

# Qualified School Construction Bonds & Build America Bonds

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An Overview for  
Florida School Districts



June 17, 2009

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# Introduction

- The \$787 billion American Recovery and Reinvestment Act of 2009 (the “Act”) was signed into law on February 17, 2009.
  - Intended to stimulate economic growth through federal spending in areas of education, health care, housing, and transportation.
  - Includes various spending initiatives for State and Local governments, as well as provisions and enhancements related to municipal bond issuance and the laws governing their type and use.
- The Act creates two new categories of direct subsidy debt for School Districts:
  - **Qualified School Construction Bonds** (“QSCBs”) – available only to School Districts;
    - separate & distinct from Qualified Zone Academy Bonds (“QZABs”) program.
  - **Build America Bonds** (“BABs”) – available to all tax-exempt borrowers.
- ***Critical data to pass along to School Board Members:***
  - ***Neither QSCBs nor BABs represent incremental Federal funding; both must be repaid by School District.***

# Summary of Programs

Summary of Programs			
	<u>Qualified School Construction Bonds</u>	<u>Build America Bonds</u>	
		<u>Issuer Subsidy</u>	<u>Investor Subsidy</u>
<b>School District Eligible</b>	Yes	Yes	Yes
<b>Interest on Bonds</b>	None	Taxable	Taxable
<b>Use of Funds:</b>			
Construction	Yes	Yes	Yes
Working Capital	No	No	Yes
Refund Existing Debt	No	No	Yes
<b>Federal Tax Subsidy:</b>			
Benefit to	Investor	Issuer	Investor
Amount	TBD at Issuance	35% of Interest	35% of Interest
Form of Subsidy	Tax Credit	Direct Subsidy	Tax Credit
Paid on	Quarterly	Interest Payment Date	Interest Payment Date
Securitization Potential	Yes	Yes	Yes
<b>Structure:</b>			
Size/Par	Subject to Allocation of Volume Cap Set by Treasury; Generally 14-16 years	No Limit	No Limit
Final Maturity		No Limit	No Limit
Types of Bonds:			
Fixed Rate	N/A	Allowed	Allowed
Variable Rate	N/A	Allowed	Allowed
Notes	N/A	Allowed	Allowed
CABs	N/A	Allowed	Allowed

# Qualified School Construction Bonds

# Qualified School Construction Bonds

## *Program Overview*

- Act authorizes \$11 billion of Qualified School Construction Bonds (“QSCBs”) each calendar year for 2009 and 2010.
- Allocation of QSCB Volume Cap:
  - 60% of the authorized volume is allocated to the states in proportion to the respective amount of local educational grants received by each state under the Elementary and Secondary Education Act of 1965 for the most recent fiscal year.
  - 40% of the authorized volume is allocated to the largest local educational agencies in the nation (as determined by the Treasury in coordination with the Department of Commerce and the Secretary of Education).
  - Large local educational agencies are defined to mean:
    1. the 100 local educational agencies with the highest number of children aged 5 through 17 from families living below the poverty level, and
    2. up to 25 local educational agencies determined by the U.S. Secretary of Education to be in particular need of assistance based on factors such as a low level of resources for school construction and a high level of enrollment growth.
  - The Act also provides an additional \$200 million in annual QSCB authority for 2009 and 2010 that is allocated to Indian tribal schools by the Secretary of the Interior.
  - Unused State allocation amounts may be carried over to the following calendar year.
    - Unused direct allocations to Districts reverts into the State allocation for the following year.

# Qualified School Construction Bonds Allocation for 2009

National Allocation of QSCB Volume Cap (Net of Allocation to Large Local Agencies)			
State	2009 Allocation	State	2009 Allocation
Alabama	118,776,000	New Hampshire	29,784,000
Alaska	29,784,000	New Jersey	223,279,000
Arizona	186,292,000	New Mexico	64,602,000
Arkansas	113,443,000	New York	192,049,000
California	773,525,000	North Carolina	187,167,000
Colorado	87,147,000	North Dakota	25,740,000
Connecticut	105,092,000	Ohio	267,112,000
Delaware	29,784,000	Oklahoma	87,018,000
District of Columbia	-	Oregon	112,886,000
Florida	106,806,000	Pennsylvania	315,737,000
Georgia	201,062,000	Rhode Island	22,062,000
Hawaii	-	South Carolina	131,364,000
Idaho	37,665,000	South Dakota	29,784,000
Illinois	244,435,000	Tennessee	121,738,000
Indiana	177,861,000	Texas	538,585,000
Iowa	64,252,000	Utah	50,962,000
Kansas	79,589,000	Vermont	24,845,000
Kentucky	135,132,000	Virginia	191,077,000
Louisiana	131,622,000	Washington	164,111,000
Maine	42,074,000	West Virginia	78,219,000
Maryland	50,354,000	Wisconsin	98,589,000
Massachusetts	144,783,000	Wyoming	24,080,000
Michigan	296,860,000		
Minnesota	75,850,000	American Samoa	10,748,000
Mississippi	132,443,000	Guam	10,980,000
Missouri	141,441,000	Northern Marianas	10,703,000
Montana	31,623,000	Puerto Rico	-
Nebraska	32,343,000	Virgin Islands	9,974,000
Nevada	6,767,000	<b>Total</b>	<b>6,600,000,000</b>

