Time to Pay the Piper
How a Hometown Investment Bank is Draining Millions from Minnesota Cities, Hospitals, State Agencies, and Non-Profit Organizations

REFUND AMERICA PROJECT

September 2016
About Us

The ReFund America Project tackles the structural problems in the municipal finance system that cost state and local governments across the United States billions of dollars each year at the expense of public services. We research the role of financial deals in contributing to public budget distress and work with policy experts, community leaders, and public officials to develop, advocate for, and implement solutions to save taxpayer dollars.

Correction: An earlier version of this report improperly conflated Piper Jaffray's role as bond underwriter and interest rate swap counterparty in connection with certain debt transactions. This version corrects those errors.
EXECUTIVE SUMMARY

The City of Saint Paul faces a budget deficit almost every year and must endure annual spending cuts. The Minnesota Housing Finance Agency (MHFA) states that there is a chronic and severe lack of affordable rental housing in the state, and that the production of new affordable housing is critically important. Allina Health closed a floor at United Hospital that was used for the treatment of epilepsy patients and now is trying to force the nurses at its five Twin Cities hospitals to accept changes in their health insurance to save Allina money. Last year, Minnesota Public Radio (MPR) laid off a number of staff in order to trim its budget.

What do all of these have in common? These are all entities that are working for the common good, but are limited financially as to what they can accomplish. Each entity has also been trapped in a predatory financial deal that has been bleeding them of millions of dollars and that would require them to pay millions more in fees if they want to refinance to a more affordable loan. In each of these cases, Minneapolis-based investment bank Piper Jaffray was involved with the broader debt transaction.

There are other non-profit entities in Minnesota that have also been impacted by interest rate swap deals that were either with Piper Jaffray or connected to bonds that the bank underwrote -- Children’s Hospitals and Clinics, St. Olaf College, Amherst Wilder Foundation, and the Hazelden Foundation.

Then-Chairman and CEO of Piper Jaffray, Addison "Tad" Piper, was even on the boards of directors of several of these organizations -- Allina, MPR, and St. Olaf -- when they took out interest rate swaps either with Piper Jaffray or in connection with bonds underwritten by the bank.

Interest Rate Swaps Could Cost These Entities over $600 Million. The interest rate swap deals held by these entities backfired in light of the 2008 financial crash. This was a result of the emergency action taken by the Federal Reserve to slash interest rates to near zero to get the economy back on track. Even though interest rate swaps were marketed and sold as instruments that would save these entities money by protecting them from rising interest rates on their variable-rate bonds, these deals instead became toxic drains.

- Through the end of 2015, the above entities had paid banks such as US Bank, Piper Jaffray, and Wells Fargo a total of $217 million in net swap payments on deals in which Piper Jaffray was involved.

- These entities continue to pay the banks another $25 million a year on these deals and are expected to pay $388 million over the remaining life of these deals, from 2016 through 2048.

- To get out of these deals early, these entities would have to immediately pay the banks $136 million in early termination penalties.
FIGURE 1: Interest Rate Swap Payments to Banks on Bond Transactions Connected to Piper Jaffray

