AUDIT REPORT

Tennessee State School Bond Authority

For the Year Ended
June 30, 2012

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

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March 5, 2013

The Honorable Bill Haslam, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Members of the Tennessee State School Bond Authority
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee State School Bond Authority for the year ended June 30, 2012. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

Deborah V. Loveless

Deborah V. Loveless, CPA
Director

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State of Tennessee

Audit Highlights

Comptroller of the Treasury | Division of State Audit

Financial and Compliance Audit
Tennessee State School Bond Authority
For the Year Ended June 30, 2012

AUDIT OBJECTIVES

The objectives of the audit were to consider the Authority's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, and contracts (including the bond resolutions); to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

Audit Report
Tennessee State School Bond Authority
For the Year Ended June 30, 2012

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Tennessee State School Bond Authority
For the Year Ended June 30, 2012

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee State School Bond Authority. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to "perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The Tennessee State School Bond Authority was established by the Tennessee State School Bond Authority Act, Chapter 256 of the Public Acts of 1965. As provided in this act and in Chapter 429 of the Public Acts of 1999, the Authority is to act as a corporate governmental agency of the State of Tennessee for financing projects of the state's higher education institutions and qualified zone academy projects for primary and secondary schools of local government. The Authority is empowered to issue negotiable bonds and notes as a means of providing funds for financing approved projects. These projects include buildings, equipment, structures, and improvements. In 1980, the legislature amended the original act to include, as a project, a program for student loans. To date, the Authority has not issued debt to fund a student loan program. The amount of funds provided should be sufficient to cover the actual project costs, as well as the Authority's administrative expenses, including the cost of conducting the bond and note sales.

In 2009, the Authority was designated by the General Assembly as the Education Agency for the Qualified School Construction Bonds (QSCBs). The QSCBs are tax credit bonds that were authorized in the American Recovery and Reinvestment Act of 2009 and Section 49-3-12, *Tennessee Code Annotated*, as amended. Through the designation, the Authority is authorized to issue QSCBs to make loans to local governments to fund K-12 school construction and renovations.

ORGANIZATION

The Tennessee State School Bond Authority consists of seven members: the Governor, the State Treasurer, the Secretary of State, the Commissioner of Finance and Administration, the Comptroller of the Treasury, the Chancellor of the Tennessee Board of Regents, and the President of the University of Tennessee. The Governor serves as chairman, and the Comptroller of the Treasury serves as secretary. The Director of the Office of State and Local Finance serves as the assistant secretary; the division provides administrative and financial services to the Tennessee State School Bond Authority.

An organization chart for the Tennessee State School Bond Authority is on the following page.

AUDIT SCOPE

The audit was limited to the period July 1, 2011, through June 30, 2012, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Financial statements are presented for the year ended June 30, 2012, and for comparative purposes, the year ended June 30, 2011. The Tennessee State School Bond Authority has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report*.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

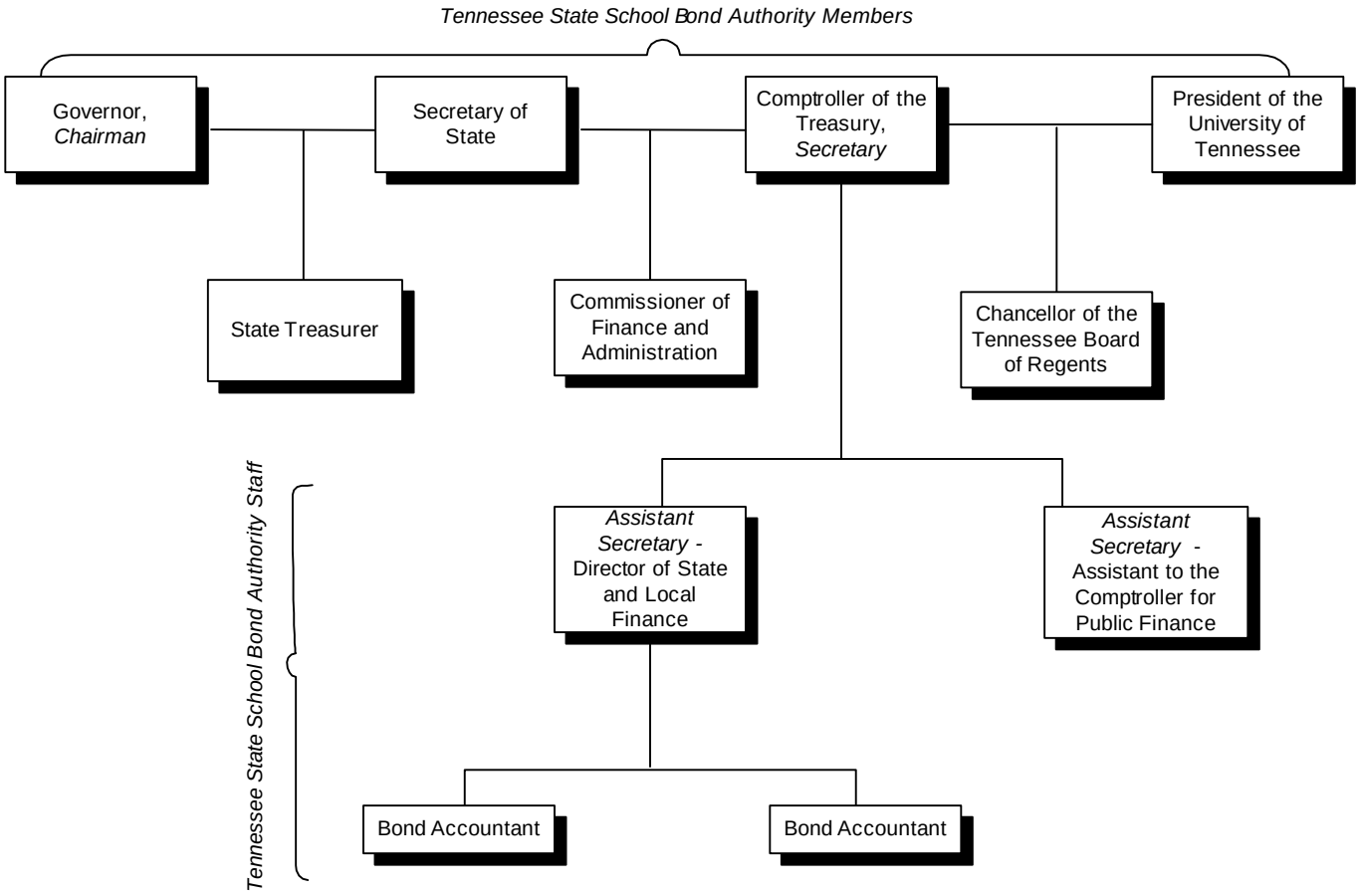
1. to consider the Authority's internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing an opinion on the financial statements;

2. to determine compliance with certain provisions of laws, regulations, and contracts (including the bond resolutions);

3. to determine the fairness of the presentation of the financial statements; and

4. to recommend appropriate actions to correct any deficiencies.

Tennessee State School Bond Authority
Organization Chart



PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

OBSERVATIONS AND COMMENTS

CERTIFICATE OF ACHIEVEMENT FOR EXCELLENCE IN FINANCIAL REPORTING

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Tennessee State School Bond Authority for its *Comprehensive Annual Financial Report* for the year ended June 30, 2011. This is the tenth year that the Authority has prepared a comprehensive annual financial report and received this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. The Authority has submitted its *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2012, to the GFOA Certificate of Achievement Program.

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

Auditors and management are required to assess the risk of fraud in the operations of the entity. The risk assessment is based on a critical review of operations considering what frauds could be perpetrated in the absence of adequate controls. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the entity is protected from fraud, waste, and abuse. Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the daily operations of the entity.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility to design, implement, and monitor effective controls in the entity. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor testing is limited and is usually targeted to test the effectiveness of particular controls. Even if controls appear to be operating effectively during the time of the auditor testing, they may be rendered ineffective the next day by management override or by other circumventions that, if left up to the auditor to detect, will not be noted until

the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the controls after the auditors have left the field.

The risk assessments and the actions of management in designing, implementing, and monitoring the controls should be adequately documented to provide an audit trail both for auditors and for management, in the event that there is a change in management or staff, and to maintain a record of areas that are particularly problematic. The assessment and the controls should be reviewed and approved by the head of the entity.

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit*, promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Tennessee State School Bond Authority's financial statements for the year ended June 30, 2012, we considered internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing an opinion on the financial

statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance and Other Matters

The results of our audit tests disclosed no instances of noncompliance or other matters that are required to be reported under generally accepted government auditing standards.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the Tennessee State School Bond Authority's financial statements.

STATE OF TENNESSEE
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Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

December 10, 2012

The Honorable Bill Haslam, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Members of the Tennessee State School Bond Authority
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have audited the financial statements of the Tennessee State School Bond Authority, a component unit of the State of Tennessee, as of and for the year ended June 30, 2012, and have issued our report thereon dated December 10, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards.

Internal Control Over Financial Reporting

Management of the Tennessee State School Bond Authority is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts (including the bond resolutions), noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under generally accepted government auditing standards.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee, the board of directors, management, and others within the entity and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/vn

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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Independent Auditor's Report

December 10, 2012

The Honorable Bill Haslam, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Members of the Tennessee State School Bond Authority
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have audited the accompanying statements of net assets of the Tennessee State School Bond Authority, a component unit of the State of Tennessee, as of June 30, 2012, and June 30, 2011, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a

member of the board of directors of the Tennessee State School Bond Authority. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Tennessee State School Bond Authority.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee State School Bond Authority as of June 30, 2012, and June 30, 2011, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The accompanying financial information listed as supplementary schedules in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

In accordance with generally accepted government auditing standards, we have also issued our report dated December 10, 2012, on our consideration of the Tennessee State School Bond Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts (including the bond resolutions) and other matters. The purpose of that report is to describe the scope of our testing of internal control over

financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with generally accepted government auditing standards and should be considered in assessing the results of our audit.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/vn

TENNESSEE STATE SCHOOL BOND AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the Tennessee State School Bond Authority (the "Authority"), we offer readers of the Authority's financial statements this narrative overview and analysis of the financial activities as presented in the financial statements and notes to the financial statements of the Authority for the fiscal year ended June 30, 2012. These activities are compared to the results of the fiscal years ended June 30, 2011, and 2010. We encourage readers to consider the information presented here in conjunction with the Independent Auditor's Report, the audited financial statements, and accompanying notes of this report.

Program Activity Highlights

The Authority's purpose is to provide loans to the state's higher education institutions by issuing bonds and notes of the Authority and to local governments on behalf of local education agencies ("LEAs") through Qualified Zone Academy Bonds ("QZABs") and Qualified School Construction Bonds ("QSCBs"). The tables below summarize this business activity.

	Higher Education Facilities Programs		
	2012	2011	2010
Number of institutions with outstanding loans	20	20	20
Total number of outstanding loans	232	252	266
Balance of outstanding loans	$1,165,180,567	$1,107,639,831	$1,071,728,642
Number of loans approved in fiscal year	10	9	16
Dollar amount of loans approved in fiscal year	$ 242,662,000	$ 85,608,000	$ 137,587,000
Dollar amount of loans approved in fiscal year - unspent	$ 237,839,410	$ 84,423,304	$ 126,040,774
Dollar amount of loans financed in fiscal year	$ 114,983,407	$ 111,260,649	$ 114,860,132
Bonds issued in fiscal year	$ -	$ 231,935,000	$ -
Commercial paper issued in fiscal year	$ 97,000,000	$ 107,218,000	$ 110,000,000

	Qualified Zone Academy Bond Program		
	2012	2011	2010
Number of LEAs with outstanding loans	12	14	14
Total number of outstanding loans	16	23	23
Balance of outstanding loans	$ 21,926,992	$ 24,729,304	$ 28,011,400
Balance held in Sinking Fund	$ 21,994,043	$ 32,480,696	$ 29,198,600
Balance of principal outstanding	$ 43,920,000	$ 57,210,000	$ 57,210,000
Dollar amount of loans approved in fiscal year	$ -	$ -	$ -
Dollar amount of loans approved in fiscal year - not disbursed	$ -	$ -	$ -
Dollar amount of loan proceeds disbursed in fiscal year	$ -	$ -	$ 88,899
Bonds issued in fiscal year	$ -	$ -	$ -

	Qualified School Construction Bond Program		
	2012	2011	2010
Number of LEAs with outstanding loans	23	23	13
Total number of outstanding loans	28	28	13
Balance of outstanding loans	$ 290,801,492	$ 145,281,252	$ 23,191,666
Balance held in Sinking Fund	$ 32,838,679	$ 9,764,134	$ -
Balance of outstanding debt	$ 389,440,000	$ 389,440,000	$ 177,000,000
Number of loans approved in fiscal year	-	15	13
Dollar amount of loans approved in fiscal year	$ -	$ 212,440,000	$ 177,000,000
Dollar amount of loans approved in fiscal year - not disbursed	$ -	$ 182,197,555	$ 164,654,954
Dollar amount of loan proceeds disbursed in fiscal year	$ 172,830,188	$ 124,797,041	$ 12,345,046
Bonds issued in fiscal year	$ -	$ 212,440,000	$ 177,000,000

The financial statements and the analysis provided in the remainder of this report reflect the financial results of this activity.