Florida Allocation of QSCB Volume Cap	
District Specific	2009 Allocation
Broward	49,913,000
Dade	104,855,000
Duval	27,220,000
Hillsborough	40,633,000
Lee	12,701,000
Orange	35,824,000
Palm Beach	33,643,000
Pasco	11,028,000
Pinellas	24,352,000
Polk	20,543,000
Volusia	11,941,000
<b>FL Allocated Portion</b>	<b>372,653,000</b>
<b>FL Unallocated Portion</b>	<b>106,806,000</b>
<b>Total FL Volume Cap</b>	<b>479,459,000</b>

# Qualified School Construction Bonds

## *Program Mechanics*

- QSCBs are non-interest bearing obligations issued by a state or local government.
- 100% of the available project proceeds must be spent on the construction, rehabilitation, or repair of public schools or for the acquisition of land for such facilities (may include equipment).
- QSCBs are issued as “principal only” with investors receiving tax credits in lieu of interest on the bonds.
- Although non-interest bearing, QSCBs are subject to a number of tax-exempt bond regulations as well as some special regulations modified by the Act:
  - No more than 2% of the Available Proceeds may be used for issuance costs.
  - Special Spending Rules - 100% of the proceeds must be reasonably expected to be spent in 3-years and a binding commitment from a 3rd party that 10% of the proceeds will be spent in the first 6-months must be in place.
  - Issuer must comply with arbitrage regulations (Section 148 of the code) but special exemptions are granted during the construction period and if sinking funds meet certain requirements.
  - Projects must comply with certain Federal wage rate requirements & labor standards.
- The maximum term of QSCBs is determined by the Treasury.
  - Currently, 16 years.

# Qualified School Construction Bonds

## Tax Credit

- The owner of QSCBs receives a tax credit, rather than receiving interest, if they hold QSCBs on one or more credit allowance dates (March 15, June 15, September 15 and December 15).
- The maximum maturity & credit rate:
  - Determined daily by the Treasury; the credit rate is the rate estimated that will permit the issuance of QSCBs with a specified maturity and redemption features to be sold without a discount or interest cost to the issuer.
  - The details for QSCBs are determined on the date that there is a binding, written contract for sale or exchange of the bond.
- QSCB Tax Credit:
  - The amount of the tax credit is treated as interest and is included in gross income.
  - The annual tax credit is equal to 100% of the product of the credit rate and the outstanding face amount of the bonds.
  - The amount of credit allowance for any quarter cannot exceed 25% of the annual credit allowance.
  - Excess credit allowances can be carried to a succeeding taxable year.
- Tax credits may be stripped from bonds and sold separately.

# Qualified School Construction Bonds Considerations

- The market is not well established (only a couple of financings completed to date). It remains to be seen if investors will accept the U.S. Treasury-set tax credit amount.
  - If not, supplemental coupons, or a discounted price to investors may be required.

U.S. Treasury QSCB Maturity & Rate Table			
Date	Rate	Maturity	PSFY
4/10/2009	7.75%	14 yrs	5.02%
6/16/2009	7.54%	16 yrs	4.66%

- Typically structured as a 15/16 year bullet, but issuers may amortize the bonds through the creation of a voluntary, internal sinking fund, subject to certain restrictions. (yield limitations, level amortization, etc)
- Reimbursement regulations
  - Expenditures must made after 2/17/2009
  - Prior to initial expenditures, issuer must declare its intent to reimburse with QSCB proceeds
  - Not more than 60 days after the original expenditure, issuer must adopt an official reimbursement resolution specifying intent to reimburse from “tax credit obligations”
  - Reimbursement must be made not more than 18 months after original expenditure
  - *May lead to a requirement for a small tax-exempt financing or cash funding a portion of a project*

# Build America Bonds

# Build America Bonds

## Program Overview

- The Build America Bond Program creates two new types of tax subsidy/credit bonds that may be used by municipal issuers as an option for accessing the capital markets.
  - **Issuer Subsidy BABs:** Municipal issuers may sell taxable bonds and *receive a direct tax subsidy* from the U.S. Treasury equaling 35% of the interest on the bonds.
  - **Investor Subsidy BABs:** Municipal issuers may sell taxable bonds and the *investor receives a tax credit* equaling 35% of the interest on the bonds. This credit is transferable from the investor to a third party.
- BAB issuance is limited to calendar years 2009 and 2010.
- BABs may be issued to fund non-private activity, governmental purposes.
- ***The intent of the BAB program is to expand the municipal issuer's reach into the global taxable bond market, enhancing market access and potentially lowering overall borrowing costs versus traditional tax-exempt debt.***

# Build America Bonds

## Subsidy Type Comparison

- At issuance, the issuer must designate the bonds being issued as BABs and must also elect the type of BAB (Issuer Subsidy or Investor Subsidy).
- BABs must follow the same tax regulations as traditional tax-exempt bonds.
  - Premiums are limited under the program to 0.25% multiplied by number of years to maturity.

