

ABC's OF SCHOOL FUNDING

**By
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1. Introduction

Section 422 of the *Economic Growth and Tax Relief Reconciliation Act of 2001* (“the 2001 Act”) provides for a new type of exempt facility bond called *Qualified Public Education Facility Bonds*. While the provision allowing for these bonds is IRC section 142(a)(13), section 142(k) provides the rules for these bonds.

What is the effective date of section 142(a)(13) and how long does it last?

Bonds may be issued pursuant to section 142(a)(13) after December 31, 2001. There is a sunset provision which provides that section 142(a)(13) (as well as ALL provisions and amendments made by the 2001 Act) shall not apply to bonds issued after December 31, 2010.

What are these Bonds?

IRC section 142(a)(13) basically allows for “public-private partnerships” between school districts and private developers.

How do these partnerships work?

The bond proceeds are loaned to a private for-profit developer, who builds the school. The school is then leased to the school district on a long-term basis. The cost of the lease is less than the cost of construction. For detailed information about how this works, see [Exhibit A](#) (reprinted with the permission of the Heritage Foundation).

Because the developer actually owns the property, the Developer makes up the difference between the loan amount and the lease amount by leasing out the school building in the off-hours.

Advantages to school district?

The school district gets a school built much faster, and at a lower cost.

Advantages to developer?

The developer's profit is directly proportional to the amount of additional leases that it can secure on the property.

What are qualified public education facilities?

IRC section 142(k) provides that for purposes of section 142(a)(13), a "qualified public educational facility" is a school facility which is:

- Part of a public elementary or secondary school, AND
- Owned by a private, for-profit corporation pursuant to a public-private partnership agreement with a State or local educational agency.

What is a school facility?

IRC section 142(k)(3) defines a school facility as:

- Any school building,
- Any functionally related and subordinate facility and land with respect to such building, including any stadium or other facility primarily used for school events, AND
- Any property, to which section 168 applies (or would apply but for section 179) for use in a facility described in subparagraph (A) or (B).

What are public elementary and secondary schools?

When defining "elementary" and "secondary" schools, IRC section 142(k)(4) refers to the definitions set forth in The Elementary and Secondary Education Act of 1965.

Accordingly, "elementary school" means a nonprofit institutional day or residential school, including a public elementary charter school, that provides elementary education, as determined under State law.

And "secondary school" means a nonprofit institutional day or residential school, including a public secondary charter school, that provides secondary education, as determined under State law, except that the term does not include any education beyond grade 12.

What is a corporation?

According to IRC section 7701(a)(3), the term “corporation” includes associations, joint-stock companies, and insurance companies. See also Treas. Reg. section 301.7701-2(b).

What is a public-private partnership agreement?

According to IRC section 142(k)(2) a “public-private partnership agreement is an agreement under which the corporation agrees to:

- Construct, rehabilitate, refurbish, and/or equip a school facility, AND
- Transfer the school facility to the agency for no additional consideration at the end of the agreement.

Also, the term of the agreement cannot exceed the term of the issue to be used to provide the school facility.

What is a state or local educational agency?

According to section 7801 of the Elementary and Secondary School Act of 1965, a “State educational agency” is the State educational agency in a State in which the State educational agency is the sole educational agency for all public schools.

“Local educational agencies” are more common, and means a public board of education or other public authority legally constituted within a State for either administrative control or direction of, or to perform a service function for, public elementary schools or secondary schools in a city, county, township, school district, or other political subdivision of a State, or of or for a combination of school districts or counties that is recognized in a State as an administrative agency for its public elementary schools or secondary schools.

2. Volume Cap Limitations

Exclusion from section 146: IRC section 146(g)(3) has been amended to exclude “qualified public educational facilities” from the volume cap limitations of section 146. However, there is a limit on the aggregate amount of these bonds that can be issued, and these limits are described in section 142(k)(5).

Aggregate limits on the amount of bonds that can be issued annually: IRC section 142(k)(5) provides a limit on the total amount of bonds that can be issued

for qualified public educational facilities per year. The limit is equal to the greater of:

- \$10 multiplied by the state population, OR
- \$5,000,000.

Because of the size of its population, only Wyoming with a population of 494,423, is limited to \$5,000,000. All other states will be able to issue bonds well above \$5,000,000 because of their populations.

The resident population estimates for all states and US possessions for bonds issued during calendar year 2002 can be found in Notice 2002-13, 2002-8, IRB 547.

Under section 142(k)(5)(B), a state can allocate the aggregate amount of bonds in whatever manner it deems appropriate.

Carryforward of unused limitation: IRC section 142(k)(5)(B) provides that states can carry forward any unused limitation, however:

- the carryover is limited to the 3 calendar years following the calendar year in which the unused limitation arose, AND
- the only purpose that the carryover can be used is for qualified public educational facilities.

3. Exception To Rebate

Small issuer exception to rebate: The 2001 Act also amended IRC section 148(f)(4)(D)(vii) to provide for an increase in the amount of bonds that governmental units may issue without being subject to the arbitrage rebate requirement. Governmental units may issue up to \$15 million of bonds in a calendar year provided that at least \$10 million of the bonds are used to finance public school construction (as defined in IRC section 148(f)(4)(C)(iv)).

Effective Date: The amendment made by the 2001 Act is effective for bonds issued in calendar years beginning after December 31, 2001.

Prior rebate exceptions applicable to school construction bonds: Prior to the amendment made by the 2001 Act, governmental issues could meet the small issuer exception to rebate if they issued no more than \$10 million in governmental bonds per calendar year, and up to \$5 million of the proceed of which were used to finance construction (as defined in IRC section 148(f)(4)(C)(iv)) for public schools. This provision was effective for bonds issued after December 31, 1997.

A. Example 1

On June 1, 1997 County A issues \$3 million in bonds the proceeds of which are expected to be used to make capital repairs to City Hall. From January 1-May 30, 1997 the County had issued \$1M in governmental bonds. On June 1, 1997, the County expects to issue \$5 million in bonds from July 1-December 31, 1997. Which of County A's bonds, if any, can meet the criteria for the small issuer exception to rebate?

None of the bonds can meet the small issuer exception to rebate. The date of issue of the bonds is before December 31, 1997 and the issuer has issued or plans to issue more than \$5 million in governmental bonds for the calendar. Therefore, County A is not a "small issuer."

B. Example 2

On July 15, 1998, County B issues \$3 million in bonds the proceeds of which are expected to be used to make capital repairs to Public School B-1. County B has already issued \$3M for public school construction expenditures in 1998. The County also expects to issue \$2 million of non-school governmental bonds during the rest of 1998. Which of County B's bonds, if any, can meet the criteria for the small issuer exception to rebate?

The date of issue of the bonds is before December 31, 2001 but after December 31, 1997, therefore, only the \$2 million in bonds for non-school governmental purposes, and only \$5 million of the \$6 million issued for school construction can qualify for the small issuer exception to rebate. As a result, we could take the position that the entire July 15, 1998 issue did not meet the small issuer exception to rebate. The issue may still be able to meet one of the spending exceptions to rebate.

C. Example 3

During 2002, County C issues \$15 million in governmental bonds. \$5 million of the bonds were for public school construction, while \$10 million were for general governmental purposes. Which of County C's bonds, if any, can meet the criteria for the small issuer exception to rebate?

None of the bonds meet the criteria for the small issuer exception to rebate. Although the bonds are issued after December 31, 2001, and issuer is permitted to issue up to \$15 million in governmental bonds during the calendar to meet the small issuer exception, the issuer must spend at least \$10 million of the proceeds of the bonds to provide public school construction. In County C's case, only \$5 million

were for public school construction, while \$10 million in bonds were issued for general governmental purposes.

4. Other Requirements

Section 147: All of the requirements of IRC section 147 apply to qualified public educational facility bonds issued under section 142(a)(13), except for section 147(c).

Changes to Form 8038 for these types of bonds: Line 11(l) has been added to Part II of Form 8038 to include Bonds issued for “Qualified public educational facility bonds.” Line 47 has been added to Part VIII to allow issuers to indicate the amount of the volume cap that has been allocated to the issuer. A copy of the state certification, if applicable, should be attached. The changed Form 8038 and the Instructions are attached as [Exhibit B](#).



Backgroundunder

Executive Summary

No. 1257

February 25, 1999

HOW PUBLIC–PRIVATE PARTNERSHIPS CAN FACILITATE PUBLIC SCHOOL CONSTRUCTION

RONALD D. UTT, PH.D.

In the United States, the funding, construction, and renovation of public elementary and secondary school buildings historically have been the sole responsibilities of state and local governments. But in recent years, the President and some Members of Congress have attempted to create new federal spending and lending programs to assist communities in meeting their school facility needs.

To date, none of these proposals has become law, and school construction remains the responsibility of states and localities. The increased intensity and frequency with which these proposals are put forward, however, ultimately may help these efforts to prevail. Such an outcome could weaken the American system of federalism, increase federal spending and lending, and centralize in Washington yet another responsibility of local government.

Before this debate over who should pay for public school construction is renewed in Congress, federal, state, and local officials would be well advised to consider the innovative public–private partnership approach that has been adopted here and abroad. These partnerships allow communities to upgrade their public school facilities at substantially lower costs and in less time than purely governmental efforts typically require. In recent

years, for example, public school systems in the Canadian province of Nova Scotia, in Great Britain, and in some U.S. jurisdictions have implemented programs or pilot projects to encourage private investors to construct (and own) “public” school buildings to the school system’s specifications. In turn, the private partner leases the facility to the school system at rent levels below what the public school system would have incurred had it built and operated the school.

A CASE STUDY IN EFFECTIVENESS

Nova Scotia offers the clearest example of how public–private partnerships facilitate school construction. For example, by the end of 1998, as many as 41 new schools had been either completed or approved for construction under the Public Private Partnership program. In the next three years, Nova Scotia expects to replace 10 percent of its schools through such partnerships. The schools are

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“turnkey” operations—the facility is fully operational when the lease begins, complete with all classroom furnishings, such as desks, shelves, and chalkboards; computers wired to the Internet and the inter-school electronic network; furnished administrative offices; landscaping; and athletic facilities. The school system provides the teachers, aides, principal, and administrative staff and maintains full control over the curriculum and all other educational services and decisions.

The chief advantages of this arrangement for Nova Scotia’s school system is the speed with which it is able to upgrade its school facilities and the average 15 percent savings it achieves through leasing arrangements with the private developers/owners. The school system leases the facilities for 20 years at a predetermined rent that is lower than the capitalized cost of construction and furnishings. Where the developer covers the additional costs and earns a profit is in the intensive use of the facility during periods in which it is not in use by the school system. In effect, the private developer/owner leases the facility to the public school system from morning to mid-afternoon, Monday through Friday, and for any additional after-hours or weekend use as negotiated. During the remaining hours of the day, as well as on weekends and holidays and over the summer when the facility otherwise would remain idle, the developer leases the classroom space to other education-oriented entities, such as for-profit trade schools and various civic, political, or religious groups, for pre-approved purposes. The purposes are carefully spelled out in the lease to ensure that activities that are inappropriate to an educational facility used by children do not occur in the building.

