This is the first of four articles explaining the basics of municipal bonds for Illinois municipalities.

I. WHAT IS A BOND AND WHY WOULD A CITY OR VILLAGE WANT TO ISSUE A BOND

Bonds are a form of debt. In the public sector, “borrowers” or “issuers” of bonds are states, cities, villages, school districts and other local government entities that need money for a variety of reasons. Typically, a borrower will want to issue a bond and pay principal and interest over time to spread out the burden of paying for public infrastructure and assets over their expected useful life, as opposed to increasing taxes or impacting the budget over a shorter term. Such borrowing is highly restricted and must be done in accordance with Illinois law.

II. USE OF BOND PROCEEDS BY A CITY OR VILLAGE

Municipal bonds, or “munis” as they are commonly called, can be issued for a variety of purposes, provided that their issuance accords with Illinois law. Commonly, cities or villages issue municipal bonds for capital projects, working capital needs or refinancing of prior debt.

A. NEW PROJECTS

Generally, a municipality compiles an annual capital improvement budget or prepares a “needs list” or a capital improvement program (“CIP”), spanning a number of years (commonly six years). The CIP consists of projects the municipality considers to be important by means of their impact on the safety, economy and general well-being of the local community. Capital projects can be funded by federal or state grants, local improvement district assessments, service area levies and other miscellaneous revenue available for general purpose use. However, the primary sources of local funding to pay for capital projects are municipal bonds. Projects involving roads, bridges, water facilities, sewer facilities, electrical facilities, municipal buildings or economic development initiatives are examples of projects that are commonly financed with bonds. Thus, generally speaking, if a municipality is building a new capital project, it is likely that the proceeds of a municipal bond issuance are financing the project.

Oftentimes, capital projects are of long-term value to citizens (buildings, roads, land development, parks, etc.). Hence, issuing bonds to fund a capital project allows current and future taxpayers within the community to pay related costs over the life of the project as they avail themselves of the benefits it bestows upon the community.

B. COVERING SHORT-TERM (OR LONG-TERM) NEEDS

Cities or villages can issue bonds to fund working capital expenditures that arise from a variety of circumstances. Traditionally, working capital bonds have been issued as short-term obligations where the proceeds are used to cover an issuer’s temporary cash flow, or operating, deficit. Short-term budgetary deficits can arise from a mismatch between the receipt of annual revenues (property taxes or other) and the timing of annual expenditures of the issuer within a year. Tax anticipation warrants (“TAWs”) are often issued in anticipation of taxes levied but not yet collected. TAWs may be issued in an amount up to 85% of the total amount levied for the particular fund against which the TAWs are issued. Longer-term working capital bonds have become more commonplace in recent times due to financial difficulties stemming from the recent economic crisis. Municipalities use these longer-term working capital bonds to address structural deficits that are not the result of a mismatch of revenues and expenses. Examples include, insurance reserve bonds, tort judgment funding bonds and working cash fund bonds, which are permitted under Illinois law assuming certain requirements are satisfied. Certain federal income tax issues exist in connection with both short-and long-term working capital financings.

C. REFUNDINGS/REFINANCINGS

Like a homeowner who refinances a mortgage when interest rates drop, a municipality with outstanding debt can issue refunding bonds in order to take advantage of lower rates. Refunding bonds can also be issued to avoid default or restrictive debt burden. A refinancing can be done as a current refunding, which means the old bonds are called or mature within 90 days of the issuance of the refunding bonds, or an advance refunding (limited to one occurrence) where the old
bonds are called on a specified call date and proceed of the new refunding bonds are typically held in an escrow account until such later call date at least 90 days after the issuance of the refunding bonds. Refundings generally do not need to satisfy direct or backdoor referendum requirements.

D. SUMMARY OF THE TYPES OF BONDS

Following is a table that briefly describes the most commonly used types of bonds. In the next issue, we will explore these different bonds in more detail.

