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Qualified School Construction Bonds
Frequently Asked Questions
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1. What are Qualified School Construction Bonds, also known as "QSCBs"?

Qualified School Construction Bonds ("QSCBs") are a new category of tax credit bonds created under the American Recovery and Reinvestment Act of 2009, enacted on February 17, 2009 ("ARRA"), which offer the bondholder a federal tax credit instead of interest. "QSCB" is a federal tax attribute: the QSCB designation of bonds or notes does not change underlying State law requirements. A total of $11 billion in funding is available in each of 2009 and 2010 nationwide. In 2009, Wisconsin has an approximately $98 million allocation, plus approximately an additional $72 million allocation to Milwaukee Public Schools ("MPS"), which received an allocation as a large local educational agency. An additional $400 million ($200 million in 2009 and $200 million in 2010) is allocated to tribal governments for schools funded by the Bureau of Indian Affairs. QSCBs, a qualified tax credit bond, are subject to Section 54A of the Internal Revenue Code of 1986, as amended (the "Code").

2. Who can issue QSCBs?

- *States,*
- *school districts (and other political subdivisions that are authorized to finance public school facilities),*
- *large local educational agencies that are a state or local governmental entity, and*
- *entities empowered to issue obligations on behalf of any such entity.*

Wisconsin technical college districts cannot issue QSCBs because post-secondary school facilities are not eligible for QSCB financing.

3. What are the permitted projects QSCBs can be issued for?

QSCBs can be issued for construction, rehabilitation or repair of a public school facility or for the acquisition of land on which such a facility is to be constructed. Eligible expenditures include expenditures for the acquisition of equipment which are used in the portion or portions of the public school facility that is being constructed, rehabilitated or repaired with the proceeds of the QSCBs.

4. When can QSCBs be issued?

An allocation for QSCBs has been made to the states for 2009 and 2010. QSCBs can be issued after an issuer receives an allocation from the State, through the Wisconsin Department of Public Instruction ("DPI"), except for MPS which has received its own allocation.

5. Are there any limits on the amount of QSCBs which may be issued?

A total of $11 billion has been authorized for QSCBs in 2009. Of that amount, Wisconsin has received an allocation of approximately $98 million in 2009, plus approximately an additional $72 million for MPS, which received an allocation as a large local educational agency. MPS may reallocate to the State of Wisconsin, to be further allocated to eligible issuers within the State of Wisconsin. Wisconsin is not imposing a specific dollar limit per issue, but DPI instructions indicate that DPI will limit the allocation of QSCB authority to 33% of a referendum approved amount to start with. This amount may be increased depending on the overall demand for QSCBs. DPI will also make allocations of QSCB authority to non-referendum approved borrowings.

6. How does an issuer apply for a QSCB allocation?

If a district desires to issue QSCBs, DPI must be provided with a letter of interest by June 15, 2009. DPI has indicated that the letter must, "[I]dentify the projects by building, QSCB funding expectations by project, and confirm the district's commitment to comply with the Davis-Bacon prevailing wage requirements." DPI has stated that it "will give priority consideration to eligible school districts that have passed a referendum or have a board approved resolution to issue non-referendum debt, and for the following purposes (so long as they are also permitted QSCB projects as described above):

- *Science, Technology, Engineering, and Math (STEM);*
- *Early Childhood, 4-year-old kindergarten;*
- *Green and Healthy Schools; and*
- *Safe and Healthful Schools."*

As mentioned, the allocation amount will initially be limited to 33% of a referendum amount and may be increased depending on the demand for QSCBs. It is expected that DPI will announce the allocations on August 1, 2009.

7. What is the interest rate charged on a QSCB?

The applicable credit rate is the rate the Secretary of the Treasury estimates will permit the issuance of qualified tax credit bonds with a specified maturity or redemption date without discount and without interest cost to the qualified issuer. The applicable credit rate is determined as of the first day on which there is a binding, written contract for the sale or exchange of the bond. The applicable credit rate is published by the Bureau of Public Debt of the Treasury at https://www.treasurydirect.gov. If the Treasury's estimate is accurate, the interest rate charged by the buyer of a QSCB to the issuer of the QSCBs will be 0%.

8. What is the maximum permitted maturity date of a QSCB?

The maximum maturity date for a QSCB is set by the U.S. Treasury and is published daily by the Bureau of Public Debt of the Treasury at www.treasurydirect.gov. The Secretary of the Treasury sets the maximum term of the QSCBs each calendar month for bonds issued during the following calendar month. The maximum term of QSCBs will be the term that the Secretary of the Treasury estimates will result in the present value of the obligation to repay the principal on the bonds being equal to 50% of the face amount of such bond, using as a discount rate the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the particular bonds are issued (rounded to the next highest whole year)

9. Can the principal be repaid in any amortization as long as it is fully repaid by the maximum term defined by the Treasury?

QSCBs do not impose any restrictions on principal amortization. The only restrictions on repayment are the maximum maturity as described above and the funding of the sinking (reserve) fund as described below in Question 10.

