



Arbitrage Compliance Trends & Topics

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Prepared for:
Colorado Government Finance Officers Association
May 22, 2025

YOUR ARBITRAGE EXPERT

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- 12 Years of arbitrage rebate experience, 17 years of financial services experience. Provides arbitrage consulting services for over 340 Cities, Counties and School Districts across the Country. ACS completes over 2,500 arbitrage calculations annually.



LEARNING OBJECTIVES

Arbitrage Rebate Key Concepts & Terminology:

- What is Arbitrage Rebate?
- Funds and Proceeds Subject to Arbitrage Rules
- Exceptions to Arbitrage Rebate – Spending Exceptions (MAY BE USEFUL AGAIN!)
- Yield Restriction (MANY YIELD RESTRICTION PAYMENTS HAPPENING NOW!)
- Reporting Requirements

Application to Current Market Trends

- Managing Rebate & Yield Restriction Payments
- Current Trends

ARBITRAGE REBATE

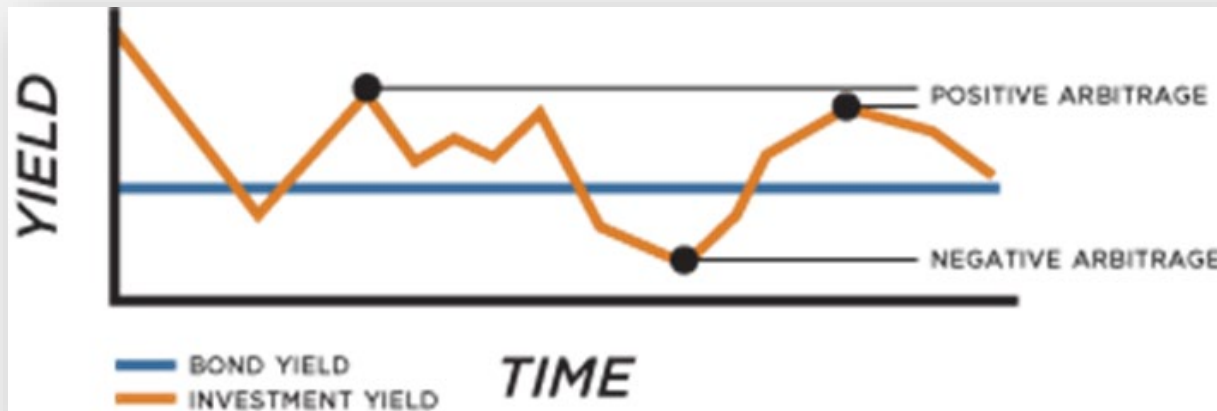
- Arbitrage rebate is a federal tax law requirement - §148 of the Internal Revenue Code.
- Applicable to **every** tax-exempt borrowing unless exceptions apply.
- Established by Congress with the intention to limit use of tax-exempt proceeds from:
 - Issuance of more bonds than necessary
 - Issuance of bonds earlier than necessary
 - Prevention of bonds from remaining outstanding longer than necessary
- Borrow what you need, when you need it, and for an appropriate duration based on financing needs.

Are you in compliance?



