INTERPRETIVE LETTER 91-34 (DECEMBER 12, 1991)

State bank that has made a commercial real estate loan in the amount of its lending limit may redeem the property for delinquent taxes and such expenditures will be deemed a liability "otherwise" extended for purposes of Section 32.

We are writing in response to your request on behalf of * Bank ("the Bank") for a no-action letter. You stated that the Bank has an outstanding commercial real estate loan secured by a first mortgage. The total loan is for $700,000, of which the Bank has retained $500,000 (the Bank's lending limit). The real property is a 70 acre parcel that is not presently developed except for water, sewage and other utilities. The Bank has learned that property has been sold for delinquent taxes in the amount of $300,000 for 1988 and $9,000 for 1990, and that the time for redeeming the property from the tax sale expires on *.

The borrowers have a contract to sell the 70 acres for $2,500,000 to a developer that has obtained preliminary approvals to use the parcel for a Planned Unit Development. However, the deal has been pending for over one year, and because of contingencies it may not close. Interest payments on the loan are current, but because of the default in the taxes, the Bank has demanded that the borrowers cure the default by the end of *. The Bank has not yet filed a foreclosure action.

You have requested a no-action letter so that the Bank may redeem the property that was sold for $309,000 in back taxes without being criticized for a lending limit violation (since the liability of the borrowers to the Bank, after redemption from the tax sale, would exceed the 20% lending limit of the Bank). You also have indicated that the Bank's loan documents with the borrowers provide for them to become liable for advances the Bank makes in tax payments to preserve its collateral position.
The basic lending limit applicable to an Illinois state bank is found in Section 32 of the Illinois Banking Act, which provides in part:

> Basic loaning limits. The liabilities to any state bank of any person for money borrowed, including in the liabilities of a partnership or joint venture the liabilities of the several members thereof, shall at no time exceed 20% of the amount of the unimpaired capital of such bank, and 20% of its unimpaired surplus.

* * *

> The total liabilities of any one person for money borrowed, or otherwise, shall not exceed 25% of the deposits of such bank, and such total liabilities shall at no time exceed 50% of the amount of the unimpaired capital and unimpaired surplus of such bank (emphasis added). Ill. Rev. Stat. ch. 17, par. 339 (1989).

It is clear that advances to pay the taxes are subject to the lending limit, because they result in a "liability to any state bank..." by the borrowers. Until the Bank acquires title, either by foreclosure or deed in lieu of foreclosure, and the property then legally becomes property of the Bank as other real estate owned ("OREO"), expenditures for taxes on the real estate pledged as collateral are, like any other additional advance a borrower has promised to repay, a liability of the borrower. Such an advance has the same effect as if the borrower asked for and received an additional loan and signed a note to obtain money to pay the taxes; if the borrowers repay their total liabilities owed to the Bank secured by this real property, they are entitled to a release of the mortgage.

If, on the other hand, the Bank were to make the same expenditure after foreclosure when it owns the property, it is protecting the Bank's property, not the borrowers' property. The borrowers would receive no benefit from the payment of taxes and would not be liable to repay them. The payment of taxes owed on OREO is not subject to lending limits.

The issue to determine the size of the applicable lending limit then becomes whether the advance for taxes is "money borrowed" subject to the 20% limit, or whether, together with loans to the borrower, it falls within the 50% limit for "money borrowed or otherwise."

There is one unreported case in the Circuit Court of Cook County which held that a certificate of deposit held by the Bank for Savings Associations (now known as the Bank for Financial Institutions) was not "money borrowed" subject to the general limit, but rather was funds "otherwise" extended that are limited to the cap of 25% of deposits or 50% of unimpaired capital and surplus. Bank for Savings and Loan Associations v. Commissioner of Banks and Trust Companies (Cook Cnty. Cir. Ct. July 19, 1977). Except for this case, the term "or otherwise" in Section 32 has not been construed by a court. Logically, however, it would seem to refer to those liabilities a borrower owes to the Bank that are not "money borrowed."

"Money borrowed" is not defined in the Illinois Banking Act. A search for cases that define "money borrowed" yields McRoberts v. Spaulding et al., 32 F.2d 315 (D.C. Iowa 1929), in which the Court stated:

> The phrase "money borrowed" has been defined as follows: "A loan is made when the borrower receives money over which he exercises dominion, and which he expressly or impliedly promises to return." First Nat. Bank of Cordova v. Tjosevig, 138 Wash. 231, 238, 244 P. 736, 738; 9 C.J. 141.

This definition of "money borrowed" focuses upon liabilities for money advanced to the borrower that are intentional advances, rather than other obligations that the borrower must repay to the bank. When a bank makes intentional advances, whether by disbursing loan proceeds or intentionally honoring overdrafts, the borrower receives money "over which the borrower exercises dominion." Other liabilities of the borrower would result, for example, when the bank pays a third party for some other purpose that the borrower

also has agreed to repay. Examples of such other liabilities are insurance payments on collateral that the borrower promised but failed to obtain or, as in your inquiry, delinquent taxes paid by the lender that the borrower has promised to repay if advanced by the bank. When the bank pays these expenses, the borrower is liable for repayment to the bank, but such funds are not money "over which the borrower exercises dominion."

Therefore, it is our conclusion that if the Bank redeems real estate collateral that was sold for delinquent taxes, or if payment is made to preserve the collateral position of the Bank and the borrower is liable for such advanced taxes, such extensions of funds will constitute a liability of the borrower for funds "otherwise" extended to the borrower. Such extensions of funds, together with the principal loans and all other liabilities of the borrowers to the Bank, may not exceed 25% of the deposits or 50% of the unimpaired capital and surplus of the bank.