<table>
<thead>
<tr>
<th>Entity/ Agency with Swaps</th>
<th>Estimated Net Swap Payments through 2015(^1)</th>
<th>Potential Termination Penalties(^2)</th>
<th>Total Net Payments &amp; Potential Penalties</th>
<th>Annual Net Payments(^3)</th>
<th>Projected Future Payments after 2015(^4)</th>
<th>Total Est. Payments over Life of Deals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allina Health</td>
<td>$80.1 M</td>
<td>$90.0 M</td>
<td>$170.1 M</td>
<td>$12.5 M</td>
<td>$175.7 M</td>
<td>$255.8 M</td>
</tr>
<tr>
<td>MN Housing Finance Agency</td>
<td>$57.4 M</td>
<td>$9.0 M</td>
<td>$66.4 M</td>
<td>$4.9 M</td>
<td>$104.0 M</td>
<td>$161.4 M</td>
</tr>
<tr>
<td>Children's Hospitals and Clinics</td>
<td>$48.5 M</td>
<td>$33.0 M</td>
<td>$81.5 M</td>
<td>$5.2 M</td>
<td>$85.2 M</td>
<td>$133.7 M</td>
</tr>
<tr>
<td>City of Saint Paul</td>
<td>$16.0 M</td>
<td>$10.0 M</td>
<td>$26.0 M</td>
<td>$2.4 M</td>
<td>$21.6 M</td>
<td>$37.6 M</td>
</tr>
<tr>
<td>MPR/ American Public Media Group</td>
<td>$4.5 M</td>
<td>$1.2 M</td>
<td>$5.7 M</td>
<td>$525,000</td>
<td>$1.5 M</td>
<td>$6.0 M</td>
</tr>
<tr>
<td>St. Olaf College</td>
<td>$4.1 M</td>
<td>N/A</td>
<td>$4.1 M</td>
<td>N/A</td>
<td>N/A</td>
<td>$4.1 M</td>
</tr>
<tr>
<td>Hazelden Foundation</td>
<td>$3.6 M</td>
<td>N/A</td>
<td>$3.6 M</td>
<td>N/A</td>
<td>N/A</td>
<td>$3.6 M</td>
</tr>
<tr>
<td>Amherst Wilder Foundation</td>
<td>$3.2 M</td>
<td>N/A</td>
<td>$3.2 M</td>
<td>N/A</td>
<td>N/A</td>
<td>$3.2 M</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$217 M</td>
<td>$143 M</td>
<td>$364 M</td>
<td>$25 M</td>
<td>$388 M</td>
<td>$605 M</td>
</tr>
</tbody>
</table>
Time to Pay the Piper

How a Hometown Investment Bank is Draining Millions from Minnesota Cities, Hospitals, State Agencies, and Non-Profit Organizations

Times are tough.

The City of Saint Paul is facing an $11 million budget shortfall for 2017 and is considering a range of actions -- none of them desirable. Options include further increases to the property tax levy and further decreases in public services, such as reductions in the number of police officers and firefighters, closing a recreation center, cutting library branch hours, and eliminating new racial equity efforts aimed at closing the city’s economic disparities. The city faced a $10 million deficit in 2015. Trimming department budgets has become an annual Saint Paul rite of summer.

The Minnesota Housing Finance Agency declared that there is a chronic shortage of affordable housing in Minnesota. Low vacancy rates and rising rents have put the squeeze on many families. Housing is considered affordable if it costs a household 30 percent or less of its monthly income. When housing costs are above that threshold, there is too little money left for other necessities such as food, medicine, and child care. There are over 200,000 low-income Minnesota households who are paying more than 30 percent of their income on housing. The Minneapolis Public Housing Authority has about 10,000 people on its waiting list; the Section 8 voucher program has more than 9,000 on its waiting list. The average wait time is five to ten years for Section 8 and up to seven years for public housing.
Allina Health announced in 2014 that it needed to cut $100 million from its budget. One of the first steps it took was to close the seventh floor of United Hospital, which had been used to treat epilepsy patients. This year, Allina wants to save $10 million a year by forcing the nurses at its five Twin Cities hospitals to accept an inferior health care plan, despite the adamant opposition of the nurses. Allina is so intent on changing the nurses’ health care plans that it endured a one-week strike in June of this year and is now experiencing an open-ended strike that began on Labor Day 2016.

In July 2015, Minnesota Public Radio (MPR) eliminated 11 positions in its newsroom -- a 13 percent cut in the news organization's workforce. An additional seven positions were eliminated at MPR's parent company American Public Media Group.

The above entities have been paying millions of dollars a year to big banks and Wall Street investment firms under a type of derivative known as an "interest rate swap." Millions of dollars that could be otherwise spent on serving the people of Minnesota.

