

Qualified Zone Academy Bonds

October 9, 2013

Summary Overview

Section 26 of the Taxpayer's Relief Act of 1997—codified into Section 1397E of the U.S. Internal Revenue Code—provides a financial tool that can be used by State Education Agencies to encourage formation of partnerships between public schools and local businesses. The Act provided \$400 million of bond authority cap in 1998 through 2008, \$1.4 billion for 2009 and 2010, and \$400 million for 2011, 2012, and 2013 for the issuance of Qualified Zone Academy Bonds (QZAB's). These partnerships with local businesses are to:

- Enhance the academic curriculum;
- Increase graduation and employment rates; and
- Better prepare students for the rigors of college and the workforce.

In addition,

- Schools must be located in an Empowerment Zone or Enterprise Community or;
- There is a reasonable expectation—as of the date of bond issuance— that at least 35% of the students will be eligible for free or reduced cost lunches under the school lunch program established under the National School Lunch Act.

QZAB's are an unusual financial instrument that provide a different form of subsidy from traditional tax-exempt bonds that school districts or public charter schools might issue. Under this program, the State receives an allocation from the US Department of Education, the Internal Revenue Service or the Rural Housing Service of the U.S. Department of Agriculture¹. School districts seek an allocation from the State in the amount of a loan that

¹Utah's 1998 allocation was \$1.576 million; the 1999 allocation was \$1.952 million; the 2000 allocation was \$2.063 million, the 2001 allocation was \$1.406 million, the 2002 allocation was \$2.537 million and the 2003 allocation was \$2.727 million. A total of \$5,151,722 was issued by three school districts (Salt Lake—\$4,727,722, South Sanpete—\$424,000 encumbered but never issued, and Washington—\$424,000) on August 17, 2000. All of the 1998 and 1999 funds and up to \$862,278 of the 2000 funds were issued. The balance of the 2000 allocation (\$1,200,722) should have been issued by December 31, 2002, it expired and was lost; the 2001 allocation of \$1.406 million should have been issued by December 31, 2003, it also expired and was lost. The 2002 allocation of \$2.537 million and \$963,000 of the 2003 allocation was issued by Duchesne School District on June 18, 2004. The balance of the 2003 allocation (\$1.764 million) plus the entire 2004 allocation of \$2.495 million and \$1.738 million of the \$2.25 million allocation for 2005 was allocated to Uintah School District on December 21, 2005; the total of \$5.997 was issued on December 29, 2005. The balance of the 2005 QZAB allocation—\$512,000 plus the 2006 allocation of \$2,381,000 as well as the 2007 allocation of \$2,381,000—a grand total of \$5,274,000—was allocated to Ogden City School District on February 21, 2007. Utah's 2008 cap authority was \$2,512,000 and the 2009 cap was \$8,792,000—for a total of \$11,304,000 and was awarded to Ogden School District on August 17, 2009. Utah's 2010 cap authority was \$8,931,000 and was awarded to Ogden School District on June 1, 2010. The Utah 2011 cap authority is \$2,872,000 and was awarded to Ogden School District.

they pay back over several years². A local financial institution purchases the bond; the interest on the bond may be “paid” by the federal government in the form of annual income tax credits to the financial institution that holds the bond, and for the 2009 and 2010 allocations, the Act allowed direct subsidy payment to be made to the issuer. The amount of the direct subsidy payment to the issuer is equal to the lesser of:

1. The interest payable on the QZAB on each interest payment date; or
2. The amount of interest that would be payable on the QZAB if the credit rate published by the Secretary of the Treasury on the sale date of the QZAB were the interest rate on the bond.

School districts and public charter schools are still responsible to repay the bond principle, but the interest is usually very low to nothing.

In addition, the school district or public charter school must also enter into an agreement with one or more local business(es) under which the business(es) agree(s) to contribute at least ten percent of the value of the bond to the school. Eligible contributions include:

- Equipment for use in the school (state-of-the-art technology and CTE equipment);
- Technical assistance in developing curriculum or in training teachers to promote appropriate market-driven technology in the classroom;
- Employees’ services as volunteer mentors;
- Internships, field trips, or other educational opportunities outside the academy; or
- Any other property (including cash) or services specified by the eligible education agency.

