

State of Ohio



Treasurer of State

**Arbitrage
Policies and Procedures**

January 2015



State of Ohio

Arbitrage Policies and Procedures

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A. Introduction

i. Purpose

The State of Ohio (the State) issues tax-exempt bonds and tax advantaged bonds to fund capital projects and facilities. The purpose of these Arbitrage Policies and Procedures is to facilitate compliance with the Internal Revenue Code of 1986, as amended (the Code) and the applicable Treasury regulations (Arbitrage Regulations) in order to maintain the tax-exempt or tax advantaged status of certain bonds issued by the State through the Ohio Public Facilities Commission (OPFC) and the Treasurer of State (TOS). Definitions of capitalized terms that are not defined when first used are found in Appendix IV to these Arbitrage Policies and Procedures.

ii. Goals and Benefits

These Arbitrage Policies and Procedures establish processes and guidelines by which the State will manage its arbitrage compliance. Benefits to the State include a comprehensive plan for using industry best practices to comply with federal tax law, specifically the Arbitrage Regulations, to maintain the tax-exempt or tax advantaged status of State bonds issued through the OPFC and TOS, as well as facilitating compliance with State law and bond covenants. The goals of the Arbitrage Regulations are to prevent the (1) exploitation of the difference between tax-exempt and taxable interest rates to obtain a material financial advantage, and (2) overburdening the tax-exempt bond market. By ensuring compliance with the Arbitrage Regulations, the State promotes municipal market efficiency and ensures its ability to cost-effectively fund capital projects and facilities through the issuance of tax-exempt or tax advantaged bonds.

iii. Relationship to Post-Issuance Compliance Procedures

Arbitrage compliance is one form of bond post-issuance compliance prescribed by the Code and the regulations promulgated thereunder to maintain the tax-exempt or tax advantaged status of bonds. The Arbitrage Regulations focus on the investment of bond proceeds, including related restrictions. These Arbitrage Policies and Procedures expand upon the section of the State's Post-Issuance Compliance Procedures for Tax-Exempt Bonds and Build America Bonds concerning "Arbitrage."

iv. Ohio Revised Code Authorization

The ORC authorizes the Treasurer's office as the responsible entity for arbitrage compliance for all OPFC and TOS-issued debt. The authority for arbitrage compliance duties can be found within those Chapters of the ORC authorizing the issuance of those debt obligations (see Appendix I for ORC references authorizing the issuance of debt for which the TOS has arbitrage compliance responsibility). In addition, the bond proceedings may also designate another State department or officer to in the alternative take such actions as are necessary for arbitrage/rebate compliance. The ORC Chapters authorizing the issuance of debt contain a clause that any or every provision of the bond proceedings are binding upon the issuing authority and upon such governmental agency or entity, officer, board, commission, authority, agency, department, institution, district, or other person or body as may from time to time be authorized to take actions as may be necessary to perform all or any part of the duty required by the provision (see ORC §151.01(E)(4); §154.08(B)(10); §5531.10(B)).



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As a result, though the TOS is statutorily authorized as responsible for arbitrage compliance, the bond proceedings may designate either the Treasurer or another State department or officer to ensure arbitrage/rebate compliance (see Appendix I for ORC authorizations by program).

B. Overview of Arbitrage Regulations

i. What is Arbitrage?

Chapter 148 of the Code was enacted to prevent issuers from exploiting the advantage of tax-exempt bonds to acquire Higher-Yielding Investments. Theoretically, Issuer A could invest all or a portion of its tax-exempt bond proceeds with a yield of 3.0% in taxable securities yielding 5.0%. Issuer A borrowed money at a cost of 3.0% and invested that money at a rate of 5.0%; the difference between these rates of return is called arbitrage.

Chapter 148 of the Code was enacted to minimize the arbitrage benefits from investing Gross Proceeds of tax-exempt bonds in Higher Yielding Investments and to remove the arbitrage incentives to issue more bonds, to issue bonds earlier, or to leave bonds outstanding longer than is otherwise reasonably necessary to accomplish the governmental purposes for which the bonds were issued. To accomplish these purposes, Section 148 restricts the direct and indirect investment of bond proceeds in Higher Yielding Investments and requires that certain earnings on Higher Yielding Investments be paid to or “rebated” to the United States Treasury. Violation of these provisions causes the bonds in the issue to become Arbitrage Bonds, the interest on which is not tax-exempt. Section 148(f)(1) of the Code provides that a bond will be treated as an Arbitrage Bond unless the rebate requirements of Code Sections 148(f)(2) and (3) are satisfied.

Prior to 1986, the arbitrage rule appeared in Section 103(c) of the Internal Revenue Code of 1954, as amended. In 1986 Congress moved them to Section 148 with related provisions in Sections 149 and 150. The arbitrage rules are part of a larger framework for tax-exempt bonds beginning with Section 103 of the Code. Section 103(a) of the Code excludes interest on certain obligations issued by states and local governments from federal gross income of the owners and are referred to as tax-exempt bonds. Bonds that do not meet requirements of Section 103(a) are considered “taxable” bonds. The exemption provision in Section 103(a) does not apply to an Arbitrage Bond, defined in Section 148(a) of the Code as any bond issued as part of an issue, any portion of the proceeds of which are reasonably expected (at the time of issuance) to be used directly or indirectly (a) to acquire Higher Yielding Investments, or (b) to replace funds which were used directly or indirectly to acquire Higher Yielding Investments. A bond becomes an Arbitrage Bond if the issuer intentionally uses any portion of the bond proceeds to do either (a) or (b) above. The Code provides that interest on bonds is not exempt from tax if the bonds are Arbitrage Bonds. If a bond is determined to be an Arbitrage Bond, it may be declared taxable retroactively to the issue date.

