



Managing Debt Proceeds Effectively

Why Investing & Arbitrage Matter

Overview

- Debt Proceeds Management
 - ✓ Regulations & compliance
- Investment of Debt Proceeds
 - ✓ Set objectives, policies, & draw schedule
 - ✓ Strategy, deposits, & investments
- Arbitrage Basics
 - ✓ Spend-down & yield

Debt Proceeds Management & Compliance

Think about
it here...



...Don't wait
'til here!

Debt Proceeds Regulations



Debt Proceeds Compliance

Issuer tax covenants associated with ALL tax-exempt debt

6.01. Tax-Exempt Bonds. The District shall comply with all the necessary requirements and take all necessary actions (or decline to take prohibited actions) to ensure that interest on the Bonds shall not be includable in gross income for federal income tax purposes under Section 103 and Sections 141 through 150 of the Internal Revenue Code of 1986, as amended (the “Code”), and applicable Treasury Regulations promulgated thereunder (the “Regulations”). The District covenants and agrees with the holders from time to time of the Bonds that it shall not take or permit to be taken by any of its officers, employees, or agents any action which would cause the interest on the Bonds to become subject to federal income taxation under the Code and the Regulations, in effect at the time of such actions, and that it shall take or cause its officers, employees, or agents to take all affirmative action within their powers that may be necessary to ensure that such interest shall not become includable in gross income for federal income tax purposes under the Code and applicable Regulations, as presently existing or as hereafter amended and made applicable to the Bonds.

6.02. Continuing Requirements. The District shall comply with requirements necessary under the Code to establish and maintain the exclusion from gross income of the interest on the Bonds under Section 103 of the Code including, without limitation, requirements relating to temporary periods for investments, limitations on amounts invested at a yield greater than the yield on the Bonds, and the rebate of excess investment earnings to the United States.

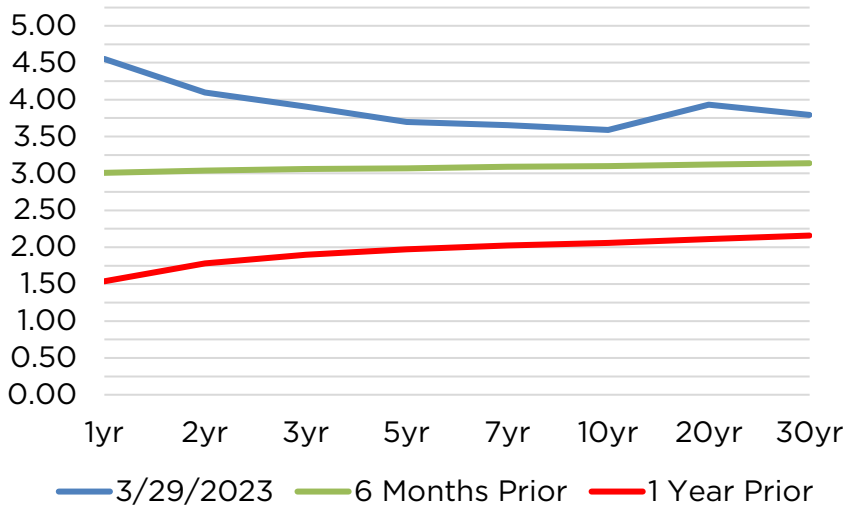
Why It Matters *More* Now...

- Yield environment for borrowing & reinvestment
- Project/materials procurement delays extending expenditure periods = increased interest earnings potential
- Earnings on ALL funds & accounts likely to increase due to higher short-term yields (debt service, reserve, etc.)
- 87,000 additional IRS employees = more audit eyes!

