COMMONWEALTH *of* VIRGINIA

MANJU S. GANERIWALA
TREASURER OF VIRGINIA

Department of the Treasury

P. O. BOX 1879
RICHMOND, VIRGINIA 23218-1879
(804) 225-2142
Fax (804) 225-3187

October 6, 2009

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 *Pat I. Wright*

SUBJECT: Upcoming Competition for Allocation of Qualified School Construction Bonds

Earlier this month, Governor Kaine announced the allocation of $71.6 million in American Recovery and Reinvestment Act (ARRA) Qualified School Construction Bonds (QSCB) for eight projects across Virginia. That announcement was the first allocation from approximately $191 million authorized for the Commonwealth through the QSCB program in 2009.

Bonds issued under the QSCB program benefit from a federal tax credit. The tax credit is determined by formula set by the U.S. Department of Treasury, and is intended to compensate the bond holders in lieu of receiving interest payments on their bonds. Depending on the market and the tax credit rate, this can result in a financing that is at or near zero percent rate of interest.

In mid-October, we expect that the Governor will formally announce a process to allocate the more than $119 million still available for allocation in 2009. The purpose of this communication is to give advance notice to school divisions and their localities of this planned process. As with the prior allocation, the Virginia Public School Authority (VPSA) will issue these QSCBs to finance eligible projects on behalf of localities and their school divisions. VPSA will lend the proceeds of the QSCBs to the participating localities. Eligible local participants must be willing to authorize and issue a general obligation local school bond with a maturity structure consistent with the program requirements. Attached is a list of questions and answers that provides additional information on the federal QSCB program.

Unlike the previous allocation, Governor Kaine has determined that this remaining $119 million be used to finance energy efficiency improvements and renewable energy retrofits to existing public school buildings. Depending on demand and the number of qualifying projects, the Governor has discretion to use the 2010 allocation as well for the same purpose. By focusing these bond allocations on projects designed to achieve energy savings, participating school divisions will realize an even greater positive impact from these projects.

This allocation is not intended to be used for new construction. Rather, the allocation is for energy efficiency improvements to existing buildings or for the installation of renewable energy equipment on school grounds. Energy use in buildings represents almost 40 percent of all domestic energy use. Governor Kaine recognizes that energy costs are an increasing threat to state, local, and school division budgets. By targeting these bond allocations to energy efficiency improvements to school buildings and energy retrofits like solar panel installation, school divisions will reduce their energy use, cut costs, and stimulate the local economy by creating green jobs.

The application, including detailed requirements will be made available on the Department of Education's website in mid-October with an anticipated deadline of early November. In the interim, we suggest that local school divisions and localities begin reviewing their school renovation and capital plans to identify potential projects and their capital funding needs.

Attachment

Questions & Answers
Qualified School Construction Bonds

Q: What are Qualified School Construction Bonds (QSCBs)?

A: QSCBs are tax-credit bonds for school construction created under the American Recovery and Reinvestment Act of 2009 (ARRA). QSCBs are taxable (rather than tax-exempt) bonds. The investor or buyer of a QSCB receives federal income tax credits that are approximately equal to the interest that the issuer would pay holders of taxable bonds. This results in a bond that is issued at an interest rate of zero percent (or close to zero depending on market conditions). 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. Governor Kaine has determined that this second round of 2009 QSCB funding be used to finance energy efficiency improvements and renewable energy retrofits to existing public school buildings, and not new construction. No more than 2 percent of the proceeds may be used for issuance costs. QSCBs cannot be used to refinance existing financing arrangements.

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.

- Special Spending Rules – 100 percent of the proceeds (including earnings thereon) must be spent within three (3) years, and a binding commitment with a 3rd party to spend 10 percent of the proceeds within the first 6 months must be in place. ANY PROCEEDS REMAINING AT THE END OF THE THREE YEAR TEMPORARY PERIOD MUST BE RETURNED AND USED TO REDEEM BONDS AND WILL NOT BE AVAILABLE FOR THE PROJECT.
- Davis-Bacon – Projects/construction contracts must be in compliance with the Davis-Bacon prevailing wage and labor standards.
- Reimbursement Rules – QSCB proceeds cannot be used to reimburse prior expenditures unless certain reimbursement rules are followed.

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 is shorter, it still results in payments significantly less than a comparable 20-year financing.

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-credit rate for QSCBs. The ARRA authorized a national cap of $11.2 billion in QSCBs in each 2009 and 2010. Virginia has been allocated $191 million in each year. States may directly issue the bonds on behalf of eligible schools or they may suballocate authority to issue the bonds within the State.

Q: Is there a time limit for issuing the bonds?

A: Yes. If an allocation to a state is unused for a calendar year, the State may carry it forward to the next calendar year, so states have up until the end of 2010 to use their 2009 allocation and until the end of 2011 to use their 2010 allocation.

The U. S. Treasury Department's recent guidance on this new program can be found at http://www.irs.gov/pub/irs-drop/n-09-26.pdf.