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**TABLE OF BOND FINANCING OPTIONS FOR ILLINOIS CITIES AND VILLAGES**

<table>
<thead>
<tr>
<th>TYPE OF DEBT</th>
<th>SECURITY</th>
<th>GENERAL REQUIREMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Obligation Home Rule</td>
<td>Full faith and credit and backed by the</td>
<td>Referendum unless exception.  No statutory</td>
</tr>
<tr>
<td></td>
<td>ad valorem taxing power of the Issuer.</td>
<td>debt limit and no need for voter approval to</td>
</tr>
<tr>
<td></td>
<td></td>
<td>issue bonds. Flexibility.</td>
</tr>
<tr>
<td>General Obligation Non Home Rule</td>
<td>Full faith and credit and backed by the</td>
<td>Referendum unless exception. Statutory debt</td>
</tr>
<tr>
<td></td>
<td>ad valorem taxing power of the Issuer.</td>
<td>limit of 8.625% of E.A.V. required BINA.</td>
</tr>
<tr>
<td>Alternate Revenue Bonds</td>
<td>“Double-barreled” – payable from a specific</td>
<td>Pledged revenues must meet 1.25 times debt service</td>
</tr>
<tr>
<td></td>
<td>revenue source with the general obligation of</td>
<td>coverage requirement. Backdoor referendum procedures and</td>
</tr>
<tr>
<td></td>
<td>the municipality serving as backup security.</td>
<td>BINA required.</td>
</tr>
<tr>
<td>Debt Certificate</td>
<td>No separate tax levy backing, obligation is</td>
<td>Borrow money by entering into installment contract</td>
</tr>
<tr>
<td></td>
<td>a promise to pay by means of budgetary</td>
<td>agreement. Statutory debt limit of 8.625% of E.A.V.</td>
</tr>
<tr>
<td>Promissory Note Payable to</td>
<td>No separate tax levy backing, obligation is</td>
<td>Borrow money by entering into promissory note or similar</td>
</tr>
<tr>
<td>Financial Institution</td>
<td>a promise to pay by means of budgetary</td>
<td>debt instrument. Statutory debt limit of 8.625% of E.A.V.</td>
</tr>
<tr>
<td>Revenue</td>
<td>Specific revenue source.</td>
<td>Varies by type of revenue. Referendum and BINA not</td>
</tr>
<tr>
<td>Special Service Area</td>
<td>Full faith and credit of the taxable real</td>
<td>required.</td>
</tr>
<tr>
<td></td>
<td>property in the special service area.</td>
<td>Area established with approval of voters/residents in the</td>
</tr>
<tr>
<td></td>
<td></td>
<td>special area. Need hearings, notice and various other</td>
</tr>
<tr>
<td>Tax Increment Finance Revenue</td>
<td>Future incremental property tax growth from</td>
<td>Validly created TIF, TIF eligible costs only.</td>
</tr>
<tr>
<td></td>
<td>project, TIF area or contiguous TIF area to</td>
<td></td>
</tr>
<tr>
<td></td>
<td>repay debt service on the TIF bonds.</td>
<td></td>
</tr>
<tr>
<td>Limited Bonds</td>
<td>Full faith and credit and backed by the</td>
<td>Payable from debt service extension base unlimited as to</td>
</tr>
<tr>
<td></td>
<td>ad valorem taxing power of the Issuer.</td>
<td>rate but limited as to amount.</td>
</tr>
</tbody>
</table>

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In the last issue we discussed what bonds are and why a city or village would want to issue them. This month we will review the major types of bonds.

A city or village may issue several types of debt to meet its financing needs. These include, among others, general obligation bonds, revenue bonds, alternate revenue source bonds, debt certificates/installment contracts, leases, special service area bonds, special assessment bonds, working cash bonds, tax anticipation warrants, tax anticipation notes, revenue anticipation notes, funding bonds and tax increment bonds. Refunding bonds can save municipalities interest costs and have been issued more frequently in recent years due to the lower interest environment.

A. GENERAL OBLIGATION BONDS

General obligations bonds or “G.O.’s” are debt issued by a municipal issuer representing its full faith and credit and backed by its ad valorem taxing power. A general obligation can be issued for any lawful purpose for which ad valorem taxes may be levied subject to constitutional, statutory or other limitations (such as debt limitations discussed further below) and pursuant to proper constitutional, statutory or other procedures. Unless an exception applies, the Illinois Municipal Code, as amended (the “Code”) requires that general obligation bonds secured by an ad valorem tax must be approved by voters of the issuer in a referendum. However, the referendum requirement has many exceptions, including, but not limited to, alternate revenue bonds (as discussed below), refunding bonds, bonds to fund or refund debt related to judicial judgments, working cash fund bonds, bonds used to pay pollution abating costs mandated under the Environmental Protection Act, bonds issued to pay for costs related to improvements of water or wastewater treatment facilities mandated by federal or state regulators, or bonds issued pursuant to the Code in an amount not to exceed one-half of one percent of the equalized assessed value of the taxable property of the issuer. Additionally, differences in procedures and limitations may apply to cities or villages depending on their status as a home rule or non-home rule unit of government and whether the city or village is located in a county subject to a tax cap on property taxes.

