

*In the opinion of Sonnenschein Nath & Rosenthal LLP, Chicago, Illinois and Charity and Associates, P.C., Chicago, Illinois, Co-Bond Counsel, subject to compliance with certain covenants made by the Board to satisfy pertinent requirements of the Internal Revenue Code of 1986, as amended, under present law, interest on the Bonds will not be includible in the gross income of the owners thereof for federal income tax purpose. Interest on the Bonds will not be included as an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. However, interest on the Bonds will be included in "adjusted current earnings" of certain corporations for purposes of computing alternative minimum tax for such corporations. Interest on the Bonds is not exempt from income taxes imposed by the State of Illinois. See the caption "TAX EXEMPTION" herein regarding a description of other tax considerations.*



**\$355,805,000**  
**BOARD OF EDUCATION OF THE**  
**CITY OF CHICAGO**  
**Unlimited Tax General Obligation Bonds**  
**(Dedicated Revenues),**  
**Series 2006B**

**Dated: Date of Issuance****Due: December 1, as set forth on the inside cover**

The Bonds will be issued as fully registered bonds and will be registered in the name of Cede & Co., the nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Bonds. The Bonds will be issued in denominations of \$5,000 or any integral multiple thereof. Purchases of Bonds will be made in book entry form through DTC participants only in authorized denominations. No physical delivery of Bonds will be made to purchasers. See "THE BONDS Book Entry Only System."

Interest on the Bonds will be payable on each June 1 and December 1, commencing June 1, 2007. Principal of, redemption premium, if any, and interest on the Bonds will be paid by Wells Fargo Bank, N.A., as trustee, bond registrar and paying agent for the Bonds, to DTC, which in turn will remit such payments to its participants for subsequent distribution to the beneficial owners of the Bonds.

The Bonds will be subject to optional and mandatory sinking fund redemption prior to maturity as described in this Official Statement.

The proceeds from the sale of the Bonds will be used to (i) provide funds for the continued implementation of the Board's Capital Improvement Program (as described herein) and (ii) pay costs of issuance of the Bonds, including bond insurance premium. See "BOARD OF EDUCATION OF THE CITY OF CHICAGO Capital Improvement Program" and "THE BONDS Estimated Sources and Uses of Funds."

The Bonds will be a general obligation of the Board to the payment of which the Board has pledged its full faith and credit. The Bonds will be payable from Pledged State Aid Revenues and Pledged Taxes, all as described herein. To the extent that the Pledged State Aid Revenues are insufficient to pay the debt service on the Bonds, the Bonds will be payable from ad valorem taxes levied by the Board, without limitation as to rate or amount, against all of the taxable property in the school district governed by the Board, the boundaries of which are coterminous with the boundaries of the City of Chicago. The Bonds are also payable from all Funds, Accounts and Sub-Accounts (each as defined in Appendix B hereto) established pursuant to the Indenture as security for the Bonds. See "SECURITY FOR THE BONDS."

The scheduled payment of principal of and interest on the Bonds maturing on and after December 1, 2008, when due, will be guaranteed under an insurance policy to be issued concurrently with the delivery of the Bonds by Financial Security Assurance Inc. The Bonds maturing on December 1, 2007 will not be insured. See "BOND INSURANCE."



**The maturities, amounts, interest rates and yields of the Bonds are set forth on the inside cover.**

The Bonds are being offered when, as and if issued and received by the Underwriters, subject to the delivery of the approving legal opinion of Sonnenschein Nath & Rosenthal LLP, Chicago, Illinois and Charity and Associates, P.C., Chicago, Illinois, Co-Bond Counsel. Certain legal matters will be passed upon for the Board by its General Counsel, Patrick J. Rocks, and by its special counsel, Gardner Carton & Douglas, LLP, Chicago, Illinois; and for the Underwriters by their Co-Counsel, DLA Piper Rudnick Gray Cary US LLP, Chicago, Illinois and Burris, Wright, Slaughter & Tom, LLC, Chicago, Illinois. Delivery of the Bonds is expected to be made through the facilities of DTC in New York, New York, on or about September 27, 2006.

**JPMorgan**

**Cabrera Capital Markets**

**Loop Capital Markets, LLC**

**Citigroup**

**George K. Baum & Company**

**Raymond James & Associates, Inc.**

**Siebert Brandford Shank & Co., LLC**

**\$355,805,000**  
**BOARD OF EDUCATION OF THE**  
**CITY OF CHICAGO**  
**Unlimited Tax General Obligation Bonds**  
**(Dedicated Revenues),**  
**Series 2006B**

**MATURITIES, AMOUNTS, INTEREST RATES, YIELDS AND CUSIPS**

<u>Maturity</u> <u>December 1</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Yield</u>	<u>CUSIP<sup>(1)</sup></u>
2007*	\$2,745,000	4.25%	3.64%	1675015H4
2008	5,915,000	4.25	3.61	1675015JO
2009	6,170,000	4.25	3.64	1675015K7
2010	6,430,000	5.00	3.67	1675015L5
2011	6,750,000	4.00	3.70	1675015M3
2012	7,020,000	4.00	3.75	1675015N1
2013	7,305,000	4.00	3.81	1675015P6
2014	7,595,000	5.00	3.87	1675015Q4
2015	7,975,000	5.00	3.92	1675015R2
2016	8,375,000	5.00	3.97	1675015SO
2017	8,795,000	5.00	4.04 <sup>+</sup>	1675015T8
2018	9,230,000	5.00	4.09 <sup>+</sup>	1675015U5
2019	9,695,000	5.00	4.13 <sup>+</sup>	1675015V3
2020	10,180,000	5.00	4.17 <sup>+</sup>	1675015W1
2021	10,685,000	5.00	4.21 <sup>+</sup>	1675015X9
2022	11,220,000	5.00	4.24 <sup>+</sup>	1675015Y7
2023	11,785,000	5.00	4.27 <sup>+</sup>	1675015Z4
2024	12,370,000	5.00	4.29 <sup>+</sup>	1675016A8
2025	12,990,000	5.00	4.31 <sup>+</sup>	1675016B6
2026	13,640,000	5.00	4.33 <sup>+</sup>	1675016C4
2027	14,320,000	5.00	4.34 <sup>+</sup>	1675016D2
2028	15,040,000	4.75	4.51 <sup>+</sup>	1675016EO
2029	15,750,000	4.75	4.54 <sup>+</sup>	1675016F7
2030	16,500,000	4.75	4.56 <sup>+</sup>	1675016G5
2031	17,285,000	4.75	4.58 <sup>+</sup>	1675016H3
2036	22,005,000	4.50	4.66	1675016K6

\$78,035,000 5.000% Term Bonds due December 1, 2035; Yield 4.47%<sup>+</sup>; CUSIP<sup>(1)</sup> 1675016J9.

<sup>(1)</sup> Copyright 2006, American Bankers Association. CUSIP data herein is provided by Standard & Poor's, CUSIP Service Bureau, a Division of The McGraw-Hill Companies, Inc.

\*Bonds maturing on December 1, 2007 are not insured.

<sup>+</sup>Priced to the optional redemption date of December 1, 2016.

## **REGARDING USE OF THIS OFFICIAL STATEMENT**

No dealer, broker, salesperson, or other person has been authorized by the Board or the Underwriters to give any information or to make any representation with respect to the Bonds, other than those contained in this Official Statement, and, if given or made, such other information or representation must not be relied upon as having been authorized by any of the foregoing. This Official Statement is neither an offer to sell nor the solicitation of an offer to buy, nor shall there be any sale of the Bonds offered hereby, by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale. The information and expressions of opinion set forth herein have been furnished by the Board and include information from other sources that the Board believes to be reliable. Such information is not guaranteed as to accuracy or completeness, and is not to be construed as a representation by the Underwriters. Such information and expressions of opinion are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall under any circumstances create any implication that there has been no change since the date hereof. Neither this Official Statement nor any statement that may have been made verbally or in writing is to be construed as a contract with the registered or beneficial owners of the Bonds.

This Official Statement should be considered in its entirety. All references herein to laws, agreements and documents are qualified in their entirety by reference to the definitive forms thereof, and all references to the Bonds are further qualified by reference to the information with respect thereto contained in the Indenture for the Bonds. A copy of the Indenture for the Bonds is available for inspection at the offices of the Board and the Trustee. The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information. The information contained herein is provided as of the date hereof and is subject to change.

These securities have not been recommended by any federal or state securities commission or regulatory authority. Furthermore, the foregoing authorities have not confirmed the accuracy or determined the adequacy of this document. Any representation to the contrary is a criminal offense.

IN CONNECTION WITH THE OFFERING OF THE BONDS, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS THAT STABILIZE OR MAINTAIN THE MARKET PRICES OF THE BONDS OFFERED HEREBY AT LEVELS ABOVE THOSE THAT MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME. THE UNDERWRITERS MAY OFFER AND SELL THE BONDS TO CERTAIN DEALERS AND DEALER BANKS AND BANKS ACTING AS AGENTS AT PRICES LOWER THAN THE PUBLIC OFFERING PRICE STATED ON THE COVER PAGE HEREOF AND SAID PUBLIC OFFERING PRICE MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITERS.

Certain capitalized terms used in this Official Statement and in the Indenture for the Bonds are defined in APPENDIX B and unless otherwise indicated shall have the respective meanings set forth therein.

Other than with respect to information concerning Financial Security Assurance Inc. (the “Bond Insurer”) contained under the caption “BOND INSURANCE” and APPENDIX D – “Specimen Municipal Bond Insurance Policy” herein, none of the information in this Official Statement has been supplied or verified by the Bond Insurer and the Bond Insurer makes no representation or warranty, express or implied, as to (i) the accuracy or completeness of such information; (ii) the validity of the Bonds; or (iii) the tax exempt status of the interest on the Bonds.

**BOARD OF EDUCATION OF  
THE CITY OF CHICAGO**

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**MEMBERS**

**Rufus Williams**  
*President*

**Clare Muñana**  
*Vice President*

**Norman R. Bobins**  
**Dr. Tariq Butt**  
**Alberto A. Carrero, Jr.**  
**Roxanne Ward**

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**MANAGEMENT**

**Arne Duncan**  
*Chief Executive Officer*

**Barbara Eason-Watkins**  
*Chief Education Officer*

**David Vitale**  
*Chief Administrative Officer  
and Chief Operating Officer*

**John Maiorca**  
*Chief Financial Officer*

**Heather A. Obora**  
*Chief Purchasing Officer*

**Patrick J. Rocks**  
*General Counsel*

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**Sonnenschein Nath & Rosenthal LLP**  
**Charity and Associates, P.C.**  
*Co-Bond Counsel*

**A.C. Advisory, Inc.**  
**D.A. Davidson & Co.**  
*Financial Advisors*

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**\$355,805,000**  
**BOARD OF EDUCATION OF THE**  
**CITY OF CHICAGO**  
**Unlimited Tax General Obligation Bonds**  
**(Dedicated Revenues),**  
**Series 2006B**

**INTRODUCTION**

**General**

The purpose of this Official Statement, including the cover page, the inside cover page and the Appendices hereto, is to set forth information in connection with the offering and sale by the Board of Education of the City of Chicago (the “Board”) of \$355,805,000 of its Unlimited Tax General Obligation Bonds. The Bonds will be issued in one series: (Dedicated Revenues), Series 2006B (the Series 2006B Bonds are referred to herein as the “Bonds” or the “Series 2006B Bonds”).

The proceeds of the Series 2006B Bonds will be used to (i) provide funds for the continued implementation of the Board's Capital Improvement Program (as described herein) and (ii) pay costs of issuance of the Bonds, including bond insurance premium. See “BOARD OF EDUCATION OF THE CITY OF CHICAGO—Capital Improvement Program” and “THE BONDS—Estimated Sources and Use of Funds.”

The Bonds will be general obligations of the Board to the payment of which the Board will pledge its full faith and credit. The Bonds will be issued by the Board pursuant to (i) the provisions of the School Code of the State of Illinois, as amended (the “School Code”), (ii) the Local Government Debt Reform Act of the State of Illinois, as amended (the “Debt Reform Act”), (iii) a resolution adopted by the Board on September 22, 2004 (the “2004 Authorization”) authorizing the issuance of alternate bonds, being general obligation bonds payable from any revenue source as provided by the Debt Reform Act (“Alternate Bonds”), in an aggregate principal amount not to exceed \$965,000,000 in the aggregate, (iv) a resolution adopted by the Board on June 28, 2006 (the “2006 Authorization”) authorizing the issuance of Alternate Bonds in an aggregate principal amount not to exceed \$750,000,000, and (v) a resolution in respect of the Series 2006B Bonds, adopted by the Board on August 23, 2006 (the “Bond Resolution” and, together with the 2004 Authorization and the 2006 Authorization, the “Resolutions”).

The Bonds will be issued under a Trust Indenture, dated as of September 1, 2006 (the “Indenture”), by and between the Board and Wells Fargo Bank, N.A., Chicago, Illinois, as trustee and paying agent (the “Trustee” or “Paying Agent”). The Bonds will be secured by and are payable (i) from the Pledged State Aid Revenues (as defined below), (ii) to the extent that the Pledged State Aid Revenues are insufficient to pay the debt service on the Bonds, from the *ad valorem* taxes levied by the Board, pursuant to the applicable Bond Resolution, against all of the taxable property in the School District (as defined herein), without limitation as to rate or amount, and pledged under the Indenture as security for the Bonds (the “Pledged Taxes”) and (iii) from all Funds, Accounts and Sub-Accounts established pursuant to the applicable

Indenture. The Pledged State Aid Revenues and other security pledged to the payment of the Bonds are not available for the payment of the Bonds of any other series.

The Pledged State Aid Revenues for the Bonds issued under each of the 2004 Authorization and the 2006 Authorization consist of, in each case, a specified annual amount of unrestricted State Aid Revenues (as defined below) received by the Board in any year. For additional information, see “SECURITY FOR THE BONDS – General” and “– General State Aid” below. For a discussion of other obligations of the Board payable from the Board’s annual receipt of State Aid Revenues see “– Other State Aid Obligations” and “– Additional Bonds Payable from Pledged State Aid Revenues” below.

The scheduled payment of principal of and interest on the Bonds maturing on and after December 1, 2008, when due, will be guaranteed under an insurance policy (the “Bond Insurance Policy”) to be issued concurrently with the delivery of the Bonds by the Bond Insurer. The Bonds maturing on December 1, 2007 will not be insured. For additional information, see “BOND INSURANCE.”

The Board is issuing the Bonds to provide funds for the continued implementation of its Capital Improvement Program. For additional information, see “BOARD OF EDUCATION OF THE CITY OF CHICAGO -- Capital Improvement Program.”

### **Other State Aid Obligations**

Alternate Bonds payable from State Aid Revenues issued under the 2004 Authorization are currently outstanding and additional Alternate Bonds payable from State Aid Revenues issued under the 2006 Authorization (“Additional Bonds”) may be issued in the future under other resolutions of the Board. See “SECURITY FOR THE BONDS – General” and “-General State Aid.” The Board has previously issued Alternate Bonds pursuant to the 2004 Authorization in the aggregate principal amount of \$663,682,800, and certain series of such bonds are secured by the State Aid Revenues available pursuant to the 2004 Authorization, such portion consisting of its Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2004C; its Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2004D; its Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2004E; its Unlimited Tax General Obligation Bond (Dedicated Revenues), Series 2005D; its Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2005E; and its Unlimited Tax General Obligation Bonds (Dedicated Revenues – Qualified Zone Academy Projects), Series 2006A (collectively, the “Prior 2004 State Aid Bonds”).

## **THE BONDS**

### **General**

The Bonds will be dated the date of original issuance thereof and will mature on December 1 of the years and in the amounts shown on the inside cover page hereof. The Bonds will be issued only as fully registered bonds in denominations of \$5,000 or integral multiples thereof. The Bonds will bear interest from the date of original issuance thereof, payable on June 1 and December 1 of each year, commencing June 1, 2007, at the rates set forth on the

cover page hereof. Each Bond will bear interest from the later of its date or from the most recent interest payment date to which interest has been paid or duly provided for, until the principal amount of such Bond is paid or duly provided for. Interest on the Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months. Interest on each Bond will be payable on each interest payment date to the person in whose name the Bond is registered at the close of business on the fifteenth day of the calendar month next preceding each interest payment date. See “APPENDIX B - Summary of Certain Provisions of the Indenture.”

The Bonds initially are registered through a book-entry only system operated by The Depository Trust Company, New York, New York (“DTC”). Details of payments of the Bonds and the book-entry only system are described below under the subcaption “-- Book-Entry Only System.” Except as described under the subcaption “-- Book-Entry Only System” below, beneficial owners of the Bonds will not receive or have the right to receive physical delivery of Bonds, and will not be or be considered to be the registered owners thereof. Accordingly, beneficial owners must rely upon (i) the procedures of DTC and, if such beneficial owner is not a DTC “Participant” (as defined below), the Participant who will act on behalf of such beneficial owner to receive notices and payments of principal, premium, if any, and interest on the Bonds, and to exercise voting rights and (ii) the records of DTC and, if such beneficial owner is not a Participant, such beneficial owner’s Participant, to evidence its beneficial ownership of the Bonds. So long as DTC or its nominee is the registered owner of the Bonds, references herein to Bondholders or registered owners of such Bonds mean DTC or its nominee and do not mean the beneficial owners of such Bonds.

### **Additional Bonds Payable From Pledged State Aid Revenues**

The Board may issue Additional Bonds from time to time under the Indenture payable from and secured by the Pledged State Aid Revenues available pursuant to the 2006 Authorization or any other source of payment which may be pledged under the Debt Reform Act. Any Additional Bonds payable from Pledged State Aid Revenues for the Bonds issued pursuant to the 2006 Authorization shall share ratably and equally in the State Aid Revenues available pursuant to the 2006 Authorization with the Bonds; provided, however, that no Additional Bonds may be issued except in accordance with the provisions of the Debt Reform Act as in existence on the date of issuance of the Additional Bonds.

The Board reserves the right to issue bonds or other evidences of indebtedness payable from the Pledged State Aid Revenues for the Bonds which are subordinate to the Bonds. Such subordinate obligations will be paid from such Pledged State Aid Revenues available to the Board in each year in excess of those required to be deposited in the Pledged State Aid Revenues Account established under the Indenture.

### **Redemption**

**Optional Redemption.** The Bonds maturing on or after December 1, 2017, are subject to redemption prior to maturity, at the option of the Board, from any available funds, on any date on or after December 1, 2016, in whole or in part, and if in part, in any order of maturity designated by the Board, and if less than an entire maturity, in Authorized Denominations,

selected by the Trustee as hereinafter provided, at the redemption price of par plus accrued interest to the date fixed for redemption.

**Mandatory Sinking Fund Redemption.** The Bonds maturing on December 1, 2035 (the “Term Bonds”) are subject to mandatory redemption prior to their maturity at a redemption price of par plus accrued interest, if any, on December 1 of the years and in the respective aggregate principal amounts set forth below:

<u>Year</u>	<u>Principal Amount</u>
2032	\$18,105,000
2033	19,010,000
2034	19,960,000
2035*	20,960,000

\*Final Maturity

The Trustee shall each year in which Term Bonds are subject to mandatory redemption make timely selection by lot or in such other equitable manner as the Trustee may determine of such Bonds or portions of such Bonds to be so redeemed. Upon written instructions duly given by the Board, the Trustee will use its best efforts to the extent practicable to utilize moneys deposited in the Debt Service Fund (as defined below) to purchase Term Bonds in the open market at a price not in excess of their principal amount, and moneys deposited in the Debt Service Fund may be used for the purpose of paying interest on the Term Bonds so purchased at the rate specified thereon to the date of purchase. Each Term Bond so purchased shall be credited at 100% of the principal amount thereof against the obligation of the Board to redeem Term Bonds of the same maturity on the next mandatory redemption date applicable to Term Bonds of such maturity, and the principal amount of Term Bonds of such maturity to be redeemed shall be reduced accordingly.

**General Redemption Terms.** The Board will, at least 60 days prior to any optional redemption date (unless a shorter time period shall be satisfactory to the Trustee), notify the Trustee of such redemption date and of the principal amount and maturity or maturities to be redeemed. Except as set forth below, if less than all of the Bonds are called for optional redemption, the particular Bonds or portions thereof to be redeemed will be selected at random by the Trustee in such manner as the Trustee in its discretion may deem fair and appropriate; provided that (i) the portion of any such Bond of a denomination of more than \$5,000 to be redeemed will be in a principal amount of an Authorized Denomination, and (ii) in selecting portions of such Bonds for redemption, the Trustee will treat each such Bond as representing that number of Bonds of \$5,000 denomination that is obtained by dividing the principal amount of such Bond to be redeemed in part by \$5,000. So long as DTC or its nominee is the registered owner of the Bonds, the particular Bonds or portions thereof to be redeemed will be selected by DTC in such manner as DTC may determine.

When the Trustee receives notice from the Board of its election or direction to optionally redeem Bonds, the Trustee will give notice, in the name of the Board, of the redemption of such Bonds, which notice will specify the maturities of the Bonds to be redeemed, the date fixed for redemption and the place or places where amounts due upon such date fixed for redemption will

be payable and, if less than all of the Bonds of any like maturity are to be redeemed, the letters and numbers or other distinguishing marks of such Bonds so to be redeemed, and, in the case of Bonds to be redeemed in part only, such notice will also specify the respective portions of the principal amount thereof to be redeemed. Such notice will further state that on such date there will become due and payable the redemption price of each Bond to be redeemed, or the redemption price of the specified portions of the principal thereof in the case of Bonds to be redeemed in part only, together, with interest accrued to the date fixed for redemption, and that from and after such date, interest thereon will cease to accrue and be payable. The Trustee will mail copies of such notice by first-class mail, postage prepaid, not less than 30 days and not more than 60 days before the date fixed for redemption, to the registered owners of the Bonds to be redeemed at their addresses as shown on the registration books of the Board maintained by the Trustee, as bond registrar; provided that if all Bonds are held in book-entry only form, such notice may be given pursuant to the then-existing agreement with the securities depository for the Bonds. The failure of the Trustee to give notice to a registered owner of any Bond or any defect in such notice will not affect the validity of the redemption of any other Bonds to be redeemed as to which proper notice was given.

Notice having been given in the manner described above, the Bonds so called for redemption will become due and payable on the date fixed for redemption at the applicable redemption price (plus interest accrued and unpaid to such date) and, upon presentation and surrender thereof at the place specified in such notice, such Bonds, or portions thereof, will be paid at the redemption price (plus interest accrued and unpaid to such date). If, on the date fixed for redemption, moneys for the redemption of all the Bonds or portions thereof of any like maturity to be redeemed (together with interest to such date) are held by the Trustee so as to be available therefor on said date and if notice of redemption has been given as described above, then, from and after the date fixed for redemption, interest will cease to accrue and become payable. If said moneys are not so available on the date fixed for redemption, interest will continue to accrue until paid at the same rate as if such Bonds had not been called for redemption.

### **Bond Registration and Transfers**

For a description of the procedure to transfer ownership of a Bond while in the book-entry only system, see “-- Book-Entry Only System” below. Subject to the limitations described below, the Bonds are transferable upon surrender thereof at the principal corporate trust office of the Trustee, duly endorsed by, or accompanied by a written instrument or instruments of transfer in form satisfactory to, the Trustee and duly executed by the Bondholder or such Bondholder’s attorney duly authorized in writing. Subject to the limitations described below, any Bond may be exchanged at the principal corporate trust office of the Trustee upon surrender thereof, together with an assignment duly executed by the registered owner thereof or such registered owner’s attorney in such form and with guarantee of signature as shall be satisfactory to the Trustee for an equal aggregate principal amount of Bonds of like date and tenor of any Authorized Denomination as the Bonds surrendered for exchange bearing numbers not contemporaneously outstanding. The Trustee and the Board may charge a fee sufficient to cover any tax, fee or other governmental charge in connection with any exchange or transfer of any Bond (except in connection with any partial redemption thereof). The Trustee shall not be

required to exchange or register the transfer of any Bonds after the mailing of notice calling such Bond for redemption has been made as provided in the Indenture.

### **Book-Entry Only System**

**General.** The following information concerning DTC has been furnished by DTC for use in this Official Statement. Neither the Board nor the Underwriters are responsible for its accuracy or completeness.

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered Bond certificate will be issued for each maturity of the Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation ("NSCC"), Fixed Income Clearing Corporation ("FICC") and Emerging Markets Clearing Corporation ("EMCC") (NSCC, FICC and EMCC are also subsidiaries of DTCC), as well as the New York Stock Exchange, Inc., the American Stock Exchange, LLC and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Direct and Indirect Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com) and [www.dtc.org](http://www.dtc.org).

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their

holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults and proposed amendments to the Bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners, or, in the alternative, Beneficial Owners may wish to provide their names and addresses to the Trustee and request that copies of the notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Bonds of a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Board as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, principal, interest and premium, if any, payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds on the payment date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Board or the Trustee, as applicable, subject to any statutory or

regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, principal, interest and premium, if any, payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Board or the Trustee, disbursement of such payments to Direct Participants is the responsibility of DTC, and disbursement of such payments to the Beneficial Owners is the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the Board and the Trustee. Under such circumstances, if a successor securities depository is not obtained, certificates for the Bonds are required to be printed and delivered.

The Board may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Bond certificates are required to be printed and delivered.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the Board believes to be reliable, but the Board takes no responsibility for the accuracy thereof.

NEITHER THE BOARD NOR THE TRUSTEE HAS ANY RESPONSIBILITY OR OBLIGATION TO THE PARTICIPANTS OR THE BENEFICIAL OWNERS WITH RESPECT TO THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC, CEDE & CO. OR ANY PARTICIPANT; THE PAYMENT BY DTC OR ANY PARTICIPANT OF ANY AMOUNT WITH RESPECT TO THE PRINCIPAL OR PURCHASE PRICE OF, PREMIUM, IF ANY, OR INTEREST ON THE BONDS; ANY NOTICE WHICH IS PERMITTED OR REQUIRED TO BE GIVEN TO BENEFICIAL OWNERS UNDER THE INDENTURE; THE SELECTION BY DTC OR ANY PARTICIPANT OF ANY PERSON TO RECEIVE PAYMENT IN THE EVENT OF A PARTIAL REDEMPTION OF THE BONDS; OR ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC.

### **Rights of the Bond Insurer**

So long as the Bond Insurance Policy is in full force and effect and the Bond Insurer has not failed to perform any of its obligations thereunder, the Bond Insurer shall be deemed the owner of Bonds insured under the applicable Bond Insurance Policy for purposes of consenting to any supplements or amendments to the Indenture as may be required under the Indenture and granting other approvals, consents, notices, directions and waivers on behalf of the Bondholders with respect to matters that require Bondholder approval, consent or waiver under the Indenture.



## Estimated Sources and Uses of Funds

The following table shows the estimated sources and uses of funds in connection with the issuance of the Bonds:

### SERIES 2006B BONDS

#### Sources:

Bond Proceeds:	
Par Amount	\$355,805,000.00
Net Premium	<u>14,443,982.70</u>
Total Sources of Funds	<u>\$370,248,982.70</u>

#### Uses:

Deposit to the Project Fund	\$366,388,793.12
Costs of Issuance <sup>(1)</sup>	<u>3,860,189.58</u>
Total Uses of Funds	<u>\$370,248,982.70</u>

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<sup>(1)</sup> Includes bond insurance premium and underwriters' discount.

## **SECURITY FOR THE BONDS**

### **General**

The Bonds will be issued pursuant to the School Code, the Debt Reform Act, the Resolutions and the Indenture. The Bonds will be general obligations of the Board to the payment of which the Board will pledge its full faith and credit, and will be payable, both as to principal and interest, from any moneys, revenues, receipts, income, assets or funds of the Board legally available for such purpose.

The Bonds will be payable from and secured by a pledge of (i) an amount that, in each year that the Bonds are outstanding, shall provide for the payment of annual debt service on the Bonds (the “Pledged State Aid Revenues”), consisting of (a) with respect to \$301,317,200 of the Bonds which are to be issued pursuant to the 2004 Authorization only, payments received by the Board in any year pursuant to Article 18 of the School Code, or such successor or replacement fund or act as may be enacted in the future (“State Aid Revenues”), not in excess of \$175,000,000, as shall provide for debt service on such Bonds, the Prior 2004 State Aid Bonds, and any Swap Payments (as defined below) in each year as set forth in the Indenture and the provision of not less than an additional .10 times the debt service on the Bonds and the Prior 2004 State Aid Bonds in such years and (b) with respect to \$54,487,800 of the Bonds which are to be issued pursuant to the 2006 Authorization only, payments of State Aid Revenues received by the Board, not in excess of \$125,000,000, as shall provide for debt service on such Bonds, any Swap Payments, and any Additional Bonds issued from time to time pursuant to the 2006 Authorization in each year as set forth in the Indenture and the provision of not less than an additional .10 times the debt service on such Bonds and Additional Bonds in such years; (ii) the Pledged Taxes, (iii) all Funds, Accounts and Sub-Accounts established pursuant to the Indenture, and (iv) any and all other moneys, securities and property furnished from time to time to the Trustee by the Board or on behalf of the Board or by any other persons, to be held by the Trustee under the Indenture. As to the lien on the Pledged State Aid Revenues for the Bonds issued pursuant to the 2004 Authorization, such Bonds will be payable on a parity basis with the Prior 2004 State Aid Bonds and as to the lien on the Pledged State Aid Revenues for the Bonds issued pursuant to the 2006 Authorization, such Bonds will be payable on a parity basis with any Additional Bonds secured by such Pledged State Aid Revenues as described in “INTRODUCTION—Other State Aid Obligations,” and “THE BONDS – Additional Bonds Payable from Pledged State Aid Revenues,” above. As described herein, the Pledged Taxes will be collected for the benefit of the Bonds only as and to the extent that the Pledged State Aid Revenues for the Bonds, together with investment earnings thereon, are not available in sufficient amounts to pay the debt service on such Bonds.

The scheduled payment of principal of and interest on the Bonds maturing on or after December 1, 2008, when due, will be guaranteed under the Bond Insurance Policy to be issued concurrently with the delivery of the Bonds by the Bond Insurer. For additional information, see “BOND INSURANCE.”

## General State Aid

General State Aid (“GSA”) represents the major portion of state support for Illinois public elementary and secondary schools. GSA is not targeted or categorical in nature, but may generally be expended at the discretion of the local school districts. However, the School Code requires the Board to dedicate a minimum of \$261.0 million annually from its GSA revenue to supplemental programs in the Supplemental General State Aid Fund (formerly known as State Chapter One Fund) for children from low-income families.

GSA consists of a regular foundation formula claim, as explained below, and a low-income student grant. The calculation of the regular foundation claim depends primarily upon a school district’s best three months’ average daily attendance and local resources, such as equalized assessed valuation of property and corporate personal property replacement tax revenues within the school district. The low-income student grant provides additional resources for school districts that have a high concentration of low-income pupils. The low-income eligible pupil count came from the most recently available federal census through fiscal year 2003. In May 2003, the General Assembly adopted a new poverty grant formula. Instead of the most recent federal census poverty data, a new poverty count prepared by the Illinois Department of Human Services is used starting in fiscal year 2004. The fiscal year 2004 count was an average of the 2002 and 2003 count of children who were eligible for assistance under Medicaid, Kidcare, Food Stamps, or Temporary Assistance for Needy Families (“TANF”). The poverty count for fiscal year 2005 and each year thereafter will be the average of the children eligible for Medicaid, Kidcare, Food Stamps and TANF for the three previous years.

The GSA formula used through fiscal year 1998 provided for different methods of allocation, depending primarily upon the equalized assessed valuation of property within a school district’s boundaries. The amount of GSA distributed to school districts was determined by the annual State appropriation. The GSA formula was amended in 1997, and as a result, the minimum or “foundation level” of GSA per pupil was \$4,425 in fiscal year 2001, \$4,560 in fiscal year 2002, remained at \$4,560 in fiscal year 2003, \$4,810 in fiscal year 2004 and \$4,964 in fiscal year 2005. In subsequent years, this “foundation level” will be set by the General Assembly, with advice from a funding advisory board. No assurance can be given that the “foundation level” will be increased or even funded at current levels in future fiscal years.

Legislation adopted in 1999 by the General Assembly increased GSA funding for school districts that would otherwise experience a decrease in this funding because of increases in equalized assessed valuation of real property. In addition, the General Assembly increased the per pupil amount of the low-income student grant for low-income students, which is based on the low-income student count prepared by the Bureau of Census. As a result, the per pupil amount of the low-income student grant that applies to the Board was \$1,273 for fiscal year 2001, \$1,333 for fiscal year 2002, \$1,362 for fiscal year 2003, \$1,230 for fiscal year 2004 and \$1,264 for fiscal year 2005. The lower per-pupil amount in fiscal year 2004 reflects the new poverty grant formula adopted in May 2003.

The following chart sets forth the total GSA allocated to the Board for each of the fiscal years 1996 through 2005, the required contributions for Supplemental General State Aid allocations to individual schools, and the net amount available for deposit into the General Fund.

**GENERAL STATE AID**  
Fiscal Years 1996 - 2005  
(Dollars in Millions)

<b>Fiscal Year</b>	<b>Total GSA Claim<sup>(1)</sup></b>	<b>Supplemental General State Allocation</b>	<b>Unrestricted GSA General Fund Deposit<sup>(2)</sup></b>
1996	501.7	261.6	240.1
1997	503.3	261.2	242.1
1998	567.7	261.2	306.5
1999	706.2	261.3	444.9
2000	711.1	261.0	450.1
2001	730.4	261.0	469.4
2002	801.8	261.0	540.8
2003	786.9	261.0	525.9
2004	853.5	261.0	592.5
2005	926.7	261.0	665.7

(1) Source: Illinois State Board of Education. Net of Illinois State Board of Education audit adjustments.

(2) Reflects moneys available to fund Pledged State Aid Revenues and pledges of State Aid Revenues made in connection with other obligations of the Board.

In calculating GSA, the State employs a formula consisting of a variety of variables, including one referred to as “available local resources.” One factor used in determining a school district’s available local resources is the amount of revenue that it derives from local property taxes. Consequently, the level of GSA in future years may be impacted by a number of factors, including increases in the aggregate real estate tax revenues that the Board may potentially derive from (i) changes in the equalized assessed valuation of property within the School District and (ii) the addition of new property to the School District’s tax base, as well as the determination of the School District’s maximum operating tax rate in any given year under the Illinois Property Tax Extension Limitation Law (the “Limitation Law”).

Illinois law further specifies that whenever new property is added to a school district’s tax base, adjustments are to be made to that school district’s GSA. As of today, as a general matter under the law, the Board will experience a \$3 decrease in GSA for every \$100 of adjusted equalized assessed valuation (the “AEAV”) resulting from the addition of new property to its tax base (the “New AEAV”). However, given the Board’s current operating tax rate, the Board could offset this decrease and receive approximately \$3.05 in additional real estate taxes for every \$100 of New AEAV, provided that the Board elects to apply its full, current operating tax rate to the New AEAV in the year in which it becomes available.

In particular, a number of tax increment financing areas (the “TIFs”) established by the City of Chicago (the “City”) in prior years are expected to begin to terminate, commencing in 2007. As these TIFs terminate, the New AEAV resulting from their termination will become part of the School District’s tax base with respect to which the Board will be entitled to levy its then current operating tax rate. As described above, the addition of the New AEAV from an expiring TIF to the School District’s tax base will cause a reduction in GSA, but this reduction can be offset by increased real estate tax revenues.

The Board does not anticipate that any future reductions in GSA resulting from New AEAV will impact the Board's ability to collect the Pledged State Aid Revenues in amounts sufficient to meet its debt service obligations and debt service coverage covenants with respect to the Bonds.

### **Pledged Taxes**

The Board has levied the Pledged Taxes to satisfy the debt service on the Bonds if Pledged State Aid Revenues are insufficient. The Pledged Taxes are *ad valorem* taxes levied pursuant to the Bond Resolutions against all of the taxable property in the School District, without limitation as to rate or amount. However, based on projected receipts of Pledged State Aid Revenues, the Board anticipates that all Pledged Taxes will be abated on a year-by-year basis prior to such taxes being extended. To the extent that the Pledged State Aid Revenues are not available in sufficient amounts, the debt service on the Bonds is payable from the Pledged Taxes. In the event the Pledged Taxes are extended for collection, in any year, the Board will direct the County Collectors to segregate from each distribution of property taxes to be paid to the Board that percentage attributable to the levy of the Pledged Taxes for the payment of the debt service on the Bonds, and that amount will be paid directly to the Trustee for application in accordance with the provisions of the Indenture. The Board has covenanted in the Indenture to take all actions necessary to cause the levy and extension of additional Pledged Taxes in excess of those previously levied if necessary to pay debt service on the Bonds. For additional information concerning the levy and collection of the Pledged Taxes, see "THE REAL PROPERTY TAX SYSTEM -- Tax Levy -- Collection."

### **Debt Service Funds and Accounts**

The Indenture for the Bonds establishes the Debt Service Fund as a separate fund pledged to the payment of debt service on the Bonds. The Indenture also establishes four separate accounts in the Debt Service Fund, known as the "Pledged State Aid Revenues Account," the "Pledged Taxes Account," the "Bond Payment Account" and the "Swap Payment Account." The Pledged State Aid Revenues Account consists of the "Interest Deposit Sub-Account" and the "Pledged State Aid Revenues Sub-Account" and the Bond Payment Account consists of the "Interest Sub-Account" and the "Principal Sub-Account."

The Trustee shall deposit to the credit of the Interest Deposit Sub-Account (i) any amounts paid by the Board to the Trustee from time to time with instructions for deposit into such Sub-Account, and (ii) any payments made by the Swap Providers under the Swap Agreements to the extent set forth in a certificate of a Designated Official filed with the Trustee. All or a portion of such amounts so deposited to the credit of the Interest Deposit Sub-Account shall be transferred no later than the next succeeding date upon which interest on the Bonds is due (an "Interest Payment Date") to the Interest Sub-Account in the Bond Payment Account and applied to pay up to the amount of interest then due on the Bonds on such Interest Payment Date as described below under "Payment of Debt Service on the Bonds and Swap Payments."

## **Application of Pledged State Aid Revenues; Abatement of Pledged Taxes**

On or before February 15 of each year, or such earlier date as may be necessary to permit the Board to lawfully make the abatement of the Pledged Taxes with respect to the Series 2006B Bonds as described below (each such date being referred to as a “Deposit Date”), the Board shall deposit to the credit of the Pledged State Aid Revenues Sub-Account such amounts derived from Pledged State Aid Revenues as shall be necessary to cause the amount on deposit in said Account to equal the “Pledged State Aid Revenues Account Requirement.” The Pledged State Aid Revenues Account Requirement is determined on each Deposit Date and is equal to the amount which will cause the amount on deposit in the Pledged State Aid Revenues Account to be equal to the sum of (i) the interest payable on the Bonds on the next succeeding June 1 and December 1; provided, however, that for any period of time during the annual period beginning on December 2 of the preceding year (each a “Bond Year”), for which a Swap Agreement (as defined below) is in place with respect to any Bonds, such amount shall be increased or decreased, as appropriate, by calculating interest with respect to such Bonds at an interest rate equal to the interest rate payable with respect to the Bonds pursuant to such Swap Agreement as set forth in any written notice delivered by the Board to the Trustee under the Indenture regarding such Swap Agreement, and (ii) the principal amount of such Bonds scheduled to become due at maturity or by mandatory sinking fund redemption on the next succeeding December 1. With respect to Pledged State Aid Revenues, in the event that on any Deposit Date there has been deposited to the credit of the Pledged State Aid Revenues Account an insufficient amount to satisfy the amount required by the Indenture governing the Series 2006B Bonds, the Board will take such actions as are necessary to cause the extension of the Pledged Taxes levied for the calendar year next preceding the calendar year of such Deposit Date in an amount sufficient, when added to the amount then on deposit in the Pledged State Aid Revenues Account, to provide funds sufficient to satisfy the Pledged State Aid Revenues Account Requirement.

On or before February 16 of each year, whenever sufficient funds are on deposit in the Pledged State Aid Revenues Account equal to the Pledged State Aid Revenues Account Requirement, the Trustee shall deliver to the Board a notice evidencing the sufficiency of such deposit for said purpose and directing the Board to take such actions as are necessary to abate the Pledged Taxes with respect to the Series 2006B Bonds.

If at any time the amount on deposit in the Pledged State Aid Revenues Sub-Account shall be insufficient to provide for the payment in full of (i) the principal of and interest on the Bonds and (ii) the Swap Payments to become due during the then-current Bond Year, the Board shall promptly deposit moneys derived from Pledged State Aid Revenues into the Pledged State Aid Revenues Sub-Account in such amounts as shall be necessary to cause the amount on deposit in the Pledged State Aid Revenues Sub-Account to be sufficient to pay (x) the interest to accrue on the Bonds for the remainder of the then-current Bond Year (y) the principal amount of Bonds scheduled to become due at maturity or by mandatory sinking fund redemption on the last day of the then-current Bond Year and (z) the Swap Payment scheduled to become due during the then-current Bond Year.

## **Payment of Debt Service on the Bonds and Swap Payments**

With respect to the Bonds, the Trustee shall transfer first from moneys on deposit in the Pledged Taxes Account, second from moneys on deposit in the Interest Deposit Sub-Account and third from the Pledged State Aid Revenues Sub-Account (i) first, to the Interest Sub-Account with respect to the Bonds the amount required for the interest payable on the next June 1 or December 1, less the amount then on deposit in the Interest Sub-Account of the Bond Payment Account and available for such payment; (ii) second, to the Principal Sub-Account of the Bond Payment Account on or before each December 1, an amount equal to the principal amount of the Bonds, if any, which mature on the next December 1, less the amount then on deposit in the Principal Sub-Account and available for such payment and (iii) to the Principal Sub-Account of the Bond Payment Account on or before December 1 on which Bonds are subject to mandatory sinking fund redemption pursuant to the Indenture, the amount required for the payment of the redemption price of such Bonds then to be redeemed.

