

May 29, 2009

Dear Chief State School Officers:

I am pleased to inform you about the authorization of Qualified School Construction Bonds (QSCBs) and Build America Bonds (BABs) and the extension of Qualified Zone Academy Bonds (QZABs). The authorizations provide Federal subsidies for public school improvement and modernization activities. The *American Recovery and Reinvestment Act of 2009* (ARRA) makes QSCBs and BABs available for the first time, while extending and expanding the authority for QZABs. QZABs provide funding for school repairs and renovation and certain other activities for eligible schools and may not be used for new construction, while QSCBs and BABs provide funding for new construction as well as renovation.

Charter schools as well as traditional public schools may benefit from all of these types of bonds. I encourage you to consider serving charter schools through these programs.

You may use all three of these types of bonds to modernize buildings and convert obsolete non-school buildings into modern school facilities. I encourage you to design energy-efficient school facilities that meet widely recognized rating systems for green buildings. Please also consider ways these bonds can improve communities in general. For instance, some local educational agencies (LEAs) have designed school facilities in a manner intended to facilitate their serving as centers of their communities that are available for non-school purposes outside of regular school hours. Particularly in a time of economic difficulty, making school facilities go further by designing and providing them for multiple uses makes eminent sense.

The benefit of all of these programs is that they help LEAs save money and make their repair, renovation, or construction dollars go further. Purchasers of QSCBs and QZABs receive a Federal income tax credit. The U.S. Treasury Department establishes State allocation limits and sets a tax-credit rate for the QSCB and QZAB bond programs that, on average, equals the amount of interest schools would ordinarily pay on debt. With the Federal Government covering most or all of the interest on the bonds, LEAs receive a substantial benefit as interest payments typically equal approximately 50 percent of the economic cost of a bond.

The ARRA makes available, to States and certain large LEAs, \$11 billion for 2009 and \$11 billion for 2010 in QSCB bonding authority for construction, rehabilitation, or repair of a public school facility and for the acquisition of land on which the school facility is to be constructed with QSCB funds. (An additional \$200 million in each of those years goes to the Department of the Interior for assistance to schools operated or supported by the Bureau of Indian Education.) The QSCB bond allocation authority generally goes to States (not necessarily State educational agencies) based on their shares of Title I Basic Grant funds under the Elementary and Secondary Education Act (ESEA). The District of Columbia and possessions of the United States also receive these allocations. Possessions other than Puerto Rico, however, receive their shares of the QSCB bonding authority based on their share of the population below the poverty line. Forty percent of the national QSCBs bonding authority goes directly to the 100 LEAs with the largest number of school-aged children living below the poverty line. The designated LEAs receive this bond allocation in proportion to their share of ESEA Title I Basic

Grant funds. States with LEAs that receive bond allocations directly from the Federal Government receive a reduced direct allocation.

BABs are bonds that can be used to finance a wide range of projects, including construction and modernization of school facilities. The BABs program allows municipal bond issuers in 2009 and 2010 to offer an unlimited amount of taxable debt and to elect either to receive a cash subsidy from the Federal Government or to provide bondholders with a tax credit. Both the payment and the tax credit would be equal to 35 percent of the interest paid on the bonds. BABs can assist public postsecondary institutions in addition to LEAs.

QZABs are another important tool that States and LEAs can use to provide additional resources for improving school facilities and instruction. The ARRA extends QZABs through 2010. As you may know, QZABs were first authorized in 1997 and are bonds the Federal Government subsidizes by allowing bondholders to receive tax credits that are approximately equal to the interest that States and communities would pay holders of taxable bonds. As a result, issuers are generally responsible for repayment of just the principal. QZABs may now be purchased by any individual or private business.

States and LEAs have considerable flexibility in the use of QZABs. They may be used for rehabilitating or repairing school facilities, purchasing equipment, developing curricula, and training school personnel, but not for new construction. To meet QZAB eligibility criteria, a public school must be located in either an Empowerment Zone or an Enterprise Community or have at least 35 percent of its students eligible for free or reduced-price lunch under the Federal lunch program (National School Lunch Act). The school must also have an education program designed in cooperation with business; receive a private contribution (which may be in-kind), the net present value of which is not less than 10 percent of the proceeds of the bond; and have an education plan that is approved by its LEA; and its students must be subject to the same standards and assessments as other students in the LEA.

