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WHAT IS ARBITRAGE?

- Arbitrage is Profit from Buying in one market and Selling in another.
- In our case, Borrowing in the Tax-Exempt Market and Investing in the Taxable Market.
- Interest rates are generally Higher in the Taxable market to compensate investors for Taxes.
- Arbitrage is the Profit from taking Advantage of the Market Differentials.

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GENERAL REBATE REQUIREMENTS

WHY?

Why Arbitrage / Rebate?

- Up Front Windfall of Proceeds
- Issuers are Tax-Exempt
- Bond Holders Receive Tax-Exempt Interest
- Federal Government wants its share – The Profits

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GENERAL REBATE REQUIREMENTS

THE IRS SINS OF REBATE

- Too Much
- Too Soon
- Too Long

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GENERAL REBATE REQUIREMENTS

IN A NUTSHELL

- Present Value Principal and Interest payments (Bond Yield)
- Future Value Investment Cash Flows at Bond Yield
- If Investment Yield Greater Than Bond Yield, you owe.
- Less than, too bad. No Subsidy or Offset.

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YIELD RESTRICTION

REBATE VS. YIELD RESTRICTION

- Rebate is the excess earnings over the bond yield on a cumulative basis from inception of the issue.
- Yield Restriction starts after a “Temporary Period” or is based on a “Size Limitation” and computed on the excess earning over the “Materially Higher” bond yield.
- No Computation Credits for Yield Restriction

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YIELD RESTRICTION

REBATE VS. YIELD RESTRICTION – TWO SEPARATE SETS OF RULES

Arbitrage Rebate

- Mandates when you must remit arbitrage (Profits) to the IRS

Yield Restriction

- Governs when you may legally earn arbitrage without jeopardizing the tax-exempt status of the bonds.

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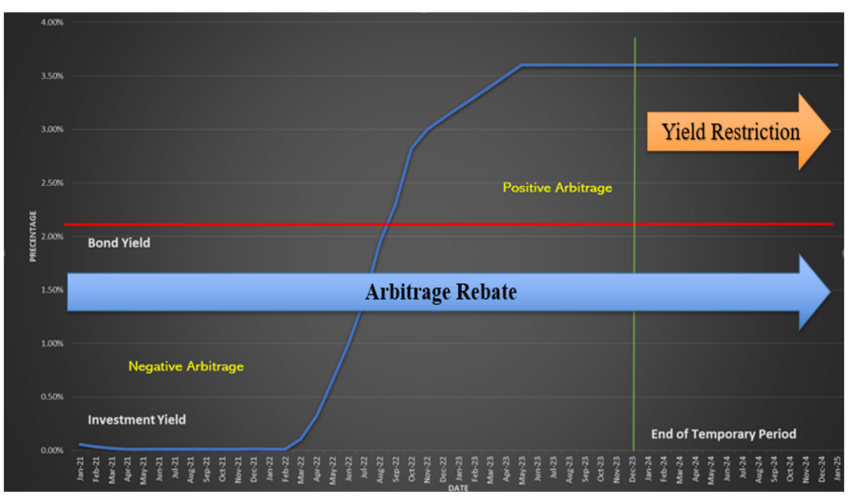
YIELD RESTRICTION

ARBITRAGE REBATE VS. YIELD RESTRICTION BIG PICTURE



Source: Texstar Monthly Rate History

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Rebate Terminology

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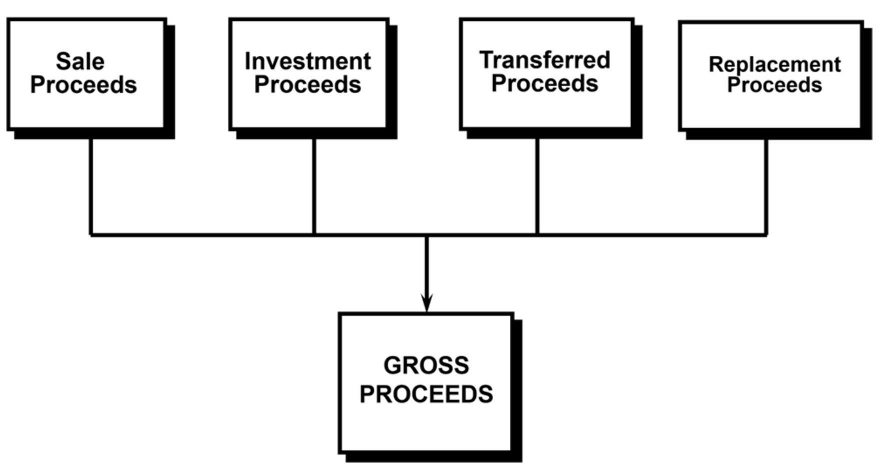
GENERAL REBATE REQUIREMENTS

TERMINOLOGY - FUNDS SUBJECT TO ARBITRAGE REQUIREMENTS ("GROSS PROCEEDS")



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GENERAL REBATE REQUIREMENTS

TERMINOLOGY - REPLACEMENT PROCEEDS

- Replacement Proceeds – Revenues or Amounts that have a sufficient Direct Nexus to the issue or the governmental purpose of issue to conclude that such amounts would have been used for the purpose of the issue if the proceeds of the issue were not used for such purpose.
- Debt Service – Bond Holders can look to in case of financial difficulty to pay Debt Service
- Debt Service Replacement Proceeds Include:
  - Debt Service Funds
  - Redemption/Sinking Funds
  - Reserve Funds
  - Pledged Funds

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Payment Dates & Filing Requirements

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GENERAL REBATE REQUIREMENTS

INSTALLMENT CALCULATION DATES

- Installments must be paid at least every 5th Bond Year (§1.148-3(f)).
- Bond Year is each one-year period ending on the date selected by the Issuer.
- If no date is selected by the Issuer, bond year ends on each anniversary date of the issue.
- Installment payable within 60 days.

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GENERAL REBATE REQUIREMENTS

FINAL COMPUTATION DATE

- Date all bonds of an issue have been retired (matured or redeemed early).
- Cash defeasance or refunding may accelerate.
- Payment due within 60 days.

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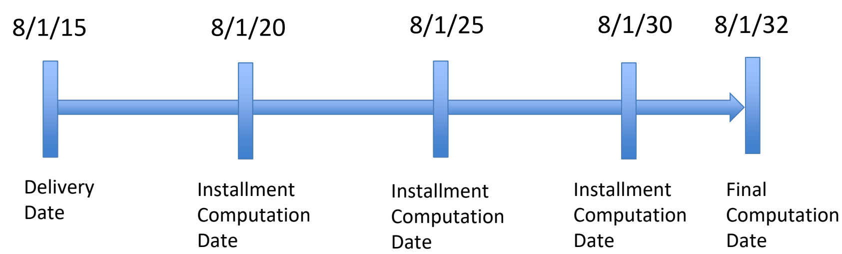
GENERAL REBATE REQUIREMENTS

REQUIRED REPORTING DATES FOR ARBITRAGE REBATE PAYMENTS



GENERAL REBATE REQUIREMENTS

PENALTIES OF NONCOMPLIANCE WITH ARBITRAGE REGULATIONS

- Loss of Tax-Exemption on the issue; or
- Assessment of penalties and interest

GENERAL REBATE REQUIREMENTS

FAILURE TO PAY REBATE

Bonds will be declared taxable unless:

- ✓ Failure was not due to willful neglect and
- ✓ Issuer pays a penalty to the United States

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