



Challenges and Opportunities of Utilizing SLGS Securities & Introduction to Cash Optimization

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Overview of State and Local Government Series (SLGS) Securities

- The SLGS program was established in 1972 as a result of federal legislation that restricted state and local governments from earning arbitrage profits by investing tax-exempt bond proceeds in higher yielding investments¹
- Key features of SLGS include:
 - A form of U.S. Treasury security **backed by the federal government**
 - Available for investment of proceeds of tax-exempt bond issues
- Types of offerings:
 - **Time Deposit SLGS** – fixed rate of interest based on maturities ranging from 30 days to 40 years (0% SLGS permitted for 15 days or more)
 - **Demand Deposit SLGS** – tax-exempt, one-day certificates of indebtedness that pay interest based on a floating rate that is reset weekly

¹Source: [Electronic Code of Federal Regulations](#), Title 31, Vol. 2, Part 344.



SLGS Summary

Type of SLGS	Size	Settlement Timing	Redemption Notice
Time Deposit	Less than \$10m	5 – 60 calendar days	14 – 60 calendar days
Time Deposit	Greater than \$10m	7 – 60 calendar days	14 – 60 calendar days
Demand Deposit	Less than \$10m	5 – 60 calendar days	1 business day – 60 calendar days
Demand Deposit	\$10m-\$500m	7 – 60 calendar days	3 business days – 60 calendar days
Demand Deposit	Greater than \$500m	7 – 60 calendar days	5 business days – 60 calendar days

Source: [Electronic Code of Federal Regulations](#), Title 31, Vol. 2, Part 344.



Overview of Time Deposit SLGS

- Time Deposit SLGS pay a fixed rate of interest based on maturities ranging from 30 days to 40 years and **are taxable securities (subject to arbitrage and yield restriction rules)**
- Yields are set daily by 10:00 a.m. Eastern and are designed to be one basis point below Treasuries
 - Can vary somewhat considerably based upon a variety of technical factors
- Commonly used in refunding or defeasance escrows
 - Easy to administer, lower transaction costs, and no concerns about fair market value
- Maturity length:
 - Certificates of Indebtedness: 15 days to 1 year
 - Notes: more than 1 year to 10 years
 - Bonds: more than 10 years to 40 years
- Time Deposit SLGS are relatively illiquid - may be redeemed at a market value upon 14 days (max of 60) of advance notice
 - The proceeds of an early redemption may not be subsequently invested in marketable securities at a higher yield

Source: [Electronic Code of Federal Regulations](#), Title 31, Vol. 2, Part 344.



