

Qualified School Construction Bonds: One School District's Experience

By Lisa Zimmerman Morstad, Ed.D., CPA



Qualified school construction bonds, or QSCBs, are part of the American Recovery and Reinvestment Act of 2009. These bonds allow school districts to finance capital projects at no or very low interest rates.

In a nutshell, bondholders accept a lower interest rate because the corresponding federal tax credit they receive subsidizes that lower interest rate. The program was designed to stimulate building projects in a construction market where business was declining.

The program's cost to the federal government is debatable, as projects are made possible through this financing strategy that may not have been possible otherwise. The program also stimulates the local economy by bringing large-scale building projects to communities that benefit the job market and that bring in income and sales tax revenues.

QSCB in Fayetteville

The Fayetteville School District in Fayetteville, Arkansas, recently participated in the QSCB program. In July 2009, the district applied through the state of Arkansas for \$60 million in QSCBs. The application process was completed

with help from the district's financial adviser, and was approved by the school board for submission to the state.

The appropriation was originally considered part of a funding strategy that included a proposed new millage levy to build a \$113 million high school campus. Timing was an issue for this particular project, as the district's QSCB application would not be officially considered until after the related millage election. This circumstance meant that the campaign's financial "marketing" strategy for the bonds could only include language that would use this program to shorten the payback time line of the debt for the project if the allocation was officially received.

Unfortunately, the millage campaign failed by a 60% to 40% margin. On September 24, 2009, the Fayetteville School District received official word that it had received \$52.3 million of Arkansas's \$113 million allocation, or 46% of the state's 2009 QSCBs.

In an effort to retain the QSCB allocation, the district developed a scaled-down version of its high school plan and proposed making needed additions and renovations to a high school that was built in 1952. The revised funding strategy included restructuring existing debt to partially fund an elementary school with \$7 million of the QSCBs and leaving the remaining \$45 million for the high school renovation project.

The revised QSCB financing structure was "wrapped" around the district's existing debt to take advantage of decreases in future annual debt service payments due to payoff of the existing debt. The strategy used a 17-year amortization of the new QSCB debt based on the current maturity limits for paying off QSCBs. (For current variables, visit www.treasurydirect.gov and click on **Get Interest Rate Data** under **Government**.)

The district went to the market on January 18, 2010, and received a bid of 2.15% for the package of \$52.3 million. Using a 17-year QSCB compared to an estimated municipal bond interest rate of 4.5%, the estimated interest savings to the district and local taxpayers is approximately \$10 million.

QSCBs use a sinking fund approach in which proceeds can earn interest up to an amount determined by the fed-

eral government, called a permitted sinking fund yield. This permitted sinking fund yield improves the savings to the district and taxpayers when combined with the decreased interest rate by lowering the annual sinking fund payment each year.

Bondholders accept a lower interest rate because the corresponding federal tax credit they receive subsidizes that lower interest rate.

District payments for the QSCBs will be made by using a combination of budget cuts, existing capital reserves for short-term cash flow, and leveraging decreases in annual payments in future years due to the payoff of existing debt. The school district also underwent a review by Moody's Investors Service to improve its credit rating before taking the bonds to market. The improved credit rating of Aa3 (prior rating of A1 enhanced) was believed to be valuable in the bidding process.

The district has plans to apply for additional QSCBs in 2010 as part of a financing strategy for phase two of the high school campus renovation project. Combining the advantages of QSCBs with economies of scale and synergies in the construction process could present opportunities to maximize savings to the district's patrons.

The district anticipates higher competition for the state's 2010 allocation of QSCBs as demand from school districts for this financing vehicle increases. Because of the increased interest, the phase two proposal will most likely use a combination of QSCBs and traditional tax-exempt bonds to finance the remaining plan. Low construction costs and availability of labor have resulted in a large increase in the bidding pool for school construction projects.

Opportunities for Other Districts?

Although the Fayetteville School District can make the necessary budgetary adjustments to take advantage of this program, many smaller or less affluent school districts might have trouble doing so. To counteract this problem, some states are considering administering the bonds at the state level. Using this approach, districts that the state deems to have the biggest need can use the funds. State building programs can handle QSCBs and the related payback plans. West Virginia is one of the states that have implemented this strategy.

Unfortunately, QSCBs have run into some snags on the investor side (Cohen 2010). To date, the number of

successful sales of QSCBs is not as large as originally estimated. Critics of the program claim that the federal government has set the effective interest rate on the bonds too low, which results in problems for school districts that have gained voter approval or that have based financing strategies on interest rates lower than they obtained.

Without improvements in the program for 2010, billions of dollars in available bonds for school districts may not be issued. Such an outcome would be a disappointing loss for school districts that are unable to access what many call a once-in-a-lifetime opportunity to save on school facility costs.

Reference

Cohen, J. 2010. What's happening with ARRA's qualified school construction bonds? Ed Money Watch: A Blog from New America's Federal Education Budget Project. New America Foundation, January 21.

http://edmoney.newamerica.net/blogposts/2010/what_s_happening_with_arra_s_qualified_school_construction_bonds-26567.

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NEIL SULLIVAN CHANGES COURSE



Neil Sullivan, RSBO, executive director for finance for Spokane (Washington) Public Schools, will retire from public school service in Spokane and Washington State on June 30 and take on a new position as the executive director for finance for Portland (Oregon) Public Schools.

"We will certainly miss his financial expertise and also miss him as a wonderful person," according to Mark E. Anderson, associate superintendent for school support services in Spokane.

Sullivan is a familiar face to ASBO members. A member of the association since 1986, he is a past member of the ASBO Board of Directors and has served on a variety of committees, including the Accounting, Auditing, and Budgeting Committee, the School Food and Nutrition Management Committee, the Professional Development Committee, the School Finance Committee, the Election Committee, and the Bylaws Committee.

In addition, Sullivan has been involved with the Certificate of Excellence and Eagle Awards programs, and received the Eagle Award for Outstanding Service to the Community in 1997.

Sullivan has been equally as active with the Washington Association of School Business Officials, serving as both president (1992) and vice president (1991).