Navigating Arbitrage: Rules, Strategy & Best Practice

Florida Government Finance Officers Association (FGFOA)

July 9, 2026

Robert Goubert, Director
Mick Devereux, Senior Manager

Arbitrage Compliance Specialists, Inc.

Your Arbitrage Experts

About Robert

Robert Goubert, Director

Robert@rebatebyacs.com | (303) 867-7536

- 25 Years of Arbitrage Rebate Experience
- Began career in client relationship management with Mariott International Inc.
- Provides Arbitrage Consulting for over 600 governmental entities across 35 states in the USA
- Enjoys biking and diving during free time

Your Arbitrage Experts

About Mick

Mick Devereux, Senior Manager
Mick@rebatebyacs.com | (303) 867-7544

- Over 10 years of Arbitrage Rebate experience
- Works with Robert on same portfolio of clients
- Over 200 calculations completed for issuers in Florida since 2025
- Enjoys sports and spending time with family during free time

Learning Objectives

Arbitrage Rebate

- What is it? How is it measured?
- Funds/Proceeds Subject to Arbitrage
- Exceptions to Arbitrage Rebate

Yield Restriction

- Compare/Contrast to Arbitrage Rebate
- Temporary Periods

Reporting Requirements

- Computation Dates
- Payment Deadlines/Submission
- Best Practices and Current Trends

The Arbitrage Rebate Framework

Regulatory compliance for tax-advantaged bonds

Regulatory Basis

- Federal Tax Law Requirement
- Section 148 of the Internal Revenue Code

Scope of Application

- Applies to all tax-exempt borrowings (unless exceptions apply)
- Certain taxable and tax credit bonds

Foundational Objective

- Limit issuance of more bonds than necessary and earlier than necessary
- Prevent bonds from remaining outstanding longer than necessary
- Borrow what you need, and when you need it

The Calculation

- Rebate Amount = Future Value of Receipts over Future Value of Payments
- Calculated at specific intervals throughout the bond's life

Failure to properly calculate and pay required rebate or yield restriction can result in the loss of tax-exempt status, leading to severe financial and legal repercussions.

Definition of Arbitrage

The Core Concept

Arbitrage is the profit generated by investing tax-exempt bond proceeds into higher-yielding taxable investments. Arbitrage rebate limits those profits not to exceed the “arbitrage yield” or bond yield for each bond issuance.