After deducting the amount required to be transferred to the Principal Sub-Account on the next succeeding December 1 and provided the Board is not in default with respect to the payment of interest on the Bonds, there shall be transferred into the Swap Payment Account on each date (each, a "Swap Payment Date") specified in the relevant interest rate swap agreement (each a "Swap Agreement") with a swap provider (a "Swap Provider") which the Board shall identify in a written notice delivered to the Trustee, and which notice shall include a direction to the Trustee regarding any changes in the Pledged State Aid Revenues Account Requirement as a result of such Swap Agreement, first from moneys on deposit in the Pledged Taxes Account, second from moneys on deposit in the Interest Deposit Sub-Account, and last from the Pledged State Aid Revenues Sub-Account, an amount equal to the sum of the payments ("Swap Payments") then owing under such Swap Agreement on such Swap Payment Date. The Trustee shall pay each Swap Provider on each Swap Payment Date from amounts then on deposit in the Swap Payment Account pursuant to payment instructions specified in the Swap Agreement and provided to the Trustee and the Board by such Swap Provider. On or prior to December 1, 2006 and each December 1 thereafter, the Board shall provide the Trustee with written notice of the amount of each Swap Payment owing to the Swap Provider on each Swap Payment Date for the succeeding Bond Year. The Board shall promptly notify the Trustee in writing if the amount of any Swap Payment shall change from the amount identified in such notice. Notwithstanding anything in the Indenture to the contrary, all payments of Swap Payments to be paid from Pledged Taxes shall be subordinate to the payment of principal of and interest on the Bonds and all payments of Swap Payments to be paid from Pledged State Aid Revenues shall be subordinate to the payment of principal of and interest on the Bonds and any Additional Bonds.

All amounts on deposit in the Pledged State Aid Revenues Sub-Account on December 1 of each year, following the transfers required to be made to the Bond Payment Account, shall be withdrawn from said Sub-Account and paid to the Board free and clear of the lien of the Indenture.

## **Indenture -- Funds, Accounts and Sub-Accounts**

In addition to the Pledged State Aid Revenues and the Pledged Taxes, all Funds, Accounts and Sub-Accounts established pursuant to the Indenture for the Bonds are pledged to

the payment of the such series of Bonds, and may not be applied to the payment of the Bonds of any other series. See “APPENDIX B - Summary of Certain Provisions of the Indenture.”

### **Bonds Are Obligations of the Board**

The Bonds are the direct and general obligations of the Board to the payment of which the Board has pledged its full faith and credit and taxing power. The Bonds are not the obligations of the City, the State or any other political subdivision of the State (other than the Board). Neither the full faith and credit nor the taxing power of the City, the State or any other political subdivision of the State (other than the Board) is pledged to the payment of the Bonds.

## **BOND INSURANCE**

Upon the issuance of the Bonds, Financial Security Assurance Inc. (the “Bond Insurer” or “Financial Security”) will issue its municipal bond insurance policy for the Bonds (a “Bond Insurance Policy”) that will guarantee the payment of scheduled principal of and interest on the Bonds maturing on and after December 1, 2008 (referred to herein as the “Insured Bonds”). The Bonds maturing on December 1, 2007 will not be insured.

### **General**

The following information has been furnished by Financial Security for use in this Official Statement. No representation is made by the Board or the Underwriters as to the completeness, accuracy or adequacy of such information or the absence of material adverse changes in such information subsequent to the dates indicated. Summaries of or references to the Bond Insurance Policy are made subject to all the detailed provisions thereof to which reference is hereby made and do not purport to be complete statements of any or all of such provisions. See APPENDIX D — “SPECIMEN MUNICIPAL BOND INSURANCE POLICY.”

### **Bond Insurance Policy**

Concurrently with the issuance of the Series 2006B Bonds, Financial Security will issue the Bond Insurance Policy. The Bond Insurance Policy guarantees the scheduled payment of principal of and interest on the Insured Bonds when due as set forth in the form of the Bond Insurance Policy included as an exhibit to this Official Statement

The Bond Insurance Policy is not covered by any insurance security or guaranty fund established under New York, California, Connecticut or Florida insurance law.

### **Financial Security Assurance Inc.**

Financial Security is a New York domiciled financial guaranty insurance company and a wholly owned subsidiary of Financial Security Assurance Holdings Ltd. (“Holdings”). Holdings is an indirect subsidiary of Dexia, S.A., a publicly held Belgian corporation, and of Dexia Credit Local, a direct wholly-owned subsidiary of Dexia, S.A. Dexia, S.A., through its bank subsidiaries, is primarily engaged in the business of public finance, banking and asset



management in France, Belgium and other European countries. No shareholder of Holdings or Financial Security is liable for the obligations of Financial Security.

At June 30, 2006, Financial Security's combined policyholders' surplus and contingency reserves were approximately \$2,514,378,000 and its total net unearned premium reserve was approximately \$1,937,740,000 in accordance with statutory accounting principles. At June 30, 2006, Financial Security's consolidated total shareholder's equity was approximately \$2,889,984,000 and its total net unearned premium reserve was approximately \$1,556,639,000 in accordance with generally accepted accounting principles.

The consolidated financial statements of Financial Security included in, or as exhibits to, the annual and quarterly reports filed after December 31, 2005 by Holdings with the Securities and Exchange Commission are hereby incorporated by reference into this Official Statement. All financial statements of Financial Security included in, or as exhibits to, documents filed by Holdings pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 after the date of this Official Statement and before the termination of the offering of the Series 2006B Bonds shall be deemed incorporated by reference into this Official Statement. Copies of materials incorporated by reference will be provided upon request to Financial Security Assurance Inc.: 31 West 52nd Street, New York, New York 10019, Attention: Communications Department (telephone (212) 826-0100).

The Bond Insurance Policy does not protect investors against changes in market value of the Insured Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. Financial Security makes no representation regarding the Insured Bonds or the advisability of investing in the Insured Bonds. Financial Security makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that Financial Security has provided to the Board the information presented under this caption for inclusion in the Official Statement.

## **BOARD OF EDUCATION OF THE CITY OF CHICAGO**

### **General**

The Board is a body politic and corporate and a school district of the State of Illinois. The Board is established under and governed by the School Code and is a non-home rule unit of government. The Board maintains a system of public schools within its boundaries (the "School District") for grades kindergarten through twelve.

The School District has boundaries coterminous with the boundaries of the City of Chicago. In addition to its Board, elected local school councils, composed of parents, teachers, principals and community representatives, exercise certain powers relating to the operation of individual schools in the public school system, including selection of principals.

### **Governing Body**

Pursuant to the provisions of Public Act 89-15, approved and effective May 30, 1995 (the "1995 Amendatory Act"), the then-existing 15-member Chicago Board of Education (the "Prior

Board”) was replaced with the Chicago School Reform Board of Trustees of the Board of Education of the City of Chicago, Illinois (the “Reform Board of Trustees”). Under the 1995 Amendatory Act, the Reform Board of Trustees served as the governing board of the School District until June 30, 1999. On July 1, 1999, by operation of the 1995 Amendatory Act, the Reform Board of Trustees became the Board. The members of the Board were appointed by the Mayor of the City (the “Mayor”) and are listed below. The appointments to the Board did not require approval of the City Council.

Under the School Code, the Board is responsible for approving the annual budget, approving contracts (including collective bargaining agreements), levying real property taxes and establishing general policies of the Board. The current members of the Board are as follows:

**Rufus Williams** is President of the Board and heads Olympus, LLC as its President and Chief Executive Officer. Mr. Williams has spent over 25 years in financial services and management with nearly 15 of those years in wealth and business management. Prior to founding Olympus, LLC, Mr. Williams worked for 10 years in various positions including Chief Financial Officer and Controller at Harpo Entertainment Group, a company best known for the production of the top-rated talk show, “The Oprah Winfrey Show.” He began his career at Arthur Andersen & Co., where he rose to the level of Experienced Audit Manager. Mr. Williams left after 10 years to take a position as Corporate Audit Manager at Baxter Healthcare Corporation. Mr. Williams graduated Magna Cum Laude from Southern University of Baton Rouge, Louisiana with a degree in Accounting.

**Clare Muñana** is Vice President of the Board and a not-for-profit, public sector management and international consultant operating her own firm. She has experience in domestic and international business and strategic and organizational planning having performed numerous engagements for clients in the United States, Europe, Africa, and Latin America. Recent assignments include an international strategy for a United States/European foundation and museum, an economic/cultural development project for an underserved region in the State of Illinois, a strategic plan for a major museum, and a feasibility study for an economic development agency of a large United States city. She holds a Bachelors degree from Boston College, a Masters in International Economics from the School of Advanced International Studies of Johns Hopkins University and a Masters of Management from the Kellogg Graduate School of Management at Northwestern University. She also holds a certificate in French Civilization and Language from the Sorbonne. Ms. Muñana serves as Vice Chairman of the Mexican Fine Arts Center Museum and is active in the Chicago Public Education Fund, the Chicago Council on Global Affairs, the Aspen Institute; the Field Museum, the Paris/Chicago Sister Cities International Program; Chicago Shakespeare Theater, the Nuestro Futuro Initiative of the Chicago Community Trust, the Chicago Chamber Musicians, the Art Institute – Trustee on Education, Mayor Daley’s Council of Technology Advisors and other not-for-profit organizations.

**Norman R. Bobins** is President and Chief Executive Officer of LaSalle Bank Corporation. He served as a Trustee of the Public School Teachers’ Pension and Retirement Fund of Chicago and was a member of the Public Building Commission of Chicago. He received a Bachelor of Arts degree from the University of Wisconsin and a Master of Business

Administration from the University of Chicago. Mr. Bobins is active in several civic organizations, including Chicago United, the Field Museum and the Art Institute of Chicago.

**Dr. Tariq Butt** is a Board Certified Family Physician with teaching appointments at the University of Illinois' Medical College, Rush University Medical School, and the Faculty with Mt. Sinai Family Residency Program affiliated with the Chicago Medical School. He is Regional Medical Director of the Access Community Health Network. As part of his medical practice, Dr. Butt provides a range of medical services to patients on the west side of the City, regardless of their ability to pay. He has also served as Chairman of the Mayor's Asian-American Advisory Council. Dr. Butt is currently serving as a member of the Board of Directors for the Illinois Association of School Boards and National School Board Association – Counsel of Urban Boards of Education (NSBA-CUBE) Steering Committee Member.

**Alberto A. Carrero, Jr.** is Senior Vice President and Public Banking Manager of Banco Popular North America ("Banco Popular"), the country's largest Hispanic-owned bank. He also serves as a Trustee of the Public School Teachers' Pension and Retirement Fund of Chicago. Prior to joining Banco Popular, Mr. Carrero worked for the Federal Deposit Insurance Company (FDIC) in the New York Region. He graduated from the University of Puerto Rico with a degree in Business Administration and Finance. Mr. Carrero has been the recipient of numerous awards from Illinois and New York City and State agencies for excellence in business.

**Roxanne Ward** is Vice President and Corporate Secretary/Corporate Liaison of Ariel Capital Management, LLC ("Ariel"), a Chicago-based investment management firm founded in 1983. Prior to joining Ariel, Roxanne spent four years working for the Chicago Park District as the First Assistant General Counsel, Board Liaison and Legislative Liaison. She has spent more than 15 years working as a private sector attorney in the Chicago offices of Skadden, Arps, Slate, Meagher, and Flom and Mayer, Brown & Platt. Ms. Ward has been actively involved with many civic and community organizations. She is a Co-Chair of the Mayoral Policy Caucus on Prisoner Reentry and serves on the Board of Directors of the Safer Foundation. She is also a former member of the Desegregation Monitoring Commission and of the Boards of the Illinois Facilities Fund and Congo Square Theater Company. Ms. Ward graduated Phi Beta Kappa from the University of Chicago with a Bachelor of Arts degree in Social Service Administration ("SSA"), followed by a Masters of Arts degree in SSA from the University of Chicago. She subsequently obtained her Juris Doctor from Harvard Law School.

The members of the Board have been appointed to serve terms ending as follows:

<b>Member</b>	<b>Term Expires</b>
Rufus Williams, President.....	June 30, 2007
Clare Muñana, Vice President.....	June 30, 2006*
Norman R. Bobins.....	June 30, 2006*
Dr. Tariq Butt.....	June 30, 2007
Alberto A. Carrero, Jr.....	June 30, 2006*
Roxanne Ward.....	June 30, 2007

\*Members continue to hold office pursuant to Section 34-3(b) of the School Code, 105 ILCS 5/1 *et seq.*

At the expiration of the term of each member, the Mayor shall appoint a successor for a four-year term from July 1 of the year in which the term commences. Any vacancy shall be filled by appointment of the Mayor for the unexpired term. Currently, there is one vacancy on the Board.

The Board elects annually from its members a president and vice-president in such manner as the Board determines.

### **Central Administration**

As authorized under the School Code, the Board has established the following offices and appointed the following individuals to serve in the capacities indicated.

Chief Executive Officer .....	Arne Duncan
Chief Education Officer.....	Barbara Eason-Watkins
Chief Administrative Officer .....	David Vitale
Chief Operating Officer .....	David Vitale
Chief Financial Officer .....	John Maiorca
Chief Purchasing Officer .....	Heather A. Obora
General Counsel.....	Patrick J. Rocks

**Arne Duncan** is the Chief Executive Officer of the Board. Mr. Duncan was formerly Deputy Chief of Staff for the previous Chief Executive Officer of the Board and, prior to that, directed the Ariel Education Initiative. He received a Bachelor of Arts degree in Sociology from Harvard University. Mr. Duncan serves on the boards of directors for the Ariel Education Initiative, The Children's Center, City Year, the Illinois Council Against Handgun Violence and the South Side YMCA, and serves on the Visiting Committee for the University of Chicago's School of Social Service Administration.

**Barbara Eason-Watkins** is the Chief Education Officer of the Board. Dr. Eason-Watkins is a nationally recognized school principal from Chicago's Woodlawn community who has spent her entire 29-year professional career in the schools, working with students, teachers and parents. Since 1988, Dr. Eason-Watkins has been principal of McCosh Elementary School in Chicago. A native of Detroit, Michigan, she received a Bachelor's degree in elementary education from the University of Michigan, a Masters degree in educational administration and supervision from Chicago State University, and a Doctorate in education, with a specialty in curriculum and instruction, from Loyola University, Chicago.

**David Vitale** is the Chief Administrative Officer and Chief Operating Officer of the Board, overseeing all of the educational support departments, including Finance, Budget, Operations, Human Resources, Technology, Security, Procurement and Business Diversity. In February of 2003, Mr. Vitale joined the Board as Senior Advisor to the Chief Executive Officer, on a full-time, pro-bono basis to improve efficiencies of the school system. Prior to joining the Board, Mr. Vitale served as President and Chief Executive Officer of the Chicago Board of Trade. In addition to serving as a member of the CBOT's Board of Directors and Executive committee, Mr. Vitale also served as President and CEO of the MidAmerica Commodity

Exchange, an affiliate of CBOT. Mr. Vitale is a graduate of Harvard University and earned a Masters of Business Administration from the University of Chicago.

**John Maiorca** is the Chief Financial Officer of the Board. Prior to his current appointment, he served as the Budget Director for the Board's Office of Management and Budget. Prior to his service with the Board, Mr. Maiorca served as First Deputy Director for the City of Chicago's Departments of Revenue and Office of Budget and Management. Mr. Maiorca received a Masters of Urban Planning degree from the City University of New York and a Bachelor of Arts from the City University of New York.

**Heather A. Obora** is the Chief Purchasing Officer of the Board. Ms. Obora previously served as the Board's Deputy Chief Financial Officer and Deputy Controller-Disbursements. Prior to joining the Board, Ms. Obora was the Comptroller for the Clerk of the Circuit Court of Cook County, a Senior Tax Accountant for Crowe Chizek in Oak Brook, Illinois and a Senior Accountant for Barbich, Longcrier, Hooper & King, a public accounting firm in Bakersfield, California. Ms. Obora holds a Bachelor of Science degree in Business Administration with a Concentration in Accounting from California State University-Bakersfield.

**Patrick J. Rocks** is the General Counsel of the Board. He has served in that office since March 1, 2005. Prior to his current appointment, Mr. Rocks served in various offices in the Office of the Corporation Counsel of the City of Chicago from 1987 to 2005. From November 2002 to February 2005, he served as First Assistant Corporation Counsel. From May 1998 to November 2002, he served as Deputy Corporation Counsel for the Employment Litigation Division. From December 1993 to May 1998, he served as Chief Assistant Corporation Counsel in the Labor Division. From July 1987 to December 1993, he served as an Assistant Corporation Counsel in the General Litigation and Labor Divisions. Prior to his service with the City of Chicago, Mr. Rocks served as a judicial clerk and was engaged in private practice. Mr. Rocks received his law degree from the John Marshall Law School in 1985 and his Bachelor's degree from Loyola University of Chicago in 1980.

## **School System**

The Chicago Public School system consists of 625 attendance centers consisting of 484 elementary schools, 119 high schools and 22 charter schools serving 420,982 children.

The following table presents the fall enrollment in the school system for the last five school years.

<b>School Year</b>	<b>Elementary School</b>	<b>High School</b>	<b>Combined</b>
2005/2006	308,993	111,989	420,982
2004/2005	320,719	106,093	426,812
2003/2004	330,196	104,223	434,419
2002/2003	337,525	101,064	438,589
2001/2002	338,445	99,173	437,618

## Capital Improvement Program

The Board continues to implement one of the largest school construction and rehabilitation programs in the nation. Initially adopted by the Board in 1996, the Capital Improvement Program is an ongoing plan of work, based on current projections of funding availability and project priorities. The Capital Improvement Program is organized around three basic and critical objectives: (a) reducing student density to no more than 80% of each elementary school's design capacity to relieve severe overcrowding; (b) achieving a minimum level of physical condition and operating efficiency for each facility; and (c) improving the overall quality of the learning environment at each individual school. To achieve these objectives, the Capital Improvement Program is organized into three general program areas:

1. New construction, including new schools, additions, annexes and modular units;
2. Building renovation, including new windows, new roofs, masonry, science labs, gymnasiums, Americans with Disabilities Act improvements, energy efficiencies and information technology, including wiring and equipment to connect all Chicago Public Schools facilities to a area wide network; and
3. Educational enhancements, including new campus parks and play lots.

All of the improvements to be funded by the Series 2006B Bonds are part of the Board's Capital Improvement Program.

*Program Management.* The Board utilizes a broad-based priority system for structuring the Capital Improvement Program, including architectural assessments that categorize capital projects by need. To date, the Capital Improvement Program has addressed primarily the highest priority exterior envelope projects such as windows, roofs and masonry work. With many of these projects completed or underway, the next phase will be addressing high priority, interior projects such as electrical and heating/air ventilation systems.

Coupled with the broad-based priority system, the Capital Improvement Program is re-evaluated annually to ensure that changing needs are incorporated into the program. For example, the Board annually updates space utilization reports to gauge current student overcrowding. To assess long-term classroom demand, the Board utilizes University of Illinois demographic forecasts. The Board also employs an aggressive preventative maintenance and evaluation program to (1) ensure that capital improvements are sustained through preventative measures and (2) provide an on-going capital needs assessment system-wide.

The Board uses third-party firms to provide program management services for the Capital Improvement Program to ensure appropriate oversight and cost control. In September 1998, the Board engaged Chicago School Associates, a joint venture of design, engineering, and construction firms, as program manager.

*Summary of Work Performed and Expenditures.* Since the program's inception, over 1,485 new permanent classrooms have been constructed, with more underway, increasing capacity to accommodate approximately 39,085 additional students. These new classrooms are distributed throughout 29 new schools, 15 replacement schools, 37 additions and 27 annexes.

Additionally, 2,479 renovations have been completed to date including new roofs at 372 schools, new windows for 347 schools, and masonry work for 330 schools. Over 779 local area network projects have been completed. The Board anticipates undertaking a similar number of renovation projects and installing local area networks in its remaining schools in the coming years. Finally, approximately 317 play lots and 16 athletic fields have been renovated to provide students with safe facilities for play and sports.

To finance the Capital Improvement Program, the Board has issued approximately \$3.9 billion aggregate principal amount of Alternate Bonds (excluding refunding bonds). As of June 30, 2006, approximately \$3.8 billion of the proceeds of such Bonds have been spent, and substantially all of the net proceeds remaining have been “encumbered” (i.e., obligated for future expenditure on identified projects).

*Future Financings.* The Board may issue additional bonds to continue implementation of the Capital Improvement Program. Further, consistent with applicable provisions of State law, the Board has the authority to adopt additional authorizing resolution(s) under which some of these bonds may be issued.

Further, the Board anticipates that, subject to market conditions and other factors, it may issue one or more series of Alternate Bonds in addition to those described above to refund, at or prior to maturity, a portion of the outstanding Alternate Bonds. Other types of debt obligations may also be used to provide the Board with funds for future implementation of certain components of the Capital Improvement Program.

### **Educational Reform Initiatives**

Under Mayor Richard M. Daley’s leadership, the Chicago Public School system (“CPS”) has become a national model for urban education. School districts across the country, as well as foreign nations, are turning to Chicago for lessons in making public education effective once again. In July 2001, Mayor Daley appointed a new management team consisting of experienced managers who have guided CPS over the past several years as well as new talent drawn from the corporate, university, and nonprofit sectors. This team remains committed to enhancing the fundamental services efficiently and effectively provided to students and to bringing new vitality to CPS’ educational programs.

*Focus on Educational Goals.* CPS has developed strategies that enhance educational opportunities and improve the academic skills of all CPS students. Working together with parents, community-based organizations, teachers, educators, and the elected officials of the Chicago Teachers Union, CPS’ focus encompasses three areas: reading, teacher excellence, and community schools.

*Reading Enhancement Action Plan.* This top priority program focuses on teaching every student in every school to read. The program establishes a uniform instructional framework structured to provide continuity citywide at all grade levels. The program requires a minimum of two hours a day be devoted exclusively to reading and writing in every elementary school. At the high school level, double periods of reading and writing are required for students not performing at grade level. In addition, CPS is training an elite corps of reading specialists,

recruited both locally and nationally, to ensure that teachers are trained to use books and materials appropriately.

*Teacher Excellence.* Rising student enrollments, an increasing number of teachers reaching retirement age, and a decreasing number of college students choosing a teaching career have led CPS to new initiatives to recruit and retain teachers. Teacher quality, one of the best predictors of student achievement, is being addressed through an initiative to ensure that all teachers are qualified and have appropriate certifications in all classrooms. Creating strong, nurturing environments that support teacher needs will further improve teacher classroom skills and drive student achievement.

*Community Schools.* Several CPS schools operate year-round and are open long hours to provide for the needs of the students before, during and after traditional school days. CPS' vision encompasses a comprehensive, coordinated and collaborative delivery of services jointly created and operated by the school, community organizations and parents as equal partners based on each school's needs. Programs currently offered include tutoring, art, sports and other enrichment activities designed to build on skills, talents and interests developed as part of the regular curriculum. By collaborating with community-based organizations already funded to provide social and health services to our students, schools can directly address the needs of children by providing services onsite.

*Educational Results.* There continue to be many positive educational trends at CPS. The 2005 results from the Iowa Test of Basic Skills show that 43.7% of elementary school students are reading at or above national norms, while 46.6% are performing at or above national norms in math. Overall, reading scores are up 17.2 percentage points and math 16.6 percentage points since 1996, the first full school year Mayor Daley assumed responsibility for the schools. Additionally, in high schools, the dropout rate has declined, the graduation rate has continued to grow, average ACT scores have increased, and more students are taking advanced placement classes than ever before.

*Renaissance 2010 Program.* Renaissance 2010 is a plan, announced by Mayor Daley, to improve the educational choices and opportunities for students throughout Chicago. Under the plan, at least 100 new schools will be created by the year 2010 which will be a combination of CPS-run, contract and charter schools. These new schools will help to address the under-utilization of CPS buildings, lack of high school options, over-crowding and low performance. Renaissance 2010 is an overarching plan that consists of multiple strategies. One strategy is to focus on geographic concentrations of under-utilized buildings and/or low performing schools with a comprehensive approach to meeting the needs of that geography and its neighborhoods. Selection of schools will be heavily informed by the community who will evaluate proposals and make recommendations to the Board. All schools will be accountable via Performance Agreements that outline expectations for student achievement, on-going community and parent involvement and school management.

*Modern Schools Across Chicago.* Modern Schools Across Chicago is a plan, announced by Mayor Daley, to build 24 new schools and renovate three others across the city over the next six years. The \$1 billion plan would be funded primarily through city tax incremental financing dollars, pending aldermanic support and CPS bond funds. It will bring nine new high schools,



fifteen new elementary schools and three high school renovations to neighborhoods across the City. The Modern Schools Across Chicago plan will bring state of the art facilities to all parts of the City, which is the next step in CPS' ongoing effort to give children the same opportunity for a good neighborhood education, regardless of where they live. Five new schools and three school renovations are projected to be completed within the next three years. The remainder of the schools will be constructed over the following three years.

### **Chicago Teachers' Union and Other Employee Groups**

For its 2006 fiscal year, the Board employed approximately 47,000 persons. Approximately 90% of the Board's employees are represented by seven unions that engage in collective bargaining with the Board. As of June 1, 2005 approximately 74% of the Board's employees were represented by the Chicago Teacher's Union (the "CTU") and approximately 16% were represented by six other unions.

The Board's current four-year agreement with the CTU expires June 30, 2007. The contract provides for base salary increases for all teachers of four percent (4%) for each fiscal year through 2007. The 4% increase for fiscal year 2007 may be adjusted upward in such fiscal year depending on the total amount of general fund revenue received by the Board in that fiscal year.

The remaining six labor unions also hold four year contracts with the Board. All of these agreements expire on June 30, 2007. Employees represented by these unions will experience a base salary increase of 4% for each fiscal year through 2007.

The Board has sought certain methods of alternative dispute resolution to reduce the number of union grievances and overall labor litigation. A voluntary grievance mediation program, a labor management committee and a class size monitoring committee designed to resolve class size complaints successfully divert numerous matters away from litigation each year.

Other issues addressed in all collective bargaining agreements with the Board include various working conditions, grievance procedure and employee benefits. For a discussion of pension and retirement benefits for eligible employees, see "– Employee Pension Obligations" below under this caption.

### **Recent Financial Information Concerning the Board**

For fiscal years 1996 through 2005, the Board adopted and achieved a balanced budget. For fiscal year 2006, the Board adopted a balanced budget and, as of June 30, 2006, the estimated revenues and expenditures for such fiscal year indicate that such balanced budget will be achieved. On June 28, 2006, the Board also adopted a balanced budget for fiscal year 2007 that reflected total resources, including \$105 million of available fund balances and appropriations of \$4.4 billion for the General Operating Fund.

The most recent audited financial statements are for the fiscal year ended June 30, 2005 and are included as APPENDIX A.

**General Operating Fund Balances.** As of June 30, 2006, the Board had a fund balance of \$431.8 million, of which \$138.4 million has been reserved for encumbrances and other specific purposes. The remaining unreserved balance was \$293.4 million, \$218.4 million of which was designated to provide operating capital. The fiscal year 2007 budget re-appropriated \$105.0 million of ending fiscal year 2006 fund balance, \$30.0 million for specific purposes and \$75.0 million to balance the general fund.

**General Operating Fund Revenues, Expenditures, Other  
Financing Sources and Changes in Fund Balances for the Board<sup>(1)</sup>**  
(Amounts in Thousands)  
As of June 30

	<b>Actual</b>				<b>Estimated</b>	<b>Budget</b>
	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006<sup>(2)</sup></b>	<b>2007<sup>(3)</sup></b>
Revenues:						
Property Taxes .....	\$1,429,307	\$1,495,382	\$1,520,557	\$1,587,803	\$1,627,050	\$1,696,562
Replacement Taxes .....	57,193	48,852	61,897	94,546	92,060	91,494
State Aid .....	1,336,586	1,307,229	1,329,390	1,417,423	1,500,002	1,584,030
Federal Aid .....	539,573	602,677	703,821	746,403	743,600	834,910
Investment Income .....	16,505	20,803	18,779	14,003	16,500	21,283
Other .....	66,917	76,609	87,545	85,377	89,011	72,444
Total Revenues .....	<u>\$3,446,081</u>	<u>\$3,551,552</u>	<u>\$3,721,989</u>	<u>\$3,945,555</u>	<u>\$4,068,223</u>	<u>\$4,300,723</u>
Expenditures						
Instruction .....	\$2,152,958	\$2,214,781	\$2,355,114	\$2,429,014	\$2,564,001	\$2,617,212
Pupil Services .....	311,628	320,380	327,653	323,225	327,720	367,049
Support Services .....	750,111	764,002	770,629	821,583	832,655	1,005,711
Food Services .....	160,063	170,238	180,588	173,872	172,910	200,973
Community Services .....	47,523	47,253	49,933	42,325	45,567	42,791
Teachers' Pension .....	65,045	65,045	65,045	65,045	74,922	169,553
Other .....	6,558	13,742	9,548	7,332	9,648	2,434
Total Expenditures .....	<u>\$3,493,886</u>	<u>\$3,595,441</u>	<u>\$3,758,510</u>	<u>\$3,862,396</u>	<u>\$4,027,423</u>	<u>\$4,405,723</u>
Revenues in Excess of (less than)						
Expenditures .....	\$ (47,805)	\$ (43,889)	\$ (36,521)	\$ 83,159	\$ 40,800	\$ (105,000)
Other Financing Sources .....	<u>1,527</u>	<u>7,711</u>	<u>15,071</u>	<u>328</u>	<u>—</u>	<u>—</u>
Change in Fund Balance Revenues and Other Financing Sources in Excess of (Less than) Expenditures .....	\$ (46,278)	\$ (36,178)	\$ (21,450)	—	—	—
Fund Balance, Beginning of Period .....	<u>411,412</u>	<u>365,134</u>	<u>328,956</u>	<u>307,506</u>	<u>390,993</u>	<u>431,793</u>
Fund Balance, End of Period .....	\$ 365,134	\$ 328,956	\$ 307,506	\$ 390,993	\$ 431,793	\$ 326,793
Composition of Ending Fund Balance:						
Reserved for:						
Encumbrances .....	\$ 118,726	\$ 78,879	\$ 67,542	\$ 97,313	\$ 108,393	\$ 108,393
Specific Purposes .....	<u>36,525</u>	<u>41,718</u>	<u>43,454</u>	<u>45,134</u>	<u>30,000</u>	<u>—</u>
Total Reserved Fund Balance .....	<u>\$ 155,251</u>	<u>\$ 120,597</u>	<u>\$ 110,996</u>	<u>\$ 142,447</u>	<u>\$ 138,393</u>	<u>\$ 108,393</u>
Unreserved:						
Designated to Provide Operating Capital .....	\$ 201,500	\$ 161,233	\$ 171,300	\$ 190,000	\$ 218,400	\$ 218,400
Undesignated .....	<u>8,383</u>	<u>47,126</u>	<u>25,210</u>	<u>58,546</u>	<u>75,000</u>	<u>—</u>
Total Unreserved .....	<u>\$ 209,883</u>	<u>\$ 208,359</u>	<u>\$ 196,510</u>	<u>\$ 248,546</u>	<u>293,400</u>	<u>\$ 218,400</u>
Total Fund Balance .....	\$ 365,134	\$ 328,956	\$ 307,506	\$ 390,993	\$ 431,793	\$ 326,793

- (1) The Board reports its financial activities through the use of fund accounting and follows the modified accrual basis of accounting for its Governmental Funds. See APPENDIX A – “Financial Statements of the Board of Education of the City of Chicago.”
- (2) Amounts are estimated for the fiscal year ended June 30, 2006. The audited financial statements for such fiscal year are not yet approved.
- (3) Amounts are derived from the Fiscal Year 2007 Budget as published by Budget Department.

## **Outstanding Debt Obligations**

**Long-Term Debt Obligations.** In addition to the Bonds, the Board has approximately \$3.9 billion aggregate principal amount of outstanding Alternate Bond debt. The Board's outstanding long-term debt consists of approximately \$458.0 million aggregate principal amount of leases with The Public Building Commission of Chicago (the "PBC Leases"). The lease rentals due under the PBC Leases are supported by separate unlimited property tax levies of the Board. For additional information on the Public Building Commission, see "OTHER LOCAL GOVERNMENT UNITS – Other Public Bodies – The Public Building Commission of Chicago." To provide for payment of the lease rentals under the PBC Leases, the Board has established lease payment debt service fund accounts with a lease payment trustee. Under the School Code and resolutions of the Board establishing those trust accounts, the Board has levied a separate tax unlimited as to rate or amount on real property within the School District to pay the lease rentals under the PBC Leases. Tax receipts of the Board attributable to the Board's PBC Leases are required to be paid by the County Collector directly to the lease payment trustee and deposited in a fund account to be used for the payment of the applicable lease rentals under the PBC Leases when due. Investment income on deposits in the fund accounts established to make lease rentals under the PBC Leases is paid to the Board to the extent not needed to meet the lease obligations for which the particular fund account is established.

**Board's Overlapping Debt Schedule  
as of September 12, 2006  
(Dollars in Thousands)**

	<b>Amount</b>
Direct Debt	
Series 2006B Bonds .....	\$ 355,805
Total Prior Bonds .....	3,866,956
Leases Securing PBC Bonds (principal component).....	458,030
Total Direct Debt.....	<u>\$ 4,680,791</u>

	<b>Amount</b>	<b>Percent Applicable</b>	<b>Amount Applicable</b>
Overlapping Debt <sup>(1)</sup>			
City	\$5,814,866	100.00%	\$ 5,814,866
School Finance Authority	187,985	100.00%	187,985
Community College District	56,105	100.00%	56,105
Chicago Park District <sup>(2)</sup>	559,760	100.00%	559,760
Water Reclamation District	1,577,751	45.42%	716,615
Cook County	3,070,610	44.47%	1,365,500
Forest Preserve District	132,855	44.47%	<u>59,081</u>
Total Overlapping Debt			<u>\$ 8,759,911</u>
Total Direct and Overlapping Debt			<u>\$ 13,440,702</u>

**Selected Debt Statistics**

Population (2000) <sup>(4)</sup> .....	2,896,016
Equalized Assessed Valuation (2005) <sup>(3) (5)</sup> .....	\$ 59,304,530
Estimated Fair Market Value (2004) <sup>(6)</sup> .....	\$262,080,627

	<b><u>Per Capita</u><sup>(7)</sup></b>	<b><u>% EAV</u></b>	<b><u>% FMV</u></b>
Direct Debt	\$1,616.29	7.89%	1.79%
Total Direct and Overlapping Debt	\$4,641.10	22.66%	5.13%

- (1) Excludes outstanding tax anticipation notes and warrants; includes the principal amount of PBC Bonds secured by leases with the following units of government:

Community College District	\$ 56,105,000
Chicago Park District	\$ 21,715,000

- (2) Excludes \$417,075,000 of outstanding general obligation bonds issued as "alternate bonds" under the Debt Reform Act for which the alternate revenue source is personal property replacement tax revenues, parking revenues, and harbor revenues.
- (3) Cook County only.
- (4) Source: United States Census Bureau.
- (5) Source: Cook County Clerk's Office. Total Equalized Assessed Value is net of exemptions and includes assessment of pollution control facilities.
- (6) Source: The Civic Federation.
- (7) Per Capita amounts are not expressed as dollars in thousands.

## Board's Debt Service Schedule

Calendar Year	Prior Bonds <sup>1,2,3</sup>	PBC Leases <sup>1</sup>	The Series 2006B Bonds	Total Annual Debt Service
2006	\$174,299,256	\$51,990,050	-	226,289,306
2007	188,897,511	52,037,000	\$22,999,024	263,933,535
2008	193,508,772	52,096,838	22,995,150	268,600,760
2009	268,500,259	52,103,825	22,998,763	343,602,847
2010	273,251,450	52,163,338	22,996,538	348,411,326
2011	287,963,729	52,232,025	22,995,038	363,190,792
2012	268,360,006	52,318,625	22,995,038	343,673,669
2013	289,409,665	52,359,513	22,999,238	364,768,416
2014	278,563,246	52,430,550	22,997,038	353,990,834
2015	289,363,667	52,467,613	22,997,288	364,828,568
2016	281,167,909	52,519,550	22,998,538	356,685,997
2017	278,270,596	52,600,125	22,999,788	353,870,509
2018	283,692,010	52,664,600	22,995,038	359,351,648
2019	308,341,511	30,635,500	22,998,538	361,975,549
2020	338,212,880	-	22,998,788	361,211,668
2021	345,082,061	-	22,994,788	368,076,849
2022	307,295,693	-	22,995,538	330,291,231
2023	329,428,839	-	22,999,538	352,428,377
2024	326,079,735	-	22,995,288	349,075,023
2025	322,438,017	-	22,996,788	345,434,805
2026	322,448,782	-	22,997,288	345,446,070
2027	292,259,858	-	22,995,288	315,255,146
2028	384,243,778	-	22,999,288	407,243,066
2029	323,490,940	-	22,994,888	346,485,828
2030	323,536,378	-	22,996,763	346,533,141
2031	323,569,061	-	22,998,013	346,567,074
2032	93,969,892	-	22,996,975	116,966,867
2033	62,097,096	-	22,996,725	85,093,821
2034	46,515,698	-	22,996,225	69,511,923
2035	31,449,780	-	22,998,225	54,448,005
2036	<u>18,344,828</u>	<u>-</u>	<u>22,995,225</u>	<u>41,340,053</u>
	\$7,854,052,903	\$710,619,152	\$689,910,648	\$9,254,582,703

- (1) Debt service payments include principal and interest due to and including the following January 1.
- (2) Interest on \$303,000,000 of variable rate, Series 2000B, Series 2000C and Series 2000D Bonds is calculated at an assumed rate of 6% per annum; although actual rates may vary, interest on \$183,775,000 of auction rates Series 2003B Bonds is calculated at the swap rate of 3.782% based on a 360-day year consisting of twelve 30-day months; interest on approximately \$72,575,000 of auction rate Series 2003D-1 and Series 2003D-2 Bonds is calculated at an assumed rate of 5% per annum; interest on \$185,350,000 of auction rates Series 2003D-3 and Series 2003D-4 Bonds is calculated at the swap rate of 3.771% based on a 360-day year consisting of 12 30-day months; interest on \$298,075,000 of auction rates Series 2004B Bonds is calculated at the swap rate of 3.5439% based on a 360-day year consisting of 12 30-day months. Interest on \$222,080,000 of variable rate Series 2004C, Series 2004D and Series 2004E Bonds is calculated at an assumed rate of 4.5% per annum, although actual rates may vary.
- (3) Includes other outstanding general obligation Alternate Bonds.

**Legal Debt Margin Information**  
**As of June 30, 2001-2005**  
**(Dollars in thousands)**

	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Debt Limit <sup>(1)</sup> .....	\$5,587,224	\$5,794,463	\$6,256,611	\$7,338,200	\$7,629,142
General obligation Bonds .....	1,161,290	1,069,366	979,083	917,855	764,761
Less: Amount set aside for repayment of bonds .....	(38,379)	(37,965)	(37,486)	(36,226)	(38,913)
Total net Debt applicable to Limit .....	<u>1,122,911</u>	<u>1,031,401</u>	<u>941,597</u>	<u>881,629</u>	<u>725,848</u>
Legal debt margin .....	<u>\$4,464,313</u>	<u>\$4,763,062</u>	<u>\$5,315,014</u>	<u>\$6,456,571</u>	<u>\$6,903,294</u>
Total net debt applicable to the limit as a percentage of debt limit	<u>20.10%</u>	<u>17.80%</u>	<u>15.05%</u>	<u>12.01%</u>	<u>9.51%</u>

<sup>(1)</sup>The debt limit is equal to 13.8% of the applicable equalized assessed valuation.

## Board's Interest Rate Swap Agreements

The Board has previously entered into the interest rate swap agreements set forth in the table below.

Series	Counterparty	Trade Date	Effective Date	Notional Amount	Termination Date	Payable Swap Rate	Variable Receivable Swap Rate
2003B	Goldman Sachs	2/4/2003	2/13/2003	\$ 110,026,500	3/1/2033	3.782%	Through 3/1/07: BMA 3/1/07 – 3/10/33: 70% of Libor Through 3/1/07: BMA 3/1/07 – 3/01/33: 70% of Libor
	Bank of America	2/4/2003	2/13/2003	73,510,000	3/1/2033	3.782%	
2003D	Lehman Brothers	12/8/2003	12/12/2003	\$ 95,350,000	3/1/2034	3.771%	70% of Libor
	Goldman Sachs	12/8/2003	12/12/2003	\$ 90,000,000	3/1/2034	3.771%	70% of Libor
2004B	Goldman Sachs	3/31/2004	4/6/2004	\$ 178,845,000	3/1/2032	3.544%	70% of Libor
	Bear Stearns	3/31/2004	4/6/2004	119,230,000	3/1/2032	3.544%	70% of Libor
	Bear Stearns	3/31/2004	4/6/2004	298,075,000	3/1/2032	70% of Libor	X% of Libor <sup>(1)</sup>
1997A	Bank of America	8/18/2005	12/1/2007 <sup>(2)</sup>	\$ 100,000,000	12/1/2030	5.25%	70% of Libor + .28%
2005A	Loop Capital Markets <sup>(3)</sup>	10/5/2005	11/1/2005	\$ 116,151,000	12/1/2031	BMA Index	70% of Libor + 0.524 bp
	Merrill Lynch & Co.	10/5/2005	11/1/2005	77,434,000	12/1/2031	BMA Index	80.76% of Libor
2005D-2 & 2005E	Loop Capital Markets <sup>(3)</sup>	11/30/2005	12/8/2005	\$ 287,055,000	3/1/2036	3.6617%	70% of Libor

<sup>(1)</sup> The percentage of Libor is a floating rate based on the following rate scale:

Libor	Percentage of Libor
Less than 1.55%	90%
Greater than 1.55% but less than 2.35%	77%
Greater than 2.35% but less than 3.45%	73%
Greater than 3.45% but less than 4.10%	71%
Greater than 4.10% but less than 6.00%	70%
Greater than 6.00%	65%

<sup>(2)</sup> Only upon exercise of option.

