

# COVID-19 and the Arbitrage Requirements: Impact for Tax-Exempt Issuers

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Since the onset of the COVID-19 pandemic, many tax-exempt bond issuers are realizing the full extent of the impact the pandemic has had on their projects, plans and budgets. Among the many challenges faced, issuers must maintain compliance with federal tax law requirements — an ongoing and integral part of every tax-exempt financing program.

There have been many questions surrounding available relief from the Internal Revenue Service (IRS) with regard to the arbitrage rebate and yield restriction requirements for tax-exempt bonds found in the Treasury Regulations (the Regulations). There have been no additional extensions for IRS filing deadlines or other arbitrage-related time frames defined in the Regulations. This means:

- ▶ **Spending Exceptions:** Each 6-month benchmark interval from the issue date of the bonds still applies, no extensions of the spending period or change to the required percentage expenditures
- ▶ **Temporary Periods:** Applicable temporary periods to yield restriction for bond proceeds remain in effect, no extensions available
- ▶ **Calculation and Filing Requirements:** Installment arbitrage calculations are required as of every fifth bond year and on the final maturity or redemption date of the bonds; rebate and yield reduction payments to the IRS are due no later than 60 days after the computation date

## Unspent Bond Proceeds: What do I do?

While some issuers are facing slower expenditures of bond proceeds and lengthened draw schedules due to the pandemic, others find themselves still sitting on small balances of bond proceeds remaining at the end of a project. Leaving bond proceeds unspent opens the door to unforeseen arbitrage implications since the arbitrage rebate, and yield restriction requirements apply to tax-exempt bonds for the entire life of the issue.

If a project is near or at completion and there is a small sum of bond proceeds remaining, the issuer should exercise due diligence to allocate the proceeds to one or more of the following uses:

- ▶ Identify additional qualified expenditures within the scope of the bond-financed project
- ▶ Allocate proceeds to the debt service fund to pay the interest due on the bonds — not principal
- ▶ Contact the local government investment pool or trustee bank to close out bond proceeds accounts promptly



If there is no other qualified use of the proceeds remaining, contact bond counsel and your financial advisors to consider establishing a defeasance escrow fund to redeem the outstanding principal of the bonds.

The chart below serves as a guide for issuers to monitor unspent bond proceeds balances during these uncertain times. Set a calendar reminder to review each fund prior to and as of the key arbitrage rebate and yield restriction compliance dates. As always, contact your arbitrage rebate consultant, bond counsel and financial advisors with questions!

What to Monitor	When to Monitor	What to do
<b>Costs of Issuance</b>	No later than 6 months after the issue date	Close account, transfer excess to the Project Fund or Debt Service Fund
<b>Project Fund Spending Exception</b>	Prior to 6-month benchmarks	Review spending one month prior to 6-month benchmark (no-catch-up provisions) and compare actual spending percentage to benchmark required percentages
<b>Project Fund Yield Restriction</b>	3 years after the issue date	Review unspent balance 3 months prior to the 3-year anniversary date, develop a plan to spend or reallocate
<b>Debt Service Fund Bona Fide Test</b>	Annually, each bond year	Compute 1/12th of prior year debt service to set target minimum account balance for next bond year, adjust deposits appropriately

To learn more or discuss in greater detail, please contact us:

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