Eligible schools must be located in an Empowerment Zone (EZ) or an Enterprise Community (EC), or expect to have at least 35 percent or more of their students eligible for free or reduced lunch under definitions in the National School Lunch Act.³

Proceeds for QZABs can be used for:

- Rehabilitating or repairing the public school facility in which the program is established;
- Providing equipment for use in the program;
- Developing course materials for education to be provided by the program; and,
- Training teachers and other school personnel in the program.

The amount of the bond, the term of the loan, and interest rates are negotiable, depending on the amount of indebtedness the LEA has already incurred, the LEA’s

²The term of the loan cannot be longer than a net present value of 50 percent of the face amount of the bond for interest–this translates to about 14 years, based on current interest rates.

³There is only one Enterprise Community (Ogden City) and no Empowerment Zones in Utah at this time. There are however 500 schools in Utah which had 35 percent or more students eligible for free or reduced lunch [as of October 2012]. Go to the USOE Child Nutrition web site at <http://www.schools.utah.gov/cnp/Free-and-Reduced-Price-Survey.aspx> and click on “Current and previous year’s October surveys” to view a complete history of free and reduced price lunch surveys.

bond rating and market conditions at the time of bond closing. The maximum term of the indebtedness, about 14 years under current market conditions, is set so that the LEA's obligation to repay in present value terms will be 50 percent of the borrowed amount.

More QZAB Information

QZAB Eligible Purposes:

- Rehabilitating or repairing the public school facility in which the educational program is established;
- Providing equipment for use at a school;
- Developing course materials for education to be provided at the school; and,
- Training teachers and other school personnel in an academy.

QZAB funds cannot be used for new construction projects. Expansion projects attached to existing buildings will be considered as renovation projects. All projects funded wholly or in part with QZAB funds must comply with the provisions of the Davis-Bacon Fair Labor Act. If one QZAB-financed dollar is spent on a project, the entire project must comply with all provisions of the Davis-Bacon Fair Labor Act.

Eligible Schools or Programs:

These bonds may be used on behalf of schools or programs that meet the following criteria:

- ✓ They are located in an empowerment zone or enterprise community (EZ/EC), or
- ✓ There is a reasonable expectation that 35% of their students will be eligible for free or reduced-cost lunches under the National School Lunch Act;
- ✓ The education program must be designed in cooperation with business and receive a contribution of 10 percent; and,
- ✓ The school's education plan must be approved by the eligible local education agency, and its students must be subject to the same standards and assessments as other students in the district.

Required Business Pledges:

Each project utilizing this program is required to have a minimum match or pledge from businesses of ten percent of the gross proceeds of the QZAB. For this purpose the following constitute eligible contributions:

- Equipment for use in the school (including state-of-the-art technology and vocational equipment);
- Technical assistance in developing curriculum or in training teachers in order to promote appropriate market-driven technology;
- Employees' services as volunteer mentors;
- Internships, field trips, or other educational opportunities outside the school for students; and,
- Any other property (including cash) or service specified by the public school.

Qualifying for a QZAB:

To qualify for a QZAB, the applicant organization must meet the following terms:

- A minimum of 95 percent of the proceeds of the issue must be used for a qualified purpose;
- The bond must be issued by a State or local government within the jurisdiction in which the school is located;
- The issuer must designate the bond for purposes of this provision;
- The issuer must certify that it has written assurances that the private business contribution requirement will be met with respect to the school; and,
- The term of the bond cannot be longer than the Secretary of the Treasury allows (based on a net present value of 50 percent of the face amount of the bond).

What is the tax treatment of the purchaser of these bonds?

- Eligible for an annual tax credit;
- Makes the bond purchaser whole (as if a traditional bond was purchased);
- Tax credit allowed to the purchaser cannot exceed the purchaser's net Federal income tax liability;
- Credit is treated as taxable income; and,
- Any premium or discount on the bond will be treated as premium or discount on a taxable obligation.

Are these bonds transferable?

- ❖ Taxpayers who do not have sufficient Federal income liability may transfer the bond to other taxpayers;
- ❖ The credit is allowed to the taxpayer who holds the bond on the credit allowance date.