

Qualified Zone Academy Bond (QZAB) Program.

The Qualified Zone Academy Bond (QZAB) program has, once again, been extended for two more years as a result of the passage of the Tax Relief and Health Care Act of 2006 (P.L. 109-432). The implementing regulations provide that the Illinois share of these allocations are \$14.790 million (for calendar year 2006) and \$ 14.790 million (for calendar year 2007), for a total of \$29.580 million. The legislation imposes several new requirements and or restrictions described below.

Prior to this 2006 legislation, according to congressional critics, the QZAB program was relatively unaccountable and therefore open to abuses, including: 1.) valuations of 10% match were often inflated and could not be validated; 2.) the QZAB Academy program was not implemented properly; and 3.) the QZAB program was exempt from IRS arbitrage rules (section 148 of the Internal Revenue Code) providing incentives to issuers to draw interest rather than spend QZAB proceeds.

In response to these concerns, Congress decided that the program needed stronger accountability. Hence, the new law requires the following: 1.) a contract must be in place with a third party to spend down at least 10% of bond proceeds within 6 months after issuance; 2.) 95% must be spent within 5 years; 3.) QZAB proceeds are subject to arbitrage rules; and 4.) all these changes subject to “obligations issued after the date of enactment,” namely December 20, 2006.

Furthermore:

- a) If less than 95% of QZAB proceeds are spent within 5 years, the unspent QZAB proceeds must be used to redeem QZABs within 90 days. This requires the inclusion of a redemption provision in the QZABs, which may increase the borrowing cost. Alternatively, the Treasury (IRS) is authorized to extend the spending period upon request from the issuer establishing reasonable cause.
- b) QZAB proceeds are generally subject to the same yield restriction and rebate requirements applicable to tax-exempt bonds.
- c) Yield on QZABs is calculated without taking into account the QZAB credit, with the result that the yield is very low or 0.
- d) While not entirely clear, it is probable that money held in an escrow to pay QZABs at maturity is subject to yield restriction, which would make the use of an escrow impractical.
- e) It is crucial to consider the year of the QZAB allocation assigned to an issue because the new spending and arbitrage restrictions apply only to post-2005 allocations.
- f) An additional reporting requirement calls for the Issuers to submit reports similar to the reports required by section 149(e) of the tax code.

The State Board of Education is accepting applications and supporting materials for the calendar year 2006 and 2007 allocations through and including May 15, 2007, so that the State Board of Education may act on the allocations at its June board meeting. Applications and additional information are available on the ISBE web site at <http://www.isbe.net/construction/html/qzab.htm>

Supporting materials.

Along with the application, the following supporting materials must be submitted:

1. letter(s) verifying the commitment of private business contributions;
2. a description of the educational plan for the zone academy;

3. a brief description of how the borrowed funds will be used to effectuate the establishment or operation of the zone academy; and
4. a brief description of how the educational plan will positively impact low income students.

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Up to 20% of the amount authorized for Illinois may be reserved for the City of Chicago School District #299 in consideration of the provisions of the School Construction law. The remainder will be allocated among qualifying applications received by May 15, 2007. If the total of qualifying requests exceeds the authorized total for Illinois, completed applications will be sorted and allocations awarded to first time applicants on the basis of the percentage of students eligible for Free or Reduced Lunch, then to other applicants on the basis of the percentage of students eligible for Free or Reduced Lunch.

A brief description of the program and FAQ, follows:

- Nationally authorizes \$400 million of locally issued bonds to be designated as ‘Zone Academy Bonds’
 1. Bonds provide federal tax credits to holders instead of paying interest.
 2. Eligible holders are limited to:
 - a. Banks
 - b. Insurance Companies
 - c. Other Companies that normally make loans
 3. Illinois’ share of national allocations: \$14.231 million in 1999; \$13.308 million in 2000; \$13.905 million in 2002; \$16.827 million in 2003, \$17.445 million in 2004, \$16.819 million in 2005, \$14.790 million in 2006, and \$14.790 million in 2007.
- State Education Agency is assigned responsibility of allocating authorized amounts among eligible schools.
- Public Schools designated as ‘Zone Academies’ are eligible.
 1. Must be located in an ‘Empowerment Zone’ or an ‘Enterprise Community’ or have at least 35% of students eligible for Free or Reduced Lunch.
 2. Curriculum must be a product of a ‘public private partnership’
 3. School must be provided ‘substantial business support’ (i.e. in-kind contributions at least equal to 10% of amount borrowed).
- Money borrowed must be used for:
 1. Repair or rehabilitation of buildings
 2. Purchase of equipment
 3. Curriculum development
 4. Teacher training
- Issuing school district must:
 1. Approve Zone Academy plan
 2. Issue bonds on behalf of Academy
 3. Issue information tax returns to purchasers

FAQ's

WHAT IS A 'QUALIFIED ZONE ACADEMY'?

The term 'qualified zone academy' means any public school which is established by and operated under the supervision of an eligible local education agency to provide education and training below the postsecondary level if:

1. the public school or program is designed in cooperation with business to enhance the academic curriculum, increase graduation and employment rates, and better prepare students for the rigors of college and the increasingly complex workforce,
2. students in the public school or program will be subject to the same academic standards and assessments as other students educated by the eligible local education agency,
3. the comprehensive educational plan of the public school or program is approved by the eligible local education agency, and
4. the public school or program is located in:
 - a) an empowerment zone, or
 - b) an enterprise community, or
 - c) there is a reasonable expectation that at least 35 percent of the students attending the school or participating in the program will be eligible for free or reduced cost lunches under the school lunch program established under the National School Lunch Act.

WHAT IS AN 'ELIGIBLE LOCAL EDUCATION AGENCY'?

The term 'eligible local education agency' means any local education agency as defined in section 14101 of the Elementary and Secondary Education Act of 1965.

WHAT ARE 'QUALIFIED PURPOSES' FOR WHICH ZONE ACADEMY BOND FUNDS MAY BE USED'?

The term 'qualified purpose' means:

1. rehabilitating or repairing the public school facility in which the academy is established
2. providing equipment for use at the academy,
3. developing course materials for education to be provided at the academy,
4. training teachers and other school personnel in the academy.