



Managing Debt Proceeds Effectively

Why Investing & Arbitrage Matter

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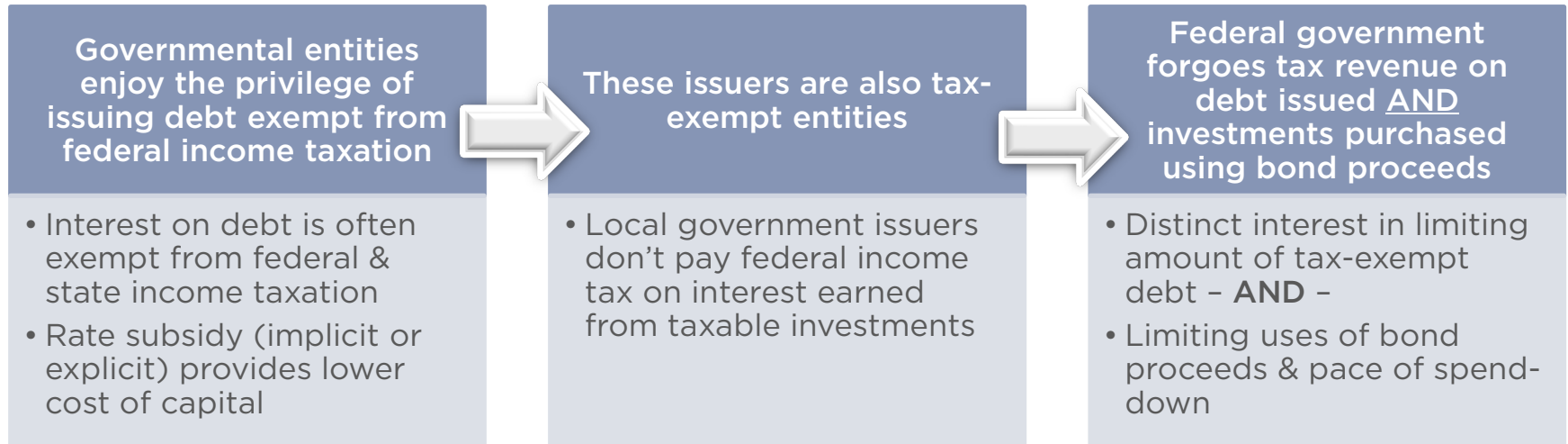
Debt Proceeds Management & Compliance

Think about
it here...



...Don't wait
'til here!

Debt Proceeds Regulations: The Concept



Debt Proceeds Compliance: Why it Matters...

Issuer tax covenants associated with ALL tax-exempt debt

12.1. The County covenants and agrees with the holders from time to time of the Bonds that it will 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 taxation under the Internal Revenue Code of 1986, as amended (the Code), and the Treasury Regulations promulgated thereunder, in effect at the time of such actions, and that it will take or cause its officers, employees or agents to take, all affirmative action within its power that may be necessary to ensure that such interest will not become subject to taxation under the Code and applicable Treasury Regulations, as presently existing or as hereafter amended and made applicable to the Bonds.

12.2. The County will 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.

Explicit language:
***Tax-exempt* bond sale**
resolution

Debt Proceeds Compliance: Why It Matters *More* Now...

Yield environment for borrowing & reinvestment

Project/materials procurement delays extending expenditure periods = increased interest earnings potential

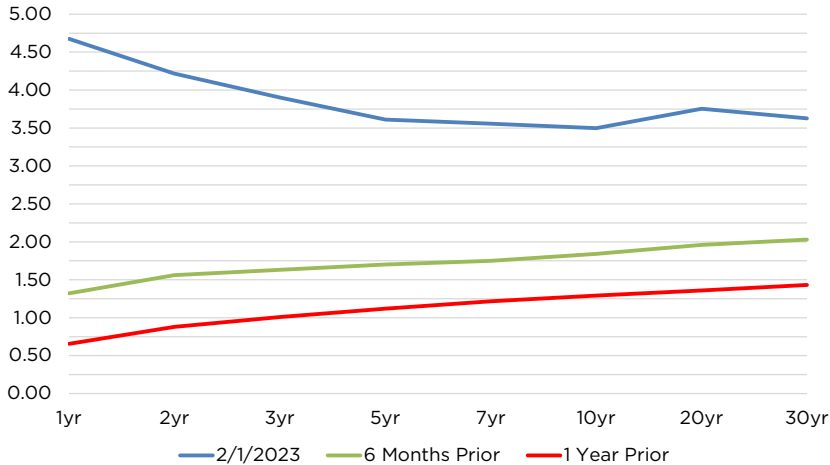
Earnings on ALL funds & accounts likely to increase due to higher short-term yields (debt service, reserve, etc.)

