

Arbitrage Opportunities with Tax Anticipation Notes

While the days of borrowing notes at interest rates below 0.50% are behind us for now, in this new interest rate environment with both higher borrowing and investment rates, opportunities exist to reduce an issuer's borrowing costs and maybe even make money.

When interest rates were extremely low, timing considerations for when and how long tax anticipation notes ("TANs") were outstanding, were not much of a concern. (A \$5 million TAN borrowed for 10 months at 0.25% cost just over \$10,000 in interest expense.) Contrast that with last year, when interest rates rose sharply on the borrowing side, but investment rates were still lagging (That same \$5 million TAN borrowed for 10 months at 2.50% cost over \$100,000!). In that market, it became necessary to take a very close look at your cash flow to determine precisely your cash flow needs, and if possible, shorten the term of your TAN to reduce your borrowing costs since those TAN proceeds were earning next to nothing in your money market accounts. Fast forward to today and interest rates have continued to rise with one-year notes currently pricing in the mid-to-high 3% range. The difference between today and last year is that there now exists an opportunity on the investment side to offset these higher borrowing costs and earn positive arbitrage, that you can keep. Treasury regulation Section 148 covers the arbitrage rules which determine whether or not an issuer must rebate interest earnings in excess of its borrowing costs or if they are allowed to keep such excess interest earnings. TANs are specifically covered under IRC Section 148(f)(4)(B)(iii) which, in summary, states that no rebate is required so long as an issuer expends 90% of its TAN proceeds within 6 months of the TAN's issue date. With investment rates significantly higher today than a year ago, issuing a TAN for a longer period, while still complying with the 6-month TAN spend down rule, can create an opportunity to generate investment earnings that will offset your borrowing costs. Here are two examples:

Scenario 1) A school district needs \$5 million in November to cover a deficit and will have the tax receipts needed to repay its TAN in January. One course of action would be to issue a TAN in October which matures in February. Under this scenario, the funds would be spent and repaid quickly following their receipt so there would be next to no investment opportunity. The cost of this \$5 million TAN borrowed for 4 months at 3.50% would be \$58,333.

Scenario 2) That same school district borrows a \$5 million TAN in July to mature the following June. The projected November deficit occurs within 6 months of the issue date so any interest earnings on those TANs would be the District's to keep. The borrowing cost of the \$5 million TAN for 11 months at 3.50% would be \$160,416. However, for 7 out of the 11 months that the TAN is outstanding, the school district is able to invest the TAN proceeds at 4%, generating interest earnings of \$116,667. Therefore, the net cost of the TAN when subtracting the interest earnings is \$43,749, or \$14,584 less than if the school district had only borrowed the TAN for 4 months.

Different market conditions require different thinking. Please call your financial advisor at CMA to make sure that your borrowing strategy is in keeping with the prevailing interest rate environment.