<sup>(3)</sup> Loop Capital Markets backed by Deutsche Bank.

The swaps represented by the Series 2003B Swap Agreements, the Series 2003D Swap Agreements, the Series 2004B Swap Agreements, the 1997A Swap Agreement, the 2005A Swap Agreements, the 2005D-1 Swap Agreement and the 2005E Swap Agreement (collectively, the “Existing Swap Agreements”) expose the Board to certain risks. Should the market value of the swaps become positive, the Board may be exposed to the credit risk of the swap providers. If a swap provider’s credit rating declines below specified rating levels and the market value of the swap reaches certain threshold amounts, the Existing Swap Agreements provide that the market value of the swap will be collateralized by the swap provider with U.S. government securities. Collateral would be posted with a third-party custodian.

The Board will be exposed to “basis risk” should the rate paid on the bonds subject to an Existing Swap Agreement exceed the rate payable to the Board pursuant to the related Existing Swap Agreements. Should any adverse basis differential occur while an Existing Swap Agreement is in effect, the rate paid on the bonds that are subject to the Existing Swap Agreement will be higher than the expected fixed rate, and therefore the expected interest cost savings may not be realized.



The Board may terminate an Existing Swap Agreement at any time at market value. In addition, the Board or a swap provider may terminate an Existing Swap Agreement under certain other conditions. If an Existing Swap Agreement is terminated, the bonds subject to that Existing Swap Agreement would no longer carry the expected fixed interest rate, and the Board would be subject to the interest rate risk associated with variable rate debt. Also, if, at the time of termination, an Existing Swap Agreement has a negative market value, the Board would be liable to the applicable swap provider for a termination payment equal to the swap's market value. Such termination payment may be substantial.

## **Employee Pension Obligations**

**Funding of Pension Obligations.** Pension benefits for eligible teachers and administrators of the Board are provided under a defined benefit plan administered by the Public School Teachers' Pension and Retirement Fund of Chicago, a separate legal entity (the "Pension Fund"). See APPENDIX A – "Financial Statements of the Board of Education of the City of Chicago – Note (12)." The 1995 Amendatory Act provided that by fiscal year 1999 the Pension Fund would be funded using the same actuarial funding method as the Illinois Teachers' Retirement Fund. Applicable provisions of the Illinois Pension Code provide that this method will cause the ratio of the actuarially determined value of the assets of the Pension Fund to its actuarially determined accrued liabilities (or "Funded Ratio") to equal 90% by fiscal year 2045. As of June 30, 2005, the end of the last fiscal year of the Pension Fund for which audited financial information is available, the Funded Ratio for the Pension Fund was 79.02%.

The 1995 Amendatory Act and various additional amendments made to the School Code in 1996, 1997 and 1998: (i) eliminated the Board's obligation to make any local employer pension contribution unless the Funded Ratio of the Pension Fund would otherwise fall below 90%; and (ii) made additional changes to the Board's obligation to fund pension benefits. Based on the current Funded Ratio for the Pension Fund, the Board is required to contribute \$26.4 million to the Pension Fund in fiscal year 2006.

## **Other Post-Employment Benefits**

Eligible teacher and administrator retirees of the Board are provided healthcare benefits under a plan administered and funded by the Pension Fund (the "Health Insurance Program"). Current State law limits the amount that the Pension Fund may contribute to the Health Insurance Program to \$65,000,000 annually and it also limits payments to reimburse individual plan participants to 75% of actual health care costs. The spending limit has changed six times within the last twenty years and is subject to further change if new legislation is passed.

The Board contributes to the Pension Fund on a pay-as-you-go basis to the extent the Funded Ratio of the Pension Fund would otherwise fall below 90% (see "Employee Pension Obligations - Funding of Pension Obligations"). Amounts diverted from the Pension Fund to the Health Insurance Program would reduce the Funded Ratio of the Pension Fund.

The Governmental Accounting Standards Board has issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pension* ("GASBS 45") for retiree healthcare benefits. The Board is not required to adopt the standards set forth in GASBS 45 until its fiscal year 2008, however the Board anticipates an early adoption of such standards in its fiscal year 2006 financial statements.

The Board has commissioned actuarial studies which have provided preliminary results for consideration, under several actuarial funding methods and sets of assumptions. Pursuant to such studies, the total actuarial liability, and the annual required contribution, for the Health Insurance Program as of June 30, 2005 has been estimated to be \$2,465,657,052 and \$182,877,688 respectively. This estimate represents the amount of healthcare benefits under the Health Insurance Program, without any assumption as to a limit on the amount the Pension Fund may divert to the Health Insurance Program. If the \$65,000,000 cap were to remain in place as an effective limit, the total actuarial liability and annual required contribution estimates would be substantially reduced.

### **Debt Management Policy**

Due to changes in the financial markets, the Board recently adopted a new Debt Management Policy (the “Debt Policy”) on April 27, 2005. The purpose of the Debt Policy is to provide guidance for debt management and capital planning and to enhance the Board’s ability to manage its debt in a conservative and prudent manner. In issuing the Bonds and any future debt, and when entering into derivative contracts, the Board will consider a number of factors, including the duration of the debt in relation to the economic life of the improvement or asset that the issue is financing, its mix of fixed and variable rate debt, negotiated and competitive methods of sale, conditions in both domestic and international markets, credit enhancement agreements, the risks associated with various types of debt and/or derivative instruments, the potential impact of debt service on the operating budget, statutory debt limitations, and credit implications. The Board also believes it should avoid financing general operating costs from debt having maturities greater than one year.

A copy of the Debt Policy is available at the Board’s website at <http://policy.cps.k12.il.us/documents/404.1.pdf>. The Debt Policy may be subsequently amended or modified by the Board, without notice to or consent of the owners of the Bonds.

### **Investment Policy**

The Board has adopted an Investment Policy (the “Investment Policy”). The objectives of the Investment Policy are to invest public funds in a manner which is consistent with all state and local statutes governing the investment of public funds and which will provide for the safety of principal, diversification and maximization of the rate of return. The Investment Policy specifically prohibits any purchase of financial futures, any leveraged investment lending securities and any collateralized mortgage obligations. All investments of the moneys on deposit in the Funds and Accounts established under the Indenture for the Bonds are subject to the provisions of the Investment Policy as in effect, from time to time.

A copy of the Investment Policy is available at the board’s website <http://policy.cps.k12.il.us/documents/403.1.pdf>. The Investment Policy may be subsequently amended or modified by the Board, without notice to or consent of the Owners of the Bonds subject, in all respects, to the provisions of the Public Funds Investment Act of the State of Illinois, as amended.

## OTHER LOCAL GOVERNMENTAL UNITS

### Overlapping Entities

There are eight major units of local government located in whole or in part within the boundaries of the school district governed by the Board, each of which (i) is separately incorporated under the laws of the State, (ii) has an independent tax levy, (iii) derives its power and authority under the laws of the State, (iv) maintains its own financial records and accounts and (v) is authorized to issue debt obligations. These units are: the City; the Board; the Chicago School Finance Authority; the Chicago Park District; Community College District Number 508; Cook County; the Forest Preserve District of Cook County; and the Metropolitan Water Reclamation District of Greater Chicago. Each of the foregoing governmental units levies taxes upon property located in the City, and, in some cases, in other parts of Cook County as well. For additional information about the Board, see “BOARD OF EDUCATION OF THE CITY OF CHICAGO.” Information about these other units of local government is set forth below.

### Major Units of Government

**The City of Chicago** is a home rule unit of government under the Illinois Constitution, and was incorporated in 1837. The City is governed by the Mayor (the “Mayor”), who is elected at-large for a four-year term, and a City Council (the “City Council”). The City Council consists of 50 aldermen each representing one of the City’s 50 wards, elected for four-year terms.

**The Chicago Park District** (the “Park District”) has boundaries coterminous with the City and is responsible for the maintenance and operation of parks, boulevards, marinas and certain other public property within the City. The Park District is governed by a seven-member board, appointed by the Mayor with the approval of the City Council.

**Community College District Number 508** (the “Community College District”) is responsible for maintaining and operating a system of community colleges within the City. The governing body is a board of seven trustees appointed by the Mayor with the approval of the City Council.

**The County of Cook** (the “County”) is a home rule unit of government under the Illinois Constitution, and includes virtually all of the City, plus numerous surrounding suburbs and unincorporated areas. The County is governed by a board of 17 Commissioners, each elected for four-year terms from one of 17 districts. The President of the County Board of Commissioners is elected by the voters of the entire County. The voters of the entire County also elect a number of other County Officials, including the County Sheriff, the County Assessor, the County Clerk, the State’s Attorney and the County Treasurer. The County is primarily responsible for the operation of the criminal justice system, the provision of health care services and numerous functions relating to property tax administration.

**The Forest Preserve District of Cook County** (the “Forest Preserve District”) has boundaries coterminous with the County and is responsible for establishing, maintaining and operating forest preserves within the County. The governing body is composed of the members of the County Board of Commissioners, chaired by the President of the County Board of Commissioners.

**The Metropolitan Water Reclamation District of Greater Chicago** (the “Water Reclamation District”), formerly known as the Metropolitan Sanitary District of Greater Chicago, includes virtually all of the City and most of the County. The Water Reclamation District constructs, maintains and operates sewage treatment plants and certain sanitary sewers. In addition, the Water Reclamation District constructs and maintains drainage outlets. The Water Reclamation District is governed by a nine-member board elected at-large by the voters of the Water Reclamation District.

### **Interrelationships of These Bodies**

The overlapping governmental taxing bodies described above and the Chicago School Finance Authority, described below, share in varying degrees a common property tax base with the Board. See “BOARD OF EDUCATION OF THE CITY OF CHICAGO – Outstanding Debt Obligations – Board’s Overlapping Debt Schedule.” However each such public body is a separate and distinct governmental unit. The financial condition of any such body does not imply the same condition for the Board.

### **Other Public Bodies**

Other governmental bodies in the Board’s geographical boundaries are described below. These governmental bodies are authorized to issue debt obligations, but are not authorized to levy real property taxes.

**The Public Building Commission of Chicago** (the “PBC”) is a municipal corporation authorized to acquire, construct and improve public buildings and facilities for use by one or more of the local governmental units. The PBC issues bonds to finance its various projects and then leases its facilities to certain governmental units. At present, the Board leases substantially all school buildings and facilities from the PBC. Several other of the major governmental units described above also lease facilities from the PBC. See “BOARD OF EDUCATION OF THE CITY OF CHICAGO – Outstanding Debt Obligations – Board’s Overlapping Debt Schedule.”

The Mayor, also one of the members of the PBC, appoints six of the 10 additional members of the PBC. Currently, a member of the Board is one of these members. The presiding officers of the Park District and the Water Reclamation District each appoint one member while the County appoints two members. The PBC is not authorized to levy real property or other taxes, but the public bodies which lease facilities from the PBC, including the Board, levy real property taxes to make the required lease rental payments.

**The Chicago Transit Authority** (the “CTA”) is a municipal corporation empowered to acquire, construct, own, operate and maintain a transportation system in the City and portions of the County. The CTA is governed by a seven-member board. Four members are appointed by the Mayor with the approval of the City Council, and three members are appointed by the Governor with the approval of the State Senate. The CTA board elects a Chairman from its members who serves for a term of three years.

**The Regional Transportation Authority** (the “RTA”) is a municipal corporation authorized to provide planning, funding, coordination and fiscal oversight of three separately governed operating entities which provide public mass transportation services in a six-county area of northeastern Illinois, including Cook County. These include the CTA, METRA, the suburban rail division, and PACE, the suburban bus division. The RTA is governed by a 13-member board, consisting of City and suburban members appointed by elected officials in the six-county RTA region. The RTA is primarily funded by

taxes imposed by the RTA on retail sales in the six-county area, and an amount from the State equal to one-fourth of the sales taxes collected in the region by the State. The RTA is also authorized to impose, but does not presently impose, taxes on automobile rentals, motor fuel and off-street parking facilities. By law, motor fuel and off-street parking taxes may not be imposed concurrently with sales taxes.

**The Metropolitan Pier and Exposition Authority** (the “MPEA”) is a municipal corporation which owns and operates the McCormick Place convention and exposition facilities and Navy Pier. MPEA has previously issued revenue bonds to finance its projects. MPEA is governed by a 13-member board, six of whom are appointed by the Governor, with the approval of the State Senate, and six of whom are appointed by the Mayor. The Mayor also appoints, with the approval of the Governor, one additional member who also serves as Chairman of MPEA. The Chief Executive Officer is appointed by the Governor, with the approval of the Mayor. MPEA receives revenue from the operation of its facilities and from the imposition of sales and other consumption-related taxes.

Various authorities have been created under Illinois law to facilitate the financing of educational facilities, health facilities, highways, housing, industrial development, sports facilities, port facilities and other activities. These authorities are not authorized to levy real property taxes.

### **Chicago School Finance Authority**

The Chicago School Finance Authority has outstanding debt issued for the benefit of the School District and is discussed below.

**Establishment.** In 1979 and early 1980, the Board experienced severe financial difficulties. In January 1980, as part of a plan to address these financial difficulties, the Illinois General Assembly established the Chicago School Finance Authority (the “Authority”). The Authority is governed by a five-member board of directors: two directors are appointed by the Mayor with the approval of the Governor; two directors are appointed by the Governor with the approval of the Mayor; the Chairman is appointed jointly by the Governor and the Mayor. The Authority will remain in existence until one year after all bonds and notes issued by it have been discharged. The final payment of principal and interest on the outstanding bonds issued by the Authority is scheduled to occur in calendar year 2009.

**Financial Oversight and Control Powers.** Prior to the adoption of the 1995 Amendatory Act, the Authority was authorized to exercise certain financial oversight and control powers with respect to the Board. Effective with the passage of the 1995 Amendatory Act, the Authority’s financial oversight and control powers were suspended until July 1, 1999. The suspension of these oversight and control powers has been extended until December 31, 2010.

**Debt Obligations.** Since 1980, the Authority has issued \$1,256,215,000 of its general obligation bonds to provide the Board with moneys for operating purposes, school rehabilitation and school construction purposes, working cash purposes and to refinance short-term debt obligations and to refund outstanding bonds of the Authority. See APPENDIX A – “Financial Statements of the Board of Education of the City of Chicago,” for a more complete description of the uses of the proceeds of the various series of bonds issued by the Authority. As of the date of this Official Statement, \$187,985,000 of the Authority’s bonds are outstanding, net of bonds defeased. The Authority’s bonds are general obligations of the Authority, payable from a separate real estate tax levied on all real property in the School District without limit as to rate or amount. The Authority’s bonds are not a direct or contingent

obligation of the Board. The Authority's levy is a separate levy in addition to all taxes which the Board or the City are authorized to levy. For additional information, see "BOARD OF EDUCATION OF THE CITY OF CHICAGO – Outstanding Debt Obligations – Board's Overlapping Debt Schedule."

## **THE REAL PROPERTY TAX SYSTEM**

### **Real Property Assessment, Tax Levy and Collection Procedures**

**General.** The following is a general summary of the real property assessment, taxing, and collection procedures applicable to the School District and counties in which it is located. As described under "SECURITY FOR THE BONDS – Pledged Taxes," the Pledged Taxes, to the extent they are levied and collected, will be derived from the proceeds of *ad valorem* taxes levied by the Board on all taxable property within the School District.

Substantially all (approximately 99.99%) of the "Equalized Assessed Valuation" (described below) of taxable property in the School District is located in Cook County (the "County"). The remainder is located in DuPage County. Accordingly, unless otherwise indicated, the information set forth under this caption and elsewhere in this Official Statement with respect to taxable property of the School District does not reflect the portion situated in DuPage County. The Illinois laws relating to real property are contained in the Illinois Property Tax Code, 35 ILCS 200/1-1, et seq., as amended (the "Property Tax Code").

**Assessment.** The Cook County Assessor (the "Assessor") is responsible for the assessment of all taxable real property within the County, except for certain railroad property and pollution control equipment assessed directly by the State. One-third of the real property in the County is reassessed each year on a repeating triennial schedule established by the Assessor. The City was reassessed in tax year 2003 and will be reassessed in 2006. The suburbs in the northern and northwestern portions of the County were reassessed in tax year 2004. The suburbs in the western and southern portions of the County were reassessed in tax year 2005.

Pursuant to the Cook County Real Property Assessment Classification Ordinance (the "Classification Ordinance"), real property in the County is separated into fourteen classifications for assessment purposes. After the Assessor establishes the fair cash value of a parcel of land, that value is multiplied by one of the classification percentages to arrive at the assessed valuation (the "Assessed Valuation") for the parcel. The current classification percentages range from 16% for certain residential, commercial and industrial properties to 36% and 38%, respectively, for other industrial and commercial property.

The Assessor has established procedures enabling taxpayers to contest their tentative Assessed Valuations. Once the Assessor certifies final Assessed Valuations, a taxpayer can seek review of its assessment by filing a complaint with the Cook County Board of Review (the "Board of Review"). The Board of Review consists of three commissioners, each elected by an election district in Cook County. The Board of Review is empowered to review and adjust Assessed Valuations set by the Assessor.

Owners of property are able to appeal decisions of the Board of Review to the Illinois Property Tax Appeal Board (the "PTAB"), a statewide administrative body. The PTAB has the power to determine the Assessed Valuation of real property based on equity and the weight of the evidence.

Depending on the amount of the proposed change in Assessed Valuation, taxpayers may appeal decisions of the PTAB to either the Circuit Court of Cook County or the Illinois Appellate Court under the Illinois Administrative Review Law.

In March 2000 and August 2001, the PTAB rendered two series of decisions in which it granted reduced Assessed Valuations to the owners of certain real property by employing lower levels of assessment. In the March 2000 decisions, the PTAB elected to utilize the median levels of assessment derived from the Illinois Department of Revenue's sales-ratio studies (the "Sales-Ratio Studies") as the mechanism for determining correct assessment levels, instead of those set forth in the Classification Ordinance. Use of the Sales-Ratio Studies resulted in a lower assessment level than required by the Classification Ordinance. In its August 2001 decisions, after examining the Sales Ratio Studies, the PTAB held that the Assessor's assessment practices violated a provision of the State Constitution, which limits the level of assessment of the highest class of property, in a county that classifies property, to two and one-half times the level of assessment of the lowest class of property in that county. As a result, the PTAB established a maximum assessment level that is significantly below the assessment levels for commercial and industrial property currently set forth in the Classification Ordinance.

The Board of Review, through the Cook County State's Attorney Office, appealed the March 2000 decisions and August 2001 decisions of the PTAB to the Illinois Appellate Court (the "Appellate Court"). On August 20, 2002, the Appellate Court issued an opinion affirming in part and reversing in part the March 2000 decisions concerning the PTAB's use of the Sales-Ratio Studies. Shortly thereafter, the PTAB filed a petition for leave to appeal with the Illinois Supreme Court asking the Court to review the Appellate Court's decision. On October 7, 2003, the Illinois Supreme Court denied the PTAB's petition for leave to appeal. The PTAB then filed a motion asking the Court to reconsider the denial of the petition for leave to appeal. On or about November 7, 2003, the Court denied the motion requesting reconsideration of the denial of the petition for leave to appeal.

In November of 2002, the Appellate Court heard oral argument on the PTAB's August 2001 decisions concerning the two and one-half times level of assessment. In December of 2003, the Appellate Court issued its decision and remanded the cases to the PTAB with directions to apply the level of assessment contained in the Classification Ordinance, concluding that the taxpayer did not timely raise proper challenges so as to justify the relief granted. In reaching this conclusion, the Court did not consider the PTAB's reading of the constitutional ratio limitation or the PTAB's use of Sales-Ratio Studies as authority to deviate from the Classification Ordinance. Both the PTAB and the property owner appealed the Appellate Court's December 2003 decision to the Illinois Supreme Court. On March 26, 2004, the Court denied the petitions for leave to appeal. The property owner in this matter then filed a petition for writ of certiorari with the United States Supreme Court, which was denied on October 4, 2004, in a case known by Docket No. 03-1716.

In both of its decisions the Appellate Court did not necessarily foreclose a taxpayer from proving the validity of the Sales-Ratio Studies and establishing a level of assessment for County property types other than the levels of assessment indicated by the Classification Ordinance. It did, however, reject the argument that the PTAB may take "judicial notice" of the Sales-Ratio Studies.

As an alternative to seeking review of Assessed Valuations by the PTAB, taxpayers who have first exhausted their remedies before the Board of Review and have fully and timely paid their taxes may file an objection in the Circuit Court of Cook County. In addition, in cases where the Assessor agrees

that an assessment error has been made after tax bills have been issued, the Assessor can correct the Assessed Value, and thus reduce the amount of taxes due, by issuing a Certificate of Error.

All reviews of assessments, whether before the Board of Review, the PTAB or the courts are decided on a case-by-case basis.

**Equalization.** After the Assessed Valuation for each parcel of real estate in a county has been determined for a given year (including any revisions made by the Board of Review), the Illinois Department of Revenue reviews the assessments and determines an equalization factor (the “Equalization Factor”), commonly called the “multiplier,” for each county. The purpose of equalization is to bring the aggregate assessed value of all real estate in each county, except certain farmland and undeveloped coal, to the statutory requirement of 33-1/3% of estimated fair cash value. Adjustments in Assessed Valuation made by the PTAB or the courts are not reflected in the Equalization Factor. The Assessed Valuation of each parcel of real estate in the County is multiplied by the County’s Equalization Factor to determine the parcel’s equalized assessed valuation (the “Equalized Assessed Valuation”).

The Equalized Assessed Valuation for each parcel is the final property valuation used for determination of tax liability. The aggregate Equalized Assessed Valuation for all parcels in any taxing body’s jurisdiction, after reduction for all applicable exemptions, plus the valuation of property assessed directly by the State, constitutes the total real estate tax base for the taxing body and is the figure used to calculate tax rates (the “Assessment Base”). The Equalization Factor for a given year is used in computing the taxes extended for collection in the following year. The Equalized Assessed Valuation used to determine any applicable tax limits is the one for the immediately preceding year and not the current year. See “– Property Tax Extension Limitation Law; Issuance of Alternate Bonds” below. For a listing of the Equalization Factors for the ten years ended December 31, 2005, see “– Property Tax Information – Assessed, Equalized Assessed and Estimated Value of All Taxable Property 1996-2005.”

**Exemptions.** The annual general homestead exemption provides for the reduction of the Equalized Assessed Valuation of certain property owned and used exclusively for residential purposes by the amount of any increase over the 1977 Equalized Assessed Valuation, up to a maximum reduction of \$5000. Additional exemptions exist for (i) senior citizens, with the Assessor authorized to reduce the Equalized Assessed Valuation on a senior citizen’s home by \$3,000, and (ii) disabled veterans, with the Assessor authorized annually to exempt up to \$70,000 of the Assessed Valuation of certain property owned and used exclusively by such veterans or their spouses for residential purposes. A homestead improvement exemption allows homeowners to exempt up to \$75,000 of the increase in the fair cash value of their residence due to certain home improvements to an existing structure without increasing the Assessed Valuation of their property for at least four years. For rehabilitation of certain historic property, the Equalized Assessed Valuation is limited for eight years to the value when the rehabilitation work began. The Senior Citizens Tax Freeze Homestead Exemption freezes property tax assessments for homeowners who are 65 and older and have annual incomes of \$45,000 or less. Certain property is also exempt from taxation on the basis of ownership and/or use.

Additionally, counties have been authorized to create special property tax exemptions in long-established residential areas or in areas of deteriorated, vacant or abandoned homes and properties. Under such an exemption, longtime, residential owner-occupants in eligible areas would be entitled to a deferral or exemption from that portion of property taxes resulting from an increase in market value because of refurbishment or renovation of other residences or construction of new residences in the area.



On June 5, 2001, the County enacted the Longtime Homeowner Exemption Ordinance, which provides property tax relief from dramatic rises in property taxes directly or indirectly attributable to gentrification in the form of an exemption of certain homeowners who have resided in their homes for 10 consecutive years (or five consecutive years for homeowners who have received assistance in the acquisition of the property as part of a government or nonprofit housing program), and whose annual household income for the year of assessment does not exceed 115% of the Chicago Primary Metropolitan Statistical Area median income as defined by United States Department of Housing and Urban Development. Recent amendments to the Property Tax Code have capped the Longtime Homeowner Exemption at \$20,000 in equalized assessed value per levy year.

In addition, recent amendments to the Property Tax Code created an optional “Alternative General Homestead Exemption” which could be adopted by the various counties at the discretion of each respective county. On July 13, 2004 the Cook County Board adopted an enabling ordinance implementing the Alternative General Homestead Exemption.

An Alternative General Homestead Exemption limits future increases in the Equalized Assessed Valuation of residential property to an average annual increase of not more than 7% per year. The amount of this exemption for each applicable year is the Equalized Assessed Valuation of the homestead property for the current tax year minus the “adjusted homestead value,” which is defined as the lesser of (i) the property’s base homestead value increased by 7% for each tax year after 2002 through and including the current tax year of (ii) the property’s Equalized Assessed Valuation for the current tax year minus \$5,000. However, the total exemptions claimed by a homeowner under the Alternative General Homestead Exemption cannot exceed \$20,000 for any taxable year. Additionally, the total exemption is limited to \$5,000 for homeowners who are also entitled to the Senior Citizens Tax Freeze Homestead Exemption.

The Alternative General Homestead Exemption is temporary and is only available for three years following the year a homeowner’s property is assessed. If the general assessment year for the property is 2003, the Alternative General Homestead Exemption applies for the assessment years 2003, 2004 and 2005. If the general assessment year for the property is 2004, the Alternative General Homestead Exemption applies for the assessment years 2004, 2005 and 2006. Lastly, if the general assessment year for the property is 2005, the Alternative General Homestead Exemption applies for the assessment years 2005, 2006 and 2007. For the first taxable year only after the Alternative General Homestead Exemption no longer applies, an additional homestead exemption of \$5,000 is available for owners (i) who have not been granted a Senior Citizens Tax Freeze Homestead Exemption for the taxable year, (ii) whose qualified property has an Assessed Valuation that has increased by more than 20% over the previous Assessed Valuation of the property, and (iii) who have a household income of \$30,000 or less. After the Alternative General Homestead Exemption is phased out, homeowners are entitled to the General Homestead Exemption and other exemptions described above.

The Board believes that the primary impact of the Alternative General Homestead Exemption will be to grant some tax relief to residential property owners who experience a large increase in the assessed value of their residences in the applicable years by effectively shifting the tax burden to residential properties that have not had such large increases in assessed valuation and to industrial, commercial and other non-residential properties. At this time, secondary impacts cannot be determined.

**Tax Levy.** There are over 800 units of local government (the “Units”) located in whole or in part in the County that have taxing power. The major Units having taxing power over property within the County include the Board, the City, the Park District, the Authority, the Community College District, the Water Reclamation District, the County and the Forest Preserve District.

As part of the annual budgetary process of the Units, each year in which the determination is made to levy real estate taxes, proceedings are adopted by the governing body of each Unit. The tax levy proceedings impose the Units’ respective real estate taxes in terms of a dollar amount. Each Unit certifies its real estate tax levy, as established by the proceedings, to the County Clerk’s Office. The remaining administration and collection of the real estate taxes is statutorily assigned to the County Clerk and the County Treasurer, who is also the County Collector.

After the Units file their annual tax levies, the County Clerk computes the annual tax rate for each Unit by dividing the levy of each Unit by the Assessment Base of the respective Unit. If any tax rate thus calculated or any component of such a tax rate (such as a levy for a particular fund) exceeds any applicable statutory rate limit, the County Clerk disregards the excessive rate and applies the maximum rate permitted by law.

The County Clerk then computes the total tax rate applicable to each parcel of real property by aggregating the tax rates of all the Units having jurisdiction over the particular parcel. The County Clerk enters in the books prepared for the County Collector (the “Warrant Books”) the tax (determined by multiplying that total tax rate by the Equalized Assessed Valuation of that parcel), along with the tax rates, the Assessed Valuation and the Equalized Assessed Valuation. The Warrant Books are the County Collector’s authority for the collection of taxes and are used by the County Collector as the basis for issuing tax bills to all property owners.

**Collection.** Property taxes are collected by the County Collector, who remits to each Unit its share of the collections. Taxes levied in one year become payable during the following year in two installments, the first always due on March 1 and the second due on the later of August 1 or 30 days after the mailing of the tax bills. The first installment is an estimated bill equal to one-half of the prior year’s tax bill. The second installment is for the balance of the current year’s tax bill, and is based on the current levy, assessed value and Equalization Factor and applicable tax rates, and reflects any changes from the prior year in those factors. Over the last 10 years, the second installment “penalty date” (that is, the date after which interest is due on unpaid amounts) has not been later than November 15 and the date for tax year 2005 was September 1, 2006. It is possible that delays in the assessment process or changes to the assessment appeal process described above will cause delays in the preparation and mailing of second installment tax bills in future years.

The County may provide for tax bills to be payable in four installments instead of two. The County has not determined to require payment of tax bills in four installments. During the periods of peak collections, tax receipts are forwarded to each Unit weekly.

At the end of each collection year, the County Collector presents the Warrant Books to the Circuit Court and applies for a judgment for all unpaid taxes. The court order resulting from the application for judgment provides for an annual sale of all unpaid taxes shown on the year’s Warrant Books (the “Annual Tax Sale”). The Annual Tax Sale is a public sale, at which time successful tax buyers pay the unpaid taxes plus penalties. Unpaid taxes accrue penalties at the rate of 1.5% per month

from their due date until the date of sale. Taxpayers can redeem their property by paying the amount paid at the sale, plus a maximum of 18% for each six-month period after the sale. If no redemption is made within the applicable redemption period (ranging from six months to two and one-half years depending on the type and occupancy of the property) and the tax buyer files a petition in Circuit Court, notifying the necessary parties in accordance with applicable law, the tax buyer receives a deed to the property. In addition, there are miscellaneous statutory provisions for foreclosure of tax liens.

If there is no sale of the tax lien on a parcel of property at the Annual Tax Sale, the taxes are forfeited to the State and are eligible to be purchased “over the counter” at any time thereafter at an amount equal to all delinquent taxes interest and certain other costs to the date of purchase. Redemption periods and procedures are the same as applicable to the Annual Tax Sale.

A scavenger sale (the “Scavenger Sale”), like the Annual Tax Sale, is a sale of unpaid taxes. A Scavenger Sale is scheduled to be held by Cook County every two years on all property in which taxes are delinquent for two or more years. The sale price of the unpaid taxes is the amount bid at the Scavenger Sale, which may be substantially less than the amount of the delinquent taxes. Redemption periods vary from six months to two and one-half years depending upon the type and occupancy of the property.

### **Property Tax Extension Limitation Law; Issuance of Alternate Bonds**

The Illinois Property Tax Extension Limitation Law (the “Limitation Law”), previously applicable only to non-home rule taxing districts located in DuPage, Kane, Lake, McHenry and Will Counties, was extended in 1995 to non-home rule taxing districts in Cook County, including the Board. The effects of the Limitation Law are to limit or retard the growth in the amount of property taxes that can be extended for a non-home rule taxing body and to impose direct referendum requirements upon the issuance of certain types of general obligation bonds by such non-home rule taxing bodies.

The Limitation Law specifically limits the annual growth in property tax extensions for the Board to the lesser of 5% or the percentage increase in the Consumer Price Index for All Urban Consumers during the calendar year preceding the relevant tax levy year. Generally, extensions can be increased beyond this limitation only due to increases in the Equalized Assessed Valuation attributable to new construction and referendum approval of tax or limitation rate increases.

The Limitation Law requires the Cook County Clerk, in extending taxes for taxing districts in Cook County, including the Board, to use the Equalized Assessed Valuation of all property within the taxing district for the levy year prior to the levy year for which taxes are then being extended.

The Limitation Law (i) authorizes the issuance of “limited bonds” payable from non-home rule taxing districts’ “debt service extension base”; and (ii) excludes certain types of general obligation bonds, known as “alternate bonds” issued pursuant to Section 15 of the Debt Reform Act, from the direct referendum requirements of the Limitation Law. Pursuant to the provisions of this amendatory legislation and the Debt Reform Act, the Bonds are being issued as Alternate Bonds. The extension and collection of the Pledged Taxes, to the extent received, for the payment of debt service on the Bonds are not limited or restricted in any way by the provisions of the Limitation Law.

**Illinois Truth in Taxation Law.** The Illinois Truth in Taxation Law imposes procedural limitations on a Unit’s real estate taxing powers and requires that notice in the prescribed form must be

published if the aggregate annual levy is estimated to exceed 105% of the levy of the preceding year, exclusive of levies for debt service, election cost and payments due under public building commission leases. A public hearing must also be held, which may not be in conjunction with the budget hearing of the Unit on the adoption of the Unit's annual levy. No amount in excess of 105% of the preceding year's levy may be used as the basis for issuing tax bills to property owners unless the levy is accompanied by a certification of compliance with the foregoing procedures. This law does not impose any limitations on the rate or the amount of the levy to pay principal of and interest on the Unit's general obligation bonds and notes.

### **Bond Issue Notification Act**

The Bond Issue Notification Act (the "Bond Issue Notification Act") requires a public hearing to be held by any governmental unit proposing to sell non-referendum general obligation bonds or limited bonds subject to backdoor referendum. The public hearing is intended to require the governing body approving the bond issue to explain the reasons for the proposed issuance and allow persons desiring to be heard an opportunity to present written or oral testimony. On September 22, 2004, a hearing pursuant to the Bond Issue Notification Act was held in connection with the Bonds to be issued pursuant to the 2004 Authorization and on July 26, 2006, a hearing pursuant to the Bond Issue Notification Act was held in connection with the Bonds to be issued pursuant to the 2006 Authorization.

### **Property Tax Information**

The tables on the following pages provide statistical data regarding the property tax base of the Board and the City; the tax rates, tax levies and tax collections for the Board; and the tax levies and property tax supported debt for overlapping units of government in Cook County.

# **ASSESSED, EQUALIZED ASSESSED AND ESTIMATED VALUE OF ALL TAXABLE PROPERTY 1996-2005**

(Dollars in Thousands)

<b>Tax Year Levy<sup>(9)</sup></b>	<b>Class 2<sup>(5)</sup></b>	<b>Class 3<sup>(6)</sup></b>	<b>Assessed Values<sup>(1)</sup> Class 5<sup>(7)</sup></b>	<b>Other<sup>(8)</sup></b>	<b>Total</b>	<b>State Equalization Factor<sup>(2)</sup></b>	<b>Total Equalized Assessed Value<sup>(3)</sup></b>	<b>Total Estimated Fair Cash Value<sup>(4)(10)</sup></b>	<b>Total Equalized Assessed Value as a Percentage of Total Estimated Fair Cash Value<sup>(10)</sup></b>
2005	\$13,420,538	\$1,842,613	\$10,502,698	\$462,099	\$26,227,948	2.7320	\$59,304,530		
2004	12,998,216	1,883,047	10,401,428	465,464	25,738,155	2.5757	55,283,639	\$262,080,627	21.09%
2003	12,677,199	2,233,572	10,303,731	487,681	25,702,183	2.4598	53,168,632	223,572,427	23.78
2002	9,221,622	1,865,646	8,878,142	349,371	20,314,781	2.4689	45,330,892	201,938,231	22.45
2001	8,973,796	1,923,257	8,757,366	354,036	20,008,455	2.3098	41,981,912	185,912,246	22.58
2000	8,758,682	1,966,921	8,807,444	342,942	19,875,989	2.2235	40,480,077	162,593,364	24.90
1999	6,777,400	2,021,411	7,910,838	282,255	16,991,904	2.2505	35,354,802	135,522,333	26.09
1998	6,646,198	2,047,577	7,848,335	267,006	16,809,116	2.1799	33,940,146	122,726,446	27.66
1997	6,554,717	2,077,044	7,809,486	262,032	16,703,279	2.1489	33,349,557	111,679,906	29.86
1996	5,843,068	1,930,178	7,338,644	255,507	15,367,397	2.1517	30,765,001	106,622,485	28.85

(1) Source: Cook County Assessor's Office.

(2) Source: Illinois Department of Revenue.

(3) Source: Cook County Clerk's Office. Calculations are net of exemptions and include assessment of pollution control facilities. Excludes DuPage County Valuation.

(4) Source: The Civic Federation. Excludes railroad property.

(5) Residential, six units and under.

(6) Residential, seven units and over and mixed-use.

(7) Industrial/Commercial.

(8) Vacant, not-for-profit and industrial/commercial incentive classes.

(9) Triennial updates of assessed valuation occurred in years 1997, 2000 and 2003.

(10) Figures compiled annually by the Civic Federation of Chicago. Year 2005 not available as of the date of this Official Statement.

**Board's Property Tax Extensions and Collections**  
(Dollars in Thousands)

Levy Year <sup>(2)</sup>	Extension	First Year Collections		Cumulative Collections <sup>(1)</sup>	
		Amount	Percent	Amount	Percent
2005	\$1,813,697	\$ 816,206	45.0%	\$ 816,206	45.0%
2004	1,734,478	1,565,982	90.3	1,716,818	99.0
2003	1,670,337	1,500,238	89.8	1,651,970	98.9
2002	1,614,473	1,548,369	95.9	1,585,514	98.2
2001	1,571,962	1,519,630	96.7	1,553,522	98.8
2000	1,503,488	1,446,847	96.2	1,475,155	98.1
1999	1,451,206	1,408,124	97.0	1,426,731	98.3
1998	1,416,346	1,317,872	93.0	1,380,819	97.5
1997	1,362,211	1,304,701	95.8	1,325,737	97.3
1996	1,331,437	1,293,278	97.1	1,282,357	96.3

- (1) Tax receivables is net of Estimated Allowance for Uncollectible taxes (the "Allowance"). The Allowance for the 2005 levy is 3.5% of the levy.
- (2) The 2005 tax extensions year reflects collections through August 14, 2006.

Source: Board of Education of the City of Chicago

**Real Property Tax Rates<sup>(1)</sup>**  
(per \$100 equalized assessed valuation)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Tax Rates by Board Fund:<sup>(2)</sup></b>										
Educational.....	\$3.202	\$2.998	\$3.059	\$3.000	\$2.756	\$2.712	\$2.670	\$2.258	\$2.301	\$2.142
Special Education.....	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
School District Medicare.....	0.023	0.022	0.044	0.048	0.047	0.031	0.017	0.000	0.000	0.000
Agricultural Science.....	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Building.....	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Playground and Recreational.....	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Textbook.....	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Workers' and Unemployment										
Compensation Tort Immunity.....	0.222	0.246	0.192	0.206	0.141	0.191	0.150	0.219	0.131	0.228
Teachers' Pension.....	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
PBC Operation and Maintenance.....	0.709	0.719	0.722	0.701	0.640	0.685	0.609	0.565	0.576	0.565
Bond Redemption & Interest.....	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
PBC Lease Rentals.....	<u>0.171</u>	<u>0.099</u>	<u>0.155</u>	<u>0.149</u>	<u>0.130</u>	<u>0.125</u>	<u>0.116</u>	<u>0.100</u>	<u>0.096</u>	<u>0.091</u>
Board Subtotal.....	<u>\$4.327</u>	<u>\$4.084</u>	<u>\$4.172</u>	<u>\$4.104</u>	<u>\$3.714</u>	<u>\$3.744</u>	<u>\$3.562</u>	<u>\$3.142</u>	<u>\$3.104</u>	<u>\$3.026</u>
<b>Other Major Government Units:</b>										
City of Chicago.....	2.182	2.024	1.998	1.860	1.660	1.637	1.591	1.380	1.302	1.243
Community College District.....	0.377	0.356	0.354	0.347	0.311	0.307	0.280	0.246	0.242	0.234
School Finance Authority.....	0.291	0.270	0.268	0.255	0.223	0.223	0.177	0.151	0.177	0.127
Chicago Park District.....	0.721	0.665	0.653	0.627	0.572	0.567	0.545	0.464	0.455	0.443
Water Reclamation District.....	0.492	0.451	0.444	0.419	0.415	0.401	0.371	0.361	0.347	0.315
Cook County.....	0.989	0.919	0.911	0.854	0.824	0.746	0.690	0.630	0.593	0.533
Cook County Forest Preserve.....	<u>0.074</u>	<u>0.074</u>	<u>0.072</u>	<u>0.070</u>	<u>0.069</u>	<u>0.067</u>	<u>0.061</u>	<u>0.059</u>	<u>0.060</u>	<u>0.060</u>
Other Unit Subtotal.....	<u>\$5.126</u>	<u>\$4.759</u>	<u>\$4.700</u>	<u>\$4.432</u>	<u>\$4.074</u>	<u>\$3.948</u>	<u>\$3.715</u>	<u>\$3.291</u>	<u>\$3.176</u>	<u>\$2.955</u>
<b>TOTAL.....</b>	<b>\$9.453</b>	<b>\$8.843</b>	<b>\$8.872</b>	<b>\$8.536</b>	<b>\$7.788</b>	<b>\$7.692</b>	<b>\$7.277</b>	<b>\$6.433</b>	<b>\$6.280</b>	<b>\$5.981</b>

(1) Source: Cook County Clerk's Office – tax rates by levy year.

(2) The 1995 Amendatory Act changed the tax rate limitations by consolidating the funds for special education, agricultural science, building, playground and recreational, textbook and teachers pension into the educational fund. Subsequent school code amendments made this consolidation permanent.

## **TAX EXEMPTION**

### **General**

The Internal Revenue Code of 1986, as amended (the “Code”), contains a number of requirements and restrictions that apply to the Bonds from and after the date of issuance of the Bonds, including investment restrictions, periodic payments of arbitrage profits to the United States, requirements regarding the proper use of Bond proceeds and the facilities financed therewith, and certain other matters. The Board has covenanted to comply with all requirements of the Code that must be satisfied in order for the interest on the Bonds to be excludible from gross income. Failure to comply with such requirements could cause interest on the Bonds to become subject to federal income tax retroactive to the date of issuance of the Bonds.