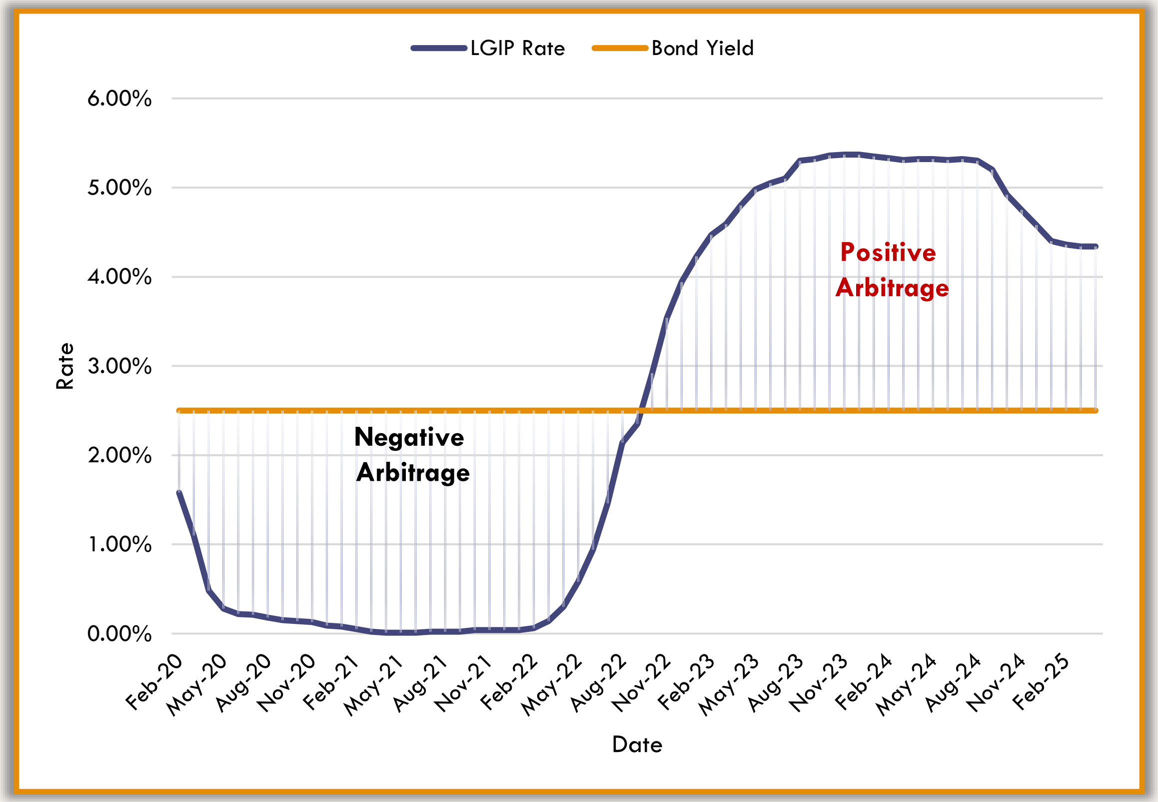
Calculation Fundamentals

- **Formula:** Rebate amount is the excess of the future value of receipts on non-purpose investments over future value of payments.
- **Regulatory Basis:** Mandated by the Tax Reform Act of 1986 for tax-advantaged bonds.
- **Measurement Basis:** Calculated on an issue-by-issue basis.

Key Distinctions

- **Positive Arbitrage:** Earnings exceed bond yield.
- **Negative Arbitrage:** Earnings are lower than bond yield.

Rebate is calculated (positive and negative arbitrage) from the issue date through a specified date.



Funds Subject to Arbitrage Rebate

Key categories requiring monitoring and calculation

- Project Funds
- Cost of Issuance
  - Expenses incurred for bond issuance.
- Reserve Funds
  - Both funded with bond proceeds and in certain instances those that are cash-funded.
- Refunding/Escrow Funds
- Replacement Proceeds
  - Debt service and interest & sinking funds usually fall under this definition.
- Transferred Proceeds
  - Unspent proceeds from prior obligations that are refunded by new bonds
- Capitalized Interest
  - Proceeds from the financing used to pay debt service
- Disposition Proceeds
  - Proceeds received from the sale of property that was financed with tax-exempt bond proceeds.

Poll Question #1

True or False - Positive Arbitrage is being earned when bond proceeds are invested below the bond yield

A. True
B. False

Overview

Exceptions to Arbitrage

Issuers may be granted exemptions from arbitrage rebate rules at either the bond or fund level.

Bond Level Exceptions

- **Small Issuer Exception:** Based on annual issuance limits and governmental status.

Fund Level Exceptions

- **Spending Exceptions:** Compliance based on expenditure milestones (6-month, 18-month, and 24-month tests).
- **Bona Fide Debt Service Fund:** Allows for the exclusion of debt service & sinking funds from rebate calculations.
- **Investment/Purchase Exceptions:** Certain permitted investments are exempt from arbitrage.

Small Issuer Exception to Arbitrage Rebate

General Limit

$5M

School Construction Limit

$15M

per calendar year

Core Requirements

- Bonds must be governmental (non-private activity)
- Issued by entities with general taxing power
- At least 95% must be used toward governmental activities.