1. HOME RULE

Under the 1970 Illinois Constitution, home rule power shifts decision making from the state level to the local level, enabling more flexibility. Home rule communities are granted a broad range of powers unless exempted by the state. Municipalities with populations over 25,000 are automatically granted home rule status, while smaller communities can put the question on a ballot and let voters decide. Home rule units can constitutionally tax anything that is not income, occupations or earnings and they are not susceptible to a tax cap on property taxes unless imposed by further voter action. Aside from not being able to issue bonds payable from ad valorem property taxes maturing more than 40 years from the time of issuance, home rule units do not adhere to any statutory debt limit. For example, home rule units can issue general obligation bonds without the need to secure voter approval through a referendum or backdoor referendum.

2. NON-HOME RULE

Non-home rule cities and villages are subject to the statutory debt limit of 8.625 percent of equalized assessed value as set forth in the Code. The principal amount, and only the principal amount, of all outstanding general obligation bonds and debt of a city or village is counted for purposes of the statutory debt limit. Also, the principal amount due under an installment contract or lease agreement constitutes municipal debt subject to statutory limits. On the contrary, any obligation of a city or village that is payable solely and only from a limited source or fund of the municipality is not considered debt subject to the statutory debt limit. Obligations excluded from the debt limit include alternate revenue source bonds, revenue bonds, special assessment bonds and tax anticipation warrants.

B. ALTERNATE REVENUE BONDS

Alternate revenue bonds or “double-barreled” bonds are essentially revenue bonds issued under the Local Government Debt Reform Act (the “Debt Reform Act”) with the general obligation of the municipality serving as backup security for the bonds. Cities and villages are authorized to use revenue from a municipal enterprise such as water, sewer, electric, gas, municipal stadiums, etc., or other revenue sources such as sales taxes, motor fuel taxes, state income taxes, etc., and pledge such revenue sources to the payment of principal and interest on alternate bonds. The intent of the Debt Reform Act is to permit the issuance of the alternate revenue bonds assuming the pledged revenue source is sufficient so that the
tax levy relating to the debt service on the alternate bonds does not need to be extended. The coverage requirements provide that the municipality must demonstrate that such pledged revenue source be sufficient in each year the bonds remain outstanding to provide not less than 1.25 times debt service on all outstanding alternate bonds payable from such revenue source and on the alternate bonds proposed to be issued. Note that the coverage requirement is 1.10 if the revenue source is either (i) federal or state funds that the village or city unit has received in some amount during each of the three fiscal years preceding the issuance of the alternate bonds or (ii) revenues to be received from another governmental unit under an intergovernmental cooperation agreement.

Apart from coverage requirements, the alternate bonds must meet two other conditions before being issued. First, the alternate bonds must be issued for a lawful corporate purpose and be payable from a revenue source limited to that purpose. For example, a waterworks and sewerage alternate revenue bond cannot be payable solely from motor fuel taxes. Instead, such a bond would need to be payable from revenues derived from the operation of the waterworks and sewerage system of the municipality. However, a waterworks and sewerage alternate revenue bond may be payable from sales taxes and/or the local share of state income taxes in addition to the system revenues. Such “multi-barreling” is a common practice used to supplement system revenues so as to meet coverage requirements. Second, alternate bonds are subject to a backdoor referendum. The backdoor referendum gives registered voters the opportunity to petition the municipality to submit the question of issuing the alternate bonds to referendum. However, the petition must be submitted within 30 days after publication of the authorizing ordinance and 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.¹

**C. DEBT CERTIFICATES/INSTALLMENT CONTRACTS**

Cities and villages are authorized to borrow money by entering into installment finance agreements. There are statutory specifications as to what constitutes an installment contract. The Debt Reform Act authorizes municipalities to purchase or lease either real or personal property through the use of installment contracts not exceeding 20 years in length. The Debt Reform Act also authorizes municipalities to issue debt certificates to evidence payment obligations under a lease or installment contract subject to statutory debt limit. Generally, however, no separate tax levy is available for the purpose of making such lease or installment payments; it is considered a promise to pay by way of budgetary appropriation. However, a municipality not subject to the Limitation Law may enter into an installment contract payable from the levy of a direct, unlimited ad valorem property tax sufficient to pay the installments if certain backdoor referendum requirements are satisfied.