Subject to the condition that the Board comply with the above-referenced covenants, under present law, in the opinion of Co-Bond Counsel, the Bonds are not “private activity bonds” under the Code, and interest on the Bonds will not be includible in the gross income of the owners thereof for federal income tax purposes. Interest on the Bonds will not be included as an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. However, interest on the Bonds will be included in “adjusted current earnings” of certain corporations for purposes of computing the alternative minimum tax for such corporations and will be taken into account in computing the “branch profits tax” imposed on certain foreign corporations.

In rendering its opinion, Bond Counsel will reply upon certifications of the Board and certain other parties with respect to certain material facts solely within their knowledge relating to the facilities to be financed with the Bonds, the application of the proceeds of the Bonds and certain other matters pertinent to the tax exemption of the Bonds.

Ownership of the Bonds may result in collateral federal income tax consequences to certain taxpayers, including, without limitation, (i) corporations subject to the branch profits tax, (ii) financial institutions, (iii) certain insurance companies, (iv) certain Subchapter S corporations, (v) individual recipients of Social Security or Railroad Retirement benefits, and (vi) taxpayers who may be deemed to have incurred (or continued) indebtedness to purchase or carry tax-exempt obligations. Prospective purchasers of the Bonds should consult their tax advisors as to the applicability of any such collateral consequences.

Interest on the Bonds is not exempt from income taxes imposed by the State of Illinois.

### **Original Issue Discount**

The initial public offering price of the Bonds maturing on December 1, 2036 (the “Discount Bonds”) is less than the principal amount thereof. The difference between the principal amount payable at maturity of the Discount Bonds and the initial public offering price of the Discount Bonds, assuming a substantial amount of the Discount Bonds is first sold at such price (the “Offering Price”), will be treated as “original issue discount.” With respect to a taxpayer who purchases a Discount Bond in the initial public offering at the Offering Price and who holds such Discount Bond to maturity, the full amount of original issue discount will



constitute interest which is not includable in the gross income of the owner of such Discount Bond for Federal income tax purposes to the same extent as current interest, and will not be treated as taxable capital gain upon payment of such Discount Bond upon maturity.

The original issue discount on the Discount Bonds is treated as accruing daily over the term of such Discount Bonds on the basis of a constant yield compounded at the end of each six-month period (or shorter period from the date of original issue). The amount of original issue discount accruing during such period will be added to the owner's tax basis for the Discount Bonds. Such adjusted tax basis will be used to determine taxable gain or loss upon disposition of the Discount Bonds (including sale, redemption or payment at maturity). An owner of a Discount Bond who disposes of it prior to maturity should consult such owner's tax advisor as to the amount of original issue discount accrued over the period held and the amount of taxable gain or loss upon the sale or other disposition of such Discount Bond prior to maturity.

Owners who purchase Discount Bonds in the initial public offering but at a price different than the Offering Price or who do not purchase Discount Bonds in the initial public offering should consult their tax advisors with respect to the tax consequences of the ownership of such Discount Bonds.

Owners of Discount Bonds should consult their own tax advisors with respect to the state and local tax consequences of owning the Discount Bonds. It is possible that under the applicable provisions governing the determination of state or local income taxes, accrued original issue discount on the Discount Bonds may be deemed to be received in the year of accrual even though there will not be a corresponding cash payment until a later year.

### **Bond Premium**

An amount equal to the excess of the purchase price of a Bond over the principal amount payable at maturity of such Bond constitutes amortizable bond premium that may not be deducted for federal income tax purposes. For purposes of determining gain or loss on the sale or other disposition of such Bond, the tax basis of each Bond is decreased by the amount of the bond premium that has been amortized. Bond premium is amortized by offsetting the interest on the Bond allocable to an accrual period with the bond premium allocable to the accrual period. The bond premium allocable to an accrual period is the excess of the interest on the Bond allocable to the accrual period over the product of the owner's adjusted acquisition price at the beginning of the accrual period and the owner's yield (determined on the basis of a constant yield over the term of the Bond). If the bond premium allocable to an accrual period exceeds the interest on the Bond allocable to the accrual period, the excess is a nondeductible loss for Federal income tax purposes that reduces the owner's basis in such Bond.

Purchasers of any Bonds at a premium, whether at the time of initial issuance or subsequent thereto, should consult with their own tax advisors with respect to the federal, state and local consequences of owning such Bonds.

### **Market Discount**

If a Bond is purchased at any time for a price that is less than the Bond's adjusted issue price, the purchaser may be treated as having purchased the Bond with market discount subject

to the market discount rules of the Code (unless a statutory *de minimis* rule applies). Accrued market discount is treated as taxable ordinary income and is recognized when a Bond is disposed of (to the extent such accrued discount does not exceed gain realized) or, at the purchaser's election, as it accrues. The applicability of the market discount rules may adversely affect the liquidity or secondary market price of such Bond. Purchasers should consult their own tax advisors regarding the potential implications of the market discount rules with respect to the Bonds.

### **Changes in Tax Law**

The opinions expressed by Bond Counsel are based on existing law as of the date of issuance and delivery of the Bonds. Bond Counsel has not undertaken to advise in the future whether any events after the date of issuance of the Bonds may affect the tax status of interest on the Bonds. The market value and marketability of the Bonds may be adversely affected by future changes in federal or State of Illinois tax treatment of interest on the Bonds or by future reductions in income tax rates or other modifications of the Code or the regulations issued thereunder.

### **RATINGS**

The Insured Bonds have received ratings of “AAA” by Standard & Poor’s, a Division of The McGraw-Hill Companies, Inc. (“Standard & Poor’s”), “AAA” by FitchRatings (“Fitch”) and “Aaa” by Moody’s Investors Services (“Moody’s”) based on the Bond Insurance Policy for the Insured Bonds to be issued by the Bond Insurer.

The Bonds maturing on December 1, 2007 have received ratings of “A+” by Standard & Poor’s, “A+” by Fitch and “A2” by Moody’s.

A rating reflects only the view of the rating agency giving such rating. Any explanation of the significance of such ratings may be obtained only from the respective rating agency. There is no assurance that any such rating will be maintained for any given period of time or that any such rating may not be raised, lowered or withdrawn entirely by the respective rating agency if in its judgment circumstances so warrant. Any change in or withdrawal of any such rating may have an effect on the price at which the Bonds may be resold.

### **FINANCIAL STATEMENTS**

The financial statements of the Board as of and for the fiscal year indicated in such financial statements are included herein. See APPENDIX A – FINANCIAL STATEMENTS OF THE BOARD OF EDUCATION OF THE CITY OF CHICAGO.

### **FINANCIAL ADVISORS**

The Board has engaged A.C. Advisory, Inc. and D.A. Davidson & Co. as Financial Advisors in connection with the authorization, issuance and sale of the Bonds. The Financial Advisors have provided advice on the plan of financing and structure of the Bonds and have

reviewed certain legal documents, including this Official Statement, with respect to financial matters. Unless indicated to the contrary, the Financial Advisors have not independently verified the factual information contained in this Official Statement, but have relied on the information supplied by the Board and other sources.

## **UNDERWRITING**

J.P. Morgan Securities Inc., as Representative of the Underwriters identified on the cover page of this Official Statement, has agreed to purchase the Series 2006B Bonds at an aggregate purchase price of \$368,457,465.19 (which represents an aggregate principal amount of \$355,805,000.00, plus net original issue premium of \$14,443,982.70, less an Underwriters' discount of \$1,791,517.51). The Bonds will be offered to the public at the price of par, as set forth on the inside cover page of this Official Statement. The Underwriters will be obligated to purchase all of the Bonds, if they are purchased. The Underwriters reserve the right to join with dealers and other underwriters in offering the Bonds to the public.

The obligation of the Underwriters to accept delivery of and pay for the Bonds is subject to various conditions set forth in the Contract of Purchase relating to such Bonds, including, among others, the delivery of specified opinions of counsel and a certificate of the Board that there has been no material adverse changes in its conditions (financial or otherwise) from that set forth in this Official Statement.

## **CERTAIN LEGAL MATTERS**

Issuance of the Bonds is subject to the issuance of the approving legal opinion of Sonnenschein Nath & Rosenthal LLP and Charity and Associates, P.C. both of Chicago, Illinois, as Co-Bond Counsel. The proposed form of such opinion is included herein as APPENDIX C. Certain legal matters will be passed upon for the Board by Patrick J. Rocks, General Counsel, and by its special counsel, Gardner Carton & Douglas LLP, Chicago, Illinois; and for the Underwriters by their Co-Counsel, DLA Piper Rudnick Gray Cary US LLP, Chicago, Illinois and Burris, Wright, Slaughter & Tom, LLC, Chicago, Illinois.

## **LITIGATION**

### **General**

The Board is involved in numerous lawsuits that arise out of the ordinary course of operating the school system, including, but not limited to, the lawsuits described in this Official Statement. Some of the cases pending against the Board involve claims for substantial monies. As is true with any complex litigation, neither the Board nor its counsel is able to predict either the eventual outcome of such litigation or its impact on the Board's finances. The Board has available to it a tort liability tax levy to pay tort judgments and settlements. This tort liability tax levy is unlimited as to rate, but subject to the limitations on the annual growth in property tax extensions of the Board imposed by the Property Tax Extension Limitation Law of the State, as amended. See "THE REAL PROPERTY TAX SYSTEM – Property Tax Extension Limitation Law; Issuance of Alternate Bonds."

Upon delivery to the Underwriters of the Bonds, the Board will furnish a certificate to the effect that, among other things, there is no litigation pending in any court seeking to restrain or enjoin the issuance or delivery of the Bonds, or in any way contesting the validity or enforceability of the Bonds.

### **Teacher Tenure Litigation**

Maurice Land, et al. v. Board of Education of the City of Chicago, et al., is a lawsuit filed in 1999 against the Board in which the plaintiffs are teachers laid-off pursuant to the Board's policy on reassignment and layoff of regularly appointed and certified teachers. Some of the plaintiffs were those who lost their assignments during the 1997 reconstitution of seven high schools. The complaint is for mandamus, declaratory and injunctive relief. The complaint asserts violation of the School Code provision relating to tenure. The trial court granted the Board's motion for summary judgment and the Chicago Teachers Union ("CTU") sought review in the Illinois Appellate Court.

On August 27, 2001, the Appellate Court issued an opinion affirming in part and reversing in part the Circuit Court's decision. The Appellate Court concluded, among other things, that (i) the Board has the statutory power to layoff tenured teachers, including the plaintiffs, (ii) the Board complied with the policy in laying off the plaintiffs, and (iii) the layoffs did not violate plaintiffs' due process rights. With respect to each of these issues (and others), the Appellate Court affirmed the Circuit Court's grant of summary judgment in favor of the Board. However, the Appellate Court also held that although "the Board may establish a layoff policy..., [the Board] may not through that policy delegate its absolute layoff power to school administrators." The Court remanded the case for further proceedings related to the delegation issue and the factual issues relating to the employment record of one of the plaintiffs.

On September 17, 2001, the Board filed a Petition for Rehearing challenging the Appellate Court's ruling on the delegation issue, which was denied on December 20, 2001. Thereafter, on February 6, 2002, the Illinois Supreme Court granted the Board's petition seeking appeal of the Appellate Court's decision. On November 21, 2002, the Illinois Supreme Court, among other things, affirmed the Appellate Court's holding that tenured teachers can be laid off, and agreed that the Board could delegate its layoff authority. However, the Illinois Supreme Court also held that the Board was prohibited from delegating its layoff authority to school principals, and explicitly did not decide "whether the [layoff] authority may be delegated to officers or administrators other than the general superintendent and attorney." The case was remanded to the Circuit Court to determine "whether the layoff authority was delegated and, if so, to whom."

Should the CTU ultimately prevail, the Court could order reinstatement and back wages for all of the Plaintiffs. The total amount of exposure may be significant, depending on the length of time that passes from the date of the layoff to the date of an ordered reinstatement. Given the current status of these matters, it is impossible to determine whether an ultimate finding of liability against the Board is probable or the exact cost associated with any such finding.

Jones, et al. v. Board of Education 00 CH 093 74 is an action brought by the CTU essentially repeating the claims asserted in Land. Based upon the decision in a previous matter and the pendency of Land, the Board filed a motion to stay this action, arguing that the legal and factual issues raised in this action will be resolved by the final decisions in the previously filed lawsuits. The Court granted the Board's motion on August 16, 2000, granting a stay of Jones in all respects. It is unlikely that this action would give rise to liability not contemplated in the discussion of the Land litigation.

The Land and Jones cases were consolidated in January, 2003. On May 11, 2006, the Court granted the Board's motion for summary judgment. Plaintiffs have appealed to the Illinois Appellate Court.

### **Tort Claim**

In Della Coleman, as Special Administrator of the Estate of Derrick Spencer v. Board of Education, the family of Derrick Spencer, an eighth grade student, filed suit against the Board and Quality Inn Hotels for damages arising from Derrick's drowning while on a field trip along with other eighth grade students from Goldblatt Elementary School. The drowning occurred in Ohio on May 24, 2002, after one of Derrick's classmates pushed him into the pool at the Quality Inn Hotel. The suit alleges that the Board was negligent in numerous respects, including: failing to provide lifeguards in connection with the swimming at Quality Inn Hotel; failing to assess Derrick's swimming skills; failing to monitor the Goldblatt students in and around the pool; failing to follow Board policies regarding school trips; and failing to protect Derrick from the dangerous water conditions at the Quality Inn Hotel.

The Board has raised tort immunity as a defense to these claims, but the outcome of this defense cannot be predicted. To the extent that the case results in a jury trial, a finding of liability on the part of the Board cannot be predicted as either probable or remote at this juncture. If there is a finding of liability against the Board, the verdict could range as high as \$10,000,000 based on other claims of wrongful deaths involving teenagers. The Board will be entitled to a set-off of \$2,500,000, however, against any adverse jury verdict, because the family settled its claim against the hotel for that amount.

### **Dispute Over Pension Fund Claims for Reimbursement**

A dispute exists between the Board and the Public School Teachers' Pension and Retirement Fund (the "Fund") regarding whether the Board has the right under the Illinois Pension Code, to require employees who want to take advantage of the Early Retirement Option ("ERO") to apply for it by the middle of May of any year that the ERO is offered to teachers. The Board is required to contribute a specified amount to the Fund for each employee selecting the ERO.

The Fund has notified the Board of its position that the Board does not have a right to impose a deadline date on eligible employees to apply for the ERO. The Fund has represented that it intends to reach out to those employees who would have been eligible for the ERO under its analysis and offer them the opportunity to retire. Under this scenario, 30% of all teachers who have reached the age of 55 years and have at least 20 years, but less than 34 years, of

service credit would be able to take advantage of the ERO in the years it was authorized by the Board. The Fund has also represented that it will send the Board an invoice for the Board's contribution, and would also, if the Board refuses to pay, take legal action. No legal action has been taken by the Fund against the Board as of the date of this Official Statement.

Should the Fund's interpretation be found correct in a court action, the Board will be required to pay the Fund the specified contribution for each employee who elects the ERO. While it is not possible to know with any certainty the number of employees who will elect the ERO under these circumstances, if the maximum number (30% of eligible employees) take advantage of it, the Board's estimated liability could be approximately \$38,000,000. The Board is unable to predict the outcome of this dispute at the present time.

### **CONTINUING DISCLOSURE UNDERTAKING**

The Board will enter into a Continuing Disclosure Undertaking (the "Undertaking") for the Bonds for the benefit of the Beneficial Owners of the Bonds to send certain information annually and to provide notice of certain events to certain information repositories pursuant to the requirements of Section (b)(5) of Rule 15c2-12 (the "Rule") adopted by the Securities and Exchange Commission (the "Commission") under the Securities Exchange Act of 1934, as amended.

The Board is in compliance with undertakings previously entered into by it pursuant to the Rule. A failure by the Board to comply with the Undertaking will not constitute an event of default under the Bond Resolution or the Indenture for the Bonds, and Beneficial Owners of the Bonds are limited to the remedies described in the Undertaking. See "– Consequences of Failure to Provide Information."

The following is a brief summary of certain provisions of the Undertaking and does not purport to be complete. The statements made under this caption are subject to the detailed provisions of the Undertaking, copies of which are available upon request from the Board.

#### **Annual Financial Information Disclosure**

The Board covenants in the Undertaking that it will disseminate its Annual Financial Information and its Audited Financial Statements, if any (as described below) to each Nationally Recognized Municipal Securities Information Repository (each, a "NRMSIR") then recognized by the Commission for purposes of the Rule and to any public or private repository designated by the State as the state depository (the "SID") and recognized as such by the Commission for purposes of the Rule. The Board is required to deliver such information so that such entities receive the information by the dates specified in the Undertaking.

"Annual Financial Information" means historical information generally consistent with information of the type set forth in this Official Statement under the following headings:

## BOARD OF EDUCATION OF THE CITY OF CHICAGO:

### School System

### General Operating Fund Revenues, Expenditures, Other Financing Sources and Changes in Fund Balances for the Board

### Board's Debt Service Schedule

The Undertaking for the Bonds requires that Annual Financial Information, excluding the Audited Financial Statements, be provided to each NRMSIR and to the SID, if any, on or prior to 210 days after the last day of the Board's fiscal year.

"Audited Financial Statements" means the general purpose financial statements of the Board which are in conformity with generally accepted accounting principles in the United States and audited by independent auditors. The Undertaking for the Bonds requires that Audited Financial Statements will be provided to each NRMSIR and to the SID, if any, within 30 days after availability to the Board.

### **Events Notification; Material Events Disclosure**

The Board covenants in the Undertaking for the Bonds that it will disseminate to each NRMSIR or to the Municipal Securities Rulemaking Board (the "MSRB") and to the SID, if any, in a timely manner the disclosure of the occurrence of an Event (as described below) with respect to the Bonds that is material, as materiality is interpreted under the Securities Exchange Act of 1934, as amended. For the Bonds, the "Events" are (i) debt service payment delinquencies; (ii) non-payment related defaults; (iii) unscheduled draws on debt service reserves reflecting financial difficulties; (iv) unscheduled draws on credit enhancements reflecting financial difficulties; (v) substitution of credit or liquidity providers, or their failure to perform; (vi) adverse tax opinions or events affecting the tax-exempt status of the Bonds; (vii) modifications to the rights of Bondholders; (viii) bond calls; (ix) defeasances; (x) release, substitution or sale of property securing repayment of the Bonds; and (xi) rating changes.

### **Consequences of Failure to Provide Information**

The Board agrees in each Undertaking to give notice in a timely manner to each NRMSIR or to the MSRB and to the SID, if any, of any failure to provide disclosure of the Annual Financial Information and Audited Financial Statements when the same are due under the Undertaking.

A default under the Undertaking shall not be deemed an event of default under the Resolutions or the Indenture with respect to the Bonds, and the sole remedy in the event of any failure of the Board to comply with the Undertaking shall be an action to compel performance. A failure by the Board to comply with the Undertaking must be reported in accordance with the Rule and must be considered by any broker, dealer or municipal securities dealer before recommending the purchase or sale of the Bonds in the secondary market. Consequently, such failure may adversely affect the transferability and liquidity of the Bonds and their market price.

## **Amendment; Waiver**

Notwithstanding any other provision of the Undertaking, the Board may amend the Undertaking, and any provision thereof may be waived, if:

(a) (i) The amendment or the waiver is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Board, or type of business conducted;

(ii) The Undertaking, as amended, or the provision, as waived, would have complied with the requirements of the Rule at the time of the primary offering, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(iii) The amendment or waiver does not materially impair the interests of the Beneficial Owners of the Bonds, as determined by parties unaffiliated with the Board (such as the Trustee or Bond Counsel), or by the approving vote of the owners of the Bonds pursuant to the terms of the Indenture at the time of the amendment; or

(b) The amendment or waiver is otherwise permitted by the Rule.

## **Termination of Undertaking**

The Undertaking shall be terminated if the Board shall no longer have any legal liability for any obligation on or relating to repayment of the Bonds under the Indenture for the Bonds. If this provision is applicable, the Board shall each give notice in a timely manner to each NRMSIR or to the MSRB and to the SID, if any.

## **Dissemination Agent**

The Board may, from time to time, appoint or engage a dissemination agent to assist it in carrying out its obligations under the Undertaking, and may discharge any such agent, with or without appointing a successor dissemination agent.



## **AUTHORIZATION AND MISCELLANEOUS**

The Board has authorized the distribution of this Official Statement. This Official Statement has been duly executed and delivered on behalf of the Board.

### **BOARD OF EDUCATION OF THE CITY OF CHICAGO**

By: /s/ John Maiorca  
Chief Financial Officer

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## **APPENDIX A**

### **Financial Statements of the Board of Education of the City of Chicago**

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## INDEPENDENT AUDITORS' REPORT

The Board of Education of the City of Chicago:

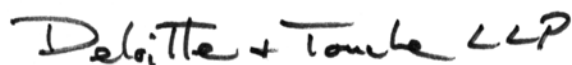
We have audited the accompanying financial statements of the governmental activities and each major fund of the Chicago Public Schools (the Board of Education of the City of Chicago, the "CPS", a body politic and corporate of the State of Illinois) as of and for the year ended June 30, 2005, which collectively comprise the CPS' basic financial statements. These financial statements are the responsibility of the CPS' management. Our responsibility is to express an opinion on the respective financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the CPS' internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Chicago Public Schools as of June 30, 2005, and the respective changes in financial position thereof and the respective budgetary comparison for the General Operating Fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the basic financial statements, the CPS adopted the provisions of Governmental Accounting Standards Board Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, as of and for the year ended June 30, 2005.

Management's Discussion and Analysis on pages A-2 to A-12 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the CPS' management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.



January 11, 2006

**CHICAGO PUBLIC SCHOOLS**  
**Management's Discussion and Analysis (MD&A)**  
**June 30, 2005**

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## **INTRODUCTION**

Our discussion and analysis of Chicago Public Schools' (CPS) financial performance provides an overview of the school district's financial activities for the fiscal year ended June 30, 2005. The intent of this management discussion and analysis is to look at CPS' financial performance as a whole; readers should also review the transmittal letter, financial statements and notes to the basic financial statements to enhance their understanding of CPS' financial performance.

The CPS has prepared its annual financial report using a combination of both government-wide financial statements and fund financial statements. The basic financial statements contain three components:

- 1) Government-wide financial statements including the Statement Of Net Assets and the Statement Of Activities which provide a broad, long-term overview of CPS' finances,
- 2) Fund financial statements including the balance sheets that provide a greater level of detail of revenues and expenditures and focus on how well CPS has performed in the short term in the most significant funds, and
- 3) Notes to the basic financial statements.

This report presents the financial highlights for last year and contains other supplementary information.

## **OVERALL ANALYSIS**

Chicago Public Schools is the third largest school district in the United States, serving approximately 427,000 students with a fiscal year 2005 operating budget of almost \$4.05 billion and a capital budget of \$660 million. In general, the financial operations of CPS have performed well during uncertain financial times with varying financial indicators and results. At the end of fiscal year 2005, CPS again maintained a strong cash position.

In summary, CPS' overall financial position remains strong, stable and consistent. It should be noted that the positive financial performance in General Operating Fund was achieved even as the CPS implemented new educational programs to improve academic achievement.

## **FINANCIAL HIGHLIGHTS**

Key financial highlights for 2005 are as follows:

- On the government-wide financial statements:
  - Total net assets decreased from \$791 million in fiscal year 2004 to \$532 million in fiscal year 2005, a decrease of approximately \$259 million, or 32.7%.
  - Total revenues increased \$139 million from \$4.10 billion in fiscal year 2004 to \$4.23 billion in fiscal year 2005, or 3.4%.
  - Total expenses increased \$184 million from \$4.31 billion in fiscal year 2004 to \$4.49 billion in fiscal year 2005, or 4.3%.

- On the fund financial statements:
  - Ending fund balance for all governmental funds decreased from \$1.12 billion in fiscal year 2004 to \$1.05 billion in fiscal year 2005, a decrease of \$75 million, or 6.7%.
  - In the General Operating Fund, unreserved funds increased from \$196 million in fiscal year 2004 to \$248 million in 2005, an increase of \$52 million, or 26.5%.
  - Total General Operating Fund actual revenues less expenditures exceeded budgeted resources less final appropriations by \$113 million.

## **OVERVIEW OF GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The government-wide financial statements are designed to provide readers with a broad overview of the school district's finances in a manner similar to a private sector business. The Statement of Net Assets and the Statement of Activities provide information about the activities of the school district as a whole, presenting both an aggregate and long-term view of the finances. These statements include all assets and liabilities using the accrual basis of accounting. This basis of accounting includes all of the current year's revenues and expenses regardless of when cash is received or paid.

The ***Statement of Net Assets*** presents information on all of CPS' assets and liabilities, with the difference between the two reported as *net assets*. Increases or decreases in net assets may serve as a useful indicator of whether the financial position is improving or deteriorating.

The ***Statement of Activities*** presents information showing how net assets changed during the fiscal year. All changes in the net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of the related cash flows*. Thus, revenues and expenses are reported in the statement for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but not used vacation leave).

Both of the government-wide financial statements distinguish functions of the CPS that are principally supported by taxes and intergovernmental revenues (*governmental activities*).

### **Financial Analysis of CPS as a Whole**

All of CPS' services are reported in the government-wide financial statements, including instruction, pupil support services, instructional support services, administrative support services, facility support services, and food services. Property taxes, replacement taxes, state aid, and interest and investment earnings finance most of these activities. Additionally, all capital and debt financing activities are reported here.

**Statement of Net Assets**  
**(Millions of dollars)**

	Governmental Activities			
	2005	2004	Difference	% Change
Current assets .....	\$ 2,918	\$ 2,898	\$ 20	0.7%
Capital assets, net .....	4,276	4,075	201	4.9
Total Assets .....	<u>\$ 7,194</u>	<u>\$ 6,973</u>	<u>\$ 221</u>	3.2
Current liabilities .....	\$ 883	\$ 932	\$ (49)	(5.3)
Long-term liabilities .....	5,779	5,250	529	10.1
Total Liabilities .....	<u>\$ 6,662</u>	<u>\$ 6,182</u>	<u>\$ 480</u>	7.8
Net Assets:				
Invested in capital assets net of related debt .....	\$ 413	\$ 455	\$ (42)	(9.2)
Restricted for:				
Debt service .....	299	391	(92)	(23.5)
Specific purposes .....	45	43	2	4.7
Unrestricted .....	(225)	(98)	(127)	129.6
Total Net Assets .....	<u>\$ 532</u>	<u>\$ 791</u>	<u>\$ (259)</u>	(32.7)

- **Total assets** increased due to new school construction and other improvement projects as part of the CPS' Capital Improvement Program.
- **Capital assets, net of depreciation** increased \$201.5 million or 4.9% over the prior fiscal year. This net increase represents \$352.3 million of additions and other increases less \$150.8 million of current year depreciation. Capital assets, net of depreciation, for fiscal year 2004 totaled \$4.07 billion and \$4.28 billion in fiscal year 2005. The increase is due to the continued progress of the Capital Improvement Program.
- **Long-term liabilities** comprise three components:
  - **Long-term debt** increased \$288 million, or 7.4%. The total long-term portion of debt outstanding and capitalized leases was \$3.91 billion in fiscal year 2004 and \$4.20 billion in fiscal year 2005. In fiscal year 2005, CPS issued \$524 million in Unlimited Tax Obligation Bonds. CPS used \$281 million of the proceeds to partially retire prior debt issuances, resulting in a present value savings of \$15 million in future debt service. The remaining \$244 million was used to fund the Capital Improvement Program.
  - **Accrued pension** increased to \$1.26 billion in fiscal year 2005 from \$1.04 billion in fiscal year 2004, an increase of \$216 million, or 20.8%. The year-end balance reflects the increase in the net pension obligation related to the Public School Teachers' Pension and Retirement Fund of Chicago.
  - **Other long-term liabilities** increased to \$322 million in fiscal year 2005 from \$297 million in fiscal year 2004, an increase of \$25 million, or 8.4%. The year-end balance reflects increases in accrued sick pay and accrued workers' compensation of \$18 million and \$8 million, respectively, and decreased tort liabilities of \$2 million.



**Statement of Activities**  
**(Millions of dollars)**

	Governmental Activities			
	2005	2004	Difference	% Change
Revenues:				
Program Revenues:				
Charges for services .....	\$ 11	\$ 10	\$ 1	10.0%
Operating grants and contributions .....	876	791	85	10.7%
Capital grants and contributions .....	22	161	(139)	(86.3)%
Total Program Revenues .....	<u>\$ 909</u>	<u>\$ 962</u>	<u>\$ (53)</u>	(5.5)%
General Revenues:				
Property taxes .....	\$ 1,664	\$ 1,561	\$ 103	6.6%
Replacement taxes .....	146	120	26	21.7%
State aid .....	1,430	1,333	97	7.3%
Interest and investment earnings .....	43	40	3	7.5%
Miscellaneous .....	42	79	(37)	(46.8)%
Total General Revenues .....	<u>\$ 3,325</u>	<u>\$ 3,133</u>	<u>\$ 192</u>	6.1%
Total Revenues .....	<u>\$ 4,234</u>	<u>\$ 4,095</u>	<u>\$ 139</u>	3.4%
Expenses:				
Instruction .....	\$ 2,777	\$ 2,663	\$ 114	4.3%
Support services:				
Pupil support services .....	338	344	(6)	(1.7)%
Administrative support services .....	158	177	(19)	(10.7)%
Facility support services .....	380	339	41	12.1%
Instructional support services .....	405	351	54	15.4%
Food services .....	182	189	(7)	(3.7)%
Community services .....	43	50	(7)	(14.0)%
Interest expense .....	201	188	13	6.9%
Other .....	9	8	1	12.5%
Total Expenses .....	<u>\$ 4,493</u>	<u>\$ 4,309</u>	<u>\$ 184</u>	4.3%
Change in Net Assets .....	<u>\$ (259)</u>	<u>\$ (214)</u>	<u>\$ (45)</u>	21.0%
Beginning Net Assets .....	<u>791</u>	<u>1,005</u>	<u>(214)</u>	(21.3)%
Ending Net Assets .....	<u>\$ 532</u>	<u>\$ 791</u>	<u>\$ (259)</u>	(32.7)%

## Capital Assets

At June 30, 2005, the CPS had \$4.3 billion invested in a broad range of capital assets, including land, buildings and improvements, and equipment. This amount represents a net increase (including additions, deductions and depreciation) of \$201 million or 4.9% over the prior fiscal year (\$000's).

	Governmental Activities					
	2004	Additions	Decreases and Transfers to In Service	2005	Difference	% Change
Land .....	\$ 218,510	\$ 13,064	\$ (186)	\$ 231,388	\$ 12,878	5.9%
Buildings .....	5,250,257	239,024	(8,172)	5,481,109	230,852	4.4%
Construction in progress	409,906	297,202	(223,366)	483,742	73,836	18.0%
Equipment .....	71,197	29,183	—	100,380	29,183	41.0%
Total Capital Assets....	\$ 5,949,870	\$ 578,473	\$ (231,724)	\$ 6,296,619	\$ 346,749	5.8%
Less: Accumulated depreciation .....	(1,874,924)	(150,805)	5,548	(2,020,181)	(145,257)	7.7%
Total Capital Assets, net	<u>\$ 4,074,946</u>	<u>\$ 427,668</u>	<u>\$ (226,176)</u>	<u>\$ 4,276,438</u>	<u>\$ 201,492</u>	4.9%

**Capital assets** increased due to the purchases of land and the continued progress of the Capital Improvement Program. For more detailed information please refer to the notes to the basic financial statements.

## Debt and Capitalized Lease Obligations

In November 2004, CPS issued \$222 million in Unlimited Tax General Obligation Bonds (Series 2004CDE). As a result of the issuance, CPS recorded net proceeds of \$217 million in the Capital Improvement Fund.

In December 2004, CPS issued \$56 million in Unlimited Tax General Obligation Bonds (Series 2004FGH) at a premium of \$6 million. As a result of the issuance, CPS recorded net proceeds of \$56.6 million in the Capital Improvement Fund.

In June 2005, CPS issued \$194 million in Unlimited Tax General Obligation Refunding Bonds (Series 2005A) and \$53 million in Unlimited Tax General Obligation Refunding Bonds (Series 2005B). The proceeds from these bonds are being used to refund a portion of Series 1997, 2001A and 2001C bonds, and to pay costs of issuance of the bonds. As a result of the issuance, net proceeds of \$280.6 million were used to purchase U.S. Government Securities, which were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on \$54 million of the Series 1997 bonds, \$36 million of the Series 2001A bonds and \$175 million of the Series 2001C bonds. As a result, these refunded bonds are considered to be defeased.

As of June 30, 2005, the CPS had \$4.26 billion in total debt, including accreted interest, and capitalized lease obligations outstanding versus \$4.11 billion last year, an increase of 3.8%. A summary of the long-term debt and capitalized lease obligations are listed in the following table:

	Governmental Activities (Millions of Dollars)				2005
	2004	Issuances	Retirements	Accreted Interest	
Unlimited Tax General Obligation Bonds . . .	\$ 3,438	\$ 524	\$ (288)	\$ 46	\$ 3,720
Qualified Zone Academy Bonds . . . . .	53	—	—	—	53
Notes Payable . . . . .	—	6	—	—	6
Asbestos Abatement Loans . . . . .	10	—	(1)	—	9
Total . . . . .	\$ 3,501	\$ 530	\$ (289)	\$ 46	\$ 3,788
Capitalized Lease Obligations . . . . .	607	—	(131)	—	476
Total Debt . . . . .	<u>\$ 4,108</u>	<u>\$ 530</u>	<u>\$ (420)</u>	<u>\$ 46</u>	\$ 4,264
Less Current Year Portion . . . . .					(46)
Less Deferred Amounts:					
On Refunding . . . . .					(83)
For Net Premiums/(Discounts) . . . . .					68
Total Long-Term Debt, Net . . . . .					<u>\$ 4,203</u>

The Chicago School Finance Authority (SFA) was created in January 1980 to exercise oversight and control over the financial affairs of the CPS. The SFA issued debt to fund construction and provide working capital. The principal amount of the SFA bonds outstanding as of June 30, 2005, net of bonds advance refunded or defeased is \$268 million. The SFA bonds are not a direct or contingent obligation of the CPS and the 1995 Amendatory Act suspended the oversight powers of the SFA through the end of 2010.

For more detailed information please refer to the notes to the basic financial statements.

## ***Pension Funding***

Employees of the CPS participate in either the Public School Teachers' Pension and Retirement Fund of Chicago (the "Pension Fund") or the Municipal Employees Annuity and Benefit Fund of Chicago (the "Annuity Fund").

State statutes determine the CPS' employer-required contribution to the Pension Fund, with the exception of federal funds. As of June 30, 2004, the funded ratio of the Pension Fund was 85.8% and the CPS has recorded an estimated pension liability of \$1.26 billion in the accompanying financial statements, as determined under generally accepted accounting principles. Because the funded ratio is below 90%, the CPS has a statutorily required contribution to the Pension Fund. The first year that CPS is required to make a contribution to the Pension Fund under the statutory requirements is fiscal year 2006.

All career service employees of the CPS, except CPS employees who are members of the Public School Teachers' Pension and Retirement Fund, participate in the Municipal Employees' Annuity and Benefit Fund of Chicago (the "Annuity Fund"). Covered employees are required by State statute to contribute 8.5% of their salary. In fiscal year 2005, as in previous fiscal years, the CPS paid a portion, 7%, or \$32 million of the required employees' contribution for most employees.

For more detailed information please refer to the notes to the basic financial statements.

## **OVERVIEW OF FUND FINANCIAL STATEMENTS**

A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. CPS, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All CPS funds are reported in the governmental funds.

***Governmental Funds.*** Governmental funds are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources, as well as on balances of spendable resources* available at the end of the fiscal year for spending in future years. Such information may be useful in evaluating a government's near-term financing requirements.

These funds are reported using the modified accrual method of accounting, which measures cash and all other financial assets that can be readily converted to cash. These statements provide a detailed short-term view of the school district's operations and the services it provides.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balance provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The CPS' fund financial statements provide detailed information about the most significant funds — not the CPS as a whole. The CPS' governmental funds use the following accounting approach. All of the CPS' services are reported in governmental funds. Governmental fund reporting focuses on showing how money flows into and out of funds and the balances left at year-end that are available for spending. They are reported using *modified accrual* accounting, which measures cash and all other *financial* assets that can readily be converted to cash. The governmental fund statements provide a detailed *short-term view* of the CPS' operations and the services it provides.

CPS maintains three significant governmental funds: General Operating, Capital Projects, and Debt Service. The following schedules presents a summary of the general operating fund, capital projects fund and debt service fund revenues and other financing sources by type and expenditures by program for the period ended June 30, 2005 as compared to June 30, 2004. It also depicts the amount and percentage increases and decreases in relation to prior year revenues and other financing resources.

***Revenues and Other Financing Sources***

<i>(Millions of dollars)</i>	<b>2005 Amount</b>	<b>2004 Amount</b>	<b>2005 Percent of Total</b>	<b>Increase (Decrease) From 2004</b>	<b>Percent Increase (Decrease) from 2004</b>
Property taxes .....	\$ 1,639	\$ 1,571	36.4%	\$ 68	4.3%
Replacement taxes .....	146	120	3.3%	26	21.7%
State aid .....	1,507	1,481	33.5%	26	1.8%
Federal aid .....	763	731	17.0%	32	4.4%
Investment income .....	43	40	1.0%	3	7.5%
Other .....	103	149	2.3%	(46)	(30.9)%
Subtotal .....	\$ 4,201	\$ 4,092	93.5%	\$ 109	2.7%
Other financing sources .....	291	253	6.5%	38	15.0%
Total .....	<u>\$ 4,492</u>	<u>\$ 4,345</u>	<u>100.0%</u>	<u>\$ 147</u>	<u>3.4%</u>

**Total revenues** increased \$109 million primarily due to increases in:

- Property taxes which increased \$68 million due to increased tax levies.
- Replacement taxes of \$26 million resulting from unanticipated fourth quarter collections by the State of Illinois.
- State aid of \$26 million due in increases in the State's foundation level per pupil funding and other categorical program revenues.
- Federal aid of \$32 million due to additional federal grants.
- Investment income of \$3 million due to higher interest rates.

These increases were offset by decreases in other miscellaneous revenue of \$46 million, which reflects the absence of the proceeds related to the \$55 million restructuring of Chicago School Finance Authority debt in fiscal year 2004.

## ***Expenditures***

<i>(Millions of dollars)</i>	<u>2005 Amount</u>	<u>2004 Amount</u>	<u>2005 Percent of Total</u>	<u>Increase (Decrease) From 2004</u>	<u>Percent Increase (Decrease) from 2004</u>
Instruction . . . . .	\$ 2,429	\$ 2,355	53.3%	\$ 74	3.1%
Pupil support services . . . . .	323	328	7.1%	(5)	(1.5)%
General support services . . . . .	822	771	18.0%	51	6.6%
Food services . . . . .	174	181	3.8%	(7)	(3.9)%
Community services . . . . .	42	50	0.9%	(8)	(16.0)%
Teachers' pension . . . . .	65	65	1.4%	—	0.0%
Capital outlay . . . . .	389	365	8.5%	24	6.6%
Debt service . . . . .	316	260	6.9%	56	21.5%
Other . . . . .	6	7	0.1%	(1)	(14.3)%
Total . . . . .	<u>\$ 4,566</u>	<u>\$ 4,382</u>	<u>100.0%</u>	<u>\$ 184</u>	<u>4.2%</u>

**Total expenditures** increased \$184 million primarily due to the increases in:

- Instruction increased \$74 million mainly due to \$60 million in services for charter school and off site tuition and \$12 million of other fixed costs.
- General support services increased \$51 million due to:
  - Increases in facilities support services of \$24 million
  - Increases in instructional support services of \$44 million
  - Offset by decreases in administrative support services of \$17 million
- Capital outlay increased \$24 million due to increased spending in the Capital Improvement Program.
- Increased debt service of \$56 million due to additional debt issuances.

## ***Notes to Basic Financial Statements***

The Notes to Basic Financial Statements follow the statements in the report and complement the financial statements by describing qualifying factors and changes throughout the fiscal year.

## **BUDGETARY HIGHLIGHTS**

Annual budgets are prepared on a basis consistent with accounting principles generally accepted in the United States for the General Operating, Capital Project and Debt Service funds. All annual unencumbered appropriations lapse at fiscal year-end.

The appropriated budget is prepared by fund, account, and unit. Certain funding allocations (primarily Federal and State programs, including Supplementary General State Aid) are made to schools but are not budgeted by account by the schools at the time the budget is adopted. These allocations are included in Other Fixed Charges for budget purposes. During the fiscal year, upon receiving the appropriate approvals from regional offices and the Office of Management and Budget, transfers are made to the appropriate accounts. Actual expenditures are reflected in the appropriate accounts.

In August 2004, the Board adopted a balanced budget for fiscal year 2005 that reflected total resources, including \$30 million of available fund balances, and appropriations of \$4.05 billion for the General Operating Fund.

In July 2005, the Board adopted a balanced budget for fiscal year 2006 that reflected total resources, including \$50 million of available fund balances, and appropriations of \$4.21 billion for the General Operating Fund.

## **REQUESTS FOR INFORMATION**

This financial report is designed to provide citizens, taxpayers, parents, students, investors and creditors with a general overview of the CPS' finances and to show the CPS' accountability for the money it receives. Additional details can be requested by mail at the following address:

The Chicago Public Schools  
Office of the Controller  
125 South Clark Street  
14th Floor  
Chicago, Illinois, 60603

Or visit our website at: [\*\*http://www.cps.k12.il.us\*\*](http://www.cps.k12.il.us) for a complete copy of this report and other financial information.