THE POTENTIAL SAVINGS

If such an approach were implemented in the United States, the potential savings could be greater than the 15 percent Nova Scotia realizes because private financing and ownership of the structure would allow school systems to avoid additional costs imposed by federal and state mandates. Such mandates include prevailing wage

laws, environmental regulations, and minority set-asides, which often add substantially to the costs of design and construction of publicly funded buildings. No such mandates exist in Canada, and the actual costs to construct private school facilities are just slightly less than the costs of public school construction. The rent savings there arise primarily from the intensity with which the facility is used for other purposes.

An indication of the potential construction cost savings that could occur through public–private partnerships in the United States was revealed by a newly opened public elementary charter school in Florida that teamed with a local design/building firm to construct its facilities. Using an approach similar to Nova Scotia’s plan and money provided by the community to build the school, the per-student construction costs fell between 22 percent and 34 percent below the state average for constructing public elementary schools. These savings were due largely to a series of innovative design efficiencies jointly devised by the builder and school system.

LEGISLATIVE EFFORTS

Of the more than 30 school construction bills introduced in the 105th Congress, only one offers an innovative approach to public school renovation and construction by harnessing the energy, resources, and expertise of the private sector. The Public Schools Partnership Act introduced by Senator Bob Graham (D–FL) as S. 2397 proposed amending the federal tax code to expand the allowable uses of tax-exempt private activity bonds to include construction of privately owned school facilities leased to public school systems. If broadened to enhance its versatility, this bill could serve as the foundation for a legislative plan that encourages the creation of innovative public–private partnerships to build public schools more rapidly and at lower cost across the country.

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RONALD D. UTT, PH.D.

In recent years, the perception that there is a shortage of classroom space and that many existing school facilities are obsolete or badly deteriorated has led to a number of proposals in Congress to increase government spending and lending for the purpose of constructing school facilities. It also has led to a growing number of proposals to create some type of federal school construction program to share the financial burden that heretofore had been the sole responsibility of local governments, with growing assistance from state governments.

To date, none of these proposals has become law, and school construction remains the responsibility of states and localities. The increased intensity and frequency with which these proposals are put forward, however, ultimately may help these efforts to prevail. Such an outcome could weaken the American system of federalism, increase federal spending and lending, and centralize in Washington yet another responsibility of local government.

One of the school construction bills introduced in the 105th Congress, however, offers an innovative approach to public school renovation and construction by harnessing the energy, resources, and expertise of the private sector. The Public Schools Partnership Act, introduced by Senator

Bob Graham (D-FL) as S. 2397, would amend the federal tax code to allow the use of tax-exempt private activity bonds for the construction of privately owned school facilities leased back to the public school systems. If this bill were broadened to enhance its versatility, it could serve as the foundation for a legislative plan that encourages the use of public-private partnerships to build public schools more rapidly and at lower cost across the country.

PUBLIC SCHOOL CONSTRUCTION TODAY

In 1997, the United States spent a total of \$35.5 billion on new school construction, of which \$8.4 billion (or 24 percent) was spent on private schools—the fastest-growing component of total school construction spending. The \$27.1 billion devoted to public school construction in 1997 represents an increase of 23

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percent in such inflation-adjusted spending since 1993, while private school construction has soared ahead at 58 percent. Over the same period, the school-age population increased by 6.6 percent, suggesting that, at the most aggregate of levels, spending on school facilities outpaced the growth in student population.¹

The recent aggregate national construction figures appear to be at variance with the prevailing view that there is a deficiency in the availability of quality school facilities. But such aggregate trends mask significant differences within and among communities and regions in the quality of school facilities. Such numbers, for example, tell little about the extent to which the condition of existing school facilities has deteriorated to the point at which it affects the quality of education or the safety of students, or the extent to which technological changes in instruction have rendered sound but older facilities below the desired standards and preferences. They tell little about the continuing demographic changes within and between metropolitan areas or regions that leave a surplus of facilities in one community—often depopulated central cities and rural communities—but severe shortages in others, such as the fast-growing fringe suburbs and exurbs.

Unfortunately, no systematic census or inventory of school facilities exists by which to make an accurate or objective assessment of their adequacy and needs. Neither is there a way to compare the information on what is available today to what existed in the past to determine whether the situation is improving (as aggregate spending data would suggest) or worsening (as anecdotes from

select states and communities would indicate).²

Special Problems for Central Cities and the Fast-Growing Suburbs

In older cities and communities, the major school construction issue is the repair and renovation of older school buildings, many of which are in poor condition because of systematic neglect by city governments. In late 1998, for example, the chief executive officer of the District of Columbia schools announced a plan to spend up to \$1 billion in school repairs over the next 10 years.³ And in early 1999, New York City's Board of Education estimated it would need to spend \$11 billion for school construction over the next 5 years.⁴

In response to concerns over the local stewardship of public school structures, some state courts have required the state government to provide financial assistance to cities to replace or upgrade school facilities; in other cases, the state government voluntarily chose to do so. In May 1998, the State of New Jersey, for example, was ordered by the New Jersey Supreme Court to replace or refurbish deteriorated school buildings in its 28 poorest school districts. Governor Christine Whitman (R) responded by proposing to spend \$5.3 billion over the next 10 years, of which \$2.6 billion would be earmarked for those districts.⁵ In Virginia, Governor James Gilmore (R) agreed to a new \$100 million state-funded school construction program in order to get the state legislature to enact the personal property tax cut for automobiles he had promised during his election campaign.⁶

At the other extreme are the classroom shortages that often occur on the suburban fringe or in

1. U.S. Bureau of the Census, "Value of Construction Put in Place," *Current Construction Reports*, C30/98-11, November 1998, Tables 1 and 2, as found at <http://www.census.gov/prod/www/titles.htm#contsvy>.
2. One comprehensive effort to assess school renovation needs can be found in U.S. General Accounting Office, "School Facilities: Profiles of School Condition By State," GAO/HEHS-96-148, June 1996. Information compiled in the report was derived from a GAO questionnaire sent to a national sample of about 10,000 schools. Because of the varying technical expertise of the 9,956 respondents, state-to-state comparisons of quality and remediation costs may be difficult to make.
3. Valerie Strauss, "Ackerman Plans to Modernize D.C. Schools," *The Washington Post*, December 20, 1998, p. B1.
4. Jacques Steinberg, "Big Control, Little Accountability," *The New York Times*, January 25, 1999, p. A24.
5. David M. Halbfinger, "\$5.3 Billion Proposed to Build or Repair Schools in New Jersey," *The New York Times*, October 5, 1998, p. A18.

the exurbs, where population growth is at its most rapid and where school construction often fails to keep pace with student enrollment. As a result, classrooms and facilities may be overcrowded, and schools may set up temporary mobile classrooms to accommodate the growth in students. Often in these circumstances, school systems on the suburban fringe contend that the growth in tax revenues derived from the new households does not keep pace with the higher school construction costs incurred in serving them; they argue for state and/or federal financial assistance to meet their immediate needs.

A combination of such pressures in Michigan contributed to voter support for Proposal A in 1994, a ballot initiative put forth by Governor John Engler (R) to begin equalizing school funding in school districts throughout the state. Under the Engler proposal, voters were offered a higher state sales and income tax in exchange for lower local property taxes (with tax cuts exceeding tax increases). The state used the increased state tax revenues to provide each school district with a \$4,800 annual payment per pupil. Among the benefits of the proposal was an end to the financial burden that a large influx of new students can create within school systems on the suburban fringe of metropolitan areas.

The effective result in each of these recent examples of change in state/local school funding is that state financial support has been substituted for the traditional local funding responsibility. Such a trend runs the risk that individual state governments may encroach further on other local education responsibilities.

EFFORTS TO MAKE SCHOOL CONSTRUCTION A FEDERAL RESPONSIBILITY

Although the trend toward greater centralization of school financial support to date has largely involved transfers of responsibility from local to state governments, considerable and growing pressure exists to move some of or all the responsibility further up the chain to the federal government. Washington heretofore has been a minor financial player in education whose assistance to local schools has been confined largely to a series of niche and add-on education programs.⁷ That changed in late 1998, when Congress agreed to include in the fiscal year (FY) 1999 federal budget a \$1 billion downpayment for a federal program to assist local school systems in hiring as many as a 100,000 new teachers over the next several years.

Such efforts to federalize public school financing are likely to continue in the 106th Congress as Members of both parties attempt to demonstrate their commitment to public education, which opinion polls suggest is an issue at the top of the list of voter concerns. But because education still is very much the responsibility of state and local governments, most of the resulting federal initiatives are likely to be directed toward devising new ways to send more money to elementary and secondary public schools.

A Flurry of Legislation

Indicative of the mounting pressure to tap the resources of the federal government for school construction, 31 bills were introduced on school construction finance during the 105th Congress alone. Many of these will be reintroduced this year, and their prospects for enactment are better than before. Among these bills, only one—S. 2397,

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6. Editorial, "Counter-Commission: State Should Exit the School Building Business," *Free Lance-Star* (Fredericksburg, VA), October 3, 1998, p. A12; Larry O'Dell, "School Buildings: F" *Free Lance-Star*, January 5, 1999, p. C1; and Dominic Perella, "Poll of Virginia Schools Finds Half Dilapidated," *The Washington Times*, December 18, 1998.
 7. Explicit federal support has been forthcoming for the construction of facilities at colleges and universities since 1986, when Congress authorized the creation of the College Construction Loan Insurance Association (also called "Connie Lee"). Congress approved the privatization of Connie Lee in 1996, and the sale of government stock in the enterprise was completed in February 1997.

Senator Graham's Public School Partnership Act—would encourage the creation of public–private partnerships between local public school systems and private, for-profit developers, a concept that is being implemented successfully in Canada, Great Britain, and even a few communities inside the United States.

Although S. 2397 did not reach the floor of the Senate for a vote, its language was incorporated in an amendment to the Education Savings PLUS Accounts Act (H.R. 2646) introduced by Senator Paul Coverdell (R–GA). H.R. 2646, as amended, passed the House and Senate with bipartisan support but was vetoed by President Bill Clinton for reasons having more to do with Senator Coverdell's A+ Accounts than with the public–private partnerships included in the amendment.

President Clinton's Proposal

In January 1998, President Clinton proposed a new federal tax credit to subsidize the interest costs on a total of \$19.4 billion in special 15-year bonds issued by local school systems to construct or renovate their school facilities.⁸ According to the Clinton Administration, the bonds would cost the U.S. Treasury an estimated \$10 billion in interest rate subsidies over the next 10 years. Under the President's "Modern Schools for the 21st Century" proposal, the new federal school bonds would be issued over two years in face amounts of \$9.7 billion per year. They would cover the construction costs of about one-third of the public schools expected to be built during those years.

