

ICCCFO 2024 Fall Conference

**Legal Topics  
in a Bond Issue**

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# Overview

The purpose of this presentation is to summarize the laws and regulations governing borrowings by Illinois public community colleges.

Under current law, such borrowings are governed by the provisions of the following laws:

## Illinois Law

*Compliance with Illinois law is necessary for the borrowing to be valid and legally binding.*

- ▶ Public Community College Act of the State of Illinois, as amended (the “*Community College Act*”)
- ▶ Local Government Debt Reform Act of the State of Illinois, as amended (the “*Debt Reform Act*”);
- ▶ Property Tax Extension Limitation Law of the State of Illinois, as amended (the “*Extension Limitation Law*”);
- ▶ Bond Issue Notification Act of the State of Illinois, as amended (the “*BINA*”)

## Tax Code and Federal Regulations

*Compliance with the Tax Code and the Federal Regulations is necessary for the interest on the borrowing to be exempt from federal income taxation.*

- ▶ Internal Revenue Code of 1986, as amended (the “*Tax Code*”)
- ▶ Arbitrage and rebate regulations promulgated thereunder (the “*Federal Regulations*”)

# Community College Act



# Debt Limit

The debt limit for community college districts is 2.875% of the equalized assessed valuation of the district.

## DO NOT Count Against the Debt Limit

- ▶ Tax anticipation warrants
- ▶ Generally, alternate bonds

## DO Count Against the Debt Limit

- ▶ Bonds (other than, generally, alternate bonds)
- ▶ Installment contracts
- ▶ Leases
- ▶ Debt certificates
- ▶ Judgments



# Lawful Borrowing Alternatives

- ▶ **Working Cash Fund Bonds** – Section 3-33.2 of the Community College Act
- ▶ **Funding Bonds** – Section 3A-7 of the Community College Act
- ▶ **Protection, Health and Safety Bonds** – Section 3-20.3.01 of the Community College Act
- ▶ **Building Bonds** – Section 3A-1 of the Community College Act
- ▶ **Installment Contracts** – Section 3-37 of the Community College Act
- ▶ **Leases** – Section 3-38 of the Community College Act
- ▶ **Refunding Bonds** – Section 3A-13 of the Community College Act

# Debt Reform Act

*Supplemental Authority granting additional powers  
above the Community College Act*



# Capitalized Interest

- ▶ Allows a community college district to use bond proceeds to pay capitalized interest on its bonds for a period not to exceed the greater of:
  - (i) Two years, or
  - (ii) 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 were issued
- ▶ The community college board may provide for such capitalized interest in the resolution authorizing the bonds

# General Terms, Premium and Discount

Bonds authorized by applicable law may:

- ▶ Be issued in one or more series
- ▶ Bear such date or dates
- ▶ Become due at such time or times within 40 years, except as expressly limited by applicable law,
- ▶ Bear interest payable at such intervals and at such rate or rates as authorized under applicable law, which rates may be fixed or variable
- ▶ Be in such denominations
- ▶ Be in such form, either coupon, registered or book-entry
- ▶ Carry such conversion, registration, and exchange privileges
- ▶ Be subject to defeasance upon such terms
- ▶ Have such rank or priority
- ▶ Be executed in such manner
- ▶ Be payable in such medium of payment at such place or places within or without the State with respect to such bonds
- ▶ Prescribe the rights, powers and duties thereof to be exercised for the benefit of the governmental unit and the protection of the bondholders
- ▶ Provide for the holding in trust, investment and use of moneys, funds or accounts held under an ordinance
- ▶ Provide for assignment of and direct payment of the moneys to pay such bonds or to be deposited into such funds or accounts directly to such trustee
- ▶ Be subject to such terms of redemption with or without premium
- ▶ Be sold in such manner at private or public sale and at such price