Debt Administration

Pursuant to Section 49-3-1201 et seq., *Tennessee Code Annotated*, the General Assembly of the State of Tennessee created the Tennessee State School Bond Authority to issue revenue bonds and notes to fund capital projects for the higher education institutions including both four-year institutions and two-year community colleges. Such loans are payable from user fees or savings generated from the projects in the case of energy conservation projects. The statute was amended in 1999 to authorize the Authority to issue QZABs and again in 2009 to authorize the Authority to issue QSCBs on behalf of LEAs throughout the state. For more specific financial information on long-term debt activity, see Note 5, Debt Payable, in the Notes to the Financial Statements.

The state is not liable on the bonds, and the bonds are not a debt of the State of Tennessee.

Higher Education Facilities Programs. When an institution applies for project funding through the Authority, an analysis of the financial feasibility of each loan application is undertaken by comparing the projected debt service to the pledged revenue before it is approved by the Authority. Once approved by the Authority, the project will be included in the Financing Agreement between the Authority and the respective higher education system (the University of Tennessee and the Tennessee Board of Regents). The higher education systems covenant and agree in the Financing Agreements to establish and collect fees and charges at each institution at a level sufficient to produce in each fiscal year no less than two times the amount required for the payment of total debt service. Fees and charges include all revenues, fees, rental, and other charges received by or on behalf of an institution which are available to pay debt service. In

addition, the Boards agree in the Financing Agreements that the Commissioner of Finance and Administration, after notice from the Authority that the Board has failed to pay its Annual Financing Charges or Administrative Fees, will deduct from the institution's appropriations the amount required to make it current with respect to the unpaid Annual Financing Charges and Administrative Fees.

Generally, under the financing program for higher education institutions, a project is funded through the Authority's commercial paper program during its construction phase. When commercial paper totaling $50 million or greater is outstanding for projects that are completed or near completion, the Authority may fix the interest rate for the term of the projects by issuing long-term debt. The ranges of the commercial paper interest rates are shown below for the fiscal year ended June 30, 2012, as compared to the fiscal years 2011 and 2010.

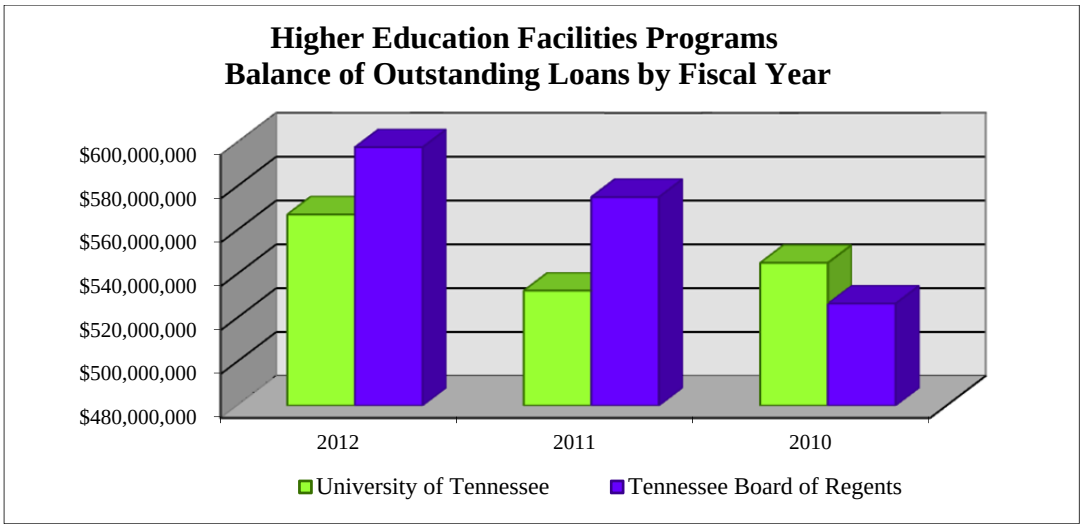
Higher Education Facilities Programs
Commercial Paper Interest Rates Range

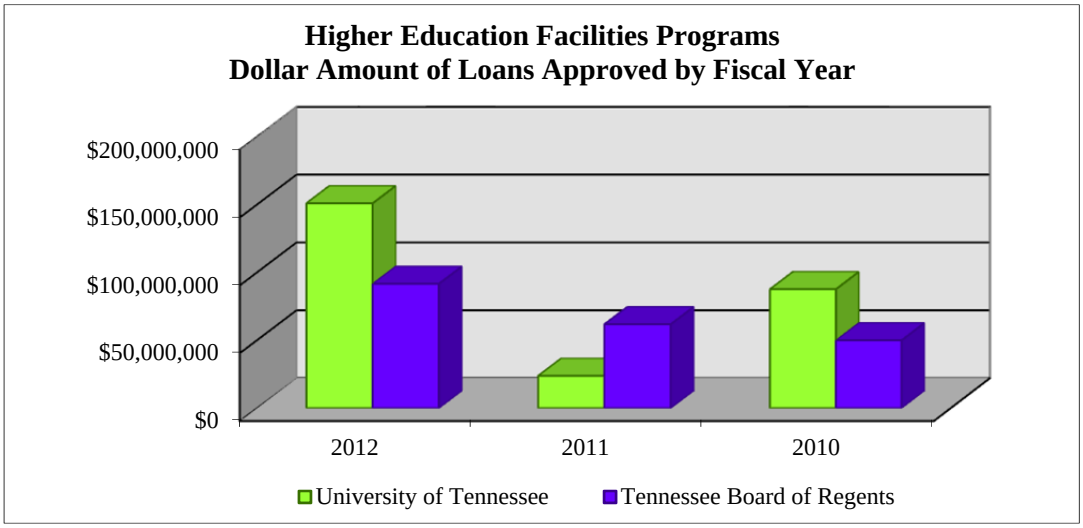
	Tax-Exempt		Federally Taxable	
Fiscal Year	**Low**	**High**	**Low**	**High**
2012	0.10%	0.33%	0.10%	0.25%
2011	0.14%	0.34%	0.20%	0.40%
2010	0.17%	0.55%	0.15%	0.50%

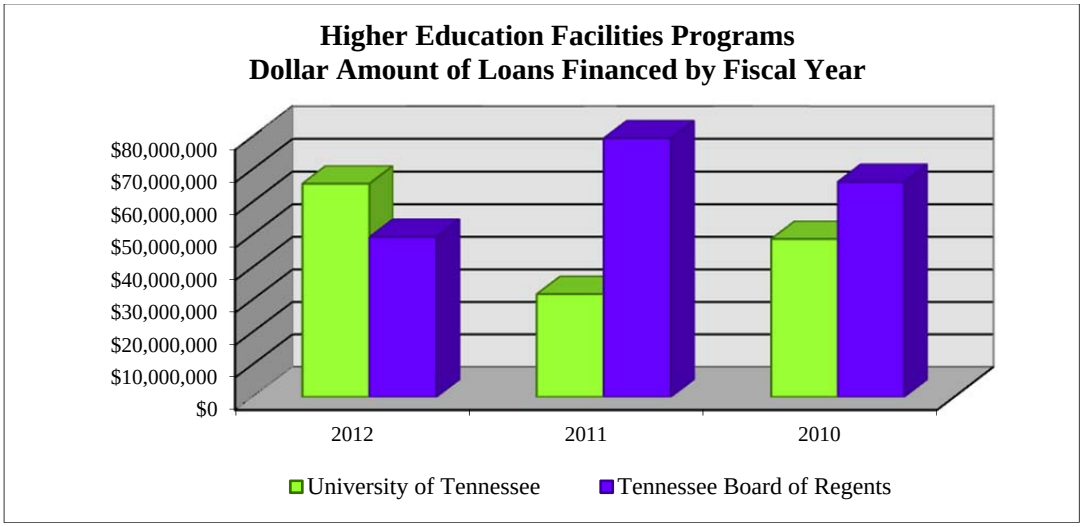
The Authority currently has a Credit Agreement with State Street Bank that provides for a total amount of $300,000,000 of commercial paper principal and 45 days of accrued interest in the amount of $4,593,750, which is calculated at the rate of 12.25% per annum on the basis of a 360-day year. The Credit Agreement with State Street Bank has an expiration date of March 30, 2014, and a commitment fee of .105% which is charged quarterly in arrears. If the liquidity facility is called upon, pursuant to the Advance Agreement, the Authority is obligated to reimburse the Bank for all amounts drawn and paid under the Liquidity Facility, together with interest thereon if not reimbursed on the same day. If not reimbursed on the same day of the advance, the principal amount will convert to a term loan with six equal semi-annual payments. As of the fiscal year ended June 30, 2012, the Authority had not called upon the liquidity facility.

For the fiscal year ended June 30, 2012, interest rates on the higher education facilities long-term fixed-rate tax-exempt bonds ranged from a low of 3.00% to a high of 5.50%, and the interest rates on the higher education facilities long-term fixed-rate federally taxable bonds ranged from a low of 2.00% to a high of 5.66%. By pooling the financing of the capital needs for all public higher education facilities, management believes that economic efficiency is achieved through a single large borrowing administered by one agency. The creditworthiness of both large and small institutions is blended into one credit, resulting in a lower cost of borrowing and providing a more equitable cost to students and other users who repay the debt through various user fees and charges and student debt service fees.

Higher Education Facilities Programs Debt Ratings. As of the fiscal year ended June 30, 2012, the Authority's higher education facilities program is rated AA+, Aa1, and AA by Fitch, Moody's Investors Service, and Standard & Poor's Rating Group, respectively.