This report focuses on swaps because there is abundant evidence that many banks did not adequately disclose the risks of these deals when selling them to state and local governments. For example, banks typically did not disclose that the swaps that they were selling to public entities, with 30- or 40-year terms, were unheard of in the corporate world, where interest rate swaps typically last no longer than five to seven years because anything longer is considered too risky.

What Is an Interest Rate Swap?

Interest rate swaps are a type of derivative instrument that investment banks pitched to public and non-profit entities as a way to save money on borrowing costs. When government and other public entities issued variable-rate bonds to borrow large sums of money, banks offered them a deal. The banks said that if the agencies would pay them a steady, fixed interest rate, then the banks would pay back a variable rate that could be used to pay the bondholders.

How Interest Rate Swaps Work

Although interest rate swaps can serve many functions, this report focuses on hedging interest rate swaps, which are meant to protect against spikes in interest on variable-rate debt. Although interest rate swaps have existed since the 1980s, these deals became especially popular with municipalities in the late 1990s and early 2000s.

Figure 2 shows the structure of a synthetic fixed-rate deal, which includes a hedging interest rate swap. The agencies’ payments on the variable-rate bond are on the right side, and the interest rate swap is on the left side.
Banks sold these deals, called interest rate swaps, as insurance policies, giving agencies a "synthetic" fixed rate that would let them lock in lower interest rates without having to worry about those rates shooting up in the future. However, for the public and non-profit entities, these deals actually turned out to be more of a gamble than an insurance policy.

If variable rates fell really low, then the banks could make millions of dollars from the agencies. That is exactly what happened when, as part of the banking industry bailout in the fall of 2008, the Federal Reserve slashed interest rates to near zero. This let banks borrow money from the federal government practically for free.14

These record low interest rates have had an unintended consequence that has proven very costly for many public and non-profit agencies. Because the banks' variable-rate payments on swap deals are linked to prevailing interest rates in the market, their swap payments have also plummeted. However, governments and non-profit agencies are still locked into substantially higher fixed rates and cannot refinance into lower rates unless they pay the banks hefty termination penalties. As a result, these agencies are typically stuck paying 3% to 6% interest rates on these deals, but they get back less than 0.5% from the banks. The banks get to pocket the difference as profit, which adds up to millions of dollars each year.

Furthermore, the sharp decline in variable interest rates actually caused the termination penalties on these deals to balloon, since the penalties are based on the net present value of future payments on the deals. Because the low variable rates caused government entities' net swap payments to go up, as interest rates dropped, the net present value of the future payments that the cities and states had to make banks rose in tandem.

So at precisely the time that it would have been most advantageous for public and non-profit agencies to refinance their bonds, the penalties to get out of the corresponding swap deals were higher than ever before. In essence, the swaps trapped public entities into deals that became immensely profitable for the banks at the expense of those public entities.

These entities have paid banks $221 million in net payments on these swaps through 2015; continue to pay $25 million a year; and are expected to pay $540 million over the remaining life of the deals, through 2048. If the entities want to end these deals early, they would have to pay $136 million in termination penalties.
Governments and public agencies entered into interest rate swaps because at the time they issued the related variable-rate debt, the cost of a conventional fixed-rate bond would have been even higher. Many of these deals seemed to make sense at the time they were initiated because interest rates were never expected to fall as low as they have. However, these deals carried hidden risks.

A key part of the problem was that many of the governments and agencies that entered into these deals did not understand the risks. The banks that sold them these swaps were not legally required to act in their best interest in giving them advice. Moreover, because interest rate swaps are structured as a zero-sum game, where agencies’ losses are the banks’ profit, there is a major conflict of interest for the banks, especially when executives from those banks are on the agencies’ boards of directors, as is the case with Piper Jaffray and several of the agencies discussed in this report.