10. What are the basic legal requirements for QSCBs?

In addition to following the applicable state law with respect to the authorization and issuance of municipal obligations, issuers of QSCBs must follow arbitrage requirements, including spend-down requirements. 100% of the available project proceeds, including investment earnings, must be spent within 3 years of the issue date, and any excess at the end of 3 years must be used to redeem bonds. The 3-year period can be extended only by going to the IRS for permission. A binding commitment with a third party to spend at least 10% of the available project proceeds must be incurred within 6 months beginning on the date of issuance. The amount of proceeds that can be used to pay costs of issuance is limited to 2%, and no sale proceeds can be used to fund a debt service reserve fund. However, Section 54A allows an issuer to set up a "reserve fund" which would more commonly be called a "sinking fund" that accumulates to pay principal at maturity without having to rebate all of the earnings to the federal government, as long as the sinking fund is funded no faster than equal installments calculated to build up to the amount due at maturity, and the investment rate does not exceed a specific rate. The yield-restriction rate is also published daily by the Bureau of Public Debt of the U.S. Treasury at www.treasurydirect.gov , though it is set on a monthly basis and would apply to all tax credit bonds sold in that month. The sinking fund provision should enhance marketability of the tax credit bonds, as the return to the investor is maximized if the entire principal amount remains outstanding for the maximum term.

11. How will obligations issued as QSCBs be titled?

They will follow the state law requirements for naming with a designation following it indicating they are QSCBs as follows:

$___________ Taxable General Obligation [School Improvement] [Bonds] [Promissory Notes]
(Qualified School Construction Bonds - Tax Credit Bonds)

12. What disclosure should be included in a Preliminary Official Statement or Official Statement regarding QSCBs?

Since there are a number of matters with respect to the tax credit available to bondholders which will need to be disclosed at length, issuers should work closely with their financial advisors and bond counsel so that disclosure for a QSCB accurately describes the eligibility for and features of the tax credit.

13. May QSCBs be used to reimburse prior expenditures?

- *For a 2009 QSCB allocation, the issuer can be reimbursed for amounts it spent after April 3, 2009 (the date the Secretary of the Treasury made the 2009 QSCB allocations) for qualified purposes only if the issuer has completed both of the following two steps:*
  - *I. declare its intent to reimburse before expenditure is paid AND*
  - *II. the school board adopts a reimbursement resolution to reimburse with QSCB proceeds not later than 60 days after expenditure is paid.*

  **Both the above steps would be satisfied by the school board adopting a reimbursement resolution prior to the payment of any expenditures. The reimbursement resolution must declare the District's official intent to reimburse qualified expenditures with qualified tax credit bond proceeds. Bond counsel can assist with the preparation of an appropriate resolution.*
- *The requirement of a declaration to reimburse with QSCB proceeds will require issuers seeking to reimburse expenditures with QSCB proceeds to adopt a resolution/declare official intent for that purpose (i.e. declare official intent to reimburse with proceeds of qualified tax credit bonds), regardless of whether they have previously adopted a traditional reimbursement resolution with respect to those expenditures.*
- *The reimbursement cannot be made more than 18 months after the date the expenditure is paid.*
- *The reimbursement rules for QSCBs do not include a "preliminary expenditure" exception. In other words, preliminary expenditures such as expenditures for architectural, engineering, surveying, soil testing and similar costs can only be reimbursed with the proceeds of a QSCB under the same conditions as all other expenditures.*

14. Are there spending requirements with respect to QSCBs?

Yes. Within six months the issuer must enter into a binding commitment with a third party to spend at least 10% of the proceeds and must spend 100% of the proceeds within three years.

15. Are there limits on costs of issuance payable from QSCBs?

Yes. The amount of costs of issuance (including underwriters' spread, legal fees, financial advisory fees, rating agency fees, paying agent fees, printing and publication costs and so on) that can be paid from QSCB proceeds are limited to 2% of the sale proceeds of QSCBs under Section 54A of the Code. Any costs of issuance above the 2% limit would need to be paid from other available sources such as funds on hand or proceeds of non-QSCB borrowings.

16. Do the continuing disclosure requirements apply to QSCBs?

Yes. All of the continuing disclosure rules and exceptions apply to QSCBs.

17. Do QSCBs count against the small issuer limit on "bank-qualified" obligations?

No. QSCBs will not count against the small issuer limit because QSCBs are not tax-exempt obligations under Section 265 of the Code and accordingly cannot be "qualified tax-exempt obligations."

18. Do projects financed with QSCBs need to comply with the Davis Bacon Act (prevailing wage requirements) or the "Buy America" requirements?

All projects financed with QSCBs must comply with the prevailing wage laws also known as the Davis-Bacon labor standards. The Buy America requirements do not apply to projects financed with QSCBs.

19. Are there any major differences in the rules and functioning of QSCBs vs. QZABs?

- *While the allocations are different, the mechanics of QSCBs are similar to the mechanics of QZABs since Section 54A of the Code applies to both types of tax credit bonds.*
- *The major differences are found in the prequalification rules and purposes (see Question 3. above) of QZABs and QSCBs.*
    - *QSCBs do not have prequalification requirements like QZABs to have written commitments from private entities to make "qualified contributions" having a present value (as of the date the bonds are issued) of not less than 10% of the proceeds of the issue and to receive written approval of the eligible local education agency.*

- *QSCBs also do not require the public school to meet qualified zone academy requirements of QZABs, including being located in an empowerment zone or enterprise community or having a reasonable expectation (as of the date the bonds are issued) that at least 35% of the students attending the school which is a "qualified zone academy" within a school district or participating in such program will be eligible for free or reduced cost lunches.*
- *Additionally, QZABs may be issued only for the purpose of rehabilitating or repairing a "qualified zone academy," purchasing equipment, developing course materials and training teachers and personnel in the "qualified zone academy". New construction is not a qualified purpose for QZABs.*

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For further information about QSCBs or any other matter, please contact one of the Quarles & Brady Public Finance attorneys. Please also refer to the client updates prepared regarding QSCBs and other bond programs created or expanded by the ARRA available at our website, www.quarles.com.