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FINANCING COMMERCIAL DEVELOPMENT IN ILLINOIS BY THE USE OF VARIOUS FORMS OF MUNICIPAL BONDS

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Difficult economic times often force real estate developers to seek new sources of financial backing. In this Article, the authors survey various options available to private commercial developers which can be obtained under the auspices of local government. Concentrating on Illinois law, the authors examine methods of bond financing, as well as tax increment financing, and offer practical considerations for would-be applicants.

As inflation continues to be a problem and financial backing for commercial development becomes difficult to procure, and expensive if it is available, alternatives to conventional financing become increasingly important. In such times, a developer must consider all available sources of aid and should not overlook financing that can be arranged with the cooperation of local governments.

The options available for municipal bond financing in Illinois depend partly on whether the community in which the project is located is a home rule community.[1] Under the Illinois Constitution of 1970[2] a home rule

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1. Home rule gives broad powers to local government. Although Illinois did not adopt this concept until 1970, it has been available in other states for a number of years, having been first used in Missouri as early as 1875. *See* MO. CONST. art. 9, § 16 (1875, amended 1945). For discussions of home rule in Illinois, see Anderson & Lousin, *From Bone Gap to Chicago: A History of the Local Government Article of the 1970 Illinois Constitution*, J. MAR. J. PRAC. & PROC. 698 (1976); Baum, *A Tentative Survey of Illinois Home Rule (Part II): Legislative Control, Transition Problems, and Intergovernmental Conflict*, 1972 U. ILL. L.F. 559; Baum, *A Tentative Survey of Illinois Home Rule (Part I): Powers and Limitations*, 1972 U. ILL. L.F. 137; Biebel, *Home Rule in Illinois After Two Years: An Uncertain Beginning*, 6 J. MAR. J. PRAC. & PROC. 253 (1973); Michael & Norton, *Home Rule in Illinois: A Functional Analysis*, 1978 U. ILL. L.F. 559; Vitullo, *Local Government: Recent Developments in Local Government Law in Illinois*, 22 DEPAUL L. REV. 85 (1972).

2. The Illinois Constitution of 1970 changed the concept of local government in Illinois in a very basic way. Prior to July 1, 1971, the effective date of this constitution, Illinois followed Dillon's Rule and treated municipal government as an appendage of the state with no power other than that expressly granted by the state legislature. *See* ILL. CONST. of 1870 art. IV, § 34 (1904). *See also* Ives v. City of Chicago, 30 Ill. 2d 582, 198 N.E.2d 518 (1964); 1 J. DILLON, MUNICIPAL CORPORATIONS § 237(89) (5th ed. 1911).

unit[3] has broader powers with regard to local financing than does a non-home rule unit.[4] Nonetheless, even in non-home rule communities the developer has several alternatives,[5] and the current trend appears to be to minimize the differences between non-home rule and home rule communities.[6]

The options available for government-assisted financing also depend on what items are being financed. More alternatives are available for financing so-called public improvements such as roads, sidewalks, and water and sewer facilities than are available for so-called private improvements such as store buildings.[7] Nonetheless, as a result of recent legislation the availability of government assistance in financing profit-centers such as retail stores has expanded.[8]

The purpose of this Article is to discuss some methods of financing commercial development in Illinois which are available with the cooperation of local government.[9] First, the possibility of obtaining funds from the sale of revenue bonds,[10] bonds issued to finance improvements in special service

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3. Municipalities which have a population in excess of 25,000 automatically have home rule powers under the Illinois Constitution of 1970, as do counties with a chief executive elected by the people. Municipalities which have a population of 25,000 or less may elect by referendum to become home rule communities and conversely any home rule community may by referendum elect to become a non-home rule community. ILL. CONST. art. VII, § 6(a), (b).

4. *See* ILL. CONST. art. VII, § 6(j)-(l). By contrast, non-home rule communities still operate under the restrictions of Dillon's Rule. *See* note 2 *supra*. *See also* Connelly v. Clark County, 16 Ill. App. 3d 947, 307 N.E.2d 128 (4th Dist. 1973).

5. Legislation exists granting non-home rule units the power to sell revenue bonds and to engage in tax increment financing. *See* Industrial Project Revenue Bond Act, ILL. REV. STAT. ch. 24, §§ 11-74-1 to -13 (1979); Commercial Renewal and Redevelopment Act, ILL. REV. STAT. ch. 24, §§ 11-74.2-1 to -19 (1979); Tax Increment Financing Act, ILL. REV. STAT. ch. 24, §§ 11-74.4-1 to -11 (1979).

6. *See* An Act to amend Sections 8-10-3, 8-10-5, 8-10-6, 8-10-7, 8-10-8, 8-10-13, 11-74-2, 11-74-3, 11-74-4, 11-74-5, 11-74-7, 11-74-9, 11-84-11, 11-74.2-2, 11-74.2-8, 11-74.2-10, 11-74.2-16, 11-131-1 and 11-143-1 of and to add Section 11-74-14 to the "Illinois Municipal Code," approved May 29, 1961, as amended, P.A. 81-1376, 1980 Ill. Legis. Serv. 831 (West) (effective August 9, 1980) [hereinafter referred to in the text as the Industrial Project Revenue Bond Act Amendment and cited as P.A. 81-1376]. *See also* text accompanying notes 33-50 *infra*.

7. *Compare* methods described in text accompanying notes 51-75 *infra with* methods described in text accompanying notes 33-50 & 78-108 *infra*.