As the following chart shows, previously authorized QZABs are still available. However, unused funds from the 2007 allocations will expire at the end of this year and, to make use of these allocations, States or municipalities must issue the bonds by December 31, 2009. If a State does not issue the amount of QZABs allocated by the Federal Government between the calendar year the funds are first made available and the date by which they must be issued, the unused QZAB allocation expires and cannot be used.

QZABs Amount	Calendar year first available	Bonds must be issued by December 31 of the year
\$400 million	2007	2009
\$400 million	2008	2010
\$1.4 billion	2009	2011
\$1.4 billion	2010	2012

On April 3, 2009, the Treasury Department issued 2008 and 2009 State allocations of QZABs bonding authority and 2009 allocations of QSCBs bonding authority for the States and the 100 large LEAs. I am enclosing those tables for your information. I am also enclosing a Fact Sheet prepared by our Department on these bond programs.

If you have questions about this information or these programs, please contact Branch 5 of the Internal Revenue Service, Office of Associate Chief Counsel/Financial Institutions and Products, at 202-622-3980 or Jane Hess of the U.S. Department of Education at 202-401-8292. I am confident that these bonds can help your communities meet some of their facility needs.

Sincerely,

/s/

Arne Duncan

2 Attachments Follow

AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

Qualified School Construction Bonds and Qualified Zone Academy Bonds

The American Recovery and Reinvestment Act of 2009 (ARRA) authorized tax-credit bonds for school construction by expanding Qualified Zone Academy Bonds (QZABs) from \$400 million annually to \$1.4 billion for each of calendar years 2009 and 2010 and authorizing \$11.2 billion in Qualified School Construction Bonds (QSCBs) for the first time. QZABs provide tax credits primarily for school renovation and may not be used for new construction, but QSCBs provide tax credits for new construction as well as renovation.

The U.S. Treasury Department establishes State allocation limits and sets a tax-credit rate for both of these bond programs that, on average, equals the amount of interest schools would ordinarily pay on debt. Since the Federal Government covers most or all of the interest on these bonds, local educational agencies (LEAs) receive a substantial benefit, as interest payments may typically equal up to 50 percent of the economic cost of a bond.

In addition to QZABs and QSCBs, the ARRA contains other provisions regarding tax-exempt debt and tax-credit programs that entities may use to finance construction of school facilities as well as other types of facilities. Build America Bonds (BABs), for example, are taxable bonds that can be used to finance a wide range of projects for governmental purposes. This BABs program allows municipal bond issuers in 2009 and 2010 to offer an unlimited amount of taxable debt and to elect either to receive a cash subsidy from the Federal Government or have it provide bondholders with a tax credit. Either the payment or the tax credit would be equal to 35 percent of the interest paid on the bonds. BABs can assist public postsecondary institutions in addition to LEAs. The Treasury Department's recent guidance on this new program can be found at <http://www.irs.gov/pub/irs-drop/n-09-26.pdf>.

The benefit of all of these school construction financing tools is that they can help State and local governments save money and make their repair, renovation, modernization, or construction funds go further.

Basic Facts about Qualified School Construction Bonds

Under this new category of tax-credit bonds, the Treasury Department distributes \$11 billion of the bond allocation in both 2009 and 2010 among the States and certain large LEAs. QSCBs are bonds the Federal Government subsidizes by allowing bondholders to receive tax credits that are approximately equal to the interest that States and communities would pay holders of taxable bonds. As a result, issuers are generally responsible for repayment of just the principal. States may directly issue the bonds on behalf of eligible schools or they may suballocate authority to issue the bonds within the State.

- QSCB allocations go to States (not necessarily State educational agencies) based on their share of Title I Basic Grant funds. The District of Columbia and possessions of the United States also receive these allocations. Possessions other than Puerto Rico, however, receive their shares of the QSCB bonding authority based on their share of the population below the poverty line. States with LEAs that receive bond allocations directly from the Federal Government receive a reduced allocation as a result of the allocations described in more detail below.
- 40 percent of the national QSCB bonding authority goes directly to the 100 LEAs with the largest number of school-aged children living below the poverty line.^[1] The designated LEAs receive this bond allocation in proportion to their shares of Title I Basic Grant funds. An LEA in this category that receives a direct allocation may reallocate any of its unused QSCB allocations to its State.
- If an allocation to a State is unused for a calendar year, the State may carry it forward to the next calendar year. In other words, States have up until the end of 2010 to use their 2009 allocation and until the end of 2011 to use their 2010 allocation.
- In addition to the amounts described above, the Department of the Interior/Bureau of Indian Affairs receives \$200 million annually in QSCB authority for its school facilities in 2009 and 2010. Indian tribal governments are qualified issuers.

