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School Bonds: Qualified Zone Academy Bonds and School Construction Tax Credit Bonds

The American Recover and Reinvestment Act of 2009: Financing Opportunities for California's Public Agencies

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OVERVIEW

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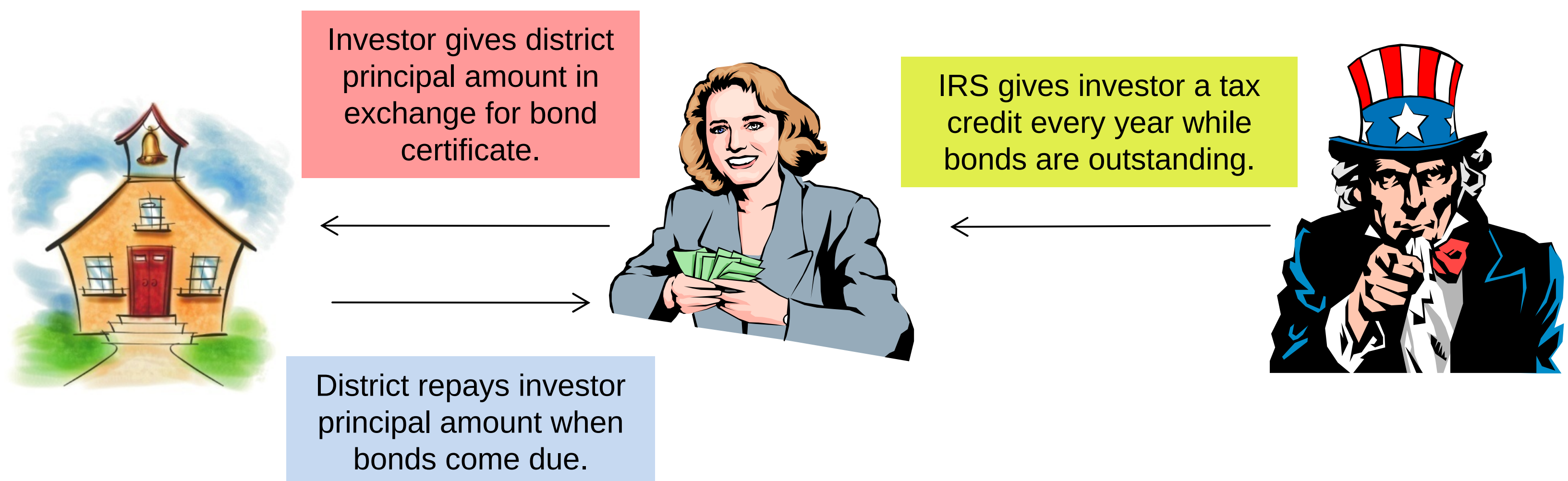
School Options for Capital Projects

- Regardless of Federal options, California school districts are still limited in ***how*** they can borrow for capital projects.
- Options for long term debt:

Type	Requirement	Repaid from	Repayment
General Obligation Bonds	Voter Approval	Special taxes	Up to 40 years
Certificates of Participation (COPs)	County Office of Education Notification	District resources	Up to 30 years
Lease	COE Notification	District resources	Up to 20 years

QZAB and QSCB

- QZAB and QSCB are a form of bond that a school district can issue.
- District repays principal, without interest, to investor.
- In place of interest, investor receives a tax credit each year from the IRS.
- Must get an allocation from the State.
- Must satisfy various IRS requirements.
- Must be issued according to State law (G.O. Bond, COP or lease).



Allocations

- QZABS have been authorized and allocated annually or biannually since 1999.
- QSCBs have only been authorized and allocated for 2009 and 2010.

QZAB	2008	2009	2010	Total
Nationally	$400,000,000	$1,400,000,000	$1,400,000,000	$2,800,000,000
California	$44,364,000	$155,275,000	TBD	

QSCB	2009	2010	Total
Nationally	$11,000,000,000	$11,000,000,000	$22,000,000,000
100 Largest Schools	$4,400,000,000	TBD	
California	$773,525,000	TBD	
Largest Schools in CA	$581,966,000	TBD	

Direct Allocations of QSCBs to California Schools

District	Allocation
Bakersfield City Unified	$15,720,000
Compton Unified	18,559,000
Fresno Unified	41,398,000
Long Beach Unified	37,905,000
Los Angeles Unified	318,816,000
Oakland Unified	26,326,000
Sacramento City Unified	21,251,000
San Bernardino City Unified	27,790,000
San Diego City Unified	38,877,000
Santa Ana Unified	19,269,000
Stockton City Unified	16,055,000
	$581,966,000

QZAB versus QSCB

Requirement	QZAB	QSCB
Site Specific	Yes	Yes
Use of Funds	100% on rehabilitation or repair of school facilities (no new construction, no site purchase). Also eligible (but not clearly allowed under State law) equipment, course materials, & teacher training.	100% on construction, rehabilitation or repair of a school facility, or purchase of a site for a school facility. Also OK for equipment.
Location or Student Demographics	Must be in an empowerment zone or enterprise community OR 35% of students at school must be on free and reduced lunch.	No requirement.
Local Match	Match must be provided by a local business partner for the equivalent of 10% of the project costs.	No requirement.
Educational Program	Project must be associated with an “academy” that promotes college and/or workforce preparedness.	No requirement.