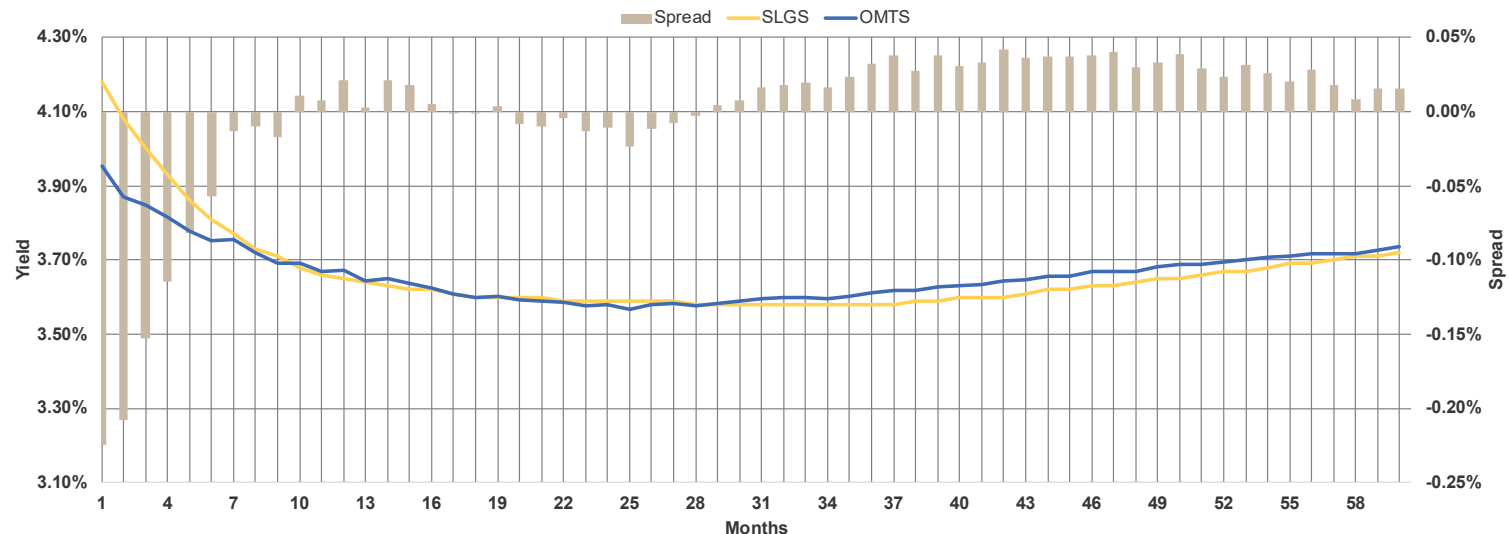
Overview of Demand Deposit SLGS

- ◆ Demand Deposit SLGS are one-day certificates of indebtedness that pay interest based on a floating rate and **are tax-exempt securities that are therefore exempt from arbitrage rebate and yield restriction**
 - **This makes them an attractive investment option for issuers earning positive arbitrage that they otherwise cannot keep**
- ◆ Yields are based on 13-week Treasury bill auctions and adjusted down to reflect tax-exempt status
- ◆ **Arbitrage rebate and yield restriction are two different calculations**
 - You could have negative arbitrage AND positive yield restriction liability
 - Example: Temporary period of project fund expires in a rising interest rate environment



Relationship Between Open-market Treasuries and SLGS

- SLGS rates are set daily by 10:00 a.m. Eastern and are fixed for the day regardless of market conditions
- **SLGS Rate Interpolation**
 - The SLGS Regulations state that SLGS yields are set one basis point below open-market Treasuries, but the spread varies considerably due to a number of technical factors
 - Interpolation of the SLGS curve is imperfect and should be carefully monitored
- Open-market securities trade throughout the day and vary in yield – sometimes considerably
- The relationship between SLGS and open-market securities can dictate the optimal investment strategy for issuers





2024 Change to SLGS Regulations

- The Treasury Department's Bureau of the Fiscal Service ("Treasury") released a final rule that amended the regulations governing SLGS securities¹
 - Rule went into effect **August 26, 2024**
 - Prevents prohibited uses of the SLGS program, which generally relate to investing in SLGS to create impermissible cost-free options
- "No Maturity Longer than Necessary"
 - As a result of the misuse of the SLGS program, the Treasury is requiring that the term of any SLGS security be no longer than reasonably necessary for the issuer's governmental purpose
 - Defined as "the issuer's expected use of invested funds"
- Maturity date restrictions:

New Rule	Old Rule
Early redemption requests cannot be entered until 14 days after the issue date	Early redemption requests could be made the day after issuance

New Rule	Old Rule
Issuers must provide maturity dates when the subscription is submitted	Issuers must provide maturity dates prior to settlement

¹ Source: [Final Rule](#). Effective August 26, 2024 by the Department of the Treasury Bureau of Fiscal Service.



Poll Question #1

- ◆ Which of the following is not true about Time Deposit and Demand Deposit SLGS?
 - A. Time Deposit SLGS are fixed rate and Demand Deposit SLGS are variable rate
 - B. Subscriptions of \$10 million or less must be submitted with 5 days notice whereas subscriptions of greater than \$10 million must be submitted with 7 days notice
 - C. They are available for investment of tax-exempt bond issues
 - D. They are not a U.S. Treasury security backed by the federal government



