Massachusetts School Building Authority

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To: Board of Directors, Massachusetts School Building Authority
From: Katherine Craven, Executive Director
Date: July 28, 2010
Subject: Results of Qualified School Construction Bonds 2010 Series A (QSCB Bonds)

As you may recall, on March 31, 2010, the Board authorized the issuance of a new type of debt called Qualified School Construction Bonds (QSCBs). On June 15, 2010, the MSBA sold $151,000,000 of QSCB bonds. The QSCB bonds were all sold with a 5.468% coupon (interest rate) and a 17-year maturity of June 15, 2027 (the maximum maturity allowed under the federal rules). On the date of the bond sale, the U.S. Treasury had set the maximum permitted subsidy for QSCBs at 5.52%. Since the interest rate on these bonds is less than the Treasury limit, the MSBA borrowed the QSCBs at an effective interest rate of 0%.

As planned, the bonds were issued as subordinate debt of the MSBA. This means the MSBA has established a hierarchy for bondholders, with the senior bondholders being paid first and the subordinate bondholders being paid next. The bonds received excellent ratings of AA/Aa2/AA from the three rating agencies. These ratings are one notch lower than the MSBA's senior debt ratings of AA+/Aa1/AA+.

The MSBA's Trust Agreement requires the MSBA to make monthly interest deposits in the Debt Service Fund, and the interest is then paid every six months to bondholders. The federal government will then reimburse the Authority. The Trust Agreement also requires the MSBA to make an annual deposit to a sinking fund. The annual sinking fund deposit is equal to $1/17^{th}$ of the par amount of the QSCB bond issue ($151 million). The sinking fund will be used to retire the bond issue at maturity in 17 years. Earnings on the sinking fund will be applied to MSBA debt service.

The Trust Agreement also established an Additional Bonds Test for MSBA subordinate debt. The ABT requirement is that the MSBA can only issue additional subordinate debt if it has Dedicated Sales Tax Revenues of not less than 130% of the maximum net debt service (both senior and subordinate debt) in any future year. This provision provides assurance to investors and rating agencies that the MSBA will not issue more debt than it can comfortably afford.

Barclay Capital and Jefferies & Company were the senior underwriters for the bond issue. As expected, all buyers were institutional investors. There were no retail orders. Th e underwriters received $200 million in orders from bond funds and insurance companies.

This bond issue was approximately half of the total QSCB allocation of the MSBA. A second and final QSCB issue is planned for later this year.

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