**D. PROMISSORY NOTES**

Cities and villages may also borrow money from a financial institution pursuant to a promissory note or similar debt instrument that is a lawful direct general obligation of the city or village, payable from the general funds of the city or village and other sources of payment as are otherwise lawfully available, subject to the statutory debt limit.

**E. REVENUE BONDS**

Cities and villages may issue revenue bonds for a proper public and corporate purpose, which includes a variety of potentially revenue-producing undertakings such as facilities financed with tax increment, transportation facilities, water and sewer systems, solid waste operations, libraries, sports facilities, exhibition facilities, housing, parking and jails. Revenue bonds generally do not require voter approval. There are two main limitations for revenue bonds in the case of non-home rule units. First, there must be a revenue source related to the purpose for the bond issuance. For example, water revenue bonds may be issued to acquire or improve water systems, but they may not be issued to acquire new police cars in a non-home rule unit. Second, for non-home rule units, there must be a specific statutory grant of power to operate the revenue-producing undertaking as listed above. A positive aspect of revenue bonds is that there is no legal limit on the amount of revenue bonds that may be issued by a non-home rule unit. Revenue bonds are often subject to a backdoor referendum. Revenue bonds are not considered debt for purposes of statutory debt limits.

**F. SPECIAL SERVICE AREA BONDS**

A special service area is a contiguous area within a municipality in which special governmental services are provided in addition to those services provided generally throughout the municipality. The cost of providing the special services is paid from revenues collected from taxes levied upon the property within the contiguous area receiving the special services. In order to establish a special service area, the city or village must publish notice and hold a hearing allowing the public and any interested person to object to the creation of the special service area. Such notice and hearing must be done no sooner than 60 days after adoption of the ordinance proposing the creation of the special service area. The area may not be created, the tax may not be levied and the bonds may not be issued if within 60 days after the public hearing at least 51 percent of the electors area and 51 percent of the land owners within the special service area file a petition objecting to the creation of the special service area, the levy of a tax or the issuance of bonds. Assuming no such petition is filed, the municipality must file with the county recorder within 60 days after final adjournment of the public hearing.

Types of bonds continues on page 20
Bonds may be issued for the purpose of financing the costs related to providing the special service. The special service area bonds are secured by the full faith and credit of the taxable real property in the special service area. To provide for the special tax, the county clerk where the municipality is located will extend an annual tax against all of the taxable real property in the special service area in amounts sufficient to pay the debt service on the bonds. The tax is typically allocated to the property owners on an ad valorem (property or transaction value), benefits, acreage or other rational basis.

G. TAX INCREMENT FINANCE BONDS

Tax increment finance (“TIF”) bonds are those issued by cities or villages to finance a project and use the future incremental property tax growth from that project or other projects in the TIF district or a contiguous district to repay the debt service on the TIF bonds. Before issuing bonds and collecting incremental property tax revenues, the municipality must form a TIF district by ordinance. However, prior to adopting the ordinance the municipality must hold a public hearing and convene a joint review board to consider the proposed TIF district. After considering comments from the public and the joint review board, the municipality may adopt the ordinance creating the TIF district. Statutory controls require that: (i) the TIF is used for a legitimate public purpose (improve a blighted area); (ii) the TIF is necessary (“but for” test); (iii) TIF projects are feasible (feasibility study or cost-benefit analysis); (iv) TIF projects are appropriately planned (a formal project plan); (v) TIF projects perform as intended; and (vi) the municipality files a timely annual report with the Illinois Comptroller. Once a TIF district begins to perform and the municipality begins to receive the incremental revenues, those revenues can be pledged to secure the issuance of TIF bonds. TIF bonds may be issued as general obligation bonds usually by a home rule unit, alternate bonds issued pursuant to the Debt Reform Act or general obligation TIF bonds issued using the specific procedures in the TIF Act, which do not have a coverage requirement but do have a backdoor referendum requirement.

H. LIMITED BONDS

Under the Debt Reform Act, limited bonds may be issued, supported by a tax unlimited as to rate, but limited as to amount. The bonds are commonly used for general capital related infrastructure projects.

I. CONCLUSION

This brief summary of types of debt available to cities and villages raises the question of how to sell the debt so that the community can benefit. We will tackle that topic next month.

1 In governmental units with fewer than 500,000 inhabitants, other than most public infrastructure projects, the necessary number of necessary petition signers for a governmental unit with more than 4,000 registered voters is the lesser of (i) 5% of the registered voters or (ii) 5,000 registered voters; and the necessary number of electors for a governmental unit with 4,000 or fewer registered voters is the lesser of (i) 15% of the registered voters or (ii) 200 registered voters.

