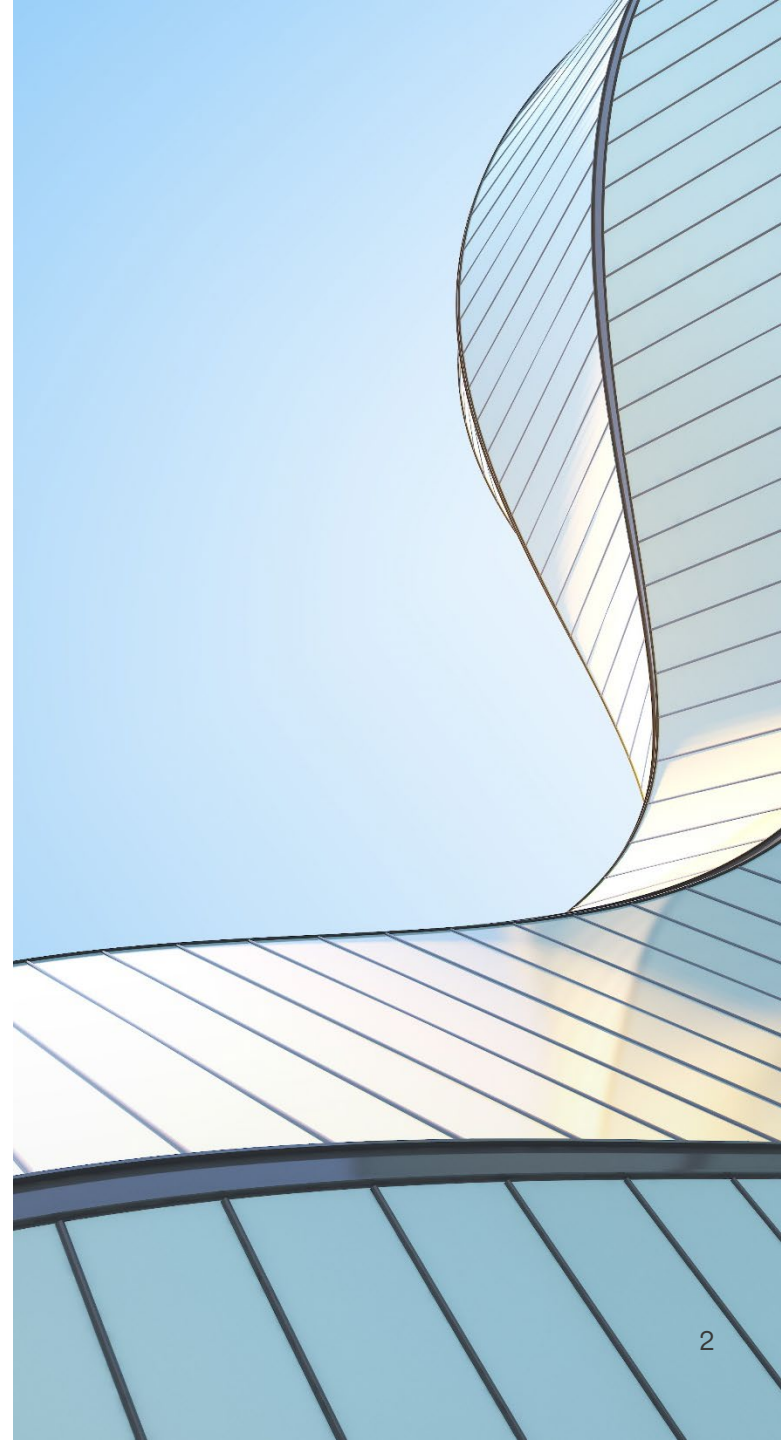


# Understanding Arbitrage Rebate

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# What is Arbitrage Rebate?