Subsequent provisions of the Code authorize the issuance of tax advantaged bonds (taxable bonds for which the investor receives a tax credit or taxable bonds the interest on which is subsidized by the United States by a direct payment to the issuer). Those newer sections of the Code apply the arbitrage provisions of Section 148 to tax advantaged bonds.

ii. Arbitrage Rebate

Section 148(f)(2) of the Code, titled *Rebate to the United States*, defines the amount owed to the Internal Revenue Service (IRS) as an amount equal to the excess of the amount earned on all Nonpurpose Investments, over the amount which would have been earned if such Nonpurpose Investments were invested at a rate equal to the yield on the issue.



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Arbitrage rebate liability is calculated by determining the difference between the issuer's actual interest earnings on the proceeds and the interest earnings that would have been received if the issuer had invested the proceeds at the Arbitrage Yield. The amount paid to the United States Treasury (referred to as the "rebate amount") for an issue is the excess of the future value (at the Arbitrage Yield), as of the Computation Date, of all receipts on Nonpurpose Investments over the future value, as of the Computation Date, of all payments on Nonpurpose Investments.

Issuers of tax-exempt bonds are subject to the arbitrage and rebate rules in accordance with Treas. Reg. § 1.148-3, and must identify in a timely manner and rebate any positive arbitrage earnings to the IRS. Arbitrage and any rebate liabilities, if any, are calculated by the Rebate Consultant and presented in an Arbitrage Report. Remitting the correct rebate payment amount to the IRS is part of the arbitrage compliance requirements of Section 148 of the Code.

iii. Spend-Down Exceptions to Rebate

In general, New Money bond issues that are eligible for a spending exception to rebate will be sized so that proceeds from the issue are able to be spent in accordance with the applicable benchmark requirements pursuant to Treas. Reg. § 1.148-7. This compliance will be evidenced through a Spending Exception Analysis prepared by the Rebate Consultant.

- Six-Month Spending Exception – All of the Gross Proceeds of the issue are allocated to expenditures for the governmental purposes of the issue within the 6-month period beginning on the issue date. This exception is available for all tax-exempt bonds and the only spending exception for which a Refunding issue may qualify.
- Eighteen-Month Spending Exception – The Gross Proceeds of the issue are allocated to expenditures for the governmental purposes of the issue in accordance with the following schedule, measured from the issue date:
 - At least fifteen (15) percent within six (6) months;
 - At least sixty (60) percent within twelve (12) months; and
 - One hundred (100) percent within eighteen (18) months.
- Two-Year Spending Exception – A Construction Issue is treated as meeting the rebate requirement for available construction proceeds if those available construction proceeds are allocated to expenditures for governmental purposes of the issue in accordance with the following schedule, measured from the issue date:
 - At least ten (10) percent within six (6) months;
 - At least forty-five (45) percent within one (1) year;
 - At least seventy-five (75) percent within eighteen (18) months;
 - One-hundred (100) percent within two (2) years.

A Construction Issue is any New Money issue (or new money portion of an issue) of which the issuer reasonably expects, as of the issue date, that at least 75 percent of the available construction proceeds of the issue will be allocated to Construction Expenditures for property owned by a governmental unit. Construction Expenditures are capital expenditures that are allocable to the cost of real property or constructed personal property (Treas. Reg. §1.148-7(g)(1)). Subject to some exceptions, Construction Expenditures do not include expenditures for acquisitions of interests in land or other existing real property.



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All of the State's New Money and/or Refunding issues that do not meet one of the aforementioned spending exceptions are subject to rebate.

iv. Arbitrage Reporting Requirements

a. Arbitrage Reports

As stated above, all New Money and/or Refunding issues that do not meet one of the spending exceptions to rebate are subject to rebate. Pursuant to Treas. Reg. §1.148-3(f), "The first rebate installment payment must be made for a Computation Date that is not later than 5 years after the issue date. Subsequent rebate installment payments must be made for a Computation Date that is not later than 5 years after the previous Computation Date for which an installment payment was made."

If an issue is subject to rebate, an Arbitrage Report will be completed upon the earlier of:

- (i) The date all Gross Proceeds have been allocated to expenditures; or
- (ii) Five years from the issue date.

Such report will be the final Arbitrage Report for that issue, contingent on the following assumptions:

- All Gross Proceeds have been expended or placed in escrow (including capitalized interest);
- The debt service fund account remains a Bona Fide Debt Service Fund as defined in Treas. Reg. § 1.148-1(b);
- No other Replacement Proceeds are available as defined in Treas. Reg. § 1.148-1(c);
- There is no reasonably required reserve or replacement fund or pledged fund;
- All previous rebate liabilities, if any, identified in prior Arbitrage Reports have been remitted to the IRS.