87,000 additional IRS employees = more audit eyes!

Yield Environment: A Brief History

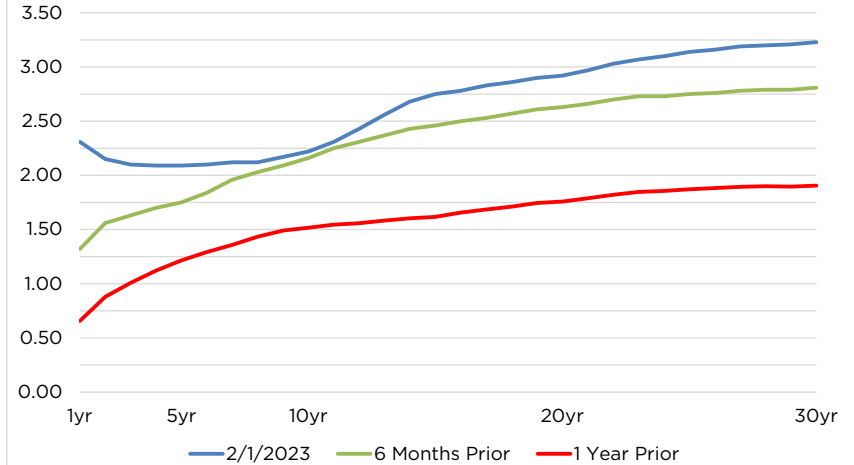
TAXABLE

US Treasury Yield Curve

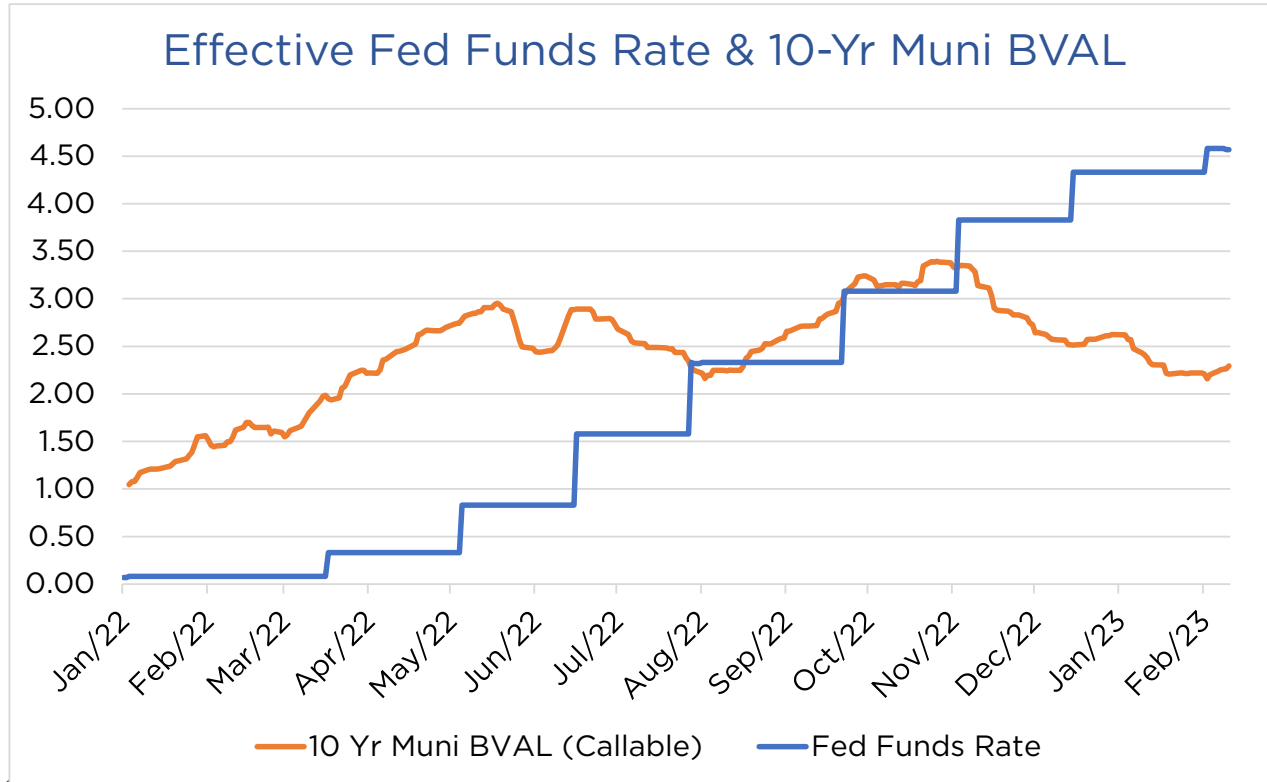


TAX-EXEMPT

AAA BVAL Muni Yield Curve



Yield Environment: Fed Funds & 10-year UST



Investing Bond Proceeds: The Objectives

Safety of Principal:

- Minimize investment risk

Liquidity:

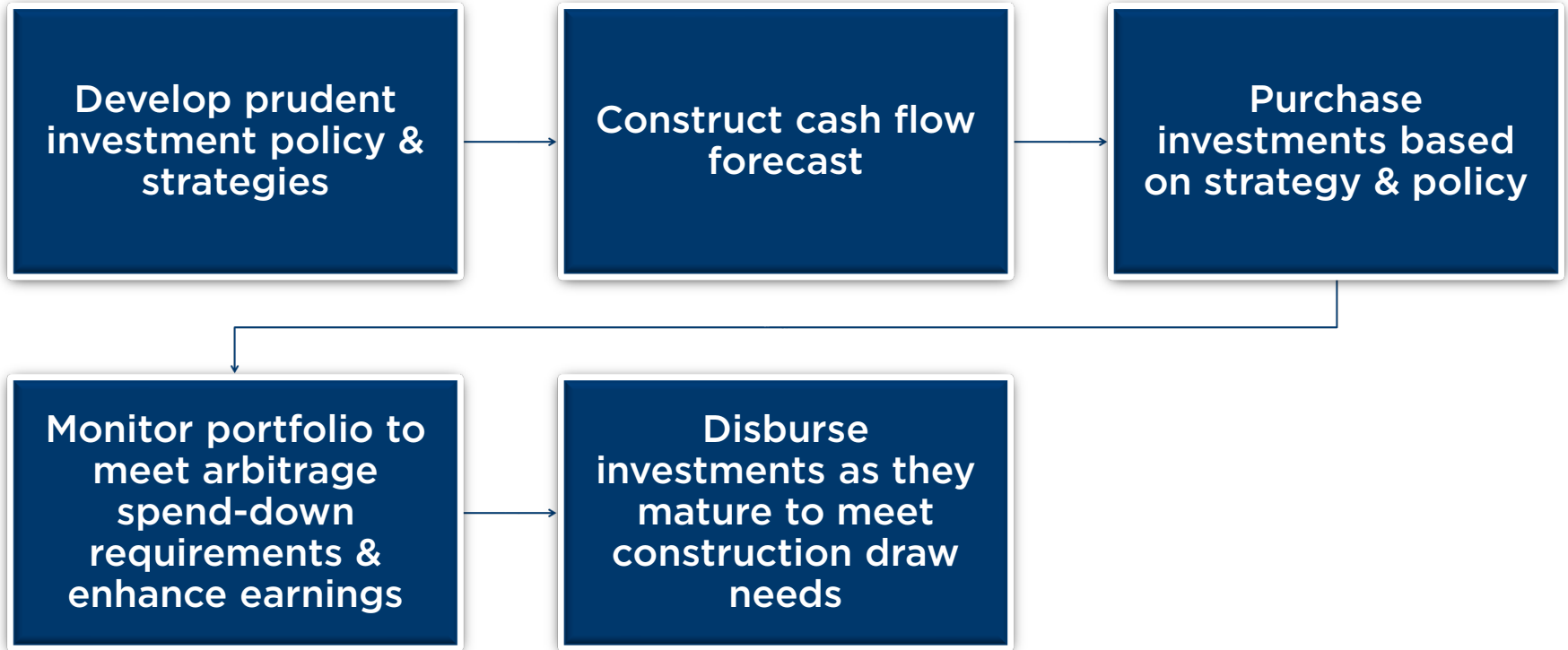
- Access funds for project costs

Yield:

- Seek to maximize investment earnings

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

Investing Bond Proceeds: The Process





the
Yield
is
Right

It's In The Bag!

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



1. Liquidity = Access funds when needed for project costs.
2. Safety of Principal = Minimize investment risk.
3. Yield = Seek to maximize earnings.