ARBITRAGE REBATE

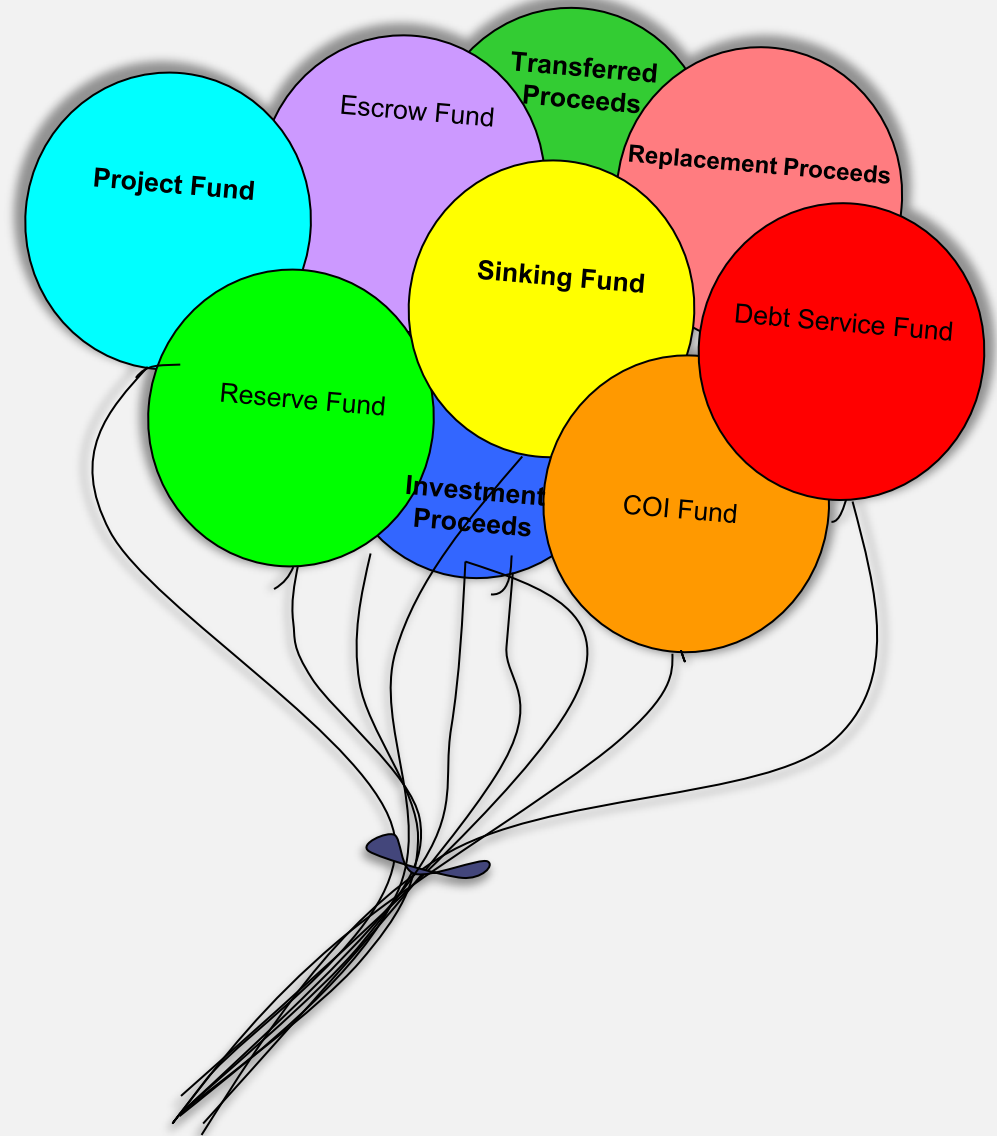
Definition of Arbitrage



- As of any computation date, the arbitrage rebate amount for an issue is the excess of the future value of all receipts on non-purpose investments over the future value of all payments on non-purpose investments. These rules have been in place for all tax-advantaged bonds since the Tax Reform Act of 1986.
- In other words, arbitrage is the profit made from investing tax-exempt bond proceeds in taxable investments. Arbitrage rebate limits those profits not to exceed the “arbitrage yield” or bond yield for each bond issuance.
- Measured on an issue-by-issue basis
 - Positive Arbitrage
 - Negative Arbitrage

FUNDS SUBJECT TO ARBITRAGE REBATE:

- ✓ Project Funds
- ✓ Capitalized Interest Funds
- ✓ Costs of Issuance Funds
- ✓ Reserve Funds
- ✓ Escrow Funds
- ✓ Transferred Proceeds
- ✓ Replacement Proceeds
- ✓ Debt Service Funds (that fail “bona fide” test)
- ✓ Reserve Funds
- ✓ Escrow Funds
- ✓ Transferred Proceeds (unspent proceeds of refunded bonds)
- ✓ Disposition Proceeds



EXCEPTIONS TO ARBITRAGE

Allow issuers to exempt funds or an entire bond from arbitrage rules

Bond Level:

- Small Issuer Exception

Fund Level:

- Spending Exceptions (6 month, 18 month, 24 month)
- Bona Fide Debt Service Fund Exception
- Investing/purchase of certain investments
- Available Project Proceeds Exception (Tax Credit Bonds)
- Sinking Fund Reserve Exception (Tax Credit Bonds)

SMALL ISSUER EXCEPTION TO ARBITRAGE REBATE

Bond Level Exemption

Issue \$ Limits:

- \$5 million of governmental bonds for municipalities
- \$15 million per calendar year for public school construction

Requirements:

- Must be governmental bonds (not private activity)
- Issuer must have general taxing powers
- At least 95% must be used for local governmental activities

Refunding considerations (these are important!)