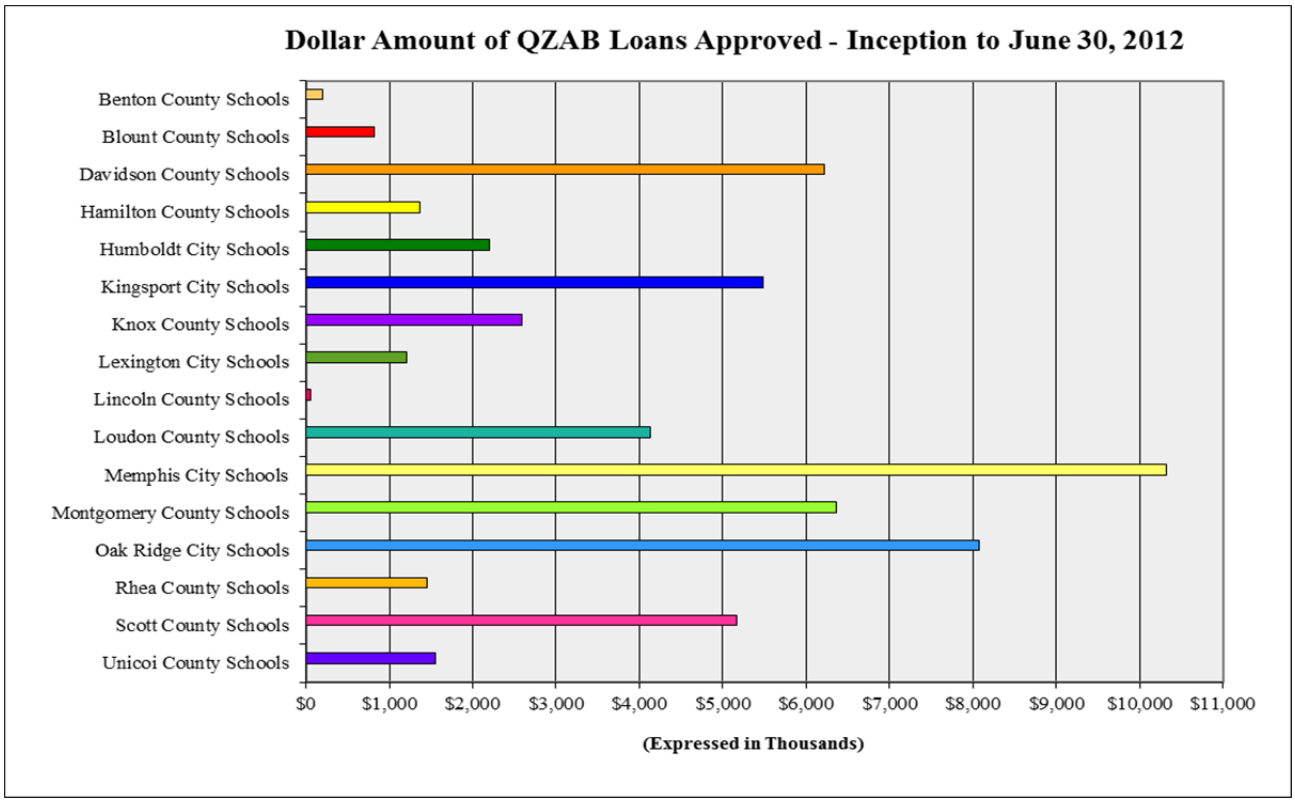




Qualified Zone Academy Bond Program. The QZAB program is a capital financing program authorized by the federal government under the Taxpayer Relief Act of 1997, Section 227(a). A QZAB is a taxable bond issued by the Authority, the proceeds of which are used to finance certain eligible public schools' renovation projects and equipment purchases. During the time the bond is outstanding, an eligible holder of a QZAB is generally allowed annual federal income tax credits in lieu of receiving periodic interest payments from the issuer. These credits compensate the holder for lending money to the borrower and function as payments of interest on the bonds. The Tennessee Department of Education distributes the application for a QZAB allocation to all LEAs in the state. The department recommends those projects that best meet the requirements of the program to the Authority for funding.

The LEA and the city or county supporting the agency must provide a general obligation pledge to the Authority for the repayment of its loans. The Authority is authorized to intercept the local community's state-shared taxes, should the LEA/local government fail to repay its loan timely.

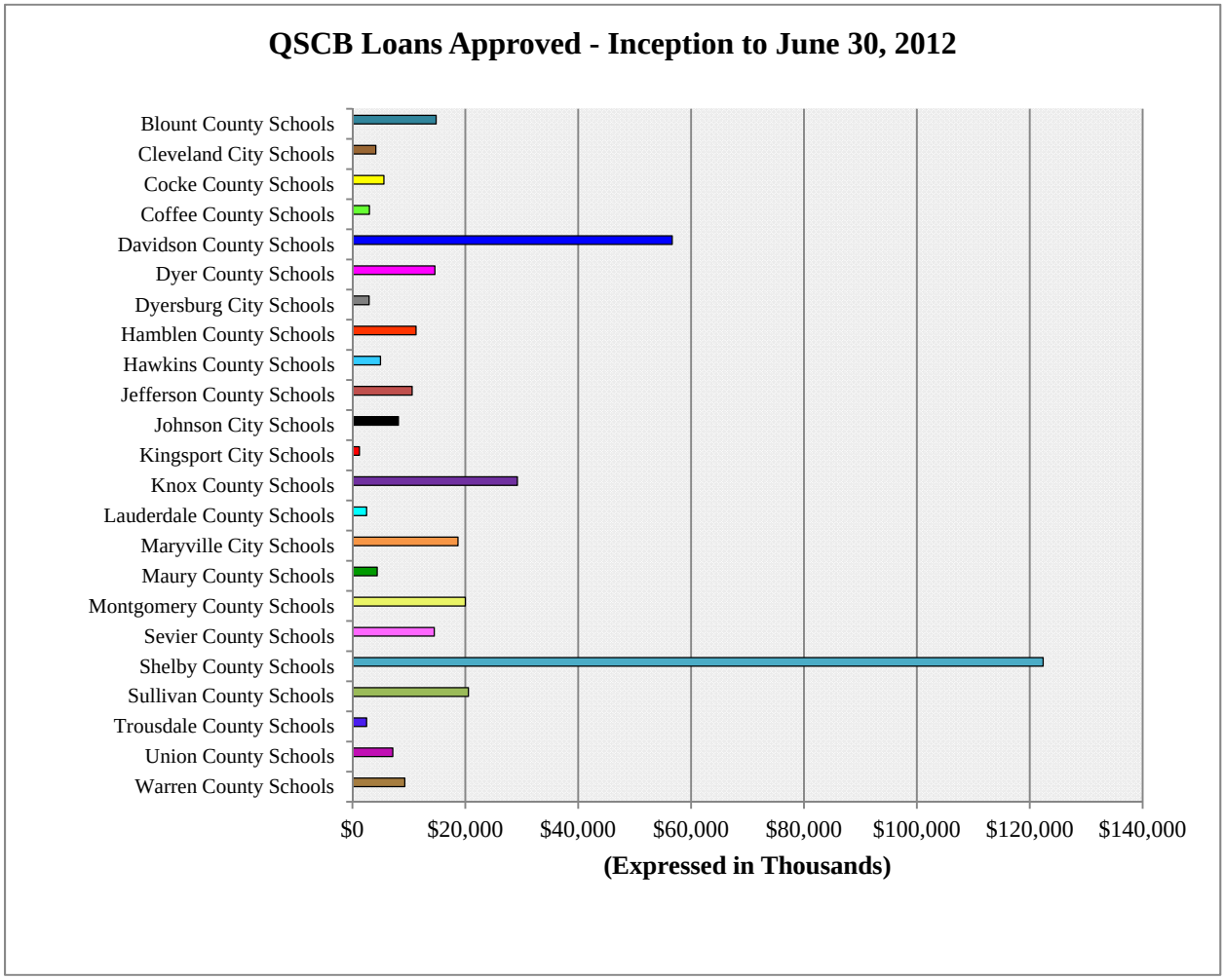
As of June 30, 2012, the QZAB program has unused allocations totaling $41,496,000. Of this amount, $32,065,000 of the 2010 allocation will expire on December 31, 2012. The state has up to two years after the yearly allocations are made by the federal government to issue bonds or the allocations will be forfeited.



Qualified Zone Academy Bond Program Debt Ratings. All of the QZABs have been placed with private investors. The QZABs are not rated.

Qualified School Construction Bond Program. The QSCB program is a capital financing program originally authorized by the federal government under the American Recovery and Reinvestment Act of 2009 and Section 49-3-12, *Tennessee Code Annotated*, as amended. The QSCBs are bonds issued by the Authority, the proceeds of which are used to finance certain eligible public schools' renovation and rehabilitation projects, equipment purchases, new building construction, and land acquisition. The Series 2009 QSCB is structured as a tax credit bond under which an eligible holder of a QSCB is generally allowed quarterly federal income tax credits in addition to quarterly supplemental interest payments from the issuer during the period the bond is outstanding. These credits compensate the bondholder for lending money to the Authority and function as partial payments of interest on the bonds. The Series 2010 QSCB is structured as a direct subsidy payment bond under which the holder of the bond is compensated with a semi-annual cash interest payment that is subsidized by the Federal Government. The Authority elects to receive the direct interest subsidy payments from the United States Treasury, and the loan agreements provide that the subsidy payments received by the Authority will then be transferred to the borrowers.

The city or county supporting the LEA must provide a general obligation pledge to the Authority for the repayment of its loans. The Authority is authorized to intercept the local community's state-shared taxes, should the local government fail to repay its loan timely.



Qualified School Construction Bonds Program Debt Ratings. As of the fiscal year ended June 30, 2012, the Authority's QSCB program is rated Aa2, AA, and AA by Moody's Investors Service, Inc., Standard & Poor's Ratings Service, and Fitch Ratings, respectively.

Overview of the Financial Statements

The Authority is a discretely presented component unit of the State of Tennessee and uses proprietary fund accounting. The financial statements are prepared in conformity with

accounting principles generally accepted in the United States of America using the accrual basis of accounting and the flow of economic resources measurement focus. This basis recognizes revenues when earned and expenses at the time liabilities are incurred. Using the economic resources measurement focus, a reader is presented information that allows him/her to determine the transactions and events that have increased or decreased the total economic resources for the period.

This discussion and analysis is intended to serve as an introduction to the Authority's basic financial statements. The Authority's basic financial statements are comprised of two components: 1) the basic financial statements and 2) notes to the financial statements. The basic financial statements consist of the Statement of Net Assets; Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows.

The Statements of Net Assets present the Authority's financial position at June 30, 2012, and June 30, 2011. The Statements of Revenues, Expenses, and Changes in Net Assets portray the results of operations and the change in net assets for the years presented. The Statements of Cash Flows summarize the sources and uses of cash for the fiscal years presented. These statements are accompanied by notes to the financial statements that provide information that is essential to the reader's understanding of the financial statements. The Authority's basic financial statements are followed by supplementary information containing the financial statement information at the program level.

Financial Analysis of the Authority

Standard indicators of financial success are not applicable to the Authority. The financial goals of the Authority are to provide timely access to the capital markets for public higher educational institutions and local governments on behalf of LEAs at the lowest possible cost, to repay debt timely, and to achieve the highest possible rating for its debt. During the fiscal year ended June 30, 2012, the Authority frequently entered the short-term market. At no time did the Authority deny approval of a loan application due to its inability to access the capital market. There were no incidents requiring the Authority to withdraw funds from the debt service reserve fund or the commercial paper credit agreement to pay debt service timely. The Authority maintained both its long- and short-term credit ratings with all rating agencies.

Statements of Net Assets Summary
(in thousands)

	2012	2011	2010
Current assets	$ 116,815	$ 131,102	$ 103,132
Noncurrent assets	1,611,468	1,576,698	1,306,432
Total assets	1,728,283	1,707,800	1,409,564
Current liabilities	82,386	100,783	74,910
Noncurrent liabilities	1,638,024	1,599,186	1,326,610
Total liabilites	1,720,410	1,699,969	1,401,520
Net assets (unrestricted)	$ 7,873	$ 7,831	$ 8,044

Note: The Authority owns no capital assets.

At June 30, 2012, current assets include $15,242,698 of unexpended bond proceeds and commercial paper that will fund approved higher education loans as compared to $31,917,018 at June 30, 2011, and $19,196,131 at June 30, 2010. During the fiscal year ended June 30, 2012, the Authority did not issue any long-term debt. During the fiscal year ended June 30, 2011, the Authority issued $231,935,000 in Higher Education Facilities Second Program Bonds, which were used to retire $220,366,027 of commercial paper proceeds with the remainder to be used to fund various project costs and costs of issuance. The Authority also issued during the fiscal year June 30, 2011, $212,440,000 in QSCBs which were used to fund various project costs and costs of issuance. During the fiscal year ended June 30, 2010, the Authority issued $177,000,000 in QSCBs, which were used to fund various project costs and costs of issuance.

Principal payments were made on the higher education outstanding long-term bonds in the amounts of $50,659,000 in 2012; $47,493,000 in 2011; and $47,352,000 in 2010. Deposits to the Sinking Fund for the QZABs were made in the amounts of $3,403,891 in 2012; $3,463,796 in 2011; and $4,116,317 in 2010. During the fiscal year ended June 30, 2012, the 1999 Series QZAB bonds were retired in the amount of $13,290,000, decreasing both the QZAB Sinking Fund balance and the balance of outstanding bonds. No QZAB bonds were retired during fiscal years 2011 or 2010. Deposits to the Sinking Fund for the QSCBs were made in the amounts of $23,074,545 in 2012 and $9,764,134 in 2011. No QSCB bonds were retired during the fiscal years 2012, 2011, or 2010.