*(Please note that some amounts may not tie to the financial statements due to rounding.)*



**CHICAGO PUBLIC SCHOOLS**  
**Chicago Board of Education**

**STATEMENT OF NET ASSETS**

**June 30, 2005**

**(Thousands of Dollars)**

	<b>Governmental Activities</b>
<b>ASSETS:</b>	
Cash and investments .....	\$ 773,128
Cash and investments in escrow .....	702,956
Cash and investments held in school internal accounts .....	27,632
Property taxes receivable, net of allowance .....	886,065
Other receivables:	
Replacement taxes .....	26,026
State aid, net of allowance .....	351,465
Federal aid .....	105,370
Other .....	10,425
Other assets .....	34,481
Land and construction in progress .....	715,130
Buildings, building improvements and equipment, net of accumulated depreciation ..	<u>3,561,308</u>
Total Assets .....	<u>\$ 7,193,986</u>
<b>LIABILITIES:</b>	
Accounts payable .....	\$ 241,129
Accrued payroll and benefits .....	538,003
Amount held for student activities .....	27,632
Other accrued liabilities .....	4,000
Interest payable .....	26,602
Current portion of long-term debt and capitalized lease obligations .....	46,288
Long-term liabilities:	
Debt, net of premiums and discounts .....	3,742,775
Capitalized lease obligations .....	458,030
Pension .....	1,256,147
Other benefits and claims .....	<u>321,966</u>
Total Liabilities .....	<u>\$ 6,662,572</u>
<b>NET ASSETS:</b>	
Invested in capital assets, net of related debt .....	\$ 413,077
Restricted for:	
Debt service .....	298,538
Specific purposes .....	45,134
Unrestricted .....	<u>(225,335)</u>
Total Net Assets .....	<u>\$ 531,414</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

**CHICAGO PUBLIC SCHOOLS**  
**Chicago Board of Education**

**STATEMENT OF ACTIVITIES**

**For the Fiscal Year Ended June 30, 2005**

**(Thousands of Dollars)**

		Program Revenues			Net (Expense) Revenue and Changes in Net Assets
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
FUNCTIONS/PROGRAMS					
Governmental activities:					
Instruction . . . . .	\$ 2,777,202	\$ 1,014	\$ 488,598	\$ 14,454	\$ (2,273,136)
Support services:					
Pupil support services	337,676	—	21,932	1,923	(313,821)
Administrative support services . . .	158,303	—	62,738	902	(94,663)
Facility support services . . . . .	379,599	—	11,420	1,881	(366,298)
Instructional support services . . . . .	404,583	—	107,748	2,106	(294,729)
Food services . . . . .	182,315	9,553	151,401	367	(20,994)
Community services . .	42,677	—	32,385	89	(10,203)
Interest expense . . . . .	201,506	—	—	—	(201,506)
Other . . . . .	8,724	—	—	—	(8,724)
Total Governmental Activities . . . . .	<u>\$ 4,492,585</u>	<u>\$ 10,567</u>	<u>\$ 876,222</u>	<u>\$ 21,722</u>	<u>\$ (3,584,074)</u>
General Revenues:					
Taxes:					
Property taxes . . . . .					\$ 1,663,783
Replacement taxes . . . . .					145,724
State aid . . . . .					1,429,611
Interest and investment earnings . . . . .					43,215
Miscellaneous . . . . .					42,001
Total General Revenues . . . . .					<u>\$ 3,324,334</u>
Change in net assets . . . . .					\$ (259,740)
Net assets — beginning . . . . .					<u>791,154</u>
Net assets — ending . . . . .					<u>\$ 531,414</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

**CHICAGO PUBLIC SCHOOLS**  
**Chicago Board of Education**

**BALANCE SHEET — GOVERNMENTAL FUNDS**

**June 30, 2005**

**(Thousands of Dollars)**

	<b>General Operating Fund</b>	<b>Capital Projects Fund</b>	<b>Debt Service Fund</b>	<b>Totals</b>
<b>ASSETS:</b>				
Cash and investments .....	\$ 709,158	\$ 56,159	\$ 7,811	\$ 773,128
Cash and investments in escrow .....	5,266	472,190	225,500	702,956
Cash and investments held in school internal accounts .....	27,632	—	—	27,632
Receivables:				
Property taxes, net of allowance .....	858,595	—	27,470	886,065
Replacement taxes .....	26,026	—	—	26,026
State aid, net of allowance .....	351,465	—	—	351,465
Federal aid .....	104,743	627	—	105,370
Other .....	6,465	1,431	2,529	10,425
Due from other funds .....	127,948	214	67,849	196,011
Other assets .....	7,151	—	—	7,151
Total Assets .....	<u>\$ 2,224,449</u>	<u>\$ 530,621</u>	<u>\$ 331,159</u>	<u>\$ 3,086,229</u>
<b>LIABILITIES AND EQUITY:</b>				
<b>LIABILITIES:</b>				
Accounts payable .....	\$ 197,196	\$ 43,057	\$ 8,975	\$ 249,228
Accrued payroll and benefits .....	490,519	—	—	490,519
Amount held for student activities .....	27,632	—	—	27,632
Due to other funds .....	68,063	127,335	613	196,011
Other accrued liabilities .....	4,000	—	—	4,000
Deferred property tax revenue .....	839,345	—	26,871	866,216
Other deferred revenue .....	206,701	256	—	206,957
Total Liabilities .....	<u>\$ 1,833,456</u>	<u>\$ 170,648</u>	<u>\$ 36,459</u>	<u>\$ 2,040,563</u>
<b>EQUITY:</b>				
Fund Balances:				
Reserved:				
Reserved for encumbrances .....	\$ 97,313	\$ 140,925	\$ —	\$ 238,238
Reserved for restricted donations .....	1,459	—	—	1,459
Reserved for specific purposes .....	43,675	—	—	43,675
Reserved for debt service .....	—	—	294,700	294,700
Unreserved:				
Designated to provide operating capital .....	190,000	—	—	190,000
Undesignated .....	58,546	219,048	—	277,594
Total Equity .....	<u>\$ 390,993</u>	<u>\$ 359,973</u>	<u>\$ 294,700</u>	<u>\$ 1,045,666</u>
Total Liabilities and Equity .....	<u>\$ 2,224,449</u>	<u>\$ 530,621</u>	<u>\$ 331,159</u>	<u>\$ 3,086,229</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

**CHICAGO PUBLIC SCHOOLS**  
**Chicago Board of Education**

**RECONCILIATION OF THE GOVERNMENTAL FUNDS**  
**BALANCE SHEET TO THE STATEMENT OF NET ASSETS**

**June 30, 2005**

**(Thousands of Dollars)**

Total fund balances — governmental funds .....	\$ 1,045,666
Prepaid assets and deferred charges are recorded as expenditures in governmental funds. The Statement of Net Assets includes these amounts as other assets.	
Prepaid interest .....	3,569
Deferred charges — bond issuance costs .....	23,760
The cost of capital assets (land, buildings and improvements and equipment) purchased or constructed is reported as an expenditure in the governmental funds. The Statement of Net Assets includes those capital assets among the assets of the CPS as a whole. The cost of those capital assets are allocated over their estimated useful lives (as depreciation expense) to the various programs reported as governmental activities in the Statement of Activities. Because depreciation expense does not affect financial resources, it is not reported in the governmental funds.	
Costs of capital assets .....	6,296,619
Accumulated depreciation .....	(2,020,181)
Liabilities applicable to the CPS' governmental activities are not due and payable in the current period and accordingly are not reported as fund liabilities. Interest payable on debt and other long-term obligations is not recorded in the governmental funds but they are reported in the Statement of Net Assets. All liabilities, both current and long-term, are reported in the Statement of Net Assets.	
Debt, net of premiums and discounts .....	\$ (3,771,050)
Capitalized lease obligations .....	(476,044)
Pension .....	(1,256,147)
Other benefits and claims .....	(367,649)
Legal settlements .....	(1,800)
	(5,872,690)
Interest payable .....	(18,502)
Revenues that have been deferred or unearned in the governmental funds but are recognized as revenue in the government-wide financial statements.	
Deferred property tax revenue .....	866,216
Other deferred revenue .....	206,957
Net Assets .....	<u>\$ 531,414</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

**CHICAGO PUBLIC SCHOOLS****Chicago Board of Education****STATEMENT OF REVENUES, EXPENDITURES AND NET CHANGES IN  
FUND BALANCES — GOVERNMENTAL FUNDS****For the Fiscal Year Ended June 30, 2005****With Comparative Amounts for the Fiscal Year Ended June 30, 2004****(Thousands of Dollars)**

	<b>General Operating Fund</b>	<b>Capital Projects Fund</b>	<b>Debt Service Fund</b>	<b>Total Fiscal Year Ended June 30, 2005</b>	<b>Total Fiscal Year Ended June 30, 2004</b>
<b>REVENUES:</b>					
Property taxes .....	\$ 1,587,803	\$ —	\$ 51,434	\$ 1,639,237	\$ 1,571,065
Replacement taxes .....	94,546	—	51,178	145,724	120,427
State aid .....	1,417,423	3,061	86,631	1,507,115	1,481,448
Federal aid .....	746,403	16,552	—	762,955	730,504
Interest and investment income .....	14,003	13,181	16,031	43,215	39,501
Other .....	85,377	6,679	10,598	102,654	149,253
Total Revenues .....	<u>\$ 3,945,555</u>	<u>\$ 39,473</u>	<u>\$ 215,872</u>	<u>\$ 4,200,900</u>	<u>\$ 4,092,198</u>
<b>EXPENDITURES:</b>					
Current:					
Instruction .....	\$ 2,429,014	\$ —	\$ —	\$ 2,429,014	\$ 2,355,114
Pupil support services .....	323,225	—	—	323,225	327,653
Administration support services ..	151,529	—	—	151,529	168,563
Facilities support services .....	316,195	—	—	316,195	291,900
Instructional support services .....	353,859	—	—	353,859	310,166
Food services .....	173,872	—	—	173,872	180,588
Community services .....	42,325	—	—	42,325	49,933
Teacher's pension and retirement benefits .....	65,045	—	—	65,045	65,045
Capital outlay .....	—	389,450	—	389,450	365,336
Debt service .....	1,420	—	314,389	315,809	259,590
Other .....	5,912	—	—	5,912	8,128
Total Expenditures .....	<u>\$ 3,862,396</u>	<u>\$ 389,450</u>	<u>\$ 314,389</u>	<u>\$ 4,566,235</u>	<u>\$ 4,382,016</u>
<b>REVENUES IN EXCESS OF/(LESS THAN) EXPENDITURES .....</b>					
	<u>\$ 83,159</u>	<u>\$ (349,977)</u>	<u>\$ (98,517)</u>	<u>\$ (365,335)</u>	<u>\$ (289,818)</u>
<b>OTHER FINANCING SOURCES (USES)</b>					
Gross amounts from debt issuances	\$ —	\$ 278,080	\$ 246,180	\$ 524,260	\$ 765,995
Proceeds from notes .....	—	5,500	—	5,500	—
Premiums .....	—	5,966	37,484	43,450	21,043
Payment to refunded bond escrow agent .....	—	—	(282,478)	(282,478)	(534,375)
Transfers in/(out) .....	328	(7,344)	7,016	—	—
TOTAL OTHER FINANCING SOURCES	<u>\$ 328</u>	<u>\$ 282,202</u>	<u>\$ 8,202</u>	<u>\$ 290,732</u>	<u>\$ 252,663</u>
<b>NET CHANGE IN FUND BALANCE ...</b>					
Fund Balances, beginning of period ..	<u>\$ 83,487</u>	<u>\$ (67,775)</u>	<u>\$ (90,315)</u>	<u>\$ (74,603)</u>	<u>\$ (37,155)</u>
Fund Balances, beginning of period ..	<u>307,506</u>	<u>427,748</u>	<u>385,015</u>	<u>1,120,269</u>	<u>1,157,424</u>
Fund Balances, end of period .....	<u>\$ 390,993</u>	<u>\$ 359,973</u>	<u>\$ 294,700</u>	<u>\$ 1,045,666</u>	<u>\$ 1,120,269</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

**CHICAGO PUBLIC SCHOOLS****Chicago Board of Education****RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES,  
EXPENDITURES, AND CHANGE IN FUND BALANCES WITH THE STATEMENT OF ACTIVITIES****For the Fiscal Year Ended June 30, 2005****(Thousands of Dollars)**

Total net change in fund balances — governmental funds .....	\$	(74,603)
Capital outlay to purchase or build capital assets are reported in governmental funds as expenditures. However, for governmental activities those costs are shown in the Statement of Net Assets and allocated over their estimated useful lives as annual depreciation expenses in the Statement of Activities. This is the amount by which capital outlay exceeds the depreciation in the period.		
Capital outlay/equipment .....	\$	355,107
Depreciation expense .....	(150,805)	204,302
Proceeds from sales of bonds and notes are reported in the governmental funds as a source of financing, whereas they are recorded as long-term liabilities in the Statement of Net Assets .....		
		(529,760)
Repayment of bond principal and refunding is an expenditure in the governmental funds, but it reduces long-term liabilities in the Statement of Net Assets and does not affect the Statement of Activities .....		
		420,955
Interest on long-term debt in the Statement of Activities differs from the amount reported in the governmental funds because interest is recorded as an expenditure in the governmental funds when it is due, and thus requires the use of current financial resources. In the Statement of Activities, however, interest cost is recognized as the interest accrues, regardless of when it is due .....		
		(46,551)
Bond discount, bond premium, issuance cost and refunding loss are amortized over the lives of the bonds in the Statement of Activities but are recorded as a reduction from the proceeds from sales of bond in the governmental funds .....		
		(21,072)
Since some property taxes and grants will not be collected for several months after the CPS' fiscal year ends, they are not considered as "available" revenues in the governmental funds, and are instead recorded as deferred revenues. They are, however, recorded as revenues in the Statement of Activities.		
Property taxes .....		24,546
Grants .....		7,401
In the Statement of Activities, legal settlements, sick pay, vacation pay, workers' compensation, and net pension obligation are measured by the amount accrued during the year. In the governmental funds, expenditures for these items are measured by the amount actually paid.		
Legal settlements .....		(300)
Sick pay .....		(24,667)
Vacation pay .....		(277)
Workers' compensation .....		(7,935)
General and automobile liability .....		182
Net pension obligation .....		(209,149)
In the Statement of Activities, gain or loss on disposals of fixed assets is reported, whereas in the governmental funds, the entire proceeds are recorded .....		
		(2,812)
Change in Net Assets .....	\$	<u>(259,740)</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

**CHICAGO PUBLIC SCHOOLS**  
**Chicago Board of Education**

**STATEMENT OF REVENUES, EXPENDITURES BY OBJECT**  
**OTHER FINANCING SOURCES AND NET CHANGES IN FUND BALANCES**  
**FINAL APPROPRIATIONS VS. ACTUAL — GENERAL OPERATING FUND**  
**For the Fiscal Year Ended June 30, 2005**  
**(Thousands of Dollars)**

	<u>Approved Budget</u>	<u>Transfers In/(Out)</u>	<u>Final Appropriations</u>	<u>Fiscal Year Actual</u>	<u>Variance</u>
<b>REVENUES:</b>					
Property taxes .....	\$ 1,582,000	\$ —	\$ 1,582,000	\$ 1,587,803	\$ 5,803
Replacement taxes .....	72,774	—	72,774	94,546	21,772
State aid .....	1,442,007	—	1,442,007	1,417,423	(24,584)
Federal aid .....	832,274	—	832,274	746,403	(85,871)
Interest and investment income .....	16,300	—	16,300	14,003	(2,297)
Other .....	72,308	—	72,308	85,377	13,069
Total Revenues .....	<u>\$ 4,017,663</u>	<u>\$ —</u>	<u>\$ 4,017,663</u>	<u>\$ 3,945,555</u>	<u>\$ (72,108)</u>
<b>EXPENDITURES:</b>					
Salaries —					
Teachers .....	\$ 1,890,279	\$ (19,351)	\$ 1,870,928	\$ 1,850,403	\$ 20,525
Career services .....	508,783	24,163	532,946	515,427	17,519
Commodities —					
Energy .....	61,503	3,723	65,226	64,647	579
Food .....	93,969	872	94,841	89,628	5,213
Textbooks .....	59,021	40,778	99,799	79,677	20,122
Supplies .....	29,609	22,991	52,600	45,210	7,390
Other .....	—	1,620	1,620	1,314	306
Services —					
Professional and construction .....	192,070	176,823	368,893	375,054	(6,161)
Transportation .....	103,275	713	103,988	93,639	10,349
Tuition .....	145,628	(69,934)	75,694	66,854	8,840
Telephone and telecommunications .....	3,213	271	3,484	8,635	(5,151)
Other .....	6,431	8,873	15,304	11,516	3,788
Equipment —					
Educational .....	23,555	27,191	50,746	44,081	6,665
Building and sites —					
Repairs and replacements .....	46,351	(4,969)	41,382	35,224	6,158
Fixed charges —					
Teachers' pension .....	198,923	(1,563)	197,360	198,065	(705)
Career service pension .....	83,161	2,715	85,876	81,560	4,316
Hospitalization and dental insurance .....	256,152	12,885	269,037	230,204	38,833
Medicare .....	25,505	2,006	27,511	26,719	792
Unemployment compensation .....	3,206	5,332	8,538	8,558	(20)
Workers compensation .....	15,972	1,866	17,838	17,953	(115)
Rent .....	10,174	305	10,479	10,393	86
Debt service .....	1,450	(30)	1,420	1,420	—
Other .....	289,733	(237,280)	52,453	6,215	46,238
Total Expenditures .....	<u>\$ 4,047,963</u>	<u>\$ —</u>	<u>\$ 4,047,963</u>	<u>\$ 3,862,396</u>	<u>\$ 185,567</u>
REVENUES IN EXCESS OF/(LESS THAN)					
EXPENDITURES .....	\$ (30,300)	\$ —	\$ (30,300)	\$ 83,159	\$ 113,459
<b>OTHER FINANCING SOURCES</b>					
Transfers in .....	328	—	328	328	—
NET CHANGE IN FUND BALANCE .....	\$ (29,972)	\$ —	\$ (29,972)	\$ 83,487	\$ 113,459
Fund Balances, beginning of period .....	307,506	—	307,506	307,506	—
Fund Balances, end of period .....	<u>\$ 277,534</u>	<u>\$ —</u>	<u>\$ 277,534</u>	<u>\$ 390,993</u>	<u>\$ 113,459</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

## **CHICAGO PUBLIC SCHOOLS**

### **Chicago Board of Education**

## **NOTES TO BASIC FINANCIAL STATEMENTS**

**June 30, 2005**

### **NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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#### **Reporting Entity**

The Board of Education of the City of Chicago, or the Chicago Public Schools (CPS), is a body politic and corporate, and a school district of the State of Illinois having boundaries coterminous with the boundaries of the City of Chicago. The Board of Education of the City of Chicago (the Board) is established under and governed by the Illinois School Code and maintains a system of schools primarily for kindergarten through twelfth grade.

As a result of legislation passed by the Illinois General Assembly, which became effective on June 30, 1995, the Mayor of the City of Chicago appoints the members of the Board of Education of the City of Chicago. The CPS is excluded from the City's reporting entity because it does not meet the financial accountability criteria for inclusion established by the Governmental Accounting Standards Board (GASB).

The City of Chicago, the Chicago School Finance Authority, the Public Building Commission of Chicago and the Public School Teachers' Pension and Retirement Fund of Chicago are deemed to be related organizations but separate entities and are not included as part of the CPS reporting entity. No fiscal dependency exists between these organizations. These units are excluded from the CPS reporting entity because they do not meet the criteria for inclusion as established by GASB.

#### **New Accounting Standards**

During fiscal year 2005, CPS adopted GASB Statement 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. Please refer to Note 6, Capital Assets for required disclosures, if applicable.

#### **Description of Government-Wide Financial Statements**

The Statement of Net Assets and the Statement of Activities display information about the government-wide entity as a whole. The Statement of Net Assets and the Statement of Activities were prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place. Revenues, expenses, gains, losses, assets, and liabilities resulting from nonexchange transactions are recognized in accordance with the GASB requirements of accounting and financial reporting for nonexchange transactions.

Program revenues included in the Statement of Activities derive directly from the program itself or from parties outside the CPS's taxpayers or citizenry, as a whole; program revenues reduce the cost of the function to be financed from general revenues.

The CPS reports all direct expenses by function in the Statement of Activities. Direct expenses are those that are clearly identifiable with a function. Indirect expenses of other functions are not allocated to those functions but are reported separately in the Statement of Activities. Depreciation expense is specifically identified by function and is included in the direct expense to each function. Interest on general long-term debt is considered an indirect expense and is reported separately on the Statement of Activities.



## **NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

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### **Government-Wide and Fund Financial Statements**

The government-wide financial statements report information on all of the activities of the CPS. Interfund balances have been removed from these statements but the services provided and used are not eliminated in the process of consolidation.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not identified as program revenues are reported as general revenues.

Separate financial statements are provided for governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements.

### **Measurement Focus, Basis of Accounting, and Financial Statement Presentation**

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. State and Federal grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. Property taxes are considered to be available if collected within 60 days of fiscal year end. For this purpose, the CPS considers State aid, Federal aid and replacement tax revenues that are susceptible to accrual to be available if they are collected within 90 days of fiscal year end. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

### **Funds**

CPS reports its financial activities through the use of “fund accounting.” This is a system of accounting wherein transactions are reported in self-balancing sets of accounts to reflect results of activities. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained, consistent with legal and managerial requirements. A description of the activities of the various funds is provided below.

## **NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

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### **Governmental Funds**

#### *a. General Operating Fund*

The General Operating Fund is established in compliance with the provisions of the Illinois Program Accounting Manual for Local Education Agencies. This Fund is the primary operating fund of CPS and is made up of the following programs:

- Educational Program
- Supplementary General State Aid Program
- School Food Service Program
- Improving America's Schools Act Program
- Education of the Handicapped Program
- Workers' and Unemployment Compensation/Tort Immunity Program
- Public Building Commission Operations and Maintenance Program
- Other Government-Funded Programs

#### *b. Capital Projects Fund*

The Capital Projects Fund includes the following programs:

*Capital Asset Program* — This program is for the receipt and expenditure of the proceeds from the sale of certain Board real estate, proceeds from the Chicago School Finance Authority, and other miscellaneous capital projects revenues from various sources as designated by the Board.

*Capital Improvement Program* — This program is for the receipt and expenditure of proceeds from the sale of Unlimited Tax General Obligation Bonds, Public Building Commission Building Revenue Bonds, State of Illinois Construction Grants, Federal E-rate capital subsidies and other revenues for the purpose of building and improving schools as designated by the Board. The bonds are being repaid in the Debt Service Fund from Replacement Tax revenue, from an Intergovernmental Agreement with the City of Chicago, State of Illinois Construction Grants, General State Aid, other revenues as designated by the Board and from a separate tax levy associated with the bonds, if necessary.

#### *c. Debt Service Fund*

The Debt Service Fund includes the following programs:

*Bond Redemption and Interest Program* — This program is for the receipt and expenditure of Replacement Taxes, City of Chicago Intergovernmental Agreement revenue, State of Illinois Construction Grants, General State Aid and other revenues as designated by the Board for the payment of interest and principal on specific bond issues.

*Public Building Commission Leases Program* — Receipts and expenditures of tax levies and State of Illinois Construction Grants for the rental payments due to the Public Building Commission of school buildings are recorded in this program. The title to these properties passes to the City of Chicago, in trust for the use of the CPS, at the end of the lease terms.

### **Assets, Liabilities, and Net Assets or Equity**

#### *Deposits and Investments*

CPS' cash and cash equivalents consists of cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition. In addition, State statutes authorize CPS to invest in obligations of the U.S. Treasury, commercial paper, repurchase agreements, and the State Treasurer's Investment Pool. CPS' investments are reported at fair value.

## **NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

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### *Restricted Assets*

Certain proceeds of the CPS bond issuances, as well as certain reset aside for their repayment, are classified as restricted assets on the balance sheet because they are maintained in separate bank accounts and their use is limited by applicable bond covenants. These amounts are consequently held in escrow.

### *Receivables and Payables*

CPS records as its property taxes receivable amounts equal to the current year tax levy plus the two years prior levies net of an allowance for estimated uncollectible amounts. The allowance is recorded at 3.5% of the gross levy.

A calendar year's property tax levies are billed (extended) in two installments in the subsequent calendar year. Calendar year 2004 property taxes were levied for fiscal year 2005 in December 2004, and were billed in fiscal year 2005. In 2005, the installment due dates were March 1 and November 1. Property taxes unpaid after these dates accrue interest at the rate of 1.5% per month. The treasurers of Cook and DuPage counties, who distribute such receipts to the CPS, receive collections of property tax installments. The CPS' property tax becomes a lien on real property on January 1 of the year for which it is levied. The levy becomes an enforceable lien against the property as of January 1 of the levy year. CPS does not record a receivable nor related deferred revenue until the Board passes the levy for the current fiscal year.

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e. the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds."

### *Capital Assets*

Capital assets, which include land, building, building improvements and equipment are reported in the governmental activities columns in the government-wide financial statements. Land, buildings and building improvements are recorded at historical cost or estimated historical cost if purchased or constructed. The capitalization threshold for equipment is a unit cost of \$25,000 or more. Donated capital assets are recorded at estimated fair market value at date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Beginning in fiscal year 2005, CPS implemented procedures related to impaired assets. Generally, a capital asset is considered impaired when its service utility has declined significantly and the events or changes in the circumstances are unexpected or outside the normal life cycle.

Depreciation of buildings and building improvements of the CPS is calculated using the straight-line method beginning in the year after they are completed. Equipment is depreciated using the straight-line method and the mid-year convention. The CPS' capital assets have the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings and building improvements .....	25-50
Administrative software/systems .....	20
Equipment .....	5

## **NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

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Depreciation of buildings and building improvements placed in service prior to fiscal year 2002 was calculated using a composite rate that CPS estimated to be 32 years. For items placed in service subsequent to fiscal year 2001, CPS utilizes the estimated useful lives for specific components within the range noted above.

For assets other than personal property placed in service prior to June 30, 2001, the amount to be recorded as a reduction to capital assets and related accumulated depreciation upon asset retirement is determined using a deflated replacement cost methodology.

### *Vacation and Sick Pay*

The CPS provides vacation and sick pay benefits for substantially all of its employees. Accrued sick pay benefits were computed using the termination payment method. The liability for accrued vacation pay benefits is computed using the employee's actual daily wage instead of average daily wage as used in prior years.

### *Long-term Obligations*

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the Statement of Net Assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental funds recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

### *Fund Balances and Equity*

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose.

The Statement of Net Assets include the following:

*Investment in Capital Assets, net of Related Debt* — the component of net assets that reports the difference between capital assets less both the accumulated depreciation and the outstanding balance of debt, excluding unexpended proceeds, that is directly attributable to the acquisition, construction or improvement of those assets.

*Restricted for Specific Purposes* — the component of net assets that reports the difference between assets and liabilities of the certain programs that consists of assets with constraints placed on their use by either external parties and/or enabling legislation.

*Restricted for Debt Service* — the component of net assets that reports the difference between assets and liabilities of the Debt Service Fund that consists of assets with constraints placed on their use by creditors.

*Unrestricted* — the difference between the assets and liabilities that is not reported as Net Assets Invested in Capital Assets, net of Related Debt, Net Assets Restricted for Specific Purpose, or Net Assets Restricted for Debt Service.

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**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

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*Comparative Data*

Comparative total data for the prior year have been presented in the fund financial statements in order to provide an understanding of the changes in the financial position and operations of these funds.

*Management's Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

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**NOTE 2. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY**

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**Budgets**

Annual Budgets are prepared on a basis consistent with accounting principles generally accepted in the United States for the General Operating, Capital Projects and Debt Service funds. All annual unencumbered appropriations lapse at fiscal year-end. Encumbrances are reported as a reservation of fund balance for subsequent year expenditures.

Certain funding allocations (primarily Federal and State programs, including Supplementary General State Aid) are made to schools but are not budgeted by account by the schools at the time the budget is adopted. These allocations are included in Other Fixed Charges for budget purposes. During the fiscal year, upon receiving the appropriate approvals from regional offices and the Office of Management and Budget, transfers are made to the appropriate accounts. Actual expenditures are reflected in the appropriate accounts.

The appropriated budget is prepared by fund, account and unit. The legal level of budgetary control is at the account level except for school-based discretionary programs. School-based discretionary program expenditures are governed by specific program policies and procedures. Board approval is required for all funding transfers except those described above. In addition, an amended budget is required for increases in total appropriation.

In August 2004, the Board adopted a balanced budget for fiscal year 2005 that reflected total resources, including \$30.3 million of available reserved fund balances, and appropriations of \$4.05 billion for the General Operating Fund.

In July 2005, the Board adopted a balanced budget for fiscal year 2006 that reflected total resources, including \$50 million of available reserved fund balances, and appropriations of \$4.21 billion for the General Operating Fund.

The Capital Projects Fund is budgeted on a project-by-project basis. Budgeted amounts in the Capital Projects Fund represent the entire project budget for projects that were expected to commence in fiscal year 2005. Actual expenditures in the Capital Projects Fund include expenditures on projects that were budgeted in the current and prior fiscal years.

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**NOTE 3. PROPERTY TAXES AND STATE AID REVENUE**

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*a. Property Taxes* — The CPS levies property taxes using tax levy rates established by statute and an equalized assessed valuation ("EAV") estimated by the CPS. The maximum billing (extension) of property taxes for the rate-limited Educational Levy in any calendar year is limited to the lesser of the tax rate established by statute multiplied by the EAV known at the time the final calendar year tax bills

**NOTE 3. PROPERTY TAXES AND STATE AID REVENUE (continued)**

are calculated by the Cook and DuPage County Clerks or the tax rates established by statute multiplied by the prior year EAV. Property taxes for the levies that are not rate-limited are levied based on the estimated requirements for such funds.

The CPS' extensions are limited to the prior year EAV multiplied by the current year maximum legal rate limit. In addition, the growth in property tax extensions of the CPS is limited to the lesser of 5% or the percentage increase in the consumer price index for all urban consumers during the calendar year preceding the tax levy year. Extensions can be increased above this limitation due to the following increases: assessed valuation attributable to new construction, referendum approval, or rate limitation.

Amounts collected in excess of the estimated net receivable for each levy year are reported as revenue in the fiscal year that the tax collections are distributed to CPS. Tax amounts collected in excess of the specified prior years levies is recorded in the year of receipt without impacting receivable and deferred revenue balances. CPS maintains the accounts receivable, reserves for uncollectibles and deferred revenue balance on the general ledger for three tax levy years. All refunds, no matter what tax year they apply, are recorded against the property tax revenue and cash accounts in the period of occurrence or notification from the respective county treasurer.

Legal limitations on tax rates and the rates extended in calendar years 2005 and 2004 are shown below.

		<b>Tax Rates Extended Per \$100 of EAV</b>	
	<b>Maximum 2005 Legal Limit</b>	<b>2005</b>	<b>2004</b>
<b>General Operating Fund:</b>			
Educational . . . . .	(A)	\$ 2.301	\$ 2.258
Workers' and Unemployment Compensation/Tort Immunity . . . . .	(B)	.131	.219
Public Building Commission Operation and Maintenance . . . . .	(B)	.576	.565
Public Building Commission Lease Program . . . . .	(B)	.096	.100
		<u>\$ 3.104</u>	<u>\$ 3.142</u>

- A. The 2005 Educational tax rate is limited to the sum of \$3.01 per \$100 of EAV plus the difference (the "difference tax") between \$.50 per \$100 of EAV and the rate of taxes extended for the School Finance Authority.
- B. These tax rates are not limited by law, but are subject to the limits described previously.
- b. *State Aid* — The components of State Aid as shown on the financial statements are as follows (\$000's):

	<b>Fund Financial Statements</b>	<b>Government Wide- Financial Statements</b>
<b>Revenues:</b>		
General State Aid Unrestricted .....	\$ 647,330	\$ 647,330
Supplementary General State Aid .....	261,000	261,000
General Education Block Grant .....	126,598	126,598
Educational Services Block Grant .....	370,937	383,743
Capital Grants .....	3,061	3,061
Other Restricted State Revenue .....	98,189	97,782
Total State Aid .....	<u>\$ 1,507,115</u>	<u>\$ 1,519,514</u>

#### **NOTE 4. CASH DEPOSITS AND INVESTMENTS**

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Cash and investments held in the name of the CPS are controlled and managed by the CPS' Treasury Department; however, custody is maintained by the Treasurer of the City of Chicago, who is the designated ex-officio Treasurer of the CPS under the Illinois School Code. Custody is not maintained by the Treasurer of the City of Chicago for cash and investments in escrow, and the schools' internal accounts. The cash and investments in escrow in the Debt Service Fund represent the amount available for debt service payments on the Unlimited Tax General Obligation Bonds and PBC Leases. The cash and investments in escrow in the Capital Projects Fund represent the unspent proceeds from the Unlimited Tax General Obligation Bonds, Public Building Commission Building Revenue Bonds, State Technology Revolving Loan Fund and other revenues.

##### **Cash**

With the exception of school internal accounts as designated by the Board, the Municipal Code of Chicago requires that cash be deposited only in chartered banks or savings and loan associations that are on the City of Chicago's approved depository listing. The ordinances allow only regularly organized State or national banks insured by the Federal Deposit Insurance Corporation, and Federal and State savings and loan associations insured by the Savings Association Insurance Fund of the Federal Deposit Insurance Corporation located within the City of Chicago, to be designated depositories.

The CPS Investment Policy requires collateral with an aggregate market value of not less than 110% of the original acquisition price, including principal and accrued interest, on depository account balances and certificates of deposit unless the bank meets certain rating requirements and or asset size. Repurchase agreement collateral shall not be less than 102%. Collateral for the CPS' bank accounts are held by a third-party custodian in the name of the City of Chicago Treasurer for the benefit of the CPS. Collateral shall be only those securities authorized as allowable investments.

As of June 30, 2005, the book amount of the CPS' deposit accounts was \$100.7 million. The bank balance as of June 30, 2005, was \$132.0 million. The difference between the book and bank balances primarily represents checks that have been issued but have not yet cleared as of June 30, 2005. The bank balance was covered by Federal depository insurance and by collateral held by a third-party custodian with the exception of \$1.2 million. CPS had an overnight exposure of \$1.2 million in one bank account, but was in compliance with its Investment Policy.

Cash and Investments Held in School Internal Accounts, and the corresponding liability, Amounts Held for Student Activities, represent the bank balance for checking and investments for individual schools.

##### **Investments**

The CPS' investments are authorized under the Illinois Compiled Statutes Finance Investment Act. The CPS' Investment Policy is derived from this Act. The CPS Investment Policy authorizes the CPS to invest in obligations guaranteed by the full faith and credit of the U.S. Government, certificates of deposit constituting direct obligations of banks, commercial paper, money market mutual funds, repurchase agreements that mature within 330 days, certain U.S. Government agency securities, and certain State and municipal securities that are rated at the time of purchase within the two highest classifications established by a nationally recognized rating service. All mutual funds purchased invest in eligible securities outlined in the parameters of the CPS Investment Policy and meet certain other regulatory requirements.

The CPS' Investment Policy contains the following stated objectives:

- Safety of Principal. Investments shall be undertaken in a manner that provides for the preservation of principal in the overall portfolio.

**NOTE 4. CASH DEPOSITS AND INVESTMENTS (continued)**

- Liquidity. The investment portfolio shall be sufficiently liquid to meet all reasonably anticipated operating and cash flow requirements.
- Rate of Return. The investment portfolio shall be constructed with the objective of attaining a market rate of return through budgetary and economic cycles, taking into account investment risk constraints and liquidity needs.

At June 30, 2005, the CPS had the following investments (\$000's) and maturities:

<b>Investment Type</b>	<b>Carrying Amount</b>	<b>Maturities Less Than 1 Year</b>	<b>Maturities 1-5 Years</b>
Repurchase Agreements .....	\$ 194,460	\$ 194,460	\$ —
U.S. Government Agency Securities .....	632,288	625,532	6,756
Commercial Paper .....	116,469	116,469	—
Money Market Mutual Funds .....	459,825	459,825	—
Total Investments .....	\$ 1,403,042	\$ 1,396,286	\$ 6,756
Cash .....	100,674		
Total Cash and Investments .....	\$ 1,503,716		

*Credit Risk* — State law and the CPS' Investment Policy limits investment in commercial paper to the top two ratings issued by at least two standard rating services. As of June 30, 2005, Moody's Investment Service rated the CPS' investments in commercial paper A1+ or A1 by Standard and Poor's, and P-1. As of June 30, 2005, Standard and Poor's rated the CPS' investments in money market mutual funds AAAM as required by the CPS' Investment Policy.

*Custodial Risk* — During the fiscal year ended June 30, 2005, repurchase agreements were supported by collateral with an aggregate market value equal to at least 102% of amounts invested. The collateral consisted of securities that were permissible under the CPS Investment Policy. Third-party custodians held all collateral in CPS' name.

The following table provides a summary of CPS' total cash and investments as of June 30, 2005 (\$000's):

<b>Fund:</b>	<b>Amount</b>
General Operating Fund .....	\$ 742,056
Capital Projects Fund .....	528,349
Debt Service Fund .....	233,311
Total Cash and Investments .....	\$ 1,503,716



**NOTE 5. RECEIVABLES**

Receivables as of June 30, 2005 for the CPS, net of the applicable allowance for uncollectible accounts, are as follows (\$000's):

	<b>Fund Financial Statements</b>	<b>Government- Wide Financial Statements</b>
Property taxes .....	\$ 946,129	\$ 946,129
Replacement taxes .....	26,026	26,026
State aid .....	355,307	355,307
Federal aid .....	105,370	105,370
Other .....	10,425	10,425
Total Receivables .....	\$ 1,443,257	\$ 1,443,257
Less: Allowance for uncollectibles .....	(63,906)	(63,906)
Total Receivables, net .....	<u>\$ 1,379,351</u>	<u>\$ 1,379,351</u>

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. At June 30, 2005, the components of deferred revenue reported in the fund financial statements are as follows (\$000's):

Deferred property taxes .....	\$ 866,216
Other deferred revenue .....	206,957
Total Deferred Revenue .....	<u>\$ 1,073,173</u>

**NOTE 6. CAPITAL ASSETS**

Capital asset activity for the year ended June 30, 2005 was as follows (\$000's):

<b>Government-wide activities:</b>	<b>Beginning Balance</b>	<b>Increases</b>	<b>Decreases and Transfers to In-service</b>	<b>Ending Balance</b>
Capital assets, not being depreciated:				
Land .....	\$ 218,510	\$ 13,064	\$ (186)	\$ 231,388
Construction in progress .....	409,906	297,202	(223,366)	483,742
Total capital assets not being depreciated .....	<u>\$ 628,416</u>	<u>\$ 310,266</u>	<u>\$ (223,552)</u>	<u>\$ 715,130</u>
Capital assets being depreciated:				
Buildings and improvements .....	\$ 5,250,257	\$ 239,024	\$ (8,172)	\$ 5,481,109
Equipment and administrative software ..	71,197	29,183	—	100,380
Total capital assets being depreciated ..	<u>\$ 5,321,454</u>	<u>\$ 268,207</u>	<u>\$ (8,172)</u>	<u>\$ 5,581,489</u>
Total Capital Assets .....	<u>\$ 5,949,870</u>	<u>\$ 578,473</u>	<u>\$ (231,724)</u>	<u>\$ 6,296,619</u>
Less accumulated depreciation for:				
Buildings and improvements .....	\$ (1,843,880)	\$ (149,157)	\$ 5,548	\$ (1,987,489)
Equipment and administrative software ..	(31,044)	(1,648)	—	(32,692)
Total accumulated depreciation .....	<u>\$ (1,874,924)</u>	<u>\$ (150,805)</u>	<u>\$ 5,548</u>	<u>\$ (2,020,181)</u>
Capital Assets, net of depreciation ..	<u>\$ 4,074,946</u>	<u>\$ 427,668</u>	<u>\$ (226,176)</u>	<u>\$ 4,276,438</u>

**NOTE 6. CAPITAL ASSETS (continued)**

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Depreciation expense was charged to functions/programs of the CPS as follows (\$000's):

Governmental activities:	
Instruction .....	\$ 97,742
Pupil support services .....	13,006
Administrative support services .....	6,097
Facility support services .....	12,724
Instructional support services .....	14,239
Food services .....	6,997
Total Depreciation .....	<u>\$ 150,805</u>

**Construction Commitments**

The CPS had active construction projects as of June 30, 2005. These projects include new construction and renovations of schools. At year-end, the CPS had approximately \$140.9 million in outstanding construction encumbrances.

**NOTE 7. INTERFUND TRANSFERS AND BALANCES**

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**Interfund Transfers**

Interfund transfers are defined as the flow of assets, such as cash or goods, without equivalent flows of assets in return. Interfund borrowings are reflected as "Due from/to Other Funds" on the accompanying governmental fund financial statements. All other interfund transfers are reported as transfers in/out.

The following represent interfund balances among all funds at June 30, 2005 (\$000's):

General Operating Fund:	
Due from Capital Improvement Program .....	\$ 127,335
Due to Capital Asset Program .....	(214)
Due to Bond Redemption and Interest Program .....	(67,849)
Due from Public Building Commission Leases Program .....	613
Total — Due from other Funds .....	<u>\$ 59,885</u>
Capital Projects Fund:	
Capital Assets Program — Due from General Operating Fund .....	\$ 214
Capital Improvement Program — Due to General Operating Fund .....	<u>(127,335)</u>
Total — Due to other Funds .....	<u>\$ (127,121)</u>
Debt Service Fund:	
Bond Redemption and Interest Program — Due from General Operating Fund .....	\$ 67,849
Public Building Commission Leases Program — Due to General Operating Fund .....	<u>(613)</u>
Total — Due from other Funds .....	<u>\$ 67,236</u>

The purpose of interfund balances is to present transactions that are to be repaid between major programs at year end. The balances result from operating transactions between funds and are repaid during the fiscal year within the normal course of business.

## **NOTE 7. INTERFUND TRANSFERS AND BALANCES (continued)**

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### **Transfers**

Effective June 30, 2005, CPS made operating transfers of \$7.3 million from the Capital Improvement Program to the Bond Redemption and Interest Program in order to provide additional debt service resources and to transfer \$328,000 of interest earnings from the Public Building Commission Leases Program to the General Operating Fund.