- Current refunding exclusions
- Refunding of prior bonds (subject to arbitrage rebate, weighted average maturity, maturity dates)

SPENDING EXCEPTIONS TO ARBITRAGE REBATE

6-month, 18-month, and 24-month Spending Exceptions

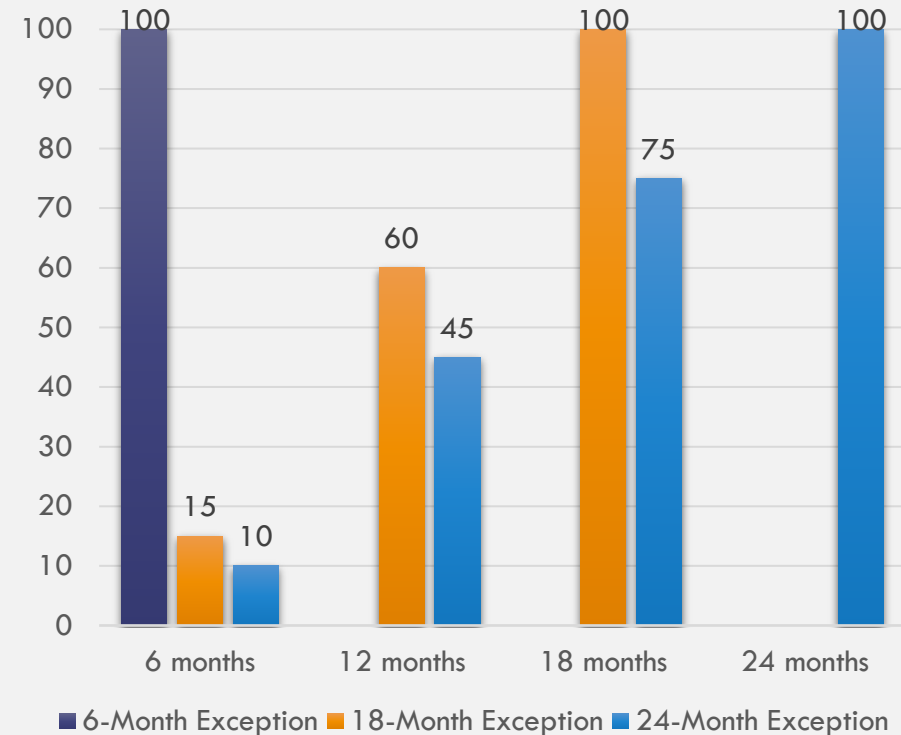
6-month: All proceeds spent by 6 months.

18-month:

- 15% in 6 months
- 60% in 12 months
- 100% in 18 months

24-month (Construction Only)

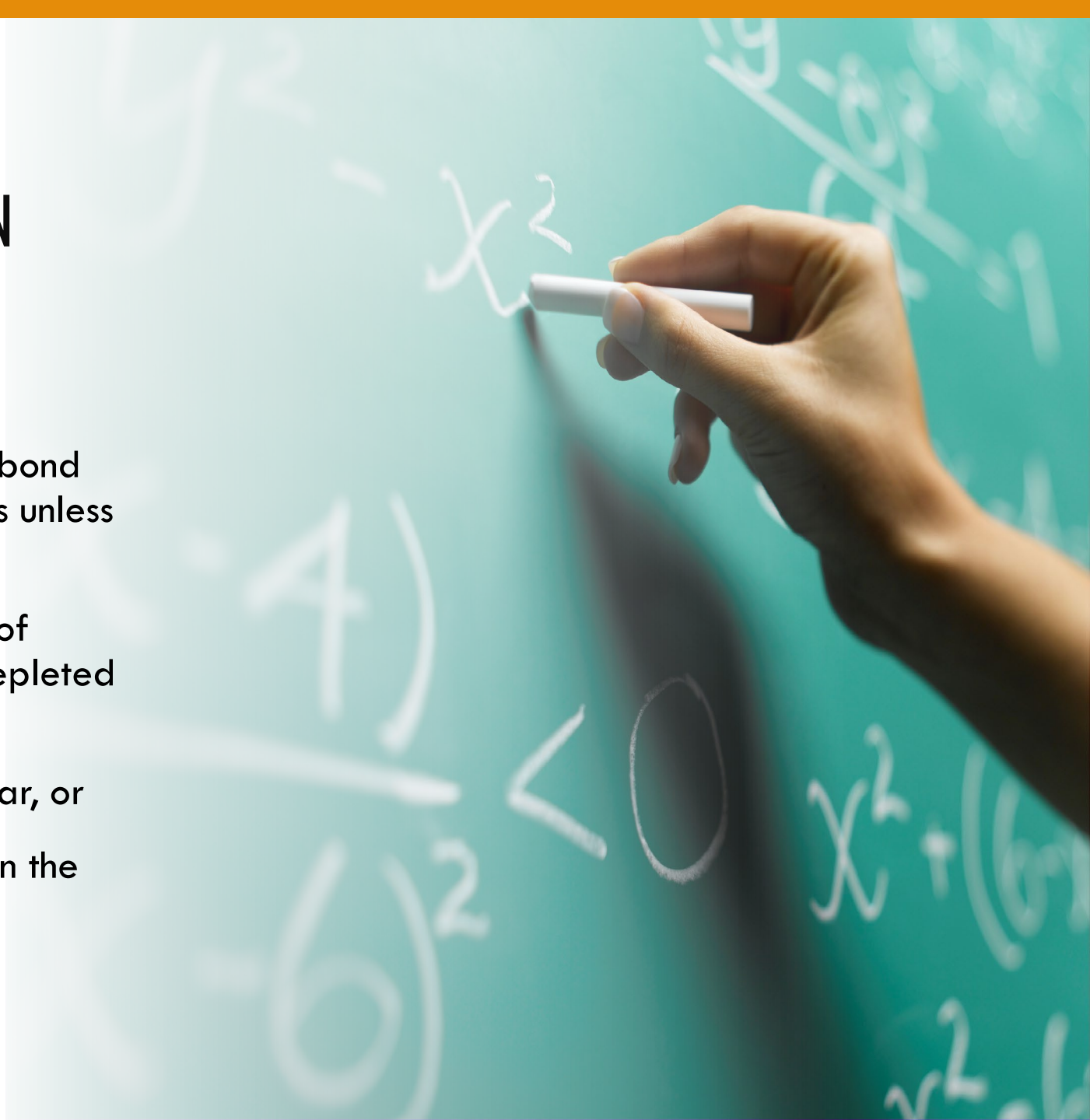
- 10% in 6 months
- 45% in 12 months
- 75% in 18 months
- 100% in 24 months