Piper Jaffray - Hometown Investment Bank

Investment bank Piper Jaffray was founded in Minneapolis in 1895 to provide loans to the Midwest’s expanding grain elevator and milling industries. In the 1920s, Piper Jaffray began underwriting stock and bond offerings for companies such as 3M, Greyhound, and Honeywell. When the government directed substantial funds toward public works projects during the Great Depression in order to boost the economy, Piper Jaffray expanded its line of business into municipal finance, selling bonds for cities and states.

Piper Jaffray was purchased by US Bank in 1998 and then spun off in 2003, although the two companies have continued to have a very close relationship. Piper Jaffray sublet space from US Bank until May 2014 when it entered into a direct lease with the building owner for the same space in the US Bancorp Center.

Piper Jaffray has now grown to have 54 offices in the US, Europe, and Asia. Throughout its history, the firm has been closely linked with the Piper family. Addison "Tad" Piper, who was Chairman and CEO until 2006, still sits on the company’s board of directors.

Several state Attorneys General and federal agencies investigated the municipal securities business and uncovered anticompetitive and fraudulent conduct involving Piper Jaffray and other investment banks.

In addition to Piper Jaffray's board, Addison Piper sits on several other boards, including several of the organizations discussed in this report who had interest rate swap deals that were either with Piper Jaffray or connected to bonds underwritten by the bank.
Addison Piper was:

- On the board of Allina Health from 1993 until at least 1998, during which time Allina issued over $400 million in bonds that were underwritten by Piper Jaffray.

- Named to the board of Minnesota Public Radio (MPR) in 1986 and is now a "life trustee." In 2009, MPR's parent company American Public Media Group entered into a swap agreement with Piper Jaffray for $33 million.

- First elected to the board of St. Olaf College in 1999. He served as Chairman from 2010 to 2013 and is now a "Senior Regent." In 2002, Piper Jaffray was the underwriter for St. Olaf College issuing $13.4 million in bonds. In 2015, Piper Jaffray was the underwriter of a new bond issuance by St. Olaf that paid off the balance of older bonds from 2006 and also paid a $583,000 early termination fee on related swaps.

In its role as underwriter, Piper Jaffray purchases the bonds and resells them to the public, making a profit based on the difference between the purchase price and sale price. This is in addition to the ongoing profits the firm makes from interest rate swaps.

Several state Attorneys General and federal agencies have investigated the municipal derivatives business and uncovered anticompetitive and fraudulent conduct involving Piper Jaffray and other investment banks. The investigations have found that investment banks rigged the bidding process for certain financial products so that issuers did not necessarily get the best prices. In 2016, Piper Jaffray and several other investment banks paid $103 million to settle a lawsuit based on these allegations.
TIME TO PAY THE PIPER

ALLINA HEALTH

Allina Health currently has five interest rate swap agreements linked to bonds with a total outstanding balance of $350 million. Piper Jaffray was one of the underwriters for all of the bond issuances associated with these swaps.

Under the swap agreements, Allina pays the banks an average fixed rate of 4.1% on the debt, and the banks pay Allina a variable rate that has been below 1.0% since 2009. In 2015, the average rate paid by the banks to Allina was 0.28%.

Through 2015, interest rate swap agreements have cost Allina more than $92 million -- more than $80 million in net swap payments and $12.6 million in termination penalties.

The net payments on interest rate swaps are costing Allina $12.5 million a year and are expected to cost Allina another $175 million over the remaining life of these deals, until 2028. If Allina were to refinance the underlying debt, in order to reduce costs, it would have to pay termination fees of over $90 million.

FIGURE 3: The Details of Allina's Swap Deals Linked to Bonds Underwritten by Piper Jaffray