Summary of Programs		
Build America Bonds		
	Issuer Subsidy	Investor Subsidy
<b>School District Eligible</b>	Yes	Yes
<b>Interest on Bonds</b>	Taxable	Taxable
<b>Use of Funds:</b>		
Construction	Yes	Yes
Working Capital	No	Yes
Refund Existing Debt	No	Yes
<b>Federal Tax Subsidy:</b>		
Benefit to	Issuer	Investor
Amount	35% of Interest	35% of Interest
Form of Subsidy	Direct Subsidy	Tax Credit
Paid on	Interest Payment Date	Interest Payment Date
Securitization Potential	Yes	Yes
<b>Structure:</b>		
Size/Par	No Limit	No Limit
Final Maturity	No Limit	No Limit
Types of Bonds:		
Fixed Rate	Allowed	Allowed
Variable Rate	Allowed	Allowed
Notes	Allowed	Allowed
CABs	Allowed	Allowed

# Build America Bonds Considerations

- While the Act allows for flexibility on the size and structure of BABs, there **MAY BE** *market-driven limitations* regarding size, amortization and call provisions.
  - **Size:** The taxable market has a strong preference for large transactions (over \$250 million).
  - **Amortization:** The taxable market has a strong preference for short, bullet maturities. *Issues that amortize principal throughout the yield curve may be subject to pricing penalties.*
  - **Call Provisions:** Taxable bonds are typically sold as non-callable, or with a make-whole call provision. *Issues structured with a typical municipal call option may be subject to pricing penalties.*
- **Note:** *In recent weeks the market has absorbed a large number of BAB financings and many were small, with serial maturities and traditional call provisions. At the same time the yields are improving when compared to other taxable financings. Generally BABs are most cost effective on later maturities.*