Net assets are available to fund ongoing operations and other expenses necessary to meet the goals of the Authority. Assets and liabilities increase and decrease together in correlation to the issuance and repayment of debt and the resulting loans. There was not a significant change in net assets from fiscal year ending June 30, 2012, to fiscal year ending June 30, 2011, because the issuance of short-term debt was offset by the repayment of loans.

Statements of Revenues, Expenses, and Changes in Net Assets Summary (in thousands)

	2012	2011	2010
Operating Revenues			
Revenue from loans	$ 59,892	$ 57,310	$ 43,377
Federal subsidy on bonds	10,299	7,524	-
Investment earnings	1,100	512	386
Total operating revenue	71,291	65,346	43,763
Operating Expenses			
Interest expense	58,007	55,355	42,114
Subsidy to borrowers	11,314	8,061	291
Other expenses	1,928	2,143	1,405
Total operating expenses	71,249	65,559	43,810
Operating income (loss) and change in net assets	$ 42	$ (213)	$ (47)

Note: The Authority has no non-operating revenues or expenses.

The Authority's operating revenues include revenue from loans in the form of administrative fees, interest on loans, and income earned on investments. Operating expenses include interest expense on outstanding bonds and commercial paper, administrative expenses, and the amortization of bond costs of issuance. The change in operating income and net assets can be attributed largely to the QSCB program. In fiscal year 2011, due to the timing of the issuance of the 2010 QSCBs, only a partial year of revenues was collected whereas in fiscal year 2012, a full year was collected, resulting in an increase in revenue from loans and the federal subsidy on bonds. Interest expense and subsidy to borrowers were also affected in the same manner.

For the fiscal year ended June 30, 2012, the Authority elected to return the investment income that it earned on funds held by the Trustee and interest earned on unspent bond proceeds to its borrowers in the higher education facilities program as a subsidy in the form of a credit to amounts due on debt service from the borrowers.

Pursuant to the bond resolution for the QZABs, Sinking Fund payments are invested in the State Pooled Investment Fund (SPIF). SPIF rates for fiscal year ended June 30, 2012, ranged from 0.12% to 0.14%. Investment earnings related to the QZAB program are held by the Authority for the benefit of the LEAs participating in the program and credited to their individual debt service sinking fund payment on an annual basis. Pursuant to the supplemental bond resolutions for the 2004 and 2005 Series QZABs, sinking fund payments are invested in Forward Delivery Agreements, which guarantee a fixed rate of interest of 3.00% and 3.64%, respectively, on investments. The investments are held by the State Treasurer in the Authority's name.

Investment earnings related to the QSCB program are held by the Authority for the benefit of the local governments participating in the program and are credited on a monthly basis to the amounts due on their individual debt service principal and interest payments.

Future Financing Activities

Higher Education Facilities Programs. As Tennessee continues into an economic era that emphasizes the human capital potential of its citizens rather than physical capital and natural resources, the higher education system must be positioned to serve the broader-based need for access to post-secondary education and to produce degree and certificate holding work-ready citizens. A host of policy and environmental factors influence the demands for access and completion, and the means through which this demand will be met.

These factors include:

- Economic conditions in 2008 led to an enrollment bulge in Tennessee colleges and universities that rippled through 2010. University enrollment increased seven percent from 2008 to 2010, while community college enrollment increased 22 percent in the same time period, the largest increase in more than two decades. These enrollment increases began to wane in 2011, but total enrollments remain well above the levels before the economic downturn. Over the last five years, enrollments have increased 12 percent at universities and 24 percent at community colleges.

- The demographic composition of the state is changing dramatically, and the higher education system must position itself to serve the needs of an increasingly diverse population.

- The advent of the Tennessee Education Lottery Scholarship program allowed more Tennesseans to attend college. In 2011-12, the Tennessee Lottery provided an estimated $313 million in scholarships to more than 103,000 students.

In January 2010, the Tennessee General Assembly enacted the Complete College Tennessee Act (CCTA), a comprehensive reform agenda that seeks to transform public higher education through changes in academic, fiscal, and administrative policies at the state and institutional level. The primary goal of these reforms is for more Tennesseans to be better educated and trained. At the heart of the CCTA is a new Public Agenda for higher education which establishes the direct link between the state's economic development and its educational system. The overarching goal of the Public Agenda is to have Tennessee meet the projected national average in educational attainment by 2025. The primary state policy levers for addressing the state's educational needs include (1) a new funding formula which incorporates outcomes in lieu of enrollment; (2) a new Performance Funding program which focuses on quality assurance; and

(3) the establishment of institutional mission statements or profiles which distinguish each institution by degree level, program offerings, and student characteristics. Other major components of the reform agenda include more efficient student transfer, a more integrated community college system, reforms to the delivery of student remediation programs, and an enhanced research focus for the University of Tennessee Knoxville and the University of Memphis, the state's two public Carnegie Research institutions.

With the creation of CCTA, the importance of receiving training beyond high school became more significant. In 2008, 24.5 percent of Tennessee's working-age adults held a college degree, compared to the national average of 29.5 percent. To reach the national average educational attainment levels of 2008, Tennessee would have needed an additional 170,000 citizens with a bachelor's degree or higher, more than double the annual degree production of the state's public and private institutions at that time. Furthermore, the percentage of adults in the state with an associate's degree or some college in 2008 was 31.3 percent, in comparison with the national average of 37.9 percent. To reach the 2008 national average, Tennessee would have needed an additional 220,000 citizens with an associate's degree or higher. As of 2011, the percentage of adults in the state with a bachelor's degree or higher was 25.3 percent, compared to the national rate of 30.1 percent. Those with an associate's degree or higher increased to 32.1 percent while the national rate was 38.7 percent. While Tennessee continues to trail the national rate, the gap has narrowed for adults with bachelor's degrees. Much work remains to achieve the goals of CCTA. However, the availability of new and/or improved learning facilities near work and home will have a major impact on the state's success in achieving these goals.

The increased enrollment during the economic downturn years and demand for advanced education and training will continue to put stress on the capital facilities at all campuses. As a result, the state anticipates an increased need for funding of various facilities through the Authority.

Higher Education Facilities Programs Change in Rating Methodology. A rating agency recently revised its rating methodology for the higher education facilities program. The new rating methodology may create limitations that could affect the program's ability to finance certain future capital projects.

Qualified Zone Academy Bonds and Qualified School Construction Bonds Programs. The issuance of bonds within the QZAB and QSCB programs is limited to the amounts allocated by the federal government. At this time, the Authority does not anticipate further issuance of debt for the QZAB program due to economic and financial conditions and constraints. The QSCB program expired December 31, 2010.

Contacting the Authority's Management Team

This discussion and analysis is designed to provide our citizens, education agencies, investors, and creditors with a general overview of the Authority's finances and to demonstrate its accountability for the monies it receives. If you have questions about this report or need additional financial information, contact the Director of State and Local Finance, State of Tennessee, Suite 1600, James K. Polk Center, 505 Deaderick St., Nashville, Tennessee 37243-1402; visit our website at www.comptroller.tn.gov/TSSBA; or call (615) 747-5370.

TENNESSEE STATE SCHOOL BOND AUTHORITY
STATEMENTS OF NET ASSETS
JUNE 30, 2012, AND JUNE 30, 2011

(Expressed in Thousands)

	June 30, 2012	June 30, 2011
ASSETS		
Current assets:		
Cash (Note 2)	$ 22,715	$ 40,968
Cash with fiscal agent (Note 2)	1,055	642
Investments with fiscal agent (Note 2)	-	14
Deferred outflow - derivatives (Note 2)	-	1,316
Derivatives - Forward Delivery Agreement (Note 2)	2,128	-
Deferred charges (Note 7)	1,561	772
Loans receivable (Note 3)	77,265	75,729
Interest receivable (Note 3)	7,626	7,787
Federal subsidy receivable	3,004	3,004
Receivables for administrative fees (Note 3)	1,461	870
Total current assets	116,815	131,102
Noncurrent assets:		
Restricted cash (Notes 2 and 4)	96,238	276,203
Restricted investments (Notes 2 and 4)	82,585	64,148
Loans receivable (Note 3)	1,400,644	1,201,921
Deferred charges (Note 7)	32,001	34,426
Total noncurrent assets	1,611,468	1,576,698
Total assets	1,728,283	1,707,800
LIABILITIES		
Current liabilities:		
Accounts payable	21	1,360
Accrued liabilities	15,118	19,284
Derivatives - Forward Delivery Agreement (Note 2)	-	1,316
Deferred inflow - derivatives (Note 2)	2,128	-
Accrued interest payable	10,533	10,858
Unearned revenue (Note 6)	4,551	4,410
Bonds payable (Note 5)	50,035	63,555
Total current liabilities	82,386	100,783
Noncurrent liabilities:		
Unearned revenue (Note 6)	11,217	12,143
Commercial paper payable (Note 5)	253,676	162,653
Bonds payable (Note 5)	1,373,131	1,424,390
Total noncurrent liabilities	1,638,024	1,599,186
Total liabilities	1,720,410	1,699,969
NET ASSETS		
Unrestricted	$ 7,873	$ 7,831

The notes to the financial statements are an integral part of this statement.

TENNESSEE STATE SCHOOL BOND AUTHORITY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2012, AND JUNE 30, 2011

(Expressed in Thousands)

	Year Ended June 30, 2012	Year Ended June 30, 2011
OPERATING REVENUES		
Revenue from loans	$ 59,892	$ 57,310
Federal subsidy on bonds	10,299	7,524
Investment earnings (loss)	1,100	512
Total operating revenues	71,291	65,346
OPERATING EXPENSES		
Interest expense-commercial paper	323	450
Interest expense-bonds	57,684	54,905
Loss on retirement of bonds	4	-
Subsidy to borrowers	11,314	8,061
Administrative expense	1,143	1,356
Amortization of bond issuance costs	781	787
Total operating expenses	71,249	65,559
Operating income (loss) and change in net assets	42	(213)
Net assets, July 1	7,831	8,044
Net assets, June 30	$ 7,873	$ 7,831

The notes to the financial statements are an integral part of this statement.

TENNESSEE STATE SCHOOL BOND AUTHORITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2012, AND JUNE 30, 2011

(Expressed in Thousands)

	Year Ended June 30, 2012	Year Ended June 30, 2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from borrowers for administrative fees	$ 367	$ 712
Payment to suppliers	(1,147)	(1,370)
Receipts from borrowers to the interest rate reserve fund	502	428
Payments to borrowers from the interest rate reserve fund	(3)	(1,136)
Net cash used in operating activities	(281)	(1,366)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from sale of bonds	-	458,118
Proceeds from sale of commercial paper	97,000	107,218
Bond interest subsidy from federal government	10,299	4,520
Call premium paid	(4)	-
Bond issuance costs paid	-	(888)
Principal paid - bonds and commercial paper	(69,922)	(273,840)
Interest paid - bonds and commercial paper	(59,191)	(51,777)
Subsidy to borrowers	(10,551)	(4,923)
Net cash provided by (used in) noncapital financing activities	(32,369)	238,428
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(38,531)	(68,174)
Proceeds from sales and maturities of investments	20,328	41,288
Interest received on investments	1,131	697
Loans issued	(287,814)	(236,058)
Loan escrow paid	(520)	(130)
Collections of loan principal	82,038	63,559
Interest received on loans	58,810	57,006
Collections of call premium	4	-
Refund to borrowers	(601)	(180)
Net cash used in investing activities	(165,155)	(141,992)
Net increase (decrease) in cash	(197,805)	95,070
Cash, July 1	317,813	222,743
Cash, June 30	$ 120,008	$ 317,813

(Continued on next page)

TENNESSEE STATE SCHOOL BOND AUTHORITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2012, AND JUNE 30, 2011

(Expressed in Thousands)

Reconciliation of cash to the Statement of Net Assets:		
Cash	$ 22,715	$ 40,968
Cash with fiscal agent	1,055	642
Restricted cash	96,238	276,203
Cash, June 30	$ 120,008	$ 317,813
Reconciliation of operating income (loss) to net cash used in operating activities:		
Operating income (loss)	$ 42	$ (213)
Adjustments to reconcile operating income (loss) to net cash used in operating activities:		
Amortization of bond issuance costs	781	788
Investment earnings	(1,215)	(512)
Interest expense	58,007	55,355
Federal subsidy on bonds	(10,299)	(7,524)
Subsidy to borrowers	11,314	8,061
Interest income from loans	(58,525)	(55,915)
Changes in assets and liabilities:		
(Increase) decrease in receivables for administrative fees	(595)	(404)
(Increase) decrease in payables for administrative fees	-	(8)
Increase (decrease) in due to primary government	-	(7)
Increase (decrease) in the interest rate reserve fund	498	(708)
Increase (decrease) in unamortized discount net bond issuance costs	(289)	(279)
Total adjustments	(323)	(1,153)
Net cash used in operating activities	$ (281)	$ (1,366)
Noncash financing activities:		
Bond issuance costs	$ -	$ (14,188)
Noncash investing activities:		
Increase in fair/amortized value of investments	$ 264	$ 22

The notes to the financial statements are an integral part of this statement.

