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MEMORANDUM

TO: Lars Erdahl, District Administrator
David Mandt, Operations and Support Services Director
Minnehaha Creek Watershed District

FROM: Barry W. Fick, Senior Vice President
Mark E. LeMay, Vice President

DATE: August 1, 2016

SUBJECT: Banking Services Review

At the request of the Minnehaha Creek Watershed District ("MCWD" or "District") Springsted has reviewed the existing banking services provided to the District by Alerus Financial ("Alerus"). Alerus Financial recently acquired Beacon Bank, which previously provided banking and savings services for the District. With the change in ownership, it was anticipated that the new firm would wish to review and possibly propose new banking options for the District. We have remained in contact with Alerus representatives, who are the same people who worked with the District when Beacon Bank was the financial services provider for the District.

Recently Alerus has proposed adjustments to the banking service package for the District. We have received a written proposal from Alerus that outlines their proposed service and fees package for providing banking and investing services for the District. In addition to the written materials, we met with Dean Friesen, Team Lead and Relationship Manager for Alerus. Dean is very familiar with District banking service requirements and was previously the Chief Operating Officer at Beacon Bank.

In addition to the services package that Alerus is suggesting the District consider, Alerus has provided additional options for handling funds that are designed to make financial transactions more efficient and cost effective for the District, while also providing a strong "audit trail" to enhance security and operations transparency.

As part of the discussion regarding the new proposed banking relationship, Alerus proposed that the District's periodic debt service payments be made through ACH transfers rather than wire transfers. This requires the recipients of those payments to be willing and able to receive these payments in this manner. We have been in touch with the District's debt service payees and have confirmed that they are amenable to being paid through ACH transfers. Details of those conversations immediately follow our review of the Alerus proposal.

This summary memorandum outlines the specifics of the Alerus proposed account structure and includes our observations, clarifications from conversations with Alerus personnel. Alerus proposes to establish the following five general accounts for MCWD:

- MCWD Operating Account
- Repo (Insured Cash Sweep (ICS) Account
- Surety Account
- Capital Account (Cold Storage Facility)
- CBRE/LaSalle Account (Cold Storage Operating)

There are a number of common features for all of the above accounts. For the Operating Account, Surety Account and Capital Account, Alerus offers "Positive Pay" and online banking services. Positive Pay is a program which improves internal control and accountability and minimizes losses from fraud. It works on both paper checks and ACH (electronic) payments.

Positive Pay essentially works by having the Authority establish the terms that must be met for check or ACH draw to be paid or honored. If the check or ACH draw falls within the preset terms (e.g. approved vendor, approved account, less than specific dollar amount, etc.), the invoice is paid or the ACH transfer approved. If the check or ACH draw request falls outside the boundaries of the terms, the item is not paid and instead is routed to a designated person or persons at the District to review.

The Positive Pay program will reduce the time that MCWD staff would otherwise spend reviewing checks or ACH authorizations to ensure they are correct. The payments made would be authorized automatically provided they are made to vendors or payees that are already approved and set up in the Positive Pay system. In addition, so long as payment amounts do not exceed a pre-set limit, the payment would be made.

If any check or ACH payment is requested for a vendor or payee that isn't in the Positive Pay system, or if the amount requested is outside the established limits, that payment would NOT be authorized or made, but would be flagged for review by a staff person at MCWD.

The system is flexible and allows MCWD full control over who is authorized to "override" the system or approve payments outside the pre-established parameters. It can provide for multiple person review and Alerus provides personalized training, setup and support for the system.

These accounts are described in more detail as they specifically relate to MCWD in the following sections.

MCWD Operating Account

Alerus will waive their monthly service fees for the Operating Account. In return, MCWD would be required to maintain a minimum balance in the account of \$20,000.

MCWD can use online banking for many basic transactions and activities (transfer of funds, review of payments, account reconciliation, etc.) and Alerus proposes to use the Positive Pay verification process (outlined above) to reduce incorrect payments. The same review process would be available for ACH transactions, where there is a pre-established set of criteria to reduce the possibility of unauthorized draws on the account. Similar to the Positive Pay program, the ACH review process allows the District to limit ACH transactions to pre-authorized originators or to transactions that have specified dollar amounts or ranges. It is designed to reduce fraud and lower administrative oversight while maintaining orderly payment of transactions.

Repo / Insured Cash Sweep (ICS) account

This is the new version of the savings account, which pays 50 basis points (0.50%) interest to MCWD. The account with this interest rate will be replaced by the new Repo / ICS account. It is fully liquid and collateralized by securities. It is tied to MCWD's operating checking account so that amounts in the operating account in excess of the minimum balance are swept to the ICS account where they earn a higher interest rate. Alerus proposes an earnings rate of 38 basis points (0.38%). While this is lower than the 0.50% rate currently in place, Alerus estimates that the new rate would be applicable to a larger portion of MCWD funds, reducing the difference between the prior rate and the new rate.

Even with the automatic transfer of funds exceeding the minimum balance in the operating account to the ICS account, all of the funds in the ICS account are available for daily use by MCWD. It is possible to transfer funds from ICS back to the operating account as needed and continue to receive the higher ICS account earnings rate. This is quite positive for MCWD.

The ICS account is integrated with the CDARS program, allowing MCWD to earn even higher interest rates. The CDARS program offers Certificates of Deposit with maturities of 4 weeks to 5 years, at the option of the investor.

For both the ICS and CDARS program, the funds invested are deposited in a network of banks, so each portion invested with a particular bank is below the FDIC insurance amount of \$250,000. This allows 100% of the funds that MCWD places in the ICS and CDARS program to be covered by FDIC insurance. This would not be the situation in place if MCWD invested the funds in specific CDs or money market accounts.