8. *See* P.A. 81-1376, *supra* note 6.

9. This Article will not consider all methods of financial assistance available from local authorities in Illinois. For example, it will not consider such devices as tax abatement. This Article also will not consider funding available to private developers under various federal programs such as the Urban Development Grants, Community Block Grants, Urban Mass Transportation Act Funds, Federal Aid-Highways Funds and Economic Development Administration Grants for Public Works and Development Facilities. A developer, of course, should carefully consider all available options.

10. Debt incurred from the sale of revenue bonds is repaid from revenue generated by the project being financed. *See* text accompanying notes 33-50 *infra* (discussion of the use of revenue bonds).

areas,[11] general obligation bonds,[12] and bonds repaid from sales tax revenues generated by the project being financed[13] will be considered. Then, use of real estate tax increment financing[14] will be explored.

RAISING MONEY BY THE SALE OF MUNICIPAL BONDS

Raising development money through the sale of bonds issued by a local governmental unit is an option worth considering to the extent that interest paid on such issues is not taxable income for federal tax purposes.[15] Accordingly, the interest rate is usually two to three points less than the interest rate on conventional financing. Although the Revenue and Expenditure Control Act of 1968[16] greatly restricted the use of tax-exempt status for bonds financing private industrial development,[17] this Act provided an exemption for certain small issues, currently defined by the Internal Revenue Code as under ten million dollars.[18] In instances where the ten million dollar limita-

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11. Bonds used to finance special services are repaid by an increase in real estate taxes in the designated special services area. *See* text accompanying notes 51-63 *infra* (discussion of the use of special services area bonds).

12. When a governmental unit issues general obligation bonds it pledges its own credit to guarantee that the principal and interest will be paid. *See* text accompanying notes 64-74 *infra* (discussion of the use of general obligation bonds).

13. *See* text accompanying note 75 *infra*.

14. Tax increment financing is a method of financing whereby monies expended on behalf of a project are repaid by the increased real estate tax revenues generated by the improvements financed. *See* text accompanying notes 78-108 *infra* (discussion of the use of tax increment financing).

15. *See* I.R.C. § 103. Section 103(a)(1) provides the general rule that "gross income does not include interest on the obligation of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia." I.R.C. § 103(a)(1). In the past, the issuance of tax-free bonds pursuant to § 103 has been a popular financing device. More than $135 billion tax-exempt securities were outstanding by mid-1970, and in 1971 new issues totalled $24 billion. Note, *The Limited Tax-Exempt Status of Interest of Industrial Development Bonds under Subsection 103(c) of the Internal Revenue Code*, 85 HARV. L. REV. 1649 (1972). Congress and the Internal Revenue Service became concerned about this proliferation and limited use of this provision. *See id.* at 1652-54.

16. Pub. L. No. 90-364, § 107, 82 Stat. 251 (codified at I.R.C. § 103(b)).

17. For federal income tax purposes the term "industrial development bond" includes bonds issued for commercial development. *See* I.R.C. § 103(b); Treas. Reg. § 1.103-7 (1972). Section 107(b)(2) of the Revenue and Expenditure Control Act of 1968 provided that after January 1, 1969, interest on industrial development bonds would no longer be tax-exempt. I.R.C. § 103(b)(2). *See also* 33 Fed. Reg. 4950 (1968) (regulations proposed by the Internal Revenue Service, providing that interest paid on industrial revenue bonds no longer be treated as tax-exempt under § 103).

18. I.R.C. § 103(b)(6). Section 107(a) of the Revenue and Expenditure Control Act of 1968 provided a special exemption for industrial development bonds which are part of issues that are one million dollars or less, provided a substantial portion of the proceeds are not used as working capital or to finance inventory. I.R.C. § 103(b)(6). An elective provision also was added to the Code whereby the governmental unit issuing the bond could establish a ten million dollar limit for tax years beginning after 1978. The Revenue Act of 1978, Pub. L. No. 96-600, § 331, 92 Stat. 2763 (1978) (codified at I.R.C. § 103 (b)(6)(D)). Earlier, an exception had been passed

tion is not exceeded, the sale of municipal bonds may be a relatively inexpensive method of raising capital.[19]

To fall within the ten million dollar small issue exemption the balance of certain other small issues and certain capital expenditures cannot exceed ten million dollars during a six-year period.[20] In determining whether this ten million dollar limitation is exceeded the Internal Revenue Service considers public and private capital expenditures made on behalf of the bond-financed improvement or any other improvement located within the issuing governmental unit[21] and used by the same person or a related person.[22] Typically, an expenditure is considered a capital expenditure if it materially adds value to or prolongs the useful life of the property in question.[23]

Despite these restrictions, it appears that in large commercial developments anchor tenants who own their own parcels of real estate and build their own buildings can be eligible to raise money from the sale of tax-exempt bonds as long as their individual capital expenditures within the governmental unit do not exceed ten million dollars.[24] Thus, while in large regional shopping centers the project developers will not qualify for tax-free bonds since their investment normally exceeds ten million dollars, anchor stores of the center may be able to procure monies by such issues. Further, this type of funding may be available to developers of smaller commercial projects.

To the extent a project qualifies under the small issues exemption, a further advantage arises from federal securities laws. Although bond issues subject to federal securities laws must comply with cumbersome disclosure requirements, the Securities Act of 1933, as amended,[25] exempts bonds coming within the small issues exception of the Internal Revenue Code from some of these requirements.[26] As a result, the only disclosure required for

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allowing a five million dollar limit for bonds issued after October 24, 1968, provided the proper election was made by the issuing governmental unit. Renegotiations Amendments of 1968, Pub. L. No. 90-634, § 401, 82 Stat. 1345 (current version at I.R.C. § 103(b)(6)(D)).