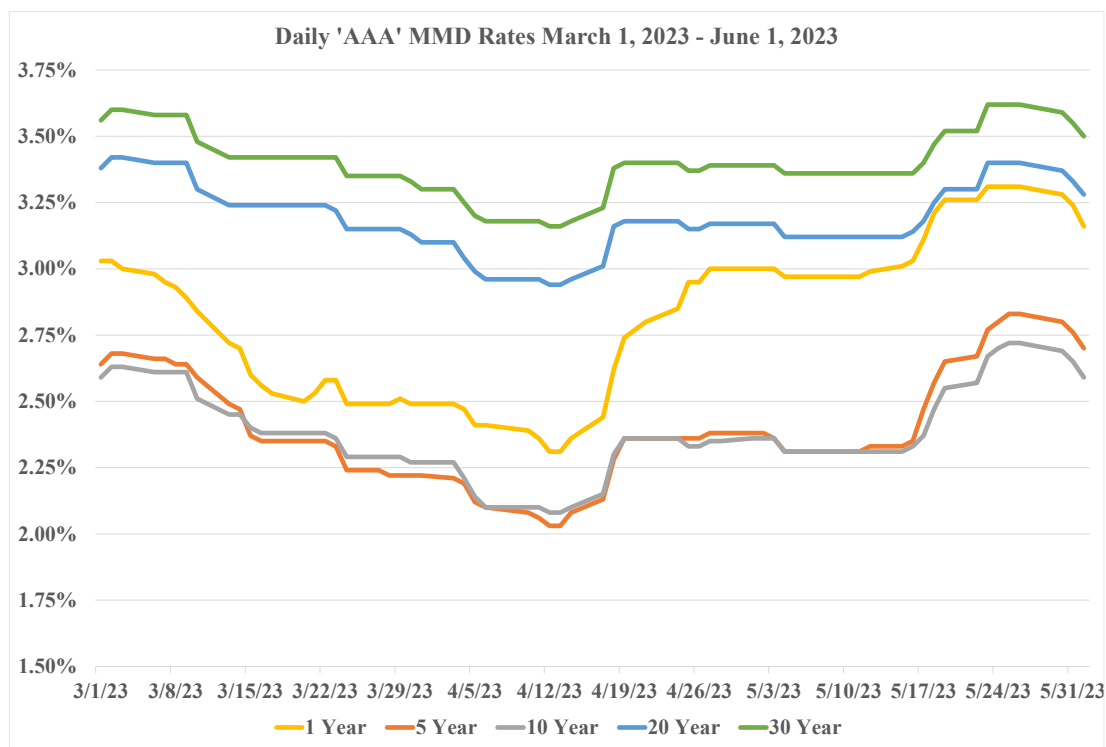
RECENT CMA CLIENT SALE RESULTS

<u>Issuer</u>	<u>Issue Type</u>	<u>Par Amount</u>	<u>Sale Date</u>	<u>Term</u>	<u>Rate</u>	<u>Purchaser</u>
Amherst Town (Aa3)	BAN	\$26,385,000	25-May	5 mos.	3.84%	JP Morgan Securities LLC
Rockville Center Village (Aaa)	Bonds	\$21,865,000	24-May	19 yrs.	3.45%	Fifth Third
Tonawanda City SD (A1)	BAN	\$45,460,000	23-May	1 yr.	3.93%	Jefferies LLC
Glen Cove City (Baa2)	Bonds	\$4,821,142	23-May	11 yrs.	3.47%	Loop Capital Markets
Oceanside UFSD (Aa2)	EPC Lease	\$15,662,187	12-May	15 yrs.	3.28%	TD Equip. finance, Inc.
Warren County (AA)	BAN	\$6,320,000	11-May	1 yr.	3.45%	Jefferies LLC
Greenburgh Town (Aaa)	Bonds (Tx.)	\$6,605,000	10-May	5 yrs.	4.21%	Roosevelt & Cross
North Tonawanda City (A3)	Bonds	\$6,819,375	2-May	25 yrs.	3.54%	Fidelity Capital Markets

Cybersecurity and Potential Impact on Credit Ratings

Cybercrimes are an active threat to local governments, which are attractive targets due to the sensitive data they maintain. As a result, credit rating agencies and lenders are putting more focus on municipalities' cyber readiness. Rating agencies review organization's cyber-related investments as well as system design and its success identifying vulnerabilities. S&P Global believes that a weakness in threat detection can indicate an organizational risk and may, negatively affect a jurisdiction's creditworthiness. S&P has three main criteria when reviewing cyber risk: how a municipality prepares, responds and recovers. Primarily, credit rating agencies are analyzing the level of defense an issuer has established to combat an attack. They are looking for preparedness in terms of system backups and response plans in place. In the event a jurisdiction is a victim of an attack, its ability to detect and respond is crucial. Cyberattacks are not a singular event but rather a chain of events. Early detection is essential to break the attack lifecycle and limit damage. The potential effects on revenue, costs, reputation, litigation, regulatory scrutiny, and customer relations can be detrimental to the operations of a public jurisdiction and result in negative pressure on credit rating.

To combat growing cyber risks, municipalities should view cybersecurity as a critical issue that requires ongoing attention and a permanent state of watchfulness. Investing in a multilayered security system, regularly educating and training employees, ensuring that software and systems are updated, and passwords protected are all ways to strengthen a jurisdiction's cybersecurity. In the same way a cyber-attack is thought of as a lifecycle rather than an event, cybersecurity should be ever-evolving line of defense. *It's no longer a question of if an attack will occur, but when.*



Term	June 1, 2023					1 Month Ago - May 1, 2023					1 Year Ago - June 1, 2022				
	Aaa	Aa	Insured	A	Baa	Aaa	Aa	Insured	A	Baa	Aaa	Aa	Insured	A	Baa
1 yr.	3.16%	3.19%	3.31%	3.30%	3.65%	3.00%	3.03%	3.15%	3.14%	3.49%	1.51%	1.66%	1.77%	1.78%	1.98%
5	2.70	2.78	2.89	2.92	3.29	2.38	2.46	2.57	2.60	2.97	2.05	2.25	2.35	2.40	2.65
10	2.59	2.75	2.90	2.95	3.49	2.36	2.52	2.67	2.72	3.20	2.43	2.70	2.83	2.90	3.27
15	3.12	3.42	3.52	3.63	4.07	2.95	3.25	3.35	3.46	3.90	2.56	2.87	2.97	3.08	3.42
20	3.28	3.62	3.73	3.83	4.27	3.17	3.62	3.62	3.72	4.16	2.65	3.00	3.11	3.21	3.55