DEBT SERVICE FUND EXEMPTION

“Replacement Proceeds”

- Debt Service Funds (although not funded with bond proceeds, can be subject to the arbitrage rules unless the fund meets a “bona-fide” exemption.
- Used primarily to achieve a proper matching of revenues with debt service payments and is depleted annually to a reasonable carryover amount:
- The earnings on the fund for the preceding year, or
- 1/12 of the principal and interest payments on the issue for the preceding bond year.



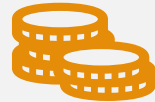
INVESTMENT EXEMPTIONS TO ARBITRAGE REBATE

Certain types of investments are also exempt from arbitrage



Investments Purchased with Bond Proceeds Exempt from Arbitrage:

Non-AMT Tax-Exempt Municipal Bonds,
Demand Deposit SLGS



Tax-Exempt Muni Bonds:

Any interest received is exempt from the arbitrage rules.

Can help lock in yields especially if rates decline.

Liquidity concerns.



Demand Deposit SLGS (not to be confused with time deposit SLGS):

Any interest received is exempt from the arbitrage rules.

Provide greater liquidity than tax-exempt muni's.

Evaluate on a bond-by-bond basis. (Depends on bond yields, expected spend-down and current slgs rates.



Note: ACS is not a registered investment advisor, the facts presented above are intended to outline certain investments that are exempt from the arbitrage and yield restriction regulations. Each issuer should consult with their investment advisor (if any) concerning any specific investments contemplated to be purchased with bond proceeds. ACS is also available to be a resource for issuers should any arbitrage-related questions arise.

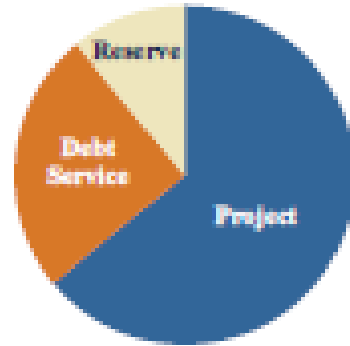
WHAT IS YIELD RESTRICTION?



Yield Restriction is the profit made from investing bond proceeds in higher yielding taxable investments above a *materially higher yield* after a designated *temporary period* and above the *minor portion*.

Enacted prior to arbitrage rebate in 1969, rules still apply to tax-exempt borrowings.

Arbitrage Rebate (Keep it?)