If one or more of the assumptions listed above are not met, subsequent Arbitrage Reports will be performed in five-year installment calculations thereafter until all assumptions are met or until retirement of the issue.

If a Refunding issue is subject to rebate, the State will rely on the verification report prepared in connection with the issue unless there is post-escrow SLGS management or reinvestments, in which case Arbitrage Reports will be completed upon the earlier of:

- (i) The date all of the escrow funds have been paid out;
- (ii) Five years from the issue date.

Subsequent Arbitrage Reports will be performed in five-year installment calculations thereafter until all post-escrow SLGS management or reinvestments have occurred and are included as part of the calculations in an Arbitrage Report.

b. Compliance with Yield Restriction and Temporary Periods

In order to comply with Section 148(f)(2) of the Code, issuers of tax-exempt bonds are subject to yield restriction in accordance with Treas. Reg. § 1.148-2, and must identify in a timely manner and return any positive earnings in excess of the Arbitrage Yield (except for a minor portion as defined in the Tax Compliance Certificate of such issue) to the IRS in the form of a "yield reduction payment."

The State will actively monitor situations that may require yield restriction and related yield reduction payments. Situations that might require active yield restriction monitoring include:



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- (i) When proceeds remain in a project fund beyond the applicable Temporary Period;
- (ii) When amounts on deposit in a reasonably required debt service reserve fund exceed the “lesser of” limits described below, so long as either:
 - a. The debt service reserve fund does not exceed 15% of the amount of the issue; or,
 - b. The debt service reserve fund, excluding investment earnings, is not reasonably expected to be used to pay debt service other than due to a reduction in the amount required to be held in such debt service reserve fund; or,
- (iii) Amounts deposited in a bond service fund that have been on deposit for more than 13 months before they are used for debt service payments, in which case it is not a Bona Fide Debt Service Fund.

In addition, in the context of a Refunding, yield restriction should be monitored with respect to Transferred Proceeds as follows:

- (i) After the expiration of the initial applicable Temporary Period for the refunded bonds, Transferred Proceeds become yield restricted to either the advance refunding or current refunding bond yield; or,
- (ii) From an outstanding advance refunding escrow fund, Transferred Proceeds become yield restricted to the current refunding bond yield.

The proceeds of a tax-exempt bond issue typically may not be invested in Higher Yielding Investments, except during the applicable Temporary Period as defined in the Tax Compliance Certificate of that issue. Typical New Money issues for capital projects will have a Temporary Period of three years during which time the proceeds may be invested at an unrestricted yield. After the Temporary Period ends and no later than the five-year Computation Date, an Arbitrage Report must be prepared for the issue to calculate the yield reduction payment amount. There is generally a three year Temporary Period for capital projects, contingent on documentation by the issuer of the following reasonable expectations: Eighty-five percent of the net sale proceeds of the issue are allocated to expenditures on the capital projects by the end of the 3-year Temporary Period, the issuer incurs within 6 months of the issue date a substantial binding obligation to a third party to expend at least 5 percent of the net sale proceeds of the issue on capital projects, and completion of the capital projects and the allocation of the net sale proceeds of the issue to expenditures proceeds with due diligence (Treas. Reg. §1.148-2(e)(2)).

In rare cases, a five-year Temporary Period could apply to proceeds used for a capital project, but only if the Issuer and a licensed engineer certify that the longer period is necessary to complete the project.

Proceeds used for a debt service reserve fund are not subject to yield restriction to the extent that they do not exceed the “lesser of” test described in Section C. IV. Debt Service Reserve Fund of this Policy.

v. Consequences of Non-Compliance

a. IRS Options to Address Non-Compliance

As an alternative to the loss of tax exemption on an issue for which rebate is not paid in accordance with Code Sections 148(f)(2) and (3), Code Section 148(f)(7) provides the option to pay a penalty if: (A) No bond which is a part of such issue is a private activity bond; (B) the failure to meet such requirements is not due to willful neglect; and (C) the issuer pays to the United States a penalty in amount equal to the sum of – (i) 50 percent of the amount which was not paid, plus (ii) interest (at the



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underpayment rate established under Section 6621 of the Code) on the portion of the amount which was not paid on the date required or the period beginning on such date.

b. Voluntary Closing Agreement Program (VCAP)

The IRS has established procedures for remedying a post-issuance compliance violation. If it is discovered that the State is not in compliance with Federal tax laws, Section 7.2.3 of the Internal Revenue Manual provides steps to be taken to remediate the violation. Outside counsel should be engaged to assist in the preparation and submission of the VCAP request. After the request is submitted, the IRS will reach out to counsel and negotiate settlement terms.