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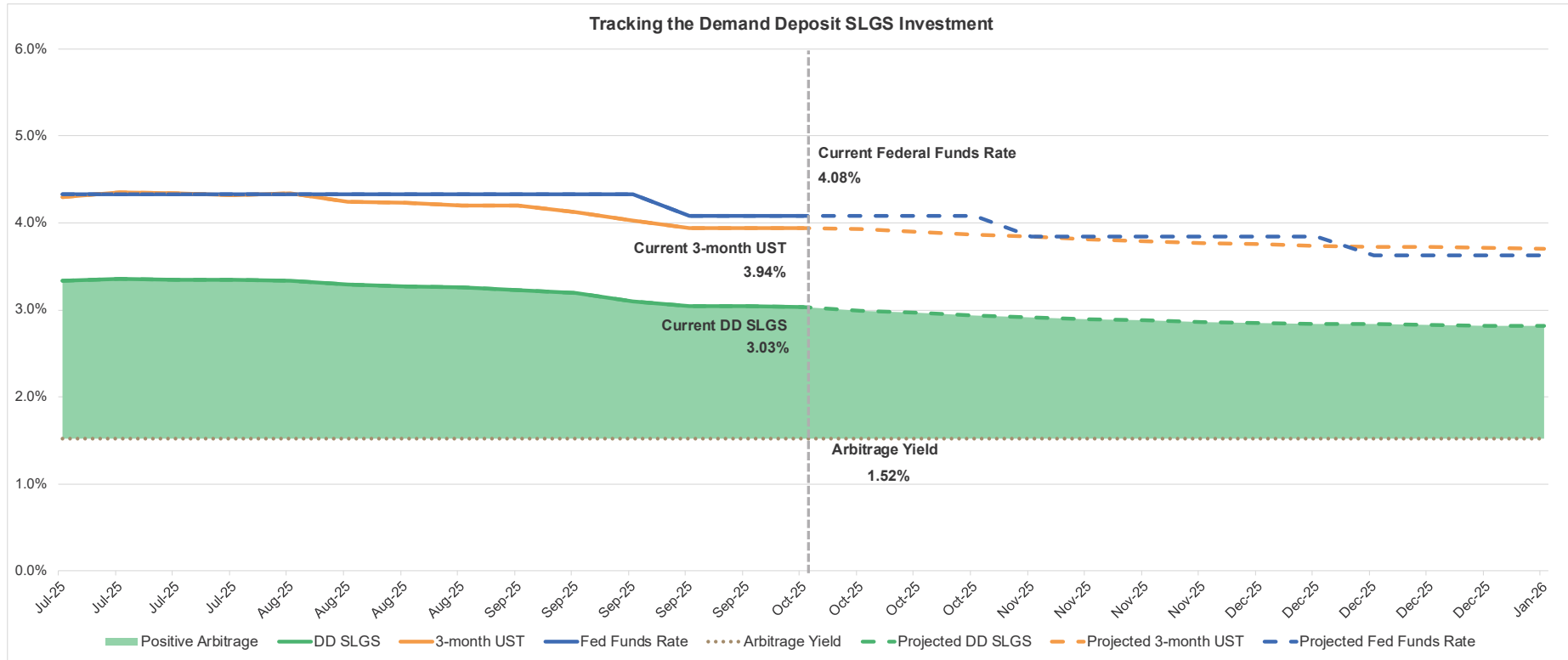
Why Demand Deposit SLGS?

- Demand Deposit SLGS may offer a unique investment opportunity due to the current high interest yield environment
 - The yield of Demand Deposit SLGS was over 3.30% this past summer – well above historical averages
 - The yield has begun to drop and is now at 3.03% as a result of Fed interest rate cuts¹
 - The yield is higher than many tax-exempt bond arbitrage yields related to issuances from the past several years
 - As a result, an opportunity may exist for issuers to earn and retain positive arbitrage by utilizing these securities
- **Immediate attention is warranted**; the Federal Reserve has started cutting rates and may continue to do so
- Always consult with your advisors and bond/tax counsel

¹ Source: [Electronic Code of Federal Regulations](#), Title 31, Vol. 2, Part 344. Yields as of October 9, 2025.



Hypothetical Demand Deposit SLGS Investment





Where are the Potential Opportunities for Demand Deposit SLGS?

Account	Fund Maturity	Typical Duration	Arbitrage Condition
Bona Fide Debt Service Fund	0 to 40 Years	0 to 1 Year	No Rebate Restrictions
Current Refunding Escrow	90 Days or less	Less than .25	No Rebate Restrictions
Construction / Project Fund	1 to 3 Years	1 to 3 Years	Potentially No Rebate Restrictions
Debt Service Reserve Fund	0 to 40 Years	1 to 2 Years	Subject to Arbitrage Rebate
Cash Defeasance Escrow	0 to 10 Years	0 to 10 Years	Subject to Arbitrage Rebate & Yield Restriction
Long-Term Sinking Fund	0 to 40 Years	0 to 40 Years	Subject to Arbitrage Rebate & Yield Restriction

 Opportunities for Demand Deposit SLGS investment strategy may exist



Liquidity and Other Considerations For SLGS

- Redemption notice required to liquidate SLGS
 - **Time Deposit** – early redemption at market value requires at least 14 days notice (no more than 60 days)
 - **Demand Deposit** – redemptions can be made at any time after settlement and require anywhere from 1 to 5 business days notice based on size
- Prudent to evaluate other alternatives such as open-market Treasuries
 - Better liquidity
 - May be higher yielding
 - No restrictions on restructuring the portfolio if liquidity needs change

Source: [Electronic Code of Federal Regulations](#), Title 31, Vol. 2, Part 344.