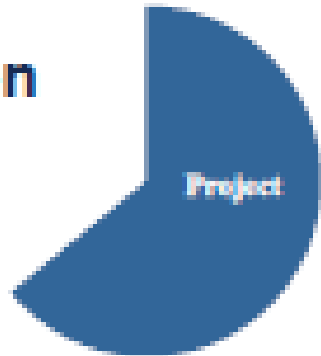


YIELD RESTRICTION VS. ARBITRAGE REBATE

Similar to arbitrage rebate, restriction against investing above arbitrage yield.

- Arbitrage Rebate = Entire “Pie”
- Yield Restriction = Parts of the “Pie”

Yield Restriction (Earn it?)



Enacted prior to arbitrage rebate in 1969, rules still apply to tax-exempt borrowings.

Exceptions apply:

- Temporary Periods
- Minor Portion
- “Reasonably Required” reserve fund(s)

YIELD RESTRICTION: TEMPORARY PERIOD

A Temporary Period defines the period for unrestricted investment per fund/proceed type. The most common Temporary Period is the 3 year period for Project Funds.

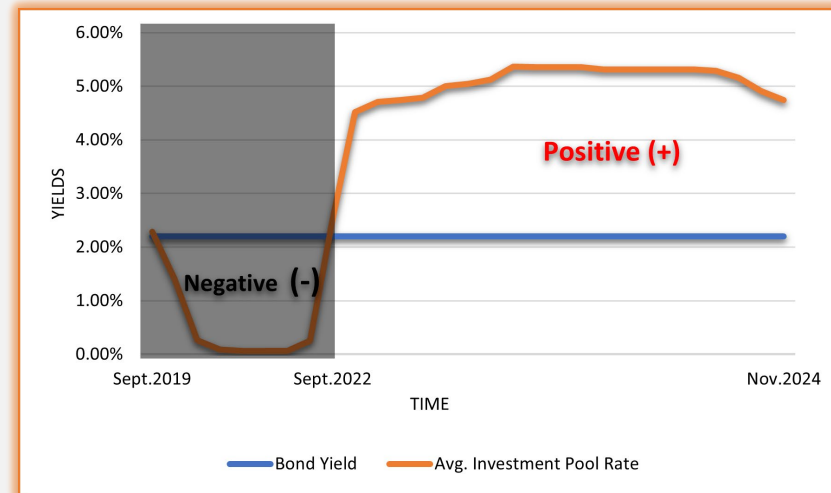
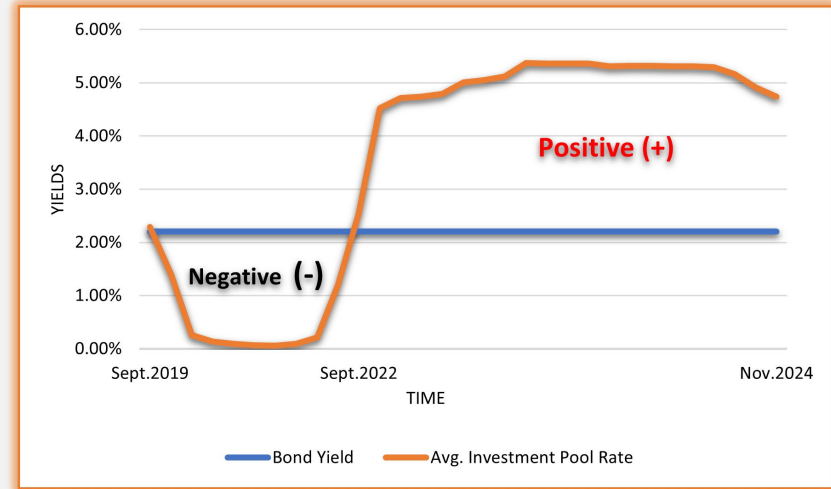
Fund Type	Temporary Period(s) Available
Project	3 or 5 Years
Cost of Issuance	13 Months
Current or Advanced refunding (Adv. is defined as a refunding that takes place after 90 days)	30 or 90 Days
Replacement Proceeds (Typically Debt Service, Pledged and Unreasonable Reserve)	30 Days
Bond Fide Debt Service	13 Months
Reasonable Required Reserve	None
Minor Portion (Aggregate amount not to exceed the lesser of 5% of sales proceeds or \$100,000)	None



YIELD RESTRICTION VS. ARBITRAGE REBATE

Remember the earlier slide with the arbitrage graph? The bond did not owe arbitrage rebate. But what about yield restriction?

Project yield restriction starts if funds remain after year three (remember the temporary period). Positive yield restriction is occurring for many 2019 & 2020 bonds where funds were not spent after year three.



WHAT ARE THE MINIMUM REPORTING REQUIREMENTS?