Tennessee State School Bond Authority
Notes to the Financial Statements
June 30, 2012, and June 30, 2011

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Tennessee State School Bond Authority (the Authority) was created to provide a mechanism for financing capital projects for the state's higher education institutions. During 1999, the General Assembly empowered the Authority to issue Qualified Zone Academy Bonds (QZABs) for local governments to borrow for financing improvement projects on behalf of local education agencies pursuant to the federal program authorized in the Taxpayer Relief Act of 1997. In addition, under the American Recovery and Reinvestment Act of 2009, the Authority was authorized to issue Qualified School Construction Bonds (QSCBs) for local governments to borrow on behalf of local education agencies at nominal or zero percent interest for financing renovation and rehabilitation projects, equipment purchases, new building construction, and land acquisition.

The Authority is a component unit of the State of Tennessee (the state) and a separate legal entity. In accordance with the Governmental Accounting Standards Board's (GASB) Statement No. 14, *The Financial Reporting Entity*, the Authority is discretely presented in the *Tennessee Comprehensive Annual Financial Report* because a majority of the Authority's board consists of state officials, which include the Governor, the State Treasurer, the Secretary of State, the Commissioner of Finance and Administration, the Comptroller of the Treasury, the Chancellor of the Tennessee Board of Regents, and the President of the University of Tennessee. The Governor serves as chairman, and the Comptroller of the Treasury serves as secretary. The Director of the Office of State and Local Finance serves as the assistant secretary; the office provides administrative and financial services to the Authority. Therefore, the state has the ability to affect the day-to-day operations of the Authority.

Basis of Presentation

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board. Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Authority has the option of following subsequent private-sector guidance subject to this same limitation. The Authority has elected not to follow subsequent private-sector guidance.

Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

The Authority distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering services in connection with principal ongoing operations. The Authority's principal ongoing operation is to provide loans for constructing capital projects, renovating and rehabilitating facilities, acquiring land, and acquiring equipment to higher educational facilities and to local government units pursuant to the criteria set by the federal government for the QZAB and QSCB programs. Therefore, the Authority also recognizes income on investments as operating revenue. The Authority's operating expenses include interest paid on borrowings, subsidies to borrowers, bond issuance costs, arbitrage, and administrative expenses. Any revenues and expenses not meeting this definition would be reported as nonoperating revenues and expenses.

Investments

Investments for the Higher Education and QZAB Programs are stated at fair value. Investments for the QSCB program will be held to maturity and are stated at amortized value.

Amortized Amounts

A. Bond Issuance Costs. The Authority amortizes bond issuance costs using the straight-line method over the life of the bonds. Unamortized bond issuance costs are reported as deferred charges.

B. Bond Discounts, Premiums, and Deferred Amount on Refundings. The Authority amortizes bond discounts and premiums using the straight-line method over the life of the bonds. The deferred amount on refundings is amortized using the straight-line method over the remaining life of the old debt or the life of the new debt, whichever is shorter. Bonds payable are reported net of the applicable unamortized bond discount or premium and the unamortized deferred amount on refundings.

   Amortization of bond discount, premium, and deferred amount on refundings is reported with bond interest expense in the financial statements.

C. Accretion. The accretion of agency zeroes and strips is the difference between the face amount of agency zeroes and strips and the initial public offering price. The accretion of agency zeroes and strips are not treated as an investment discount. Agency zeroes and strips are subject to redemption at prices which increase from the public offering price to the face amount. The carrying amounts of these investments are adjusted annually at June 30 to reflect the increased value, with a corresponding credit to interest income.

D. Unearned Revenue. When the Authority issues bonds to finance capital projects, the par amount of the bonds is adjusted by certain amounts (such as bond discount/premium, underwriters' fees, and other costs of issuance) in order to arrive at the amount of bond proceeds available for capital expenditures. These amounts, discussed above, are capitalized and amortized pursuant to accounting principles generally accepted in the United States of America. A similar situation arises when accounting for the loans to the higher education institutions and local governments. Because of the adjustments mentioned above (discount, costs of issuance, etc.), the principal amount of the loan differs from the actual amount of funds available for capital expenditures. Because the higher education institutions and the local governments bear the cost of this difference, it is carried on the statement of net assets as unearned revenue and amortized on a straight-line basis over the life of the related bond. When the premium exceeds the costs of issuance and underwriters fees, the adjustment is carried on the statement of net assets as deferred charges.

The Authority requires the higher education institutions to contribute funds to the Interest Rate Reserve Fund based on the amount of outstanding commercial paper. The principal of the Interest Rate Reserve Fund is credited back to the institution as commercial paper is redeemed. The Interest Rate Reserve Fund is reported on the statement of net assets as unearned revenue and is not amortized.

The Authority requires the QSCB borrowers to prepay bondholder interest to the Debt Service Fund as outlined in the loan agreements. The interest of the Debt Service Fund is credited back to the borrower as bondholder interest payments are made. The prepaid interest is reported on the statement of net assets as unearned revenue and is not amortized.

E. Deferred Charges. When the Authority issues bonds to finance capital projects, the Authority incurs certain costs of issuance and underwriters' fees. These amounts, discussed above, are capitalized and amortized pursuant to accounting principles generally accepted in the United States of America. These costs are

carried on the statement of net assets as deferred charges and amortized on a straight-line basis over the life of the related bond.

When the Authority issues bonds to finance capital projects, the par amount of the bonds is adjusted by certain amounts (such as bond premium, underwriters' fees, and other costs of issuance) in order to arrive at the amount of bond proceeds available for capital expenditures. When the premium exceeds the costs of issuance and underwriters fees, the higher education institutions and the local governments bear the benefit of this difference. Because of this, it is carried on the statement of net assets as a deferred charge and amortized on a straight-line basis over the life of the related bond.

NOTE 2. DEPOSITS AND INVESTMENTS

Moneys pertaining to the Higher Education Second Program General Bond Resolution, the Qualified Zone Academy Bonds First Program Resolution, and the Qualified School Construction Bonds General Bond Resolution of the Tennessee State School Bond Authority, pursuant to *Tennessee Code Annotated,* Section 49-3-1205, can be invested, pursuant to each Bond Resolution listed above, in obligations of the United States or its agencies under flexible repurchase agreements which are fully collateralized by obligations of the United States or obligations, the timely payment of the principal of and interest on which are guaranteed by the United States, the state's pooled investment fund as provided in *Tennessee Code Annotated,* Section 9-4-603, and any other investment authorized by the State Investment Policy adopted by the State Funding Board pursuant to *Tennessee Code Annotated,* Section 9-4-602.

Deposits

The Authority has cash on deposit in the State Pooled Investment Fund and Local Government Investment Pool administered by the State Treasurer. The funds' investment policy and required risk disclosures are presented in the *State of Tennessee Treasurer's Report.* That report is available on the state's website at www.treasury.tn.gov.

The Authority's deposits are held in a financial institution, which participates in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement,

public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

Investments

As of June 30, 2012, the Authority has the following Higher Education and QZAB investments:

Investment	Maturity	Fair Value
U.S. Treasury Bill	December 6, 2012	$6,106,273
U.S. Treasury Notes	July 31, 2012	4,790,135
	September 15, 2013	8,548,110
	October 15, 2013	23,774,728
U.S. Government Supported Corporate Debt	September 28, 2012	4,111,789
	December 28, 2012	4,165,764
Total Investments		$51,496,799

As of June 30, 2012, the Authority has the following QSCB investments:

Investment	Maturity	Amortized Value
U.S. Treasury Notes	August 15, 2026	$14,039,237
U.S. Treasury Securities:		
Agency Zeroes & Strips	August 15, 2026	17,049,334
Total Investments		$31,088,571

As of June 30, 2011, the Authority had the following Higher Education and QZAB investments:

Investment	Maturity	Fair Value
U.S. Treasury Bill	November 17, 2011	$4,159,126
U.S. Treasury Notes	November 30, 2011	4,992,394
	April 30, 2012	402,460
	September 15, 2013	8,540,545
	October 15, 2013	23,673,012
U.S. Government Supported Corporate Debt	September 28, 2012	4,171,044
	December 28, 2012	4,212,283

U.S. Treasury Securities:	
State and Local Government Series	4,944,110
Total Investments	$55,094,974

As of June 30, 2011, the Tennessee State School Bond Authority held two separate State and Local Government Series U.S. Treasury Securities. One security covers the debt of the QZAB borrower's remaining loan balance of $4,434,886, and the other security covers the remaining loan balance of $509,224 of the Higher Education borrower's debt.

As of June 30, 2011, the Authority had the following QSCB investments:

Investment	Maturity	Amortized Value
U.S. Treasury Notes	August 15, 2026	$5,098,034
U.S. Treasury Securities:		
Agency Zeroes & Strips	August 15, 2026	3,969,372
Total Investments		$9,067,406

Interest Rate Risk

Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The state's Investment Policy does not formally address interest rate risk. As a matter of practice, higher education investments are invested no longer than five years to reduce the interest rate risk. QZAB investments follow the guidelines in the Forward Delivery Agreements which are limited to six-month maturities so that interest rate risk is contained. The Authority's investments are specifically identified above.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. At June 30, 2012, and June 30, 2011, the Authority only invested in U.S. Government obligations, or obligations of which the principal and interest are guaranteed by the United States.

Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of the failure of a counterparty, the Authority will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Authority's investment securities are exposed to custodial credit risk if they are uninsured, are not

registered in the name of the Authority, and are held by either the counterparty or the counterparty's trust department or agent but not in the Authority's name. At June 30, 2012, and June 30, 2011, the Authority's investments were registered in the name of the Authority.

Concentration of Credit Risk

A concentration of investments in any one single issuer of debt securities presents a greater risk for loss in the event that the issuer fails on its obligations. At June 30, 2012, and June 30, 2011, the Authority only invested in U.S. Treasury securities, or obligations of which the principal and interest are guaranteed by the United States.

Forward Delivery Agreements

On November 24, 2004, the Authority entered into a Forward Delivery Agreement (the "Agreement") with Bank of America, N.A. related to the series 2004 QZAB Bonds. The Agreement guarantees to the Authority a fixed rate of interest of 3%. Cash from borrowers' loan repayments will be used to purchase securities from Bank of America, N.A. in accordance with the Agreement. The accumulated funds will be used to redeem the $12,600,000 series 2004 QZAB Bonds at maturity. As a result of the Agreement, borrowers will repay only $9,984,800 of the $12,600,000 principal. The investments will be held by the State Treasurer in the Authority's name. As of June 30, 2012, there is $4,790,135 invested through the Agreement. As of June 30, 2011, there was $4,159,126 invested through the Agreement. The Authority negotiated a "one way" termination provision in the event of counterparty default on the Agreement. The Authority also has the right to optionally terminate the Agreement at any time.

On December 28, 2005, the Authority entered into a Forward Delivery Agreement (the "Agreement") with J.P. Morgan Chase Bank, N.A. related to the series 2005 QZAB Bonds. The Agreement guarantees to the Authority a fixed rate of interest of 3.64%. Cash from borrowers' loan repayments will be used to purchase securities from J.P. Morgan Chase Bank, N.A. in accordance with the Agreement. The accumulated funds will be used to redeem the $17,545,000 series 2005 QZAB Bonds at maturity. As a result of the Agreement, borrowers will repay only $13,438,510 of the $17,545,000 principal. The investments will be held by the State Treasurer in the Authority's name. As of June 30, 2012, there is $6,106,273 invested through the Agreement. As of June 30, 2011, there was $4,992,394 invested through the Agreement. The Authority negotiated a "one way" termination provision in the event of counterparty default on the Agreement. The Authority also has the right to optionally terminate the Agreement at any time.