Congress did not include the proposal in its FY 1999 budget. President Clinton attempted unsuccessfully to revive it in during the final days of federal budget negotiations in October 1998. He proposed this initiative again in his FY 2000

budget, but he increased the volume of eligible bonds to \$22 billion.⁹

AN ALTERNATIVE TO FEDERAL AND STATE BORROWING

Although public financing of public schools has been the norm in the United States, all except one of the new legislative initiatives introduced at both the state and federal level last year would perpetuate and expand that practice by tapping into new governmental sources of money, notably at the federal level. In contrast to such proposals to extract more public resources to build public schools, a number of innovative approaches here and abroad clearly demonstrates that the private sector could build the desired facilities more quickly and for less money than currently is the case. The early success of these diverse efforts with public–private partnerships suggests that the key elements of these efforts could be emulated in most other U.S. public school systems, to the considerable benefit of students and the taxpayers who fund their education.

Nova Scotia's Partnership Approach

In 1997, Canada's province of Nova Scotia implemented one of the most ambitious programs to use public–private partnerships to facilitate the construction of new schools. By the end of 1998, as many as 41 new schools had been either completed or approved for construction under this Public Private Partnership program (or "P3," as it is known officially) and another 12 have been proposed for approval.¹⁰ Drawing on the resources and talents of the private sector, P3 was implemented as a way to boost public services quickly while making as little impact as possible on Nova Scotia's limited budgetary resources.¹¹

8. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 1999* (Washington, DC: U.S. Government Printing Office, February 1998), p. 52.

9. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2000* (Washington, DC: U.S. Government Printing Office, February 1999), p. 66.

10. See, for example "Nova Scotia Schools Boom," *PWFinancing*, December 1997, p. 23, and "Nova Scotia Picks School Developers," *PWFinancing*, September 1998, p. 33.

Nova Scotia has a population of approximately 947,000 (about as many as in the Oklahoma City, Oklahoma, metropolitan area) scattered across 55,362 square kilometers. With an unemployment rate hovering at just over 10 percent, an economy still suffering from the long-term decline of the North Atlantic fishing industry, and a freeze on the provincial capital budget since 1990, efforts to upgrade the school system might have been postponed pending the availability of financial resources. As it is, 38 percent of Nova Scotia's provincial budget is covered by transfer payments from Canada's federal government under a revenue-sharing program in which federal tax revenues from wealthier provinces, such as Ontario and British Columbia, are transferred to less-affluent provinces.

As a result of these pervasive financial shortfalls, Nova Scotia's government needed to tap alternative sources of money. According to the province's Ministry of Finance,

The key objective is to enable Nova Scotia tax payers to get better value for their tax dollars by shifting the responsibility for the operation and/or financing of non-core activities to the private sector. In the process, the potential exists for service to improve within the same public expenditure framework, or for the same level of public service to be provided at a lesser cost to taxpayers.¹²

As the P3 program relates specifically to schools, the province's Ministry of Finance notes that:

Schools delivered via a Public Private Partnership will be flexible, high tech learning environments to support programs and services for students during the useful life of the school. All technology will be integrated and provide valuable

support tools for students and professional staff.

These schools will be connected electronically to neighboring schools so that equitable access to technology is accomplished.

The private sector will refresh the technology, and refreshed technology will be provided to other schools in the region.¹³

The first phase of Nova Scotia's P3 program encompassed as many as 41 new schools within three years. Eight already have been completed and now are in service, and agreements on the remaining 30 to 33 were approved and signed in early 1999. Twelve additional schools have been proposed but still await approval.

Under the P3 program, Nova Scotia's Ministry of Finance requests bids from qualified developers to provide one or several school facilities built to the ministry's specifications in a designated district. Completed projects are provided on a "turnkey" basis—the developer furnishes the desks, telephones, blackboards, and computers while the school system provides teachers, principals, and students.

Prospective qualified bidders compete on price, and the cost of the project is converted into a 20-year lease with annual rent payments equal to 85 percent of the capitalized cost of the project. In effect, the school system gets to use the building for less than the cost to build and finance it, while the developer begins the lease 15 percent in the hole. In order for the developer to make up the difference in cost and earn a profit on his investment, the contract is structured so that the school system leases the building for specific hours, such as 8:30 a.m. to 3:30 p.m., Monday through Friday, September through June, as well as select off-hour

11. Summary details of Nova Scotia's P3 program can be found in "Transferring Risk in Public Private Partnerships," the Ministry of Finance of the Government of Nova Scotia, at <http://www.gov.ns.ca/fina/minister/p3guide/p3g.htm#introduction>.

12. *Ibid.*, Section 1.4.1.

13. *Ibid.*, Section 1.4.2.

periods. During the hours and days in which the public school system is not using the facility, the developer can rent its space to other approved and compatible organizations and businesses.

Off-Hours Use. Such off-hours use could include renting the facility to for- and not-for-profit educational organizations, such as trade schools and refresher educational programs, day care, community colleges and universities, civic groups, religious organizations, local governments, political groups, and similar entities for which classroom-, meeting-, and auditorium-type space is essential. Organizations and businesses whose purpose and activities are not compatible with a building used primarily by children are prohibited from leasing space, and such prohibitions are defined clearly in the contract. By using the building more intensively than would be the case if its occupancy were limited to just public school functions, the developer/owner of the building would obtain more revenues and earn more profit. These extra revenues are “passed on,” in effect, to the public school system in the form of below-cost rent.

Because developers must compete actively with other providers of space for off-hours revenue, they have an important incentive to ensure that construction is done to high-quality standards and design. One of the first developers to win the right to construct and lease five schools, Nova Learning Inc., also won the province’s 1998 Lieutenant Governor’s Design Award in Architecture.

Lease Terms. The school system’s 20-year lease on each facility includes options to renew the lease at the same rent for up to two additional 5-year terms. The school system also has the option of buying the facility at a predetermined price if it so chooses. Most important, the school system has no obligation to rent the facility beyond the first lease term, thereby providing the developer/owner with a powerful incentive to maintain the building to its highest standard and upgrade it with the latest technology.

If the public school system determines that the original developer performed inadequately, it simply can contract with another developer for a new facility. Alternatively, if demographic changes in the province or community lead to a reduction in school-age children, the public school system can elect not to renew as many leases as necessary to match facility space with student population and consolidate its students in the leased facilities that remain. In any case, Nova Scotia’s P3 program allows the school system to shift a number of important technological and demographic risks to the developer/owner and at the same time enhance its own flexibility and educational choices—at a lower cost than would be the case if the construction, financing, and ownership were entirely within the public domain.

As in any new program that differs significantly from the old, the first few schools built under the P3 program experienced some startup problems, which, in turn, were reviewed by the province’s Auditor General (AG) in a report to the government.¹⁴ In particular, the AG did a comprehensive study of the first completed P3 school and raised a number of concerns about whether the long-term lease arrangement violated provincial budget rules and whether the purported cost savings were significant enough to justify the program. These and other concerns raised by the AG have been used to modify the program for the 30 schools most recently approved.

Scotland

The Scottish Office (which is the governing body responsible for policy initiatives under limited home rule) encourages the government and local communities to utilize private financial resources to fund the construction and renovation of public infrastructure, such as wastewater treatment facilities, hospitals, and “state” schools.¹⁵ This program is entitled PFI (Private Finance Initiative) Scotland. As in Nova Scotia, PFI Scotland has moved beyond the pilot project stage and now is a fully operational component of the

14. “Department of Education and Culture: O’Connell Drive Elementary School Lease,” Special Report of the Auditor General, Halifax, Nova Scotia, July 21, 1998.

government's infrastructure program, particularly for public schools.

As of late November 1998, more than 70 schools with approximately 50,000 students in eight local authorities—including Scotland's two largest cities—were scheduled to be replaced or renovated under PFI Scotland. Included in the program were all of Glasgow's 29 secondary schools and Edinburgh's 27 secondary and primary schools.¹⁶ The cost of this renovation and replacement initiative is expected to total £332 million (\$554 million in U.S. dollars)—but it will be provided by private-sector investors.

To encourage these partnerships, the Scottish Office provides a subsidy to local authorities to meet the lease payments and operating costs. According to the Scottish Office,

A schools project taken forward under PFI will generally involve a contract being signed between a local authority and a private sector consortium for the provision of educational facilities and infrastructure along with on going maintenance and non-educational operations. The length of the contract would normally be around 25 years. PFI projects do not require Councils to take loans. Instead they pay an annual charge for the services.¹⁷

Under this program, Glasgow's City Council has signed a contract with a construction company, which will receive a 30-year concession to improve and manage all of the city's secondary schools. When the offer first was announced in June 1998, formal expressions of interest came from around 40 businesses in the first week; these were narrowed down to a group of 6 qualified

bidders who competed for the concession. The city expects that the concessionaire will upgrade all of the schools within 3 years, compared with an estimated 15 years under the former government-run system, and that the savings will amount to an estimated 30 percent below what it would have cost the city to upgrade and manage the school facilities itself.¹⁸

England and Wales

Beginning in 1997, the United Kingdom's Department for Education and Employment began to select a number of proposals for public-private partnerships for schools submitted by Local Education Authorities (LEA) in England and Wales for its financial support. This program was implemented as a comprehensive nationwide pilot project to demonstrate the feasibility of alternative partnerships for school facility improvements. In order to encourage the development and submission of a diverse array of public-private proposals from the LEAs, the Department for Education and Employment offers approved projects a series of financial incentives to facilitate the implementation. The department believes that a program designed to test a variety of different techniques will be more accurate in determining what works best, and that the lessons learned from these experiments will help to guide the development of a more ambitious and comprehensive program in the future.

To date, the Department for Education and Employment has approved and funded three projects. These include a partnership to rebuild a secondary school in Dorset, another to build and operate a new primary school in Kingston-upon-Hull, and the third to build a new school music center, including a recording studio, in Waltham

15. In Scotland and elsewhere in the United Kingdom, the term "state school" is used the same as "public school" in the United States; conversely, a "public" school refers in the United Kingdom to what people in the United States call a "private" school.

16. The Scottish Office, Edinburgh, Scotland, "Major Boost for Schools Buildings from Private Public Partnerships," News Release: 2408/98, November 20, 1998.

17. *Ibid.*

18. "Scotland Sets Largest Schools Deal," *PWFinancing*, July/August 1998, p. 13.

Forest. In the latter case, the private investor in the project expects to earn a return on his investment by leasing space in the music facility during after-school hours. In addition to these 3 projects, another 23 proposals from the LEAs for 293 separate facilities have been approved for funding and now await final contract signing. An additional 18 proposals for more than 194 facilities have been submitted and are under review.

To encourage the submission of additional innovative school construction and renovation projects, the Department for Education and Employment provides the LEAs with the financial support to develop their proposals. As of September 1998, eight additional proposals were under development with such support.¹⁹

The Department for Education and Employment's approved projects reflect an eclectic mix of techniques and facilities. In addition to projects that involve the construction or renovation of school facilities, the approved projects include: (1) a long-term contract to replace the school kitchens in 66 Lewisham schools and provide all school meals, as well as meals for the community's social service programs (like Meals on Wheels) for a 10-year period; (2) a joint venture to provide energy repair and supply at more than 120 schools in Stoke-on-Trent; and (3) land swaps with the developers of new schools that allow them to redeploy the school's former sites for other purposes, such as housing.²⁰ In several of the land-swap projects, the estimated value of the land is used to defray some of the costs incurred in constructing the new building, thereby relieving the community's taxpayers of some of the financial burden.