Cash Defeasance Escrows

- Many issuers who are doing cash defeasances are investing in Time Deposit SLGS that are actively yield restricted
- **Opportunities:**
 - **Blending of Yield Restriction Liability**
 - Leveraging existing negative yield restriction liability may allow the issuer to invest in time deposit SLGS at a yield in excess of the arbitrage yield
 - **Demand Deposit SLGS**
 - Investing in this type of tax-exempt security allows the issuer to retain all earnings including those above the arbitrage yield of the bonds being defeased
 - Most appropriate for short-duration defeasances
 - Could underperform if interest rates drop quickly
 - Must be gross funded because variable rate earnings are uncertain



Project Funds Not Meeting a Spending Exception¹

- A project fund is exempt from rebate if it meets a spending exception
 - Consider Demand Deposit SLGS if a spending exception is not met and they offer a yield in excess of the arbitrage yield
- **Other Considerations:** Small Issuer Exception
 - \$5 million of tax-exempt bonds in a calendar year (increased to \$15 million if at least \$10 million is used to finance public schools)
 - Exempt from rebate and therefore should not consider Demand Deposit SLGS
 - *Small Issuer Exception does not apply to private activity bonds*

Spending Exception	Expenditure of Proceeds Timeframe
Six-Month Spending Exception (All Gross Proceeds)	6 months – 100% ²
Eighteen-Month Spending Exception (All New Money)	6 months – at least 15% 12 months – at least 60% 18 months – 100% ³
Two-Year Spending Exception (Construction Issues)	6 months – at least 10% 12 months – at least 45% 18 months – at least 75% 24 months – 100% ³

¹ Source: [Treasury Regulations Section 1.148-7](#).

² Exceptions for 5% of the proceeds of the issue if spend within one year.

³ De minimis (lesser of 3% of issue price or \$250k) and reasonable retainage (5% spent in 12 months) exceptions may apply for last benchmark.



Project Funds – Temporary Period Expiring

- The temporary period is a timeframe during which available construction proceeds can be invested without being subject to yield restriction
 - Applies only if the issuer “reasonably expects” to satisfy the expenditure test, time test, and due diligence test at the time of issuance
 - Reminder, the time test says an issuer must “reasonably expect” to expend at least 5% of the net sale proceeds on capital projects within 6 months after issuance
 - Typically 3 years
 - Other temporary periods can apply depending on nature of proceeds
 - 5 years possible with certification from an engineer or architect
- **Potential Opportunity:**
 - Invest in Demand Deposit SLGS as soon as the temporary period has expired as long as Demand Deposit SLGS have a yield higher than the arbitrage yield
 - Make sure temporary period was not waived in tax certificate
- **Consideration:**
 - Best opportunity for bonds issued to fund large and complex projects in 2020 and 2021

Source: [Treasury Regulations Section 1.148-2](#)



Debt Service Reserve Funds

- Debt Service Reserve Funds can be invested without yield restriction if the fund is “reasonably required”, however they are still subject to rebate
 - The small-issuer exception (less than \$5 million) applies for reserve and replacements funds
- “Reasonably required” means the fund cannot exceed:
 1. 10% of the principal amount of the issue
 2. Maximum annual debt service on the issue
 3. 125% of the average annual debt service on the issue
- **Opportunity:** If the corresponding bond issue has a positive overall arbitrage position, consider moving to Demand Deposit SLGS if the yield is higher than the arbitrage yield

Source: [Treasury Regulations Section 1.148-2](#)



Poll Question #2

◆ Arbitrage rebate and yield restriction are the same thing.

