COMMONWEALTH of VIRGINIA

Department of the Treasury

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MEMORANDUM

TO: School Division Superintendents and
Local Government Chief Administrative Officers

FROM: Manju S. Ganeriwala, State Treasurer Manju Ganeriwala
Patricia I. Wright, Superintendent of Public Instruction PIW

SUBJECT: Announcement of Third Round Application Process for Qualified School Construction Bonds (QSCBs) Allocations

Governor McDonnell announced today an application process for the remaining $229.5 million in Qualified School Construction Bonds (QSCBs) authorized under the American Recovery and Reinvestment Act of 2009 (ARRA). QSCBs are tax credit bonds for school construction and renovation projects. Under the program, issuers are eligible to receive a direct federal subsidy in an amount that is expected to offset the interest payments made on the bonds, resulting in zero or near zero interest cost. Issuers are still responsible for repayment of principal. Two prior QSCB issues have been completed for Virginia school projects -- $61.1 million in fall 2009 and $72.6 million in July 2010.

This latest QSCB allocation will be available for projects involving new construction (including land purchase), building additions, and renovations involving local public school facilities, and will be awarded based on various selection criteria. To be considered for an award, school divisions must submit an application for each individual school project. QSCB allocation awards will be capped at $15 million per school division (for one or multiple projects).

Allocations will be awarded to individual projects (subject to the $15 million division cap) based on the following criteria and a rank ordering of the associated points (100 maximum per project):

1) a consolidation project that results in a net reduction of at least one school (25 points);
2) a project that eliminates student overcrowding or trailers (20 points);
3) a project in a division with a composite index below 0.2500 or an unemployment rate in the locality above 10 percent (20 points);

4) a project that replaces a public school facility that is more than 35 years old (15 points);
5) a project that includes the installation of a school-wide, high-speed computer network for use by teachers and students (10 points); and
6) preference for a project in a division that has not received any prior QSCB allocation (10 points).

Governor McDonnell may, on a discretionary basis, award QSCB allocations to emergency projects with significant health or safety issues, to projects with other significant extenuating circumstances, or to eligible projects on the Literary Fund First Priority Waiting List as approved by the Virginia Board of Education in July 2010.

QSCB allocations will be provided through the Virginia Public School Authority (VPSA), and will require the issuance of general obligation bonds by the participating localities with a maturity structure consistent with the program requirements. School projects must meet specific ARRA requirements to be eligible for funding, such as a three-year spend down requirement and compliance with Davis-Bacon Act prevailing wage requirements for contractors. Using QSCB proceeds to refinance prior interim financing has restrictions as well.

The QSCB application, instructions, and related information are available on the Virginia Department of Education's Web site at:

http://www.doe.virginia.gov/school_finance/arra/competitive/index.shtml.

The deadline for submitting an application to the Department of Education is November 19, 2010. An Executive Order will document the awarded projects and allocation amounts and set out the parameters of the bond issuance, expected to occur in winter 2011.

We hope this new QSCB allocation will be of interest to your school division and locality and that you will find ways to utilize this program to modernize your school facilities in a manner that improves instruction and ultimately to reduce your operating costs. For general questions on the QSCB program or the application process, please contact Brian Logwood, Department of Education, at (804) 225-2025 or Brian.Logwood@doe.virginia.gov. For QSCB financing questions, please contact Richard Davis, Department of the Treasury, at (804) 225-4928 or Richard.Davis@trs.virginia.gov.

Following this memorandum is a Questions and Answers document which provides additional information regarding the QSCB program and the Round 3 application process.

Revised October 2010

Questions & Answers
Qualified School Construction Bonds (QSCBs)

Q: What are Qualified School Construction Bonds (QSCBs)?
A: QSCBs are tax credit bonds created under the American Recovery and Reinvestment Act of 2009 (ARRA) for school construction and renovation projects. The structuring option for QSCBs that will likely be used by the VPSA enables the locality to issue taxable bonds, and receive a federal subsidy reimbursement that is expected to completely offset the interest expense paid by the issuer. In that way, QSCBs are designed to provide zero or near zero interest to the issuer. Issuers are still responsible for repayment of principal.