19. The tax advantage in purchasing tax-exempt bonds increases with increases in the purchaser's taxable income. For a married couple filing a joint return in 1979, a 7% tax-exempt bond is equivalent, after taxes, to a taxable return of 9.72% if their taxable income was between $20,200 and $24,600 (20% tax bracket). If this same couple had a taxable income in excess of $215,400 (70% tax bracket), an equivalent taxable issue would have to yield 23.33% [1980 Index] STAND. FED. TAX. REP. (CCH) ¶ 278.10.

20. I.R.C. § 103(b)(6)(D)(ii). For an excellent discussion of the small issues exemption see Podolin & O'Leary, *Capital Expenditure Problems under the Ten Million Dollar Exemption for Industrial Development Bonds*, 33 TAX LAW. 153, 154 (1979).

21. I.R.C. § 103(b)(6)(E).

22. *Id.* The Code defines an exempt person as a governmental unit or organization described in § 501(c)(3) and exempt under § 501(a). *See* I.R.C. § 103(b)(3).

23. I.R.C. § 263; Treas. Reg. § 1.263(a)-1 (1960).

24. *See* IRS Private Letter Ruling 7951067 (Sept. 20, 1979).

25. 15 U.S.C. §§ 77a-77aa (1976).

26. *See* Employment Security Amendments of 1970, Pub. L. No. 91-374, § 401, 84 Stat. 695 (codified at 15 U.S.C. § 77c (1976)).

such small issues is the disclosure required in order for underwriters to sell the bonds.

Several forms of bond financing are available for improvements benefiting commercial developments in Illinois. As a result of recent legislation,[27] the Industrial Project Revenue Bond Act[28] offers the broadest possibilities and is now available in both home rule and non-home rule communities.[29] Nonetheless, other alternatives such as bonds issued in special service areas,[30] general obligation bonds,[31] and bonds repaid through sales tax revenues generated by the project being financed[32] may be available. The following sections of this Article survey these options and comment on the advantages and limitations of each.

The Use of Revenue Bonds

Revenue bonds, bonds repaid from the revenue generated by the project being financed, probably will become an important method of financing commercial development as a result of recent changes in Illinois law. Whereas prior to August 1980 the use of revenue bonds as a vehicle for financing commercial development in non-home rule communities was only available if the project was in what could be classified as a "blighted" or "historical preservation" area,[33] new legislation effective August 9, 1980,[34] significantly expanded the ability of a developer to have revenue bonds issued to raise money for projects located in non-home rule communities. By making the broad provisions of the industrial revenue bond statute applicable to commercial developments,[35] Illinois law now affords commercial real estate developers the same options available to developers of industrial projects. Further, the new legislation grants non-home rule communities almost

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27. *See* P.A. 81-1376, *supra* note 6.

28. *See* text accompanying notes 33-50 *infra*.

29. *See* ILL. REV. STAT. ch. 24, § 11-74-2(2) (1979).

30. *See* text accompanying notes 51-63 *infra*.

31. *See* text accompanying notes 64-74 *infra*.

32. *See* text accompanying note 75 *infra*.

33. *See* ILL. REV. STAT. ch. 24, § 11-74.2-16 (1979). The more liberal provisions of the Industrial Project Revenue Bond Act did not apply to commercial developments. *See* ILL. REV. STAT. ch. 24, §§ 11-74-1 to -13 (1979).

34. P.A. 81-1376, *supra* note 6.

35. *See* ILL. REV. STAT. ch. 24, § 11-74-2(1) (1979), *as amended by* P.A. 81-1376, *supra* note 6. The amended Act provides in relevant part that "industrial project" means any

> (a) capital project, including one or more buildings and other structures, improvements, machinery and equipment whether or not on the same site or sites now existing or hereafter acquired, suitable for use by any manufacturing, industrial, research or commercial enterprise, including but not limited to, use as a factory, mill, processing plant, assembly plant, packaging plant, fabricating plant, office building, industrial distribution center, warehouse, repair, overhaul or service facility . . . or (b) any land, buildings, machinery or equipment comprising an addition to, or renovation, rehabilitation or improvement of any existing capital project.

Id.

the same powers as home rule municipalities to issue revenue bonds[36] and probably renders the statute governing the issuance of revenue bonds to encourage commercial projects in blighted or historical preservation areas[37] obsolete.[38]

Issuing bonds pursuant to the revised Industrial Project Revenue Bond Act is especially attractive because of the wide range of items that the revenue generated from the sale of bonds may finance. Under this Act, bonds may be sold to pay for buildings and other structures and improvements, improved and unimproved sites, "site preparation and landscaping, and all appurtenances and facilities incidental thereto" including access roads and parking facilities and "any land, buildings, machinery or equipment comprising an addition to, or renovation, rehabilitation or improvement of any existing capital project."[39] Thus bonds issued pursuant to the Industrial Project Revenue Bond Act may finance the actual profit-centers—the retail store buildings. This is in distinct contrast to bonds issued pursuant to the Special Services Area Act,[40] general obligation bonds,[41] and bonds which are repaid by the sales tax revenues generated by the project being financed.[42] These latter bonds may only be used to finance public improvements such as roads, sidewalks, parking areas, and water and sewer facilities.[43]