<table>
<thead>
<tr>
<th>Swap</th>
<th>Related Bond Balance</th>
<th>Fixed rate paid</th>
<th>Rate received from banks</th>
<th>Average rate received in 2015</th>
<th>Annual Net Swap Payment</th>
<th>Bank Counterparty</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009B&amp;C</td>
<td>$41.1 M</td>
<td>3.74%</td>
<td>1-Mo. LIBOR</td>
<td>0.48%</td>
<td>$1.3 M</td>
<td>Wells Fargo</td>
</tr>
<tr>
<td>2009B&amp;C</td>
<td>$123.4 M</td>
<td>3.73%</td>
<td>1-Mo. LIBOR</td>
<td>0.47%</td>
<td>$4.0 M</td>
<td>JPMorgan Chase</td>
</tr>
<tr>
<td>2007C</td>
<td>$120.5 M</td>
<td>3.58%</td>
<td>1-Mo. LIBOR</td>
<td>0.36%</td>
<td>$3.9 M</td>
<td>US Bank</td>
</tr>
<tr>
<td>2001</td>
<td>$50.0 M</td>
<td>5.17%</td>
<td>% SIFMA</td>
<td>0.03%</td>
<td>$2.6 M</td>
<td>Goldman Sachs</td>
</tr>
<tr>
<td>1988</td>
<td>$15.1 M</td>
<td>4.44%</td>
<td>% SIFMA</td>
<td>0.03%</td>
<td>$665,000</td>
<td>Goldman Sachs</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$350 M</td>
<td>$12.5 M</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Some of the complicated deals directly involved Piper Jaffray.

- In 1993 when three Piper Jaffray executives were on its board, Allina issued $254 million in bonds, of which more than $14 million went to fees and compensation for the firms involved in issuing the bonds, including Piper Jaffray which was one of the underwriters.23

- In 1998, two of these same Piper Jaffray executives, including CEO Addison "Tad" Piper, were still on the board when Allina issued another $150 million, of which almost $3 million went to the firms involved in issuing the bonds, including Piper Jaffray as one of the underwriters.24
In 2007, there were three investment bankers with close ties to Piper Jaffray on the Allina Health board, when Allina issued $475 million in bonds. Just $122 million of these funds -- 25% of the total -- were designated for a new construction and renovation project. Over $12 million went to fees and compensation to the firms involved in issuing the bonds, including Piper Jaffray as one of the underwriters. The remainder -- over $330 million -- was used to refinance other bonds held by Allina. The Allina board in 2007 included:

- **Edson W. Spencer**, who was the board chair. He was a general partner at Affinity Capital, whose president B. Kristine Johnson joined the Piper board in 2004, the same year Spencer joined the Allina board.

- **Mark Jordahl**, Chief Investment Officer at US Bank Asset Management. Piper Jaffray was a subsidiary of US Bank until it was spun off in 2003. The two companies have continued to work closely together, and one part of the separation agreement between the two firms was that Piper Jaffray would offer its customers various investment fund products managed by Jordahl's group.

- **John Turner** joined the Allina board in 2001, the same year he founded Hillcrest Capital with his son Jeff Turner who was an executive at Piper Jaffray.

Piper Jaffray continues to be well represented on the Allina board. Debra Schoneman, Piper Jaffray CFO, has been on Allina's board of directors since 2013.
Children’s Hospitals and Clinics have entered into four interest rate swaps with Piper Jaffray that are linked to bonds that have a total outstanding balance of $145 million.\(^{30}\)

Under the agreements, Children’s pays Piper Jaffray an average fixed rate of 3.86% on the debt, and Piper Jaffray pays Children’s a variable rate that has been below 1.0% since 2009 and that averaged 0.12% in 2015.

Through 2015, interest rate swap agreements have cost Children’s a total of almost $50 million in net swap payments and are expected to cost Children’s another $85 million over the remaining life of the deals, until 2037. If Children’s were to refinance the underlying debt in order to reduce costs, it would have to pay termination fees of almost $33 million.\(^{31}\)