Refunding Considerations

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

Spending Exceptions to Arbitrage Rebate

6-Month Spending Exception

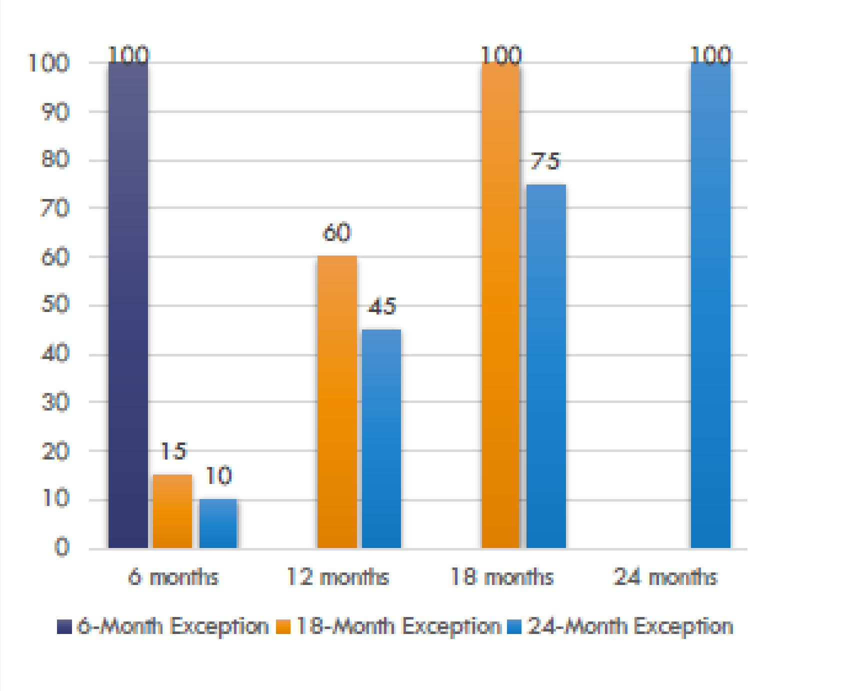
100% of proceeds must be spent within 6 months.

18-Month Spending Exception

Spend 15% in 6 months, 60% in 12 months, and 100% in 18 months.

24-Month Spending Exception

Spend 10% in 6 months, 45% in 12 months, 75% in 18 months, and 100% in 24 months.



Note: The 24-month spending exception is restricted to construction projects only.

Debt Service Fund Exemption

Understanding Bona-Fide Exemption Requirements

- Purpose of the Exemption

  Debt service funds are classified as 'Replacement Proceeds' subject to arbitrage rules unless they meet a 'bona-fide' exemption criteria.

- Annual Depletion Requirement

  To maintain bona-fide status, the fund must be depleted annually, leaving only a reasonable carryover amount.

- Earnings Test

  The carryover must be no greater than the earnings on the fund from the preceding bond year.

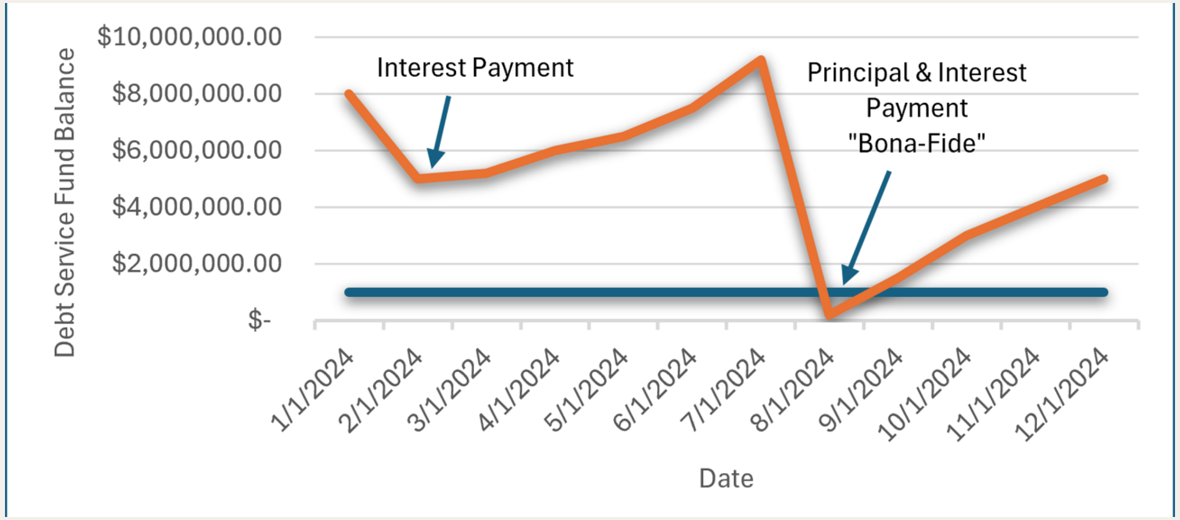
- 1/12th Test

  The carryover must be no greater than 1/12th of the principal and interest payments made during the preceding bond year.

