White Paper
Community Schools and Access to Bonds for Facilities

Fact: In the state of Ohio, community schools lack bonding authority for access to capital for facilities acquisition and building improvements.

Fact: Community schools receive no facilities funding from the state; therefore, community schools are forced use funds intended for the classroom to make lease, rent or mortgage payments for facilities.

Fact: Ohio has failed to take advantage of two federal programs that can help community schools with their facilities funding:

1. 501(c)(3) tax exempt bonds, and
2. Qualified zone academy bonds (QZABs).

Making these two options available to community schools is uncontroversial and uncomplicated.

1 - <u>501(c)(3) tax-exempt municipal bonds</u> are a method of making qualified private activity bonds available through a federal authorization and approval process called TEFRA. The principal advantages of this kind of bond financing are the low interest rates and the attractiveness of the debt to lenders and investors; and, they can be readily accessible to community schools (charters).

Interest rates are low with these bonds because the issuer can be qualified to pay tax-exempt interest to the investors under the Internal Revenue Code, and the low interest rate is passed on to the non-profit, in this case the community school. The money raised from the bonds is re-loaned by the issuer to the community school or used to acquire facilities to be leased or sold by the Issuer to the community school. The loan, lease or sale agreement is pledged by the issuer as the payment source for the bonds *and the issuer is not otherwise liable for the bonds*.[1]

Under section 147 of the Internal Revenue Code, in order for such bonds to be considered "tax-exempt," they must have TEFRA approval (Tax Equity and Fiscal Responsibility), the public approval process under Section 147f. Federal statute says that approval must come from a publicly elected official or body at either the local or state level (to wit: mayor, city council, county commission, secretary of state, state auditor, state treasurer, lieutenant governor, or governor).

[1] Smith Gambrell and Russell LLP

One Ohio charter-management organization pioneered this bond opportunity, working with the investment banking firm of Piper Jaffrey, securing funding for the purchase of facilities. They were able to effect authorization from State Treasurer Josh Mandel.

Given the acute need for facilities funding support for charter schools, Ohio needs to quickly provide a simple, apolitical solution to the authorization process. The most logical way to effect this process would be for Ohio's Governor to vest his statutory authority in these regards to the Ohio School Facilities Commission (OSFC); or, alternatively to set up a non-profit entity with his conferred authority to oversee such authorizations. It's important to emphasize that there are zero liabilities to the authorizing entity.

2 – Qualified Zone Academy Bonds provide the bondholder with a federal tax credit in lieu of a cash interest payment. Because the federal government provides the interest payment the LEA then is typically only responsible for repaying the value of the bond. Unlike the 501(c)(3) tax-exempt bonds, this program can only be used for renovations and capital needs inside facilities, not for the purchase of properties.

According to federal statue, charters or districts must apply to a state entity for authorization. Each state is supposed to have its own application process, usually through the department of education. Ohio has never defined that process and few know of the presence of QZABs.

Given the tight financial circumstances that most charter schools find themselves in, these two tax-exempt and tax-credit bond alternatives should be made available to Ohio's community schools as soon as possible.