Arbitrage Rebate & Yield Restriction

- Any arbitrage or yield restriction payments must be made no later than 60 days after the computation date.
- Computation Date: No later than 5-years after the issue date and every five years thereafter until the final maturity date
- Payment(s): 90% or 100%
- Submit check and IRS Form 8038-T.
- Do not send calculations!
- No filing requirement if no payment is due.

Internal Revenue Service [Go to www.irs.gov/Form8038T for instructions and the latest information.](https://www.irs.gov/Form8038T)

Part I Reporting Authority Check box if Amended Return

1 Issuer's name _____

2 Issuer's employer identification number (EIN) _____

3 Number and street (or P.O. box no. if mail is not delivered to street address) _____ Room/suite _____

4 Report number (For IRS Use Only)

5 City, town, or post office, state, and ZIP code _____

6 Date of issue _____

7 _____

8 CUSIP number _____

9 Name and title of officer or other person whom the IRS may call for more information _____

10 Telephone number of officer or other person _____

11 Type of issue Issue price **11** _____

Part II Arbitrage Rebate and Yield Reduction Payments **Amount**

12 Computation date to which this payment relates (MM/DD/YYYY) _____

13 Arbitrage rebate payment (see instructions) check box if less than 100% of rebate amount **13** _____

14 Yield reduction payment (see instructions) check box if less than 100% of yield reduction amount **14** _____

15 Rebate payment from Qualified Zone Academy Bond (QZAB) defeasance escrow (see instructions) **15** _____

Part III Penalty in Lieu of Arbitrage Rebate

16 Number of months since date of issue: 6 mos 12 mos 18 mos 24 mos Other. No. of mos _____

17 Penalty in lieu of rebate **17** _____

18 Date of termination election (MM/DD/YYYY) _____

19 Penalty upon termination **19** _____

Part IV Late Payments

20 Does failure to pay timely qualify for waiver of penalty? See instructions Yes No _____

21 Penalty for failure to pay on time (see instructions) **21** _____

22 Interest on underpayment (see instructions) **22** _____

Total Payment

23 Total payment. Add lines 13, 14, 15, 17, 19, 21, and 22. Enter total here **23** _____

Part VI Miscellaneous

24 Unspent proceeds as of this computation date **24** _____

25 Proceeds used to redeem bonds **25** _____

26 Gross proceeds used for qualified administrative costs for guaranteed investment contracts (GICs) and defeasance escrows **26** _____

27 Fees paid for a qualified guarantee **27** _____

28 Is the issue a variable rate issue? **28** Yes No

29 Did the issuer enter into a hedge? Name of provider _____ Term of hedge _____ **29** Yes No

30 Were gross proceeds invested in a GIC? Name of provider _____ Term of GIC _____ **30** Yes No

31 Were any gross proceeds invested beyond an available temporary period? **31** Yes No

32 Calculations for filing of this form prepared by: Issuer Preparer: _____

Signature and Consent

Under penalties of perjury, I declare that I have examined this return, and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. I further declare that I consent to the IRS's disclosure of the issuer's return information, as necessary to process this return, to the person that I have authorized above.

Signature of issuer's authorized representative _____ Date _____ Type or print name and title _____

Print/Type preparer's name _____ Preparer's signature _____ Date _____ Check if _____ PTIN _____

FILING REQUIREMENTS

What if payments are not made on time?



- Subject to interest and penalties:
- 50% of rebate amount, plus interest
- Interest computed at underpayment rate
- Late payment explanation required
- IRS can consider waiving penalty (excluding interest) if:
- Liability plus late interest is paid within 180 days after the date the failure was discovered
- Bonds are not under audit
- Late payment was not caused by “willful neglect”

WHAT IF ISSUERS OWE REBATE OR YR?

1

Draft effective policies and procedures that fit your Policies:

- Helps identify potential problems early
- Promotes awareness throughout the department.
- In certain situations, may provide advantages when dealing with the IRS.