C. Other Arbitrage Compliance Matters

i. Final Maturity

With respect to an issuance that is subject to rebate, has had an Arbitrage Report completed, and that satisfies all assumptions, the issue is considered to be in compliance with the arbitrage rebate regulations and an Arbitrage Report is not necessary upon final maturity. If an issue that is subject to rebate is refunded or defeased and has not previously had an Arbitrage Report completed, then an Arbitrage Report will be due within sixty (60) days of the Refunding or defeasance thereof.

ii. Refunding

Bond proceeds generated from the sale of a Refunding series will fund remaining debt service payments on all or a portion of a prior (refunded) issue; meaning the proceeds will not be considered fully spent until the final debt service payment is made on the refunded portion of the prior issue, or the prior issue is called. A Refunding issue may or may not require completion of an Arbitrage Report depending on the criteria set forth in Section (B)(iii)(a) of these Arbitrage Policies and Procedures.

iii. Investments – Regulatory Safe Harbor

TOS will ensure that investments acquired with tax-exempt bond proceeds satisfy IRS regulatory safe harbors for establishing fair market value (e.g., through the use of bidding procedures where applicable), and maintain records to demonstrate satisfaction of such safe harbors, all of which should be set forth in or attached to the Tax Compliance Certificate.

iv. Debt Service Reserve Fund

TOS will ensure that amounts invested in any reasonably required debt service reserve fund do not exceed the least of: (i) 10% of the stated principal amount of the issue (or the sale proceeds of the issue if the issue has original issue discount or original issue premium that exceeds 2% of the stated principal of the issue plus, in the case of premium, reasonable underwriter's compensation); (ii) maximum annual debt service on the issue; or (iii) 125% of average annual debt service on the issue.

D. Structuring Bonds to Enhance Compliance

i. Pre-Issuance Matters

New Money bond issues are sized to enable a reasonable expectation with respect to the bond proceeds (including the interest earnings on the bond proceeds) being expended within eighteen months or two years, as applicable, of the date of the issue in order to qualify for the applicable spending exception. When working with the Agency Program Manager(s) during the issuance



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process, the working group should discuss the timing of expenditures and use of proceeds to determine if the proceeds of the issue are estimated to be spent in accordance with the benchmark requirements of the applicable spending exception.

The sale date will be set based on a reasonable expectation that at least 10% of the bond proceeds will be spent within six months of the issue date. In certain situations, the sale date may not be set based on a reasonable expectation that at least 10% of the bond proceeds will be spent within six months of the Issue date. In those cases, the sale date will be set to ensure compliance with the applicable spending exception and/or Temporary Period requirement.

a. Agency Disbursement Schedule

The State agency or agencies administering the applicable bond fund(s) must provide a schedule of projected disbursements that details the nature and timing of projected expenditures from the bond-funded program on a monthly, but not less than quarterly, basis beginning in the then-current month and extend to a period sufficiently long to enable full expenditure of the bond proceeds. The detailed disbursement schedule will be reviewed by the issuer, bond counsel, and OBM.

b. Costs of Issuance (COI)

Costs of issuance are usually paid with bond proceeds, and the Rebate Consultant will request statements from the cost of issuance (COI) account in order to prepare a Spending Exception Analysis or Arbitrage Report. Various bond series do not have a separate COI account outside of the custodial account for that program. In such case the payment for COI is evidenced through bank statements for the custodial account, the program ledger, and the bond file. After COI is completely paid there are usually excess COI funds, the balance of which will be transferred to the debt service fund for the applicable bond program within 13 months of the issue date and credited against the next debt service payment. The Rebate Consultant will also request supporting documentation or other confirmation of the transfer to the bond service fund.

c. Tax Compliance Certificate

In structuring new issues, TOS will ensure that the Tax Compliance Certificate includes the following:

- Determination of the issuer's expectation with respect to the applicable Temporary Period
- Provision electing to use applicable spending exception to rebate or option to bifurcate in the case of multi-purpose issues in a common plan of finance.
- Agency Program Manager Certification(s) demonstrating their understanding of applicable spending requirements within the Tax Compliance Certificate.

d. Investments

TOS will not invest proceeds of the issue in investments with a yield above the Arbitrage Yield (as shown on the applicable IRS Form 8038-G) following the end of the available Temporary Period unless yield reduction payments may be made. OBM will monitor the expenditure of bond proceeds, including investment proceeds, at least quarterly relative to expenditure expectations as of the issue date for satisfaction of the applicable Temporary Period requirements.

The Office of Budget and Management, through the Ohio Administrative Knowledge System (OAKS), allocates investment earnings across the funds of the State that are authorized to retain their own interest, including bond improvement funds. The Earnings Redistribution Account (Fund 6080)



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receives investment earnings from the TOS' office where bond proceeds are invested as part of a large commingled portfolio known as the regular account. Investment earnings are posted to each applicable fund quarterly based on each fund's pro-rata share of the average daily balance of all interest-receiving funds multiplied by actual quarterly investment earnings deposited in the Earnings Redistribution Account.