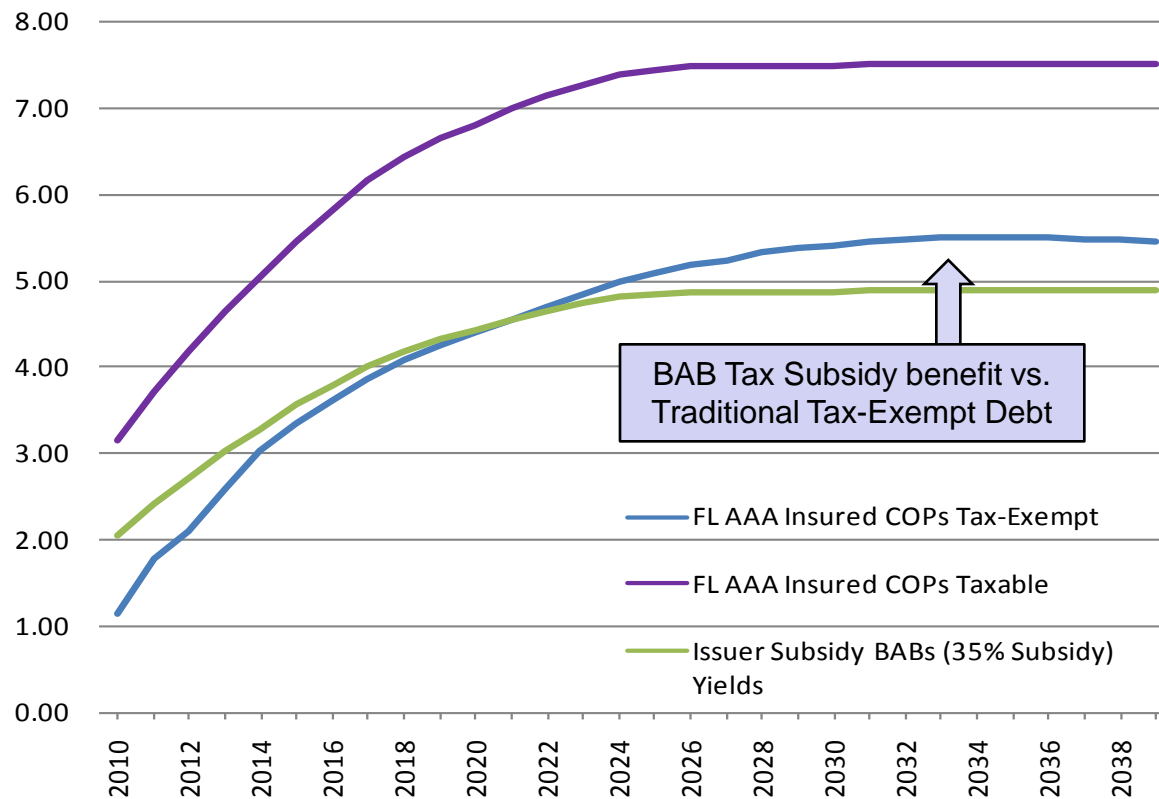
# Build America Bonds

## *Considerations (continued)*

- **Derivatives:** The Act is silent in regards to the use of derivative products.
  - Fixed-Receiver Swaps may provide issuers with a way to achieve cost-effective variable rate exposure when combined with Fixed Rate Issuer Subsidy BABs.
- **Currency:** Certain foreign buyers (Europe) will prefer that the bonds are denominated in local currency.
- **Ratings:** Foreign investors will typically look for a global rating in the “A” or better category.
  - While the switch to a global ratings system is currently on hold at the Rating Agencies, BAB issuance may help Rating Agencies understand the need for global ratings.
- **Marketing:** For larger financings, in order to attract foreign investors, a global marketing strategy must be devised.
  - Credit education is crucial to a successful marketing campaign, as foreign investors are not familiar with U.S. municipal credits.
  - Underwriting syndicate must have global reach.

# Build America Bonds Pricing

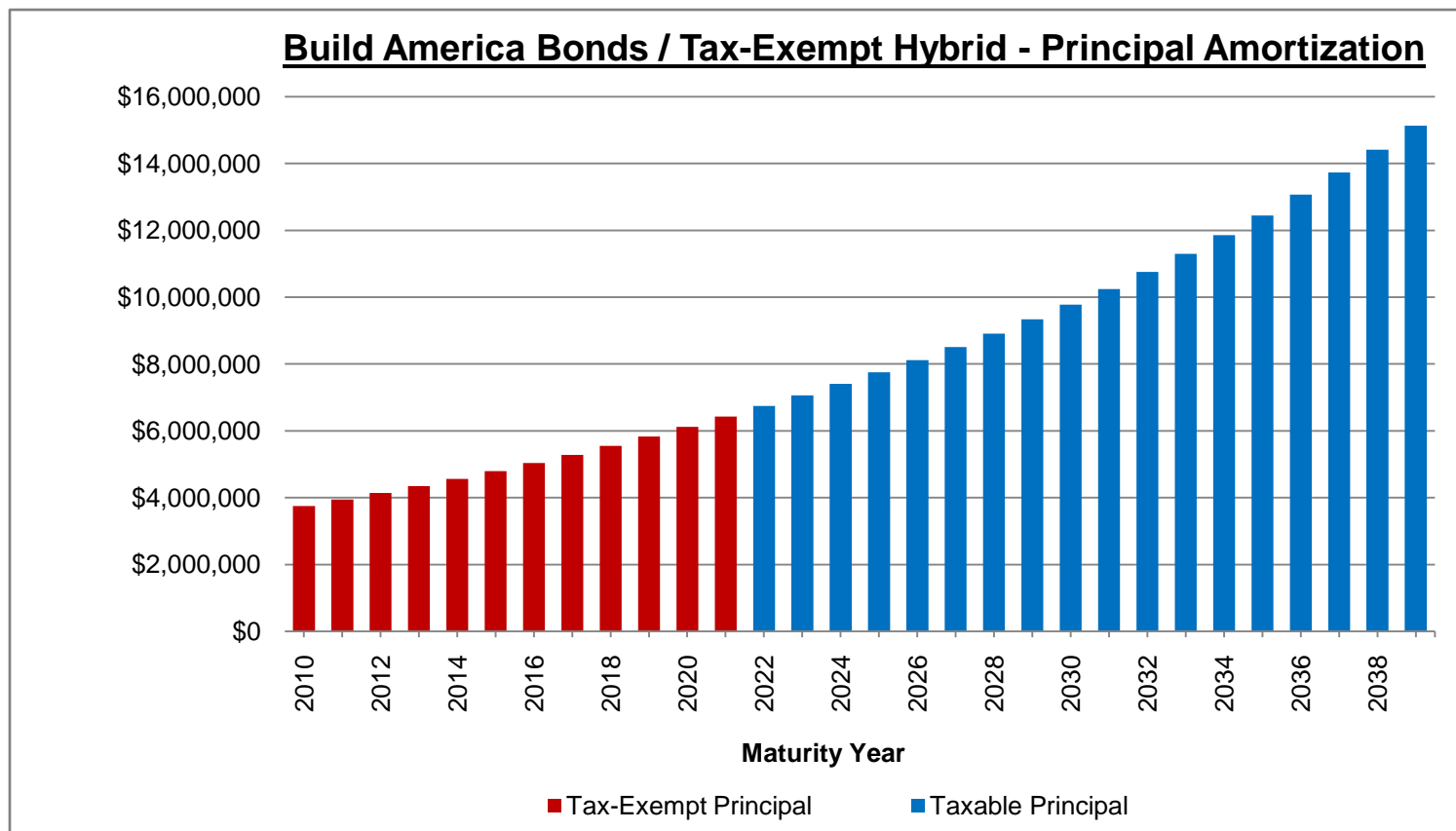
- Issuer Subsidy BABs that are structured according to taxable market preferences may achieve savings versus traditional tax-exempt debt.