2

Create listing of key bond facts:

- Borrowing Cost (Bond Yield)
- Issuance Date
- Maturity Date
- 5th Year Payment Dates (Due within 60 days of 5th Year)
- Accrued Liabilities but not yet paid (list in Annual Report)

3

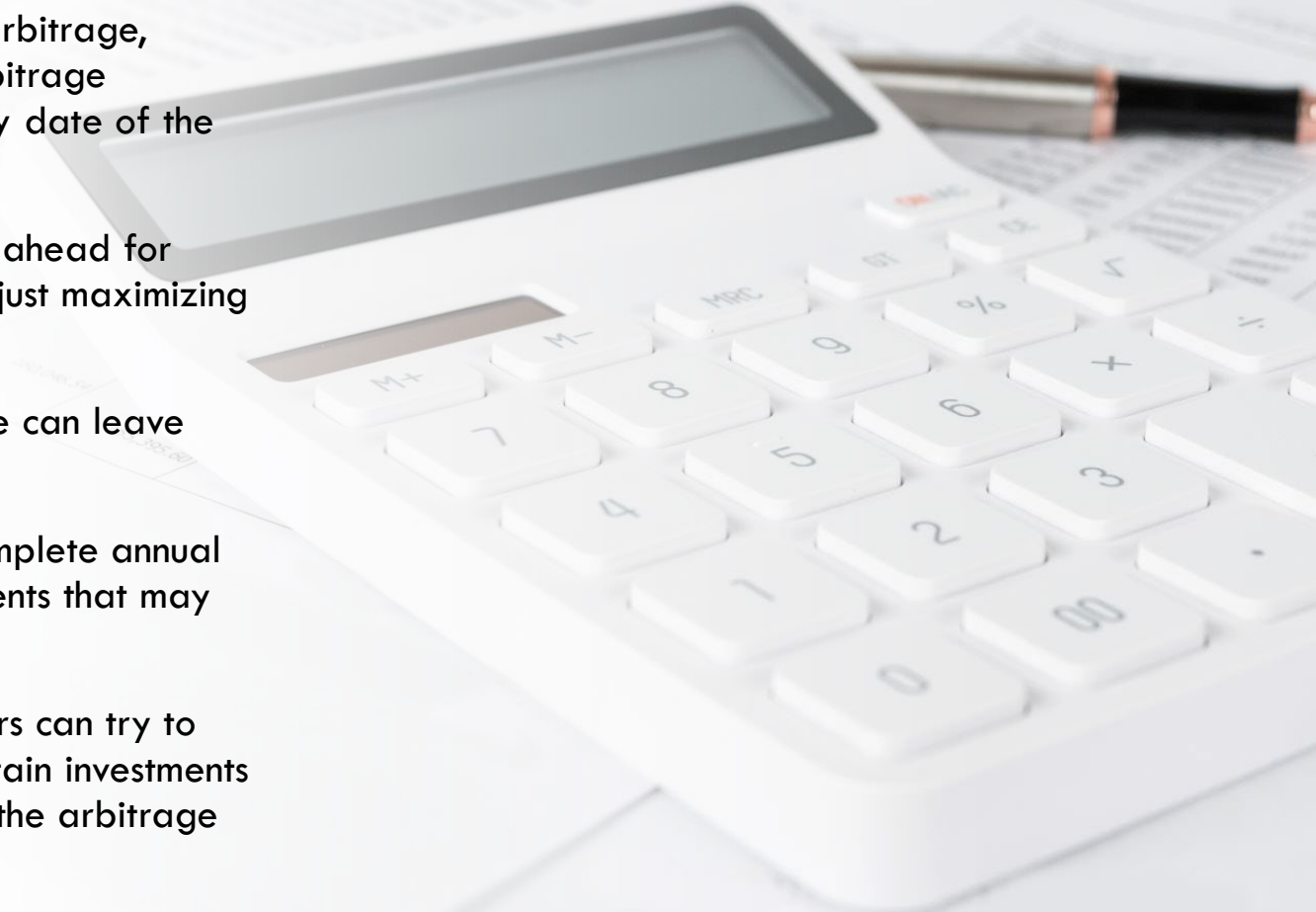
Read through policies annually, and create and execute due diligence checklists.

WHAT IF ISSUERS OWE REBATE OR YR?

- Arbitrage Report - 60 Days to complete and make payment to the IRS and covers 5 Years
- Personal Taxes – 105 Days to complete and make payment to the IRS and covers 1 Year
- Arbitrage Rebate and Yield Restriction Calculations involve working with:
 - Investments
 - General and Subsidiary Ledgers
 - Annual Comprehensive Financial Report
 - Official Statement, Tax Certificate, Form 8038-G, Escrow Verification
 - Tax Code Interpretation
- Can include over thousands of pages of documentation!