Yield Environment

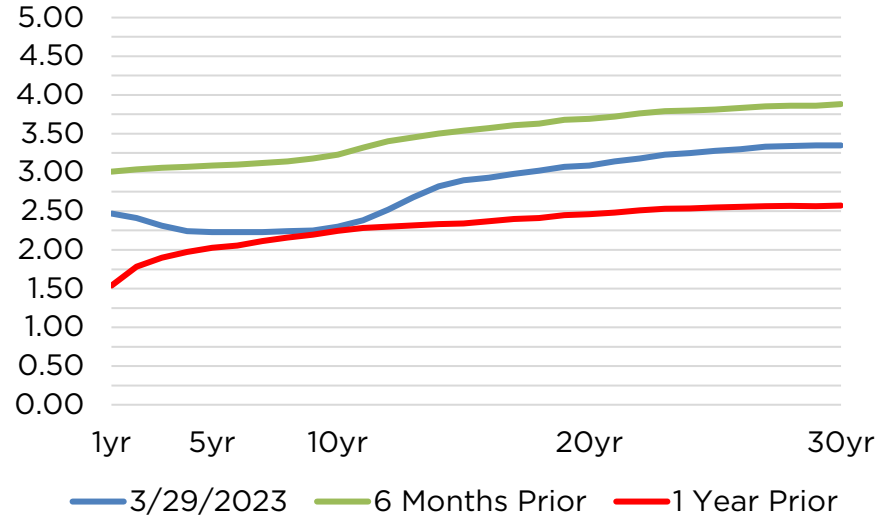
TAXABLE

US Treasury Yield Curve



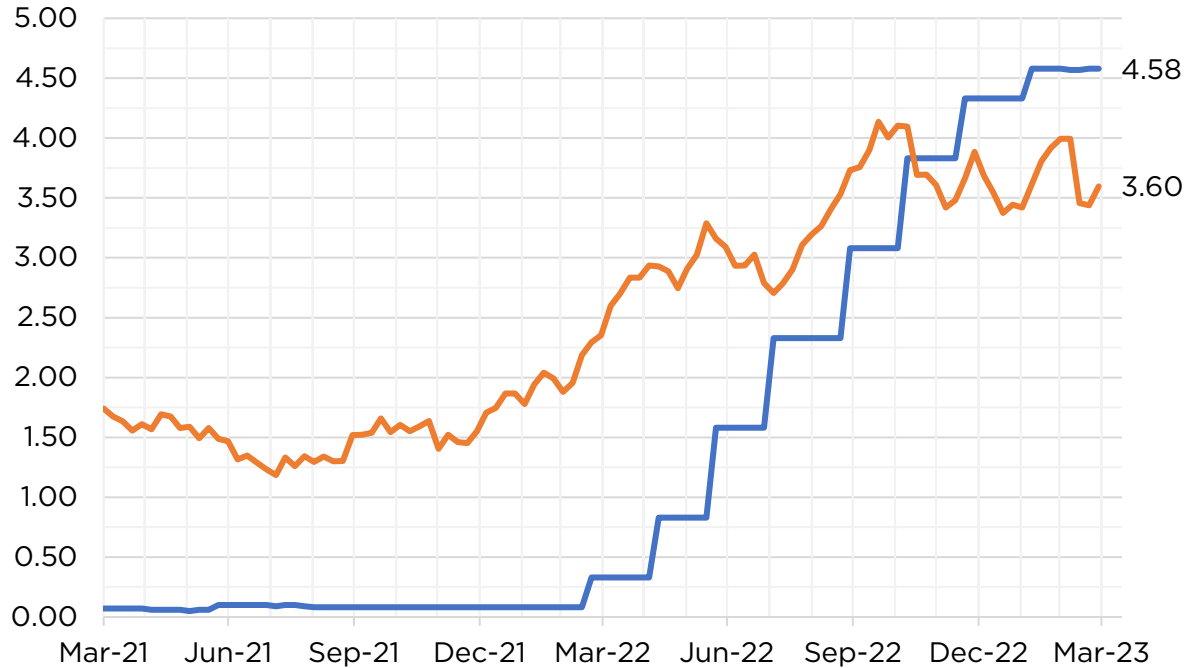
TAX-EXEMPT

AAA BVAL Muni Yield Curve



Fed Funds & 10-Year UST

Effective Fed Funds Rate & 10-Yr Muni BVAL



Investing Bond Proceeds

Safety :

- Minimize investment risk

Liquidity:

- Access funds for project costs

Yield:

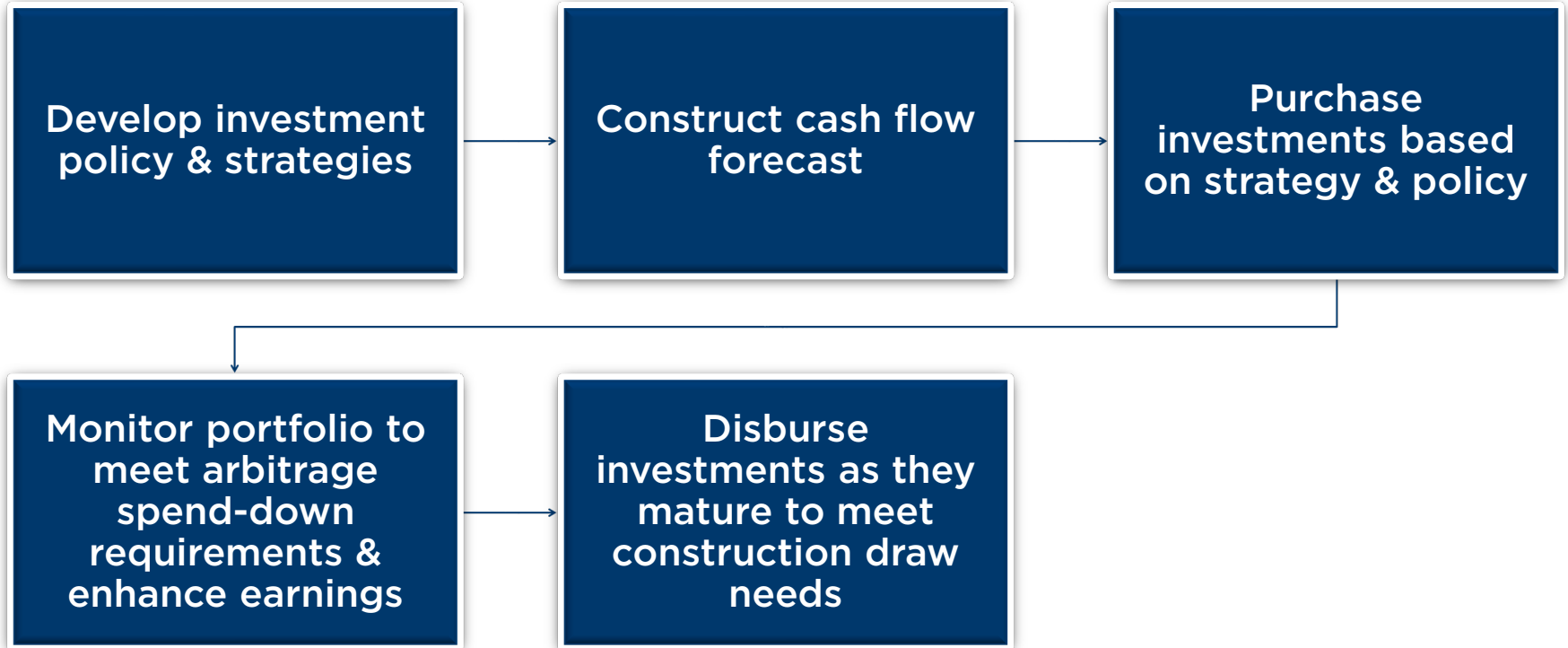
- Maximize investment earnings

Plan ahead! Be aware of arbitrage requirements & establish/adjust spend-down or investment strategy accordingly.

MN 118A Deposit & Investments

- Depositories 118A.03
 - ✓ Depositories
 - ✓ Collateral requirements
 - ✓ Perfecting collateral
- Permissible Investments 118A.04
 - ✓ Types
 - ✓ Fixed- vs. variable-rate investments

