

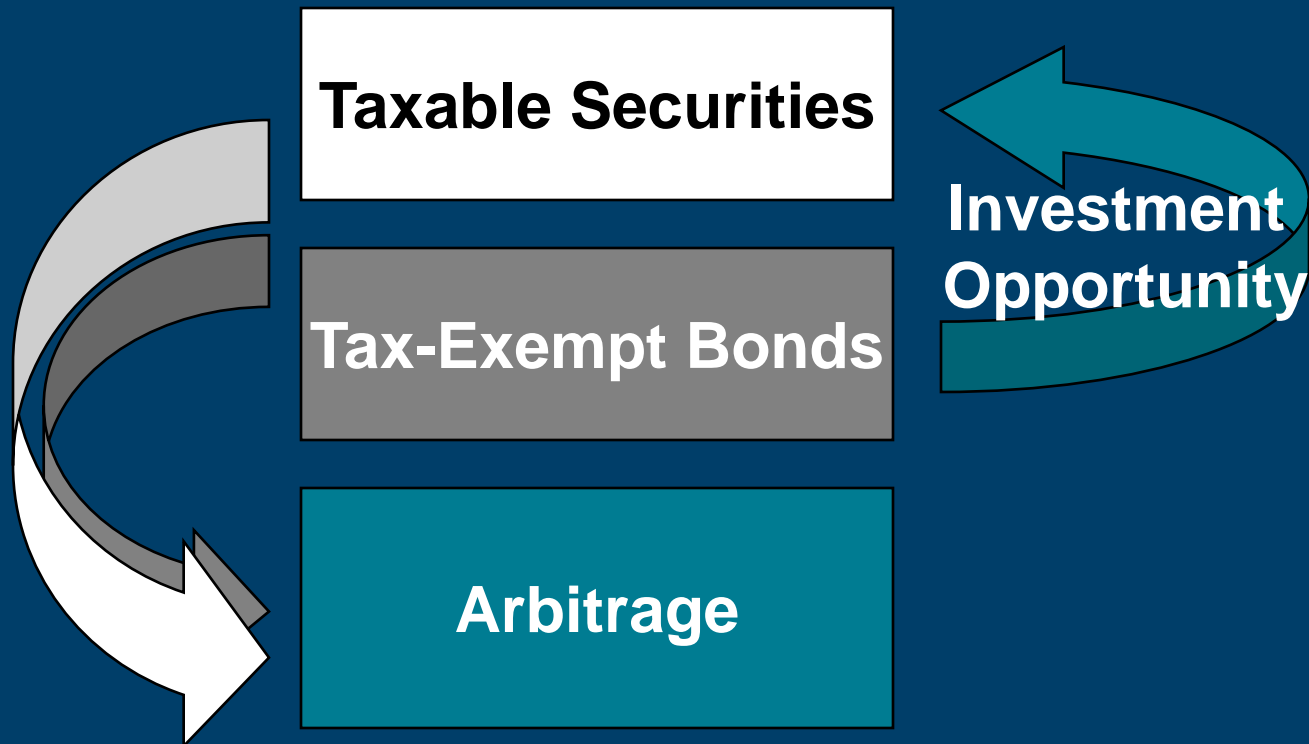


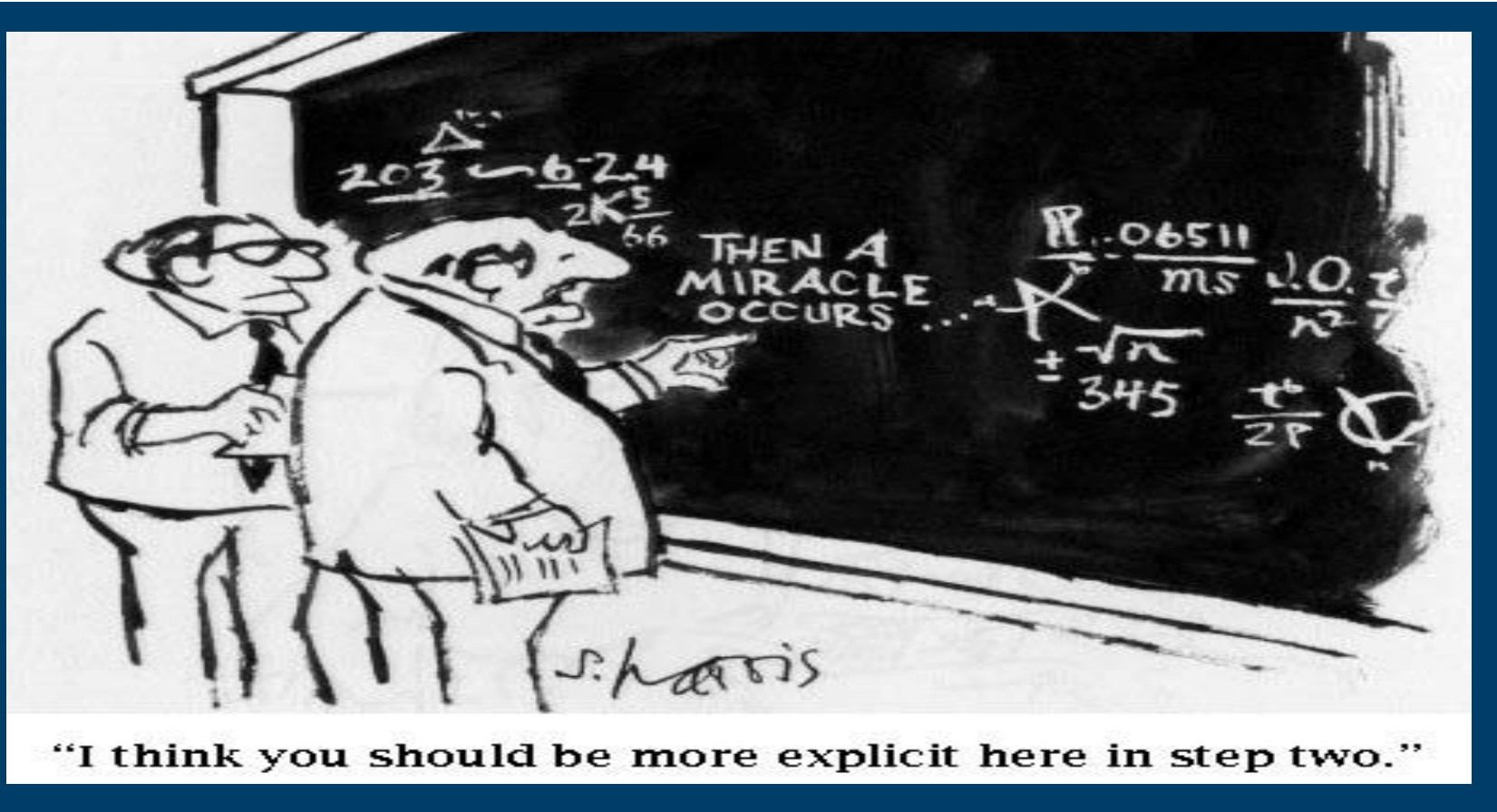
# Understanding Arbitrage Rebate

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# What is Arbitrage Rebate?





**"I think you should be more explicit here in step two."**

# *Two Sets of Rules*

## Arbitrage Rebate

Compares Yield on  
Investments  
to  
Interest Paid  
to Bondholders

## Yield Restriction

Limits  
Investment Yield  
to  
Bond Yield

# *Multiple Exceptions*

## Arbitrage Rebate

- Small issuer
- Spending Exceptions
  - 6 months
  - 18 months
  - 24 months
- Bona fide debt service

## Yield Restriction

- Temporary Periods
  - 13 months
  - 3 years
- Reserve Funds
- Escrows Funds

# **Arbitrage Rebate Reporting & Payment**

# ***Required Documents***

- Official Statement
- Tax Certificate
  - 8038G
- Trust Indenture
- Escrow Verification Report (Refundings Only)
- Cash flow transactions/ Asset Statements
- SWAP Agreement



# Fund Analysis

Tracking proceed investment by fund provides easy audit.