TOS will ensure that investments acquired with bond proceeds satisfy IRS regulatory safe harbors for establishing fair market value (e.g., through the use of bidding procedures where applicable), and maintain records to demonstrate satisfaction of such safe harbors, all of which should be set forth in or attached to the Tax Compliance Certificate.

ii. Bona Fide Debt Service Fund

All debt service is and will continue to be paid through a Bona Fide Debt Service Fund, defined to be a fund that is used primarily to achieve proper matching of revenues with principal and interest payments within each bond year; and is depleted at least once each bond year, except for a reasonable carryover amount not to exceed the greater of: (i) the earnings on the fund for the immediately preceding bond year; or (ii) 1/12 of the principal and interest payments on the issue for the immediately preceding bond year).

iii. Capitalized Interest Period

During the pre-issuance structuring of a bond sale, Ohio Office of Budget and Management (OBM) will determine the amount of funded interest, which may include capitalized interest that may be applied by taking into account the current budgetary framework and any legal considerations after consulting with bond counsel. The Code limits the amount of funded interest to three years from the issuance date which coincides with the typical three-year Temporary Period. In general, funded interest shall be structured in order to meet either the eighteen-month or two-year spending exception to rebate.

The spending of bond proceeds for funded interest is incorporated into Arbitrage Reports by the Rebate Consultant. For tax purposes, funded interest is applied pursuant to the Tax Compliance Certificate only to interest payable on the series for which the funded interest was generated.

iv. Spending of Proceeds / Ongoing Monitoring

New Money issues are anticipated to qualify for a spending exception to rebate unless other circumstances warrant a longer expenditure timeframe, but in no event will that anticipated timeframe extend beyond the period necessary for the bonds to qualify for the applicable Temporary Period (in most cases the three-year Temporary Period). Final expenditure of bond proceeds is monitored by OBM utilizing its Bond Fund Balances spreadsheet, which is used by the Rebate Consultant to prepare Spending Exception Analyses and Arbitrage Reports (See Appendix II – TOS Semiannual Arbitrage Reporting Procedures).

OBM monitors spending via OAKS accounting reports of State bond funds at least quarterly to ensure that the rate of spending is generally consistent with projected expenditures. If significant deviations occur, OBM will contact the State agency administering the bond funds to determine the cause and, to the extent possible, assist in remediation so that spending can resume at expected levels. Refer to the Post-Issuance Compliance Procedures for Tax-Exempt Bonds and Build America Bonds formally adopted by TOS and OBM concerning "Use of Proceeds."



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E. Arbitrage Reports

The Rebate Consultant will prepare Arbitrage Reports according to Appendix II - TOS Semiannual Arbitrage Reporting Procedures. TOS will process payment of any fees related to the preparation of Arbitrage Reports according to Appendix III – TOS Rebate Consultant Fee Procedures. Each issue of bonds is determined to need a Spending Exception Analysis or Arbitrage Report completed at the earlier of: (i) the final expenditure of proceeds (including the final interest posting on those proceeds); or (ii) the 5-year anniversary date of issuance. Please refer to Section (B)(iii) of these Arbitrage Policies and Procedures for guidelines related to Arbitrage Report requirements and frequency.

F. Payment of Rebate

For issues that have accrued a positive arbitrage rebate liability and/or yield reduction liability, the Rebate Consultant will coordinate remittance to the U.S. Treasury. In those cases in which the State has an option to pay either the arbitrage rebate payment or the yield reduction payment (as referenced on the summary page included with the Arbitrage Report), it is the State's policy to pay the smaller liability.

The Rebate Consultant will prepare a letter to the IRS and complete the IRS Form 8038-T which will be submitted to the IRS after execution by the authorized officer of TOS or OPFC, as applicable. Payment of yield reduction and arbitrage rebate liabilities is an authorized use of bond service funds and may be paid out of the agency's debt service line item from the GRF, as authorized by the General Assembly. The rebate authorization is also established in uncodified law in each biennial budget bill to be made from the improvement fund or bond service fund. If the rebate payment is made from the GRF, a letter from OBM authorizing the disbursement is required. Depending on the amount, the payment may also be made from the custodial account bond service fund or administrative fund.

It is the State's policy to pay 100% of any arbitrage rebate or yield restriction liability upon discovery. All rebate or yield reduction payments are due to the IRS within sixty (60) days after the Computation Date to which the payment relates before late interest begins accruing and the possibility of a penalty. The amount of required interim rebate installment payment(s) is detailed in Treas. Reg. § 1.148-3(f)(1) as an amount that, when added to the future value, as of the Computation Date, of previous rebate payments made for the issue, equals at least 90% of the rebate amount as of that date. The final rebate payment as detailed in Treas. Reg. § 1.148-3(f)(2) must be paid in an amount that, when added to the future value of previous rebate payments made for the issue, equals 100% of the rebate amount as of that date.

G. Recordkeeping

For each issue, maintain Arbitrage Reports and other documents described in these procedures in physical and/or electronic form while any of the bonds of the issue are outstanding and during the three-year period following the final maturity or redemption of the bond issue or, if later, while any bonds that refund (or re-refund) bonds of that original issue are outstanding and for the three-year period following the final maturity or redemption date of the latest refunding bond issue.