QSCBs are less restrictive in their uses than QZABs. For a QSCB bond that is issued by a State or local government where a public school is located, 100 percent of available project proceeds must be used for the construction, rehabilitation, or repair of the public school facility. In addition, a portion of the proceeds of such a bond may be used for the acquisition of land on which a public school facility is to be constructed.

QSCBs may be purchased by any individual or private business, and used to generate a tax credit against the individual's or entity's Federal income taxes. The Department of the Treasury

recently issued initial guidance for the program, which is posted at: www.irs.gov/pub/irs-drop/n-09-35.pdf, that reports the allocation of the annual bond volume among the States and the 100 largest LEAs.

Basic Facts about Qualified Zone Academy Bonds

QZABs were first authorized in 1997 and are bonds the Federal Government subsidizes by allowing bondholders to receive tax credits that are approximately equal to the interest that States and communities would pay holders of taxable bonds. As a result, issuers are generally responsible for repayment of just the principal. The Treasury Department allocates the authority to issue these bonds to States based on their proportion of the U.S. population living below the poverty line. States may directly issue the bonds on behalf of eligible schools or they may suballocate authority to issue the bonds within the State. These bonds may be used only on behalf of schools or programs that:

- are located in an Empowerment Zone or an Enterprise Community; or
- have a reasonable expectation (as of the date of the bond issuance) that at least 35 percent of their students will be eligible for free or reduced-cost lunches under the National School Lunch Act.

To benefit from a QZAB, an eligible school must also:

- have an education program designed in cooperation with business;
- receive a private contribution (which may be in-kind), the net present value of which is not less than 10 percent of the proceeds of the bond;
- have an education plan that is approved by its LEA; and
- subject its students to the same standards and assessments as other students in the LEA.

QZABs may not be used for new construction but may be used for the following activities:

- renovating and repairing buildings;
- investing in equipment and up-to-date technology;
- developing challenging curricula; and
- training quality teachers.

In past years, QZABs could be purchased only by banks, insurance companies, and other companies engaged in the business of lending money. Effective October 2008, however, QZABs may be purchased by any individual or private business. The Department of the Treasury has issued recent guidance for the extended program available at: <http://www.irs.gov/pub/irs-drop/n-09-30.pdf>. Existing ED guidance on QZABs is available at: www.ed.gov/programs/qualifiedzone/faq.html.

TABLES FOR STATE ALLOCATIONS OF QUALIFIED SCHOOL CONSTRUCTION BONDS:

**2009 Allocations to States of Volume Cap for
Qualified School Construction Bonds**

(Net of Allocations to Large Local Educational Agencies)

State/Territory	Total Allocation by State/Territory
Alabama	118,776,000
Alaska	29,784,000
Arizona	186,292,000
Arkansas	113,443,000
California	773,525,000
Colorado	87,147,000
Connecticut	105,092,000
Delaware	29,784,000
District of Columbia	0
Florida	106,806,000
Georgia	201,062,000
Hawaii	0
Idaho	37,665,000
Illinois	244,435,000
Indiana	177,861,000
Iowa	64,252,000
Kansas	79,589,000
Kentucky	135,132,000
Louisiana	131,622,000
Maine	42,074,000
Maryland	50,354,000
Massachusetts	144,783,000
Michigan	296,860,000
Minnesota	75,850,000
Mississippi	132,443,000
Missouri	141,441,000
Montana	31,623,000
Nebraska	32,343,000
Nevada	6,767,000
New Hampshire	29,784,000
New Jersey	223,279,000
New Mexico	64,602,000
New York	192,049,000
North Carolina	187,167,000
North Dakota	25,740,000
Ohio	267,112,000
Oklahoma	87,018,000
Oregon	112,886,000

State/Territory	Total Allocation by State/Territory
Pennsylvania	315,737,000
Rhode Island	22,062,000
South Carolina	131,364,000
South Dakota	29,784,000
Tennessee	121,738,000
Texas	538,585,000
Utah	50,962,000
Vermont	24,845,000
Virginia	191,077,000
Washington	164,111,000
West Virginia	78,219,000
Wisconsin	98,589,000
Wyoming	24,080,000
American Samoa	10,748,000
Guam	10,980,000
Northern Marianas	10,703,000
Puerto Rico	0
Virgin Islands	9,974,000
Total	6,600,000,000