The Process





the
Yield
is
Right

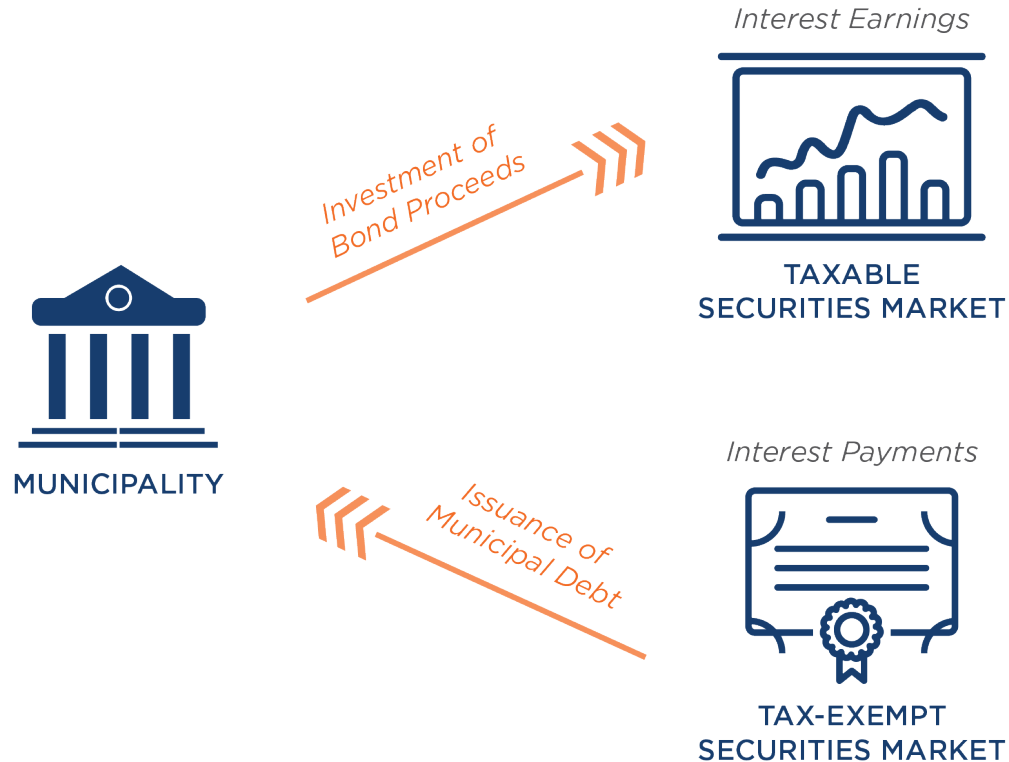
It's In The Bag!

Match the concepts with the correct bag & WIN what's inside!



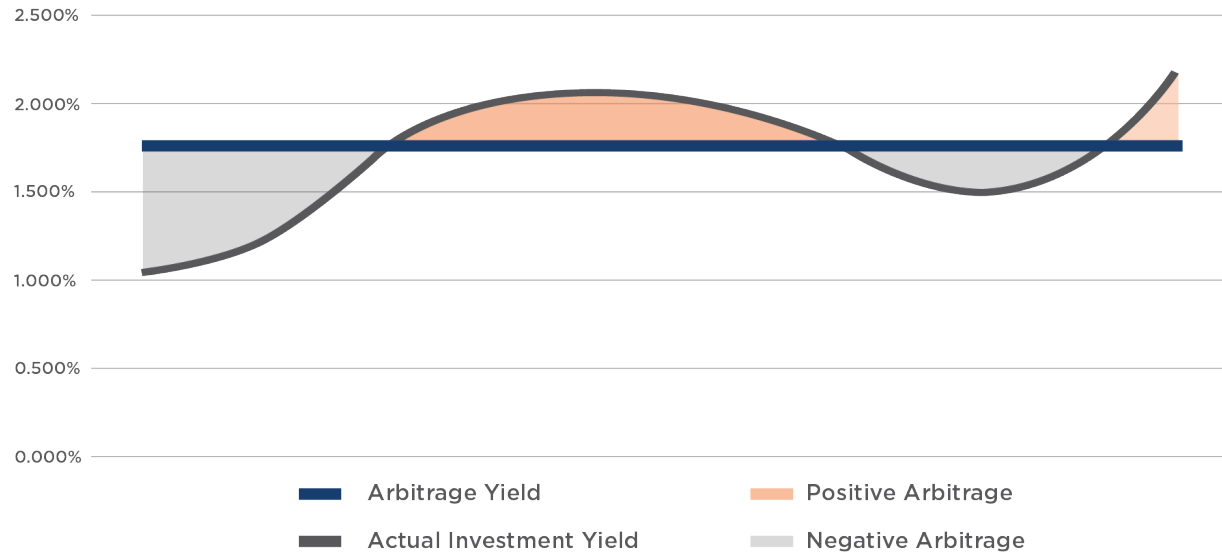
1. Liquidity = Access funds for project costs
2. Safety of Principal = Minimize investment risk
3. Yield = Maximize investment earnings

Arbitrage Creation



Arbitrage Monitoring

It's ALWAYS been a “thing.”