# Understanding Arbitrage Rebate

## Arbitrage

When the yield on taxable investments exceeds the tax-exempt restricted rate

## Rebate

Issuer's "rebate" or pay excess earnings to the IRS

## Purpose

Financial disincentive to violate the rules  
Prevent issuance of tax-exempt debt for profit-driven reasons



# Positive and Negative Arbitrage

$$\frac{\begin{array}{l} \text{Actual investment earnings yield} \\ - \\ \text{Average borrowing rate or "arbitrage yield"} \end{array}}{\quad} = \text{Arbitrage \%}$$

## **“Positive Arbitrage” =**

Actual earnings > Earnings @ arbitrage yield  
(*positive earnings yield spread*)

## **“Negative Arbitrage” =**

Actual earnings < Earnings @ arbitrage yield  
(*negative earnings yield spread*)

## **• Arbitrage Rebate Liability =**

- Earnings of bond proceeds invested in taxable securities less (-)
- Earnings of bond proceeds invested at the arbitrage yield
  - Future value methodology
  - Measured on an issue-by-issue basis
  - Cumulative from the issue date

# Arbitrage Rebate and Yield Restriction

**Applies to every tax-exempt borrowing and some taxable subsidy obligations**

- Measured on an issue-by-issue basis
- Non-compliance could result in taxable bonds
- Overlapping requirements – “Belt & Suspenders”
  1. **Arbitrage Rebate – IRC Section 148(f):**  
Arbitrage Rebate begins on the issue date
  2. **Yield Restriction – IRC Section 148(b):**  
Yield Restriction begins at the expiration of a temporary period



## Requirement #1

# Arbitrage Rebate



# Exceptions to Arbitrage Rebate

## Small Issuer Exception

- Calendar year exception
  - \$5 million of governmental bonds for municipalities
  - \$15 million per year for public school construction
- Requirements
  - General taxing powers
  - Governmental bonds (not private activity bonds)
  - At least 95% of the proceeds must be used for local governmental activities
- Exclusion of current refunding issue in certain circumstances

**Exception to  
Arbitrage Rebate  
Only**



# Exceptions to Arbitrage Rebate

## Spending Exceptions (Can Be Internally Monitored)

- “Reward” for spending bond proceeds quickly
- Allowed to keep positive arbitrage
- Simple way to establish compliance (no future value, no yields)
- Must meet each benchmark, no catch-up allowed

**Exception to  
Arbitrage Rebate  
Only**

### 6-Month

#### All gross proceeds

✓ 6 months 100%\*

### 18-Month

#### All new money

✓ 6 months 15%  
✓ 12 months 60%  
✓ 18 months 100%\*\*

### 2-Year (ACP)

#### “Construction” issues only

✓ 6 months 10%  
✓ 12 months 45%  
✓ 18 months 75%  
✓ 24 months 100%\*\*

\* Exceptions for 5% of the proceeds of the issue if spent within one year.

\*\* De minimis (lesser of 3% or \$250K) and reasonable retainage (5% spent in 12 months) exceptions may apply for last benchmark.



