

Qualified School Construction Bond (QSCB) Primer

- Qualified School Construction Bond (QSCB) is a tax credit bond program authorized early last year in the American Recovery and Reinvestment Act of 2009 (ARRA).
- QSCBs may be used to finance new construction or renovation of public schools, including land acquisition and equipment.
- Vermont's federal QSCB allocation for 2009 is \$24.845 million and \$24.236 million for 2010.
 - The federal allocation is to the State, with further allocations permitted to local school districts. The Vermont DOE administers and approves QSCB allocations to school districts.
 - The program allows for the State to carry forward unused QSCB allocation to 2011.
- The allowable tax credit rate and maximum term of the QSCB is determined by the U.S. Treasury. Qualified tax credit bond rates and maximum term are published daily at - https://www.treasurydirect.gov/govt/apps/slgs/slgs_irstax.htm.
- While QSCBs are intended to be interest free to a borrower, the ARRA legislation allows a lender to charge supplemental interest. Supplemental interest is the responsibility of the school district (no tax credit or interest refund is available on the supplemental interest).
- Under the recently-passed Hiring Incentives to Restore Employment Act (HIRE) of 2010, a QSCB issuer, in lieu of issuing tax credit bonds, now has the option to elect to receive a direct cash subsidy payment from the U.S. Treasury. The amount of the subsidy payment is equal to the lesser of the tax credit rate or the taxable interest rate on the bonds as established at the time of sale. The election for issuing tax credit or direct cash subsidy bonds is irrevocable.
 - If a tax credit bond, the school district pays the principal and any supplemental interest to the lender. The school district then files IRS Form 8038 (as adjusted to apply to tax credit bonds) or IRS Form 8038-TC.
 - If a direct subsidy bond, the school district pays the full amount of taxable interest (including supplemental interest) to the lender. The school district then must file (prior to an interest payment date as described below) IRS Form 8038-CP to receive a subsidy payment. To insure timely receipt of the subsidy, Form 8038-CP must be filed no more than 90 days before nor less than 45 days before the bond interest payment is due. Late filing of Form 8038-CP may delay the receipt of the interest refund (forms filed after the statutory 3-year period of limitations may be barred). The IRS will not refund the amount of any supplemental interest paid on a QSCB.
- Other differences from tax-exempt financing:
 - Until further guidance is received from the IRS, QSCBs cannot be used to refinance Bond Anticipation Notes.

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- No more than 2% of QSCB proceeds can be used to finance the issuing costs of the bonds.
- To take full advantage of the interest subsidy, QSCBs are usually issued as “bullet” maturities with the full amount of the principal due at the termination of the bond.
 - Instead of making annual principal payments to the lender, the school district makes equal annual payments into a sinking fund. The sinking fund is used to payoff the bond at termination. The DOE recommends the use of a sinking fund, and the lender may require it.
 - Subject to negotiations with the lender, the school district is able to retain earnings and avoid any rebate on investments in the sinking fund so long as earnings do not exceed the qualified rate which is published daily at - https://www.treasurydirect.gov/govt/apps/slgs/slgs_irstax.htm and established on the sale date of the Bonds.
 - While IRS arbitrage and rebate rules apply to QSCBs, there will be no rebate or interest restriction if bond proceeds are spent within 3 years and the sinking fund is not invested above the qualified rate.
- At closing, 10% of the QSCB proceeds must be subject to a binding commitment to be spent within six months of issuance and 100% must be spent within three years. If QSCB bond proceeds are not spent within 3 years of loan closing, unspent proceeds must be used to redeem an equivalent amount of outstanding bonds from the lender within 90 days after the three year period ends.
- QSCB projects must pay Davis-Bacon Act prevailing wages. “Buy America” provisions do not apply to QSCB funded projects.
- To date, Vermont school districts have sold QSCBs as bank bonds without a supplemental interest. The Vermont Municipal Bond Bank encourages school districts to continue working with banks to obtain privately placed QSCBs, as this appears to be the cheapest source of financing. Of course there is no guarantee that future QSCBs will be issued without a supplement interest. Also, some banks may exhaust their capacity for these types of bonds. If so, the VMBB is prepared to assist school districts in obtaining publically offered QSCB financing.

Disclaimer: This report was developed by the Vermont Municipal Bond Bank (VMBB) at the request of the Vermont Department of Education. While the VMBB has made its best effort to insure the correctness of the information provided, we can in no way guarantee the accuracy and completeness. All such information is provided “AS IS” without warranty of any kind. Please consult your local bond counsel for more information on tax-exempt and Qualified School Construction Bond financing.