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In the last issue we covered the major types of bonds. This month, we’ll discuss how to sell the bonds. Once the city or village makes a decision to raise capital by means of issuance of bonds, it must next consider which method of finding a “lender” or buyer of the bonds works best. Illinois cities and villages have flexibility as to the method of sale. A competitive sale is not required. The method by which to attract potential investors of bonds can be a critical component to the resulting interest rate the city or village will pay to service its bonds. A credit rating is not legally required to be obtained by the village or city in order to issue a bond, but may help lower the interest costs, particularly in the case of a public bond sale. Below are four typical ways to offer bonds to investors or “lenders.”

1. NEGOTIATED SALE

In a negotiated sale, the process begins with the village or city, as issuer, choosing an underwriter (or managing underwriter if more than one underwriter). The issuer and the underwriter then negotiate the terms of the offering. Assuming all procedural issuance requirements are met by the issuer, the underwriter purchases the bonds from the issuer and sells the bonds to its investors.

2. COMPETITIVE SALE

In a competitive sale, bonds are advertised for sale. The announcement, by way of a notice of sale, includes both the terms of the sale and the terms of the bond issue. Any investment bank, broker-dealer or dealer bank may bid on the bonds at the designated date and time in a “blind” fashion, meaning each bidder does not have knowledge of the other bids. The bidder with the lowest interest cost is awarded the bonds.

3. DIRECT PLACEMENT

Direct placement or direct lending in the context of municipal bonds refers to any arrangement in which a single lender/buyer, such as a bank, pension fund, mutual fund, etc., purchases the bonds of the city or village directly. This form of sale may also be described as a private placement, a direct purchase or a bank loan. Advantages include avoiding instability in public markets, avoiding continuing disclosure requirements and avoiding the rating process, which make direct placements an attractive option for issuers.

4. BANK QUALIFIED OR NON-BANK QUALIFIED

Pursuant to the Internal Revenue Code, banks and savings and loans are not generally permitted to deduct interest expenses attributable to tax-exempt bonds acquired, unless the “small issuer exemption” applies. The exemption for small issuers states that if an issuer reasonably expects to not issue more than $10 million of tax-exempt bonds during the calendar year and it designates the bonds as “qualified tax-exempt obligations,” the restriction on the deduction for interest expense does not apply. Issuing so called bank-qualified bonds or “BQ” bonds can reduce the interest rate on the bonds since banks that purchase bank-qualified bonds do not have a restriction on their interest expense deduction.

In the next issue, we will explain the numerous laws governing bond issuance.

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In the last issue we covered the types of bonds sales. In this article, the last of the series, we’ll discuss the laws that govern bonds.

Adherence to federal and Illinois state laws is a required component of any bond issuance. Below is a sampling of current laws that govern the borrowing activities of cities and villages.

**ILLINOIS STATE LAW**

The Illinois Municipal Code, the Local Government Debt Reform Act (the “Debt Reform Act”), the Property Tax Extension Limitation Law (the “Limitation Law”), the Bond Issue Notification Act (“BINA”), the Bond Authorization Act, the Registered Bond Act, and the Bond Replacement Act, all authorize and govern the issuance of municipal bonds. A detailed analysis of these laws is beyond the scope of this article, but below we briefly summarize aspects of the key laws.

The Debt Reform Act was adopted by the Illinois General Assembly to provide supplemental authority to local governmental units to issue and sell bonds to accommodate the effect of market practices that resulted in additional costs for those citizens residing in local governmental units because of high interest rates. The Debt Reform Act, among other things, provides for back door referendum procedures and also the issuance of alternate revenue source bonds and limited tax bonds, which can provide significant advantages to issuers in the State of Illinois. Under the Debt Reform Act, voter referendum or back door referendum approval, once obtained, remains effective (a) for five years after the date of the referendum or (b) for three years after the end of the petition period for the back door referendum.

BINA requires non-home rule cities and villages proposing to sell non-referendum general obligation bonds or limited bonds, except refunding bonds, to hold a public hearing concerning its intent to issue such bonds. Issuers must follow the specific requirements of BINA regarding publication of notice and timing of the public hearing in order to conform to Illinois law when issuing general obligation bonds through non-referendum procedures. The city or village clerk must publish notice of the hearing at least once in a newspaper of general circulation in the municipality not less than seven (7) and not more than thirty (30) days before the date of the hearing and must post notice of the hearing at the principal office of the municipality at least forty-eight (48) hours before the hearing. The governing body must then wait at least seven (7) days following the hearing before adopting an ordinance providing for the issuance of the bonds.

