monthly cash flow estimates for the fund for which the borrowing is to be made. The proceeds of the borrowing may be invested without regard to yield restriction if the size of the borrowing is not greater than the sum of (a) the projected greatest cumulative cash flow deficit for the fund for which the borrowing is to be made during the 13 months following the issuance of the bonds and (b) the lesser of (i) 5% of the actual total expenditures from all operating funds in the preceding fiscal year or (ii) the average maintained reserve as calculated in the manner specified in the Federal Regulations. In addition, Federal Regulations require warrants or notes to mature within the greater of (a) 13 months after their issuance or (b) 60 days after the delinquency date for the taxes being anticipated.

Interfund Borrowings. Pursuant to Section 8-1-3.1 of the Municipal Code, a municipality may borrow money from one of its funds for use by another fund. The borrowing must be for a lawful corporate purpose and repaid within the fiscal year.

Promissory Notes. Pursuant to Section 8-1-3.1 of the Municipal Code, a municipality may borrow money from any bank or financial institution. The indebtedness is evidenced by a promissory note or similar debt instrument (but not a bond) authorized by an ordinance of the corporate authorities and executed by the mayor or president of the municipality, as the case may be. The borrowing must be for a lawful corporate purpose and must be repaid within 10 years. The obligation of the municipality to make payments due under the promissory note shall be a lawful direct general obligation of the municipality. The municipality is expected to agree to annually appropriate amounts sufficient to make payments due under the promissory note, but the promissory note will be valid whether or not the municipality includes such appropriation in any annual or supplemental appropriation adopted by the corporate authorities. The indebtedness evidenced by the promissory note does count against the municipality's statutory debt limit.

Tax Anticipation Warrants. Tax anticipation warrants are issued in anticipation of taxes levied but not yet collected, under Sections 8-1-1 through 8-1-18 of the Municipal Code. Such taxes are pledged to the payment to the warrants and must be set aside and held for the payment of the warrants. Such warrants may be issued in an amount up to 85% of the total amount of the taxes levied for the particular fund against which the warrants are issued. Additionally, municipalities must ensure that the amount of warrants does not exceed 85% of (a) the municipality's last known equalized assessed valuation multiplied by (b) the maximum permitted tax rate for the particular fund involved. Warrants may have a fixed maturity date and are payable in the numerical order of their issuance solely from the taxes levied for the particular fund involved.

General Obligation Tax Anticipation Warrants. General obligation tax anticipation warrants are authorized by Section 14 of the Debt Reform Act. Such warrants bear a specified due date and are secured by a levy of ad valorem taxes upon all taxable property in the municipality without limit as to rate or amount (provided the municipality is not subject to the Extension Limitation Law). No additional money should accrue to the municipality as a result of the taxes levied to pay general obligation tax anticipation warrants because when such warrants are issued, the county clerk(s) will be instructed to reduce the specific tax rate by the percentage necessary to produce the amount needed to pay the principal of and interest on the warrants. A municipality may not issue general obligation tax anticipation warrants in excess of the formula described in the preceding “Tax Anticipation Warrants” section.

Under the Debt Reform Act, a municipality may issue *refunding warrants or general obligation bonds to refund warrants* should taxes or other revenues be delayed or insufficient to pay such warrants. The refunding warrants or bonds may also be secured by a levy of ad valorem taxes upon all taxable property in the municipality without limit as to rate or amount or, for a municipality subject to the Extension Limitation Law, may be issued as limited bonds.

Warrants initially issued are not included in any computation of indebtedness for the purpose of any statutory provision or limitation. Refunding warrants and general obligation bonds issued to refund warrants may be issued without regard to existing debt limitations. Upon being issued, however, such general obligation refunding bonds or warrants must be included and regarded as indebtedness.

Tax Anticipation Notes. Tax anticipation notes, like general obligation tax anticipation warrants, have a fixed maturity date and are general obligations issued in anticipation of taxes levied but not yet collected. A municipality may issue notes under Section 2 of the Tax Anticipation Note Act in an amount, including principal, interest thereon and costs of issuance thereof, not exceeding 85% of the taxes levied for the particular fund against which the notes are issued. The amount of notes, including principal, interest and costs of issuance, also may not exceed 85% of (a) the municipality’s last known equalized assessed valuation multiplied by (b) the maximum permitted tax rate for the particular fund involved. No notes may be issued if there are tax anticipation warrants outstanding against the tax to be anticipated by the notes. Tax anticipation notes are secured by the levy and collection of a direct annual tax upon all taxable property in the municipality sufficient to pay the principal and interest on the notes to maturity. As with general obligation warrants, no additional money should accrue to the municipality as a result of the tax because when tax anticipation notes are issued, it is the duty of the county clerk(s) to reduce the specific tax rate by the percentage necessary to produce the amount needed to pay the principal of, interest on and costs of issuance of the notes. Unlike tax anticipation warrants, tax anticipation notes count against a municipality’s debt limit.

Because general obligation tax anticipation warrants and tax anticipation notes are, and refunding warrants and general obligation bonds to refund warrants may be, secured by an unlimited property tax, they are subject to the requirements of the Extension Limitation Law and the BINA and are, therefore, rarely issued.