# Build America Bonds

## *Principal Amortization*

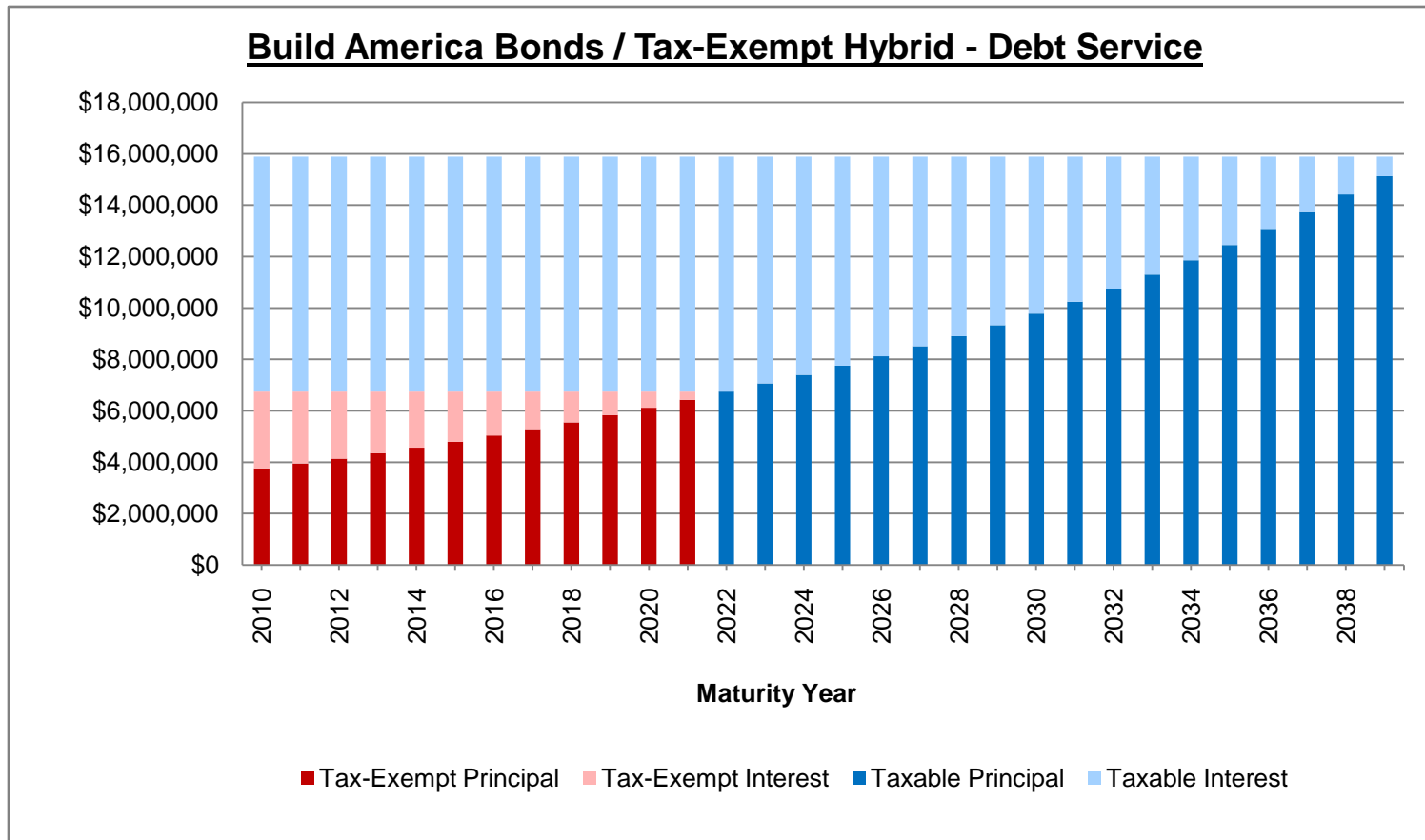
- Issuers may “wrap” BABs around traditional tax-exempt bonds in order to take advantage of the pricing differential on the long end of the yield curve.



# Build America Bonds

## *Level Debt Service*

- Taxable/tax-exempt hybrid structure can be crafted to result in level aggregate debt service.



# Build America Bonds

## Market Update

- **Buyers** – Investment grade, corporate bond funds have been loading up on BABs due to historically lower municipal default rates and higher risk adjusted returns.
- **Size** – to date, there has been wide acceptance of BABs of all sizes ranging from less than \$1 million to \$5 billion.
- **Structure** – terms have been more favorable than initially suggested by underwriters.
  - Serial bonds & amortizing term bonds vs. long dated bullet maturities
  - Traditional 10-year par calls vs. make whole calls (primarily for issues less than \$100 million)
  - No appreciable yield penalty for credits rated below “AA/Aa”

# Case Study

## Broward Schools

# QSCB/BAB Case Study

## *Broward County School Board*

- **Background** – PFM advised the District to accelerate approval of its June 2009 financing to December /January to give staff flexibility to managing market timing given market instability. Board authorized \$135 million COP financing late in the fall. Insurance, ratings and all documents completed in January.
- Congress began discussion of special allocations for school districts. This, combined with market deterioration led to PFM recommending to “pull” the deal from the market in February.
- **Revised Plan of Finance** – In order to take advantage of QSCB authorization (\$49 million in 2009) and the potential efficiencies of BABs, PFM recommended that the District amend its authorization to include all three financing structures.