Bona-Fide (Exempt) vs. Overfunded Debt Service

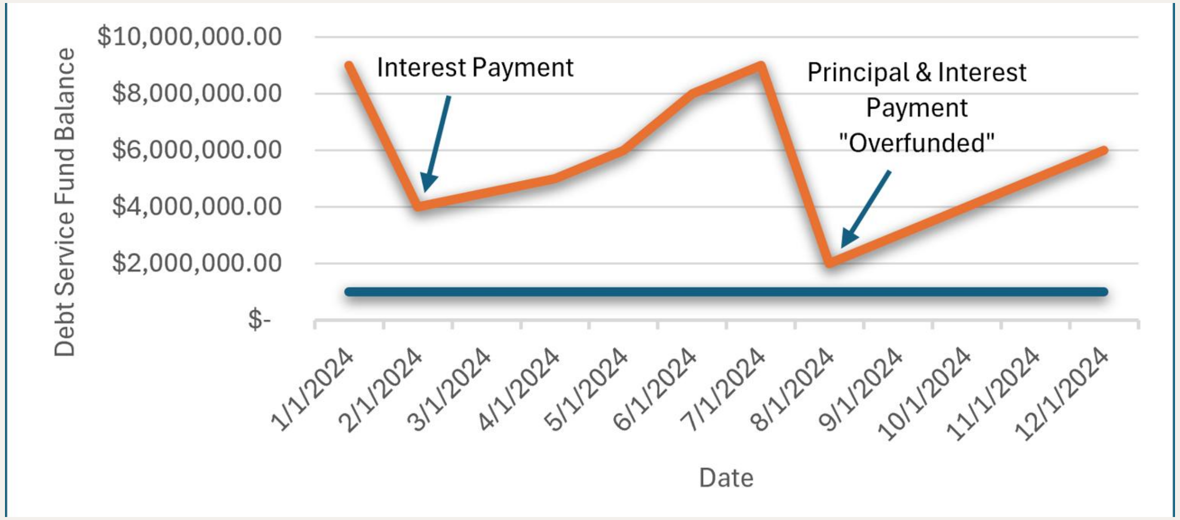
Practical Example: Assessing Compliance ($12M P&I during the bond year). 1/12th depletion = $1M Safe Harbor

Bona-Fide Fund



Debt service fund balance is depleted below $1,000,000 for at least one day during the bond year, investment earnings are exempt from arbitrage rebate.

Overfunded Fund



Balance remains consistently above the $1,000,000 threshold throughout the bond year, investment earnings are subject to arbitrage rebate.

Arbitrage Compliance Specialists

Investment Exemptions to Arbitrage Rebate

Strategic options for issuers regarding arbitrage rebate rules.

Non-AMT Tax-Exempt Municipal Bonds

Exempt from rebate rules; useful for locking in yields, provided liquidity constraints are managed.

Demand Deposit SLGS

Exempt from arbitrage rules; offers higher liquidity than municipal bonds. Strategy should be tailored based on yields and spend-down schedules.

Poll Question #2

The 3 Spending Exceptions for Arbitrage Rebate are:

A. 6 months, 12 months, 18 months
B. 6 months, 18 months, 24 months
C. 6 months, 24 months, 3 years
D. 12 months, 3 years, 5 years

Understanding 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.***

Key Thresholds

- Applies after the designated **Temporary Period** expires.
- Applies to investments exceeding the **Minor Portion**.
- Must be kept at or below the **Materially Higher Yield** limit.

Historical Context & Objective

- **Rules:** Enacted in 1969, predating arbitrage rebate regulations; critical compliance requirement.

Yield Restriction: Temporary Period

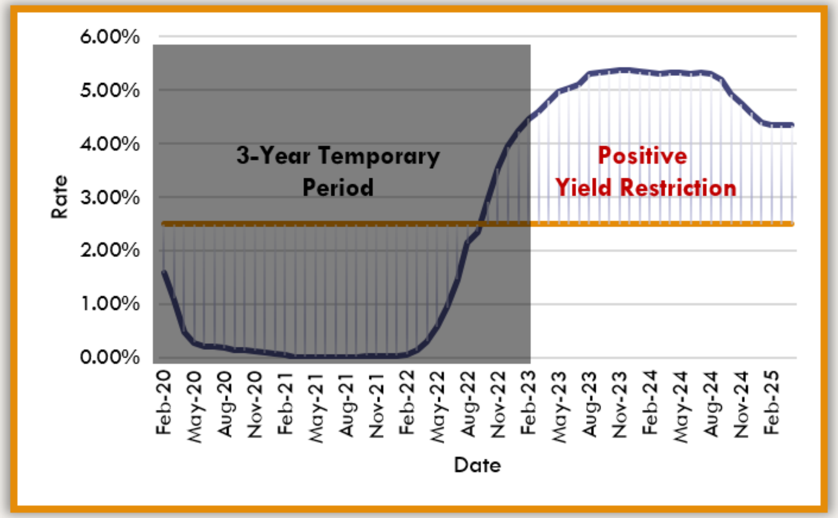
Duration during which bond proceeds may be invested at unrestricted yields per fund/proceed type.