Currently, MCWD investments in excess of \$250,000 are secured by US Government securities. This security or collateral is intended essentially to make MCWD whole if the bank would default on payment. If the bank defaulted, however, the securities held as collateral would have to be liquidated for MCWD to receive their funds. Under

changing market conditions, there is a risk that the value of the collateral may not be 100% of the funds invested. This is minimized by having collateral that has a face value of 102% or more of the value of the funds on deposit. This does not fully eliminate the risk to MCWD of a default, as interest rates might rise and the value of the collateral may be less than face value and less than the amount invested with the bank.

The use of FDIC insurance (made possible by distributing the funds to a number of banks with each account having a value of \$250,000 or less) eliminates the risk of loss of principal to MCWD. The ability to offer the FDIC insurance is available by Alerus' participation in a multi-bank program which reduces overall risk to MCWD since it spreads the risk among many banks, but allows MCWD to work only with a single bank, Alerus, to manage the accounts.

The new rate of 0.38% is higher than the rate paid by most commercial banks on similar accounts. Springsted is aware of other local or regional banks that pay a similar or slightly higher rate, but to receive that rate, the bank requires that the primary banking relationship be established with that bank. The cost and disruption that can result from a change in banks can be substantial and is not likely to offset the same or only slightly higher rate that might be realized at a different bank.

Surety Account

Capital Account (Cold Storage Facility)

CBRE Account (Cold Storage Operating Account)

These three accounts have the same features proposed by Alerus, so they will be discussed together. Common features for *each individual account* include the following:

- 250 paper items per month per account at no charge
- No charge for any number of electronic items per month per account
- Excess over 250 items per account per month @ \$0.40 each
- Online banking services fully available for each account separately
- Positive Pay process available (fraud minimization/detection)
- ACH – positive pay process available (fraud minimization/detection)

The number of paper items permitted monthly with no charge is determined by account. At Springsted's request, Alerus reviewed the use of each of these accounts for the number of monthly transactions processed through them. The result of the analysis showed that there have been no instances where more than 10-50 monthly paper item transactions have been used in any of the accounts. This is substantially below the 250 maximum and in discussions with MCWD staff it is very unlikely that there would be any time where there would be more than 250 paper transactions in any account in any month. It is our expectation that this proposed limitation would have no effect on the ability of MCWD to modify its operating procedures or otherwise change their payment methods.

The unlimited use of electronic items and full use of online banking has the capability to offer as many transactions as needed by MCWD at no cost to the District. This, combined with the Positive Pay program for checks and ACH, offers the ability to reduce staff time related to bank transaction review, enhance reconciliation efficiency and provide a strong audit trail for financial statement preparation.

The level of transactions available without cost has the possibility of allowing MCWD to have no cost for transactions in its bank accounts and should enable MCWD to operate efficiently and with adequate control over banking transactions to minimize any possibility of fraud or mistaken payments or transfers.

Single "Account Executive"

Not part of the Alerus written proposal, but discussed with the District, is the Alerus request to work with a single person at the District who would be designated an "Account Executive" for banking purposes. With regard to District authorization for monetary transactions, District policy imposes tight restrictions on any individual's ability to authorize monetary transactions. Lars Erdahl, for example, has authority to commit no more than \$5,000. The District understands that Alerus has a preference to work with a single person who could authorize and direct transactions for District funds.

The District has delegated such authority not with staff, but with two members of the District's Board of Managers: Sherry White and Dick Miller. The District intends to maintain this conservative, dual control approach. In order to achieve some of what Alerus seeks, the District could appoint a specific staff person in the District's Offices to be the recipient of any questions from Alerus, which will provide the singular point of contact. The District contact does not need to be given transaction approval authority, but would act as a contact person. The internal District contact would in turn coordinate with the appropriate Managers to resolve any issues and obtain final approval, modification or denial for transactions.

ACH Transfers to MCWD'S Debt Service Payees

The District makes periodic debt service payments to three payees on its outstanding long term debt, specifically:

1. Wells Fargo Bank as payee on the District's \$15,000,000 Note from 2011, revised in 2013, and the \$2,000,000 Variable Rate Note from 2012.
2. Hennepin County as payee on the District's portion of three series of Hennepin County's bonds: \$3,190,000 portion of Series 2010B, \$4,715,000 portion of Series 2012A, and \$7,075,000 portion of Series 2013B.
3. The City of Richfield as payee on the District's portion (\$2,770,000) of Richfield's Series 2013B Bonds.

Margaret (Maggie) Rydel is the contact person at Wells Fargo who confirmed that the Bank would be willing to accept ACH payments. She indicated that there are forms that need to be filled out, and that Wells would initiate the ACH transactions. Maggie's contact information: 612-316-3193, margaret.e.rydel@wellsfargo.com.

John Villerius at Hennepin County was quite receptive to ACH transfers. He indicated that the County would prefer that the transfer be a "push" rather than a "pull," meaning that he preferred MCWD to initiate the ACH rather than the County. John's phone: 612-543-0448.

(Mr.) Chris Regis at the City indicated that accounts are at Wells Fargo, and the City can accept ACH transfers. Chris' phone: 612-861-9723.

The efficiency of ACH payments, especially if set up as "pull" payments, is that the payee initiates the payment pursuant to a payment schedule. All of the District's long term debt is fixed rate debt with schedules fixed through maturity, except for the single variable rate Note with Wells Fargo from 2012. The District can easily monitor ACH transfers to confirm that they are made in the proper amounts as they must match the predetermined payments schedules for the fixed rate debt. With regard to the variable rate note, Wells Fargo calculates the rate monthly based on LIBOR resets and will have calculated each semiannual interest payment at the beginning of the month prior to the payment due date. MCWD can independently confirm this number and then allow Wells Fargo to initiate and complete the ACH transfer.