# QSCB/BAB Case Study

## Reimbursement Analysis

### THE SCHOOL BOARD OF BROWARD COUNTY, FLORIDA COPs SERIES 2009

Facilities	Project Description	Estimated Total Project Cost	All Actual Expenses as of May 20	Actual Expenses Prior to February 17	Actual Expenses Prior to May 5	Commitments (Open PO's) as of May 20	Total Expenses/Comm
AC Perry	New Cafeteria	2,120,000	2,600	2,600	-	-	2,600
Banyan ES	New Media Center	2,725,000	11,790	2,600	7,327	-	11,790
Blanche Ely HS	Physical Education Center	10,900,000	10,848	2,700	8,148	-	10,848
Harbordale ES	Classroom Addition Program	2,075,214	3,737	2,700	1,037	729,572	733,309
Lloyd Estates	Media Center	2,725,000	24,100	2,600	21,500	46,217	70,317
Northeast HS	Swimming Pool Complex	5,450,000	2,265	1,900	365	3,606,597	3,608,862
Palmview ES	Kitchen Cafeteria	8,374,000	2,700	2,700	-	-	2,700
Parkway MS	Replacement - Phase 1 (Classroom, Gym)	27,250,000	231,838	3,250	227,106	174,254	406,092
Pines Lakes ES	Classroom Addition	5,617,581	286,149	2,600	219,559	81,638	367,787
PPO Zone 4	New Maintenance Office	5,212,189	148,935	40,475	108,460	4,184,975	4,333,909
Seagull Center	Media Center	3,813,161	4,763	2,600	-	2,000	6,763
Walker ES	Kitchen / Cafeteria	7,199,520	3,250	3,250	-	6,397,771	6,401,021
	<b>SUBTOTAL</b>	<b>83,461,666</b>	<b>732,975</b>	<b>69,975</b>	<b>593,502</b>	<b>15,223,023</b>	<b>15,955,998</b>

QSCB Eligible	BAB Eligible	TE Funded
2,117,400	2,117,400	2,600
2,713,210	2,722,400	2,600
10,889,152	10,897,300	2,700
1,341,905	2,072,514	2,700
2,654,683	2,722,400	2,600
1,841,138	5,448,100	1,900
8,371,300	8,371,300	2,700
26,843,908	27,246,750	3,250
5,249,794	5,614,981	2,600
878,280	5,171,714	40,475
3,806,398	3,810,561	2,600
798,499	7,196,270	3,250
67,505,667	83,391,691	69,975