A. True

B. False



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A. True

B. False



Cash Optimization Strategy



Cash Optimization – Description of Strategy

- Re-allocation of capital to attempt to take advantage of tax-exempt borrowing rates and taxable investments
- Issuer uses pay-as-you-go capital to defease outstanding debt instead of issuing refunding bonds
- New money capital projects are funded with tax-exempt debt instead of pay-as-you-go capital





Cash Optimization – Description of Economics

- Economics can mimic or even exceed benefits of an advance refunding (not permitted on a tax-exempt basis)
- New money debt service should be less than the defeased debt service, thereby generating savings
- Issuers may take advantage of relationship between tax-exempt new money borrowing costs and taxable investment rates in the defeasance escrow (generally limited to the arbitrage yield of the defeased bonds)
 - Yield blending may be permitted if there is negative yield restriction liability associated with the defeased tax-exempt bonds
 - If defeasing taxable debt, the defeasance escrow can be unrestricted



Cash Optimization – Description of Benefits

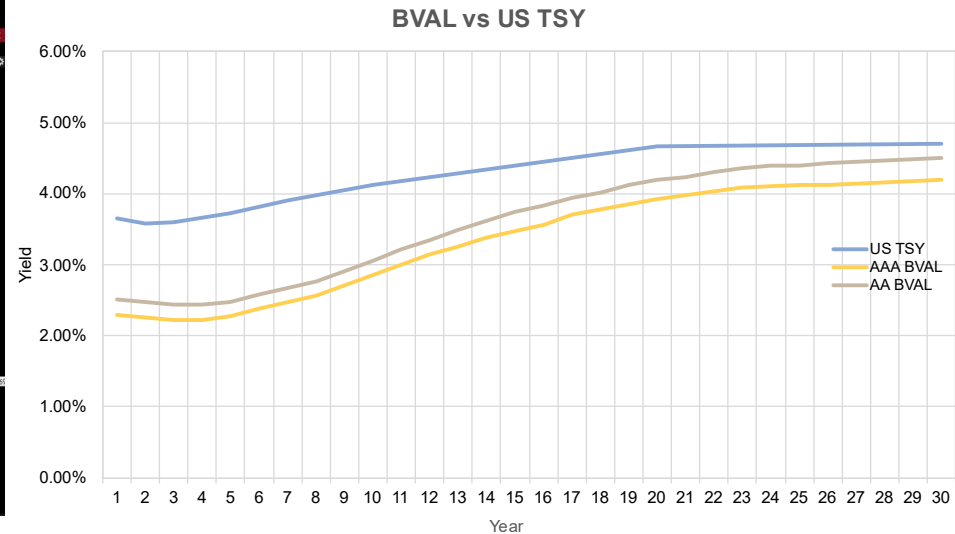
- ◆ Savings increase when:
 - Spread between defeasance escrow yield and new money borrowing rate increases
 - Length of investment horizon increases
 - Call option on new money bonds is exercised in the future
 - Arbitrage is earned and kept on invested new money bond proceeds
 - Escrow restructuring is completed in the future if an escrow to maturity was originally built
 - Call option on bonds must be preserved
- ◆ Issuer's equity position and other financials may be essentially neutral



Impact of Market Conditions

◆ Economics of cash optimization impacted by:

- Ratios between taxable investment rates and tax-exempt (new-money) borrowing rates
- Tight muni ratios can provide compelling economics, especially on the short end of the curve
- Relatively tight spread between AAA and AA issuers dampens the effect of lower ratings on potential savings



Source: Bloomberg, as of October 9, 2025.



Legal Considerations, Timing, and Risks

- Cash defeasance creates replacement proceeds
 - Pay-go funds used to buy defeasance escrow are likely an *Invested Sinking Fund* and restricted to the arbitrage yield of the defeased bonds (assuming they are tax-exempt)
- Pay-go funds that have already been appropriated/earmarked for capital projects likely become replacement proceeds of new money issue
 - Creates a nexus between the new money issuance and the pay-go funds – probably cannot “un-appropriate” or “un-earmark” subject to review with bond/tax counsel
- Reimbursement of prior expenditures may be problematic
 - Escrowed funds could therefore be restricted to arbitrage yield of new money reimbursement bonds
- Consult with bond and tax counsel regarding timing
 - Likely need to separate defeasance and new money bonds by at least 15 days
 - Separation creates interest rate risk and ratio risk that should be carefully evaluated with advisors

Replacement Proceeds

Relationship or “nexus” to a bond issue causes moneys to be subject to arbitrage restrictions (e.g., deposits to a debt service fund or cash-funded reserve fund)

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Poll Question #3

- ◆ Which of the following has an effect on the economics of cash optimization?
 - A. Ratios between taxable investment rates and tax-exempt (new-money) borrowing rates
 - B. Arbitrage yield of the refunded bonds
 - C. Interest rate volatility
 - D. All of the above



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Questions/Discussion



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