Terms of the Forward Delivery Agreements

	QZAB Series 2004	QZAB Series 2005
Trade Date	11/24/2004	12/28/2005
Provider	Bank of America, N.A	J.P. Morgan Chase Bank, N.A.
Notional Amount	$12,600,000	$17,545,000
Guaranteed Interest Rate	3.00%	3.64%
Amount Invested in Agreement at 6/30/12 at fair value	$4,790,135	$6,106,273
Amount Invested in Agreement at 6/30/11 at fair value	$4,159,126	$4,992,394
Date of Deposits	Nov. 24, 2005 through 2020	Dec. 8, 2006 through 2020

For the fiscal year ended June 30, 2012, the Forward Delivery Agreement for the 2004 QZAB bonds has a positive fair value of $422,423 and the Forward Delivery Agreement for the 2005 QZAB bonds has a positive fair value of $1,705,408. These positive fair values are reported as assets on the statement of net assets. For the fiscal year ended June 30, 2011, the Forward Delivery Agreement for the 2004 QZAB bonds had a negative fair value of ($761,795) and the Forward Delivery Agreement for the 2005 QZAB bonds had a negative fair value of ($554,729). The Authority did not enter into these agreements as interest rate hedges. These negative fair values are reported as liabilities on the statement of net assets. The agreements were valued by an independent investment advisor using the parameters contained in the Forward Delivery Agreements and prevailing market conditions and benchmark yields on June 30, 2012, upon which the fair values depend. Borrowers pay no interest on these bonds. The interest rate credit is established by the federal government. The Forward Delivery Agreements are agreed to as one of the terms of purchase to induce the investor to purchase the bond. The Authority has a scheduled amount of Qualified Securities required to be on deposit on specified delivery dates. These Forward Delivery Agreements are forward contracts, or commitments to deliver the same Qualified Securities on the scheduled dates at a pre-determined rate. Therefore, these are hedging derivative instruments employed as a fair value hedge of the Qualified Securities for the required deposits. These forward contracts meet all criteria under GASB 53, Paragraph 39, which addresses the consistent critical terms method for forward contracts. All terms of the required deposits and the Forward Delivery Agreements are consistent; therefore, hedge accounting is applied.

Termination Risk

Termination risk is the risk that a counterparty will terminate a Forward Delivery Agreement at a time when the state owes it a termination payment. The state has

mitigated this risk by specifying that the counterparty has the right to terminate only as a result of the following events: the failure by the state, for any reason, to purchase Qualified Securities in accordance with the Agreement; the amount to purchase Qualified Securities on the Delivery date is less than the Scheduled Fund Amount; the state is not in compliance with any covenant or obligation, incorporated by reference in, this Agreement; any representation or warranty of the state contained in the Agreement proves to have been incorrect, false or misleading; insolvency of the state; or the principal amount under the Bonds becomes due and payable for any reason prior to the maturity date.

If the current market interest rate is higher than the fixed interest rate agreed to in the Forward Delivery Agreement, the Forward Delivery Agreement has a negative fair value. In the event of termination under this circumstance, the state owes a termination payment to the counterparty. If the fair value is positive, the state is due a termination payment from the counterparty. As of June 30, 2012, the fair value of the state's Forward Delivery Agreements is a total positive value of $2,127,831. As of June 30, 2011, the fair value of the state's Forward Delivery Agreements was a total negative value of ($1,316,524).

NOTE 3. LOANS RECEIVABLE

Higher Education Facilities Programs

The Authority has entered into financing agreements with both the Board of Trustees of the University of Tennessee (the Board of Trustees) and the Tennessee Board of Regents of the State University and Community College System of the State of Tennessee (the Tennessee Board of Regents). The First Financing Agreement and the Second Financing Agreement (the "Agreements"), are dated May 1, 1967, and November 1, 1997, respectively, as amended. Under the Agreements, the Authority agrees to finance construction projects for the Board of Trustees or the Tennessee Board of Regents. Annual financing charges payable under the Agreements must be sufficient to pay the debt obligations of the Authority and the costs of administering the programs.

Qualified Zone Academy Bonds Program

The Authority has entered into loan agreements with the local governments on behalf of local education agencies for the 1999 QZABs, dated November 30, 1999; the 2001 QZABs dated December 18, 2001; the 2003 QZABs dated December 23, 2003; the 2004 QZABs dated November 24, 2004; and the 2005 QZABs dated December 28, 2005. Under the agreements, the Authority agrees to finance renovation projects and

equipment for the local education agencies. On the date designated in the agreements, annual financing charges must be paid by the borrower sufficient to pay the annual principal payment, which is deposited into a bond sinking fund held by the State Treasurer that will pay the bonds at maturity, and the costs of administering the program.

Qualified School Construction Bonds Program

The Authority has entered into loan agreements with the local governments on behalf of local education agencies for the 2009 QSCBs, dated December 1, 2009, and the 2010 QSCBs, dated October 1, 2010. Under the agreements, the Authority agrees to finance renovation and rehabilitation projects, equipment purchases, new building construction, and land acquisition for the local education agencies. On the dates designated in the agreements, monthly financing charges must be paid by the borrower sufficient to pay the monthly principal payment, which is deposited into a bond sinking fund held by the State Treasurer that will pay the bonds at maturity, and the costs of administering the program.

NOTE 4. RESTRICTED ASSETS

Cash and Investments

The Higher Education Facilities Second Program General Bond Resolution, effective for all bonds issued in 1998 and thereafter, permits the Authority to satisfy the debt service reserve requirement by either placing an amount equal to the maximum semiannual debt service requirement in a debt service reserve account or by maintaining a Reserve Fund Credit Facility. The Authority obtained a surety bond, constituting a Reserve Fund Credit Facility under the Resolution, in lieu of maintaining a debt service reserve fund for the 1998 Series A, B, C, and D; 2000 Series A and B; 2002 Series A; 2004 Series A, B, and C; 2005 Series A and B; 2006 Series A and B; 2007 Series A, B and C; and 2008 Series A Bonds. Due to market conditions at the time of issuance of the 2008 Series B, 2009 Series A, 2010 Series A, and 2010 Series B Bonds, the Authority deposited funds into a debt service reserve account equal to the maximum semiannual debt service for those bonds.

The first program bond resolution of the QZABs requires the establishment of a special trust fund, the bond sinking fund account. This account represents the funds set aside to redeem the QZABs at maturity.

The first program bond resolution of the QSCBs requires the establishment of a special trust fund, the bond sinking fund account. This account represents the funds set aside to redeem the QSCBs at maturity.

NOTE 5. DEBT PAYABLE

The State of Tennessee shall not be liable on the bonds issued by the Authority and the bonds shall not be a debt of the State of Tennessee.

Higher Education Facilities Programs

A. Bonds. The principal, Sinking Fund Installments, if any, and Redemption Price of and interest on the bonds are payable solely from the Annual Financing Charges, Legislative Appropriations, and other moneys and securities held or set aside under the Resolutions.

B. Commercial Paper. Commercial paper constitutes a special obligation of the Authority. Principal of and interest on the commercial paper is payable from the following sources: (i) as to principal only, the proceeds of the sale of commercial paper issued to pay the principal of other outstanding commercial paper, (ii) the proceeds of draws on the Liquidity Facility, (iii) available revenues, (iv) the moneys and securities (if any) on deposit in the Reimbursement Fund and in the Debt Service Fund, (v) the moneys and securities (if any) on deposit in the Project Construction Account for such projects, and (vi) the proceeds of bonds or notes issued to make such payments.

Qualified Zone Academy Bonds Program

On September 9, 1999, the Authority adopted a Qualified Zone Academy Bond Resolution authorizing the issuance of Qualified Zone Academy Bonds to make loans to local governments on behalf of local education agencies for the purpose of financing eligible costs of certain projects. The State Department of Education recommends the projects to the Authority that should be funded under the QZAB program. The Taxpayer Relief Act of 1997 provided this financial tool whereby interest on QZABs is paid by the federal government in the form of an annual tax credit to the financial institutions that hold the QZABs. The bonds are secured solely by the payments made by the borrowers under the Loan Agreements, including amounts collected from unobligated state-shared taxes in the event of non-payment by the local governments and by certain funds held under the Qualified Zone Academy Bond Resolution.

Qualified School Construction Bonds Program

On November 5, 2009, the Authority adopted a Qualified School Construction Bond Resolution authorizing the issuance of Qualified School Construction Bonds to make loans to local governments on behalf of local education agencies for the purpose of financing eligible costs of certain projects. The Tennessee Advisory Commission on Intergovernmental Relations (TACIR) recommended the projects to be funded by the Authority under the QSCB program. The American Recovery and Reinvestment Act of 2009 provided this financial tool whereby interest on QSCBs, Series 2009, is paid by the federal government in the form of a quarterly tax credit to the financial institutions that hold the QSCBs. Market conditions at the time of issuance demanded the borrowers pay an additional quarterly interest payment to supplement the tax credit to the investors. The 2010 QSCBs were issued as direct subsidy payment bonds, a financial tool whereby the interest on the QSCBs is fully subsidized by the federal government. The bonds are secured solely by the payments made by the borrowers under the Loan Agreements, including amounts collected from unobligated state-shared taxes in the event of non-payment by the local governments and by certain funds held under the Qualified School Construction Bond Resolution.

Changes in debt payable for the years ended June 30, 2012, and 2011 are as follows (expressed in thousands):

	Balance July 1, 2011	Additions	Deletions	Balance June 30, 2012	Amounts Due Within One Year
Commercial paper	$ 162,653	$ 97,000	$ 5,977	$ 253,676	$ -
Bonds payable	$ 1,465,630	$ -	$ 63,949	$ 1,401,681	$ 50,035
Less: unamortized bond discount	(312)	-	(44)	(268)	-
Add: unamortized bond premium	39,955	-	1,915	38,040	-
Plus: call premium	-	4	-	4	-
Less: unamortized deferred amount on refundings	(17,328)	-	(1,037)	(16,291)	-
Total bonds payable	$ 1,487,945	$ 4	$ 64,783	$ 1,423,166	$ 50,035

	Balance July 1, 2010	Additions	Deletions	Balance June 30, 2011	Amounts Due Within One Year
Commercial paper	$ 281,782	$ 107,218	$ 226,347	$ 162,653	$ -
Bonds payable	$ 1,068,748	$ 444,375	$ 47,493	$ 1,465,630	$ 63,555
Less: unamortized bond discount	(363)	-	(51)	(312)	-
Add: unamortized bond premium	24,985	16,759	1,789	39,955	-
Less: unamortized deferred amount on refundings	(18,366)	-	(1,038)	(17,328)	-
Total bonds payable	$ 1,075,004	$ 461,134	$ 48,193	$ 1,487,945	$ 63,555

Bonds and commercial paper payable at June 30, 2012, and June 30, 2011, are as follows (expressed in thousands):

	June 30, 2012	June 30, 2011
Bonds Payable:		
1998 Refunding Series D at interest rates from 4.60% to 4.85% maturing to 2021 (original par - $33,540)	$ 13,245	$ 14,395
2002 Series A at an interest rate of 5.00% maturing to 2012 (original par - $119,135)	0	4,725
2004 Series A at interest rates from 4.00% to 4.50% maturing to 2026 (original par - $67,965)	46,586	50,860
2004 Series B at interest rates from 4.00% to 4.50% maturing to 2034 (original par - $60,575)	44,545	46,815
2004 Series C (Federally Taxable) at interest rates from 4.25% to 5.50% maturing to 2034 (original par - $37,230)	29,150	30,415
2005 Series A at interest rates from 3.625% to 5.00% maturing to 2030 (original par - $100,540)	83,205	88,480
2005 Series B (Federally Taxable) at interest rates from 4.31% to 4.88% maturing to 2028 (original par - $30,960)	26,365	28,435
2006 Series A at interest rates from 4.00% to 4.60% maturing to 2036 (original par - $53,820)	42,505	44,520