## **NOTE 8. LONG-TERM DEBT**

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### *a. General Obligation Bonds*

The CPS issued the following bonds in fiscal year 2005:

#### Unlimited Tax General Obligation Bonds (Series 2004CDE)

In November 2004, CPS issued \$222,080,000 in Unlimited Tax General Obligation Bonds (Series 2004CDE). The proceeds from these bonds are being used as part of CPS' Capital Improvement Program, to pay capitalized interest, and to pay costs of issuance of the bonds. As a result of the issuance, CPS recorded net proceeds of \$217,008,506 in the Capital Improvement Fund. The debt service on this issuance will be paid from General State Aid.

#### Unlimited Tax General Obligation Bonds (Series 2004FGH)

In December 2004, CPS issued \$56,000,000 in Unlimited Tax General Obligation Bonds (Series 2004FGH) at a premium of \$5,966,226. The proceeds from these bonds are being used as part of CPS' Capital Improvement Program, to pay capitalized interest, and to pay costs of issuance of the bonds. As a result of the issuance, CPS recorded net proceeds of \$56,640,757 in the Capital Improvement Fund. The debt service on this issuance will be paid by revenues received pursuant to an intergovernmental agreement with the City of Chicago supported by certain Tax Incremental Financing revenues.

#### Unlimited Tax General Obligation Refunding Bonds (Series 2005AB)

In June 2005, CPS issued \$193,585,000 in Unlimited Tax General Obligation Refunding Bonds (Series 2005A) and \$52,595,000 in Unlimited Tax General Obligation Refunding Bonds (Series 2005B). The proceeds from these bonds are being used to refund a portion of Series 1997, 2001A and 2001C bonds, and to pay costs of issuance of the bonds. As a result of the issuance, net proceeds of \$280,645,171 were used to purchase U.S. Government Securities, which were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on \$53,975,000 of the Series 1997 bonds, \$35,810,000 of the Series 2001A bonds and \$174,575,000 of the Series 2001C bonds. As a result, these refunded bonds are considered to be defeased. The debt service on this issuance will be paid from General State Aid and Personal Property Replacement Tax revenues.

The following table details the payments to refunded bond escrow agent (\$000's):

<u>Description</u>	<u>Amount</u>
Net proceeds .....	\$ 280,645
Amounts on hand related to refunded debt .....	1,833
Total .....	<u>\$ 282,478</u>

The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$18.1 million. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2012. CPS completed the advance refunding to reduce its total debt service payments over the next 27 years

**NOTE 8. LONG-TERM DEBT (continued)**

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by \$26.0 million and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$14.9 million.

*b. Note Payable*

In March 2005, CPS entered into an agreement to purchase Lourdes High School for \$8 million from the Chicago Catholic Archdiocese. In June of 2005, a lump sum payment of \$2.5 million was paid with the balance of \$5.5 million to be paid ratably over the following 60 months at an interest rate of 9½%. CPS may prepay this loan without penalty provided thirty days notice is given. The initial lump sum was funded by the Capital Improvement Program with the remainder being funded out of the General Operating Fund, specifically the Public Building Commission Operations and Maintenance Program.

**NOTE 8. LONG-TERM DEBT (continued)**

The following is a summary of changes in Long-term Debt outstanding (\$000's):

Series	Principal Outstanding June 30, 2004	Issuances	Retirements	Principal Outstanding June 30, 2005	Accreted Interest	Principal and Accreted Interest June 30, 2005
2005B .....	\$ —	\$ 52,595	\$ —	\$ 52,595	\$ —	\$ 52,595
2005A .....	—	193,585	—	193,585	—	193,585
2004H .....	—	18,500	—	18,500	—	18,500
2004G .....	—	12,500	—	12,500	—	12,500
2004F .....	—	25,000	—	25,000	—	25,000
2004E .....	—	44,730	—	44,730	—	44,730
2004D .....	—	53,030	—	53,030	—	53,030
2004C-2 .....	—	48,910	—	48,910	—	48,910
2004C-1 .....	—	75,410	—	75,410	—	75,410
2004B .....	298,075	—	—	298,075	—	298,075
2004A .....	205,410	—	—	205,410	—	205,410
2003D .....	257,925	—	(3,925)	254,000	—	254,000
2003C .....	4,585	—	—	4,585	—	4,585
2003B .....	183,775	—	—	183,775	—	183,775
2003A .....	75,890	—	(4,725)	71,165	—	71,165
2002A .....	48,970	—	—	48,970	—	48,970
2001C .....	213,870	—	(178,135)	35,735	—	35,735
2001B .....	9,440	—	—	9,440	—	9,440
2001A .....	43,720	—	(36,550)	7,170	—	7,170
2000E .....	13,390	—	—	13,390	—	13,390
2000B,C,D .....	303,000	—	—	303,000	—	303,000
2000A .....	16,525	—	—	16,525	—	16,525
IDFA 1999A .....	12,000	—	—	12,000	—	12,000
1999A .....	532,554	—	—	532,554	111,643	644,197
1998B-1 .....	328,714	—	—	328,714	131,478	460,192
1998 .....	14,000	—	—	14,000	—	14,000
1997A .....	499,995	—	—	499,995	18,968	518,963
1997 .....	152,070	—	(62,425)	89,645	—	89,645
1996 .....	61,285	—	(2,725)	58,560	—	58,560
Total Bonds .....	\$ 3,275,193	\$ 524,260	\$ (288,485)	\$ 3,510,968	\$ 262,089	\$ 3,773,057
Note Payable .....	—	5,500	—	5,500	—	5,500
Asbestos Abatement .....	8,994	—	(1,420)	7,574	—	7,574
Total Long-Term Debt .....	<u>\$ 3,284,187</u>	<u>\$ 529,760</u>	<u>\$ (289,905)</u>	<u>\$ 3,524,042</u>	<u>\$ 262,089</u>	<u>\$ 3,786,131</u>
Less Current Portion .....						(28,274)
Deferred Amounts:						
On Refunding .....						(82,944)
For Net Premium/(Discount) .....						67,862
Total Long-term Debt, net of Refunding, Current Portion and Premium/(Discount) .....						<u>\$ 3,742,775</u>

**NOTE 8. LONG-TERM DEBT (continued)**

The current portion of long-term debt and long-term lease obligations is comprised of the following (\$000's):

Bonds .....	\$ (29,615)
Note Payable .....	(902)
Asbestos Abatement Loans .....	(1,420)
Refunding .....	<u>3,663</u>
Subtotal .....	\$ (28,274)
Long-term lease obligations .....	<u>(18,014)</u>
Total Current Portion .....	<u>\$ (46,288)</u>

The Unlimited Tax General Obligation Bonds are being repaid in the Debt Service Fund from Replacement Tax revenue, revenue from Intergovernmental Agreements with the City of Chicago, and General State Aid to the extent possible, and then from a separate tax levy associated with the bonds.

**Defeased Debt**

Defeased bonds have been removed from the Statement of Net Assets because related assets have been placed in irrevocable trust that, together with interest earned, will provide amounts sufficient for payment of all principal and interest. Defeased bonds at June 30, 2005 are as follows (\$000's):

<b><u>Description</u></b>	<b><u>Amount Defeased</u></b>	<b><u>Amount Outstanding</u></b>
Unlimited Tax General Obligation Bonds Series 2001C .....	\$ 174,575	\$ 174,575
Unlimited Tax General Obligation Bonds Series 2001A .....	35,810	35,810
Unlimited Tax General Obligation Bonds Series 2000A .....	90,435	90,435
Unlimited Tax General Obligation Bonds Series 1997 .....	370,995	370,995
Unlimited Tax General Obligation Bonds Series 1996 .....	<u>281,280</u>	<u>281,280</u>
Total .....	<u>\$ 953,095</u>	<u>\$ 953,095</u>

*Future debt and associated swap payments* (see Note 10). Interest rates on fixed rate bonds range from 2.5% to 6.75%, except that CPS does not pay or accrue interest on the Series 2001B Bonds, the Series 2000E Bonds, the IDFA Series 1999A Bonds and the Series 1998 Bonds. These bond series were issued as "qualified zone academy bonds" within the meaning of Section 1397E of the Internal Revenue Code of 1986, as amended. CPS does not pay interest on the bonds, however, for Federal income tax purposes, "eligible taxpayers," as defined in Section 1397E of the Internal Revenue Code, who own the Series 2001B bonds will be entitled to a credit against taxable income. Interest rates on variable rate bonds and net swap payments assume the debt service deposit requirement rate and that auction rates as of June 30, 2005 remain the same through their term. Debt service requirements for the Unlimited Tax General Obligation Bonds and net swap payments are scheduled as follows (\$000's):

**NOTE 8. LONG-TERM DEBT (continued)**

Fiscal Year(s)	Fixed Rate Bonds		Variable Rate Bonds			Total
	Principal	Interest	Principal	Interest*	Interest Rate Swaps, Net**	
2006 .....	\$ 21,850	\$ 79,914	\$ 7,765	\$ 47,802	\$ 9,310	\$ 166,641
2007 .....	19,875	79,835	8,155	47,430	9,310	164,605
2008 .....	25,124	79,232	8,525	47,066	9,310	169,257
2009 .....	28,000	78,514	8,980	46,631	9,310	171,435
2010 .....	79,257	101,980	13,040	46,147	9,310	249,734
2011-2015 .....	435,660	500,450	80,590	219,478	46,548	1,282,726
2016-2020 .....	482,172	464,699	148,955	194,869	45,798	1,336,493
2021-2025 .....	545,898	499,286	295,015	155,995	38,776	1,534,970
2026-2030 .....	463,422	525,985	458,980	88,630	21,242	1,558,259
2031-2035 .....	148,780	304,039	230,925	17,828	3,996	705,568
<b>Total .....</b>	<b>\$ 2,250,038</b>	<b>\$ 2,713,934</b>	<b>\$ 1,260,930</b>	<b>\$ 911,876</b>	<b>\$ 202,910</b>	<b>\$ 7,339,688</b>

\* Interest on Series 2000B,C,D variable rate demand notes was calculated at an assumed rate of 6% per annum and interest on Series 2003D unhedged auction rate bonds was calculated at an assumed rate of 5% per annum (equals annual debt service deposit requirement). Interest on Series 2004CDE variable rate demand notes calculated at an assumed rate of 4.5% per annum. Interest on auction rate securities assumes current interest rates remain the same as of June 30, 2005 and was calculated as follows:

Series 2003B — 2.308%  
Series 2003D — 2.347%  
Series 2004B — 2.565%

\*\* Series 2003B computed:  $(3.782\% - 2.280\%) \times \text{Outstanding Principal}$   
Series 2003D computed:  $(3.771\% - 2.338\%) \times \text{Outstanding Principal}$   
Series 2004B computed:  $(3.5439\% - 2.338\% - 0.1002\%) \times \text{Outstanding Principal}$

Interest and maturities include accretable interest on the Capital Appreciation Bonds as follows (\$000's):

Series	Accreted Interest June 30, 2004	Increase	Accreted Interest June 30, 2005	Total Accretable Interest	Remaining Accretable Interest
1997A .....	\$ 16,004	\$ 2,964	\$ 18,968	\$ 53,485	\$ 34,517
1998B-1 .....	108,856	22,622	131,478	816,756	685,278
1999A .....	91,628	20,015	111,643	617,287	505,644
	<u>\$ 216,488</u>	<u>\$ 45,601</u>	<u>\$ 262,089</u>	<u>\$ 1,487,528</u>	<u>\$ 1,225,439</u>

The loans with the EPA to fund specific asbestos abatement projects are non-interest bearing and are being repaid over a 20-year period. No specific revenue sources are currently dedicated to provide for asbestos abatement loan retirements.

**NOTE 9. CAPITALIZED LEASE OBLIGATIONS***Capitalized Leases*

Annual rental payments are made pursuant to lease agreements with the Public Building Commission (the "PBC"). The PBC constructs, rehabilitates and equips school buildings and facilities for use by the

**NOTE 9. CAPITALIZED LEASE OBLIGATIONS (continued)**

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CPS. The annual lease rentals are funded either by a tax levy, established when the CPS approved such construction, or State school construction grants.

The leases are structured so that annual rentals will exceed the PBC's requirements for debt service and other estimated expenses including administrative expenses. This ensures that the PBC will receive adequate revenue to cover these obligations. The PBC can authorize rent surpluses to be used either to reduce future rental payments or to finance construction of other CPS projects.

The future PBC leases due at June 30, 2005, are as follows (\$000's):

<u>Fiscal Year(s)</u>	<u>PBC Lease Rentals</u>
2006 .....	\$ 51,359
2007 .....	51,765
2008 .....	51,800
2009 .....	51,838
2010 .....	51,830
2011-2015 .....	259,773
2016-2020 .....	<u>238,825</u>
Total Rentals .....	\$ 757,190
Less — Interest and other costs .....	<u>(281,146)</u>
Principal amount of rentals due .....	<u>\$ 476,044</u>

Following is a summary of changes in PBC Leases and Capitalized Lease outstanding (\$000's):

	<u>Balance June 30, 2004</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2005</u>
PBC Leases .....	<u>\$ 607,094</u>	<u>\$ —</u>	<u>\$ (131,050)</u>	\$ 476,044
Less Current Portion .....				<u>(18,014)</u>
Total PBC Leases Outstanding .....				<u>\$ 458,030</u>

**Operating Leases**

CPS is a lessee in numerous operating leases associated with the rental of trucks, automobiles and various office equipment. The lease arrangements are both cancelable and non-cancelable with some having structured rent increases.

**NOTE 10. DERIVATIVES INSTRUMENTS**

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**Interest Rate Swaps****Series 2003B**

*Swap Objective.* CPS entered into two interest rate swaps associated with the issuance of the Series 2003B bonds in February 2003 as a means of lowering its borrowing costs when compared against fixed-rate bonds at the time of issuance. The intention of entering into the swaps was to effectively change the variable interest rate on the auction rate bonds to a fixed interest rate of 3.782%.

*Swap terms.* The bonds and the related swap agreements mature on March 1, 2033, and the total notional amount of the swaps equals the \$183,775,000 of Series 2003B variable auction rate bonds.



**NOTE 10. DERIVATIVES INSTRUMENTS (continued)**

Starting in fiscal year 2018, the notional value of the swap declines by the same amount of the associated principal amortization. Under the swap, CPS pays each counterparty a fixed payment of 3.782% and receives a variable payment computed at the Bond Market Association Municipal Swap Index™ (BMA) until March 1, 2007, then computed as 70% of the London Interbank Offered Rate (LIBOR) from March 1, 2007 through March 1, 2033.

*Fair value.* Because long-term interest rates have remained low since execution of the swaps, the flattening of the yield curve resulted in the swaps having a negative fair value as of June 30, 2005. The swaps' negative fair value may be countered by a reduction in total interest payments required under the variable rate bonds, creating a lower synthetic interest rate. Because the coupons on CPS's variable rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The fair value was determined by market prices quoted by each counterparty as of June 30, 2005 (see table below).

*Credit risk.* As of June 30, 2005, CPS was not exposed to credit risk because the swaps had a negative fair value. However, should interest rates change and the fair value of the swaps becomes positive, CPS would be exposed to credit risk in the amount of the derivatives' fair value. To mitigate the potential for credit risk, if a counterparty's credit rating from either Standard & Poor's and Moody's Investors Service are "A+"/"A1", respectively or lower, and the fair value of the swap reaches certain threshold amounts, the fair value of the swap will be collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

**Swap Counterparty Data as of June 30, 2005**

<u>Counterparty</u>	<u>Swap Notional Amount</u>	<u>Credit Rating; Outlook</u>		<u>Swap Fair Value</u>
		<u>Moody's</u>	<u>S&amp;P</u>	
Goldman Sachs .....	\$ 110,265,000	A1	A+; stable	\$ (9,013,960)
Bank of America .....	73,510,000	Aa2	AA-; stable	(6,062,718)
Total .....	<u>\$ 183,775,000</u>			<u>\$ (15,076,678)</u>

*Basis risk.* The swaps expose CPS to basis risk should the rate paid on the auction rate securities increase to more than the BMA rate received through March 1, 2007. After March 1, 2007, in addition to the basis risk between BMA and the auction rate securities, the swaps expose CPS to further basis risk should the relationship between LIBOR and BMA converge. Should any adverse basis differential occur during the swap contract, the rate paid on the bonds will be higher than the 3.782% synthetic rate, and therefore the expected cost savings may not be realized. As of June 30, 2005, the weighted average auction rate was 2.308% and the BMA rate was 2.28%. As of June 30, 2005 the BMA rate was 2.28%, whereas 70% of LIBOR was 2.338%. To mitigate the potential for basis risk, CPS intends to fund a reserve to provide for potential basis differential (annual debt service fund deposit is calculated at a rate of 3.902%, and \$3,000,000 will fund a reserve in 2006).

*Termination risk.* CPS or the counterparties may terminate the swaps if the other party fails to perform under the terms of the contract. The swaps may also be terminated by CPS if the counterparty's credit quality rating falls below designated rating levels from Standard & Poor's, Moody's Investors Service and/or Fitch ("A-" as issued by Standard & Poor's and Fitch or "A3" as issued by Moody's Investors Service). The swaps may also be terminated by the counterparty if CPS's credit quality rating by any two of Standard & Poor's, Moody's Investors Service and Fitch falls below "BBB" as issued by Standard & Poor's or Fitch and "Baa2" as issued by Moody's. If the swaps are terminated, the Series 2003B bonds would no longer carry a synthetic fixed interest rate, and would be subject to the interest rate risk associated with variable rate debt. Also, if at the time of termination the swap has a negative fair value, CPS would be liable to the counterparty for payment equal to the swap's fair value.

## NOTE 10. DERIVATIVES INSTRUMENTS (continued)

### Series 2003D

*Swap Objective.* CPS entered into two interest rate swaps associated with the issuance of the Series 2003D bonds in December 2003 as a means of lowering its borrowing costs when compared against fixed-rate bonds at the time of issuance. The intention of entering into the swaps was to effectively change the variable interest rate on certain of the auction rate bonds to a fixed interest rate of 3.771%.

*Swap terms.* The bonds and the related swap agreements mature on March 1, 2034, and the total notional amount of the swaps equals the \$185,350,000 of Series 2003D variable auction rate bonds. Starting in fiscal year 2018, the notional value of the swap declines by the same amount of the associated principal amortization. Under the swap, CPS pays each counterparty a fixed payment of 3.771% and receives a variable payment computed at the 70% of the London Interbank Offered Rate (LIBOR) through March 1, 2034.

*Fair value.* Because long-term interest rates have remained low since execution of the swaps, the flattening of the yield curve resulted in the swaps having a negative fair value as of June 30, 2005. The swaps' negative fair value may be countered by a decrease in total interest payments required under the variable rate bonds, creating a lower synthetic interest rate. Because the coupons on CPS's variable rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The fair value was determined by market prices quoted by each counterparty as of June 30, 2005 (see table below).

*Credit risk.* As of June 30, 2005, CPS was not exposed to credit risk because the swaps had a negative fair value. However, should interest rates change and the fair value of the swaps becomes positive, CPS would be exposed to credit risk in the amount of the derivatives' fair value. To mitigate the potential for credit risk, if a counterparty's credit rating from either Standard & Poor's and Moody's Investors Service are "A-" / "A3", respectively or lower, and the fair value of the swap reaches certain threshold amounts, the fair value of the swap will be collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

#### Swap Counterparty Data as of June 30, 2005

Counterparty	Swap Notional Amount	Credit Rating; Outlook		Swap Fair Value
		Moody's	S&P	
Lehman Brothers . . . . .	\$ 95,350,000	A1	A+; stable	\$ (8,019,552)
Goldman Sachs . . . . .	90,000,000	A1	A+; stable	(7,534,820)
Total . . . . .	<u>\$ 185,350,000</u>			<u>\$ (15,554,372)</u>

*Basis risk.* The swaps expose CPS to basis risk should the rate paid on the auction rate securities be higher than the 70% of LIBOR rate received by the swap counterparties. Should any adverse basis differential occur during the swap contract, the rate paid on the bonds will be higher than the 3.771% synthetic rate, and therefore the expected cost savings may not be realized. As of June 30, 2005, the weighted average auction rate was 2.347% and 70% of LIBOR was 2.338%. To mitigate the potential for basis risk, CPS funded a reserve of \$3,000,000 upon closing the bonds to provide for potential basis differential, and annual debt service fund deposit is calculated at a rate of 3.891%.

*Termination risk.* CPS or the counterparties may terminate the swaps if the other party fails to perform under the terms of the contract. The swaps may also be terminated by CPS if the counterparty's credit quality rating falls below designated rating levels from Standard & Poor's, Moody's Investors Service and/or Fitch ("A-" as issued by Standard & Poor's and Fitch or "A3" as issued by Moody's Investors Service). The swaps may also be terminated by the counterparty if CPS's credit quality rating by any two of Standard & Poor's, Moody's Investors Service and Fitch falls below "BBB" as issued by

## NOTE 10. DERIVATIVES INSTRUMENTS (continued)

Standard & Poor's or Fitch and "Baa2" as issued by Moody's. If the swaps are terminated, the Series 2003D bonds would no longer carry a synthetic fixed interest rate, and would be subject to the interest rate risk associated with variable rate debt. Also, if at the time of termination the swap has a negative fair value, CPS would be liable to the counterparty for payment equal to the swap's fair value.

### Series 2004B

*Swap Objective.* CPS entered into three interest rate swaps associated with the issuance of the Series 2004B bonds in April 2004 as a means of lowering its borrowing costs when compared against fixed-rate bonds at the time of issuance. The intention of entering into the swaps was to effectively change the variable interest rate on the auction rate bonds to a fixed interest rate of 3.5439%.

*Swap terms.* The bonds and the related swap agreements mature on March 1, 2032, and the total notional amount of the swaps equals the \$298,075,000 of Series 2004B variable auction rate bonds. Starting in fiscal year 2018, the notional value of the swap declines by the same amount of the associated principal amortization. Under two of the swap agreements, CPS pays each counterparty a fixed payment of 3.5439% and receives a variable payment computed at 70% of the London Interbank Offered Rate (LIBOR) through March 1, 2032. Under the third swap agreement, which allows CPS to better hedge against the associated variable rate debt, CPS receives either a lower percentage of LIBOR in a high interest rate environment, or a higher percentage of LIBOR in a low interest rate environment, based on the following scale:

<u>LIBOR</u>	<u>Percentage of LIBOR</u>
Less than 1.55% .....	90%
Greater than 1.55% but less than 2.35% .....	77%
Greater than 2.35% but less than 3.45% .....	73%
Greater than 3.45% but less than 4.10% .....	71%
Greater than 4.10% but less than 6.00% .....	70%
Greater than 6.00% .....	65%

*Fair value.* Because long-term interest rates have remained low since execution of the swaps, the flattening of the yield curve resulted in the swaps having a negative fair value as of June 30, 2005. The swaps' negative fair value may be countered by a decrease in total interest payments required under the variable rate bonds, creating a lower synthetic interest rate. Because the coupons on CPS's variable rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The fair value was determined by market prices quoted by each counterparty as of June 30, 2005 (see table below).

*Credit risk.* As of June 30, 2005, CPS was not exposed to credit risk because the swaps had a negative fair value. However, should interest rates change and the fair value of the swaps becomes positive, CPS would be exposed to credit risk in the amount of the derivatives' fair value. To mitigate the potential for credit risk, if a counterparty's credit rating from either Standard & Poor's and Moody's Investors Service are "A+"/"A1", respectively or lower, and the fair value of the swap reaches certain threshold amounts, the fair value of the swap will be collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

**NOTE 10. DERIVATIVES INSTRUMENTS (continued)****Swap Counterparty Data as of June 30, 2005**

<u>Counterparty</u>	<u>Swap Notional Amount</u>	<u>Credit Rating; Outlook</u>		<u>Swap Fair Value</u>
		<u>Moody's</u>	<u>S&amp;P</u>	
Goldman Sachs .....	\$ 178,845,000	A1	A+; stable	\$ (9,353,434)
Bear Stearns .....	119,230,000	Aaa	AAA; stable	(6,242,813)
Bear Stearns .....	298,075,000	Aaa	AAA; stable	(323,047)
Total .....	<u>\$ 596,150,000</u>			<u>\$ (15,919,294)</u>

*Basis risk.* The swaps expose CPS to basis risk should the rate paid on the auction rate securities be higher than the rates received by the swap counterparty. Should any adverse basis differential occur during the swap contract, the rate paid on the bonds will be higher than the 3.5439% synthetic rate, and therefore the expected cost savings may not be realized. As of June 30, 2005, the weighted average auction rate was 2.565% and the 70% of LIBOR rate was 2.338%, however under the third swap agreement, the total rate received by the swap counterparty was 73% of the LIBOR rate which was 2.4382%. To additionally mitigate the potential for basis risk, CPS's annual debt service fund deposit is calculated at a rate of 3.6639%.

*Termination risk.* CPS or the counterparties may terminate the swaps if the other party fails to perform under the terms of the contract. The swaps may also be terminated by CPS if the counterparty's credit quality rating falls below designated rating levels from Standard & Poor's, Moody's Investors Service and/or Fitch ("A-" as issued by Standard & Poor's and Fitch or "A3" as issued by Moody's Investors Service). The swaps may also be terminated by the counterparty if CPS's credit quality rating by any two of Standard & Poor's, Moody's Investors Service and Fitch falls below "BBB" as issued by Standard & Poor's or Fitch and "Baa2" as issued by Moody's. If the swaps are terminated, the Series 2004B bonds would no longer carry a synthetic fixed interest rate, and would be subject to the interest rate risk associated with variable rate debt. Also, if at the time of termination the swap has a negative fair value, CPS would be liable to the counterparty for payment equal to the swap's fair value.

**NOTE 11. OTHER LONG-TERM LIABILITIES**

The following is a summary of changes to other long-term liabilities (\$000's)

	<u>Balance June 30, 2004</u>	<u>Additions</u>	<u>Payments</u>	<u>Balance June 30, 2005</u>
Accrued Sick Pay Benefits .....	\$ 223,413	\$ 75,545	\$ (50,879)	\$ 248,079
Accrued Vacation Pay Benefits .....	47,962	6,117	(5,840)	48,239
Accrued Workers' Compensation Claims .....	58,343	19,346	(11,410)	66,279
Accrued General and Automobile Claims .....	5,234	23	(205)	5,052
Tort Liabilities and Other Claims .....	1,500	—	(1,500)	—
Total .....	<u>\$ 336,452</u>	<u>\$ 101,031</u>	<u>\$ (69,834)</u>	<u>\$ 367,649</u>
Less: Current Portion of Accrued Sick Pay Benefits .....				(39,866)
Less: Current Portion of Accrued Vacation Pay Benefits .....				(5,817)
Total Other Long-term Liabilities .....				<u>\$ 321,966</u>

Sick Pay Benefits

The CPS provides sick pay benefits for substantially all of its employees. Eligible employees can accumulate a maximum of 315 days. If an employee either reaches age 65; is age 58 with between 20 and 33 years of service; has 34 years of service, or; dies, the employee is entitled to receive, as additional

**NOTE 11. OTHER LONG-TERM LIABILITIES (continued)**

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cash compensation, all or a portion of their accumulated sick leave days. The CPS budgets an amount each year in the General Operating Fund for these estimated payments to employees terminated in the current fiscal year.

Vacation Pay Benefits

For eligible employees, the maximum number of accumulated unused vacation days permitted is 40 days for those employees with up to 10 years of service; 53 days for those with 10 to 20 years of service; and 66 days for those with more than 20 years of service. Eligible employees are entitled to receive 100% of accumulated vacation days at their current salary rate.

Accrued Workers' Compensation, General and Automobile and Tort Liabilities and Other Claims

The CPS is substantially self-insured and assumes risk of loss as follows:

The CPS maintains commercial excess property insurance for "all risks" of physical loss or damage with limits of \$150,000,000 and Boiler & Machinery Insurance with limits of \$100,000,000 with the following deductibles:

Data Processing Equipment & Media .....	\$ 25,000
Mechanical Breakdown .....	\$ 50,000
All Other Losses .....	\$ 500,000

During fiscal years 2005, 2004 and 2003 no settlements were made in excess of the self-insured amount.

The CPS maintains commercial excess liability insurance with limits of \$100,000,000 in excess of a \$10,000,000 self-insured retention per loss for claims arising from: General Liability; Automotive Liability; Employers Liability; and Wrongful Acts.

As discussed in Note 15, there are pending workers' compensation and tort claims involving the CPS which have arisen out of the ordinary conduct of business. The CPS budgets an amount each year in the Workers' and Unemployment Compensation/Tort Immunity Fund for the estimated claims, of which the expenditures are met through an annual tax levy.

The CPS' estimate of liabilities for workers' compensation claims, general and automobile claims and tort is based on reserves established by the respective trial attorneys or the claims administrators. The CPS accrues for the estimated workers' compensation, general and automobile claims and tort claims in the General Operating Fund where there is a likelihood that an unfavorable outcome is probable and that expenditures will be liquidated with expendable available financial resources.

The CPS is self-insured for workers' compensation claims and certain employee health insurance costs (reimbursed to a provider on a cost plus fees basis). A liability of \$45 million has been recorded for health insurance costs as a part of accrued payroll in the General Operating Fund, which includes \$26 million for estimated medical claims incurred but not reported as of June 30, 2005. Following is the activity related to medical claims for which the CPS is self-insured (\$000's):

<u>Balance</u> <u>June 30, 2003</u>	<u>Additions</u>	<u>Payments</u>	<u>Balance</u> <u>June 30, 2004</u>	<u>Additions</u>	<u>Payments</u>	<u>Balance</u> <u>June 30, 2005</u>
<u>\$ 37,020</u>	<u>\$ 172,978</u>	<u>\$ (176,343)</u>	<u>\$ 33,655</u>	<u>\$ 215,468</u>	<u>\$ (204,098)</u>	<u>\$ 45,025</u>

**NOTE 12. PENSION BENEFITS**

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Pension benefits for certified teachers and administrators are provided under a defined benefit single employer plan administered by the Public School Teachers' Pension and Retirement Fund of Chicago

**NOTE 12. PENSION BENEFITS (continued)**

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(the "Pension Fund"). There are no assets of the CPS included in the Pension Fund. Copies of the Pension Fund Annual Report are available by contacting the Public School Teachers' Pension & Retirement Fund of Chicago, 203 North LaSalle Street, Chicago, Illinois 60601.

Article 17 of the Illinois Pension Code governs the retirement, survivor and disability benefits provided by the Pension Fund. Participation in the Pension Fund is mandatory for all members of the teaching force and employees of the Pension Fund. As of June 30, 2004, the most recent report, there were 37,362 active participants in the Pension Fund, substantially all of who were employees of the CPS.

A member of the Pension Fund with at least 20 years of service is entitled to a pension upon attainment of age 55. A member with at least 5 but less than 20 years of service is entitled to a pension upon attainment of age 62. The pension benefit is based upon years of service and salary level.

Participating members contribute 9% of salary, allocated as follows: 7.5% for retirement pension, 0.5% for automatic annual increases and 1.0% for survivor's pension. In fiscal year 2005, as in previous fiscal years, the CPS paid a portion (7% — \$123.4 million) of the required employees' contribution, which has been recorded as an expenditure in the accompanying financial statements. A portion of grant funds from the Federal government and General Operating Fund revenues provides the funding of the 7% portion. The remaining portion (2%) is withheld from teachers' salaries.

The CPS' employer-required contributions, with the exception of contributions from Federal funds, are not actuarially determined. For fiscal year 2004, CPS did not receive a specific appropriation from the State of Illinois for a contribution to the pension fund. State law requires statutorily determined CPS employer contributions. The CPS' employer contributions towards the cost of retirement benefits, and their related sources of funding, are as follows (\$000's):

**Retirement benefit contribution:**

A contribution from the State of Illinois .....	\$ 65,045
A portion of grant funds from the Federal government for teachers paid from certain Federally-funded programs .....	<u>9,684</u>
Total contributions .....	<u>\$ 74,729</u>

For the fiscal year ended June 30, 2005, employee contributions are \$158.6 million which is 9% of covered payroll. Employer contributions for the year are \$74.7 million which is approximately 5% of covered payroll.

The CPS recognizes its pension expenditures as the amount accrued during the year that normally would be liquidated with expendable available financial resources (i.e., total CPS contributions).

The governmental fund financial statements reflect expenditures on both a functional and budgetary account basis. Teachers' pension expenditures reflected on the budgetary account basis include both the CPS' employer share of pension expenditures of \$74.7 million and amounts incurred by the CPS for a portion of the required employees' pension contribution of \$123.4 million, which total \$198.1 million. For functional reporting purposes, all teachers' pension expenditures, except that portion funded by the State, are reflected in the same functional classifications as the teachers' salaries.

The government-wide financial statements reflect pension expense representing the change in net pension obligation.

**NOTE 12. PENSION BENEFITS (continued)**

The CPS' annual pension cost for fiscal years 2005, 2004 and 2003 are as follows (\$000's):

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Annual required contribution (ARC) .....	\$ 258,883	\$ 202,971	\$ 160,196
Interest on Net Pension Obligation (NPO) .....	83,200	71,580	59,973
Adjustment to annual required contribution .....	<u>(51,206)</u>	<u>(44,053)</u>	<u>(36,911)</u>
Annual Pension Cost (APC) for the fiscal year ended June 30, 2005 .....	\$ 290,877	\$ 230,498	\$ 183,258
Less: Contributions made .....	(74,729)	(85,253)	(78,172)
Add: Segregated health care benefits .....	<u>n/a</u>	<u>n/a</u>	<u>40,000</u>
Increase in NPO .....	\$ 216,148	\$ 145,245	\$ 145,086
Add NPO, beginning of year .....	<u>1,039,998</u>	<u>894,753</u>	<u>749,667</u>
NPO, end of year .....	<u>\$ 1,256,146</u>	<u>\$ 1,039,998</u>	<u>\$ 894,753</u>

Actuarial valuation date .....	June 30, 2004
Actual cost method .....	Projected Unit Credit
Amortization method .....	Level percent, open
Remaining amortization period .....	40 years
Asset valuation method .....	4 year smoothed market
Actuarial assumptions:	
Investment rate of return .....	8%
Projected salary increases .....	Average of 4.6% per year
Inflation .....	3%

With the exception of fiscal year 2003, the ARC calculated by the Fund included a component for the annual statutory amount that could be expended by the Fund for post retirement health care benefits. For fiscal year 2003, the Fund calculation for the annual required contribution excludes the statutory health care benefits because the Fund has begun to segregate assets for health insurance in its financial statements (see below). For purposes of comparability, CPS has adjusted the 2003 calculation of the net pension obligation to exclude the \$40 million. As a result, the impact on the annual increase to the net pension obligation is not significant.

In fiscal years 2002 and 2003, the Fund allocated the entire amount of the State of Illinois' appropriation to pay for current and future health care benefits. Accordingly, the financial statements of the Fund show a balance of net assets in a Health Insurance Fund which is separate from the Pension Fund. In CPS' management's opinion, the Fund should not be able to allocate amounts in excess of the statutory spending limits.

For the fiscal years 2004, 2003 and 2002, the Fund spent \$65 million, \$40 million and \$44 million, respectively, for retiree medical premiums which included the \$40 million and prior year carryover amounts as allowed by statute.

**NOTE 12. PENSION BENEFITS (continued)**

At June 30, 2004, 2003 and 2002 (the actuarial valuation dates), the Schedule of Funding Progress and other trend information is as follows (\$000's):

	2004	2003	2002
Actuarial value of assets .....	\$ 10,392,193	\$ 11,411,528	\$ 11,025,482
Less: Actuarial Accrued Liability (AAL) .....	(12,105,681)	(10,494,755)	(10,619,061)
AAL unfunded (liability)/surplus .....	\$ (1,713,488)	\$ 916,773	\$ 406,421
Funded ratio .....	85.8%	92.0%	96.3%
Covered payroll .....	\$ 1,767,631	\$ 1,706,205	\$ 1,759,046
Unfunded AAL as a percentage of covered payroll ...	96.9%	53.7%	23.1%

As discussed above, the amount shown for the actuarial value of pension assets for 2003 exclude amounts allocated/transferred to the Health Insurance Fund.

	2005	2004	2003
Annual pension cost .....	\$ 290,877	\$ 230,498	\$ 183,258
Percentage of annual pension cost contributed .....	25.7%	37.0%	20.8%
Net Pension Obligation .....	\$ 1,256,146	\$ 1,039,998	\$ 894,753

In the opinion of the CPS' legal counsel, the unfunded actuarial liability of the Pension Fund is not a liability to be funded by the CPS; however, the CPS is required to provide funding in addition to amounts provided from Federal and State sources if the funded ratio drops below 90%. No additional General Operating Fund appropriation was required for the fiscal year ended June 30, 2005.

**OTHER PERSONNEL —**

All career service employees of the CPS, except CPS employees who are members of the Public School Teachers' Pension and Retirement Fund, participate in the Municipal Employees' Annuity and Benefit Fund of Chicago (the "Annuity Fund"). The Annuity Fund is considered a defined contribution plan.

Employees with at least 10 years of service who have attained 55 years of age at the time they withdraw from service must accept an annuity if they are not eligible for a refund of their annuity contribution. Employees under the age of 55 with at least 10 years of service who withdraw from service may accept a refund of their contributions plus interest or let the contributions remain in the Annuity Fund and receive an annuity, beginning upon application for an annuity, after they attain 55 years of age. If an employee withdraws from service with less than 10 years of service, accumulated annuity contributions plus interest are refunded.

Except as described below, the CPS makes no direct contributions to the Annuity Fund, which receives its income from three primary sources: a City of Chicago tax levy; income from investments; and deductions from participating employees' salaries.

Covered employees are required by Article 8, Chapter 40 of the Illinois Compiled Statutes to contribute a percentage of their salary (8.5%). In fiscal year 2005, as in previous fiscal years, the CPS agreed to pay a portion (7% — \$31.7 million) of the required employees' contribution for most employees. The CPS also receives a portion of the cost of providing pension benefits from grants by the Federal government for career service employees paid from certain Federally-funded programs. The amount reflected as career service pension expenditures in the accompanying governmental fund financial statements is \$81.6 million, \$31.7 million of this amount represents the required employees' contribution paid by the CPS on behalf of its employees, and \$43.5 million is contributed by the City of Chicago through its specific tax levies for pension plans and the remaining \$6.4 million is funded under Federally-funded



**NOTE 12. PENSION BENEFITS (continued)**

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programs. The portion funded by the City of Chicago and Federal Government is also reflected as revenue in the General Operating Fund.

Career service pension expense in the government-wide financial statements is \$81.6 million.

As of December 31, 2004, the date of the latest available report, the Annuity Fund had net assets of approximately \$6.24 billion and an unfunded accrued actuarial liability for all covered employees, including CPS employees, of approximately \$2.5 billion. The CPS employs approximately 15,000 of the 33,267 active participants in the Annuity Fund. The CPS, in the opinion of its legal counsel, has no duty to contribute any sum to the Annuity Fund.

**NOTE 13. THE CHICAGO SCHOOL FINANCE AUTHORITY**

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In 1979, the CPS was unable to continue normal operations because of a severe cash shortage. As a result, the Chicago School Finance Authority (the "Authority") was created in January 1980 to exercise oversight and control over the financial affairs of the CPS. Additionally, the Authority issued \$573,000,000 of bonds and provided the CPS with \$450,431,000 for operating purposes in fiscal years 1980 and 1981.

In 1984, the Authority issued \$114,500,000 principal amount of additional general obligation bonds to provide the CPS with money for school rehabilitation and construction purposes.

In February 1994, the Authority issued \$405,380,000 principal amount of general obligation bonds to provide the CPS with \$175,000,000 and \$203,000,000 for operating purposes for the CPS' fiscal year ending August 31, 1994 and 1995, respectively.

In February and March 2004, the CPS remarketed certain of the Authority's outstanding bonds, while in March 2004, the Authority refunded certain outstanding maturities. The result of the remarketing and refunding resulted in \$10,784,451 of funds becoming available to the CPS. In May 2004, the Authority issued \$21,620,000 principal amount of general obligation limited tax bonds, which when combined with an additional refunding issue resulted in funds of \$22,325,800 available to CPS. These funds have been recorded in the Debt Service Fund.

The amount of Authority bonds outstanding at June 30, 2005, net of bonds advance refunded or defeased is \$268,075,000. The Authority's bonds are not a direct or contingent obligation of the CPS.

The principal amount of general obligation bonds of the Authority at June 30, 2005 is shown below:

<u>Fiscal Year(s)</u>	<u>Maturities</u>		
	<u>Principal and Sinking Fund Installments</u>	<u>Interest</u>	<u>Total</u>
2006 .....	\$ 80,090	\$ 14,479	\$ 94,569
2007 .....	60,190	10,242	70,432
2008 .....	61,150	6,943	68,093
2009 .....	66,645	3,605	70,250
Total .....	<u>\$ 268,075</u>	<u>\$ 35,269</u>	<u>\$ 303,344</u>

Interest rates on the above Authority bonds range from 4.2% to 7.6%.

The Authority is a separate body politic and corporate and a unit of local government with the power to levy property taxes. The Authority will remain in existence until one year after all bonds and notes

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**NOTE 13. THE CHICAGO SCHOOL FINANCE AUTHORITY (continued)**

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issued by it have been discharged. The Authority had various financial oversight powers related to the CPS until June 30, 1995. Public Act 93-0488 suspended the powers of the Authority until 2010.

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**NOTE 14. FUND BALANCE RESERVATIONS AND NET ASSET RESTRICTIONS**

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*a. Fund Balance Reservation*

On the fund financial statements, the Fund Balance Reserved for Specific Purposes consists of the following (\$000's):

<u>Purpose</u>	<u>Reserved Amount</u>
Workers' Compensation/Tort Immunity .....	\$ 6,156
Supplementary General State Aid .....	32,440
Public Building Commission Operations and Maintenance .....	5,079
Total .....	<u>\$ 43,675</u>

The amount reserved for Supplementary General State Aid represents the unexpended and unencumbered portion of the 2004 Supplementary General State Aid allocation.

In its fiscal year 2005 budget, CPS appropriated in its General Operating Fund \$30.3 million of fund balances from amounts reserved for specific purposes. In its fiscal year 2006 budget, CPS appropriated in its General Operating Fund \$30.0 million of fund balances from amounts reserved for specific purposes and \$50.0 million of general fund balance.