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Appendix I – Ohio Revised Code Authority

Obligation Type	ORC Authorizing Arbitrage Compliance	Statute Text	Programs authorized for issuance by ORC	Applicable Program	Bond Service Fund Created by ORC*
General Obligation (Chapter 151)	§151.01(S)	"The treasurer of state shall have the responsibility for keeping records, making reports, and making payments relating to any arbitrage rebate requirements under the applicable bond proceedings."	§151.01(B)	Common Schools	\$151.03
				Higher Education	\$151.04
				Natural Resources	\$151.05
				Highway Capital	\$151.06
				Coal	\$151.07
				Infrastructure	\$151.08
				Conservation	\$151.09
				Third Frontier	\$151.10
Site Development	\$151.11				
Lease-Appropriation (Chapter 154)	§154.08(G)	"The issuing authority shall have responsibility for keeping records, making reports, and making payments related to arbitrage compliance and rebate requirements under the bond proceedings for obligations issued pursuant to this chapter."	§154.02(A)	Mental Health	\$154.20
				Parks and Recreation	\$154.22
				Cultural Facilities	\$154.23
				Administrative Building	\$154.24(F)
				Adult Correctional	\$154.24(F)
				Juvenile Correctional	\$154.24(F)
				Highway Safety	\$154.24(F)
Transportation Facilities	\$154.24(F)				
Special Obligation (Chapter 5531)	§5531.10(B)	"[...] The issuing authority may appoint [...] financial advisors, accounting experts[...] as are necessary in the issuing authority's judgement to carry out this section."	§5531.10(B)	GARVEE	\$5531.09(B)

* Any arbitrage compliance related fees or rebate payments necessary to be paid to a financial accounting firm or the IRS are authorized by the ORC as Costs of Capital Facilities (as defined in ORC §151.01(A)(4) and §154.01(K), to be paid from the respective bond service fund created for each program pursuant to the above referenced ORC Sections (to the extent that the appropriated monies available for administrative fees held in the program custodial account (or for GARVEE the applicable trustee account) are insufficient to pay such expenses).



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Appendix II – TOS Semiannual Arbitrage Reporting Procedures

Prepare List of Issues Requiring Calculations - Throughout the year update the Master Arbitrage Spreadsheet to identify which issues will need upcoming calculations prepared. Each January and July, prepare the List of Issues Requiring Calculations to summarize which issues the Rebate Consultant will need to focus on. The List of Issues Requiring Calculations is structured by spent issues (including capitalized interest), and unspent issues. The reports are completed based on the spending activity of all series issued in a common plan of finance (unless otherwise indicated in the Tax Compliance Certificate).

Coordination with Office of Budget & Management (OBM) – Once the List of Issues Requiring Calculations is prepared, send to OBM Debt Management Department for review. The agreed-upon list will be submitted to the Rebate Consultant by TOS.

Documents Requested – The Rebate Consultant will request various documents related to the issues requiring calculations. TOS will provide the following documents: Tax Compliance Certificate, IRS Form 8038-G, Debt Service Fund Statements, COI Statements, STAR Ohio Statements, Reserve Fund Statements, Escrow Fund Statements and any other documents as requested. OBM Debt Management will provide the bond fund balances to TOS for submission to the Rebate Consultant. Throughout the preparation of the Arbitrage Reports, the Rebate Consultant may inquire about specific transfers or investments. TOS will research answers for the Rebate Consultant for clarification of any questions. Answers can usually be found in the ledgers or by reaching out to the applicable Trustee or Escrow Agent. The Rebate Consultant will inquire about the application of capitalized interest, if applicable and for tax purposes, the proceeds to be used as capitalized interest are considered spent and allocated exclusively to the interest payments due on the series for which the capitalized interest was generated. For the payment of debt service, at the request and direction of OBM, TOS applies all proceeds classified as capitalized interest to the first interest payment after a new issue closing, provided that the capitalized interest amount does not exceed all interest due on any outstanding bonds payable in that bond program on that payment date. One exception to this practice is the GARVEE program where pursuant to the current Certificate and Agreement, capitalized interest may only be applied toward interest payable on the series for which it was generated.

Reports – Once completed, the Rebate Consultant will send electronic copies only to both TOS and OBM. TOS Debt Management will update the Master Arbitrage Spreadsheet with this information. Reports may take several months to complete after the List of Issues Requiring Calculations is submitted to the Rebate Consultant. The Rebate Consultant's Arbitrage Reports will include a cover page summarizing the calculations and any yield reduction and/or arbitrage rebate liabilities, and an invoice for services in accordance with the current contract and fee schedule agreement for arbitrage rebate calculations between the TOS and the Rebate Consultant.

Recordkeeping – TOS files electronic copies of the Arbitrage Reports in the respective electronic bond file folder, as well as in the Arbitrage Reports folder of the applicable fiscal year folder of the Arbitrage Compliance folder on the X drive. Arbitrage Reports fall under the Treasurer of State Record Retention Schedule Debt-3 Bond Issue of Series which are retained for five (5) years after the final maturity of that issue, or if refunded; five (5) years after the final maturity of the refunding bond issue. In addition to appropriately filing Arbitrage Reports, TOS will send each program's Trustee or Escrow Agent a copy of all Arbitrage Reports for their records.



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Appendix III – TOS Rebate Consultant Payment Procedures

Invoices received from the Rebate Consultant will be entered into the Invoice Payments spreadsheet and verified against the current contract and fee schedule agreement for arbitrage rebate calculations between TOS and the Rebate Consultant. Once the fees are confirmed, the invoice is paid accordingly from Administrative Fees for the various General Obligation, Lease-Appropriation and Special Obligation bond program custodial accounts in accordance with the Office of Debt Management Invoice Payments Procedure (X:\Procedures\Procedure Handbook\201.55 Invoice Approval for Payment).