Bonds issued pursuant to the revised Industrial Project Revenue Bond Act have the additional advantage of not being limited as to how much interest their holders can receive.[44] Bonds issued by local government units pursuant to certain other statutes such as the Commercial Renewal and Redevelopment Act[45] are limited as to how much interest they can pay.[46]

To qualify for revenue bond financing under the revised Industrial Project Revenue Bond Act, rent and other revenue generated by the project must

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36. Home rule units have broad constitutional authority to issue revenue bonds whereas non-home rule units must have statutory authority to do so. *See* note 4 *supra*. Nonetheless, as a result of the Industrial Project Revenue Bond Act Amendments, non-home rule units now have power commensurate, although not identical, with home rule communities with regard to the issuance of revenue bonds. *See* P.A. 81-1376, *supra* note 6.

37. ILL. REV. STAT. ch. 24, §§ 11-74.2-1 to -19 (1979).

38. Because the purpose of the Commercial Renewal and Redevelopment Act is restricted to "the eradication and elimination of commercial blight areas and the construction of redevelopment projects and commercial projects in these areas" and because this Act limits interest payable on its bonds to 9%, developers undoubtedly will seek to have bonds issued pursuant to the less restrictive Industrial Project Revenue Bond Act. *Compare* ILL. REV. STAT. ch. 24, § 11-74.2-1(e) (1979) *with* ILL. REV. STAT. ch. 24, § 11-74-5 (1979), *as amended by* P.A. 81-1376, *supra* note 6.

39. ILL. REV. STAT. ch. 24, § 11-74-2 (1979), *as amended by* P.A. 81-1376, *supra* note 6.

40. *See* text accompanying notes 51-63 *infra*.

41. *See* text accompanying notes 64-74 *infra*.

42. *See* text accompanying note 75 *infra*.

43. *See* text accompanying notes 51-75 *infra*.

44. *See* ILL. REV. STAT. ch. 24, § 11-74-5 (1979), *as amended by* P.A. 81-1376, *supra* note 6. The amended Act states that "bonds shall bear interest at such rate or rates without regard to any limitation in any other law. . . ." *Id.*

45. ILL. REV. STAT. ch. 24, § 11-74.2-1 to -19 (1979).

46. *See id.* § 11-74.2-16.

be sufficient to repay the principal when due and to pay interest as required by terms of the issue.[47] The project also must generate sufficient revenue to provide for its operation and maintenance, including an allowance for depreciation.[48]

Because under Illinois law borrowing evidenced by revenue bonds is not treated as the debt of the issuing community,[49] local government generally will cooperate with developers who request that such bonds be issued. Nonetheless, because the payment of interest and principal is not guaranteed by local government, use of revenue bonds is a viable alternative only when the marketplace has confidence that the revenue seeker is creditworthy and purchase of its bonds is warranted. When commercial development is financed in the private sector, a developer is commonly able to secure permanent non-recourse financing. It is possible, however, when such a development is financed in the public sector that a developer may have to supplement the creditworthiness of its tenant with some kind of personal guaranty.

Prior to the recent broadening of the Industrial Project Revenue Bond Act to include commercial developments, developers sometimes secured bond financing through the services of a neighboring home rule community acting pursuant to extraterritorial powers which have been attributed to these communities,[50] and such developers typically paid a fee to the home rule community for this accommodation. The revision to the Industrial Project Revenue Bond Act is likely to have the effect of eliminating use of this extraterritorial role for home rule units.

In short, the recent amendment to the Industrial Project Revenue Bond Act has broadened the scope of developer activities that may be financed and has substantially equalized the status of developers in home rule and non-home rule communities. The revised Act offers many possibilities for financing improvements that benefit commercial developments through the sale of industrial revenue bonds. During inflationary times these bonds may become a significant alternative source of commercial development financing.

The Use of Bonds Issued to Fund Special Services

The Illinois Constitution of 1970 authorizes both home rule and non-home rule communities to issue bonds to finance special services. Both types of communities may "levy or impose additional taxes upon areas within their boundaries in the manner provided by law for the provision of special services to those areas and for the payment of debt incurred in order to provide

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47. *Id., as amended by* P.A. 81-1376, *supra* note 6.

48. *Id.*

49. Revenue bonds are not guaranteed by the issuing governmental units. *See generally* R. LAMB & S. RAPPAPORT, MUNICIPAL BONDS 221 (1980).

50. *See, e.g.*, City of Salem v. McMackin, 52 Ill. 2d 347, 365-66, 291 N.E.2d 807, 818 (1972).

these special services."[51] The state legislature passed enabling legislation in support of the constitutional grants in 1973.[52]

Bonds issued to finance special services are repaid by an increase in real estate taxes in the designated special services area. Because the interest and principal are funded in this manner, these bonds are most attractive in instances where the developer is able to pass real estate taxes on to its tenants.

Unlike bonds issued pursuant to the Industrial Project Revenue Bond Act, bonds issued under the Special Services Area Act apparently may not be issued to finance the profit centers of a commercial development such as retail store buildings. Rather, the Act limits its bonds to the financing of "special services" which it defines as "all forms of services pertaining to the government and affairs of the municipality or county, including but not limited to improvements permissible under Article 9 of the Illinois Municipal Code."[53] Moreover, the Illinois Attorney General has advised non-home rule communities that they may use such a tax only to finance projects which they have the statutory authority to undertake. This interpretation presumably limits non-home rule communities to financing such local improvements as streets, curbs, gutters, sanitary and storm sewers, water mains, gas mains, street lights, sidewalks, and the necessary appurtenances thereto.[54]

Home rule communities, relying on the language in the Illinois Constitution of 1970 authorizing municipalities to "exercise any power and perform any function pertaining to the government and affairs [of the municipality],"[55] may also be able to finance improvements such as traffic controls and possibly public parking lots and parking structures. It is fair to conclude that special service area taxes are given the same general treatment as special assessments[56] except that they are not separately billed but are itemized on the general real estate tax bills.