In its fiscal year 2005 budget, CPS designated \$171.3 million to provide working capital. In its fiscal year 2006 budget, CPS has designated \$190 million to provide working capital.

During fiscal year 2005, the Board reserved \$294.7 million for Debt Service of which \$258.0 million was allocated to the Bond Redemption and Interest Program and the remaining \$36.7 million was allocated to the Public Building Commission Leases Program.

*b. Net Assets Restrictions*

On the government-wide financial statements, Net Assets Restricted for Specific Purposes consists of the following:

<u>Purpose</u>	<u>Restricted Amount</u>
Restricted Donations .....	\$ 1,459
Specific Purposes .....	43,675
Total .....	<u>\$ 45,134</u>

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**NOTE 15. LITIGATION AND CONTINGENCIES**

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*a. Teacher Tenure*

Maurice Land, et al. v. Board of Education of the City of Chicago, et al., is a lawsuit filed in 1999 against the Board in which the plaintiffs are teachers laid-off pursuant to the Board's policy on reassignment and layoff of regularly appointed and certified teachers. Some of the plaintiffs were those who lost their assignments during the 1997 reconstitution of seven high schools. The complaint is for mandamus, declaratory and injunctive relief. The complaint asserts violation of the School Code provision relating

#### **NOTE 15. LITIGATION AND CONTINGENCIES (continued)**

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to tenure. The trial court granted the Board's motion for summary judgment and the Chicago Teachers Union ("CTU") sought review in the Illinois Appellate Court.

On August 27, 2002, the Appellate Court issued an opinion affirming in part and reversing in part the Circuit Court's decision. The Appellate Court concluded, among other things, that (i) the Board has the statutory power to layoff tenured teachers, including the Plaintiffs here, (ii) the Board complied with the Policy in laying off the Plaintiffs, and (iii) the layoffs did not violate Plaintiffs' due process rights. With respect to each of these issues (and others), the Appellate Court affirmed the Circuit Court's grant of summary judgment in favor of the Board. However, the Appellate Court also held that although "the Board may establish a layoff policy ..., [the Board] may not through that policy delegate its absolute layoff power to school administrators." The Court remanded the case for further proceedings related to the delegation issue and related to the factual issues relating to the employment record of one of the Plaintiffs.

On September 17, 2002, the CPS filed a Petition for Rehearing challenging the Appellate Court's ruling on the delegation issue, which was denied on December 20, 2002. The Board intends to continue to litigate this matter vigorously and will now ask the Illinois Supreme Court to review the delegation issue.

On November 21, 2002, the Supreme Court reversed the judgment of the Appellate Court holding that the Board had the statutory authority to delegate its power to make layoffs, but affirmed the Appellate Court's order remanding the case to the Circuit Court for further fact finding regarding the specific process which led to the layoffs at issue. Specifically, the Supreme Court indicated that the Board could not delegate its layoff power to principals (as opposed to central office administrators) and, accordingly, found that fact finding regarding the mechanics of the layoff process was necessary.

Should the CTU ultimately prevail, the Court could order reinstatement and back wages for all of the Plaintiffs. The total amount of exposure may be significant, depending on the length of time that passes from the date of the layoff to the date of an ordered reinstatement. Given the current status of these matters, it is not possible to determine whether an ultimate finding of liability against the Board is probable or the exact cost associated with any such finding.

Jones, et al. v. Board of Education, is an action brought by the CTU essentially repeating the claims asserted in Land. Based upon the decision in a previous matter and the pendency of Land, the Board filed a motion to stay this action, arguing that the legal and factual issues raised in this action will be resolved by the final decision in the previously filed lawsuits. The Court granted the Board's motion on August 16, 2000, granting a stay of Jones in all respects. It is unlikely that this action would give rise to liability not contemplated in the discussion of the Land litigation. Based upon agreement of the parties, the Land case and the Jones case were consolidated.

##### *b. Property Tax Appeals Board (PTAB) Decisions*

In March 2000 and August 2001, the PTAB rendered two series of decisions in which it granted reduced assessed valuations to the owners of certain real property by employing lower levels of assessment. In the March decisions, the PTAB elected to utilize the median levels of assessment derived from the Illinois Department of Revenue's sales-ratio studies (the "Sales-Ratio Studies") as the mechanism for determining correct assessment levels, instead of those set forth in the Cook County Real Property Assessment Classification Ordinance (the "Classification Ordinance"). Use of the Sales-Ratio Studies resulted in a lower assessment level than required by the Classification Ordinance. In its August 2001 decisions, after examining the Sales Ratio Studies, the PTAB held that the Cook County Assessor's assessment practices violated a provision of the State Constitution, which limits the level of assessment of the highest class of property, in a county that classifies property, to two and one-half times the level

#### **NOTE 15. LITIGATION AND CONTINGENCIES (continued)**

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of assessment of the lowest class of property in that county. As a result, the PTAB established a maximum assessment level that is significantly below the assessment levels for commercial and industrial property currently set forth in the Classification Ordinance. Consistent with these opinions, the PTAB has continued to apply a lower level of assessment to certain commercial and industrial properties that have come before it on appeal and has awarded property tax refunds to such property owners.

The Cook County Board of Review (the “Board of Review”), through a Cook County State’s Attorney, appealed the March 2000 and August 2001 decisions of the PTAB to the Illinois Appellate Court. On August 20, 2002, the Illinois Appellate Court issued an opinion affirming in part and reversing in part the March 2000 decision concerning the PTAB’s use of the Sales-Ratio Studies. The PTAB challenged that decision by filing a petition for re-hearing asking the Illinois Appellate Court to reconsider portions of its decision. On June 30, 2003, the Illinois Appellate Court denied the PTAB’s petition for re-hearing. Shortly thereafter, the PTAB filed a petition for leave to appeal with the Illinois Supreme Court, which is currently pending. In November of 2002, the Illinois Appellate Court heard oral arguments on the appeal of the PTAB’s August 2001 decision concerning the two and one-half times level of assessment. In December of 2003, the Appellate Court issued its decision and remanded the cases to the PTAB with directions to apply the level of assessment contained in the Classification Ordinance, concluding that the taxpayer did not timely raise proper challenges so as to justify the relief granted. In reaching this conclusion, the Court did not consider the PTAB’s reading of the constitutional ratio limitation or the PTAB’s use of Sales-Ratio Studies as authority to deviate from the Classification Ordinance. Both the PTAB and the property owner have appealed the Appellate Court’s December 2003 decision to the Illinois Supreme Court. On March 26, 2004, the Court denied the petitions for leave to appeal. The property owner in this matter then filed a petition for writ of certiorari with the United States Supreme Court, which was denied on October 2, 2004.

If either of the PTAB decisions were affirmed in a final judicial decision, the lower levels of assessments would be applied to all property tax appeals then pending before either the PTAB or before a court, resulting in corresponding property tax refunds that the Board would be obligated to pay. At present, however, the Board is unable to predict the amount of any such refunds, all of which would be funded from the Board’s future general revenues.

##### *c. State and Federal Aid Receipts*

State and Federal aid is generally subject to review by the responsible governmental agencies for compliance with the agencies’ regulations governing the aid. In the opinion of CPS management and legal counsel, any potential adjustments to the Federal or State aid recorded by CPS through June 30, 2005, resulting from a review by a responsible government agency will not have a material effect on CPS’ financial statements at June 30, 2005.

##### *d. Asbestos and Lead Abatement*

Under Federal and State asbestos and lead abatement laws and guidelines, CPS will be required to perform significant amounts of asbestos and lead abatement in school facilities. The cost of the asbestos and lead abatement is estimated to be substantial. These future costs will be recorded as expenditures when the work is performed. Although the amount, funding and timing of the future expenditures required is uncertain, CPS intends to comply with all Federal and State asbestos and lead abatement laws and guidelines.

##### *e. Wrongful Death Claim*

In *Della Coleman, as Special Administrator of the Estate of Derrick Spencer v. Board of Education*, the family of Derrick Spencer, an eighth grade student, filed suit against the Board and Quality Inn Hotels for damages arising from Derrick’s drowning while on a field trip with other eighth grade students from

## **NOTE 15. LITIGATION AND CONTINGENCIES (continued)**

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the Goldblatt Elementary School. The drowning occurred in Ohio on May 24, 2002, after one of Derrick's classmates pushed him into the pool at the Quality Inn Hotel. The suit alleges that the Board was negligent in numerous respects, including: failing to provide lifeguards in connection with the swimming at Quality Inn Hotel; failing to assess Derrick's swimming skills; failing to monitor the Goldblatt students in and around the swimming pool; failing to follow Board policies regarding school trips, and; failing to protect Derrick from the dangerous water conditions at the Quality Inn Hotel. A finding of liability on the part of CPS cannot be predicted as either probable or remote at this juncture.

### *f. Dispute Over Pension Fund Claims for Reimbursement*

A dispute exists between the Board and the Public School Teachers' Pension and Retirement Fund (the "Fund") regarding whether the Board has the right under the Illinois Pension Code, to require employees who want to take advantage of the Early Retirement Option ("ERO") to apply for it by the middle of May of any year that the ERO is offered to teachers. The Board is required to contribute a specified amount to the Fund for each employee selecting the ERO.

The Fund has notified the Board of its position that the Board does not have a right to impose a deadline date on eligible employees to apply for the ERO. The Fund has represented that it intends to reach out to those employees who would have been eligible for the ERO under its analysis and offer them the opportunity to retire. Under this scenario, thirty percent (30%) of all teachers who have reached the age of 55 years and have at least 20 years, but less than 34 years, of service credit would be able to take advantage of the ERO in the years it was authorized by the Board. The Fund has also represented that it will send the Board an invoice for the Board's contribution, and would also, if the Board refuses to pay, take legal action. No legal action has been taken by the Fund against the Board as of the date of the audit opinion.

Should the Fund's interpretation be found correct in a court action, the Board will be required to pay the Fund the specified contribution for each employees who elect the ERO. While it is not possible to know with any certainty the number of employees who elects the ERO under these circumstances, if the maximum number (30% of eligible employees) take advantage of it, the Board's estimated liability could be approximately \$38 million. The Board is unable to predict the outcome of this dispute at the present time.

### *g. Property Tax Refunds*

Involves disputes regarding property taxes payable by various taxpayers based on the applicability of the Cook County assessment classification ordinance and/or the market values placed on certain properties between the assessment years 1999 to 2003. These taxpayers are seeking refunds from the Board totaling approximately \$17,100,000.

The Board is vigorously defending its revenue interest in each case. The Board also believes none of these taxpayers is likely to obtain refunds in excess of \$1,000,000 for any individual year, although if these taxpayers succeed on their arguments, the total refunds would exceed \$1,000,000. Settlements would be payable from receipts of future tax levies.

### *h. Other Litigation and Claims*

There are numerous other claims and pending legal actions involving CPS, including actions concerned with civil rights of employees, workers' compensation, torts, property tax objections, and other matters, arising out of CPS' ordinary conduct of its business. Certain actions involve alleged damages in substantial amounts. The amounts of liability, if any, on these claims as of June 30, 2005, in excess of related insurance coverage with respect to certain claims, are not determinable at this time. In the

**NOTE 15. LITIGATION AND CONTINGENCIES (continued)**

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opinion of CPS management and legal counsel, the final resolution of these claims and legal actions will not be material to CPS' financial statements as of June 30, 2005.

**NOTE 16. SUBSEQUENT EVENTS**

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**Derivative Instruments**Series 1997A

In August 2005, CPS sold an option to Bank of America N.A. under which CPS may be caused to enter into an interest rate swap associated with \$100,000,000 of the Series 1997A bonds upon exercise of the option in July 2007 (effective December 2007) as a means of monetizing the call option of these bonds in a low interest rate environment. The intention of entering into the swap was to effectively and economically refund \$100,000,000 of the Series 1997A bonds, avoiding negative arbitrage in advance refunding escrows, while realizing an upfront payment of \$18,345,000 to be used for costs of issuance and for debt service requirements in fiscal year 2006. Any swap payments payable by CPS upon exercise of the option will be periodic and payable from the same revenue source pledged to the refunding bonds to be issued at that time.

Series 2005A

In October 2005, CPS entered into two interest rate swaps with Merrill Lynch Capital Services, Inc. and Loop Capital Markets LLC backed by Deutsche Bank. The interest rate swaps are associated with the Series 2005A bonds. The intention of entering into the swaps was to effectively change the fixed interest rate on the Series 2005A bonds from the stated coupon on the bonds to a lower interest rate. Any swap payments payable by CPS will be paid from the General Operating Fund.

**Bond Issuances**Unlimited Tax General Obligation Bonds (Series 2005C)

In November 2005, Chicago Public Schools issued \$54,750,000 in Unlimited Tax General Tax Obligation Bonds at a premium of \$4,124,158. The proceeds from these bonds are being used as part of CPS' Capital Improvement Program, to pay capitalized interest on the bonds, and to pay costs of issuance of the bonds. As a result of the issuance, Chicago Public Schools recorded net proceeds of \$54,210,825 in the Capital Improvement Program in fiscal year 2006. The debt service on this issuance will be paid by revenues received pursuant to an intergovernmental agreement with the City of Chicago by certain Tax Incremental Financing revenues.

Unlimited Tax General Obligation Bonds (Series 2005DE)

In December 2005, Chicago Public Schools issued \$325,000,000 in Unlimited Tax General Tax Obligation Bonds. The proceeds from these bonds are being used as part of CPS' Capital Improvement Program, to pay capitalized interest on the bonds, and to pay costs of issuance of the bonds. The Series 2005DE bonds were issued as variable rate demand notes in the following sub-series:

<u>Series</u>	<u>Par Amount</u>	<u>Maturity Date</u>
Series 2005D-1	\$ 37,945,000	March 1, 2012
Series 2005D-2	157,055,000	March 1, 2036
Series 2005E-1	65,000,000	March 1, 2020
Series 2005E-2	65,000,000	March 1, 2026
Total	<u>\$ 325,000,000</u>	

**NOTE 16. SUBSEQUENT EVENTS (continued)**

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The Series 2005D-1 and Series 2005D-2 will bear interest at a Daily Rate, Series 2005E-1 and Series 2005E-2 will bear interest at a weekly rate. As a result of the issuance, Chicago Public Schools will record net proceeds of \$321,791,592.22 in the Capital Improvement Program in fiscal year 2006. The debt service on this issuance and periodic swap payments payable by CPS will be paid from General State Aid revenues.

Upon closing the Series 2005D-2, Series 2005E-1 and Series 2005E-2 bonds, CPS also entered into an interest rate swap agreement with Loop Financial Products ILLC for a notional amount of \$287,055,000. The \$287,055,000 aggregate notional amount of the swaps represents the principal amount of the Series 2005D-2 bonds, the Series 2005E-1 bonds and the Series 2005E-2 bonds. The swap agreements mature on March 1, 2036 and the notional amounts decline by the same amount of the associated principal amortization of the bonds. Under the swap agreements, the swap providers agree to pay a variable rate of interest and the Board agrees to pay a fixed rate of interest on the notional principal amount of the swaps.

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## **APPENDIX B**

### **Summary of Certain Provisions of the Indenture**

The following is a summary of certain provisions of the Indenture not summarized elsewhere in this Official Statement. Reference is made to the Indenture for a complete description thereof. The discussion herein is qualified by such reference.

#### **DEFINITIONS OF CERTAIN TERMS**

*“Act”* means the Local Government Debt Reform Act of the State, as amended.

*“Additional Bonds”* means any alternate bonds issued in the future in accordance with the provisions of the Act on a parity with and sharing ratably and equally in all or any portion of the Pledged State Aid Revenues with the Bonds, as described in this Appendix B under the heading “ADDITIONAL BONDS PAYABLE FROM PLEDGED STATE AID REVENUES.”

*“Alternate Bonds”* means general obligation bonds of the Board payable from any revenue source as provided by the Act, particularly Section 15 thereof.

*“Authorized Denominations”* means \$5,000 or any integral multiple thereof.

*“Authorized Officer”* means (i) any Designated Official, (ii) the Controller and Chief Operating Officer of the Board acting together or (iii) any other officer or employee of the Board authorized to perform specific acts or duties under the Indenture by resolution duly adopted by the Board.

*“Available Funds”* means, as of any determination date, the sum of (i) the cash and (ii) the amount of Investment Securities (valued for this purpose at the lower of cost or market value) held by the Trustee in all Funds, Accounts and Sub-Accounts established by the Indenture (after taking into account any amounts paid for any Debt Service payment made on such determination date).

*“Board”* means the Chicago Board of Education, created and established pursuant to Article 34 of the School Code.

*“Bond Counsel”* means any nationally recognized firm(s) of municipal bond attorneys approved by the Board and acceptable to the Trustee.

*“Bondholder”* means the Owner of any Bond.

*“Bond Insurance Policy”* or *“Policy”* means the insurance policy issued by the Bond Insurer insuring the payment of the principal of and interest on the Bonds maturing on and after December 1, 2008, as provided therein.

*“Bond Insurer”* or *“Insurer”* means Financial Security Assurance Inc., the issuer of the Bond Insurance Policy.

*“Bond Payment Account”* means the account of that name within the Debt Service Fund established by the Indenture.

*“Bond Resolution”* means Resolution No. 06-0823-RS4, adopted by the Board on August 23, 2006 authorizing the issuance of the Bonds secured by the Indenture.

*“Bond Year”* means each annual period beginning on December 2 of a calendar year to and including December 1 of the next succeeding calendar year.

*“Bonds”* means collectively, \$301,317,200 aggregate principal amount Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2006B, of the Board, being issued under the Indenture pursuant to the 2004 Authorization and any Bonds issued hereunder in substitution or replacement therefor and \$54,487,800 aggregate principal amount Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2006B, of the Board, being issued under the Indenture pursuant to the 2006 Authorization and any Bonds issued thereunder in substitution or replacement therefor.

*“Business Day”* means any day other than a Saturday, Sunday or (i) a day on which banks located (a) in the city in which the designated corporate trust office of the Trustee is located, and (b) in the city in which the office of the Bond Insurer or the Bond Insurer’s custodian at which claims under the Bond Insurance Policy are to be paid (initially, New York, New York) is located, or (ii) a day on which The New York Stock Exchange is closed.

*“Code”* or *“Code and Regulations”* means the Internal Revenue Code of 1986, as amended, and the regulations promulgated or proposed pursuant thereto as the same may be in effect from time to time.

*“Counsel’s Opinion”* or *“Opinion of Counsel”* means an opinion signed by an attorney or firm of attorneys of recognized standing in the area of law to which the opinion relates, who may be counsel to the Board (including the General Counsel to the Board) or Bond Counsel.

*“County Clerks”* means, collectively, the County Clerks of The Counties of Cook and DuPage, Illinois.

*“County Collectors”* means, collectively, the County Treasurers of The Counties of Cook and DuPage, Illinois, in their respective capacities as county collector, or, respectively, such other officer as may be lawfully appointed in the future to serve as county collector in either of said counties.

*“Current Funds”* means moneys which are immediately available in the hands of the payee at the place of payment.

*“Date of Issuance”* means the date of original issuance and delivery of the Bonds under the Indenture.

*“Debt Service”* means, for any period of computation, the principal of and interest on the Bonds becoming due and payable (whether upon maturity or otherwise) during such period.

*“Debt Service Fund”* means the fund of that name established by the Indenture.

*“Defaulted Interest”* means interest on any Bond which is payable but not duly paid on the date due.

*“Defeasance Government Obligations”* means Government Obligations which are not subject to redemption other than at the option of the holder thereof.

*“Defeasance Obligations”* means (i) Defeasance Government Obligations and (ii) Pre-refunded Municipal Obligations.

*“Deposit Date”* means February 15 of each year beginning February 15, 2007 or, such earlier date as may be necessary to permit the Board to lawfully make the abatement of taxes as described in the Indenture.

*“Deposit Sub-Account”* means the sub-account of that name in the Pledged State Aid Revenues Account established in the Indenture.

*“Designated Official”* means (i) the President of the Board, (ii) the Chief Fiscal Officer of the Board or (iii) the Treasurer of the Board, or (iv) any other officer of the Board authorized to perform specific acts and duties under the Indenture by resolution duly adopted by the Board.

*“DTC”* means The Depository Trust Company, New York, New York, as securities depository for the Bonds.

*“DTC Participant”* means any securities broker or dealer, bank, trust company, clearing corporation or other organization depositing Bonds with DTC pursuant to the book-entry only system described in the Indenture.

*“Event of Default”* means any event so designated and specified as such in this Appendix B under the heading “EVENTS OF DEFAULT AND REMEDIES -- EVENTS OF DEFAULT.”

*“Fiduciary” or “Fiduciaries”* means the Trustee, the Registrar and any Paying Agent, or any or all of them, as may be appropriate.

*“Forward Supply Contract”* means any contract entered into between the Board and a supplier of Investment Securities selected by or pursuant to the direction of the Board (a *“Counterparty”*) pursuant to which the Counterparty agrees to sell to the Board (or to the Trustee on behalf of the Board) and the Board (or the Trustee on behalf of the Board) agrees to purchase specified Investment Securities on specific dates at specific purchase prices, all as established at the time of the execution and delivery of such contract and as set forth in such contract. Any amounts due and owing from the Board to the Counterparty pursuant to any Forward Supply Contract (other than the specified purchase prices of the Investment Securities set forth therein) shall be treated as current operating expenses of the Board subject to annual appropriation, and shall not constitute indebtedness of the Board.

*“Government Obligations”* means (i) any direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by, the United States of

America and (ii) certificates of ownership of the principal of or interest on obligations of the type described in clause (i) of this definition, (a) which obligations are held in trust by a commercial bank which is a member of the Federal Reserve System in the capacity of a custodian; (b) the owner of which certificate is the real party in interest and has the right to proceed directly and individually against the obligor of the underlying obligations; and (c) for which the underlying obligations are held in safekeeping in a special account, segregated from the custodian's general assets, and are not available to satisfy any claim of the custodian, any person claiming through the custodian, or any person to whom the custodian may be obligated.

*"Indenture"* means the Trust Indenture, dated as of September 1, 2006 between the Board and the Trustee, as from time to time amended and supplemented.

*"Insurance Agreement"* means any agreement between the Board and a Bond Insurer, executed and delivered from time to time, relating to the Board's obligations to a Bond Insurer.

*"Insured Bonds"* means the Bonds maturing in the years 2008 through 2036 which are guaranteed under the Bond Insurance Policy.

*"Interest Deposit Sub-Account"* means the sub-account of that name in the Payment Sub-Account of the Pledged State Aid Revenues Account established in the Indenture.

*"Interest Sub-Account"* means the sub-account of that name in the Bond Payment Account established by the Indenture.

*"Investment Policy"* means the Investment Policy approved by the Board, as currently in effect and as may be amended from time to time.

*"Investment Securities"* means any of the following securities authorized by law and the Investment Policy as permitted investments of Board funds at the time of purchase thereof:

- (i) Government Obligations;
- (ii) Obligations of any of the following federal agencies which obligations represent the full faith and credit of the United States of America, including:
  - (1) Export-Import Bank
  - (2) Farm Credit System Financial Assistance Corporation
  - (3) Farmers Home Administration
  - (4) General Services Administration
  - (5) U.S. Maritime Administration
  - (6) Small Business Administration
  - (7) Government National Mortgage Association (GNMA)

- (8) U.S. Department of Housing & Urban Development (PHA's)
- (9) Federal Housing Administration;
- (iii) Senior debt obligations which at the time of purchase are rated "AAA" by Standard & Poor's, a division of the McGraw-Hill Companies ("S&P") and "Aaa" by Moody's Investors Service ("*Moody's*") issued by Fannie Mae, the Federal Home Loan Mortgage Corporation, or any other agency created by act of the United States Congress;
- (iv) U.S. dollar denominated deposit accounts, federal funds and banker's acceptances with domestic commercial banks which have a rating on their short term certificates of deposit on the date of purchase of "A-1" or "A-1+" by S&P and "P-1" by Moody's and maturing no more than 360 days after the date of purchase (ratings on holding companies are not considered as the rating of the bank);
- (v) Commercial paper which is rated at the time of purchase no less than "A-1" or above by S&P and "P-1" by Moody's and which mature not more than 180 days after the date of purchase;
- (vi) Investments in a money market fund which at the time of purchase is rated "AAAm" or "AAAm-G" or better by S&P, including those of the Trustee;
- (vii) Repurchase agreements of government securities having the meaning set out in the Government Securities Act of 1986 subject to the provisions of said act and the regulations issued thereunder. The government securities that are the subject of such repurchase agreements, unless registered or inscribed in the name of the Board, shall be purchased through banks or trust companies authorized to do business in the State; and
- (viii) Pre-refunded Municipal Obligations.

*"Letter of Representations"* means the Blanket Issuer Letter of Representations dated March 15, 2002, between the Board and DTC, relating to the book-entry only system for the Bonds described in the Indenture.

*"Opinion of Bond Counsel"* means a written opinion of Bond Counsel in form and substance acceptable to the Board and the Trustee, which opinion may be based on a ruling or rulings of the Internal Revenue Service.

*"Outstanding"* means, as of any date, all Bonds authenticated and delivered under the Indenture except:

- (i) Any Bonds canceled by the Trustee at or prior to such date;

(ii) Bonds (or portions of Bonds) for the payment or redemption of which moneys and/or Defeasance Obligations, equal to the principal amount or Redemption Price thereof, as the case may be, with interest to the date of maturity or date fixed for redemption, are held in trust under the Indenture and set aside for such payment or redemption (whether at or prior to the maturity or redemption date), provided that if such Bonds (or portions of Bonds) are to be redeemed, notice of such redemption will have been given as provided in the Indenture or provision satisfactory to the Trustee will have been made for the giving of such notice;

(iii) Bonds in lieu of or in substitution for which other Bonds will have been authenticated and delivered in connection with any substitution, transfer or exchange; and

(iv) Bonds deemed to have been paid as described herein under the heading “DEFEASANCE.”

*“Outstanding 2004 Alternate Bonds”* means the Board’s 2004 Alternate Bonds previously issued pursuant to the 2004 Authorization in the aggregate principal amount of \$663,682,800, consisting of its Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2004C; its Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2004D; its Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2004E; its Unlimited Tax General Obligation Bonds (Dedicated Revenues – Albany Park Academy Project), Series 2004F; its Unlimited Tax General Obligation Bonds (Dedicated Revenues – Benito Juarez Community Academy Project), Series 2004G; its Unlimited Tax General Obligation Bonds (Dedicated Revenues – DePriest Elementary School Project), Series 2004H; its Unlimited Tax General Obligation Bonds (Dedicated Revenues – Westinghouse High School Project), Series 2005C; its Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2005D; its Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2005E; and its Unlimited Tax General Obligation Bonds (Dedicated Revenues – Qualified Zone Academy Projects), Series 2006A.

*“Owner,” “Bondholder” or “Holder”* means any person who is the registered owner of any Bond or Bonds.

*“Participant,”* when used with respect to any Securities Depository, means any participant of such Securities Depository.

*“Paying Agent”* means the Trustee and any other bank, national banking association or trust company designated by a Designated Official as paying agent for the Bonds, and any successor or successors appointed by a Designated Official under the Indenture.

*“Payment Sub-Account”* means the sub-account of that name in the Pledged State Aid Revenues Account established in the Indenture.

*“Person”* means and includes an association, unincorporated organization, a corporation, a partnership, a limited liability company, a joint venture, a business trust, or a government or an

agency or a political subdivision thereof, or any other public or private entity, or a natural person.

*“Pledged State Aid Revenues”* means with respect to the Series 2006B Bonds issued pursuant to the 2004 Authorization that amount of the State Aid Revenues, not in excess of available amounts pursuant to the 2004 Authorization in each year, as shall provide for the payment of such Bonds, the Prior 2004 State Aid Bonds, any Swap Payments, and the provision of not less than an additional .10 times debt service on such Bonds and the Prior 2004 State Aid Bonds, in such year, and with respect to the Series 2006B Bonds issued pursuant to the 2006 Authorization that amount of the State Aid Revenues, not in excess of available amounts pursuant to the 2006 Authorization in each year, as shall provide for the payment of such Bonds, any Swap Payments, any Additional Bonds issued from time to time pursuant to the 2006 Authorization and the provisions of this Indenture and the provision of not less than an additional .10 times debt service on such Bonds, in such year.

*“Pledged State Aid Revenues Account”* means the account of that name in the Debt Service Fund established by the Indenture.

*“Pledged State Aid Revenues Account Requirement”* means on each Deposit Date an amount which will cause the amount on deposit in the Pledged State Aid Revenues Account to be equal to the sum of (A) the interest payable on the Bonds on the next succeeding June 1 and December 1; provided, however, that for any period of time during the current Bond Year for which a Swap Agreement is in place with respect to any Bonds, such amount shall be increased or decreased, as appropriate, by calculating interest with respect to such Bonds at an interest rate equal to the interest rate payable with respect to the Bonds pursuant to such Swap Agreement as set forth in the notice with respect to such Swap Agreement delivered to the Trustee pursuant to the Indenture, and (B) the principal amount of such Bonds scheduled to become due at maturity or by mandatory sinking fund redemption on the next succeeding December 1.

*“Pledged State Aid Revenues Sub-Account”* means the sub-account of that name in the Pledged State Aid Revenues Account established by the Indenture.

*“Pledged Taxes”* means the *ad valorem* taxes levied against all of the taxable property in the School District without limitation as to rate or amount levied pursuant to the Bond Resolution, and pledged under the Indenture as security for the Bonds.

*“Pledged Taxes Account”* means the account of that name in the Debt Service Fund established by the Indenture.

*“Pre-refunded Municipal Obligations”* means any bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state which are not callable at the option of the obligor prior to maturity or as to which irrevocable instructions have been given by the obligor to call on the date specified in the notice, and

(A) which are rated, based on an irrevocable escrow account or fund (the *“Escrow”*), in the highest rating category of S&P and Moody’s or any successors thereto; or

(B) (i) which are fully secured as to principal and interest and redemption premium, if any, by an Escrow consisting only of cash or Government Obligations, which Escrow may be applied only to the payment of such principal of and interest and redemption premium, if any, on such bonds or other obligations on the maturity date or dates thereof or the specified redemption date or dates pursuant to such irrevocable instructions, as appropriate, and (ii) which Escrow is sufficient, as verified by a nationally recognized independent certified public accountant, to pay principal of and interest and redemption premium, if any, on the bonds or other obligations described in this paragraph on the maturity date or dates specified in the irrevocable instructions referred to above, as appropriate.

*“Principal Sub-Account”* means the sub-account of that name in the Bond Payment Account established by the Indenture.

*“Prior 2004 State Aid Bonds”* means the Board’s 2004 Alternate Bonds previously issued pursuant to the 2004 Authorization in the aggregate principal amount of \$663,682,800, consisting of its Unlimited Tax General Obligation Bond (Dedicated Revenues), Series 2004C; its Unlimited Tax General Obligation Bond (Dedicated Revenues), Series 2004D; its Unlimited Tax General Obligation Bond (Dedicated Revenues), Series 2004E; Series 2005C; its Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2005D; its Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2005E; and its Unlimited Tax General Obligation Bond (Dedicated Revenues – Qualified Zone Academy Projects), Series 2006A.

*“Project”* means the construction, acquisition and equipping of school and administrative buildings, site improvements and other real and personal property in and for the School District, all in accordance with the estimates of cost, including the Board’s Capital Improvement Program, as approved and from time to time amended by the Board.

*“Project Costs”* means the cost of acquisition, construction and equipping of the Project, including the cost of acquisition of all land, rights of way, property, rights, easements and interests, acquired by the Board for such construction, the cost of demolishing or removing any buildings or structures on land so acquired, including the cost of acquiring any lands to which such buildings or structures may be moved, the cost of all machinery and equipment determined to be necessary and desirable by the Board, the costs of issuance of the Bonds, financing charges, financial advisory fees, consultant fees, required payments of arbitrage rebate pursuant to the Code and Regulations, interest prior to and during construction and for such period after completion of construction as the Board shall determine, the cost of engineering and legal expenses, plans, specifications, estimates of cost and revenues, other expenses necessary or incident to determining the feasibility or practicability of constructing any portion of the Project, administrative expenses and such other costs, expenses and funding as may be necessary or incident to the construction of the Project, the financing of such construction and the placing of the Project in operation.

*“Project Fund”* means the Project Fund established by the Indenture.



*“Rating Services”* means the nationally recognized rating services, or any of them, that will have assigned ratings to any Bonds Outstanding as requested by or on behalf of the Board, and which ratings are then currently in effect.

*“Record Date”* means with respect to any interest payment date for the Bonds, the fifteenth day (whether or not a Business Day) of the calendar month next preceding such interest payment date.

*“Redemption Price”* means, with respect to any Bond, the principal amount thereof plus the applicable premium, if any, payable upon the date fixed for redemption.

*“Registrar”* means the Trustee and any other bank, national banking association or trust company appointed by a Designated Official under the Indenture and designated as registrar for the Bonds, and its successor or successors.

*“School Code”* means the School Code of the State of Illinois, as amended.

*“School District”* means the school district constituted by the City of Chicago, Illinois pursuant to Article 34 of the School Code of the State, as amended, and governed by the Board.

*“Securities Depository”* means DTC and any other securities depository registered as a clearing agency with the Securities and Exchange Commission pursuant to Section 17A of the Securities Exchange Act of 1934, as amended.

*“SLG’s”* means United States Treasury Certificates of Indebtedness, Notes and Bonds-State and Local Government Series.

*“Special Record Date”* means the date fixed by the Trustee pursuant to the Indenture for the payment of Defaulted Interest.

*“State”* means the State of Illinois.

*“State Aid Revenues”* means State Aid payments received by the Board in any Year pursuant to Article 18 of the School Code, or such successor or replacement fund or act as may be enacted in the future.

*“Supplemental Indenture”* means any Supplemental Indenture of the Board authorized pursuant to the Indenture.

*“Swap Agreements”* means any agreement between the Board and a counterparty, the purpose of which is to provide to the Board an interest rate basis, cash flow basis or other basis from that provided in the Bonds for the payment of interest.

*“Swap Payment”* means, with respect to each Swap Agreement, each periodic scheduled payment owing to the Swap Provider made with respect to the notional amount identified in such Swap Agreement. For purposes of the Indenture, “Swap Payment” excludes any non-scheduled payments, including but not limited to termination payments, indemnification payments, tax gross-up payments, expenses and default interest payments.

“*Swap Payment Account*” means the Account of that name in the Debt Service Fund established in the Indenture.

“*Swap Payment Date*” means the date as set forth in the Indenture.

“*Swap Providers*” means any other counterparty to a Swap Agreement.

“*Tax Agreement*” means the Tax Regulatory Agreement, dated the date of issuance of the Bonds and relating to the Bonds, executed by the Board and the Trustee.

“*Trustee*” means Wells Fargo Bank, N.A., Chicago, Illinois, and any successor or successors appointed under the Indenture as thereafter provided.

“*Trust Estate*” means the Pledged State Aid Revenues available pursuant to the 2004 Authorization (solely with respect to the Series 2006B Bonds issued pursuant to the 2004 Authorization), the State Aid Revenues available pursuant to the 2006 Authorization (solely with respect to the Series 2006B Bonds issued pursuant to the 2006 Authorization) the Pledged Taxes and all other property pledged to the Trustee pursuant to the Indenture.

“*Year*” or “*year*” means a calendar year.

#### **PLEDGE OF TRUST ESTATE**

In order to secure the payment of the principal of, premium, if any, and interest on all Bonds issued under the Indenture, according to the import thereof, and the performance and observance of each and every covenant and condition contained in the Indenture and in the Bonds, the Board in the Indenture pledges and grants a lien upon the following Trust Estate to the Trustee and its successors in trust and assigns, for the benefit of the Owners and the Bond Insurer, to the extent provided in the Indenture:

- (a) The Pledged State Aid Revenues and the Pledged Taxes.
- (b) All moneys and securities and earnings thereon in all Funds, Accounts and Sub-Accounts established pursuant to the Indenture.
- (c) Any and all other moneys, securities and property furnished from time to time to the Trustee by the Board or on behalf of the Board or by any other persons to be held by the Trustee under the terms of the Indenture.

#### **THE BONDS ARE GENERAL OBLIGATIONS**

The Bonds are at all times Outstanding the general obligation of the Board, for the payment of which its full faith and credit are pledged, and are payable, in addition to the Pledged State Aid Revenues, from the levy of Pledged Taxes, as described in the Indenture. The Bonds do not represent or constitute a debt of the Board within the meaning of any constitutional or any statutory limitation unless the Pledged Taxes have been extended for collection, in which case the Outstanding Bonds shall to the extent required by law will be included in the computation of indebtedness of the Board for purposes of all statutory provisions or limitations until such time

as an audit of the Board shows that the Bonds have been paid from the Pledged State Aid Revenues, together with investment earnings thereon, for a complete fiscal year of the Board.

#### **ADDITIONAL BONDS PAYABLE FROM PLEDGED STATE AID REVENUES**

Except as provided below, the Board shall not hereafter issue any bonds or other evidences of indebtedness, other than the Bonds, which are secured by a pledge of or lien on the Pledged State Aid Revenues, the Pledged Taxes or the moneys, securities or funds held or set aside by the Board or by the Trustee under the Indenture, and shall not, except as expressly authorized in the Indenture, create or cause to be created any lien or charge on the Pledged State Aid Revenues, the Pledged Taxes or such moneys, securities or funds.

The Board reserves the right to issue Additional Bonds from time to time payable from and secured by the State Aid Revenues available pursuant to the 2006 Authorization or any other source of payment which may be pledged under the Act, and any such Additional Bonds shall share ratably and equally in the State Aid Revenues available pursuant to the 2006 Authorization with the Bonds; *provided, however*, that no Additional Bonds shall be issued except in accordance with the provisions of the Act as in existence on the date of issuance of the Additional Bonds.

The Board reserves the right to issue bonds or other evidences of indebtedness payable from Pledged State Aid Revenues subordinate to the Bonds. Such subordinate obligations will be paid from Pledged State Aid Revenues available to the Board in each year in excess of those required to be deposited and retained in the Pledged State Aid Revenues Account under the Indenture during such year.

#### **PROVISIONS REGARDING PAYMENT OF BONDS**

The principal and Redemption Price of the Bonds is payable at the designated corporate trust office of the Trustee, Chicago, Illinois, as Paying Agent, and at such offices of any co-Paying Agent or successor Paying Agent or Paying Agents appointed for the Bonds pursuant to the Indenture. Interest on the Bonds is payable by check or bank draft mailed or delivered by the Trustee to the Owners as the same appear on the registration books of the Board maintained by the Registrar as of the close of business on the Record Date or, at the option of any Owner of \$1,000,000 or more in aggregate principal amount of Bonds, by wire transfer of Current Funds to such bank in the continental United States as said Owner shall request in writing to the Registrar. Defaulted Interest with respect to any Bond shall cease to be payable to the Owner of such Bond on the relevant Record Date, and shall be payable to the Owner in whose name such Bond is registered at the close of business of the Trustee on the Special Record Date for the payment of such Defaulted Interest, which shall be fixed in the following manner. The Board shall notify the Trustee in writing of the amount of Defaulted Interest proposed to be paid on each Bond and the date of the proposed payment (which date shall be such as will enable the Trustee to comply with the next sentence hereof), and at the same time the Board shall deposit with the Trustee an amount of money equal to the aggregate amount proposed to be paid in respect of such Defaulted Interest or shall make arrangements satisfactory to the Trustee for such deposit prior to the date of the proposed payment, such money when deposited to be held in trust for the benefit of the Owners entitled to such Defaulted Interest as provided in the Indenture. Following receipt of

such funds, the Trustee shall fix a Special Record Date for the payment of such Defaulted Interest which shall be not more than fifteen (15) nor less than ten (10) days prior to the date of the proposed payment and not less than ten (10) days after the receipt by the Trustee of the notice of the proposed payment. The Trustee shall promptly notify the Board of such Special Record Date and, in the name and at the expense of the Board shall cause notice of the proposed payment of such Defaulted Interest and the Special Record Date therefor to be mailed, first class postage prepaid, to each Owner of a Bond at the address of such Owner as it appears on the Bond Register not less than ten (10) days prior to such Special Record Date. Such Defaulted Interest shall be paid to the Owners in whose names the Bonds on which such Defaulted Interest is to be paid are registered on such Special Record Date. The Bonds are payable, with respect to interest, principal, redemption premium (if any) in any coin or currency of the United States of America which at the time of payment is legal tender for the payment of public and private debts.

#### **PROVISIONS REGARDING TRANSFER AND EXCHANGE OF BONDS**

Subject to the operation of the global book-entry only system described in the body of this Official Statement, the following provisions apply to the transfer and exchange of Bonds under the Indenture. Each Bond shall be transferable only upon the registration books of the Board, which shall be kept for such purpose by the Registrar, by the Owner in person or by its attorney duly authorized in writing, upon surrender thereof with a written instrument of transfer satisfactory to the Registrar, duly executed by the Owner or its duly authorized attorney. Upon the transfer of any such Bond, the Board shall issue in the name of the transferee a new Bond or Bonds in Authorized Denominations of the same aggregate principal amount. Upon surrender at the principal office of the Registrar with a written instrument of transfer satisfactory to the Registrar, duly executed by the Owner or its duly authorized attorney, any Bond may, at the option of the Owner and upon payment of any charges sufficient to reimburse the Trustee for any tax, fee or other governmental charge required to be paid, be exchanged for an equal aggregate principal amount of fully registered Bonds of the same maturity and tenor of any other Authorized Denominations. The Registrar and the Trustee will not be required to make any registration, transfer or exchange of any Bond during the period between each Record Date and the next succeeding interest payment date for such Bond, or after such Bond has been called for redemption or, in the case of any proposed redemption of Bonds, during the 15 days next preceding the date of first giving of notice of such redemption.