Arbitrage & Yield Restriction

- Prohibits “abuse” associated with investing proceeds of tax-exempt debt in higher yielding taxable securities
- IRS limitations related to:
 - ✓ Issuing earlier than necessary
 - ✓ Issuing more than necessary
 - ✓ Keeping proceeds invested longer than necessary
- Must reasonably establish each tax-exempt issue complies with requirements

Gross Proceeds



Bond Sale Proceeds

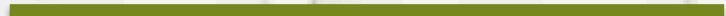
Investment Proceeds



Transferred Proceeds



Replacement Proceeds



Gross Proceeds



Temporary Periods

Expenditure Test

- 85% of sale proceeds must be allocated to expenditures within three years

Time Test

- Must expend at least 5% of sales proceeds within six months of date of issue

Due Diligence Test

- Project completion & sale proceeds allocation to expenditures must proceed with “due diligence”

Exceptions to Rebate

Small Issuer Status:

Applies to School District construction projects where the issuer reasonably expects to issue no more than \$15MM in tax-exempt debt during a calendar year

(\$5MM for general issuers)

Current refundings generally excluded from \$5 million limit.

Exceptions to Rebate

Spending Exceptions:

6-Month Exception

- Must spend 100% of gross proceeds within 6 months of issuance date

18-Month Exception

- Must spend at least 15% within 6 months of issuance date
60% within 12 months...
100% within 18 months

Exceptions to Rebate

24-Month Exception

- Must reasonably expect at least 75% of “construction proceeds” will be used for construction expenditures
- Must spend at least 10% of construction proceeds within 6 months of issuance date
 - 45% within 12 months...
 - 75% within 18 months...
 - 100% spent within 24 months

NEW TERM!

Issue Price



Earnings

— Deposit to Reserve Fund

— Proceeds Used to Finance Issue Costs

Construction Proceeds

Exceptions to Rebate

- Establishing reasonable expectations at time of issuance
- Bifurcating & applying different exceptions to respective purposes (streets, water, sewer, TIF, etc.)
- Paying penalty in lieu of rebate
 - ✓ 1.5% penalty at time of issuance
 - ✓ Can be difficult to calculate in advance
 - ✓ Risk of any deviation from construction schedule

Uncommon

Spending Gross Proceeds

Involves cash outlay to a governmental expenditure purpose

Reasonably expected to occur within five banking days of allocation

Exceptions apply, particularly for working capital borrowings

Maintaining “Bona Fide” Status

Funds & accounts related to a bond issue...

Debt Service

- Should be depleted each bond year to maintain arbitrage & yield restriction exemptions
- Reasonable “carry-over” amount permitted (1/12th of annual)

Reserve

- Earnings should be regularly transferred to debt service fund to maintain compliance with traditional “three-pronged” test

Common Pitfalls for MN School Issuers

- 105% Over-Levy Requirement
 - ✓ Be careful or you may exceed reasonable carry over after two years
- Bond-funded Capital Projects
 - ✓ Close out funds & allocate unspent proceeds timely
 - ✓ Discuss any alternative uses of unspent borrowed proceeds with advisors and bond counsel

Monitoring & Reporting

- Rebate/Yield Restriction Payments (IRS Form 8038-T)
 - ✓ Sent to IRS no later than 60 days after soonest of:
 - Each five-year anniversary date of issue - OR -
 - Date in which bonds are no longer outstanding
- IRS Compliance Checks
 - ✓ Questionnaires
 - ✓ Audits & investigations

Plinko!

Answer each question correctly & get one Plinko chip for a chance to win!