Fund Type	Temporary Period(s) Available
Project	3 or 5 Years
Cost of Issuance	13 Months
Current or Advanced Refunding	30 or 90 Days
Replacement Proceeds	30 Days
Bona 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

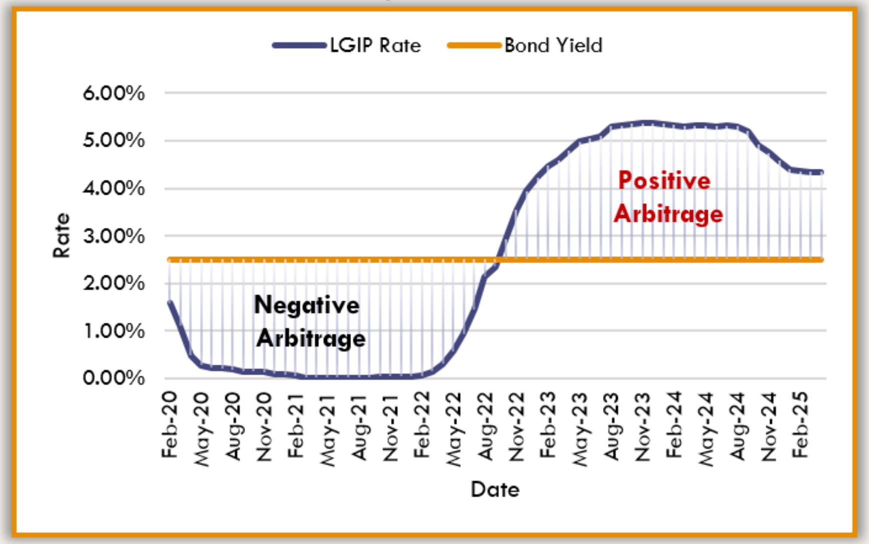
Key Distinctions and Strategic Compliance Requirements

Yield Restriction



Project yield restriction starts if funds remain after year three (remember the temporary period). Positive yield restriction is occurring for many bonds issued between 2019-2021 where funds were not spent after the three-year anniversary of the issue date.

Arbitrage Rebate



In these examples, many calculations result in a "negative" arbitrage rebate liability, meaning no rebate payment is owed; however, a yield restriction payment is due in lieu of rebate

Poll Question #3

While Rebate and Yield Restriction are calculated similarly, Yield Restriction has different ___________________ that are applied to the fund(s)

A. Temporary Periods
B. Spending Exceptions
C. Payment Deadlines

Minimum Reporting Requirements

Key Compliance Guidelines for Arbitrage Rebate and Yield Restriction

Computation Date

Must be completed within 5 years of the issue date, and every five years thereafter until final maturity.

Payment Deadline

Arbitrage or yield restriction payments must be made within 60 days of the computation date.

Payment Amounts

Minimum payment must be at least 90% of the liability amount. Pay higher liability if multiple accrue for one bond issuance.