The Illinois Supreme Court has upheld the use of municipal bonds to fund special services in a commercial development. In *Coryn v. City of Moline*,[57]

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51. ILL. CONST. art. VII, §§ 6(e)(2) (home rule), 7(6) (non-home rule).

52. Act of Sept. 21, 1973, §§ 1-11, ILL. REV. STAT. ch. 120, §§ 1301-1310 (1979) [hereinafter cited as Special Services Area Act]. Prior to the effective date of the Special Services Area Act, legislation specifying the procedure for implementing power granted pursuant to article VII, section 6(1)(2) of the Illinois Constitution of 1970 had not been passed. This led the Illinois Supreme Court to hold that special service taxes could not be levied because no statutory procedure had been established. *See* Oak Park Sav. & Loan Ass'n. v. Village of Oak Park, 54 Ill. 2d 200, 296 N.E.2d 344 (1973). Passage of the Special Services Area Act has eliminated this problem.

53. ILL. REV. STAT. ch. 120, § 1302 (1979).

54. 1975 Op. Att'y Gen. No. S-951.

55. ILL. CONST. art. VII, § 6(a). Section 6(*l*)(1) of the Illinois Constitution provides that the General Assembly may not limit the power of a home rule unit "to make local improvements by special assessment and to exercise this power jointly with other counties and municipalities, and other classes of units of local government having that power on the effective date of this Constitution unless that power is subsequently denied by law to any such other units of local government." *Id.* § 6(*l*)(1).

56. *See* ILL. CONST. art. VII, § 6(*l*)(2).

57. 71 Ill. 2d 194, 374 N.E.2d 211 (1978).

the court rejected the argument that because the city as a whole, rather than the declared special services area in particular, would benefit, a shopping mall could not qualify for treatment as a "special service"[58] and that such financing would amount to a deprivation of property without due process.[59] In upholding the power of the City of Moline to declare a special services area in the manner it did, the Illinois Supreme Court stated that an area can be declared a special services area even though the project being financed benefits the entire community.[60] The court further stated that the taxes imposed on property within a declared special services area "need not directly correspond to the monetary value of the benefits received."[61] In reaching this decision, the court applied a rational basis test[62] and stated that "the mere alleged excess of additional taxes payable over additional services received does not render the whole scheme of taxation irrational and unconstitutional."[63]

Thus, when a developer is evaluating its options with regard to financing, it should not overlook the possibility of financing items that could be considered special services through the sale of municipal bonds issued pursuant to the Special Services Area Act. This alternative should especially be considered in situations where real estate taxes are paid by the tenants.

The Use of General Obligation Bonds

In addition to raising money through establishment of a special services area, a home rule community can aid in the financing of certain improvements benefiting a commercial development by issuing general obligation bonds. The power to do so is set forth in article VII, section 6(a) of the Illinois Constitution.[64] This section provides that:

> Except as limited by this Section, a home rule unit may exercise any power and perform any function pertaining to its government and affairs including, but not limited to, the power to regulate for the protection of the public health, safety, morals and welfare; to license; to tax; *and to incur debt*.[65]

The key to being eligible to finance improvements by the sale of general obligation bonds is whether the revenue generated will be used for a proper

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58. *Id.* at 198-99, 374 N.E.2d at 213.

59. *Id.* at 199, 374 N.E.2d at 213.

60. *Id.* at 201-02, 374 N.E.2d at 214.

61. *Id.* at 202, 374 N.E.2d at 214.

62. The court stated that the due process and equal protection clauses of the Illinois and federal constitutions only required that there be a "rational basis" for taxing a given area for special services. *Id.*

63. *Id.* Because the City of Moline is a home rule unit, the supreme court's decision extended only to a home rule unit's power to create special services areas. Therefore, the *Coryn* decision does not address the breadth of the power accorded non-home rule units to create special services areas.

64. *See* ILL. CONST. art. VII, § 6(a).

65. *Id.* (emphasis added).

governmental purpose. Although general obligation bonds cannot be used to fund the building of a department store in an affluent community, the Illinois Supreme Court has been liberal in what it will uphold as a proper public purpose. In *City of Urbana v. Paley*,[66] the court upheld the constitutionality of general obligation bonds to be issued to raise money so that land in a blighted area could be acquired by the City.[67] Once acquired, this land was to be leased to private developers.[68] In reaching its conclusion, the court in *Paley* stated:

> [T]oday's decision denotes that the application of the public-purpose doctrine to sanction urban redevelopment can no longer be restricted to areas where crime, vacancy, or physical decay produce undesirable living conditions or imperil public health. Stimulation of commercial growth and removal of economic stagnation are also objectives which enhance the public weal.[69]

Further, the court stated that to constitute a public purpose blight need not have occurred or reached its apex[70] and that the existence of a public purpose is not defeated "by the use to which the land will subsequently be put, including nonresidential development, or sale or lease to private interests for redevelopment after acquisition."[71]

The court had no trouble finding a public purpose for the *Paley* bonds. Both the Mayor and the City had agreed that Urbana was suffering from rather severe urban blight.[72] To deal with this problem, the City had hired a consultant.[73] The court noted the consultant's recommendation that a major renewal effort be undertaken and its conclusion that, unless this were done, the central city area would suffer from further deterioration which would eventually result in the cost of services provided to the area being greater than the tax revenues generated.[74]

Despite *Paley*, however, raising money for a commercial development through the sale of general obligation bonds has a serious drawback in that it may be difficult to persuade a community to pledge its own credit for the benefit of a private developer. While such financing may be feasible in certain situations, as where employment or urban renewal are involved, in the majority of situations a local government will be reluctant to issue such bonds.