**FIGURE 4: The Details of Children's Hospitals' Swap Deals**

<table>
<thead>
<tr>
<th>Swap</th>
<th>Related Bond Balance</th>
<th>Fixed rate paid</th>
<th>Rate received from banks</th>
<th>Average rate received in 2015</th>
<th>Annual Net Swap Payment</th>
<th>Bank Counterparty</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004A</td>
<td>$20.1 M</td>
<td>4.13%</td>
<td>65% of 1-Mo. LIBOR</td>
<td>0.12%</td>
<td>$800,000</td>
<td>Piper Jaffray</td>
</tr>
<tr>
<td>2004B</td>
<td>$30.0 M</td>
<td>4.27%</td>
<td>65% of 1-Mo. LIBOR</td>
<td>0.12%</td>
<td>$1.2 M</td>
<td>Piper Jaffray</td>
</tr>
<tr>
<td>2007A</td>
<td>$47.7 M</td>
<td>3.52%</td>
<td>65% of 1-Mo. LIBOR</td>
<td>0.12%</td>
<td>$1.6 M</td>
<td>Piper Jaffray</td>
</tr>
<tr>
<td>2007B</td>
<td>$47.7 M</td>
<td>3.52%</td>
<td>65% of 1-Mo. LIBOR</td>
<td>0.12%</td>
<td>$1.6 M</td>
<td>Piper Jaffray</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$145.5 M</td>
<td></td>
<td></td>
<td></td>
<td>$5.2 M</td>
<td></td>
</tr>
</tbody>
</table>

Children’s entered into two of the interest rate swap agreements in 2004 when the cities of Minneapolis and Saint Paul issued two series of Auction Rate Securities (ARS) bonds totaling $103.6 million on behalf of Children’s. The bonds were underwritten by Piper Jaffray, and US Bank is the trustee. Children’s paid fees of $3.6 million to Piper Jaffray and the other service providers for issuing the bonds.

In 2007, Minneapolis and Saint Paul again issued two additional ARS bonds on behalf of Children’s. These bonds totaled $103 million and were underwritten by Piper Jaffray, with US Bank again serving as the trustee. Children’s paid over $2 million in fees to issue the bonds.

As with Allina, Children’s Board of Directors included several investment bankers. In 2004, the Board included Brian Peters, the President and CEO of Dain Rauscher,\(^{32}\) and the 2007 Board of included Sima Griffith, founder and principal of investment bank Aethlon Capital, and Katherine Low, a former Vice President at Goldman Sachs.\(^{33}\)
Auction Rate Securities

In November 2007, Piper Jaffray and UBS underwrote $475 million of bonds for Allina. Allina had to pay more than $10 million in upfront fees. The bonds not only included an interest rate swap, but $125 million of the bonds were structured as Auction Rate Securities (ARS), a type of variable-rate bond packed with hidden risks that were not widely understood by municipal and non-profit borrowers.34

ARS have interest rates that typically reset every 7, 28, or 35 days. At the end of every reset period, bondholders who want to sell their ARS can do so at an auction, and banks collect exorbitant fees for conducting these auctions.

The bonds are auctioned to investors who bid the lowest interest rate they are willing to accept for the bond. However, ARS require bidders. If no investors submit bids at the auctions, then the government and non-profit entities that issued the debt could be forced to pay double-digit penalty interest rates to the bondholders that are unable to sell. That is precisely what happened in 2008.

Allina’s ARS had an high penalty interest rates of 15% that it had to pay to the broker-dealers (UBS and Piper Jaffray) when there were no longer any purchasers for the securities.

We now know that before the market crashed, banks were quietly propping up the ARS market for years by bidding in auctions so that the auctions wouldn’t fail, creating an illusion of a strong, safe market. We also know that banks continued to push these deals to public entities even though they knew the market was shaky. And finally, when the market did start to melt down, banks stopped propping it up -- in other words, they stopped intervening in the auctions by bidding on the bonds.