#### **ESTABLISHMENT AND APPLICATION OF PROJECT FUND**

The Project Fund is established under the Indenture with the Trustee to be held and applied in accordance with the terms and provisions of the Indenture. Moneys on deposit in the Project Fund will be paid out from time to time by the Trustee to or upon the order of the Board in order to provide for the payment or to reimburse the Board for the payment of Project Costs upon receipt by the Trustee of a certificate of an Authorized Officer of the Board describing the Project Costs to be paid or reimbursed with such moneys and stating that:

- (i) the costs of an aggregate amount set forth in such certificate are necessary and appropriate Project Costs that (A) have been incurred and paid or (B) are expected to be paid within the next 60 days;

(ii) the amount to be paid or reimbursed to the Board, as set forth in such certificate, is reasonable and represents a part of the amount payable for the Project Costs and that such payment is to be made or, in the case of reimbursement to the Board, was made, in accordance with the terms of any applicable contracts and in accordance with usual and customary practice under existing conditions;

(iii) no part of the Project Costs that are the subject of such certificate was included in any certificate previously filed with the Trustee under the provisions of the Indenture; and

(iv) the use of the money so withdrawn from the Project Fund and the use of the facilities provided with such moneys will not result in a violation of any covenant, term or provision of the Tax Agreement.

Moneys in the Project Fund will be invested at the written direction of a Designated Official to the fullest extent practicable in Investment Securities maturing in such amounts and at such times as may be necessary to provide funds when needed to pay Project Costs or such other costs as may be required to be paid from such moneys. The Board may, and to the extent required for payments from the Project Fund shall, direct the Trustee to sell any such Investment Securities at any time, and the proceeds of such sale, and of all payments at maturity and upon redemption of such investments, shall be held in the Project Fund. Earnings received on moneys or securities in the Project Fund will be retained therein and applied to the purposes for which moneys in the Project Fund are otherwise held.

The completion, substantial completion or abandonment of the Project shall be evidenced by a certificate of an Authorized Officer, which is to be filed promptly with the Trustee, stating the date of such completion, anticipated completion, abandonment or reduction in scope and the amount, if any, required in the opinion of the signer of such certificate for the payment of any remaining part of the Project Costs. Upon the filing of such certificate, the balance in the Project Fund in excess of the amount, if any, stated in such certificate of the Board as necessary to complete the Project will be deposited into such accounts of the Debt Service Fund as may be directed in such certificate.

## **INVESTMENT OF FUNDS**

### **INVESTMENT OF CERTAIN MONEYS**

Moneys held in the several Accounts and Sub-Accounts of the Debt Service Fund and in the Project Fund will be invested and reinvested by the Trustee at the written direction of a Designated Official in Investment Securities within the parameters established in the Indenture and the Investment Policy which mature no later than necessary to provide moneys when needed for payments to be made from such Fund. A Designated Official may direct the Trustee to make any such investments or reinvestments through the use of a Forward Supply Contract, to the extent permitted by Illinois law and the Investment Policy, and the Trustee shall comply with the terms and provisions of any such Forward Supply Contract. The Trustee may make any and all such investments through its trust department or the bond department of any bank (including the

Trustee) or trust company under common control with the Trustee. The Board has provided a certified copy of the Investment Policy to the Trustee in connection with the initial delivery of the Bonds and the Board covenants and agrees to provide to the Trustee in a timely fashion any amendments to or revisions of such Investment Policy. The Trustee shall be entitled to conclusively rely on the Investment Policy provided to it by the Board as the Investment Policy in effect at the time any investment is made. Any transfers of funds between any Fund, Account, or Sub-Account required or permitted by the Indenture may be made by transferring all or a portion of an Investment Security. All such investments made under the Indenture must be consistent with the expectations expressed in the Tax Agreement.

#### VALUATION AND SALE OF INVESTMENTS

Investment Securities in any Fund, Account or Sub-Account created under the Indenture shall be deemed at all times to be part of such Fund, Account or Sub-Account and any profit realized from the liquidation of such investment shall be credited to such Fund, Account or Sub-Account and any loss resulting from liquidation of such investment will be charged to such Fund, Account or Sub-Account. Valuations of Investment Securities held in the Funds, Accounts and Sub-Accounts established under the Indenture shall be made by the Trustee as often as may be necessary or requested by the Board to determine the amounts held therein. In computing the amounts in such Funds, Accounts and Sub-Accounts, Investment Securities therein will be valued as provided in the following paragraph.

The value of Investment Securities will mean the fair market value thereof, *provided, however*, that all SLG's will be valued at par and those obligations which are redeemable at the option of the holder will be valued at the price at which such obligations are then redeemable.

Except as otherwise provided in the Indenture, the Trustee at the written direction of a Designated Official shall sell at a fair market price, or present for redemption, any Investment Security held in any Fund, Account or Sub-Account held by the Trustee whenever it will be necessary to provide moneys to meet any payment or transfer from such Fund, Account or Sub-Account as the case may be.

#### PARTICULAR COVENANTS AND REPRESENTATIONS OF THE BOARD

##### COVENANTS REGARDING PLEDGED STATE AID REVENUES

Pursuant to Section 15(e) of the Act, the Board covenants under the Indenture, so long as there are any Outstanding Bonds, to provide for, collect and apply the State Aid Revenues available pursuant to the 2004 Authorization with respect to the Series 2006B Bonds issued pursuant to the 2004 Authorization, to the payment of the such Bonds, the Prior 2004 State Aid Bonds, and the Swap Payments and the provision of not less than an additional .10 times annual Debt Service, and to provide for, collect and apply the State Aid Revenues available pursuant to the 2006 Authorization with respect to the Series 2006B Bonds issued pursuant to the 2006 Authorization, to the payment of the such Bonds, any Additional Bonds issued from time to time pursuant to the provisions of the 2006 Authorization and the Indenture, and the Swap Payments and the provision of not less than an additional .10 times annual Debt Service as further described herein. The Board will comply with all present and future applicable laws in order to

assure that the Pledged State Aid Revenues may be allocated and paid to the Board for application as provided in the Indenture.

#### COVENANTS REGARDING PLEDGED TAXES

The Board has directed the County Collectors to deposit all collections of the Pledged Taxes, if and when extended for collection, directly with the Trustee for application in accordance with the provisions of the Indenture. So long as any of the Bonds remain Outstanding, the Board will not modify or amend such direction, except for such modifications or amendments as may be necessitated by changes in State law or procedures or rules, regulations or procedures there under with respect to the collection and distribution of *ad valorem* property taxes; provided, that no such modification or amendment shall provide for the deposit with the Trustee of less than all of the Pledged Taxes to be collected in any Year.

As described in the Official Statement under the heading "SECURITY FOR THE BONDS -- Pledged Taxes," the Board will direct the abatement of the Pledged Taxes in whole or in part as described therein, and proper notification of any such abatement will be filed with (i) the County Clerks, in a timely manner to effect such abatement and (ii) the County Collectors, so as to advise such officers of the amount of the Pledged Taxes to be extended for the relevant levy year.

So long as there are any Outstanding Bonds, the Board and its officers will comply with all present and future applicable laws in order to assure that the Pledged Taxes may be levied and extended and collected and deposited to the Pledged Taxes Account as described above.

In furtherance of the general obligation, full faith and credit promise of the Board to pay the principal and Redemption Price of and interest on the Bonds, and in furtherance of the covenant of the Board to pay the Swap Payments, the Board will take all actions necessary to (i) cause the levy and extension of the Pledged Taxes, including any Pledged Taxes required to be levied in excess of those levied pursuant to the Bond Resolution, for collection on a timely basis to make all such payments and (ii) to cause such Pledged Taxes when extended for collection to be deposited directly with the Trustee for application pursuant to the Indenture.

#### INDEBTEDNESS AND LIENS

The Board shall not hereafter issue any bonds or other evidences of indebtedness, other than the Bonds and Additional Bonds, which are secured by a pledge of or lien on the Pledged State Aid Revenues, the Pledged Taxes or the moneys, securities or funds held or set aside by the Board or by the Trustee under the Indenture, and shall not, except as provided in the Indenture, create or cause to be created any lien or charge on the Pledged State Aid Revenues, the Pledged Taxes or such moneys, securities or funds.

#### ACCOUNTS AND REPORTS

The Board shall keep or cause to be kept proper books of record and account (separate from all other records and accounts) in which complete and correct entries shall be made of its transactions relating to the Pledged State Aid Revenues, the Pledged Taxes and the Funds,

Accounts and Sub-Accounts established by the Indenture, and which, together with all other books and financial records of the Board, shall at all reasonable times be available for the inspection of the Trustee and the Owners of not less than twenty-five percent (25%) in aggregate principal amount of Outstanding Bonds or their representatives duly authorized in writing.

#### ARBITRAGE

The Board will not at any time permit any of the proceeds of the Bonds or any other funds of the Board to be used directly or indirectly to acquire any securities or obligations the acquisition of which would cause any Bond to be an “arbitrage bond” as defined in the Code and Regulations.

#### EVENTS OF DEFAULT AND REMEDIES

##### EVENTS OF DEFAULT

Each of the following events constitutes an Event of Default under the Indenture:

- (1) if a default shall occurs in the due and punctual payment of interest on any Bond, when and as such interest becomes due and payable;
- (2) if a default shall occurs in the due and punctual payment of the principal or Redemption Price of any Bond when and as the same shall becomes due and payable, whether at maturity or by call for redemption or otherwise;
- (3) if a default occurs in the performance or observance by the Board of any other of the covenants, agreements or conditions contained in the Indenture or in the Bonds, and such default shall continue for a period of 60 days after written notice thereof to the Board by the Trustee or after written notice thereof to the Board and to the Trustee by the Owners of not less than a majority in aggregate principal amount of the Outstanding Bonds, provided that if the nature of the default is such that it cannot be cured within the 60-day period but can be cured within a longer period, no event of default shall occur if the Board institutes corrective action within the 60-day period and diligently pursues-such action until the default is corrected (provided such default is correctable); or
- (4) if the Board files a petition seeking a composition of indebtedness under the federal bankruptcy laws or under any other applicable law or statute of the United States of America or of the State.

##### PROCEEDINGS BROUGHT BY TRUSTEE

***There is no provision for the acceleration of the maturity of the Bonds if an Event of Default occurs under the Indenture.***



If an Event of Default shall happen and shall not have been remedied, then and in every such case, the Trustee, by its agents and attorneys, may proceed, and upon identical written request of the Owners of not less than a majority in aggregate principal amount of the Bonds Outstanding and upon being indemnified to its satisfaction shall proceed, to protect and enforce its rights and the rights of the Owners of the Bonds under the Indenture forthwith by a suit or suits in equity or at law, whether for the specific performance of any covenant contained in the Indenture, or in aid of the execution of any power granted in the Indenture, or for an accounting against the Board as if the Board were the trustee of an express trust, or in the enforcement of any other legal or equitable right as the Trustee, being advised by counsel, shall deem most effectual to enforce any of its rights or to perform any of its duties under the Indenture.

All actions against the Board under the Indenture must be brought in a state or federal court located in the State of Illinois.

The Owners of not less than a majority in aggregate principal amount of the Bonds at the time Outstanding may direct the time, method and place (subject to the preceding paragraph) of conducting any proceedings to be taken in connection with the enforcement of the terms and conditions of the Indenture or for the enforcement of any remedy available to the Trustee, or exercising any trust or power conferred upon the Trustee, provided that the Trustee will have the right to decline to follow any such direction if the Trustee is advised by counsel that the action or proceeding so directed may not lawfully be taken, or if the Trustee in good faith shall determine that the action or proceeding so directed would involve the Trustee in personal liability or be unjustly prejudicial to the Owners not parties to such direction.

#### APPLICATION OF TRUST ESTATE AND OTHER MONEYS ON DEFAULT

During the continuance of an Event of Default, the Trustee shall apply all moneys, securities, funds, Pledged State Aid Revenues and Pledged Taxes and the income therefrom as follows and in the following order:

- (1) to the payment of the reasonable and proper charges and expenses of the Trustee, including the reasonable fees and expenses of counsel employed by it; and
- (2) to the payment of the principal of, Redemption Price and interest on the Bonds then due, as follows:

FIRST: to the payment to the persons entitled thereto of all installments of interest then due on the Bonds in the order of the maturity of such installments, together with accrued and unpaid interest on the Bonds theretofore called for redemption, and, if the amount available shall not be sufficient to pay in full any installment or installments of interest maturing on the same date, then to the payment thereof ratably, according to the amounts due thereon, to the persons entitled thereto, without any discrimination or preference; and

SECOND: to the payment to the persons entitled thereto of the unpaid principal or Redemption Price of any Bonds which shall have become due, whether at maturity or by call for redemption, in the order of their due dates, and, if the amount available shall not be sufficient to pay in full all the Bonds due on any date, then to the payment thereof ratably, according to the amounts of principal or Redemption Price due on such date, to the persons entitled thereto, without any discrimination or preference.

(3) to the payment of the Swap Payments.

If and whenever all overdue installments of principal and Redemption Price of and interest on all Bonds, together with the reasonable and proper charges and expenses of the Trustee, and all other overdue sums payable by the Board under the Indenture, including the overdue principal and Redemption Price of and accrued unpaid interest on all Bonds held by or for the account of the Board, and any and all unpaid Swap Payments, or provision satisfactory to the Trustee shall be made for such payment, and all defaults under the Indenture or the Bonds are made good or secured to the satisfaction of the Trustee or provision deemed by the Trustee to be adequate is made therefore, the Trustee will pay over to the Board all moneys, securities and funds then remaining unexpended in the hands of the Trustee (except moneys, securities and funds deposited or pledged, or required by the terms of the Indenture to be deposited or pledged, with the Trustee), and thereupon the Board, the Trustee and the Owners shall be restored, respectively, to their former positions and rights under the Indenture. No such payment over to the Board by the Trustee nor such restoration of the Board and the Trustee to their former positions and rights shall extend to or affect any subsequent default under the Indenture or impair any right consequent thereon.

#### RESTRICTIONS ON BONDHOLDERS' ACTIONS

No Owner of any Bond will have any right to institute any suit or proceeding at law or in equity for the enforcement or violation of any provision of the Indenture or the execution of any trust under the Indenture or for any remedy under the Indenture, unless such Owner shall have previously given to the Trustee written notice of the happening of an Event of Default, as provided in the Indenture, and the Owners of at least a majority in aggregate principal amount of the Bonds then Outstanding shall have filed a written request with the Trustee, and have offered it reasonable opportunity either to exercise the powers granted in the Indenture or by the laws of the State or to institute such suit or proceeding in its own name, and unless such Owners shall have offered to the Trustee adequate security and indemnity against the costs, expenses and liabilities to be incurred therein or thereby, and the Trustee shall have refused or failed to comply with such request within 60 days after receipt by it of such notice, request and offer of indemnity, it being understood and intended that no one or more Owners of Bonds shall have any right in any manner whatever by its or their action to affect, disturb or prejudice the pledge created by the Indenture or to enforce any right under the Indenture, except in the manner provided in the Indenture; and that all proceedings at law or in equity to enforce any provision of the Indenture shall be instituted, had and maintained in the manner provided in the Indenture and for the equal benefit of all Owners of the Outstanding Bonds.

## REMEDIES CONFERRED BY THE ACT

The Board and the Trustee each acknowledge that Section 15(e) of the Act provides that all covenants of the Board relating to the issuance of the Bonds as Alternate Bonds pursuant to Section 15 of the Act and the conditions and obligations imposed by said Section 15 are enforceable by any Owner of the Bonds, any taxpayer of the Board and the people of the State acting through the Attorney General of the State or any designee, and in the event that any such action results in an order finding that the Board has not properly collected and applied the Pledged State Aid Revenues as required by the Act, the plaintiff in any such action shall be awarded reasonable attorney's fees.

## NO REMEDY EXCLUSIVE

No remedy by the terms of the Indenture conferred upon or reserved to the Trustee or the Owners is intended to be exclusive of any other remedy, but each remedy will be cumulative and shall be in addition to every other remedy given under the Indenture or existing at law or in equity or by statute on or after the date of the execution and delivery of the Indenture.

## WAIVER

The Owners of not less than two-thirds in aggregate principal amount of the Bonds at the time Outstanding, or their attorneys-in-fact duly authorized, may on behalf of the Owners of all of the Bonds waive any past default under the Indenture and its consequences, except a default in the payment of interest on, or principal or Redemption Price of any of the Bonds when due. No such waiver shall extend to any subsequent or other default or impair any right consequent thereon.

## RIGHTS OF BOND INSURER

The foregoing notwithstanding, so long as the Bond Insurance Policy is in full force and effect and the Bond Insurer has not failed to perform any of its obligations there under, the Bond Insurer shall have the right to direct all remedies with respect to the Insured Bonds upon the happening of an Event of Default and shall have the right to institute any suit, action or proceeding at law or in equity under the same terms as an Owner in accordance with the terms of the Indenture.

## PROVISIONS RELATING TO TRUSTEE

### RESIGNATION AND REMOVAL OF TRUSTEE

The Trustee may at any time resign and be discharged of the duties and obligations imposed upon it by the Indenture by giving not less than 60 days written notice to the Board, all Owners of the Bonds and the other Fiduciaries, and such resignation will take effect upon the day specified in such notice but only if a successor will have been appointed by the Board or the Owners as provided below, in which event such resignation shall take effect immediately on the appointment of such successor whether or not the date specified for such resignation to take effect has arrived. If a successor Trustee shall not have been appointed within a period of 90 days

following the giving of notice, then the Trustee shall be authorized to petition any court of competent jurisdiction to appoint a successor Trustee as described below.

The Trustee may be removed at any time by an instrument in writing approved by and executed in the name of the Board and delivered to the Trustee; provided, however, that if an Event of Default shall have occurred and be continuing, the Trustee may be so removed by the Board only with the written concurrence of the Owners of a majority in aggregate principal amount of Bonds then Outstanding. The Trustee may be removed at any time by the Owners of a majority in aggregate principal amount of the Bonds then Outstanding, excluding any Bonds held by or for the account of the Board, by an instrument or concurrent instruments in writing signed and duly acknowledged by such Owners or their attorneys-in-fact duly authorized, and delivered to the Board. Copies of each such instrument shall be delivered by the Board to each Fiduciary.

#### **APPOINTMENT OF SUCCESSOR TRUSTEE**

In case at any time the Trustee shall resign or shall be removed or shall become incapable of acting, or shall be adjudged a bankrupt or insolvent, or if a receiver, liquidator or conservator of the Trustee, or of its property, shall be appointed, or if any public officer or court shall take charge or control of the Trustee, or of its property or affairs, the Board shall appoint a successor Trustee. The Board shall cause notice of any such appointment made by it to be mailed to all Owners of the Bonds.

If no appointment of a Trustee shall be made by the Board as described in the foregoing paragraph, the Owner of any Outstanding Bond may apply to any court of competent jurisdiction to appoint a successor Trustee. Such court may thereupon, after such notice, if any, as such court may deem proper and prescribe, appoint a successor Trustee.

Any successor Trustee appointed under the provisions of the Indenture shall be a bank or trust company or organized under the laws of any state of the United States or a national banking association, doing business and having its designated corporate trust office in the State, and having capital and undivided surplus aggregating at least \$15,000,000, or shall be a wholly owned subsidiary of such an entity, if there be such a bank, trust company, national banking association or subsidiary willing and able to accept the office on reasonable and customary terms and authorized by law to perform all the duties imposed upon it by the Indenture.

#### **SUPPLEMENTAL INDENTURES**

##### **SUPPLEMENTAL INDENTURES NOT REQUIRING CONSENT OF OWNERS**

The Board and the Trustee may without the consent of, or notice to, any of the Owners, enter into a Supplemental Indenture or Supplemental Indentures for any one or more of the following purposes:

- (1) to impose additional covenants or agreements to be observed by the Board;

- (2) to impose other limitations or restrictions upon the Board;
- (3) to surrender any right, power or privilege reserved to or conferred upon the Board by the Indenture;
- (4) to confirm, as further assurance, any pledge of or lien upon the Pledged State Aid Revenues, the Pledged Taxes or any other moneys, securities or funds;
- (5) to make any necessary amendments to or to supplement the Indenture in connection with the issuance of Additional Bonds, as authorized in the Indenture, including, without limitation, any amendments thereto necessary or desirable to reflect the issuance of such Additional Bonds in any calculations or determinations required or permitted by the Indenture;
- (6) to cure any ambiguity, omission or defect in the Indenture;
- (7) to provide for the appointment of a successor securities depository;
- (8) to provide for the appointment of any successor Fiduciary; and
- (9) to make any other change which, in the judgment of the Trustee, does not materially adversely affect the rights of the Trustee or the Owners.

#### SUPPLEMENTAL INDENTURES EFFECTIVE UPON CONSENT OF OWNERS

Any Supplemental Indenture not effective in accordance with the foregoing provisions shall take effect only if permitted and approved and in the manner described below under the heading "AMENDMENTS - Consent of Owners."

#### AMENDMENTS

##### GENERAL

Except for Supplemental Indentures not requiring consent of the Owners as described above, the Owners of not less than a majority in aggregate principal amount of the Bonds then Outstanding shall have the right, from time to time, anything contained in the Indenture to the contrary notwithstanding, to (i) consent to and approve the execution by the Board and the Trustee of such other indenture or indentures supplemental to the Indenture as shall be deemed necessary and desirable by the Board for the purpose of modifying, altering, amending, adding to or rescinding, in any particular, any of the terms or provisions contained in the Indenture or in any Supplemental Indenture, or (ii) waive or consent to the taking by the Board of any action prohibited, or the omission by the Board of the taking of any action required, by any of the provisions of the Indenture or of any indenture supplemental to the Indenture; provided, however, that nothing in the Indenture permits or may be construed as permitting, (a) an extension of the stated maturity or reduction in the principal amount or reduction in the rate or extension of the time of paying of interest on, or reduction of any premium payable on the payment or redemption of any Bond, without the consent of the Owner of such Bond, or (b) a

reduction in the amount of, or extension of the time of, any payment required by any sinking fund applicable to any Bonds without the consent of the Owners of all the Bonds which would be affected by the action to be taken, or (c) except for the pledge of the Pledged State Aid Revenues in connection with the issuance of Additional Bonds, the creation of any lien prior to or on a parity with the lien of the Indenture, without the consent of the Owners of all the Bonds at the time Outstanding, or (d) a reduction in the aforesaid aggregate principal amount of Bonds, the Owners of which are required to consent to any such waiver or Supplemental Indenture, without the consent of the Owners of all the Bonds at the time Outstanding which would be affected by the action to be taken, or (e) a modification of the rights, duties or immunities of the Trustee, without the written consent of the Trustee, or (f) the loss of the exclusion from federal gross income of the Owners of the interest paid on the Bonds held by a non-consenting Bondholder to the extent otherwise afforded under the Code and Regulations.

#### CONSENT OF OWNERS

The Board may at any time authorize the execution and delivery of a Supplemental Indenture making a modification or amendment described in the preceding paragraph, to take effect when and as described in this paragraph. Upon the authorization of such Supplemental Indenture, a copy thereof will be delivered to and held by the Trustee for the inspection of the Owners. A copy of such Supplemental Indenture (or summary thereof or reference thereto in form approved by the Trustee and the Board) together with a request to Owners for their consent thereto in form satisfactory to the Trustee, shall be mailed by the Trustee to the Owners, but failure to mail such copy and request will not affect the validity of such Supplemental Indenture when consented to as described below. Such Supplemental Indenture shall not be effective unless and until, and shall take effect in accordance with its terms when there shall have been filed with the Trustee (i) the written consents of the Owners of the required aggregate principal amount of Outstanding Bonds, and (ii) a Counsel's Opinion stating that the execution and delivery of such Supplemental Indenture has been duly authorized by the Board in accordance with the provisions of the Indenture, is authorized or permitted by the Indenture and, when effective, will be valid and binding upon the Board and the Trustee. Any such consent shall be binding upon the Owner of the Bonds giving such consent and upon any subsequent Owner of such Bonds and of any Bonds issued in exchange therefore whether or not such subsequent Owner has notice thereof, provided, however, that any consent may be revoked by any Owner of such Bonds by filing with the Trustee, prior to the time when the Trustee's written statement described below is filed, a written revocation, with proof that such Bonds are held by the signer of such revocation. The Trustee shall give notice by mail to the Owners of the Bonds that the Supplemental Indenture has been consented to by the Owners of the required aggregate principal amount of Outstanding Bonds and will be effective (but failure to mail such notice or any defect therein will not prevent such Supplemental Indenture from becoming effective and binding).

The Indenture and the rights and obligations of the Board and of the Owners of the Bonds may be modified or amended in any respect by a Supplemental Indenture effecting such modification or amendment and with the consents of the Owners of all the Bonds then Outstanding, each such consent to be accompanied by proof of the holding at the date of such consent of the Bonds with respect to which such consent is given. Such Supplemental Indenture will take effect upon the filing (a) with the Trustee of (i) a copy thereof, (ii) such consents and accompanying proofs and (iii) the Counsel's Opinion referred to in the preceding paragraph and

(b) with the Board of the Trustee's written statement that the consents of the Owners of all Outstanding Bonds have been filed with it. No mailing or publication of any Supplemental Indenture (or reference thereto or summary thereof) or of any request or notice will be required.

The foregoing notwithstanding, so long as the Bond Insurance Policy is in full force and effect and the Bond Insurer has not failed to perform any of its obligations thereunder, the Bond Insurer shall be deemed the owner of the Bonds for purposes of consenting to any supplements or amendments to the Indenture as may be required by the Indenture.

#### **RIGHTS OF BOND INSURER**

The Bond Insurer shall receive copies of all notices required to be delivered to Bondholders and, on an annual basis, be provided by the Board with copies of the Board's audited financial statements and Annual Budget. Any notice that is required to be given to a Holder of the Obligation or to the Trustee pursuant to the Indenture shall also be provided to the Bond Insurer.

Notwithstanding anything contained in the Indenture or in the Insured Bonds to the contrary, the existence of all rights given to the Bond Insurer thereunder with respect to the giving of consents or approvals, the receipt of notices and the direction of proceedings or otherwise are expressly conditioned upon the timely and full performance of the obligations of the Bond Insurer under the Bond Insurance Policy.

#### **DEFEASANCE**

If the Board shall pay or causes to be paid or there shall otherwise be paid to the Owners of all Bonds the principal or Redemption Price, if applicable, and interest due or to become due thereon, at the times and in the manner stipulated therein and in the Indenture, then the pledge of the Trust Estate pledged under the Indenture and all covenants, agreements and other obligations of the Board to the Owners shall thereupon be discharged and satisfied. In such event, the Trustee, upon request of the Board, shall provide an accounting of the assets managed by the Trustee to be prepared and filed with the Board for any year or part thereof requested, and shall execute and deliver to the Board all such instruments as may be desirable to evidence such discharge and satisfaction, and the Paying Agent shall pay over or deliver to the Board all moneys and securities held by it pursuant to the Indenture which are not required for the payment of Bonds not previously surrendered for such payment or redemption. If the Board shall pay or cause to be paid, or there shall otherwise be paid, to the Owners of all Outstanding Bonds of a particular maturity or portion of any maturity (which portion shall be selected by lot by the Trustee in the manner provided in the Indenture for the selection of Bonds to be redeemed in part), the principal or Redemption Price, if applicable, thereof and interest due or to become due thereon, at the times and in the manner stipulated therein and in the Indenture, such Bonds shall cease to be entitled to any lien, benefit or security under the Indenture, and all covenants, agreements and obligations of the Board to the Owners of such Bonds and to the Trustee shall thereupon be discharged and satisfied.

Bonds or interest installments for the payment or redemption of which moneys shall have been set aside and held in trust by the Trustee at or prior to their maturity or redemption date

shall be deemed to have been paid as described in the preceding paragraph if the Board shall have delivered to or deposited with the Trustee (a) irrevocable instructions to pay or redeem all of said Bonds in specified amounts no less than the respective amounts of, and on specified dates no later than the respective due dates of, their principal, (b) irrevocable instructions to mail the required notice of redemption of any Bonds so to be redeemed, (c) either moneys in an amount which shall be sufficient, or Defeasance Obligations the principal of and the interest on which when due will provide money which shall be sufficient, in the opinion of a nationally recognized firm of independent public accountants, to pay when due the principal or Redemption Price, if applicable, and interest due and to become due on said Bonds on and prior to each specified redemption date or maturity date thereof, as the case may be, and (d) if any of said Bonds are not to be redeemed within the next succeeding 60 days, irrevocable instructions to mail to all Owners of said Bonds a notice that such deposit has been made with the Trustee and that said Bonds are deemed to have been paid in accordance with the Indenture and stating the maturity or redemption date upon which moneys are to be available for the payment of the principal or Redemption Price, if applicable, of said Bonds.

The Defeasance Obligations (or any portion thereof) held for the payment of the principal and Redemption Price of and interest on said Bonds as described in the preceding paragraph may not be sold, redeemed, invested, reinvested or removed from the lien of the Indenture in any manner or other Defeasance Obligations substituted therefore (any such direction to sell, redeem, invest, reinvest, remove or substitute to be referred to as a "*Subsequent Action*") unless prior to the taking of such Subsequent Action, the Trustee shall have received the following: (i) either (a) a certified copy of the proceedings of the Board authorizing the Subsequent Action, or (b) an opinion of counsel to the effect that such Subsequent Action has been duly authorized by all necessary action on the part of the Board; (ii) an opinion from a nationally recognized firm of independent public accountants to the effect that the Defeasance Obligations and cash available or to be available for payment of the Bonds after the taking of the Subsequent Action will remain sufficient to pay, without any further reinvestment thereof, the principal and Redemption Price of and interest on said Bonds at or prior to their maturity or redemption date in the manner provided in the preceding paragraph; (iii) an opinion of Bond Counsel to the effect that the Subsequent Action will not adversely affect any exemption from federal income tax of the interest paid on the Bonds to which such Bonds are otherwise entitled; and (iv) such other documents and showings as the Trustee may reasonably require.

Notwithstanding anything in the Indenture to the contrary, in the event that the principal of and/or interest on the Bonds shall be paid by the Bond Insurer pursuant to the Bond Insurance Policy, the Bonds shall remain Outstanding for all purposes, shall not be deemed to be defeased or otherwise satisfied and not be considered paid by the Board, and the assignment and pledge of the Trust Estate and all covenants, agreements and other obligations of the Board to the Owners of the Bonds shall continue to exist and shall run to the benefit of the Bond Insurer, and the Bond Insurer shall be subrogated to the rights of such Owners.



## **APPENDIX C**

### **Form of Opinions of Co-Bond Counsel**

September 27, 2006

Board of Education of the City of Chicago  
Chicago, Illinois

J. P. Morgan Securities Inc.  
as Representative of the Underwriters  
named in the Contract of Purchase,  
dated September 12, 2006  
Chicago, Illinois

Wells Fargo Bank, N.A., as Trustee  
Chicago, Illinois

Financial Security Assurance  
New York, New York

Re: Board of Education of the City of Chicago, Unlimited Tax General Obligation  
Bonds (Dedicated Revenues), Series 2006B

Ladies and Gentlemen:

We have acted as Co-Bond Counsel in connection with the issuance by the Board of Education of the City of Chicago (the "School District"), governed by the Chicago Board of Education (the "Board") of its \$355,805,000 aggregate principal amount Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2006B (the "Bonds"). The Bonds are being issued pursuant to a Trust Indenture, dated as of September 1, 2006 (the "Indenture"), between the Board and Wells Fargo Bank, N.A., Chicago, Illinois, as trustee (the "Trustee"). The Bonds are further issued pursuant to the authority of the Local Government Debt Reform Act of the State of Illinois, as amended (the "Act"), a Resolution adopted by the Board on September 22, 2004, authorizing the issuance of alternate bonds of the Board, being general obligation bonds payable from any revenue source as provided by the Act, and the completion of the backdoor referendum proceedings and the notice and hearing requirements of the Act (the "2004 Authorization"), a Resolution adopted by the Board on June 28, 2006, authorizing the issuance of alternate bonds of the Board being general obligation bonds payable from any revenue source as provided by the Act and the completion of the backdoor referendum proceedings and the notice and hearing requirements of the Act (the "2006 Authorization"), and a Resolution adopted by the Board on August 23, 2006 (the "Bond Resolution") authorizing the issuance of the Bonds pursuant to the 2004 Authorization, the 2006 Authorization and the Indenture. Capitalized terms used herein without definition shall have the meanings assigned to such terms in the Indenture.

The Bonds are issued for the purpose of paying (i) the costs of the construction, acquisition and equipping of school and administrative buildings, site improvements and other

real and personal property in and for the School District, all in accordance with the estimates of cost, including the Board's Capital Improvement Program, as approved and from time to time amended by the Board (the "Project"), and (ii) costs related to the issuance of the Bonds, including bond insurance premium.

The Bonds consist of fully registered Bonds without coupons numbered from R-1 consecutively upward, in the denomination of \$5,000 or any multiple integral thereof, dated as of the date of their initial issuance and delivery, and becoming due on December 1 in the years, and bearing interest as set forth in the Indenture.

Interest on the Bonds is payable semiannually on June 1 and December 1 (each an "Interest Payment Date") in each year, beginning on June 1, 2007. The principal of the Bonds shall be payable at the principal corporate trust office of the Trustee. The interest on the Bonds shall be payable by check or draft mailed by the Trustee to the persons in whose names the Bonds are registered at their addresses as they appear on the Bond registration books maintained by the Trustee on the fifteenth day of the calendar month preceding each Interest Payment Date.

In connection with the issuance of the Bonds, we have examined the following:

A. The Constitution and statutes of the State of Illinois, including the Act, and such other laws as we deem relevant to this opinion.

B. A certified copy of the proceedings of the Board relating to the 2004 Authorization, the 2006 Authorization, the Bond Resolution and preliminary to and in connection with the issuance of the Bonds, authorizing, among other things, the following (collectively, the "Bond Documents"):

- i) the execution and delivery of the Indenture and the issuance, sale and delivery of the Bonds; and
- ii) the execution and delivery of the Tax Regulatory Agreement (the "Tax Regulatory Agreement") dated as of even date herewith, by and between the Board and the Trustee.

C. An original certified copy of the 2004 Authorization, the 2006 Authorization, and the Bond Resolution, and executed counterparts of the Indenture, and the Tax Regulatory Agreement.

D. A specimen of the Bonds.

E. Representations and certifications of the Board, J. P. Morgan Securities Inc., as representative of the original purchasers of the Bonds, and A. C. Advisory, Inc. and D. A. Davidson & Co., each of Chicago, Illinois, the co-financial advisors to the Board.

F. The opinion of even date herewith of counsel for the Board.

G. Such other matters, laws and documents as we deem necessary for purposes of this opinion.

In rendering the opinions set forth herein we have assumed, without undertaking to verify the same by independent investigation, (a) as to questions of fact, the accuracy and completeness of all representations of the Board set forth in the 2004 Authorization, the 2006 Authorization, the Bond Resolution, the Indenture, and the Tax Regulatory Agreement (the “Bond Documents”) and all representations and certifications of officers, officials and representatives of the Board and others examined by us, (b) the conformity to original documents of all documents submitted to us as copies and the authenticity of such original documents and all documents submitted to us as originals, (c) that the proceeds of the Bonds will be used in accordance with the Bond Documents and (d) that all covenants and requirements of the Bond Documents will be duly complied with and fulfilled.

We have not been engaged or undertaken to review the accuracy, completeness or sufficiency of the Official Statement dated September 12, 2006 with respect to the Bonds or other offering material relating to the Bonds (except to the extent stated therein), and we express no opinion relating thereto (except to the extent stated therein).

Based upon the foregoing and subject to the exceptions and clarifications set forth herein, we are of the opinion, as of the date hereof and under existing law, that:

1. The Board has full power and authority and has taken all necessary corporate action to authorize the execution and delivery by, and the binding effect on the Trustee of the Indenture, and the Indenture is valid and binding upon the Board and enforceable in accordance with its terms.

2. The Indenture creates the valid pledge which it purports to create of the Trust Estate held or set aside or pledged under the Indenture, subject to the application thereof to the purposes and on the conditions permitted by the Indenture.

3. The Bonds are payable ratably and equally (i) together with any bonds issued on a parity therewith under the terms of the Indenture, from the Pledged State Aid Revenues, and (ii) from the “Pledged Taxes,” being ad valorem taxes levied against all of the taxable property in the School District without limitation as to rate or amount for the payment of the Bonds. The Bonds are further secured by the other moneys, securities and funds pledged under the Indenture. The scheduled payment of principal and interest when due on the Bonds maturing in the years 2008 through 2036 is guaranteed under an insurance policy issued by Financial Security Assurance, New York, New York.

4. The Board has taken all necessary action to cause the County Collector of the County of Cook, Illinois, to deposit the Pledged Taxes directly with the Trustee for application pursuant to the Indenture.

5. Subject to the condition that the Board complies with certain covenants made to satisfy pertinent requirements of the Internal Revenue Code of 1986, as amended (the “Code”),

under present law, the Bonds are not private activity bonds under the Code, and interest on the Bonds is excludable from gross income of the owners thereof for federal income tax purposes. Interest on the Bonds will not be included as an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. However, interest on the Bonds will be included in adjusted current earnings of certain corporations for purposes of computing the alternative minimum tax for such corporations. Failure to comply with certain of these covenants could cause interest on the Bonds to be included in gross income retroactive to the date of issuance of the Bonds. Ownership of the Bonds may result in other federal tax consequences to certain taxpayers. We express no opinion regarding any such collateral consequences arising with respect to the Bonds. In rendering our opinion on tax exemption, we have relied upon certifications of the Board and certain other parties with respect to certain matters solely within their knowledge relating to the facilities to be financed or refinanced with the Bonds, the application of proceeds of the Bonds and certain other matters pertinent to the tax exempt status of the Bonds. Interest on the Bonds is not exempt from present Illinois income taxation. We express no opinion regarding any other such state or local tax consequences arising with respect to the Bonds.

The rights of the registered owners of the Bonds and the enforceability of provisions of the Bonds and the Bond Documents may be subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights. Enforcement of provisions of the Bonds and the Bond Documents by an equitable or similar remedy is subject to general principles of law and equity governing such a remedy, including the exercise of judicial discretion whether to grant any particular form of relief.

By rendering the foregoing opinion, we do not undertake to advise you of any changes in laws or facts which may occur or come to our attention after the date hereof.

Respectfully submitted,

## **APPENDIX D**

### **Specimen Municipal Bond Insurance Policy**

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**FINANCIAL  
SECURITY  
ASSURANCE®**

## **MUNICIPAL BOND INSURANCE POLICY**

ISSUER:

Policy No.: -N

BONDS:

Effective Date:

Premium: \$

FINANCIAL SECURITY ASSURANCE INC. ("Financial Security"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY agrees to pay to the trustee (the "Trustee") or paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the Bonds, for the benefit of the Owners or, at the election of Financial Security, directly to each Owner, subject only to the terms of this Policy (which includes each endorsement hereto), that portion of the principal of and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

On the later of the day on which such principal and interest becomes Due for Payment or the Business Day next following the Business Day on which Financial Security shall have received Notice of Nonpayment, Financial Security will disburse to or for the benefit of each Owner of a Bond the face amount of principal of and interest on the Bond that is then Due for Payment but is then unpaid by reason of Nonpayment by the Issuer, but only upon receipt by Financial Security, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in Financial Security. A Notice of Nonpayment will be deemed received on a given Business Day if it is received prior to 1:00 p.m. (New York time) on such Business Day; otherwise, it will be deemed received on the next Business Day. If any Notice of Nonpayment received by Financial Security is incomplete, it shall be deemed not to have been received by Financial Security for purposes of the preceding sentence and Financial Security shall promptly so advise the Trustee, Paying Agent or Owner, as appropriate, who may submit an amended Notice of Nonpayment. Upon disbursement in respect of a Bond, Financial Security shall become the owner of the Bond, any appurtenant coupon to the Bond or right to receipt of payment of principal of or interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by Financial Security hereunder. Payment by Financial Security to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of Financial Security under this Policy.

Except to the extent expressly modified by an endorsement hereto, the following terms shall have the meanings specified for all purposes of this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment" means (a) when referring to the principal of a Bond, payable on the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity unless Financial Security shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration and (b) when referring to interest on a Bond, payable on the stated date for payment of interest. "Nonpayment" means, in respect of a Bond, the failure of the Issuer to have provided sufficient funds to the Trustee or, if there is no Trustee, to the Paying Agent for payment in full of all principal and interest that is Due for Payment on such Bond. "Nonpayment" shall also include, in respect of a Bond, any payment of principal or interest that is Due for Payment

made to an Owner by or on behalf of the Issuer which has been recovered from such Owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to Financial Security which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

Financial Security may appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy by giving written notice to the Trustee and the Paying Agent specifying the name and notice address of the Insurer's Fiscal Agent. From and after the date of receipt of such notice by the Trustee and the Paying Agent, (a) copies of all notices required to be delivered to Financial Security pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to Financial Security and shall not be deemed received until received by both and (b) all payments required to be made by Financial Security under this Policy may be made directly by Financial Security or by the Insurer's Fiscal Agent on behalf of Financial Security. The Insurer's Fiscal Agent is the agent of Financial Security only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of Financial Security to deposit or cause to be deposited sufficient funds to make payments due under this Policy.

To the fullest extent permitted by applicable law, Financial Security agrees not to assert, and hereby waives, only for the benefit of each Owner, all rights (whether by counterclaim, setoff or otherwise) and defenses (including, without limitation, the defense of fraud), whether acquired by subrogation, assignment or otherwise, to the extent that such rights and defenses may be available to Financial Security to avoid payment of its obligations under this Policy in accordance with the express provisions of this Policy.

This Policy sets forth in full the undertaking of Financial Security, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto. Except to the extent expressly modified by an endorsement hereto, (a) any premium paid in respect of this Policy is nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Bonds prior to maturity and (b) this Policy may not be canceled or revoked. THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

[Countersignature]

FINANCIAL SECURITY ASSURANCE INC.

By \_\_\_\_\_

By \_\_\_\_\_

Authorized Officer

A subsidiary of Financial Security Assurance Holdings Ltd.  
31 West 52<sup>nd</sup> Street, New York, N.Y. 10019

(212) 826-0100

Form 500NY (5/90)



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NEIGHBORHOODS

*Alive!*



BUILDING CHICAGO TOGETHER

RICHARD M. DALEY, MAYOR



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