Mechanics of Tax Credit Bonds

- Tax Credit Rate & Maximum Maturity Date
  - Published daily by the U.S. Department of Treasury, Bureau of Public Debt
  - Investor must claim the tax credit as income before taking the credit against taxes due.

- Sinking Fund
  - Rather than wait and repay in one bullet payment, a sinking fund can be established and payments made each year.
  - Payments made to sinking fund must be no more rapid than equal annual installments.
  - Interest earned in sinking fund must be at or less than Permitted Sinking Fund Yield.

- From www.TreasuryDirect.gov – Qualified Tax Credit Bond Rates:

Date	Rate	Maturity	Permitted Sinking Fund Yield
June 17, 2009	**7.43%**	**16 yrs**	**4.66%**

Example

- Investor purchases an ABC School District QSCB at par value of $100,000 and tax credit rate of 7.43% for a tax-credit of $7,430.
- The net impact to the investor is the same as having invested $100,000 in a tax-exempt bond earning 4.83% interest. ***(7.43% less (7.43% x 35%) = 4.83%)***

	Tax Credit	Tax Exempt Interest
Investor's other income for 2010:	$100,000	$100,000
Plus tax credit as income:	**7,430**	**0**
Total taxable income:	107,430	100,000
Gross tax due at 35% tax rate:	37,601	35,000
Less tax credit:	**(7,430)**	**0**
Net tax due:	30,171	35,000
Post tax income:	69,829	65,000
Plus tax-exempt interest:	**0**	**4,830**
Net post tax income:	$69,829	$69,830

For School Districts – No Interest, Principal Only

- By only having to repay principal, with no interest, debt service payments are drastically reduced on any type of borrowing.
- If part of a G.O. Bond program, this drastically reduces the tax levy needed to repay this portion of principal.
  - For tax-constrained Districts, this provides flexibility.
  - Can be set-up with no payments at all for several years.
  - Invested sinking fund can reduce overall tax collection requirement.
- If part of a General Fund-supported debt issue, this drastically reduces the District's payments.
  - Payments made to the invested sinking fund defray total cost of repayment – net cost to District is less than original principal amount.

Invested Sinking Fund

- To provide investor full term and amount of tax credit, repayment is in one lump payment on maturity date.
- To improve the credit quality and to help the District defray the full cost, the IRS allows an invested sinking fund.
- Payment into the fund cannot be more accelerated than equal annual installments.
- Maximum interest that can be earned is set by the IRS at the time of issue.

	Uninvested Sinking Fund	Invested Sinking Fund		
	District	District Payment	Interest Earned	Balance
9/1/2009			4.66%	
9/1/2010	$ 312,500	$ 217,252		$ 217,252
9/1/2011	312,500	217,252	$ 10,124	444,628
9/1/2012	312,500	217,252	20,720	682,600
9/1/2013	312,500	217,252	31,809	931,661
9/1/2014	312,500	217,252	43,415	1,192,329
9/1/2015	312,500	217,252	55,563	1,465,144
9/1/2016	312,500	217,252	68,276	1,750,672
9/1/2017	312,500	217,252	81,581	2,049,505
9/1/2018	312,500	217,252	95,507	2,362,264
9/1/2019	312,500	217,252	110,082	2,689,598
9/1/2020	312,500	217,252	125,335	3,032,185
9/1/2021	312,500	217,252	141,300	3,390,737
9/1/2022	312,500	217,252	158,008	3,765,998
9/1/2023	312,500	217,252	175,496	4,158,746
9/1/2024	312,500	217,252	193,798	4,569,795
9/1/2025	312,500	217,252	212,952	5,000,000
	$ 5,000,000	$ 3,476,035	$ 1,523,965	$ 5,000,000

Considerations

- Difficult to find investors who understand the program.
- May not be completely "interest-free" - an additional coupon (1% or less), or a discount off the total amount of bonds may be need if Treasury-set rate is not attractive enough to investors.
- Costs of issuance:
  - May be more expensive than ordinary bonds.
  - Limited to 2% of bond proceeds.