	June 30, 2012	June 30, 2011
2007 Series A at interest rates from 4.00% to 5.00% maturing to 2036 (original par - $33,730)	27,680	28,845
2007 Series B (Federally Taxable) at interest rates from 5.243% to 5.666% maturing to 2036 (original par - $14,040)	10,975	11,580
2007 Series C at interest rates from 4.00% to 5.00% maturing to 2032 (original par - $89,940)	84,080	84,425
2008 Series A at interest rates from 3.50% to 5.00% maturing to 2037 (original par - $118,530)	105,635	108,950
2008 Series B at interest rates from 4.00% to 5.50% maturing to 2038 (original par - $166,990)	150,270	155,885
2009 Series A at interest rates from 3.00% to 5.00% maturing to 2039 (original par - $109,905)	86,695	94,285
2010 Series A at interest rates from 3.00% to 5.00% maturing to 2040 (original par - $213,920)	200,110	208,635
2010 Series B at interest rates from 2.00% to 5.20% maturing to 2040 (original par - $18,015)	17,275	17,730
1999 Qualified Zone Academy Bonds non-interest bearing maturing in 2011 (original par - $13,290)	0	13,290
2001 Qualified Zone Academy Bonds non-interest bearing maturing in 2015 (original par - $11,330)	11,330	11,330
2003 Qualified Zone Academy Bonds non-interest bearing maturing in 2018 (original par - $2,445)	2,445	2,445
2004 Qualified Zone Academy Bonds non-interest bearing maturing in 2020 (original par - $12,600)	12,600	12,600
2005 Qualified Zone Academy Bonds non-interest bearing maturing in 2020 (original par - $17,545)	17,545	17,545
2009 Qualified School Construction Bonds at an interest rate of 1.515% and a federal tax credit rate of 5.86% maturing in 2026 (original par - $177,000)	177,000	177,000
2010 Qualified School Construction Bonds at an interest rate of 4.848% maturing in 2027 (original par - $212,440)	212,440	212,440
Total Par Amount of Bonds Payable	$ 1,401,681	$ 1,465,630
Plus: Unamortized Premium/Less Unamortized Discount	37,772	39,643
Call Premium	4	0

	June 30, 2012	June 30, 2011
Bonds Payable Net of Unamortized Premium/Discount and Call Premium	$ 1,439,457	$ 1,505,273
Less: Deferred Amount on Refundings	(16,291)	(17,328)
Net Bonds Payable	$ 1,423,166	$ 1,487,945
Commercial paper, at interest rates from 0.10% to 0.33%	$ 253,676	$ 162,653

Debt service requirements to maturity of the bonds payable at June 30, 2012, are as follows (expressed in thousands):

For the Year(s) Ending June 30	Principal	Interest	Total
2013	$ 51,901	$ 42,205	$ 94,106
2014	53,456	40,078	93,534
2015	49,301	37,976	87,277
2016	61,341	35,957	97,298
2017	50,856	33,777	84,633
2018-2022	294,117	135,453	429,570
2023-2027	626,600	79,630	706,230
2028-2032	155,839	34,543	190,382
2033-2037	74,097	10,107	84,204
2038-2040	21,949	-	21,949
	$ 1,439,457	$ 449,726	$ 1,889,183

The above principal for bonds is more than that presented on the accompanying financial statements by $16.291 million, representing the deferred amount on bond refundings. This amount is deducted from bonds payable in the accompanying financial statements but is included in the debt service schedule above.

The Authority may issue taxable and/or tax-exempt bonds. Proceeds for the tax-exempt bonds issued after September 1, 1986, are subject to the 1986 Tax Reform Act. The Authority invests, records, and reports these proceeds in the manner set forth by the U.S. Treasury and Internal Revenue Service to maintain the tax-exempt status of the bonds. Arbitrage liabilities, when applicable, are reported as a current accrued liability. For the years ended June 30, 2012, and June 30, 2011, the Authority did not have a liability for arbitrage.

On September 15, 2010, the Authority issued two new series of bonds, 2010 Series A and B. The 2010 Series A tax-exempt bond proceeds in the amount of $213,920,000 were issued to redeem $94,035,610 of the Authority's tax-exempt commercial paper

and $110,498,299 of the Authority's taxable commercial paper. The 2010 Series B taxable bond proceeds in the amount of $18,015,000 were issued to redeem $15,832,118 of the Authority's taxable commercial paper. The balance of the proceeds of the 2010 Series A and B was used to pay for new construction projects, various costs of issuance, and to fund the debt service reserve fund.

On October 7, 2010, the Authority issued the 2010 Qualified School Construction Bonds ("2010 QSCBs"). The 2010 QSCB proceeds in the amount of $212,440,000 were issued for the purpose of financing various qualifying QSCB projects and to pay the costs of issuance of the 2010 QSCBs.

Prior-Year Defeasance of Debt

In prior years, certain Authority bonds were defeased by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Authority's financial statements. On June 30, 2012, the Authority did not have any bonds outstanding that were considered defeased.

Commercial Paper Program

The Tennessee State School Bond Authority issues short-term debt to finance certain capital projects for the State of Tennessee's higher education institutions. The maximum principal to be issued by the Authority is $300,000,000. Commercial paper may be issued as tax-exempt or as taxable. At the program's inception, commercial paper refinanced certain outstanding bond anticipation note indebtedness that the Authority had previously issued to finance capital projects. The commercial paper dealer is J.P. Morgan Chase. At June 30, 2012, $214,328,000 of tax-exempt commercial paper and $39,348,000 of taxable commercial paper is outstanding. At June 30, 2011, $145,058,000 of tax-exempt commercial paper and $17,595,000 of taxable commercial paper was outstanding.

The maturity of the paper may not exceed 270 days, and the maximum interest rate may not exceed 12%. Upon maturity, the paper is remarketed by the commercial paper dealer, redeemed, or extinguished with long-term debt. Interest rates on commercial paper ranged from 0.10% to 0.33% during the fiscal year. Interest is payable upon maturity.

The Authority currently has State Street Bank and Trust Company as their liquidity provider under a Credit Agreement with an expiry date of March 30, 2014, subject to extension and earlier termination. The total available commitment, including 45 days of accrued interest in the amount of $4,593,750, is $304,593,750. The obligation of

State Street Bank and Trust Company is to purchase unremarketed commercial paper. In the event the liquidity facility is called upon, the Authority must repay the advance on the earlier of (i) the date of such Advance or (ii) the Termination Date. Unless the Authority repays the advance by the Term Loan Closing Date, the principal amount will convert to a term loan with six equal semi-annual payments. In accordance with Financial Accounting Standards Board *Accounting Standards Codification* (ASC) 275 *Risks and Uncertainties*, this agreement meets the criteria of a financing agreement; thus, the commercial paper payable is classified as a long-term liability.

NOTE 6. UNEARNED REVENUE

Changes in unearned revenue for the years ended June 30, 2012, and 2011, are as follows (expressed in thousands):

	Balance July 1, 2011	Additions	Deletions	Balance June 30, 2012
Interest rate reserve fund	$ 667	$ 502	$ 3	$ 1,166
Other unearned revenue	15,886	2,434	3,718	14,602
Total unearned revenue	$ 16,553	$ 2,936	$ 3,721	$ 15,768

	Balance July 1, 2010	Additions	Deletions	Balance June 30, 2011
Interest rate reserve fund	$ 1,375	$ 431	$ 1,139	$ 667
Other unearned revenue	12,682	4,702	1,498	15,886
Total unearned revenue	$ 14,057	$ 5,133	$ 2,637	$ 16,553

Unearned revenue at June 30, 2012, and June 30, 2011, is as follows (expressed in thousands):

	June 30, 2012	June 30, 2011
Interest Rate Reserve Fund	$ 1,166	$ 667
Difference in bond proceeds available for capital expenditure and the par value of bonds to be repaid-adjustments for discount, underwriters' fees, and other costs of issuance:		

1998 Series D bonds, which was an advance refunding of the 1992 Series A bonds; amortized through 2021	1,237	1,378
1999 QZAB bonds; amortized through 2012	0	7
2001 QZAB bonds; amortized through 2016	72	94
2002 Series A bonds; amortized through 2012	0	36
2003 QZAB bonds; amortized through 2019	52	60
2004 Series A bonds; amortized through 2026	3,037	3,258
2004 Series C bonds; amortized through 2034	353	368
2004 QZAB bonds; amortized through 2020	43	49
2005 Series A bonds; amortized through 2030	65	68
2005 Series B bonds; amortized through 2028	3,083	3,277
2005 QZAB bonds; amortized through 2021	313	350
2006 Series A bonds; amortized through 2021	436	484
2007 Series B bonds; amortized through 2036	117	122
2009 QSCB bonds; amortized through 2026	2,172	2,228
2010 QSCB bonds; amortized through 2027	3,434	3,910
2010 Series B bonds; amortized through 2040	174	181
Other unearned revenue	14	16
Total	$ 15,768	$ 16,553

NOTE 7. DEFERRED CHARGES

Changes in deferred charges for the years ended June 30, 2012, and 2011, are as follows (expressed in thousands):

	Balance July 1, 2011	Additions	Deletions	Balance June 30, 2012
Unamortized costs of issuance	$ 13,124	$ -	$ 781	$ 12,343
Other deferred charges	22,074	-	855	21,219
Total deferred charges	$ 35,198	$ -	$ 1,636	$ 33,562

	Balance July 1, 2010	Additions	Deletions	Balance June 30, 2011
Unamortized costs of issuance	$ 10,007	$ 3,905	$ 788	$ 13,124
Other deferred charges	8,366	14,479	771	22,074
Total deferred charges	$ 18,373	$ 18,384	$ 1,559	$ 35,198

Deferred charges at June 30, 2012, and June 30, 2011, are as follows (expressed in thousands):

	June 30, 2012	June 30, 2011
Unamortized costs of issuance:		
1998 Series D bonds, which was an advance refunding of the 1992 Series A bonds; amortized through 2021	$ 111	$ 124
1999 QZAB bonds; amortized through 2012	0	10
2001 QZAB bonds; amortized through 2016	64	83
2002 Series A bonds; amortized through 2012	0	45
2003 QZAB bonds; amortized through 2019	31	36
2004 Series A bonds; amortized through 2026	556	597
2004 Series B bonds; amortized through 2034	559	585
2004 Series C bonds; amortized through 2034	347	363
2004 QZAB bonds; amortized through 2020	37	42
2005 Series A bonds; amortized through 2030	759	802
2005 Series B bonds; amortized through 2028	225	239
2005 QZAB bonds; amortized through 2021	305	341
2006 Series A bonds; amortized through 2021	422	468
2007 Series A bonds; amortized through 2026	226	243
2007 Series B bonds; amortized through 2036	117	122
2007 Series C bonds; amortized through 2032	769	808
2008 Series A bonds; amortized through 2027	913	976
2008 Series B bonds; amortized through 2038	1,162	1,208
2009 Series A bonds; amortized through 2039	761	789

	June 30, 2012	June 30, 2011
2009 QSCB bonds; amortized through 2026	1,380	1,475
2010 QSCB bonds; amortized through 2027	1,314	1,401
2010 Series A bonds; amortized through 2040	2,096	2,173
2010 Series B bonds; amortized through 2040	189	196
Other unearned revenue:		
Difference in bond proceeds available for capital expenditure and the par value of bonds to be repaid-adjustments for premium, underwriters' fees, and other costs of issuance:		
2004 Series B bonds; amortized through 2034	1,108	1,159
2007 Series A bonds; amortized through 2026	290	311
2007 Series C bonds; amortized through 2032	842	885
2008 Series A bonds; amortized through 2027	1,076	1,150
2008 Series B bonds; amortized through 2038	1,860	1,933
2009 Series A bonds; amortized through 2039	2,479	2,572
2010 Series A bonds; amortized through 2040	13,564	14,062
Total	$ 33,562	$ 35,198

NOTE 8. SUBSEQUENT EVENTS

As of December 10, 2012, the Authority has $114,468,000 outstanding in tax-exempt commercial paper and $5,861,000 in taxable commercial paper. Between June 30, 2012, and December 10, 2012, the Authority has issued $30,000,000 in commercial paper to pay construction expenditures.