Each program will pay its respective portion of fees charged for the preparation of Arbitrage Reports for that program. If there are series from more than one program charged a single fee as listed on the invoice, each program will pay a ratable portion of that fee. For the Major New State Infrastructure Program (GARVEE), the administrative fund is held in the custody of the Trustee where the fees will be disbursed for payment by the Trustee at the direction of the TOS. Fees may also be paid from costs of issuance withheld from program bond issues.

If there are insufficient amounts of administrative fees remaining in a program's custodial account for the payment of fees related to the preparation of Arbitrage Reports, TOS will work with OBM to obtain the necessary amount. If additional administrative fees are needed for General Obligation programs, TOS Debt Management will prepare a Certification Letter in accordance with Office of Debt Management Procedures (X:\Procedures\Procedure Handbook\201.30 Certification Letter Procedures). If additional administrative fees are needed for Lease-Appropriation programs, TOS Debt Management will prepare a new Lease Rental Report (X:\Procedures\Procedure Handbook\202.30 Lease Revenue Report Procedures). After the Certification Letter or Lease Rental Report is complete, the vouchers are entered in OAKS and the additional funds are deposited into the appropriate custodial account. OBM will review and approve Certification Letters and Lease Rental Reports as applicable and as necessary.



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Appendix IV – Definitions

Agency Program Manager: The representative from the benefitting agency of bond proceeds for an issue of bonds. Each Agency Program Manager will be a part of the bond issuance process and is responsible for monitoring the spend-down of bond proceeds and notifying the issuer of any prospective changes or deviation from original spending expectations.

Arbitrage Bond: A bond the interest on which is not excludable from the gross income under (Section 103(a) of the Code).

Arbitrage Report: A report prepared by the Rebate Consultant that calculates the yield reduction and/or arbitrage rebate liabilities as of the Computation Date of the report. These reports serve as evidence of compliance with federal income tax rebate requirements.

Arbitrage Yield: The yield on a fixed yield issue is the discount rate that, when used in computing the present value as of the issue date of all unconditionally payable payments of principal, interest, and fees for qualified guarantees on the issue, produces an amount equal to the present value, using the same discount rate, of the aggregate issue price of bonds of the issue as of the issue date. Further, payments include certain amounts properly allocable to a qualified hedge (Treas. Reg. §1.148-4(b)(1)(ii)). For tax advantaged bonds, the yield is adjusted to reflect any direct subsidy payments from the IRS.

Bona Fide Debt Service Fund: A fund that is used primarily to achieve proper matching of revenues with principal and interest payments within each bond year, and is depleted at least once each bond year, except for a reasonable carryover amount not to exceed the greater of: (i) the earnings on the fund for the immediately preceding bond year; or (ii) 1/12 of the principal and interest payments on the issue for the immediately preceding bond year (Treas. Reg. §1.148-1(b)).

Computation Date: The date as of which the issuer chooses to cause the Yield Reduction and/or Arbitrage Rebate liabilities to be computed (Treas. Reg. §1.148-1(b)).

Computation Period: The date range that an Arbitrage Report spans. The first Computation Period begins on the issue date and ends on the first Computation Date. Each succeeding Computation Period begins on the date immediately following the Computation Date and ends on the next Computation Date (Treas. Reg. § 1.148-1(b)).

Construction Expenditures: Capital Expenditures that are allocable to the cost of real property or constructed personal property (Treas. Reg. §1.148-7(g)(1)).

Construction Issue: Any New Money issue that the issuer reasonably expects, as of the issue date, that at least 75 percent of the available construction proceeds of the issue will be allocated to Construction Expenditures for property owned by a governmental unit. (Treas. Reg. § 1.148-7(f)(1)).

Escrow Agent: The bank responsible (pursuant to an escrow agreement as part of the transcript of proceedings) for the management of an escrow account for the purpose of using Refunding bond proceeds to purchase securities to be used to pay debt service on refunded bonds (also see Trustee).

General Obligation: A type of State debt that is secured by the full faith and credit (taxing power) of the General Assembly with some limits. The current General Obligation programs include: Conservation, Coal, Common Schools, Highway Capital, Higher Education, Infrastructure, Site



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Development, Third Frontier Research and Development, Natural Resources, and Veteran's Compensation.

Gross Proceeds: Any sale proceeds, investment proceeds, Replacement Proceeds, and Transferred Proceeds of an issue (Treas. Reg. §1.148-1(b)).

Hedge Bonds: Any part of a bond issue that meets the following two elements: 1) the issuer reasonably expects that less than 85% of the net proceeds of the issue will be used to finance its qualified purpose within 3 years of the issue date; and 2) over 50% of the proceeds of the issue are invested in Nonpurpose Investments having a substantially guaranteed yield for 4 or more years. Section 149(g) of the Code provides that an issue meeting the definition of Hedge Bonds will not be tax-exempt unless certain requirements are satisfied.