HOW PARTNERSHIPS WOULD HELP SCHOOL CONSTRUCTION IN THE UNITED STATES

The success of private-public partnerships in other countries offers policymakers in the United States the framework for developing a cost-effective and timely means of financing and constructing public schools. In these countries, as in the United States, the decision-making and operating responsibility for public school systems lies primarily at the local level, albeit to varying degrees, with some financial support and regulatory guidelines imposed from above. In both Canada and the United States, schools are run locally but they operate under rules and standards established by the state or province and may receive significant financial support from the state or province for operating and capital costs.

Construction Cost Advantages

In the United States, publicly funded construction projects often are guided by an extensive series of costly regulations and mandates. Such mandates come in addition to the normal building safety and soundness requirements embodied in the local building codes, which all private and public construction projects follow in order to obtain building and occupancy permits. For example, with all federally funded projects, builders must adhere to provisions on payment of prevailing wages, environmental reviews, minority contracting, small business set-asides, origin of materials, and other constraints. All these provisions can add substantially to the cost of construction, compared with the cost to build an identical structure to local building code requirements and market-determined wages.

Although such mandates are at their most costly at the federal level, states have imposed similar mandates, which add to the cost of state- and locally financed projects, such as school facilities.

19. Department for Education and Employment, Government of the United Kingdom, "Public Private Partnership (PPP) Projects in Schools: Project List," September 1998.

20. A similar project in Philadelphia, Pennsylvania, is for an underutilized school facility on a large plot of land.

Indeed, 31 states have their own Davis-Bacon-type laws mandating that prevailing wages be paid at all state-financed projects.²¹ In states in which such restrictive laws exist, all public construction projects (including schools) are likely to cost more than they would if built under the competitive conditions that guide all privately financed construction projects. Depending on the way in which federal assistance is ultimately provided, these federal mandates might extend to a part of the U.S. economy that heretofore had been free of such burdens—at least for those 19 states without prevailing wage laws and possibly for another 12 states whose prevailing wage laws are less onerous than the federal law.

Even in the absence of state and federal regulatory mandates, privately funded and owned private-sector construction projects generally have a cost advantage over publicly funded projects because the owner has a powerful incentive not to waste money or incur unnecessary costs that will directly reduce or eliminate profits. With public construction operating with taxpayer money and in the absence of a profit incentive, the pressure to keep costs down is less compelling. Indeed, to the extent that such buildings become monuments to the existing political leadership, there often is the temptation toward costly and grandiose designs—frequently the case with federal office buildings, government housing projects, and courthouses.²²

Case Studies in Florida

Pembroke Pines Public Charter School.

Pembroke Pines, Florida, highlights just how significant such private-sector construction efficiencies can be. Pembroke Pines, a public charter school, teamed up with Haskell Educational Services (HES) of Miami, a subsidiary of the Haskell Companies—a firm that specializes in designing and constructing assisted-living facilities—to build

and operate its new facility, which opened in September 1998. The cost of building the school was between 22 percent and 34 percent below that incurred for each public elementary school built in recent times. But while HES designed and built the school, the community financed it (with tax-exempt borrowing), owns it, and leases it to HES to operate as a charter school.

HES receives a state reimbursement of \$3,750 per student per year, which is not sufficient to pay both school operating costs and the facility lease payments to the city government. Thus, HES has a powerful incentive to control costs *and* increase revenues. Any money saved through construction efficiencies, for example, means lower lease payments and fewer additional sources of revenue that must be found. As in the case with the public-private partnerships in Nova Scotia, HES generates the additional revenues to cover the remaining costs and earn a profit by offering fee-based, after-hours programs at the school. At present, such programs are offered before and after normal school hours, on weekends, and during the summer, and include such services as day care, enrichment, and other education programs for students.

HES was able to achieve the necessary construction cost savings primarily by design efficiencies, including reconfiguring special-purpose rooms that otherwise would stand idle during the school day into multipurpose rooms that are used more intensively. The traditional teachers' planning rooms that typically occupy space between every two classrooms were reconfigured into small, computer-based media centers shared by the same two classrooms. The centers contain several computers that offer all the learning resources typically found in a school library, thereby obviating the need for a large school library. Because the charter school plans to have a more streamlined administrative structure than the typical public school

21. See Robert W. Poole, "Defederalizing Transportation Funding," Reason Foundation *Policy Study* No. 216, October 1996, pp. 5-7.

22. See, for example, U.S. General Accounting Office, "Courthouse Construction: Better Courtroom Use Data Could Enhance Facility Planning and Decision-Making," GGD-97-39, May 19, 1997; and National Park Service, "Special Report: Cost of Construction of Employee Housing at Grand Canyon and Yosemite National Parks," Report No. 97-I-224, December 1996, pp. 47, 65.

(in 43 of the 50 states, public school systems have more administrative workers than teachers),²³ less administrative office space was needed.

Classrooms were built smaller than the average size in Florida that fits up to 35 students because of existing or prospective overcrowding. Pembroke Pines is committed, however, to limiting class size to no more than 25. Another important space and cost savings came from contracting out the daily food service, thereby eliminating the need for costly commercial kitchen facilities (and staff). Instead, the school has a much smaller “warming kitchen” in which prepared meals are brought in each day by the food service contractor and stored in the warming ovens until served. In a related savings, the cafeteria, which in many schools is used for only an hour or so a day, is designed to do double-duty by serving as a general-purpose meeting room and auditorium. In addition to the savings from these and other design efficiencies, better management of construction allowed for lower per-square-foot building costs as well.

As a result of these cost efficiencies, Pembroke Pines was built for \$8,600 per “student station,” compared with the Florida state experience of between \$11,000 and \$13,000 for public elementary schools. These design cost savings and efficiencies appear not to have deterred parent/student interest in the public charter school: Applicants to the school exceeded available space, and enrollment slots had to be allocated by way of a lottery. This occurred despite the fact that parents of Pembroke Pines students are required to provide 30 hours per year of volunteer service.

It is important to note that these savings are due mostly to the advantages of profit-driven, private-sector design and construction management efficiencies, compared with the public-sector building process. Florida does not burden its public-sector construction with the types of environmental, labor, and equal opportunity mandates that add to the cost of federally funded construction or public construction for states that impose such mandates.

If Florida did impose these burdens, then the cost savings of a Pembroke Pines-type project, if privately financed, would be likely to grow even larger. This also suggests that the potential cost benefits of this approach could be quite substantial for the 19 states that have strong prevailing wage laws applied to public construction.

Public Schools at Private Work Sites. Florida also is home to another emerging concept in school public-private partnerships—large corporations that finance the construction of a public school at major work sites for the convenience of working parents. This offers parents an attractive education option, minimizes their morning and evening transportation demands, and adds the convenience of afterschool day care services at the same facility. At least two such schools exist, one sponsored by NationsBank in Jacksonville and another built by the Orlando Regional Healthcare System. Executives at HES believe such schools offer the greatest near-term opportunity for public-private partnerships.²⁴

OTHER ADVANTAGES OF PUBLIC-PRIVATE PARTNERSHIPS

In addition to the substantial cost savings public-private partnership offer compared with current publicly financed and managed school construction methods, there are other significant advantages.

Timeliness

Public-private partnerships can shorten the time between the determination that new school facilities are needed and the completion of the project. In most states and communities, acquiring funds for major public construction projects entails a complicated and lengthy process with an uncertain outcome. Once a need is recognized, hearings must be scheduled and held by the community's elected body, usually a city or county council. Depending on state law, the bond issue

23. Peter Brimelow, “Top Heavy,” *Forbes*, November 2, 1998, pp. 60–61.

24. “Fall Service Charter School Opens,” *PWFinancing*, July/August 1998, p. 13.

needed to raise the money then must be submitted to the voters for approval; this sometimes must wait until the next election, which may be a year or two away.

Because there is no assurance that the voters will approve the bond issue (in 1998, voters rejected 33 percent of school bond issues),²⁵ none of the necessary work that must be finished prior to construction—including engineering, design, and bid solicitation—can go forward until the bond offering is approved. As a result, as many as five years could pass before the school is ready for occupancy. By placing the financial responsibility with the developer/owner and eliminating the need for the public sector to raise the capital, the time-consuming political and legal approval process can be greatly shortened with private-sector partnerships, although the time saved will vary from state to state and community to community depending on existing procedures and laws.

With public–private partnerships, once the elected officials decide to go forward with the new school, they can go right to the bidding process with competing developer/owners, although instead of competing on the price to build, developers compete on the long-term lease rates they will offer.

Flexibility

Under the build/own process that characterizes most construction of public facilities today, there is little leeway in devising construction, financing, and operating arrangements that more closely fit the particular needs of a community. For rapidly growing communities with a steadily escalating school-age population, classroom space can be added only in periodic and costly lumps whose “cost-to-carry” initially will exceed tax revenues generated by new residents and businesses. As a consequence, such communities often have

higher-than-average tax rates; many respond simply by prohibiting or severely limiting population growth by way of restrictive land-use regulations or high “impact fees” on each new house or apartment.²⁶

The flexibility of public–private partnerships can overcome these cost constraints by designing and offering capital project packages a community can grow to fit. Such fast-growing communities have capital needs beyond just schools, including libraries, community colleges, and government office space, all of which may exceed a community’s current borrowing capacity significantly. Such communities may also be short of other non-public facilities, such as day care, job training, driver education, and places of worship.

By using the Nova Scotia model, developers could build facilities that initially serve multiple purposes and are used intensively in off-hours for a variety of community purposes. As the population (and tax revenue) rises, a combined elementary/middle school and public library branch could be replaced with separate facilities for the two schools and another for the public library. Under this approach, fast-growing communities would face rising rental fees that more closely match rising tax revenues, instead of the periodic, large capital expenditures that may impose burdensome debt service requirements on a still-thin tax base.

For older, established suburbs with stable overall populations but widely fluctuating school-age populations due to demographic cycles, the partnerships of the Nova Scotia approach would give the community the flexibility to add or delete classroom space at minimal cost, which would allow 20-year leases with options to renew or terminate. If, at the end of 20 years—or whatever period is deemed appropriate—the school-age population declined, the school system could

25. From “Nationwide School Bond Referenda: 1978-98,” table provided by American Banker Bond Buyer, One State Street Plaza, New York, NY 10004.

26. See Samuel R. Staley, “Urban Sprawl’ and the Michigan Landscape: A Market-Oriented Approach,” Mackinac Center for Public Policy and Reason Public Policy Institute, October 1998, pp. 24–30, for an analysis of the cost burdens confronting fast-growing communities.

consolidate the remaining students in a smaller number of schools while the developer bore the risk of re-renting the space. In the event that the demographic cycle repeated itself, the school system could re-contract for new space as may be needed temporarily. In either event, the risk of holding costly empty space would fall on the developers/owners, whose expertise and entrepreneurial skills make them better-suited to recycle the space quickly and more profitably to its best use.