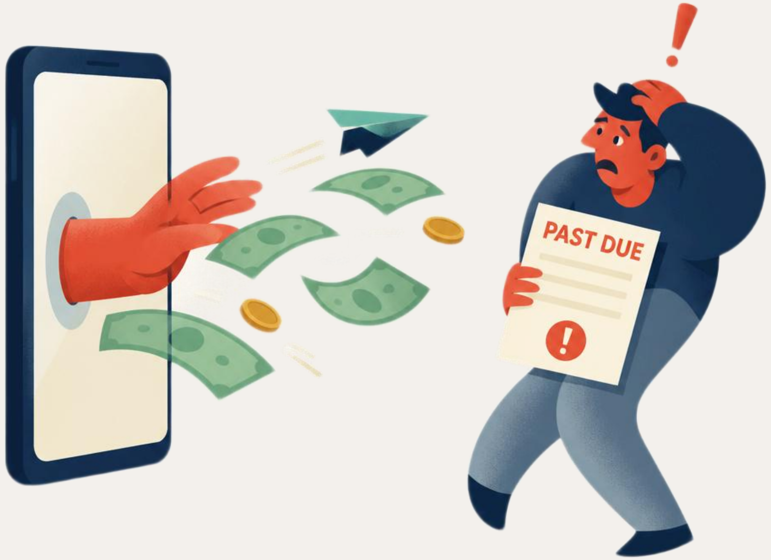
Submission Process

File IRS Form 8038-T alongside payment; do not need to submit supporting calculations.

Filing Exceptions

No filing is required if there is no positive liability.

What if payments are not made on time?



Late Payment Implications

Filing Requirements

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”

Poll Question #4

What item(s) need to be received by the IRS when an Arbitrage Rebate or Yield Restriction payment is due?

A. IRS Form 8038-T
B. Payment
C. Completed Calculations
D. All of the above
E. Only A and B

WHAT IF ISSUERS OWE REBATE OR YR?

Recommended Compliance Protocols

Draft effective policies and procedures

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

Create listing of key bond facts

- Borrowing Cost (Bond Yield)
- Issuance/Maturity Date
- 5^{th} Year Payment Dates (Due within 60 days of 5th Year)
- Accrued Liabilities but not yet paid (you only pay the higher if multiple accrue for one issuance)

Perform annual due diligence

Read through policies annually, and create and execute due diligence checklists. Review spending schedules and discuss any potential impacts with your arbitrage consultant.

Implementing these structured steps ensures proactive compliance and minimizes risk regarding rebate and yield reduction payments.

Compliance Timelines in Perspective

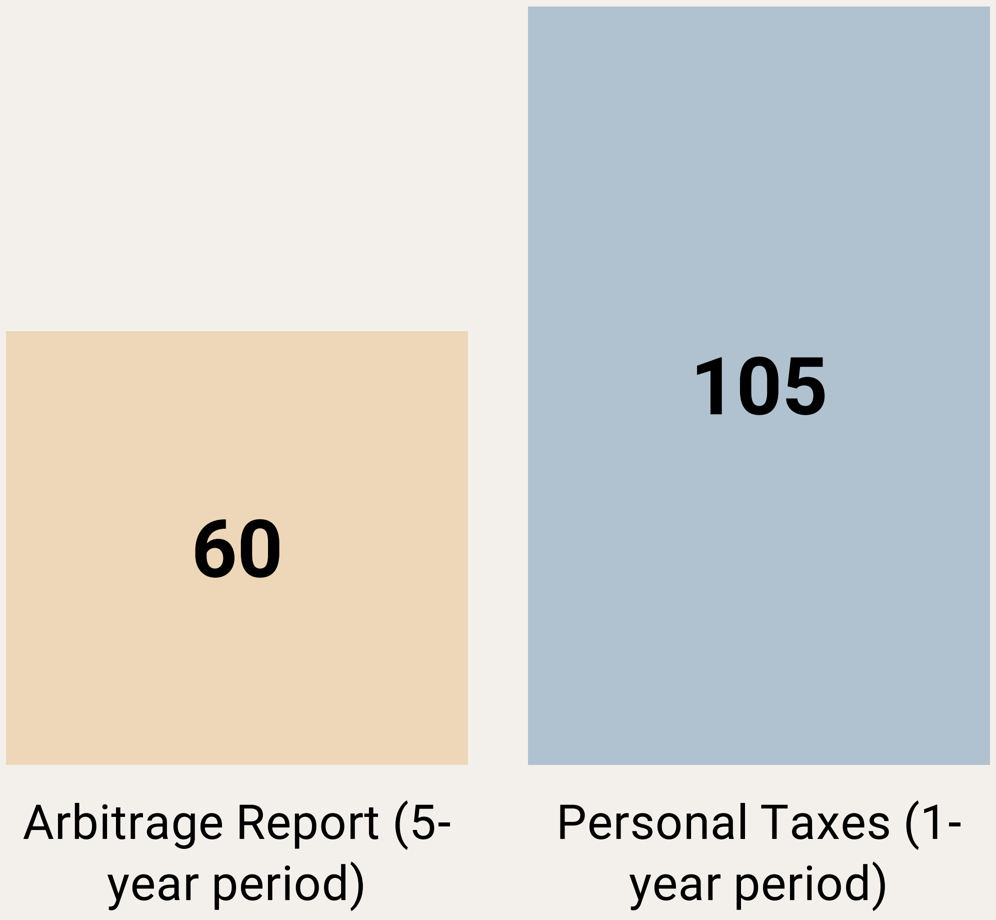
Deadlines for reporting and remittance to the IRS