Piper Jaffray and UBS sold Allina these bonds just months before the ARS market collapsed. Allina said that due to the ARS it was forced to spend millions of dollars in higher interest payments and that it was forced to refinance the bonds almost immediately, which caused it to incur additional costs.35

Piper Jaffray also sold Children's Hospitals and Clinics $103 million in auction rate securities in 2007.
CITY OF SAINT PAUL

In 2007, the City of Saint Paul entered into two interest rate swap agreements with Piper Jaffray and Royal Bank of Canada linked to $65.5 million in bonds. Under the terms of the agreement, the City pays the banks a fixed interest rate of 5.23% on the swaps, and the banks pay the City a variable rate that has been below 1.0% since 2009 and that averaged 0.2% in 2015.36

Net swap payments have cost the City of Saint Paul $16 million through 2015 and are expected to cost another $22 million over the remaining life of the deals, until 2025. There is currently a balance of $48.6 million on these bonds. The City can only refinance this debt if it pays termination fees of $10 million.37

FIGURE 5: The Details of the City of Saint Paul’s Swap Deals

<table>
<thead>
<tr>
<th>Swap</th>
<th>Related Bond Balance</th>
<th>Fixed rate paid</th>
<th>Rate received from banks</th>
<th>Rate received as of 12/30/15</th>
<th>Annual Net Swap Payments</th>
<th>Bank Counterparty</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>$24.3 M</td>
<td>5.23%</td>
<td>1-Mo. LIBOR</td>
<td>0.43%</td>
<td>$1.2 M</td>
<td>Piper Jaffray</td>
</tr>
<tr>
<td>2007</td>
<td>$24.3 M</td>
<td>5.23%</td>
<td>1-Mo. LIBOR</td>
<td>0.43%</td>
<td>$1.2 M</td>
<td>RBC</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$48.6 M</td>
<td></td>
<td></td>
<td></td>
<td>$2.4 M</td>
<td></td>
</tr>
</tbody>
</table>
The Minnesota Housing Finance Agency (MHFA) entered into six interest rate swap agreements as part of its issuance of variable rate Residential Housing Finance Bonds (RHFB) between 2003 and 2009. Piper Jaffray was one of the underwriters for all of the bond issuances associated with these swaps. The compensation to Piper Jaffray and the other underwriters of these bonds totaled at least $3.6 million.

Under the agreements, MHFA pays the banks a fixed rate between 2.4% and 4.2% and the banks pay MHFA a variable rate that has been below 1% since 2009. The variable rate paid to MHFA in 2015 ranged from 0.01% to 0.28%.

Net swap payments have cost MHFA $57 million through 2015 and are expected to cost MHFA another $104 million over the remaining life of the deals, until 2026. There is currently a balance of $127 million on these bonds. If MHFA were to refinance this debt in order to reduce costs, it would have to pay termination fees of almost $9 million.

**FIGURE 6: The Details of MHFA’s Swap Deals Linked to Bonds Underwritten by Piper Jaffray**

<table>
<thead>
<tr>
<th>Swap</th>
<th>Notional Value</th>
<th>Fixed rate paid</th>
<th>Rate received from banks</th>
<th>Rate received as of 12/30/15</th>
<th>Annual Net Swap Payments</th>
<th>Bank Counterparty</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003B</td>
<td>$10.7 M</td>
<td>3.5%</td>
<td>65% of 1-Mo. LIBOR</td>
<td>0.28%</td>
<td>$452,000</td>
<td>Bank of New York Mellon</td>
</tr>
<tr>
<td>2003J</td>
<td>$8.7 M</td>
<td>4.2%</td>
<td>65% of 1-Mo. LIBOR</td>
<td>0.28%</td>
<td>$400,000</td>
<td>Bank of New York Mellon</td>
</tr>
<tr>
<td>2004G</td>
<td>$18.7M</td>
<td>4.2%</td>
<td>65% of 1-Mo. LIBOR</td>
<td>0.28%</td>
<td>$821,000</td>
<td>Royal Bank of Canada (RBC)</td>
</tr>
<tr>
<td>2008C</td>
<td>$36.4 M</td>
<td>4.1%</td>
<td>65% of 1-Mo. LIBOR</td>
<td>0.28%</td>
<td>$1.4 M</td>
<td>RBC</td>
</tr>
<tr>
<td>2009C</td>
<td>$40.0 M</td>
<td>4.2%</td>
<td>65% of 1-Mo. LIBOR</td>
<td>0.28%</td>
<td>$1.5 M</td>
<td>RBC</td>
</tr>
<tr>
<td>2009F</td>
<td>$12.5M</td>
<td>2.4%</td>
<td>100% SIFMA</td>
<td>0.01%</td>
<td>$307,000</td>
<td>RBC</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$127 M</td>
<td></td>
<td></td>
<td></td>
<td>$4.9 M</td>
<td></td>
</tr>
</tbody>
</table>
In May 2009, Minnesota Public Radio’s parent company American Public Media Group (APMG) entered into an interest rate swap agreement with Piper Jaffray. The bonds linked to the swap agreement have a total outstanding balance of $21.3 million.

