# Five Keys to Successfully Managing Your Arbitrage Rebate Calculation

The term "Arbitrage" should not make tax-exempt bond issuers nervous. If you follow a few simple rules when issuing the bonds and when allocating the proceeds among the various funds, the arbitrage calculation process should be much smoother and less costly.

Generally, arbitrage is defined as the excess earnings resulting from obtaining tax-exempt bond proceeds and investing those funds in higher yielding taxable securities resulting in profit. Under certain circumstances the federal government may require a rebate computation and payment of any excess arbitrage earnings (profit).

The five keys to successfully managing your arbitrage rebate calculation are:

1. Develop an Investment Strategy
2. Review the Tax and Arbitrage Certificate
3. Develop Project Accounting Strategies
4. Take Advantage of Spend-Down Exceptions to Rebate
5. Arrange for Your Rebate Calculation

Let's look at the details on the first of those five keys.

Key 1: Develop an Investment Strategy -- Management should work closely with their engineer/architect, bond counsel, trustee, local counsel and financial/investment advisor to determine:

- when the bonds need to be issued,
- what funds or accounts are to be maintained, and
- the type and timing of investments that will be purchased with the remaining proceeds as the project moves forward to a) maximize the investment earnings you retain while b) remaining in compliance with tax laws and regulations.

Key 2: Review the Tax and Arbitrage Certificate -- Review with bond counsel and your financial advisor the Tax and Arbitrage Certificate located in the bond transcript. The Tax and Arbitrage Certificate spells out much useful information such as amount of the bond proceeds that will go into each fund, what the issuers' reasonable expectations are for each of the funds, the arbitrage yield limit, and what accounts are subject to rebate.

Key 3: Develop Project Accounting Strategies -- Often, there are multiple bond issues for a project, multiple accounts to segregate funds for special purposes (such as debt service accounts, debt service reserve accounts, construction accounts, etc.) and sometimes even accounts held separately by the trustee and the issuer. In these situations, it is not a good idea to commingle funds of one bond issue with that of another or commingle other project funds with other funds of the entity. Developing an appropriate project accounting system up front that avoids commingling of funds can greatly simplify the arbitrage rebate calculation and in turn reduce the time and expense involved.

Key 4: Take Advantage of Spend-Down Exceptions to Rebate -- There is a temporary period (usually three years, but occasionally five years) when proceeds can be invested in investments with an unrestricted yield. Although projects can be difficult to keep on schedule and delays almost always happen, it is advantageous to spend down the proceeds as quickly as possible to avoid owing rebate or being subject to yield reduction payments after the temporary period.

Key 5: Arrange for Your Rebate Calculation -- It is important for issuers to understand the rules of arbitrage and how arbitrage relates to the bond issue. Generally, rebate calculations should be made every five years from the date of issue as long as the bonds are outstanding. The rules state that if a rebate is owed to the U.S. Treasury the issuer has 60 days after the five-year date to remit payment. If payment is not sent within 60 days the issuer could be subject to penalty and interest on the underpayment. So, it is imperative that the issuer be proactive in following the rules.

Umbaugh offers arbitrage rebate services and cash advisory services to assist management of governmental entities through their projects. We provide investment strategies with a goal of creating additional interest earnings as well as guidance on arbitrage rebate rules. If you need assistance or have questions, please contact us at footnotes@umbaugh.com.