The Limitation Law limits the annual growth in the amount of property taxes to be extended for certain Illinois non-home rule units of government. In general, the annual growth permitted under the Limitation Law is the lesser of 5% or the percentage increase in the Consumer Price Index during the calendar year preceding the levy year. Taxes can also be increased due to new construction, referendum approval of tax rate increases, mergers and consolidations. The Limitation Law currently applies to Cook County, the collar counties and counties that have specifically approved the Limitation Law by referendum. County boards of any county may decide whether or not to allow voters to choose if property tax extension increases should be limited. The county board can place the issue on the ballot at any election other than a consolidated primary election by passing an ordinance or resolution at least 79 days before the election. If the referendum is successful, then the Limitation Law will become applicable to those non-home rule taxing bodies having all of their equalized assessed valuation in the county beginning January 1 of the year following the date of the referendum. Villages and cities subject to the Limitation Law are able to issue limited bonds in lieu of general obligation bonds authorized by applicable law payable from a separate tax levy unlimited as to rate but limited by amount pursuant to the Limitation Law. Limited bonds are payable from the city or village’s debt service extension base (generally the amount of the non-referendum bond levy (excluding alternate bonds) for the year to which the Limitation Law first applied).
Limitation Law does not restrict referendum-approved general obligation bonds and alternate bonds.

FEDERAL INCOME TAX LAW

The Internal Revenue Code of 1986 as amended and its arbitrage and rebate regulations govern the tax-exempt status of municipal bonds. Upon issuance of any municipal bond, the city or village will covenant to follow certain federal rules and regulations in order to maintain the tax-exempt status of the bonds. These covenants include reasonable expectations that the bonds are not private activity bonds (meaning they would benefit a private entity), or arbitrage bonds (which are issued to profit from the difference between tax-exempt and taxable rates).

SECURITIES LAWS

Rule 10b-5 of the Securities Exchange Act of 1934 (the “Rule 10b-5”), states that:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme or artifice to defraud.
(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
(c) To engage in any act, practice or course of business that operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Rule 10b-5 sets out the general statement of federal intent to protect investors against misleading statements or omissions of important facts in official statements or other documents pertaining to the bond issuance. Full disclosure for bond purposes means disclosure of all information material to investors. The federal government’s MCDC effort (described below) reflected a vigorous enforcement initiative against bad disclosure practices, and targeted issuers and their officials. Issuers should adopt “best practices” to protect themselves and their officials from antifraud provisions including, but not limited to, hiring of disclosure counsel, which is a law firm that typically represents the issuer on disclosure issues, and the adoption of effective disclosure policies and procedures that ensure appropriate disclosure. Based on recent enforcement actions against big and small issuers (ranging from large states to small local municipalities), claiming “small unsophisticated issuer” as a defense may not be viable. See below for an example.

CONTINUING DISCLOSURE

Rule 15c2-12 governs the preparation and distribution of official statements for municipal securities. While this rule applies primarily to directly regulated entities such as underwriters, broker-dealers and dealer banks, a significant portion of the burden of compliance with Rule 15c2-12 falls on the issuer to supply certain information and disclosure and to take the proper steps to comply with Rule 15c2-12 in a timely fashion. As an example of the importance of meeting continuing disclosure requirements, the Securities and Exchange Commission (“SEC”) recently charged a school district in Indiana and a municipal bond underwriter with falsely stating to bond investors that the school district had been properly providing annual financial information and notices required as part of its bond offerings. The school district was ordered to cease and desist from violating securities laws and undertake remedial actions, and the underwriter agreed to a $580,000 fine along with a one year collateral bar and permanent supervisory bar for one of its employees.

The SEC’s Municipalities Continuing Disclosure Cooperation Initiative (the “MCDC Initiative”) addressed what the SEC believed to be widespread violations of the federal securities laws by municipal issuers and underwriters of municipal securities in connection with certain representations about disclosures in bond offering documents and mandated continuing disclosure post issuance. The MCDC Initiative provided issuers and underwriters an opportunity to self-report materially inaccurate statements made in final official statements regarding prior compliance with their continuing obligations as described in Rule 15c2-12. In connection with the MCDC Initiative, the SEC has released three separate waives of settlement agreements with underwriters. As of the date of this article, no settlement agreements with municipal issuers have been released in connection with the MCDC Initiative.

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