**All as the governing body shall determine.**



## General Terms, Premium and Discount (continued)

- ▶ Whenever bonds are sold at price less than par, they shall be sold at a price and bear interest at rate(s) such that either the true interest cost (yield) or the net interest rate (as selected by the governing body) does not exceed the maximum rate otherwise authorized by applicable law
- ▶ *Except for an ordinance required to be published by applicable law in connection with a backdoor referendum, any bond ordinance adopted by a governing body under applicable law shall become effective immediately*



# Tax Levy

**Districts are authorized to file a tax levy with the county clerk 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 prior to March 1
- ▶ In extending taxes for general obligation bonds, the county clerk must add to the levy an amount sufficient to produce tax receipts adequate for the prompt payment of such debt service



# Deadline to Issue Bonds

- ▶ **Bonds Authorized by Referendum**
  - ▷ Five years after the date of the referendum
- ▶ **Bonds Authorized by Backdoor Referendum**
  - ▷ Three years after the end of the petition period



# Borrowing Alternatives

- ▶ **Limited Bonds** – Section 15.01 of the Debt Reform Act
- ▶ **Debt Certificates** – Section 17(b) of the Debt Reform Act
- ▶ **Alternate Bonds** – Section 15 of the Debt Reform Act

# Extension Limitation Law



## Limited Bonds

- ▶ Community college districts subject to the Extension Limitation Law — commonly referred to as being “tax-capped” — are permitted to issue limited bonds
- ▶ Tax-capped districts may only issue non-referendum general obligation bonds as limited bonds
- ▶ Limited bonds are issued in lieu of general obligation bonds that otherwise have been authorized by applicable law
- ▶ Limited bonds are payable from a separate property tax levy that is unlimited as to rate
- ▶ The amount of taxes that will be extended to pay the bonds is limited

# Debt Service Extension Base

Limited bonds are payable from a community college district's debt service extension base (the "Base").

- ▶ The Base is an amount equal to that portion of the community college district's extension for the applicable levy year for the payment of non-referendum bonds (other than alternate bonds or refunding bonds issued to refund bonds initially issued pursuant to referendum)
- ▶ The Base is increased each year by the lesser of:
  - ▷ 5%, or
  - ▷ The percentage increase in the Consumer Price Index for All Urban Consumers during the 12-month calendar year preceding the levy year
- ▶ The district may establish or increase a Base pursuant to referendum

# Bond Issue Notification Act





# Bond Issue Notification Act

**BINA requires a community college board proposing to sell non-referendum general obligation bonds or limited bonds (other than refunding bonds) to hold at least one public hearing.**

- ▶ The secretary of the community college board must publish and post notice of the public hearing:
  - ▷ At least once in a newspaper of general circulation in the community college district not less than seven and not more than thirty days before the date of the public hearing, **and**
  - ▷ At the principal office of the community college board at least 48 hours before the public hearing
- ▶ Notice must be continuously available to the public
- ▶ Notice must appear above the name or title of the secretary of the community college board



# Public Hearing

- ▶ At the public hearing, the community college board must:
  - ▷ Explain the reasons for the proposed bond issue, **and**
  - ▷ Permit persons to present written or oral testimony
- ▶ The community college board must then wait at least seven days following the public hearing before adopting a resolution providing for the sale of the bonds

# Tax Code and Federal Regulations



## Timing of Expenditures

- ▶ 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 district reasonably expects to spend the proceeds with due diligence within such three-year period*
- ▶ The district 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

# Reimbursement with Proceeds of Tax-Exempt Bonds

- ▶ Federal Regulations restrict the ability of a community college district to use bond proceeds to reimburse itself for expenditures incurred prior to the issuance date of the bonds, *unless the district, in compliance with Federal Regulations, formally declares its intent to reimburse itself for such expenditures with bond proceeds*
- ▶ Preliminary expenditures may be reimbursed without a formal declaration, so long as such preliminary expenditures do not exceed 20% of the bond proceeds
- ▶ Preliminary expenditures include:
  - ▷ Architectural
  - ▷ Engineering
  - ▷ Surveying
  - ▷ Soil testing and similar costs
- ▶ Preliminary expenditures **do not include** land acquisition or site preparation costs