Q: What types of projects can QSCBs be used for?
A: 100 percent of available project proceeds must be used for the construction, rehabilitation, or repair of public school facilities. In addition, a portion of the proceeds may be used for the acquisition of land on which a public school facility is to be constructed, and equipment to be used in the facility that is being constructed, rehabilitated or repaired with the proceeds. No more than two percent of the proceeds may be used for issuance costs.

Governor McDonnell has announced that the focus of the third round of QSCBs will be for projects that reduce local operational costs or modernize schools, such as school consolidations, elimination of student overcrowding or trailers, and replacement of facilities that are more than 35 years old. Projects that include the installation of school-wide, high-speed computer networks and projects from school divisions that have not received any prior QSCB funding from Rounds 1 and 2 will also be considered, as will local economic conditions as measured by the Composite Index or unemployment rate. Also, Governor McDonnell may, on a discretionary basis, award direct QSCB allocations to eligible projects on the Literary Fund First Priority Waiting List, to emergency projects with significant health or safety issues, or to projects with other significant extenuating circumstances.

Q: Since these are taxable bonds, are they subject to arbitrage rebate regulations?
A: Yes. Issuers must still comply with arbitrage regulations, but special exemptions are granted during the construction period and if sinking funds meet certain requirements.

Q: Are there other eligibility requirements for QSCBs projects?
A: Yes. And there are important additional federal rules that should be considered by any locality thinking about issuing QSCBs such as:

- Special Spending Rules – a binding commitment with a 3rd party to spend 10 percent of the proceeds must be entered into within 6 months of the issuance of the bonds, and 100 percent of the proceeds (including earnings thereon) must be spent within three (3) years of issuance. ANY PROCEEDS REMAINING AT

THE END OF THE THREE YEAR TEMPORARY PERIOD MUST BE USED TO REDEEM BONDS AND WILL NOT BE AVAILABLE FOR THE PROJECT.

- Davis-Bacon Act Prevailing Wage Requirements – Projects/construction contracts must be in compliance with the Davis-Bacon Act prevailing wage and labor standards established by the U.S. Department of Labor.
- Refinancing of Existing Debt – QSCB proceeds can be used to pay off interim financing. However, any such interim financing (1) cannot be a qualified tax credit bond (this would be highly unlikely), (2) must otherwise meet the requirements for qualifying expenditures for QSCB financing, and (3) must have been issued or incurred on or after March 18, 2010.

Q: What is the term (i.e., repayment period) on QSCBs?
A: The maximum term for QSCBs is set by formula by the U. S. Treasury each month, and has ranged between 14 and 16 years. Even though this term is shorter than with typical school construction financing, it still results in debt service payments significantly less than a comparable 20-year financing due to the interest rate subsidy.

Q: Is there a limit to the amount of QSCBs that can be issued?
A: Yes. The U.S. Treasury Department established state allocation limits and sets the tax-subsidy rate for QSCBs. The ARRA authorized a national cap of $11.2 billion in QSCBs in each of 2009 and 2010. Virginia was allocated $191.1 million in 2009 and $172.2 million in 2010. An additional 2010 allocation was made directly to Virginia's two Large Local Education Agencies (LEAs) by the U. S. Treasury. States may directly issue the bonds on behalf of eligible schools or they may suballocate authority to issue the bonds within the State. The remaining balance available for allocation (from the 2009 and 2010 state allocations) is $229.5 million.

Like Virginia's first two issuances of QSCBs, the third issuance will be conducted as a "pooled" issuance through the Virginia Public School Authority (VPSA), which requires each participating locality to issue general obligation debt for purchase by the Authority from the participating localities. An Executive Order will document the awarded projects, the awarded allocation amounts, and set out the parameters of the bond issuance. Under Round 3, the maximum QSCB allocation that can be awarded per division (for one or multiple projects) will be $15 million.

Q: Can Virginia's remaining calendar year 2009 and total calendar year 2010 QSCB allocation be carried forward to calendar year 2011 if necessary?
A: Yes. Any remaining 2009 or 2010 allocation not issued by December 31, 2010, may be carried forward for issuance in calendar year 2011.

The U.S. Treasury Department's guidance on the QSCB program can be found at: *http://www.irs.gov/pub/irs-drop/n-09-26.pdf; http://www.irs.gov/pub/irs-drop/n-10-17.pdf; http://www.irs.gov/pub/irs-drop/n-10-35.pdf.*