On August 1, 2012, the Authority issued the 2012 Series A Bonds, the 2012 Series B Bonds (Federally Taxable), and the 2012 Refunding Series C Bonds. The 2012 Series A tax-exempt bond proceeds in the amount of $208,295,000 were sold with an original issue premium of $24,312,813 to redeem $129,859,517 of the Authority's tax-exempt commercial paper and $13,659,450 of the Authority's taxable commercial paper. A portion of a project funded under the 2012 Series A Bonds was being funded with taxable commercial paper. With a change in scope and a review from bond counsel, it was decided that this project could be financed with tax-exempt bonds and

was included in the 2012 Series A Bond issuance. The 2012 Series B taxable bond proceeds in the amount of $103,790,000 were issued to redeem $19,826,419 taxable commercial paper and refund $26,455,000 of the 2004 Series C Bonds and $19,595,000 of the 2005 Series B Bonds. The 2012 Refunding Series C tax-exempt bond proceeds in the amount of $125,635,000 were sold with an original issue premium of $18,135,085 to provide the funds necessary for refunding $13,245,000 of the 1998 Series D Bonds, $46,590,000 of the 2004 Series A Bonds, $44,545,000 of the 2004 Series B Bonds, and $33,625,000 of the 2006 Series A Bonds. The balance of the proceeds of the 2012 Series A, 2012 Series B, and 2012 Series C Bonds was used to pay for new construction projects and various costs of issuance.

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY SCHEDULES OF NET ASSETS - PROGRAM LEVEL
JUNE 30, 2012, AND JUNE 30, 2011

(Expressed in Thousands)

	June 30, 2012				June 30, 2011			
	Higher Education Facilities Programs	Qualified Zone Academy Bonds Program	Qualified School Construction Bonds Program	Total	Higher Education Facilities Programs	Qualified Zone Academy Bonds Program	Qualified School Construction Bonds Program	Total
ASSETS								
Current assets:								
Cash	$ 21,837	$ 138	$ 740	$ 22,715	$ 40,254	$ 129	$ 585	$ 40,968
Cash with fiscal agent	1,040	-	15	1,055	553	-	89	642
Investments with fiscal agent	-	-	-	-	-	14	-	14
Deferred outflow - derivatives	-	-	-	-	-	1,316	-	1,316
Derivates - Forward Delivery Agreement	-	2,128	-	2,128	-	-	-	-
Deferred charges	1,380	-	181	1,561	772	-	-	772
Loans receivable	50,035	2,930	24,300	77,265	50,156	3,482	22,091	75,729
Interest receivable	7,379	-	247	7,626	7,691	-	96	7,787
Federal subsidy receivable	-	-	3,004	3,004	-	-	3,004	3,004
Receivables for administrative fees	1,454	7	-	1,461	859	11	-	870
Total current assets	83,125	5,203	28,487	116,815	100,285	4,952	25,865	131,102
Noncurrent assets:								
Restricted cash	-	11,206	85,032	96,238	7	19,070	257,126	276,203
Restricted investments	40,600	10,896	31,089	82,585	41,509	13,572	9,067	64,148
Loans receivable	1,115,145	18,998	266,501	1,400,644	1,057,484	21,247	123,190	1,201,921
Deferred charges	29,051	437	2,513	32,001	31,038	512	2,876	34,426
Total noncurrent assets	1,184,796	41,537	385,135	1,611,468	1,130,038	54,401	392,259	1,576,698
Total assets	1,267,921	46,740	413,622	1,728,283	1,230,323	59,353	418,124	1,707,800
LIABILITIES								
Current liabilities:								
Accounts payable	21	-	-	21	1,360	-	-	1,360
Accrued liabilities	-	-	15,118	15,118	-	-	19,284	19,284
Derivatives - Forward Delivery Agreement	-	-	-	-	-	1,316	-	1,316
Deferred inflow - derivatives	-	2,128	-	2,128	-	-	-	-
Accrued interest payable	7,381	-	3,152	10,533	7,707	-	3,151	10,858
Unearned revenue	1,837	79	2,635	4,551	1,347	111	2,952	4,410
Bonds payable	50,035	-	-	50,035	50,265	13,290	-	63,555
Total current liabilities	59,274	2,207	20,905	82,386	60,679	14,717	25,387	100,783
Noncurrent liabilities:								
Unearned revenue	7,845	401	2,971	11,217	8,509	448	3,186	12,143
Commercial paper payable	253,676	-	-	253,676	162,653	-	-	162,653
Bonds payable	939,782	43,909	389,440	1,373,131	991,047	43,903	389,440	1,424,390
Total noncurrent liabilities	1,201,303	44,310	392,411	1,638,024	1,162,209	44,351	392,626	1,599,186
Total liabilities	1,260,577	46,517	413,316	1,720,410	1,222,888	59,068	418,013	1,699,969
NET ASSETS								
Unrestricted	$ 7,344	$ 223	$ 306	$ 7,873	$ 7,435	$ 285	$ 111	$ 7,831

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY SCHEDULES OF REVENUES,
EXPENSES, AND CHANGES IN NET ASSETS - PROGRAM LEVEL
FOR THE YEARS ENDED JUNE 30, 2012, AND JUNE 30, 2011

(Expressed in Thousands)

	Year ended June 30, 2012				Year ended June 30, 2011			
	Higher Education Facilities Programs	Qualified Zone Academy Bonds Program	Qualified School Construction Bonds Program	Total	Higher Education Facilities Programs	Qualified Zone Academy Bonds Program	Qualified School Construction Bonds Program	Total
OPERATING REVENUES								
Revenue from loans	$ 46,257	$ 93	$ 13,542	$ 59,892	$ 46,541	$ 128	$ 10,641	$ 57,310
Federal subsidy on bonds	-	-	10,299	10,299	-	-	7,524	7,524
Investment earnings (loss)	398	(67)	769	1,100	299	29	184	512
Total operating revenues	46,655	26	24,610	71,291	46,840	157	18,349	65,346
OPERATING EXPENSES								
Interest expense-commercial paper	323	-	-	323	450	-	-	450
Interest expense-bonds	44,697	6	12,981	57,684	44,658	13	10,234	54,905
Loss on retirement of bonds	4	-	-	4	-	-	-	-
Subsidy to borrowers	253	-	11,061	11,314	403	-	7,658	8,061
Administrative expense	944	7	192	1,143	1,182	16	158	1,356
Amortization of bond issuance costs	525	75	181	781	539	89	159	787
Total operating expenses	46,746	88	24,415	71,249	47,232	118	18,209	65,559
Operating income (loss) and change in net assets	(91)	(62)	195	42	(392)	39	140	(213)
Net assets, July 1	7,435	285	111	7,831	7,827	246	(29)	8,044
Net assets, June 30	$ 7,344	$ 223	$ 306	$ 7,873	$ 7,435	$ 285	$ 111	$ 7,831

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY SCHEDULES OF CASH FLOWS - PROGRAM LEVEL
FOR THE YEARS ENDED JUNE 30, 2012, AND JUNE 30, 2011

(Expressed in Thousands)

	Year ended June 30, 2012				Year ended June 30, 2011			
	Higher Education Facilities Programs	Qualified Zone Academy Bonds Program	Qualified School Construction Bonds Program	Total	Higher Education Facilities Programs	Qualified Zone Academy Bonds Program	Qualified School Construction Bonds Program	Total
CASH FLOWS FROM OPERATING ACTIVITIES								
Receipts from borrowers for administrative fee	$ -	$ 16	$ 351	$ 367	$ 455	$ 16	$ 241	$ 712
Payment to suppliers	(948)	(7)	(192)	(1,147)	(1,186)	(17)	(167)	(1,370)
Receipts from borrowers to the interest rate reserve fun	502	-	-	502	428	-	-	428
Payments to borrowers from the interest rate reserve fun	(3)	-	-	(3)	(1,136)	-	-	(1,136)
Net cash provided by (used in) operating activitie	(449)	9	159	(281)	(1,439)	(1)	74	(1,366)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES								
Proceeds from sale of bonds	-	-	-	-	246,633	-	211,485	458,118
Proceeds from sale of commercial pape	97,000	-	-	97,000	107,218	-	-	107,218
Bond interest subsidy from federal governmen	-	-	10,299	10,299	-	-	4,520	4,520
Call premium paid	(4)	-	-	(4)	-	-	-	-
Bond issuance costs paid	-	-	-	-	(378)	-	(510)	(888)
Principal paid - bonds and commercial pape	(56,632)	(13,290)	-	(69,922)	(273,840)	-	-	(273,840)
Interest paid - bonds and commercial pape	(46,210)	-	(12,981)	(59,191)	(44,575)	-	(7,202)	(51,777)
Subsidy to borrowers	(252)	-	(10,299)	(10,551)	(403)	-	(4,520)	(4,923)
Net cash provided by (used in) noncapital financing activitie	(6,098)	(13,290)	(12,981)	(32,369)	34,655	-	203,773	238,428
CASH FLOWS FROM INVESTING ACTIVITIES								
Purchases of investments	-	(16,714)	(21,817)	(38,531)	(41,247)	(17,866)	(9,061)	(68,174)
Proceeds from sales and maturities of investment	976	19,352	-	20,328	25,181	16,107	-	41,288
Interest received on investment	349	368	414	1,131	128	454	115	697
Loans issued	(114,984)	-	(172,830)	(287,814)	(111,260)	-	(124,798)	(236,058)
Loan escrow paid	(520)	-	-	(520)	(130)	-	-	(130)
Collections of loan principal	56,629	3,021	22,388	82,038	50,808	2,979	9,772	63,559
Interest received on loans	46,156	-	12,654	58,810	44,560	-	12,446	57,006
Collections of call premium	4	-	-	4	-	-	-	-
Refund to borrower	-	(601)	-	(601)	-	(180)	-	(180)
Net cash provided by (used in) investing activitie	(11,390)	5,426	(159,191)	(165,155)	(31,960)	1,494	(111,526)	(141,992)
Net increase (decrease) in cash	(17,937)	(7,855)	(172,013)	(197,805)	1,256	1,493	92,321	95,070
Cash, July 1	40,814	19,199	257,800	317,813	39,558	17,706	165,479	222,743
Cash, June 30	$ 22,877	$ 11,344	$ 85,787	$ 120,008	$ 40,814	$ 19,199	$ 257,800	$ 317,813
Reconciliation of cash to the Statement of Net Assets:								
Cash	$ 21,837	$ 138	$ 740	$ 22,715	$ 40,254	$ 129	$ 585	$ 40,968
Cash with fiscal agent	1,040	-	15	1,055	553	-	89	642
Restricted cash	-	11,206	85,032	96,238	7	19,070	257,126	276,203
Cash, June 30	$ 22,877	$ 11,344	$ 85,787	$ 120,008	$ 40,814	$ 19,199	$ 257,800	$ 317,813
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:								
Operating income (loss)	$ (91)	$ (62)	$ 195	$ 42	$ (392)	$ 39	$ 140	$ (213)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities								
Amortization of bond issuance costs	525	75	181	781	539	89	160	788
Investment earnings	(398)	(48)	(769)	(1,215)	(299)	(30)	(183)	(512)
Interest expense	45,020	6	12,981	58,007	45,108	13	10,234	55,355
Federal subsidy on bonds	-	-	(10,299)	(10,299)	-	-	(7,524)	(7,524)
Subsidy to borrowers	253	-	11,061	11,314	403	-	7,658	8,061
Interest income (loss) from loans	(45,661)	117	(12,981)	(58,525)	(45,682)	1	(10,234)	(55,915)
Changes in assets and liabilities:								
(Increase) decrease in receivables for administrative fees	(595)	-	-	(595)	(404)	-	-	(404)
(Increase) decrease in payables for administrative fees	-	-	-	-	(4)	-	(4)	(8)
Increase (decrease) in due to primary governmen	-	-	-	-	-	-	(7)	(7)
Increase (decrease) in the interest rate reserve fun	498	-	-	498	(708)	-	-	(708)
Increase (decrease) in unamortized discount net bond issuance cost	-	(79)	(210)	(289)	-	(113)	(166)	(279)
Total adjustments	(358)	71	(36)	(323)	(1,047)	(40)	(66)	(1,153)
Net cash provided by (used in) operating activitie	$ (449)	$ 9	$ 159	$ (281)	$ (1,439)	$ (1)	$ 74	$ (1,366)
Noncash financing activities:								
Bond issuance costs	$ -	$ -	$ -	$ -	$ (14,698)	$ -	$ 510	$ (14,188)
Noncash investing activities:								
Increase (decrease) in fair/amortized value of investment	$ (41)	$ -	$ 305	$ 264	$ (46)	$ -	$ 68	$ 22