The Use of Bonds Repaid by Sales Tax Revenues

Another way a local governmental unit may aid in financing commercial development is by issuing bonds that will be repaid by sales taxes generated

66. 68 Ill. 2d 62, 368 N.E.2d 915 (1977).
67. *Id.* at 78, 368 N.E.2d at 922.
68. *Id.* at 74, 368 N.E.2d at 920.
69. *Id.* at 74-75, 368 N.E.2d at 920-21.
70. *Id.* at 73, 368 N.E.2d at 920.
71. *Id.* at 74, 368 N.E.2d at 920.
72. *Id.* at 66, 368 N.E.2d at 916.
73. *Id.*
74. *Id.*

by the completed project. Although no statutory authority for this type of financing exists, some developers have been able to persuade local authorities to commit a portion of the sales tax revenues that will be generated by the project for repayment of the debt incurred in building it. Because local government typically is hesitant to commit itself in this way, a developer is most likely to procure this type of financing if local officials are convinced that without it the project will not be built in their community.

Like bonds sold to finance special assessments and general obligation bonds, revenue from the sale of bonds which are to be repaid from sales tax revenues can only be used to finance public improvements. The rationale for this restriction is that sales tax revenues are needed to repay the developer for assuming the responsibility for installing public improvements which would otherwise have been the responsibility of the municipality. Consequently, such bonds do not offer as much flexibility as bonds issued pursuant to the Industrial Project Revenue Bond Act.[75]

The Use of Tax Increment Financing

Tax increment financing, a method of raising money whereby local government assumes financial responsibility and is repaid by the increase in real estate taxes which occurs as a result of the property increasing in value, is another source of funding that may be available with the cooperation of local government. Although this method of financing has been used in other states for a number of years,[76] the Illinois legislature did not adopt it until 1977.[77]

Tax increment financing was authorized in Illinois by the Real Property Tax Increment Allocation Redevelopment Act.[78] Its use is limited by this statute to blighted and conservation areas.[79] Nonetheless, if the development is located in such an area, tax increment financing can be very attractive in that it may be used for items government does not ordinarily finance such as the acquisition of land, restoration of buildings, and construction of parking areas, as well as to pay architectural, engineering and legal fees and to provide various public improvements.[80] A further advantage of this method of financing is that it provides the developer with funds to be repaid through real estate taxes which would, under any circumstances, have been the obligation of the developer. Thus, unlike the forms of government

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75. ILL. REV. STAT. ch. 24, §§ 11-74-1 to -13 (1979). *See* text accompanying notes 33-50 *supra*.

76. *See, e.g.*, CAL. CONST. art. XVI, § 16 (authorizing tax increment financing); CAL. HEALTH & SAFETY CODE § 33670 (West 1973) (state law implementing tax increment financing); MINN. STAT. §§ 462.585(1)-(4), 474.10 (1974) (state law authorizing tax increment financing).

77. The Illinois legislature provided for tax increment financing in the Real Property Tax Increment Allocation Redevelopment Act, ILL. REV. STAT. ch. 24, §§ 11-74.4-1 to -11 (1979), which became effective January 10, 1977.

78. *Id.*

79. *Id.* § 11-74.4-2.

80. *Id.* § 11-74.4-3(i).

financing previously discussed in this Article, tax increment financing imposes no new burdens on developers.

To qualify for tax increment financing, the area in which the proposed development is to be built must be designated as a "redevelopment project area."[81] The Illinois statute defines a redevelopment project area to be an area not less than one and one-half acres which can be classified either as a blighted or conservation area.[82] The statute is very specific as to what constitutes a blighted or conservation area, thus making the use of tax increment financing unavailable in many situations.

To be considered a blighted area, an area which contains industrial, commercial, and residential buildings or improvements must be "detrimental to the public safety, health, morals or welfare"[83] as a result of at least five of the following fourteen factors: (1) age; (2) dilapidation; (3) obsolescence; (4) deterioration; (5) illegal use of individual structures; (6) presence of structures below minimum code standards; (7) excessive vacancies; (8) overcrowding of structures and community facilities; (9) lack of ventilation, light or sanitary facilities; (10) inadequate utilities; (11) excessive land coverage; (12) deleterious land use or layout; (13) depreciation of physical maintenance; and (14) lack of community planning.[84] For a vacant area to be considered blighted, the statute requires that the area qualify as blighted immediately prior to being vacated or that the sound growth of taxing districts be impaired by a combination of at least two of four enumerated factors: (1) obsolete platting of the vacant land; (2) diversity of ownership of such land; (3) tax and special assessment delinquencies on such land; and (4) deterioration of structures or site improvements in neighboring areas adjacent to the vacant land.[85]

Basically the statute treats a conservation area as one not yet blighted but having the potential to become so.[86] Specifically, to qualify as a conservation area, fifty percent or more of the structures in the area must be at least thirty-five years old and must have the potential of becoming blighted as a result of the existence of at least three of the same fourteen factors listed by the statute as causing blight.[87]

If the project area can be classified as a blighted or a conservation area, financing projects pursuant to the tax increment financing statute offers a wide range of possibilities. The Act provides that obligations may be issued

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81. *Id.* § 11-74.4-8. A redevelopment project area is
> an area designated by the municipality, which is not less in the aggregate than 1½ acres and in respect to which the municipality has made a finding that there exists conditions which cause the area to be classified as a blighted area or a conservation area, or a combination of both blighted areas and conservation areas.