Cash flow analysis helps to meet expenditure tests.

Fund/Account: Costs of Issuance		Exhibit C			
<b>Public Financing Authority</b>					
<b>1997 Lease Revenue Bonds</b>					
		Delivery Date		09-Oct-97	
		<b>Computation Date</b>		<b>01-Oct-02</b>	
		<b>Arbitrage Yield</b>		<b>4.53195524%</b>	
		Investment Yield		5.06061283%	
		Total Earnings		\$ 582.63	
Date	Receipts	Payments	Earnings	Balance	Future Value
09-Oct-97	\$ 69,242.82	\$ 0.00	\$ 0.00	\$ 69,242.82	\$ (86,547.39)
09-Oct-97		(3,780.00)		65,462.82	4,724.67
09-Oct-97		(6,104.68)		59,358.14	7,630.31
09-Oct-97		(29,994.62)		29,363.52	37,490.62
27-Oct-97		(4,500.00)		24,863.52	5,612.01
03-Nov-97			85.53	24,949.05	
04-Nov-97		(85.53)		24,863.52	106.57
01-Dec-97			103.15	24,966.67	
02-Dec-97		(103.15)		24,863.52	128.08
02-Jan-98			106.59	24,970.11	
05-Jan-98		(106.59)		24,863.52	131.81
02-Feb-98			106.35	24,969.87	
02-Feb-98		(106.35)		24,863.52	131.07
24-Feb-98		(6,800.00)		18,063.52	8,357.76
02-Mar-98		(4,000.00)		14,063.52	4,911.43
02-Mar-98			91.38	14,154.90	
03-Mar-98		(91.38)		14,063.52	112.19
01-Apr-98			60.71	14,124.23	
02-Apr-98		(60.71)		14,063.52	74.27
15-Apr-98		(14,063.52)		0.00	17,175.83
01-May-98			28.92	28.92	
04-May-98		(28.92)		0.00	35.24
<b>Total Rebataable Arbitrage</b>				<b>\$ 74.46</b>	

# Calculation Summary

Snapshot analysis puts critical detail at your finger tips.

## CALCULATION SUMMARY

**Public Financing Authority**  
**1997 Lease Revenue Bonds**  
**\$2,620,000.00**

**Arbitrage Yield:** 4.53195524%  
**Final Maturity Date:** October 1, 2007

**Arbitrage Rebate Liability**  
**For the Period October 9, 1997 – October 1, 2002**

Costs of Issuance	\$	74.46
Site Lease Payment		5,108.91
Reserve		19,884.06
FV Computation Date Credit – 10/01/98		(1,196.33)
FV Computation Date Credit – 10/01/99		(1,143.90)
FV Computation Date Credit – 10/01/00		(1,093.77)
FV Computation Date Credit – 10/01/01		(1,045.83)
Computation Date Credit – 10/01/02		(1,000.00)
<b>Total</b>	<b>\$</b>	<b>19,587.60</b>
<b>Rebate Liability (90% of Total)</b>	<b>\$</b>	<b>17,628.84</b>

**Balance of Funds/Accounts**  
**Subject to Rebate Requirement**  
**As of October 1, 2002**

Reserve	\$	269,672.63
<b>Total</b>	<b>\$</b>	<b>269,672.63</b>

# Compliance Monitoring

## Agency Arbitrage Rebate Compliance Summary as of 1/31/04

Issue Date	Original Principal	Issue Name	Last Report	Liability	Next Report
10/07/1993	\$2,405,000.00	Peacock Gap Refunding	10/01/1998	(\$26,061.00)	10/01/2003
01/28/1997	\$5,250,000.00	1997 Revenue Bonds	05/31/2003	(\$42,382.16)	01/28/2007
06/30/1999	\$23,504,004.00	1999 TAB	06/30/2003	\$215,345.89	06/30/2004
12/06/2001	\$3,220,000.00	2001 Revenue, Series A	--	--	12/06/2006
10/20/2002	\$25,020,000.00	TARB Series 2002	--	--	10/20/2007

# *Computation Schedules*

- Annual calculation on all variable rate issues and fixed rate bonds that have accrued liabilities.
- 1<sup>st</sup> year, 3<sup>rd</sup> year, 5<sup>th</sup> year schedule for fixed rate bonds with no accruing liability.
- Minimum computation schedule, every 5 years.

