

Department of Administrative Services, Capital Investment Section
 Arbitrage Compliance Procedures: Investments, Reserves & Bona Fide Debt Service Funds
 Updated: January 17, 2012

This document establishes the general operating procedures for investments, reserves and debt service funds for bonds issued by the Capital Investment Section (CIS) on behalf of the State and its agencies. This guidance helps assure continuing compliance with Internal Revenue Code and GASB Statements as well as conformity with generally accepted accounting principles.

Responsible Party	Action	Time Frame
Bond Counsel / CIS Staff	<p>If a portion of bond sale proceeds are to be placed in a reserve fund(s), perform analysis to ensure that total reserve(s) do not exceed the least of the following:</p> <ul style="list-style-type: none"> ➤ 10% of the principal amount of the issue. Use 10% of issue price if more than 2% net Original Issue Premium (OIP) or Original Issue Discount (OID); ➤ Maximum annual debt service on the issue; or ➤ 125% of the average annual debt service on the issue. <p>The maximum size of the reserve fund may, upon consultation with bond counsel, be based on applying the above three tests to all bond issues secured by the reserve fund. In no event may more than 10% of the principal amount of the bond issue be contributed to reserve (if an issue is sold at more than 2% net OID or OIP, 10% of issue price is used instead of 10% of principal amount. IRC Sec. 148 (d); Section 148-2(f).</p>	Prior to bond sale / at time of sale
CIS Staff / Treasury Staff	In consultation with State Treasurer's Office, determine appropriate investment of reserve fund.	Prior to bond sale
CIS Staff / Treasury Staff / DOJ	Obtain State Treasurer approval to use of a Guaranteed Investment Contract (GIC). Develop a term sheet based on state law and obtain Treasury and DOJ approval.	Prior to bond sale
CIS Staff / GIC Broker	Work with Treasury, bond counsel and financial advisor to develop list of eligible financial institutions from which to solicit bids. Review financial institutions financial statements and ratings for long-term financial condition and stability.	Prior to bond sale
CIS Staff / Treasury Staff	With Treasury's approval, use of GIC broker or auction bid platform provider (e.g. State Street) may facilitate this process.	Prior to bond sale

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CIS Staff / GIC Broker / Auction Bid Platform Provider	Conduct competitive bid for investment agreement using IRS approved practices including such items as competitive bid process, time record of bid submission, and retaining documentation of bid process.	Date of bond sale
CIS Staff / Trustee / Disbursing Agent / Treasury Banking	Establish separate accounts (project, reserve and administrative) for each series from which debt service payments will be made in accordance with generally accepted accounting principles and Oregon Accounting Manual.	At time of bond sale
CIS Staff / Treasury Staff	<p>When investments mature, generally re-investment will be facilitated by Trustee/Disbursing Agent at the direction of CIS or Treasury Investment Division. With input from Bond Counsel, analyze need if any, to “yield restrict” investments, pursuant to the following:</p> <ul style="list-style-type: none"> ➤ The project proceeds of tax-exempt borrowings for capital projects can be invested at an unrestricted yield for a temporary period of 3 years (Treasury Reg. Sec. 1.148-2(e)(2)). ➤ After the third anniversary date, any unspent project proceeds are yield restricted to the bond yield plus 1/8% (Treasury Reg. Sec. 1.148-2(d)(2)(i)). ➤ However, the regulations permit issuers to make yield reduction payments to satisfy the yield restriction rule (Treasury Reg. Sec. 1.148-5(c)(3)(i)(A)). ➤ The yield reduction payments need to be calculated at the same time and in the same manner as rebate payments (Treasury Reg. Sec. 1.148-5(c)(2)(i)). ➤ Although the calculation of yield reduction payments and rebate payments are made at the same time and in the same manner, the calculation of yield reduction payments is a separate calculation and so the amount of rebate owed would not generally equal the amount of yield reduction payments owed at a computation date. <p>Example: It took 5 years to spend all project proceeds of an issue. For the first 2.5 years, there was negative arbitrage, but for the second 2.5 years there was positive arbitrage. It is possible that over the 5 year</p>	At maturity of initial investment in series

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	<p>rebate computation period, the State did not earn net positive arbitrage on the project fund and would not owe rebate. However, if the State did earn positive arbitrage after the temporary period ended at year three (between year 3 and year 5), the State would owe yield reduction payments in an amount necessary to bring the post year-3 yield down to the bond yield plus 1/8%. The State could owe yield reduction payments but not rebate.</p>	
CIS Staff	<p>Prior to making deposits or transfers into debt service accounts, perform an analysis to ensure that either:</p> <ol style="list-style-type: none"> 1) The account balance will be depleted annually from debt service requirements and therefore will be considered “bona fide” under the Internal Revenue Code; or 2) The deposit or transfer for which the analysis is being performed will be paid for debt service within 13 months of the deposit or transfer. <p>A “bona fide” debt service fund is a fund that is:</p> <ul style="list-style-type: none"> ➤ Used primarily to achieve a 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: <ul style="list-style-type: none"> ○ The earnings on the fund for the immediately preceding bond year, or ○ One-twelfth of the principal and interest payments on the issue for the immediately preceding bond year. 	Ongoing
CIS Staff / Counsel	<p>If an analysis reveals that a deposit or transfer into a debt service account would, in the absence of corrective action, disqualify the fund as a “bona fide” debt service fund and would not be fully spent for debt service within 13 months, CIS will, in consultation with Counsel, document analysis to segregate the excess portion and invest such amounts in yield-restricted investments as necessary.</p>	Ongoing