For central city schools, in which years of financial mismanagement have left an inventory of very old and poorly maintained facilities, declining student enrollment has led to vacant or underutilized buildings and ongoing consolidation of students and teachers in better facilities. Here, too, public-private partnerships could provide the key to promoting rebuilding and replacement programs, particularly because many central cities have precarious financial conditions that preclude or limit their access to bond markets. With a shrinking need for many of the facilities such school systems currently own, a central city public-private partnership could incorporate elements of the land-swap programs that Britain's Department for Education and Employment is trying as a way of tapping into the value of underutilized assets already owned by the system.

Such a program could involve either new schools or, considering the constraints on land suitable for development in many central cities, the substantial renovation of existing structures. For example, a private company could acquire a deteriorated building under a long-term lease, renovate it, and lease it back to the school system at a higher rent. Of course, more than just building repairs could be involved in the renovation: The contract also could call for the developer to provide a substantial upgrade in the building's telecommunications and information technology and to install computers and other learning devices in all the classrooms. To the extent that the developer could rent out portions of the facilities to other users on an after-hours basis, the rent paid by the school system for the improved facility would be less than the capitalized cost of the renovation, as

is the case under Nova Scotia's plan for new construction.

Community-Wide Benefits

In addition to the obvious improvements to educational services that these new facilities would provide on a less costly basis, the availability of additional, conveniently located meeting and classroom space would foster other for- and not-for-profit activities that benefit the members of the community as well as school-aged children. Leasing space to one or several day care providers before and after school hours would benefit working parents and promote the safety of children who otherwise might be transported from one facility to another or become "latchkey" children at home.

Likewise, other non-school-sponsored, after-school programs could utilize the space and reduce the time that children otherwise might spend going from place to place. Moreover, by putting many afterschool services within a single facility, the community would allow students greater access to activities they otherwise might not be able to attend for lack of transportation. Similarly, programs of interest to adults—whether civic groups, continuing education, work-related refresher courses, political meetings, or job training programs—could lease the space in the school building.

PRIVATE-SECTOR INTEREST

Although growing evidence from Canada, Great Britain, and a few U.S. communities suggests that public-private partnerships for school facilities can be attractive for public school systems, there is not much documentation to indicate that the concept offers private U.S. real estate investors and developers an attractive investment option. That might be changing, however, as evidence begins to emerge that, here and there, a few communities and a few entrepreneurs are experimenting with public-private partnerships for public schools.

For example, LTC Properties, Inc., in Oxnard, California, a real estate investment trust holding nearly \$500 million in assets, notes the following

change in its investment policy in its quarterly 10Q report to the U.S. Securities and Exchange Commission. (Up to this point, the firm had focused exclusively on investment in assisted-living facilities.)

After a careful ongoing study of the child-care and education industry, during the six months ended June 30, 1998, the Company invested approximately \$7,936,000 in two private schools and one charter school. These schools are leased to a publicly-traded company engaged in the operation of private and charter schools from pre-school through twelfth grade.²⁷

This example and that of Florida's Haskell Education Services—as well as reports of exploratory interest by one of the country's major financial investors and by one of the “big six” consulting/accounting firms—may represent growing interest on the part of investors. It also shows that some have realized the opportunity. This suggests that there could be even greater growth in private investment in school facilities once school systems and investors become aware of the opportunity.

THE FEDERAL ROLE IN SCHOOL CONSTRUCTION

The Influence of Tax-Exempt Borrowing

Although the federal government operates no explicit program to facilitate or fund the construction of public elementary and secondary schools,²⁸ it nevertheless has an important influence on school construction. It allows local communities to raise money for public construction by issuing bonds whose interest payments are exempt from federal income tax as well as any state income taxes for bondholders residing in the state of issue. Making such tax preferences available to investors in municipal bonds means that communities are able to borrow at lower costs

than would be the case otherwise. In December 1998, when long-term AA taxable corporate bonds yielded 6.34 percent, the high-grade, long-term, tax-exempt municipal bonds yielded 4.17 percent, or more than two percentage points below the taxable equivalent.

Although the tax-exempt privilege imparts an important benefit to communities by enhancing their ability to afford new schools and other public infrastructure, that same privilege, under certain circumstances, can deter states from utilizing public-private partnerships. The cost advantages of the traditional, all-public approach often appears to be the least costly option, particularly if the alternative is a new and largely untried approach. But this need not be the case, as the growing, albeit limited, experience of some communities with various aspects of school partnerships suggests.

Potential savings from a well-conceived public-private partnership could overwhelm whatever cost benefits derive from using tax-exempt over taxable financing. Specifically, if (1) construction costs savings of 25 percent or more are possible (as in Pembroke Pines, Florida); (2) leases can be negotiated for rent levels equivalent to 85 percent of the (now lowered, as described in [1]) capitalized cost of the project; and (3) additional cost savings can be achieved by avoiding state (or federal) construction mandates and regulations, then the potential savings from unsubsidized public-private partnership borrowing at a higher *taxable* interest rate could more than offset the savings associated with the use of tax-exempt borrowing.

Such potential savings, dependent as they are on a new and novel way of building schools, may be seen as too risky and uncertain for many school districts to give up the certainty of using traditional forms of public construction. Considering the difference between the taxable and tax-exempt rates, as described above, a public-private partnership utilizing the taxable borrowing rate

27. LTC Properties, Inc., “Form 10Q, for the quarterly period ended June 30, 1998,” p. 7.

28. It has created, however, a government-sponsored enterprise (Connie Mac) to facilitate the financing of construction at colleges and universities.

would have to generate a cost savings of at least 34 percent, compared with the traditional mechanism using tax-exempt financing.

For example, under the traditional approach with tax-exempt borrowing (4.17 percent), a school costing \$10 million to build would require annual interest payments of \$41,700 per year. But if built through a public-private partnership borrowing at the taxable rate (6.34 percent), then the same school would have to be built for only \$6,600,000 to equalize such annual interest costs. The potential cost disparities between the two alternatives may make it difficult for many school systems to take advantage of the private-sector alternative. As a consequence, any effort to encourage local school systems to try a cost-saving alternative may have to be accompanied by interim subsidies comparable with those available by way of the existing tax-exempt borrowing privilege available to state and local governments.

LEGISLATIVE DIRECTION

Despite the increase in school facility partnerships here and abroad, there still is little awareness in the United States among public school officials, real estate investors, and policymakers of the benefits of public-private partnerships. These cooperative efforts offer the opportunity for the public sector to be more efficient in harnessing the resources and skills of the private sector to build more and better schools. Without this knowledge of private-sector opportunities, future legislative initiatives at the state and federal levels to boost school construction could result in more schools—although probably not as many as needed, and the additional public money spent would keep resources from other public needs. They also would run the risk of becoming another type of federal pork-barrel project, in which any congruence between spending and need occurred by chance.

Demonstration Projects

To explore innovative alternatives, the federal government and local officials should establish federal and state demonstration programs with

financial incentives to encourage local public school officials to sign on. A federal financial incentive program to demonstrate the feasibility and benefits of public school construction through public-private partnerships could be structured so as not to add additional spending to the budget or increase tax revenue losses. The traditional approach to public school construction already entails significant federal subsidies by virtue of the tax-exempt status of the general obligation bonds that communities issue to fund their schools. To the extent that public schools would be built or renovated with the subsidies offered through a new public-private demonstration program, a portion represents schools that would have been built or renovated with funds borrowed with tax-exempt municipal bonds. This would not be likely to be a one-for-one offset in any given year, but the net “cost” per year could be only a small fraction of the total “cost” because of this substitution effect.

A Good Starting Point

A good platform to initiate a demonstration incentive program could be the Public School Construction Partnership Act, which was introduced as S. 2397 by Senator Bob Graham during the 105th Congress. This bill proposed amending the federal tax code to allow the use of tax-exempt *private activity* bonds for the construction of privately owned school facilities leased back to the public school systems.

Under current law, each state is provided an annual allocation, based on population, of tax-exempt private activity bonds to be used for such purposes as economic redevelopment, manufacturing, student loans, and home mortgages, but not public schools. A business as large as a *Fortune* 500 company can use these bonds to build or refurbish a for-profit manufacturing facility, but a company that wants to provide a building to the public school system is ineligible. Senator Graham's bill would rectify this exclusion and increase each state's bond allocation—by an additional \$10 multiplied by the state population—so that the additional uses of the tax-exempt borrowing privilege would not come at the expense of other users, including major manufacturing corporations.

To address concerns about the potential for the increased loss of tax revenue, Senator Graham's bill could be modified to extend the use of tax-exempt private activity bonds to privately owned public school facilities but not to increase the state cap on the issuance of private activity bonds beyond those already scheduled to go into effect over the next few years. This change would force corporations, hydroelectric projects, and other for-profit redevelopment projects to compete with schools for the available existing federal tax benefit. Alternately, Senator Graham's proposed increase in the caps and the ensuing loss in federal revenues could be maintained in the legislation but the revenue loss could be offset with the inclusion of legislative changes that would gain revenues.

One such possible legislative change is to add a somewhat modified version of the Higher Education Bond Parity Act, which was introduced as S. 1880 in the 105th Congress by Senator Daniel Patrick Moynihan (D-NY). S. 1880 would prohibit the use of tax-exempt general obligation bonds from being used to build costly stadiums and arenas for the owners of professional sports teams; the resulting revenue savings would be used to increase the number of private activity bonds that private universities and colleges could issue. By including privately owned schools that are leased to public school systems as investments also eligible for use with the savings achieved from the Moynihan bill, some of or all the potential revenue loss from this new program would be offset.

Improving Flexibility

Congress might want to consider also some modifications to the Graham bill to allow for more flexibility in structuring the nature of such arrangements between private developers and public school systems. As currently written, the bill would require that the arrangements be of the "build-own-transfer" (B.O.T.) type, which means that, at the end of the lease term (which would not exceed the term of the underlying bond issue), the facility would revert to the school system at no additional cost. Although this arrangement could be appropriate in some situations, it would preclude other arrangements that could be more

advantageous to school systems in certain circumstances, and it also would limit the opportunity to experiment with other techniques to determine which works better under different circumstances.

For example, by allowing a lease arrangement that permitted (or required) the developer to retain ownership beyond the initial lease term (the Nova Scotia approach), the developer would have a powerful incentive to maintain and upgrade the building in order to encourage the school system to re-lease the facility. In addition, the school system would avoid the risk of having to retain a potentially obsolete or unneeded building that could be as old as 20 to 30 years by the lease's end. Permitting leases that let the developer retain ownership in perpetuity would allow the school system to negotiate lower annual lease payments than would be the case if the developer had to relinquish the building at the end of the lease term.

Another limiting component of the Graham bill that should be modified is its requirement that nearly all of a state's allocation to issue such bonds be used for school systems experiencing rapid growth in student population. This provision probably would cover most communities in the fast-growing states of the South and West, but in the slower-growing North and the Midwestern states, the bill's qualifications would limit the use of the bonds largely to distant suburbs. It also would prohibit the program's use (except for \$5 million per state) in older central cities whose declining student populations often occupy old, deteriorated structures.