# ***IRS Form 8038-T***

- Form 8038-T only filed when there is a positive liability and/or yield reduction payment needed.
- Check payable to US Treasury.
- Mail rebate or yield reduction payment to IRS Center in Ogden, UT.



# *Payment Requirements*

- **Installment Dates**
  - Every 5 years from issue date or bond year
  - Bond year election – first year can be shorter than a year
  - 90% payments due within 60 days
- **Final Maturity**
  - Date bonds matured or redeemed early
  - 100% payment due within 60 days

# Refund Requests



# *Filing for a Refund*

- Use Form 8038R for filing.
- Overpayment of less than \$5,000 may not be recovered before the final computation date.
- Overpayment is limited to actual dollars paid.

# ***Refund Rules***

- 1992 Regulations
  - Generally applies to bonds issued prior to 6/30/93.
  - Only permits refunds caused by mathematical errors.
- 1993 Regulations
  - Permits refunds whenever an overpayment can be demonstrated.

# Calculating Arbitrage Rebate

# *Overview*

- Section 148 is the principal Code section governing arbitrage rebate.
- Other provisions are found in Section 103, 149 & 150.
- Specific requirements for applying the rebate rules are complex and often open to interpretation.

# *Computation of Bond Yield*

- Fixed Rate Bond
- Variable Rate Bond

# Exceptions to Rebate

# ***Exceptions to Rebate***

- Small Issuer Exception
- Spending Exceptions
- Bona Fide Debt Service Funds

# *Small Issuer Exception*

- General taxing powers
- Not “Private Activity” Bonds
- 95% or more proceeds used toward local government activities
- Aggregate tax-exempt debt must not exceed \$5 million within a calendar year



# ***Small Issuer Exception for Schools***

- January 1, 1998 limit increased to \$10 million
- January 1, 2002 limit increased to \$15 million
  - \$10 million must be used for construction of public school facilities
  - \$5 million for non-construction purposes

# *Spending Exceptions*

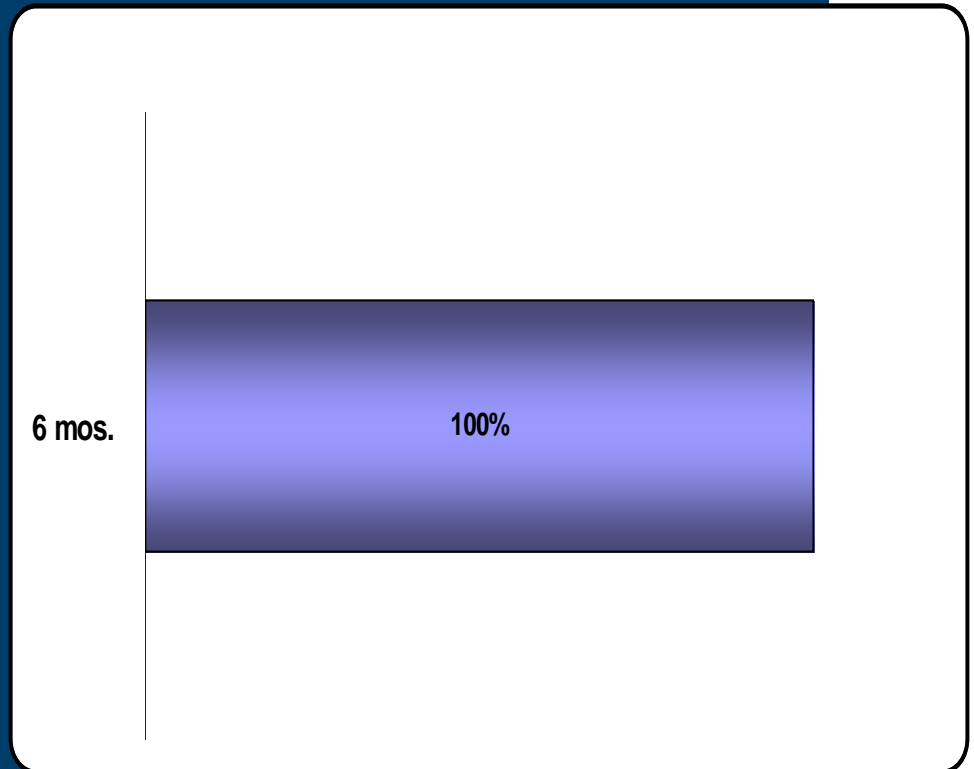
- Six Month Spending Exception
- Eighteen Month Spending Exception
- Twenty-Four Month Spending Exception