Arbitrage: How it's Created

ARBITRAGE CREATION



Investment of
Bond Proceeds

Interest Earnings



TAXABLE
SECURITIES MARKET

Issuance of
Municipal Debt

Interest Payments

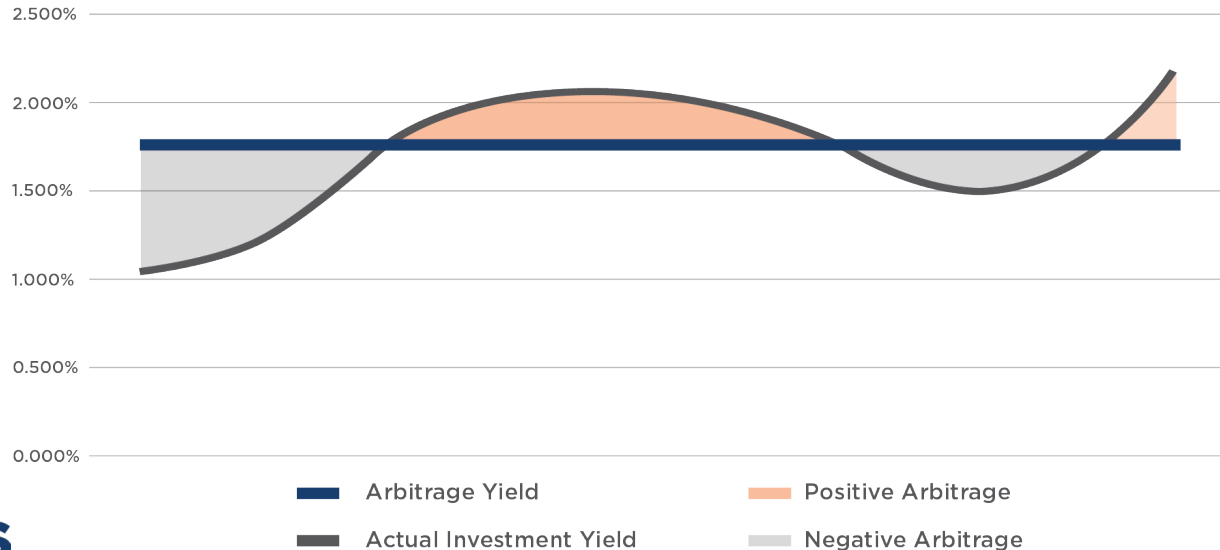


TAX-EXEMPT
SECURITIES MARKET

Arbitrage: What it Looks Like...

ARBITRAGE MONITORING

It's ALWAYS been a “thing.”



Basic Principles: 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

Basic Principles: Gross Proceeds



Basic Principles: 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”

Basic Principles: Exceptions to Rebate

Small Issuer Status:

Applies to issuers that reasonably expect to issue no more than \$5MM in tax-exempt debt during a calendar year

(\$15MM for public school construction projects)

Current refundings generally excluded from \$5 million limit.