1. Under the Expenditure Test, what percentage must issuers spend within 3 years? **85%**

2. True or False: 100% of debt proceeds must be spent within 6 months to meet the 6-month exception. **TRUE**

3. Form 8038T must be filed to report rebate liability & payment made within how many days? **60**

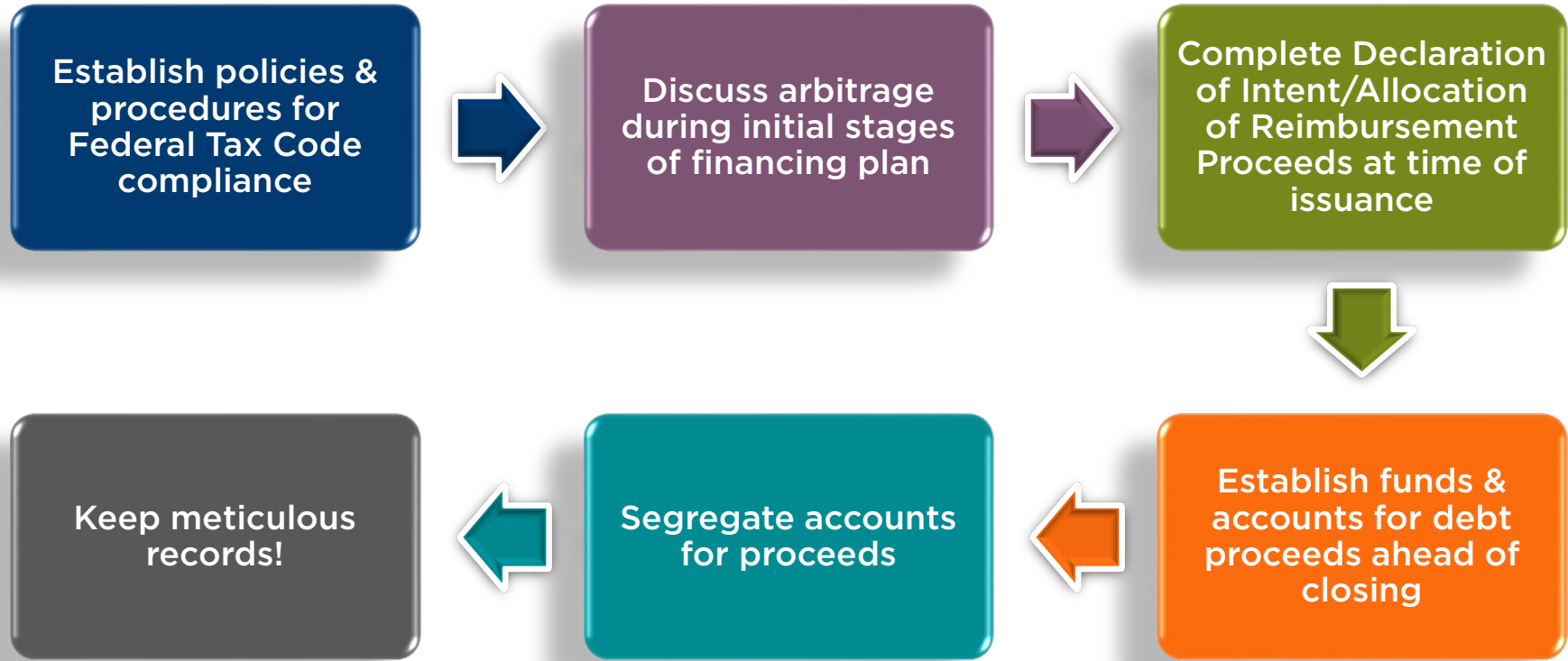
Arbitrage Compliance

Develop plan & procedures for lifespan of project, bond issue

- Monitor spend-downs & adjust investing strategy/portfolio, as warranted
- When unspent funds remain after project completion, transfer to debt service fund or repurpose to other eligible expenditures
- Monitor all funds & accounts at least annually to maintain bona fide status
- File all required reporting! Monitoring DOES NOT = Reporting



Best Practices Process



Hole-In-One!

Sink your putt & win a prize! Complete each hidden term to move one foot closer to the hole:



1. Yield Restriction
2. Spend-down
3. Form 8038T
4. Gross Proceeds
5. Rebate

The Price of Non-Compliance

A myriad of potential consequences...

Fines

Bonds deemed
taxable

Bonds
removed from
market by
issuer

Bondholder
lawsuits

Required
securities
disclosures

Credit rating
risks

Reputational
risk

Difficulty
accessing
capital

IRS Examinations & Audits

- Commingled funds permitted, but **NOT** recommended
- Fund transfers & journal entries **DO NOT = EXPENDITURES**
- Performing accurate arbitrage reporting is an essential function
- Staff education is critical
- IRS Information Document Request (IDR) = **AUDIT LETTER!**



Thanks for Playing!



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Resources

GFOA Debt Management Best Practices

<https://www.gfoa.org/best-practices/debt-best-practices>

Post Issuance Compliance Policies IRS Form 8038-G

Form: <https://www.irs.gov/pub/irs-pdf/f8038g.pdf>

Instructions: <https://www.irs.gov/pub/irs-pdf/i8038g.pdf>

Arbitrage Rebate IRS Form 8038-T

Form: <https://www.irs.gov/pub/irs-pdf/f8038t.pdf>

Instructions: <https://www.irs.gov/pub/irs-pdf/i8038t.pdf>

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