Id. § 11-74.4-3(h).

82. *Id.*

83. *Id.* § 11-74.4-3(a).

84. *Id.*

85. *Id.*

86. *Id.* § 11-74.4-3(b).

87. *Id.* See text accompanying note 84 *supra*.

to pay for "redevelopment project costs" which are statutorily defined to include:

> (1) Costs of studies, and surveys, plans, and specifications; professional service costs including but not limited to architectural, engineering, legal, marketing, financial, planning or special services;
>
> (2) Property assembly costs, including but not limited to acquisition of land and other property, real or personal, or rights or interests therein, demolition of buildings, and the clearing and grading of land;
>
> (3) Costs of rehabilitation, reconstruction or repair or remodeling of existing buildings and fixtures;
>
> (4) Costs of the construction of public works or improvements;
>
> (5) Financing costs, including but not limited to all necessary and incidental expenses related to the issuance of obligations and which may include payment of interest on any obligations issued hereunder accruing during the estimated period of construction of any redevelopment project for which such obligations are issued and for not exceeding 18 months thereafter and including reasonable reserves related thereto;
>
> (6) All or a portion of a taxing district's capital costs resulting from the redevelopment project necessarily incurred or to be incurred in furtherance of the objectives of the redevelopment plan and project, to the extent the municipality by written agreement accepts and approves such costs;
>
> (7) Relocation costs to the extent that a municipality determines that relocation costs shall be paid or is required to make payment of relocation costs by federal or State law; and
>
> (8) Payment in lieu of taxes.[88]

A major advantage of tax increment financing is that the increase in taxes attributable to improvements financed is used to repay the development costs.[89] After the property is developed and reassessed for tax purposes, tax revenues in excess of the amount which would have been levied had the property not been improved are placed in a "special tax allocation fund."[90] Any surplus funds remaining in this special tax allocation fund after redevelopment costs have been fully repaid are disbursed in the same manner and proportion as would have been the case had regular disbursement procedures been used.[91]

The Illinois Supreme Court recently rejected a challenge to the constitutionality of the tax increment financing statute. In *City of Canton v. Crouch*,[92] a majority of the court stated that while tax increment financing is a " 'novel proposition' " they were unable to conclude that it violates any constitutional provision.[93] The *Canton* case grew out of an attempt by the Canton City Council to provide financial assistance for redevelopment of a part

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88. *Id.* § 11-74.4-3(i).
89. *See id.* § 11-74.4-8(b).
90. *Id.*
91. *Id.*
92. 79 Ill. 2d 356, 403 N.E.2d 242 (1980).
93. *Id.* at 363, 403 N.E.2d at 245.

of its downtown area. The area in question consisted of nine blocks containing numerous dilapidated buildings, many of which had structural deficiencies and violated prevailing building codes. In 1978, the Canton City Council, acting pursuant to the tax increment financing statute, designated the downtown property a "redevelopment project area"[94] and authorized the sale of tax allocation bonds with a face value of $50,000. The lawsuit arose when Canton's Mayor refused to execute the bonds.[95]

Although the Illinois Supreme Court affirmed the constitutionality of the Illinois Act,[96] members of the court were not in agreement in reaching this result.[97] One of the Mayor's arguments was that revenues collected by special taxing districts should only be used to advance the purpose for which such districts were created and not to fund any other endeavors.[98] Justices Clark and Moran agreed with this line of reasoning[99] and concluded that the Tax Increment Financing Act "authorizes an invasion of the fiscal integrity of the various taxing districts."[100] They were critical of the fact that the tax increment financing statute permitted tax revenues generated in one taxing district to be diverted to another district without the consent of the taxpayers.[101]

Nonetheless, a majority of the court cited language in the 1970 Illinois Constitution that permits one governmental unit to use the funds of another.[102] The court explained that this provision was intended to permit such events as the taxation scheme embraced in the tax increment financing statute.[103] In concluding that the Illinois Act served a public purpose, the court cited the *City of Urbana v. Paley* decision.[104] The majority emphasized that under the tax increment financing scheme only those revenues raised by implementation of a development plan may be used to fund the special tax allocation fund.[105] Therefore, the court reasoned, only taxpayers

94. *See* notes 81-88 and accompanying text *supra*.

95. 79 Ill. 2d at 359, 403 N.E.2d at 243.

96. *Id.* at 378, 403 N.E.2d at 252.

97. *See id.* at 378-82, 403 N.E.2d at 253-54 (Clark & Moran, JJ., dissenting).

98. *Id.* at 364, 403 N.E.2d at 246.

99. *See id.* at 378-82, 403 N.E.2d at 253-54 (Clark & Moran, JJ., dissenting).

100. *Id.* at 379, 403 N.E.2d at 253 (Clark & Moran, JJ., dissenting).