Precise calculations involve the consolidation of extensive financial documents such as:

- Official Statements, Tax Certificates, IRS Forms
- Bank Statements and ledger records

Comprehensive federal requirements govern record retention

- Establish strong systems for bond record storage
- Perform calculations more frequently than the minimum five-year requirement



Poll Question #5

Arbitrage Rebate or Yield Restriction payments must be made within _________ of the computation date

A. 30 days
B. 1 year
C. 90 days
D. 60 days

Managing Rebate and Yield Reduction Payments

Strategies for Compliance and Earnings Optimization

Compliance vs. Earnings

The tax code permits positive arbitrage; issuers stay compliant by making required payments within 60 days of the 5-year anniversary.

Avoid Over-Correction

Attempting to lower yields to avoid payments often results in leaving significant potential interest income on the table.

Strategic Mindset

Frame rebate payments as a byproduct of maximizing permissible interest earnings, rather than viewing them as penalties.

Proactive Management

To manage liabilities effectively, perform interim rebate calculations and explore spending exceptions & arbitrage-exempt investments while monitoring spending schedules, consult with arbitrage and investment professionals.

Poll Question #6

One Issuance has accrued a positive rebate and yield restriction liability at the end of the 5th year computation period; the Issuer must pay…

A. Both liabilities
B. Neither liabilities
C. The higher of the two liabilities
D. Whatever liability is convenient

Strategic Overview

Current Arbitrage Trends

Why are we here?

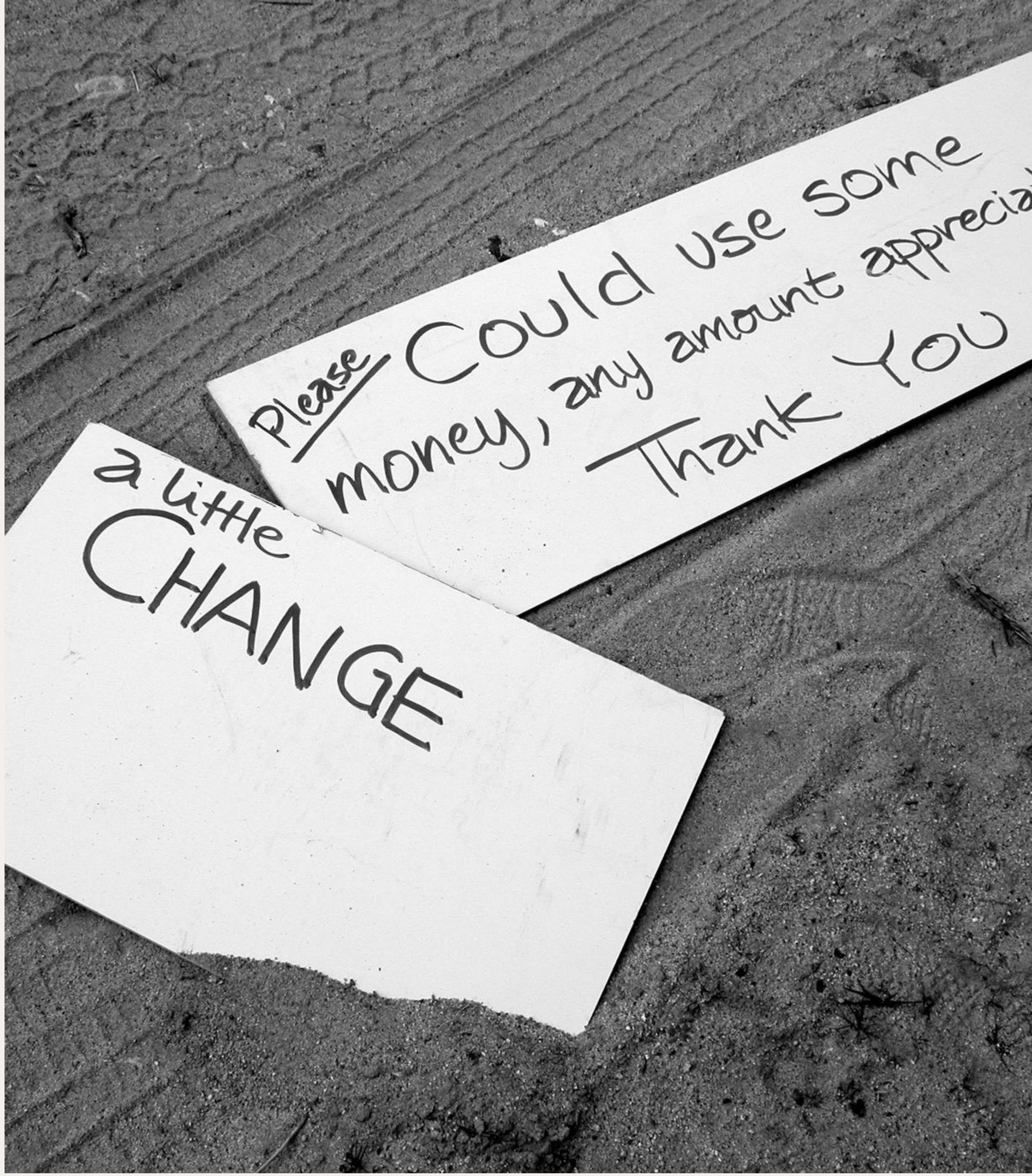
- **Market Dynamics:** Higher investment rates coupled with lower borrowing rates increase the potential for positive arbitrage.