Pennsylvania, which has a student population of just over 12 million, the Graham bill would allow it to issue up \$120 million of such public-private partnership bonds per year, but \$5 million of that amount would have to be shared by Chester, Harrisburg, Philadelphia, Pittsburgh, and perhaps six other declining cities in which substandard schools can be the norm. In such cities, in which renovation rather than new construction represents the most cost-effective response to school facility needs, public-private partnerships could help to restore aging structures, as they do in the PFI Scotland program in Glasgow, Scotland.

By allowing states more flexibility in allocating the special bond proceeds to systems in which the need is greatest, the public-private partnership approach would have the opportunity to demonstrate its efficacy and versatility under a variety of different conditions and needs. And out of these many and varied demonstration projects would arise a series of successful techniques, concepts, and approaches that could be implemented by states and localities across the country.

CONCLUSION

The many proposals to move the federal government into providing financial support for public school construction confront Congress with two considerable risks. The first is the prospect of creating a new budget-busting spending program that very easily could become another costly pork-barrel program. The lack of restraint Congress often demonstrates in regard to such infrastructure programs as highways and water projects would spill over very easily into a new school construction program as Members of Congress attempted to demonstrate their “commitment to education.”

The second risk is that such a program could greatly expand the scope and power of the federal government into an area that traditionally has been the responsibility of local and state governments. Even if the program were oriented initially toward nothing more than providing cash for school construction, the temptation to add controlling strings to the cash would be difficult for politicians to resist—and every one of the added strings would undermine the local control of our public education system.

Of the many public school construction proposals that are likely to come before Congress, the approach embodied in Senator Bob Graham’s Public Schools Partnership Act would allow Congress to avoid these risks, while at the same time allow local school systems to tap into the vast financial and management resources that America’s private sector offers.

—*Ronald D. Utt, Ph.D., is Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation.*

**Information Return for Tax-Exempt
 Private Activity Bond Issues**
 (Under Internal Revenue Code section 149(e))
 ▶ See separate instructions.

Part I Reporting Authority

Check if Amended Return

1 Issuer's name		2 Issuer's employer identification number	
3 Number and street (or P.O. box if mail is not delivered to street address)		Room/suite	4 Report number
5 City, town, or post office, state, and ZIP code		6 Date of issue	
7 Name of issue		8 CUSIP number	
9 Name and title of officer or legal representative whom the IRS may call for more information		10 Telephone number of officer or legal representative ()	

Part II Type of Issue (check the applicable box(es) and enter the issue price for each)

Issue Price

11 Exempt facility bond:		
a <input type="checkbox"/> Airport (sections 142(a)(1) and 142(c))	11a	
b <input type="checkbox"/> Docks and wharves (sections 142(a)(2) and 142(c))	11b	
c <input type="checkbox"/> Water furnishing facilities (sections 142(a)(4) and 142(e))	11c	
d <input type="checkbox"/> Sewage facilities (section 142(a)(5))	11d	
e <input type="checkbox"/> Solid waste disposal facilities (section 142(a)(6))	11e	
f <input type="checkbox"/> Qualified residential rental projects (sections 142(a)(7) and 142(d)), as follows:	11f	
Meeting 20–50 test (section 142(d)(1)(A)) <input type="checkbox"/>		
Meeting 40–60 test (section 142(d)(1)(B)) <input type="checkbox"/>		
Meeting 25–60 test (NYC only) (section 142(d)(6)) <input type="checkbox"/>		
Has an election been made for deep rent skewing (section 142(d)(4)(B))? <input type="checkbox"/> Yes <input type="checkbox"/> No		
g <input type="checkbox"/> Facilities for the local furnishing of electric energy or gas (sections 142(a)(8) and 142(f))	11g	
h <input type="checkbox"/> Facilities allowed under a transitional rule of the Tax Reform Act of 1986 (see instructions)	11h	
Facility type.....		
1986 Act section.....		
i <input type="checkbox"/> Qualified enterprise zone facility bonds (section 1394) (see instructions)	11i	
j <input type="checkbox"/> Qualified empowerment zone facility bonds (section 1394(f)) (see instructions)	11j	
k <input type="checkbox"/> District of Columbia Enterprise Zone facility bonds (section 1400A) (see instructions)	11k	
l <input type="checkbox"/> Qualified public educational facility bonds (sections 142(a)(13) and 142(k))	11l	
m <input type="checkbox"/> Other. Describe (see instructions) ▶.....	11m	
12 <input type="checkbox"/> Qualified mortgage bond (section 143(a))	12	
13 <input type="checkbox"/> Qualified veterans' mortgage bond (section 143(b)) ▶	13	
Check the box if you elect to rebate arbitrage profits to the United States <input type="checkbox"/>		
14 <input type="checkbox"/> Qualified small issue bond (section 144(a)) (see instructions) ▶	14	
Check the box for \$10 million small issue exemption <input type="checkbox"/>		
15 <input type="checkbox"/> Qualified student loan bond (section 144(b))	15	
16 <input type="checkbox"/> Qualified redevelopment bond (section 144(c))	16	
17 <input type="checkbox"/> Qualified hospital bond (section 145(c)) (attach schedule—see instructions)	17	
18 <input type="checkbox"/> Qualified 501(c)(3) nonhospital bond (section 145(b)) (attach schedule—see instructions)	18	
Check box if 95% or more of net proceeds will be used only for capital expenditures ▶ <input type="checkbox"/>		
19 <input type="checkbox"/> Nongovernmental output property bond (treated as private activity bond) (section 141(d))	19	
20 <input type="checkbox"/> Other. Describe (see instructions) ▶	20	

Part III Description of Bonds (Complete for the entire issue for which this form is being filed.)

	(a) Final maturity date	(b) Issue price	(c) Stated redemption price at maturity	(d) Weighted average maturity	(e) Yield
21		\$	\$	years	%

Part IV Uses of Proceeds of Issue (including underwriters' discount)			Amount
22	Proceeds used for accrued interest	22	
23	Issue price of entire issue (enter amount from line 21, column (b))	23	
24	Proceeds used for bond issuance costs (including underwriters' discount)	24	
25	Proceeds used for credit enhancement	25	
26	Proceeds allocated to reasonably required reserve or replacement fund	26	
27	Proceeds used to currently refund prior issue (complete Part VI)	27	
28	Proceeds used to advance refund prior issue (complete Part VI)	28	
29	Add lines 24 through 28	29	
30	Nonrefunding proceeds of the issue (subtract line 29 from line 23 and enter amount here)	30	

Part V Description of Property Financed by Nonrefunding Proceeds
Caution: The total of lines 31a through e below must equal line 30 above. Do not complete for qualified student loan bonds, qualified mortgage bonds, or qualified veterans' mortgage bonds.

Part V Description of Property Financed by Nonrefunding Proceeds:			Amount
a	Land	31a	
b	Buildings and structures	31b	
c	Equipment with recovery period of more than 5 years	31c	
d	Equipment with recovery period of 5 years or less	31d	
e	Other (describe)	31e	

Part V Description of Property Financed by Nonrefunding Proceeds:					
32 North American Industry Classification System (NAICS) of the projects financed by nonrefunding proceeds.					
	NAICS Code	Amount of nonrefunding proceeds		NAICS Code	Amount of nonrefunding proceeds
a		\$	c		\$
b		\$	d		\$

Part VI Description of Refunded Bonds (Complete this part only for refunding bonds.)

33	Enter the remaining weighted average maturity of the bonds to be currently refunded	▶	_____ years
34	Enter the remaining weighted average maturity of the bonds to be advance refunded	▶	_____ years
35	Enter the last date on which the refunded bonds will be called	▶	_____
36	Enter the date(s) the refunded bonds were issued ▶		

- Part VII Miscellaneous**
- 37 Name of governmental unit(s) approving issue (see the instructions) ▶ _____
- 38 Check the box if you have designated any issue under section 265(b)(3)(B)(i)(III) ▶
- 39 Check the box if you have elected to pay a penalty in lieu of arbitrage rebate ▶
- 40 Check the box if you have identified a hedge (see instructions) ▶
- 41 Check the box if the issue is comprised of qualified redevelopment, qualified small issue, or exempt facilities bonds and provide name and EIN of the primary private user ▶
- Name ▶ _____ EIN ▶ _____

Part VIII Volume Caps			Amount
42	Amount of state volume cap allocated to the issuer. Attach copy of state certification	42	
43	Amount of issue subject to the unified state volume cap	43	
44	Amount of issue not subject to the unified state volume cap or other volume limitations:	44	
a	Of bonds for governmentally owned solid waste facilities, airports, docks, wharves, environmental enhancements of hydroelectric generating facilities, or high-speed intercity rail facilities	44a	
b	Under a carryforward election. Attach a copy of Form 8328 to this return	44b	
c	Under transitional rules of the Tax Reform Act of 1986. Enter Act section ▶ _____	44c	
d	Under the exception for current refunding (section 146(i) and section 1313(a) of the Tax Reform Act of 1986)	44d	
45a	Amount of issue of qualified veterans' mortgage bonds	45a	
b	Enter the state limit on qualified veterans' mortgage bonds	45b	
46a	Amount of section 1394(f) volume cap allocated to issuer. Attach copy of local government certification	46a	
b	Name of empowerment zone ▶ _____		
47	Amount of section 142(k)(5) volume cap allocated to issuer. Attach copy of state certification.	47	

Sign Here

Under penalties of perjury, I declare that I have examined this return, and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete.

▶ _____ ▶ _____
 Signature of officer Date

 Name of above officer (type or print) Title of officer (type or print)



Instructions for Form 8038

(Rev. January 2002)

Information Return for Tax-Exempt Private Activity Bond Issues

Section references are to the Internal Revenue Code, unless otherwise noted.



Department of the Treasury
Internal Revenue Service

A Change To Note

Recent legislation added new section 142(a)(13), qualified public educational facilities, to the list of exempt facility bonds, effective for obligations issued after December 31, 2001. See **Qualified public educational facilities** on this page.

General Instructions

Purpose of Form

Form 8038 is used by the issuers of tax-exempt private activity bonds to provide the IRS with the information required by section 149 and to monitor the requirements of sections 141 through 150.

Who Must File

Issuers must file a **separate** Form 8038 for **each** issue of the following tax-exempt private activity bonds issued after 1986:

- Exempt facility bonds
- Qualified mortgage bonds
- Qualified veterans' mortgage bonds
- Qualified small issue bonds
- Qualified student loan bonds
- Qualified redevelopment bonds
- Qualified hospital bonds
- Qualified 501(c)(3) bonds
- Nongovernmental output property bonds
- Texas Veterans' Land Bonds, Oregon Small-Scale Energy Conservation and Renewable Resource Loan Bonds, and Iowa Industrial New Jobs Training Bonds
- All other tax-exempt private activity bonds

When To File

File Form 8038 by the 15th day of the 2nd calendar month after the close of the calendar quarter in which the bond was issued. Form 8038 may not be filed before the issue date and must be completed based on the facts as of the issue date.