101. *Id.* at 380-81, 403 N.E.2d at 253-54 (Clark & Moran, JJ., dissenting).

102. *See* ILL. CONST. art. VII, § 10(a). Section 10(a) provides:

> Units of local government and school districts may contract or otherwise associate among themselves, with the State, with other states and their units of local government and school districts, and with the United States to obtain or share services and to exercise, combine, or transfer any power or function, in any manner not prohibited by law or by ordinance. Units of local government and school districts may contract and otherwise associate with individuals, associations, and corporations in any manner not prohibited by law or by ordinance. Participating units of government may use their credit, revenues, and other resources to pay costs and to service debt related to intergovernmental activities.

103. 79 Ill. 2d at 366, 403 N.E.2d at 247.

104. *Id.* at 364, 403 N.E.2d at 246 (citing City of Urbana v. Paley, 68 Ill. 2d 62, 368 N.E.2d 915 (1977)). For a discussion of *Paley*, see notes 66-74 and accompanying text *supra*.

105. 79 Ill. 2d at 370, 403 N.E.2d at 249.

directly benefiting from the redevelopment actually pay the taxes to the municipality.[106] The majority also refuted the Mayor's arguments that the Illinois Act was vague and indefinite[107] and violated the separation of powers clause of the Illinois Constitution.[108]

The concept of tax increment financing has been criticized on a number of grounds in addition to the objections raised in *Canton*.[109] Some critics have suggested that financing under this method offers a greater potential for abuse by local officials than federal grant programs, especially in those situations where a project is economically feasible even without public aid.[110] Others have criticized the relative ease with which tax increment financing may be implemented.[111] Proponents of this line of reasoning argue that if economic conditions or priorities change, the public body authorizing tax increment financing may find itself saddled with a debt requiring the commitment of tax revenues in a manner that does not represent their best possible use.[112] Finally, some critics have suggested that if the project financed through the tax increment method is unsuccessful, public funds may be wasted.[113] Critics taking this approach contend that the public authority would be obligated to assume primary responsibility for a project's outstanding debt if the developer fails to pay property taxes or if the tax increment added as a result of the development is insufficient to repay the amount owed.[114]

Although criticism of tax increment financing may have some validity, the problems raised can be solved by establishing and enforcing meaningful controls.[115] Despite drawbacks that may exist, the development encouraged by the availability of this method of financing can benefit an entire community.[116] Tax increment financing offers a municipality the possibility of re-

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106. *Id.* at 371, 403 N.E.2d at 249.

107. *Id.* at 372, 403 N.E.2d at 249-50.

108. *Id.*

109. *See* text accompanying notes 100-105 *supra*.

110. *See* Davidson, *Tax Increment Financing as a Tool for Community Redevelopment*, 56 J. URBAN L. 405, 408 (1979).

111. *Id.* at 443.

112. *Id.*

113. *Id.* at 413.

114. *Id.*

115. A municipality or the state can check potential abuses by setting stringent requirements which must be met in order for a developer to qualify for tax increment financing. Further, the municipality can carefully monitor use of the funds provided pursuant to this type of financing arrangement.

116. *See, e.g.*, Richards v. City of Muscatine, 237 N.W.2d 48 (Iowa 1975) (upholding tax increment financing); Miller v. Covington Dev. Auth., 539 S.W.2d 1 (Ky. 1976) (holding that the state's tax increment financing law violates the state's constitution); Sigma Tau Gamma Fraternity House v. City of Menomonie, 93 Wis. 392, 288 N.W.2d 85 (1980) (upholding the Wisconsin statute authorizing tax increment financing). In *Sigma Tau Gamma*, the Wisconsin Supreme Court concluded that since all taxpayers continue to be taxed at a uniform rate applied to valuations which are uniformly set, tax increment financing does not have a disproportionate impact on taxpayers within the same taxing unit. *Id.* at 412, 288 N.W.2d at 93-94.

juvenating a blighted area without directly expending its own monies or bringing each project directly to the voters for approval. The recipients of property tax revenue continue to receive the same amount of funds they would ordinarily receive, plus additional tax revenues generated by financing the project. Further, as property is improved, the market value of surrounding property typically will also appreciate. Tax increment financing offers the developer a relatively attractive source of money when funds might otherwise be unavailable or very costly. In addition, it may provide governmental assistance that avoids some of the "red tape" and delay often associated with federal programs.

CONCLUSION

This Article has assumed the ready marketability of the municipal bonds in question, which is not always the circumstance.[117] Developers in situations where the bonds are not readily marketable may be tempted to purchase all or part of the bond issues themselves. Purchases of bonds by the developer should not be undertaken casually, however, because such purchases may affect the tax exempt status of the bonds. Every effort should be made to effect the sale of the bonds to third parties—usually wealthy individuals, banks, insurance companies, pension funds, and employee benefit plans.

Clearly, a commercial developer should not overlook the various Illinois schemes for financing private developments with municipal assistance that have been examined in this Article. Although many of the Illinois statutes contain limitations based upon the situs of the project or upon the nature of the financed activities, the recent amendments to the Industrial Project Revenue Bond Act greatly undercut the validity of such distinctions. The use of government issued bonds and tax increment financing may be attractive alternatives to pursue. With the advice of knowledgeable bond and tax counsel, development may continue despite current financial uncertainties.

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117. *See generally* R. LAMB & S. RAPPAPORT, MUNICIPAL BONDS 27-74 (1980).