Higher Yielding Investment: An investment that produces a yield materially higher than the Arbitrage Yield. Usually "materially higher" means 1/8%; for investments in an advance refunding escrow "materially higher" means 0.001% (Treas. Reg. §1.148-2(d)).

Lease-Appropriation Obligation: A type of debt the State issues that is secured primarily by lease rental payments appropriated by the General Assembly for the payment of debt service charges by the particular agency that is a party to the lease. The current Lease-Appropriation Obligation debt includes the following programs: Mental Health, Parks and Recreation, Cultural Facilities, Administrative Building Fund, Adult Correctional, Juvenile Correctional, Highway Safety and Transportation Facilities Fund.

New Money: A bond issue the proceeds of which will fund capital or construction projects as provided in the applicable General Assembly Appropriation Act(s), as opposed to a Refunding bond issue.

Open Market Securities: If a refunding escrow is not invested in SLGS, all other securities eligible to be purchased for a yield-restricted defeasance escrow are considered Open Market Securities, including Treasury Bills and Notes. When structuring a refunding escrow with Open Market Securities the issuer must be in compliance with formal bidding procedure requirements outlined in Treas. Reg. § 1.148-5(d)(6)(iii).

Purpose/Nonpurpose Investment: A Purpose Investment is an investment acquired to carry out the governmental purpose of an issue. All other investments are Nonpurpose Investments such as securities purchased in a debt service reserve fund (Code §148(f)(6)(A)).

Rebate Consultant: A firm contracted for the services of performing Arbitrage Reports and Spending Exception Analyses.

Refunding: An issue the proceeds of which will be used to call outstanding obligations and/or fund remaining debt service payments for a prior issue to its earliest call date(s), as opposed to a New Money bond issue.

Replacement Proceeds: Amounts that have a sufficiently direct nexus to the issue or to the governmental purpose of the issue to conclude that the amounts would have been used for that governmental purpose if the proceeds of the issue were not used or to be used for that governmental purpose (Treas. Reg. §1.148-1(c)).

SLGS: Most advance refunding escrows are invested in State and Local Government Series (SLGS). They are purchased directly from the U.S. Treasury Department, Bureau of Public Debt. SLGS are



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purchased by subscribing for certain specifications such as principal amount, interest rate and maturity date. These specifications are based on future cash flows necessary for the payment of bond service charges for the refunded bonds, limited by the yield on the advance refunding bond issue.

Special Obligation: A type of debt the State issues that is secured by a dedicated stream of revenues, as opposed to General Obligation debt and Lease-Appropriation debt. The current Special Obligation debt includes Major New State Infrastructure, Buckeye Tobacco Settlement Financing Authority bonds, and the Treasurer's conduit programs. The Treasurer is not responsible for preparation of Arbitrage Reports for conduit bond programs; rather, it is the conduit borrower's responsibility to maintain the tax-exempt status of the bonds. The Treasurer's conduit programs include the State Infrastructure Bank, the Ohio Enterprise Bond Fund, the Community College Intercept and the Centric Student Loan.

Spending Exception Analysis: A report prepared by the Rebate Consultant in the case that an issue of bonds qualifies for one of the spending exceptions to rebate. The report evidences the expenditure of bond proceeds in accordance with the applicable spending benchmark, and is considered to be sufficient documentation of compliance with federal rebate requirements for the remaining life of that issue.

STAR Ohio: The State's pooled investment program. Bond proceeds may be invested by the Office of Debt Management in STAR Ohio. Monthly statements for any investment holdings in STAR Ohio will be provided to the Rebate Consultant for preparation of Arbitrage Reports.

Temporary Period: The time period during which proceeds of an issue may be invested in Higher Yielding Investments without causing the bonds in the issue to become Arbitrage Bonds (Treas. Reg. §1.148-2(e)(1)). There is generally a three-year Temporary Period for capital projects, contingent on the issuer's following reasonable expectations: Eighty-five percent of the net sale proceeds of the issue are allocated to expenditures on the capital projects by the end of the 3-year Temporary Period, the issuer incurs within 6 months of the issue date a substantial binding obligation to a third party to expend at least 5 percent of the net sale proceeds of the issue on capital projects, and completion of the capital projects and the allocation of the net sale proceeds of the issue to expenditures proceeds with due diligence (Treas. Reg. §1.148-2(e)(2)).

Transferred Proceeds: Unspent proceeds of a prior (refunded) issue that are allocated to a Refunding series when the proceeds of the Refunding series are used to pay the principal of the prior (refunded) issue. When proceeds of the prior (refunded) issue are "transferred" or allocated to a Refunding series, the proceeds of the Refunding series and any investments become subject to yield restriction (Treas. Reg. §1.148-9(b)(1)).

Trustee: For Lease-Appropriation and Special Obligation debt, the bank or corporate trust company responsible (pursuant to the trust indenture as part of the transcript of proceedings) for the management of accounts for the purpose of paying debt service, administrative fees, or as otherwise specified in the trust indenture for the applicable program. For purposes of Refunding bonds, the Trustee is also responsible for the management of an escrow account for the purpose of using refunding bond proceeds to purchase securities to be used to pay debt service on refunded bonds, if applicable. Depending on the bond proceedings, the Trustee may also be the Escrow Agent.