Recent Trends & Impacts

- **2022-2026 Bond Issues:** Most "new money" bonds currently show positive arbitrage earnings; each financing requires bond-specific calculation.
- **The 'Flipping' Risk:** Older bonds may shift into positive arbitrage liability due to changing market conditions.

Forgotten Focus: Yield Restriction

- **Construction Proceeds:** Immediate attention is recommended for 2019 - 2021 bonds where the 3-year temporary period has lapsed and construction proceeds remain.



You are not alone—many issuers are currently navigating positive arbitrage liabilities, making proactive review essential.

Arbitrage Rebate & Yield Restriction Payments

Trends and Liability Accruals (2020–Current)

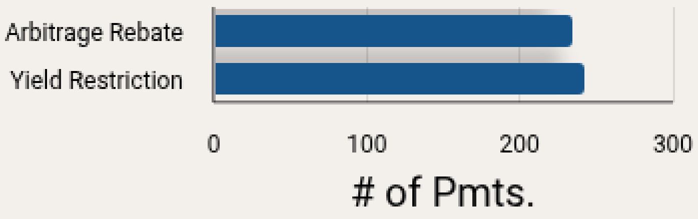
Avg Arbitrage Rebate Liability

$670,000

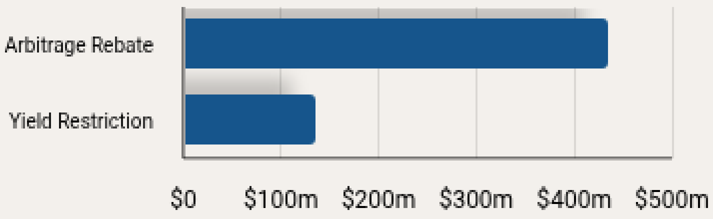
Avg Yield Restriction Liability

$163,000

Payment Analysis (2020–Current)



Total Liability Value (2020–Current)



ACS completes approximately 2,800 calculations annually; interim reporting is recommended for identifying true liability status.

May 2026 Payments (Rebate & YR)

$15,512,580

41 total payments

Interim reporting is vital, as many issuers lack visibility into their true liability status.

Questions?

Contact Us

(303) 867-7536 (Robert)
(303) 867-7544 (Mick)

robert@rebatebyacs.com
mick@rebatebyacs.com