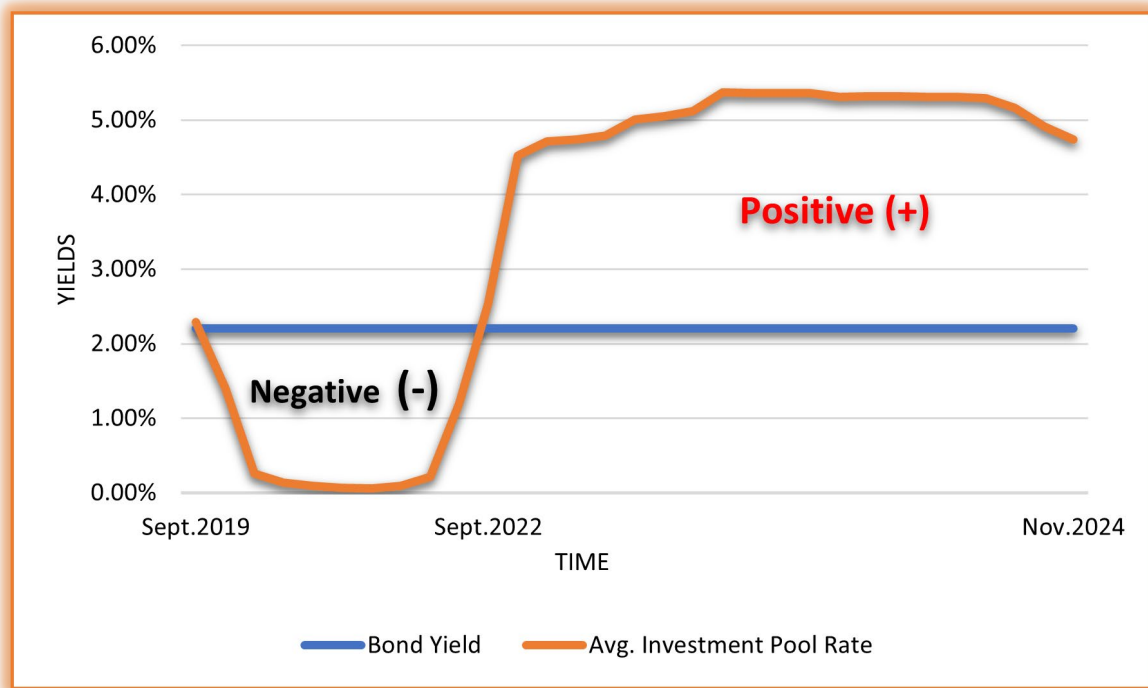
WHAT IF ISSUERS OWE REBATE OR YR?

What should I do if we are earning positive arbitrage?

1. The tax code does not prevent issuers from earning positive arbitrage, issuers are still compliant with the tax code if any positive arbitrage payment is made within 60-days after the 5-year anniversary date of the issue.
 2. Every issuer's tolerance for risk is different, but if issuers plan ahead for positive arbitrage and make payments on time, then you are just maximizing interest earnings allowed under the federal tax code.
 3. Trying to blend down investment yields to not "owe" arbitrage can leave potential earnings on the table.
 4. If positive arbitrage is being earned, we advise issuers to complete annual calculations and set aside funds to make future rebate payments that may be due
 5. There are also options to for "spending exceptions" that issuers can try to meet that allow all earnings to be retained. Additionally, certain investments can be purchased with bond proceeds that are exempt from the arbitrage regulations.
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CURRENT ARBITRAGE TRENDS

Are we the only issuer earning arbitrage? (No)



- Why are we here?
 1. Higher investment rates
 2. Lower Borrowing Rates
- Recent Trends in Investment Rates and its Effect on Arbitrage:
 1. Currently, a majority of 2022, 2023 & 2024 bonds are earning arbitrage (however, doesn't mean that there is a possibility for older bonds to start "flipping" into positive arbitrage liabilities, or that all 2022 – 2024 bonds are earning positive arbitrage). Each financing has different elements that can be unique to each arbitrage rebate calculation.

CURRENT TRENDS:

ARBITRAGE REBATE & YIELD RESTRICTION PAYMENTS & LIABILITY ACCRUALS

ACS completes approximately 2,500 arbitrage rebate & yield restriction calculations per year.

Report Type	Report Periods	ACS # of Reports Completed	Number of Payments	Liabilities (to be paid)
Arbitrage Rebate	2009 to 2019	25,208	27	N/A
Arbitrage Rebate	2020 to Current	11,301	72	456*
Total Paid or Accrued Liability Amounts (Rebate)				<u>\$354,192,334</u>

Project Yield Restriction	2009 to 2019	See above	9	N/A
Project Yield Restriction	2020 to Current	See above	131	153*
Total Paid or Accrued Liability Amounts (YR)				<u>\$46,336,677</u>

*Note: Difficult to access true number, since many issuers do not complete interim reports.



QUESTIONS?

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