Late filing. An issuer may be granted an extension of time to file Form 8038 under Section 3 of Rev. Proc. 88-10, 1988-1 C.B. 635, if it is determined that the failure to file timely is not due to willful neglect. Type or print at the top of the form, "This Statement Is Submitted in Accordance with Rev. Proc. 88-10." Attach to the Form 8038 a letter explaining why Form 8038 was not filed on time. Also indicate whether the bond issue in question is under examination by the IRS. Do not submit copies of the trust indenture or other bond documents. See **Where To File** next.

Where To File

File Form 8038, and any attachments, with the Internal Revenue Service Center, Ogden, UT 84201.

Signature

An authorized representative of the issuer must sign Form 8038 and any applicable certification. Also print the name and title of the person signing Form 8038.

Other Forms That May Be Required

For bonds other than private activity bonds, use **Form 8038-G**, Information Return for Tax-Exempt Governmental Obligations, or **Form 8038-GC**, Information Return for Small Tax-Exempt Governmental Bond Issues, Leases, and Installment Sales, to comply with these requirements.

Bonds described in section 1312(c)(2) of the Tax Reform Act of 1986 to which the transitional rules in section 1312 or 1313 apply are not private activity bonds for purposes of information reporting. Report them on Form 8038-G or Form 8038-GC.

For rebating arbitrage or paying a penalty in lieu of arbitrage rebate to the Federal government, use **Form 8038-T**, Arbitrage Rebate and Penalty in Lieu of Arbitrage Rebate.

Rounding Off to Whole Dollars

You may show the money items on this return as whole-dollar amounts. To do so, drop any amount less than 50 cents and increase any amount from 50 to 99 cents to the next higher dollar.

Definitions

Tax-exempt bond. This is any obligation on which the interest is excluded from gross income under section 103 of the Internal Revenue Code.

Private activity bond. This includes an obligation issued as part of an issue in which:

- More than 10% of the proceeds are to be used for any private business use, **and**
- More than 10% of the payment of principal or interest of the issue is **either (a)** secured by an interest in property to be used for a private business use (or payments for such property), or **(b)** to be derived from payments for property (or borrowed money) used for a private business use.

It also includes a bond, the proceeds of which **(a)** are to be used (directly or indirectly) to make or finance loans (other than loans described in section 141(c)(2)) to

persons other than governmental units and **(b)** exceeds the lesser of 5% of the proceeds or \$5 million.

Exempt facility bond. This is part of an issue of which 95% or more of the net proceeds are to be used to finance an exempt facility listed in section 142(a)(1) through (13). Exempt facility bonds include qualified enterprise zone facility bonds for use in empowerment zones and enterprise communities.

Qualified public educational facilities.

The private activities for which tax-exempt bonds may be issued include elementary and secondary public school facilities that:

- Are owned by a private, for-profit corporation,
- Have a public-private partnership agreement with a state or local educational agency, and
- Are operated by a public educational agency as part of a public school system.

The term **school facility** includes school buildings and other facilities that are related such as stadiums, athletic facilities used for school events, and depreciable personal property used in connection with the school facility.

A **public-private partnership** is defined as an arrangement in which the for-profit corporation constructs, rehabilitates, refurbishes, or equips a school for the public school agency. The agreement must provide that, at the end of the contract term, ownership of the bond-financed property is transferred to the public school agency at no additional consideration.

The requirements for section 147(c) on land acquisitions do not apply to qualified public educational facilities bonds. Also, separate state volume cap limits and carryforward rules apply; see section 142(k) for details.

Qualified mortgage bond. This is part of an issue:

1. Of which all proceeds (except issuance costs and reasonably required reserves) are to be used to finance owner-occupied residences,
2. That meets the requirements of subsections (c) through (i) and (m)(7) of section 143,
3. That does not meet the private business tests of sections 141(b)(1) and (2), and
4. For which repayments of principal on financing provided by the issue (that are received more than 10 years after the date of issuance) are used to redeem bonds that are part of the issue. Amounts of less than \$250,000 need not be used to redeem bonds under this requirement.

Qualified veterans' mortgage bond. This is part of an issue:

1. Of which 95% or more of the net proceeds are to be used to provide residences for veterans,
2. For which the payment of the principal and interest is secured by the general obligation of a state,
3. That meets the requirements of subsections (c), (g), (i)(1), and (l) of section 143, and
4. That does not meet the private business tests of sections 141(b)(1) and (2).

Qualified small issue bond. This is part of an issue not exceeding \$1 million of which 95% or more of the net proceeds are to be used to finance (a) land, (b) depreciable property, or (c) a redemption of a prior issue of (a) or (b). See section 144(a). The \$1 million limit can be increased to \$10 million if an election is made to take certain capital expenditures into account. See Regulations section 1.103-10(b)(2)(vi).

Qualified student loan bond. This is part of an issue of which:

1. 90% or more of the net proceeds are to be used to make or finance student loans under a program of general application to which the Higher Education Act of 1965 applies (see section 144(b)(1)(A) for additional requirements), or
2. 95% or more of the net proceeds are to be used to make or finance student loans under a program of general application approved by the state (see section 144(b)(1)(B) for additional requirements).

Qualified redevelopment bond. This is generally part of an issue of which 95% or more of the net proceeds are to be used to finance certain specified real property acquisition and redevelopment in blighted areas. See section 144(c) for other requirements.

Qualified 501(c)(3) bond. This is any private activity bond that meets the following conditions:

1. All property financed by the net proceeds of the bond issue is to be owned by a 501(c)(3) organization or a governmental unit, and
2. The bond would not be a private activity bond if (a) section 501(c)(3) organizations were treated as governmental units with respect to their activities that do not constitute unrelated trades or businesses (determined by applying section 513), and (b) the private activity bond definition was applied using a 5% threshold (instead of 10%) for the private use, security, and/or payment tests, and the activities that constitute unrelated trades or businesses are aggregated with any other private use, security, or payment.

A qualified 501(c)(3) bond includes a:

- Qualified hospital bond, i.e., part of an issue of which 95% or more of the net proceeds are to be used for a hospital.
- Qualified nonhospital bond, i.e., other than a qualified hospital bond. In general, an organization cannot have more than \$150 million of qualified 501(c)(3) nonhospital bonds; see section 145(b). However, the

limit does not apply to bonds issued after August 5, 1997, if 95% or more of the net proceeds of the issue are to be used solely for capital expenditures incurred after that date.

Restrictions apply to the use of qualified 501(c)(3) bonds (both hospital and nonhospital) to provide residential rental housing. See section 145(d).

Issue price. The issue price of obligations is generally determined under Regulations section 1.148-1(b). Thus, when issued for cash, the issue price is the price at which a substantial amount of the obligations are sold to the public. To determine the issue price of an obligation issued for property, see sections 1273 and 1274 and the related regulations.

Note: *The issue price does not include interest from the date the bonds are dated to the date of issue.*

Issue. Generally, bonds are treated as part of the same issue if they are issued by the same issuer, on the same date, and in a single transaction, or series of related transactions.

Arbitrage rebate. Generally, interest on a state or local bond is not tax exempt unless the issuer of the bond rebates to the United States arbitrage profits earned from investing proceeds of the bond in higher yielding nonpurpose investments. See section 148(f).

Construction issue. This is an issue of tax-exempt bonds that meets both of the following conditions:

1. At least 75% of the available construction proceeds are to be used for construction expenditures with respect to property to be owned by a governmental unit or a 501(c)(3) organization, and
2. All the bonds that are part of the issue are qualified 501(c)(3) bonds, bonds that are not private activity bonds, or private activity bonds issued to finance property to be owned by a governmental unit or a 501(c)(3) organization.

In lieu of rebating any arbitrage that may be owed to the United States, the issuer of a construction issue may make an irrevocable election to pay a penalty. The penalty is equal to 1½% of the amount of construction proceeds that do not meet certain spending requirements. See section 148(f)(4)(C) and the Instructions for Form 8038-T.

Specific Instructions

Part I—Reporting Authority

Amended return. If you are filing an amended Form 8038, check the amended return box. Complete Part I and only those parts of Form 8038 you are amending. Use the same report number (line 4) that was used on the original report. **Do not** amend estimated amounts previously reported once the actual amounts are determined.

Line 1. The issuer's name is the name of the entity issuing the bonds, not the name of the entity receiving the benefit of the financing.

Line 2. An issuer that does not have an employer identification number (EIN) should apply for one on **Form SS-4**, Application for Employer Identification Number. You can get this form on the IRS Web Site at www.irs.gov or by calling 1-800-TAX-FORM (1-800-829-3676). You may receive an EIN by telephone by following the instructions for Form SS-4.

Line 4. After the preprinted 1, enter two self-designated numbers. Number reports consecutively during any calendar year (e.g., 134, 135, etc.).

Line 6. The date of issue is generally the date on which the issuer physically exchanges the bonds for the underwriter's (or other purchaser's) funds.

Line 7. If there is no name of the issue, please provide other identification of the issue.

Line 8. Enter the CUSIP (Committee on Uniform Securities Identification Procedures) number of the bond with the latest maturity. If the issue does not have a CUSIP number, write "None."

Part II—Type of Issue

Caution: *Elections referred to in Part II are made on the original bond documents, not on this form.*

You must identify the type of bonds issued by checking the appropriate box(es) and entering the corresponding issue price (see **Issue price** under **Definitions**).

Line 11f. After entering the issue price, check the appropriate box for the percentage test elected by the issuer at the time of issuance of the bonds. Then, check the appropriate box to show whether an election was made for deep rent skewing. See Rev. Rul. 94-57, 1994-2 C.B. 5, for guidance on computing the income limits applicable to these bonds.

Line 11h. Bonds issued to finance certain facilities may also qualify as exempt facility bonds if they were (a) permitted as exempt facility bonds under prior law and (b) issued under one of the transitional rules of the Tax Reform Act of 1986 (the 1986 Act).

These facilities include...	As described in former section...
A sports facility	103(b)(4)(B)
A convention or trade show facility	103(b)(4)(C)
A parking facility	103(b)(4)(D)
A pollution control facility	103(b)(4)(F)
A hydroelectric facility	103(b)(4)(H)
An industrial park	103(b)(5)

If one of the above applies, **indicate the facility type** and then give the **specific provision of the 1986 Act** pertaining to the facility on line 11h.

Line 11i. Check the box if the bonds are part of any issue 95% or more of the net proceeds of which are to be used to provide

any enterprise zone facility in an empowerment zone or enterprise community. See section 1394.

Note: Check the box on line 11j for empowerment zone facility bonds or line 11k for District of Columbia Enterprise Zone facility bonds.

Line 11j. Check the box if the bonds are: (a) issued after August 5, 1997, and (b) part of any issue 95% or more of the net proceeds of which are to be used to provide any empowerment zone facility. See section 1394(f).

The updated information on the designated urban empowerment zones is available at www.hud.gov; for the designated rural empowerment zones, go to www.ezec.gov.