# *Six Month Exception*

Applies to any type of tax-exempt issue

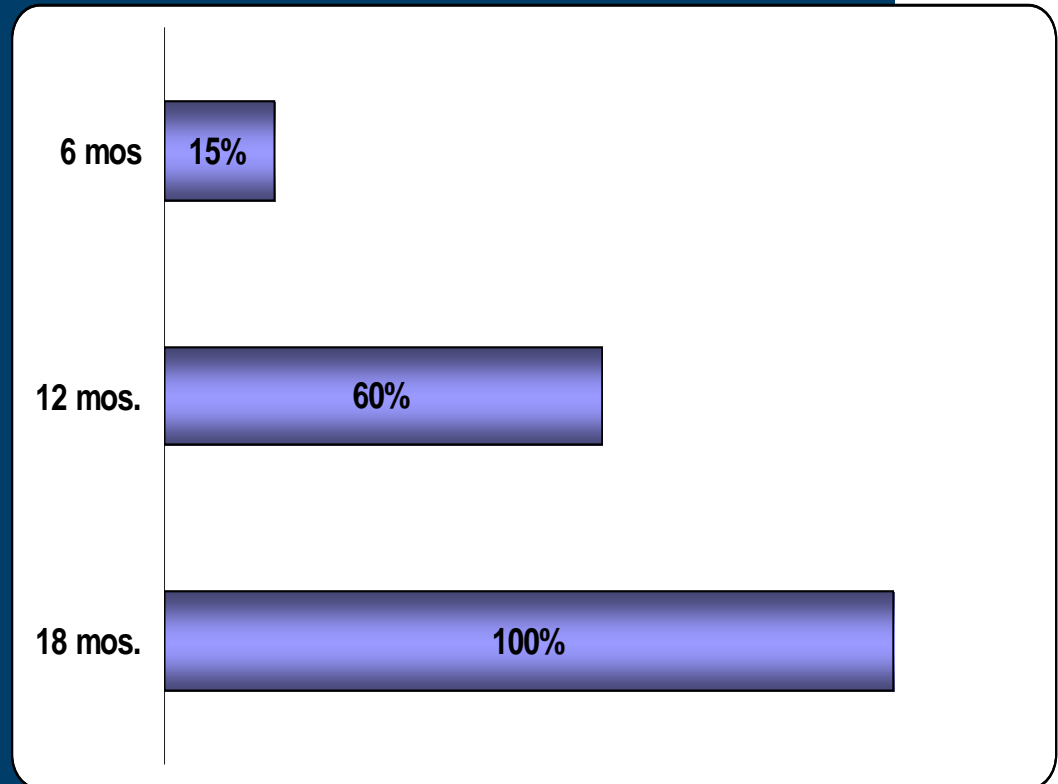
501(c)(3) have additional 6 months to spend 5% of proceeds

Private activity bonds are not afforded the additional 6 months



# ***Eighteen Month Exception***

Applies to any type of tax-exempt issuance for a capital project including industrial bonds or qualified mortgage bonds