Basic Principles: 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

Basic Principles: 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

Basic Principles: 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

Basic Principles: 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

Basic Principles: 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

Basic Principles: 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**

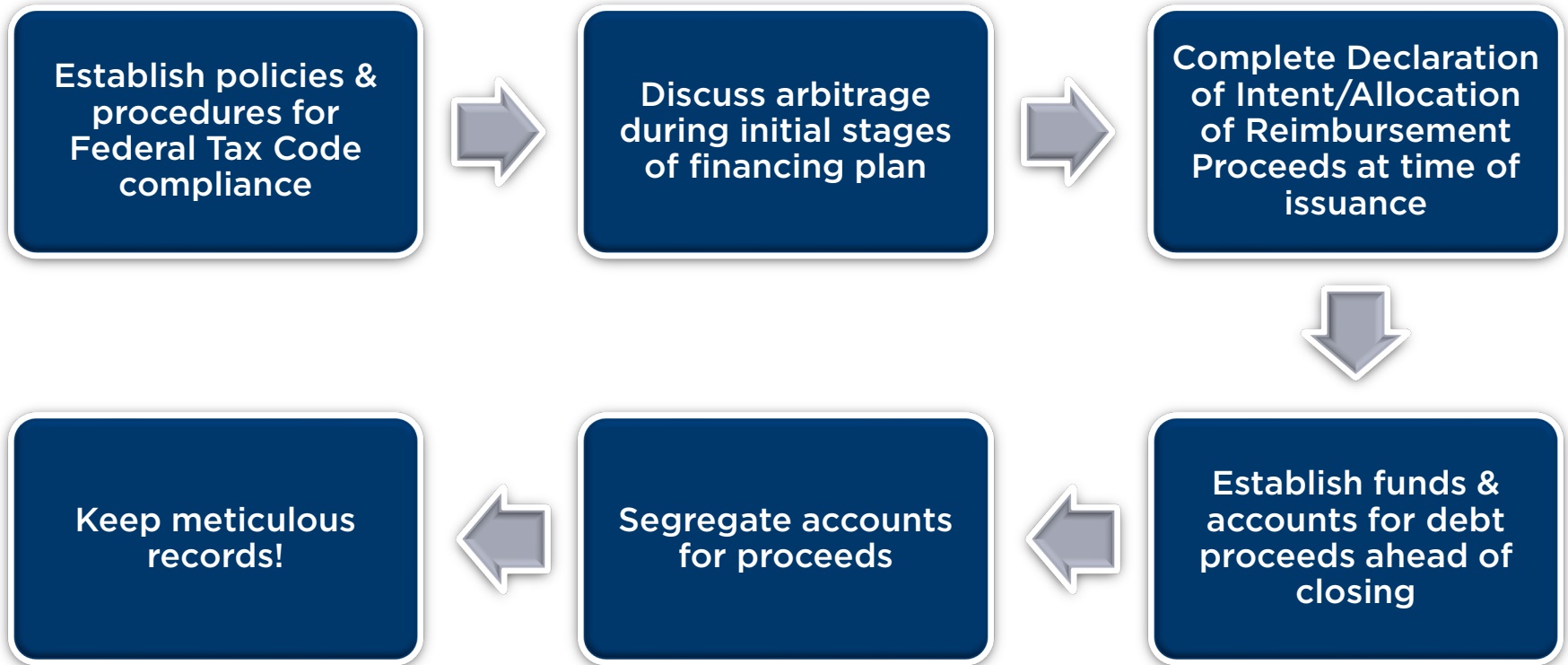
Arbitrage Compliance: Planning

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



Arbitrage Compliance: Best Practices Process



Putting It All Together: Example

- \$15,000,000 debt issue for construction project
- Arbitrage yield = 2.675%
- Estimated investment yield = 4.5%
- Spend-down within three years

Proceeds Detail	
02/09/23	Sales Proceeds Received Date
\$ 15,643,857.30	Sales Proceeds Received
+ \$ -	Investment Proceeds
= \$ 15,643,857.30	Total Proceeds Available as of 02/06/23
- \$ 796,808.62	Cumulative Expenditures as of 02/06/23
= \$ 14,847,048.68	Outstanding Proceeds as of 02/06/23
\$ 2,346,578.60	Allowable Proceeds as of 02/09/26 (85% Reasonable Expectation)

Plan Ahead: Preliminary Draw Down Review

Yield Restriction Exception???



Date	Projected Expenditures			Arbitrage Detail			Days
	Monthly Spending	Cumulative Spending	% Spent	18-month Spending Exception % Spent	24-month Spending Exception % Spent	Reasonable Spend Test % Spent	
02/09/23	\$ 252,430.00	\$ 252,430.00	1.54%				0
08/09/23	\$ 644,200.00	\$ 2,204,511.00	13.41%	15%	10%		181
02/09/24	\$ 1,375,960.00	\$ 8,925,116.83	54.29%	60%	45%		365
08/09/24	\$ 418,114.00	\$ 15,547,105.83	94.56%	100%	75%		547
02/09/25		\$ 15,643,857.30	95.15%		100%		731
02/09/26		\$ 15,643,857.30	95.15%			85%	1096

Plan Ahead: Preliminary Draw Down Review

Rebate Exception???



Date	Projected Expenditures			Arbitrage Detail			Days
	Monthly Spending	Cumulative Spending	% Spent	18-month Spending Exception % Spent	24-month Spending Exception % Spent	Reasonable Spend Test % Spent	
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08/09/24	\$ 418,114.00	\$ 15,547,105.83	94.56%	100%	75%		547
02/09/25		\$ 15,643,857.30	95.15%		100%		731
02/09/26		\$ 15,643,857.30	95.15%			85%	1096

Hole-In-One!

Sink your putt & win a prize!
Complete each hidden term and 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

Lessons Learned: 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!



Debt Proceeds Management: 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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