## Requirement #2

# Yield Restriction



# Dual Requirements

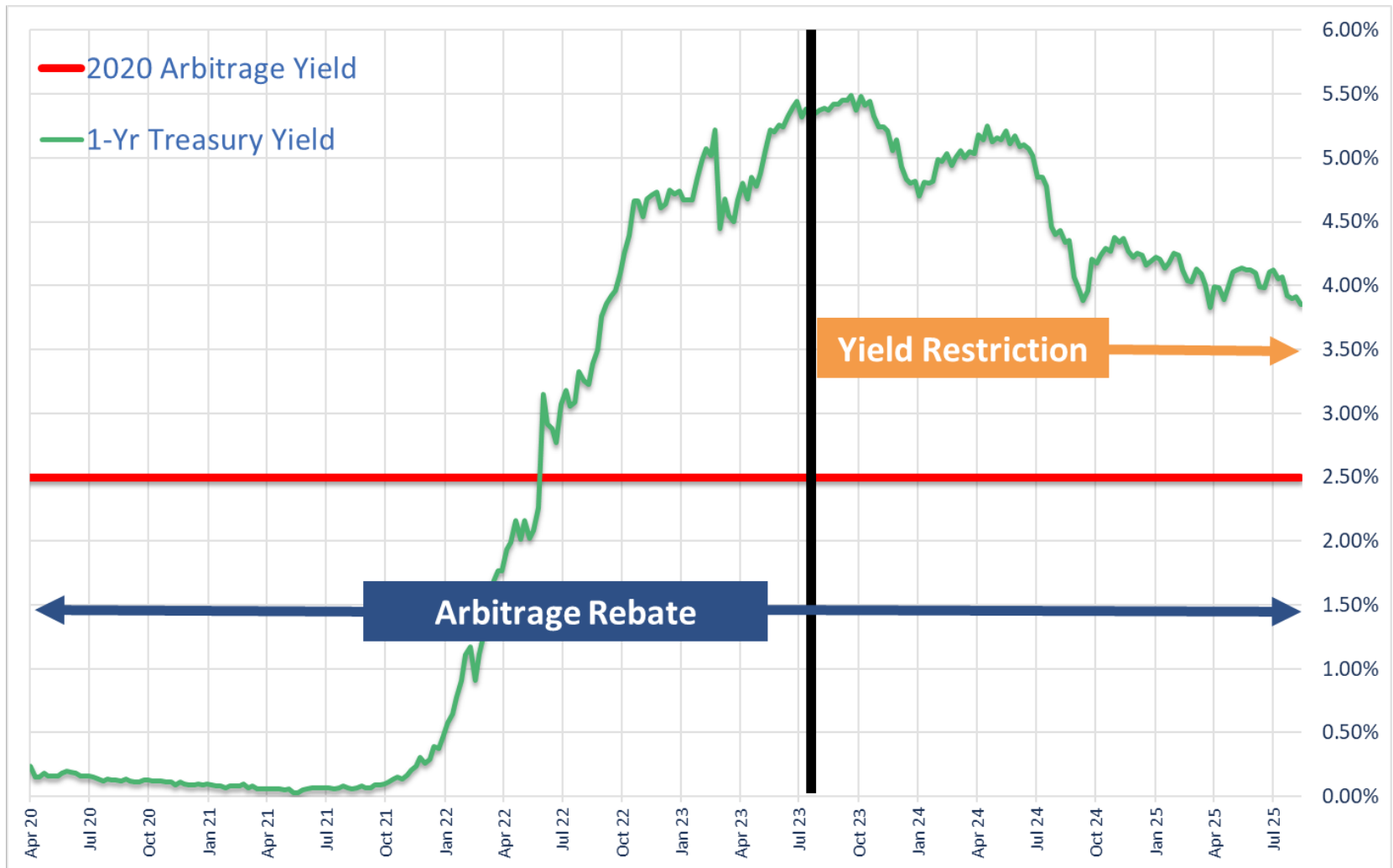
**Key differences are timing and amounts restricted**

Separate requirements require separate calculations

- Cannot blend Arbitrage Rebate and Yield Restriction liabilities
- Common situation to end up with negative arbitrage rebate but positive yield restriction or vice versa

	Construction Funds	
	Arbitrage Rebate	Yield Restriction
<b>Requirement Begins</b>	Issue Date	Typically, after a 3-year Temporary Period (may be waived or extended to 5-years)
<b>Amounts Restricted</b>	Sale Proceeds	Unspent Proceeds

# Arbitrage Rebate vs. Yield Restriction



For illustrative purposes only.  
Sources: Bloomberg, Refinitiv, EMMA. Rates as of August 29, 2025.

# Yield Restriction Compliance Methods



## Active Yield Restriction

- Investments must be purchased at fair market value
- Tax exempt investments



## Yield Reduction Payments

- Rebate-like payments
- Limited availability for advance refunding issues and defeasance escrows



## Other Options

- Longer construction fund temporary period (5-years vs. 3-years)
- Waiver of temporary period at issuance



# Calculation Requirement



# Calculation and Filing Requirement

- Payment due no later than 60 days after the computation date
  - No later than 5-years after the issue date
  - Every 5-years thereafter until the final maturity date
  - At least 90% of the liability
  - As of final maturity date, 100% of the liability
- Submit check and IRS Form 8038-T
- Do not submit calculations
- No filing required if no payment is due
- Late Payments
  - Require explanation and payment of late interest
  - May also require payment of a penalty (50%)
- Overpayment
  - Refunds can be requested if liability reverses
  - IRS will not pay interest on overpayment



# Questions?



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