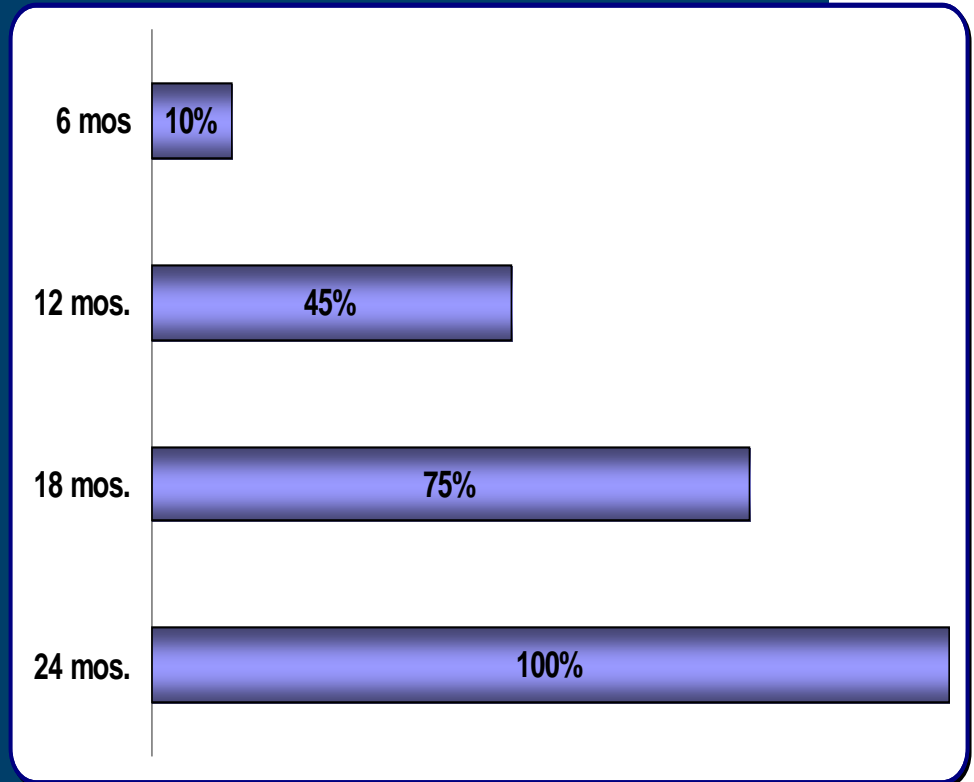


# ***Twenty-Four Month Exception***

Governmental bonds, 501(c)(3), or private activity construction bonds.

75% of proceeds to be used for construction

Expenditures must be on property owned by a governmental unit or 501(c)(3).



# ***Bona Fide Debt Service Funds***

- Used primarily to match revenue and debt service in a bond year.
- Must deplete annually minus a reasonable carryover.

# Exceptions to Yield Restriction

# ***Exceptions to Yield Restriction***

- Temporary Periods
- Reasonably Required Reserve
- De Minimus Exception



# *Temporary Periods*

- Three Year Temporary Period
  - Project Funds, Capitalized Interest and Costs of Issuance qualify
  - Within six months from issue date, issuer incurs a substantial binding obligation to a third party to expend 5% of net sale proceeds.
  - 85% of net sale proceeds expended within three year period.

# *After the Temporary Period*

- Yield restrict remaining proceeds
- Yield reduction payment may be permitted under 1993 Regulations

# ***Reasonable Required Reserve***

- Should not exceed the lesser of
  - 10% of principal amount
  - Maximum annual debt service
  - 125% of the average annual debt service
- Excess Reserve Portion
  - Must be funded from other source such as revenues, not sale proceeds
  - Excess amount must be yield restricted

# ***Yield Reduction Payments***

- 1993 administrative solution to yield restriction.
- Yield Reduction Payments are payments made to the IRS on yield restricted funds.
- Paid at same time and manner as a rebate payment.

# Common Errors

## ***Failure To:***

- Comply with both the arbitrage rebate and yield restriction regulations
- Pay on time
- Take into account all “Gross Proceeds”
- Verify the bond yield
- Understand the Spending Exceptions
- Remember a bond year election
- Consider the impact of a refunding

# ***News and Notes***

- Build America Bonds (BABs)
- IRS Examinations
- Questionnaires
- Written Policies/Procedures