Personal Property Tax Replacement Anticipation Notes. Personal property tax replacement anticipation notes may be issued pursuant to Section 4.1 of the Tax Anticipation Note Act in an amount not to exceed 75% of the entitlement of replacement taxes for the year anticipated. The amount of any transfers from the working cash fund of the municipality in anticipation of replacement taxes should be subtracted from the amount authorized by the 75% formula. The entitlement amount must be certified by

the Director of the Illinois Department of Revenue. Such notes are payable solely from personal property replacement taxes distributed to the municipality.

Revenue Anticipation Notes. Revenue anticipation notes may be issued under Section 2 of the Revenue Anticipation Act in anticipation of revenue from a reliable source such as federal aid, state revenue sharing or local taxes and fees. Such notes must mature within one year of their date of issue. Revenue anticipation notes may not be issued after the revenue to be anticipated has become delinquent and may not be issued in an amount in excess of 85% of such revenues. The notes are payable solely from the revenues that have been anticipated and do not count against a municipality's debt limit.

Long-Term Borrowing Alternatives to Meet Operating Expenses

Federal Regulations require an analysis of the anticipated need for the borrowings discussed in this portion of this memorandum. These bonds are secured by the levy of a direct annual tax on all taxable property in a municipality without limitation as to rate or amount or, for a municipality subject to the Extension Limitation Law, may be issued as limited bonds.

Insurance Reserve Bonds. Insurance reserve bonds may be issued without referendum for the purpose of creating a reserve (i) for the payment of any cost, liability or loss against which a municipality may protect itself or self-insure pursuant to Section 9-103 of the Tort Immunity Act, or (ii) for the payment of which a municipality may levy a tax pursuant to Section 9-107 of such Act, including any or all tort judgments or settlements entered against or entered into by the municipality. Such reserve fund, including interest earnings reasonably anticipated thereon, may not be funded in an amount in excess of that which is reasonably required for the payment of such costs (including costs of issuance of the bonds issued for the purpose of funding such reserve fund) as certified by an independent auditor, actuary or insurance underwriter. Furthermore, such reserve may not be increased beyond 125% of the auditor's, actuary's or insurance underwriter's estimated ultimate losses at the 95% confidence level. The Tax Code imposes significant restrictions on the ability of a municipality to issue insurance reserve bonds on a tax-exempt basis. Generally, in order to issue insurance reserve bonds on a tax-exempt basis, bond proceeds on deposit in the insurance reserve fund may be invested only in certain other tax-exempt obligations until the bonds are retired.

Tort Judgment Funding Bonds. Tort judgment funding bonds may be issued without referendum for the payment of any tort judgment or settlement entered against or entered into by a municipality pursuant to Section 9-103 of the Tort Immunity Act. Such bonds may be issued in an amount necessary to discharge obligations under such judgments or settlements and do not count against the municipality's statutory debt limit.

Working Cash Fund Bonds. A municipality may create, set apart, maintain and administer a fund for the purpose of enabling the municipality to have in its treasury at all times sufficient money to meet its demands. Such a fund may be used for ordinary and necessary expenditures and for general and special corporate purposes. For the purpose of creating the working cash fund, pursuant to Section 8-7-2 of the Municipal Code, the municipality may incur debt and issue bonds in an amount not to exceed \$700,000. The ordinance authorizing the issuance of the bonds is operative and valid without a referendum, and the corporate authorities must provide for the collection of an ad valorem property tax unlimited as to rate or amount. A municipality subject to the Extension Limitation Law may issue Working Cash Fund Bonds as limited bonds.

All money received from the issuance of Working Cash Fund Bonds must be set apart in the working cash fund and must be used only for the purposes for which the bonds were issued. The fund will not be regarded as a current asset available for appropriation and may not be appropriated by the corporate authorities in an annual appropriation ordinance. In order to provide money with which to meet ordinary and necessary disbursements for salaries and other general and special corporate purposes, money may be transferred from the working cash fund to the general or special corporate fund of the municipality. Money so transferred will be deemed to have been transferred in anticipation of the collection of taxes levied for such general or special corporate fund. The amount of money transferred from the working cash fund to such general or special corporate fund, together with the aggregate amount of tax anticipation warrants or notes drawn against the taxes levied for such general or special corporate fund, including the amount of interest accrued and estimated to accrue thereon, cannot exceed 90% of (a) the municipality's last known equalized assessed valuation multiplied by (b) the maximum permitted tax for such general or special corporate purposes.

[For additional information, please contact:](#)

Andrea G. Bacon

312.845.3817
bacon@chapman.com

Lynda K. Given

312.845.3814
given@chapman.com

Anjali Vij

312.845.3472
anjvij@chapman.com

Erin P. Bartholomy

312.845.3893
bartholo@chapman.com

Kyle W. Harding

312.845.3278
harding@chapman.com

Lawrence E. White

312.845.3426
white@chapman.com

William E. Corbin

312.845.3494
corbin@chapman.com

Kelly K. Kost

312.845.3875
kost@chapman.com

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