# QSCB/BAB Case Study

## Broward County School Board

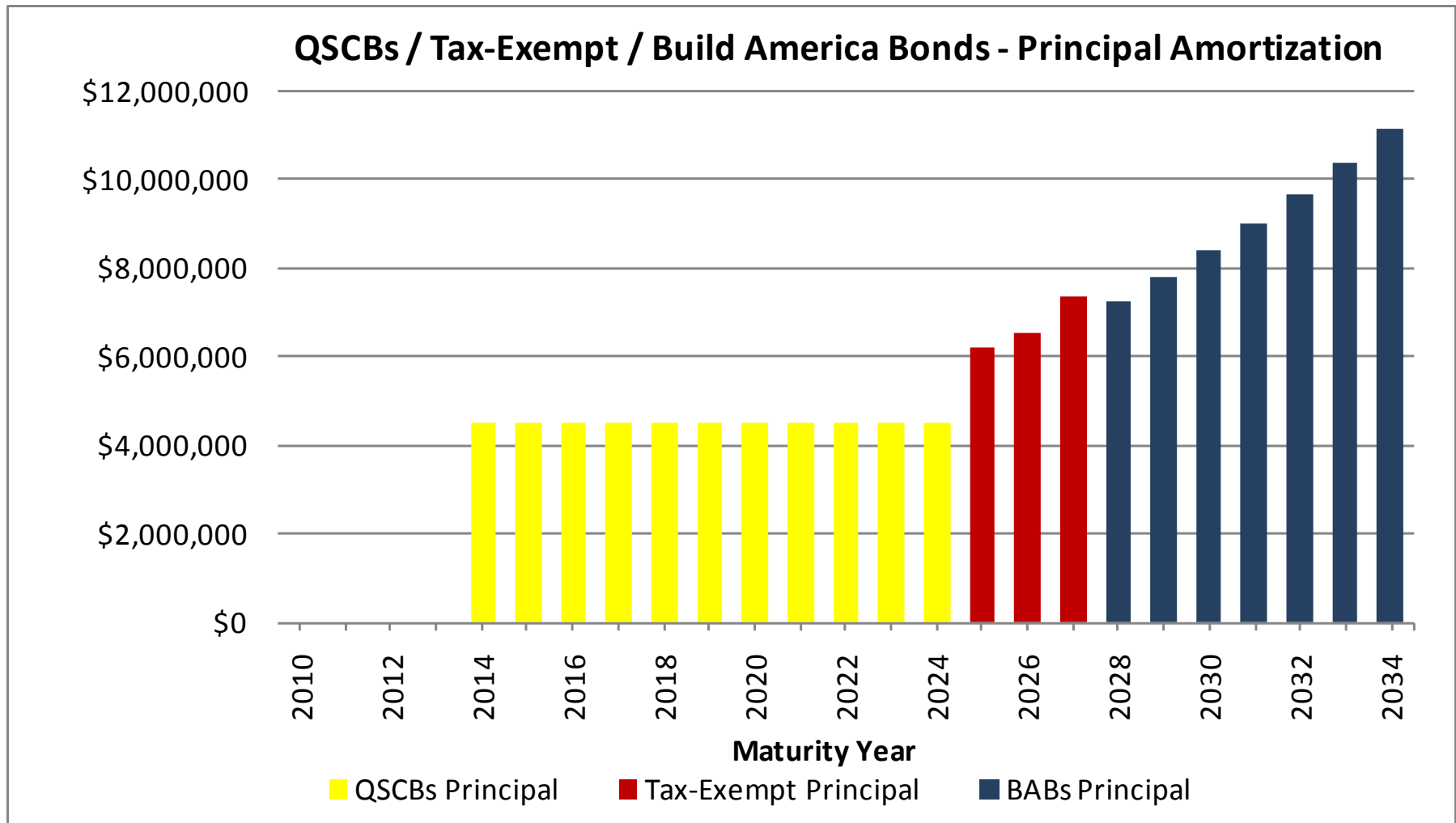
- **Implementation** – PFM separated the process into the \$49 million QSCB and the remaining \$80 million funded by either BABs or traditional tax-exempt COPs.
  - QSCB – PFM evaluated underwriter proposals and solicited separate concepts to privately place the QSCB. PFM was able to draw on a wide range of concepts and used competition to lock in a price at “par” without any onerous conditions (stripping away credits, etc).
  - Tax Exempt versus BAB – Concurrent with the QSCB process, PFM’s pricing desk worked to develop strategies to minimize/eliminate “make whole” call provisions, large block size requirements and bullet maturities. This enabled the District to make an apples-to-apples comparison between BABs and tax-exempt COPs.
- **COP Sale** – On June 17<sup>th</sup>, the District closed:
  - (i) privately placed \$49 million as a QSCB,
  - (ii) \$20 million in tax-exempt COPs for projects that were not eligible for QSCB/BABs, and
  - (ii) \$64 million in taxable “BABs”. Recent market spreads for COPs were 130bps to 160bps over MMD. The BABs sold at a net spread of 30bps over MMD(after taking into account the interest subsidy payments).
  - Tax exempt portion was required because certain expenditures were not eligible and/or occurred prior to authorized dates.
- **Savings** – The net savings to the District is approximately \$20 million.