Line 11k. Check the box if the bonds are: (a) issued after December 31, 1997, and (b) part of any issue 95% or more of the net proceeds of which are to be used to provide a District of Columbia Enterprise Zone facility. See section 1400A for other requirements.

Line 11l. Check the box for bonds that are: (a) issued after December 31, 2001, and (b) part of any issue 95% or more of the net proceeds of which are used to provide a qualified public educational facility. See section 142(k) for other requirements.

Line 11m. Check this box only if none of the other boxes apply. On the space provided, enter the facility type.

Facility types include...	As described in section...
Mass commuting facilities	142(a)(3) and 142(c)
Local district heating or cooling facilities	142(a)(9) and 142(g)
Environmental enhancements of hydroelectric generating facilities	142(a)(12) and 142(j)
High-speed intercity rail facilities*	142(a)(11), 142(c), and 142(i)

***Note:** Proceeds of an exempt bond may not be used for this type of facility if there is a nongovernmental owner of the facility unless that owner makes an irrevocable election not to claim (1) depreciation under section 167 or 168, or (2) any credit against its income tax with respect to the property financed with the net proceeds of the issue.

Line 13. Check the box on line 13 if the issuer has elected, in the bond indenture or related document, to pay to the United States the amount described in section 143(g)(3)(D).

Line 14. Check the box on line 14 if the bond issue is an exempt issue of \$10 million or less for which an election under section 144(a)(4) has been made by the issuer at or before the time of issuance on the bonds or in its records. See Regulations section 1.103-10(b)(2)(vi).

Line 17. Attach a schedule listing the name and EIN for each 501(c)(3) organization

benefiting from these qualified hospital bonds.

Line 18. Enter the total amount of qualified nonhospital bonds described in section 145(b)(2) that are a part of this issue. For each 501(c)(3) organization benefiting from these qualified nonhospital bonds, attach a schedule listing:

1. The name of the organization,
2. Its EIN,
3. The amount of this issue of bonds benefiting the organization, and, if the box for line 18 is not checked,
4. The amount of all other nonhospital bonds outstanding as of the date of this issue that benefit the organization.

Note: The amount in item 4 above plus line 18 cannot exceed \$150 million with respect to bonds issued: (a) prior to August 6, 1997, and (b) after August 5, 1997, if used for noncapital expenditures. The \$150 million limit does not apply to bonds issued after August 5, 1997, if 95% or more of the net proceeds are used solely for capital expenditures incurred after that date.

Line 19. Check the box if the bonds are used to acquire nongovernmental output property, which is property used by a nongovernmental person in connection with an output facility (such as an electric or gas power project).

Line 20. Check the box only if none of the other boxes apply. In the space provided, enter a description of the bonds, for example, "Texas Veterans' Land Bonds," "Oregon Small-Scale Energy Conservation and Renewable Resource Loan Bonds," or "Iowa Industrial New Jobs Training Bonds."

Part III—Description of Bonds

Line 21

For column (a), the final maturity date is the last date the issuer must redeem the entire issue.

For column (b), see **Issue price** under **Definitions** on page 2.

For column (c), the stated redemption price at maturity of the entire issue is the sum of the stated redemption prices at maturity of each bond issued as part of the issue.

For column (d), the weighted average maturity is the sum of the products of the issue price of each maturity and the number of years to maturity (determined separately for each maturity and by taking into account mandatory redemptions), divided by the issue price of the entire issue (from line 21, column(b)).

For column (e), the yield, as defined in section 148(h), is the discount rate that, when used to compute the present value of all payments of principal and interest to be paid on the obligation, produces an amount equal to the purchase price, including accrued interest. See Regulations section 1.148-4 for specific rules to compute the yield on an issue. If the issue is a variable rate issue, write "VR" as the yield of the issue. For other than variable rate issues, carry the yield out to four decimal places (e.g., 5.3125%).

Part IV—Uses of Proceeds of Issue

Line 22. Enter the amount of proceeds that will be used to pay interest from the date the bonds are dated to the date of issue.

Line 24. Enter the amount of the proceeds that will be used to pay bond issuance costs, including fees for trustees and bond counsel.

Line 25. Enter the amount of the proceeds that will be used to pay fees for credit enhancement that are taken into account in determining the yield on the issue for purposes of section 148(h) (e.g., bond insurance premiums and certain fees for letters of credit).

Line 26. Enter the amount of the proceeds that will be allocated to such a fund.

Lines 27 and 28. Enter the amount of the proceeds that will be used to pay principal or interest on any other issue of bonds.

Part V—Description of Property Financed by Nonrefunding Proceeds

Line 31. Enter the amount of the nonrefunding bond proceeds received by the issuer and used to finance real or depreciable personal property. If the amounts are not available at the time of issuance, make a reasonable proration between the land, buildings, and equipment.

Note: Under section 147(c), a private activity bond is not a qualified bond if 25% or more of the proceeds are used for the acquisition of land or if any of the proceeds are used to acquire farm land (other than an amount of proceeds not in excess of \$250,000 to be used by a first-time farmer). An exception to this general rule is for land acquired for certain environmental purposes. See section 147(c)(3). Also, a bond is not a qualified bond if the proceeds are used for the acquisition of used property (other than land), except in the case of certain rehabilitations. See section 147(d).

For items that do not readily fit within categories 31a, b, c, or d, enter the amount of those proceeds in category 31e, *Other*, and briefly describe them on the line.

Line 32. For each project to be financed by the issue, enter the corresponding:

- Six-digit North American Industry Classification System (NAICS) code that best describes the project, and
- Face amount of the project.

If there are more than four projects to be financed by the issue, attach a separate sheet of paper stating the NAICS codes and face amount of each project.

For the purpose of determining NAICS codes where the project fits into more than one category, the ultimate use of the facility determines the NAICS code number. For example, an investment partnership financing a manufacturing facility should use the relevant manufacturing NAICS code, not the partnership's financial activities code.

The NAICS codes are available on the U.S. Census Bureau Web Site at www.census.gov/naics.

Part VI—Description of Refunded Bonds

Complete this part only if the bonds are to be used to refund a prior issue of tax-exempt private activity bonds.

Lines 33 and 34. The remaining weighted average maturity is determined without regard to the refunding. The weighted average maturity is determined in the same manner as for line 21, column (d).

Line 35. Enter the last date on which any of the bonds being refunded will be called.

Line 36. If more than a single issue of bonds will be refunded, enter the date of issue of each of the issues.

Part VII—Miscellaneous

Line 37. Under the rules of section 147(f), private activity bonds are not tax exempt unless they receive public approval by certain officials or voter referendums. Enter the name of the governmental unit(s) approving the issue. Enter also the date of approval by the applicable elected representatives and the date of the public hearing. In the alternative, enter the date of the voter referendum.

If, under the rules of section 147(f), no approval is needed because the issue meets an exception to the public approval requirement, write "No approval needed" on line 37. Also enter on line 37 the provision of section 147(f) under which the issue is excepted (e.g., "section 147(f)(2)(D)"), or if under any transitional rule write "Transitional rule" and the applicable Act (e.g., "Tax Reform Act of 1986") and section.

Line 39. Check this box if the issue is a construction issue and an irrevocable election to pay a penalty in lieu of arbitrage rebate has been made on or before the date the bonds were issued. The penalty is payable with a Form 8038-T for each 6-month period after the date the bonds are issued. Do not make any payment of penalty in lieu of arbitrage rebate with this form. See Rev. Proc. 92-22, 1992-1 C.B. 736 for rules regarding the "election document."

Line 40. Check this box if the issuer has identified a hedge on its books and records in accordance with Regulation sections 1.148-4(h)(2)(viii) and 1.148-4(h)(5) that permit an issuer of tax-exempt bonds to identify a hedge for it to be included in yield calculations for computing arbitrage.

Line 41. Check this box if:

The issue is comprised of...	As described in section...
Qualified redevelopment bonds	144(c)
Qualified small issue bonds	144(a)
Exempt facilities bonds	142(a)(4) through 142(a)(11) and 142(a)(13)

If one of the above applies, then enter the name and EIN of the primary private user. A "primary private user" is the nongovernmental entity that meets the private business tests of section 141(b) or private loan financing test of section 141(c).

Part VIII—Volume Cap

Line 42. Enter the amount of volume cap allocated to the issuer. Attach a copy of the state certification, if applicable. The appropriate state official must certify that the issue meets the requirements of section 146 (relating to volume cap on private activity bonds). See the regulations under section 149(e). The certification must also include the information requested by lines 1 through 3 and 5 through 8 on page 1 of Form 8038, as well as the title of the certifying official.

Line 43. Enter the amount of the issue subject to the unified state volume cap for private activity bonds under section 146. If, under section 141, the nonqualified amount of an issue exceeds \$15 million, but does not exceed the amount that would cause a bond which is part of an issue to be treated as a private activity bond, the issuer must allocate a part of its volume cap to the nonqualified amount over \$15 million.

Line 44a. Enter the amount of any bond issued as part of an issue to finance exempt facilities that are **not** subject to the volume cap. These facilities include:

- Airports.
- Docks.
- Wharves.
- Environmental enhancements of hydroelectric generating facilities.
- Solid waste facilities. **Note:** *These facilities may have to be governmentally owned. See section 146(h).*
- High-speed intercity rail facilities. **Note:** *Only 75% of any exempt facility bond for these facilities is not subject to the volume cap; however, no volume cap applies if all the bond-financed property is governmentally owned. See sections 146(g) and 142(b)(1)(B).*

Line 44b. If any part of the issue is issued under a carryforward election, enter the amount of the bonds being issued under that election. Attach a copy of the applicable **Form 8328**, Carryforward Election of Unused Private Activity Bond Volume Cap.

Line 44c. If any part of the issue is not subject to the volume cap under a transitional rule of the Tax Reform Act of 1986, enter the appropriate section of the Act and then the amount of the bonds excepted from the volume cap by that rule.

Line 44d. Any bond that is issued to currently refund another bond is not subject to the volume cap to the extent that the amount of such bond does not exceed the outstanding amount of the refunded bond. See section 146(i) and section 1313(a) of the Tax Reform Act of 1986. Enter the amount not subject to the volume cap.

Line 45b. Enter the state limit on qualified veterans' mortgage bonds for the calendar year under section 143(l)(3).

Line 46a. Enter the amount of volume cap allocated to the issuer. Attach a copy of the local government's certification, if applicable. The official must certify that the issue meets the requirements and the applicable volume cap under section 1394(f). The certification must also include the information requested by lines 1 through 3 and 5 through 8 on page 1 of Form 8038, as well as the title of the certifying official.

Line 46b. Enter the name of the empowerment zone. See the instructions for line 11j for where to get the names of the empowerment zones.

Line 47. Enter the amount of volume cap allocated to the issuer. Attach a copy of the state certification, if applicable. The appropriate state official must certify that the issue meets the volume cap requirements of section 142(k)(5). The certification must also include the information requested by lines 1 through 3 and 5 through 8 on page 1 of Form 8038, as well as the title of the certifying official.

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