# Arbitrage Rebate

- ▶ Section 148(f) of the Tax Code requires community college districts 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.**



# Rebate Exception

- ▶ Arbitrage earnings need not be rebated to the United States Treasury if:
  - ▷ The expenditure of bond proceeds meets certain spend-down requirements,
  - ▷ The district does not issue more than \$5,000,000 of tax-exempt bonds in the calendar year in which the bonds are issued, **or**
  - ▷ The district does not issue more than \$10,000,000 of tax-exempt bonds in the calendar year in which the bonds are issued
    - > So long as the amount in excess of \$5,000,000 is used to finance the construction of public school facilities

# Private Use

## Arbitrage Rebate Exceptions

- ▶ 6-Month Exception – No rebate payment required if all proceeds of the issue are spent within 6 months of the issue date
- ▶ 18-Month Spend-down Exception

Period	Spend-down Requirement
6 months	15%
12 months	60%
18 months	100%

- ▶ Two-Year Construction Spend-down Exception – At least 75% of the proceeds must be spent on construction expenditures

Period	Spend-down Requirement
6 months	10%
12 months	45%
18 months	75%
24 months	100%





# Private Use (continued)

## Private Business Use and Payments

- ▶ Tax exemption does not apply to any “private activity bond”, with limited exceptions
- ▶ A private activity bond is a bond that has excessive private business use AND has excessive private payments/security
- ▶ De Minimis allowance
  - ▷ Private business use is limited to 10%, but
  - ▷ 5% limit for “unrelated” or “disproportionate” private business use (with little guidance from the IRS), so most tax counsel use the 5% limit as the baseline

# Private Use (continued)

## Private Business Use and Payments (continued)

- ▶ “Private business use”
  - ▷ More than 5% of bond proceeds finance a public facility used by a non-governmental trade or business
  - ▷ Examples of private use:
    - > Sale, transfer or lease of property to private user
    - > Management of property by private user under a management contract
- ▶ “Private payment or security”
  - ▷ More than 5% of debt service on the bonds is secured by an interest or derived from payments related to private use
  - ▷ Example of private payment:
    - > Payments of lease rentals to the issuer by a private operator



# Record-keeping

## Record Retention

- ▶ Sufficient records must be retained to support the tax status over the term of the Bonds, plus 3 years after the final maturity date
  - ▷ For a refunding issue, material records relating to the original new money bonds and material records related to the refunding issue should be maintained until 3 years after the final redemption of both bond issues
- ▶ Consequences if adequate records are not maintained
  - ▷ Difficult to calculate private business use
  - ▷ Difficult to demonstrate tax compliance in the event of audit



## Record-keeping (continued)

### Post-Issuance Tax Compliance Policy

- ▶ Adopt *written* procedures that can be understood and implemented over time even as officials responsible for compliance change
- ▶ Having written post issuance compliance procedures may allow for more favorable settlement treatment from the IRS

# Record-keeping (continued)

## Post-Issuance Tax Compliance Policy (continued)

- 1) Designate a Compliance Officer
  - ▷ Assign responsibility for monitoring
  - ▷ Include training with regard to tax and disclosure requirements
- 2) Retain accurate records
- 3) Implement procedures reasonably expected to timely identify and timely correct noncompliance
  - ▷ Integrate monitoring of tax law compliance with existing accounting systems (for example, use special coding on a ledger to review sales, leases or contracts involving bond financed property)
  - ▷ Use a compliance checklist
  - ▷ Due diligence at regular intervals
    - > Principal and interest payment dates are good benchmarks
    - > Self-help remedial actions may only be taken within specified time frames
- 4) Report compliance efforts to elected officials (annually)

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