# Build America Bonds Pricing

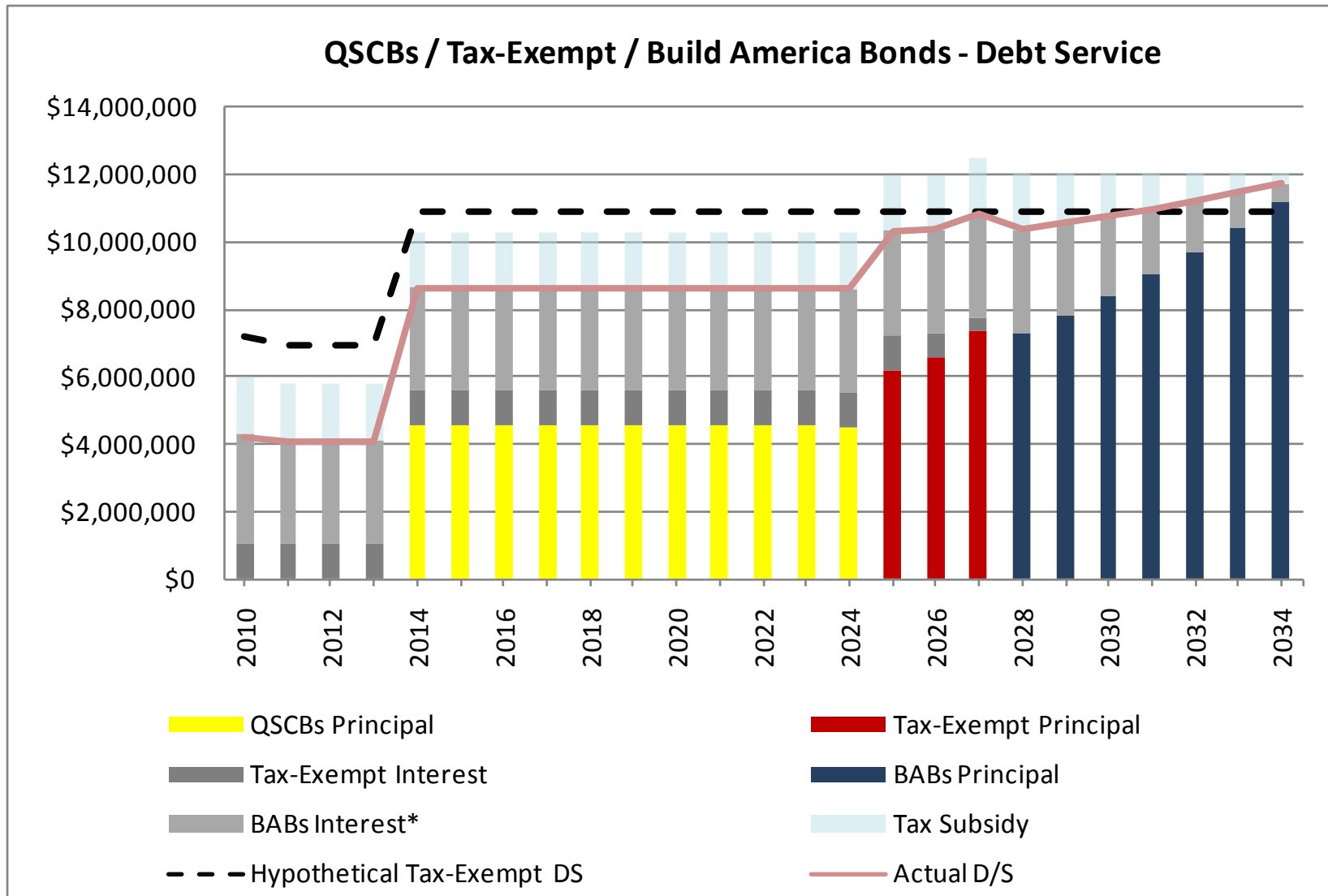
Issuer	School Board of Broward County									
Sale Type	QSCBs			Tax-Exempt			BABs			
Par	\$49,913,000			\$20,140,000			\$63,910,000			
Insurance				Assured Guaranty						
Underwriter/ Placement Agent	Bank of America Capital Corp			Merrill Lynch			Merrill Lynch			
<u>Maturity</u>	<u>Yield</u>	<u>MMD</u>	<u>Spread</u>	<u>Yield</u>	<u>MMD</u>	<u>Spread</u>	<u>Yield</u>	<u>Yld.</u>	<u>MMD</u>	<u>Spread</u>
7/1/2014	0.00%	2.02%	-2.02%							
7/1/2015	0.00%	2.22%	-2.22%							
7/1/2016	0.00%	2.42%	-2.42%							
7/1/2017	0.00%	2.62%	-2.62%							
7/1/2018	0.00%	2.82%	-2.82%							
7/1/2019	0.00%	3.01%	-3.01%							
7/1/2020	0.00%	3.18%	-3.18%							
7/1/2021	0.00%	3.31%	-3.31%							
7/1/2022	0.00%	3.44%	-3.44%							
7/1/2023	0.00%	3.57%	-3.57%							
7/1/2024	0.00%	3.70%	-3.70%							
7/1/2025				5.15%	3.82%	1.33%				
7/1/2026				5.27%	3.94%	1.33%				
7/1/2027				5.37%	4.04%	1.33%				
7/1/2034							7.47%	4.86%	4.56%	0.30%

# Broward Schools 2009 COP

## Principal Amortization



# Build America Bonds Debt Service Breakdown



•BABs Interest net of 35% tax subsidy

# Broward Schools 2009 COP

## Benefit Analysis

- The combination of QSCBs, BABs, and traditional tax-exempt COPs provided an estimated \$20 million savings (\$15 million present value) to Broward Schools.

Issuance Comparison		
	Traditional Tax-Exempt Bonds	Broward Schools COPs, Series 2009A
<b>Total Par</b>	\$134MM	\$134MM
<b>Term</b>	25 years	25 years
<b>Issuer Subsidy</b>	None	35% Tax Credit
<b>Structure</b>	Tax-Exempt \$134MM Level DS: 2014-2034	QSCBs \$49.9MM Level DS: 2014-2024 Tax-Exempt \$20.1MM Level DS: 2025-2027 BABs \$63.9MM Term Bond 2034 (2028-2034)
<b>Scale</b>	Tax-Exempt AAA MMD (6/4/09)	Tax-Exempt AAA MMD (6/4/09) Taxable AAA MMD x 65% (6/4/09)
<b>Avg. Life</b>	17.05 years	16.96 years
<b>TIC</b>	5.43%	5.21%
<b>All-in TIC</b>	5.60%	3.80%
<b>Total Net Debt Service</b>	\$257,351,056	\$237,963,566
<b>Present Value of Debt Service <sup>1</sup></b>	\$159,657,889	\$144,532,067
<b>Savings to Issuer</b>	N/A	\$15,125,822 (11.28% of Par)

(1) Debt Service present valued at 3.80% (All-in TIC of Series 2009A COPs)