Under the terms of the agreement, APMG pays Piper Jaffray a fixed interest rate of 2.6% on the swap, and Piper Jaffray pays APMG a variable rate that has been below 1.0% since 2009 and that averaged 0.21% in 2015. This difference in interest rates has resulted in a total net swap payment of $4.5 million for APMG and is expected to cost APMG another $1.5 million over the remaining life of the deal, until 2019.

In 2002, Piper Jaffray was the underwriter for $13.4 million in bonds issued by St. Olaf College. Under the terms of the agreement, St. Olaf pays the counterparty banks a fixed interest rate of 4.4% on swaps related to this debt, and the banks paid St. Olaf a variable rate that has been below 1.0% since 2009 and that averaged 0.2% in 2015. This difference in interest rates resulted in a total net swap payment of $4.1 million for St. Olaf.

In 2015, Piper Jaffray was the underwriter of a new bond issuance by St. Olaf. that paid off the balance of older bonds from 2006 and also paid a $583,000 early termination fee on related swaps.

Piper Jaffray’s Addison Piper was on the boards of both Minnesota Public Radio and St. Olaf College when they entered into these deals.

- Addison Piper was named to the board of Minnesota Public Radio (MPR) in 1986 and is now a “life trustee.”

- Piper was first elected to the board of St. Olaf College in 1999. He served as Chairman from 2010 to 2013 and is now a “Senior Regent.” In addition, B. Kristine Johnson is the chair of the Board of Regents. She is the President of Affinity Capital and is on the board of Piper Jaffray. Mark Jordahl, the President of US Bank Wealth Management, is also on the St. Olaf Board of Regents.
In 2006 the Port Authority of the City of Saint Paul issued $33.3 million of bonds, underwritten by Piper Jaffray, on behalf of the Amherst H. Wilder Foundation and entered into a related swap agreement with Piper Jaffray. Under the agreement, the Foundation paid Piper Jaffray a fixed interest rate of 3.67%, and in turn Piper Jaffray paid the Foundation a variable rate of that was below 1.0% in 2009 and 2010. The swap cost a total net swap payment of $3.2 million for the Foundation.

In 2010, Piper Jaffray underwrote another bond offering for the Port Authority of the City of Saint Paul on behalf of the Foundation. The amount of the bonds, $28.4 million, refinanced the $24.4 million balance of the 2006 bonds and paid a $4.4 million termination fee on related swaps.

The Foundation paid $1.8 million in net swap payments in 2009 and $1.2 million in 2010, before the swap was terminated.

The Hazelden Foundation entered into an interest rate swap agreement with Piper Jaffray in 2005 as part of a $13.2 million bond issuance underwritten by Piper Jaffray to finance the construction of the Women’s Recovery Center in Center City, MN. Under the agreement, Hazelden paid a fixed interest rate of 3.8%, and in turn received a variable rate that was below 1.0% from 2009 until the balance of the bonds were refinanced in 2014 with a new bond issuance also underwritten by Piper Jaffray. The swap cost Hazelden $3.6 million.

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**FIGURE 7: Non-Profits' Swap Deals on Bond Transactions Connected to Piper Jaffray**

<table>
<thead>
<tr>
<th>Agency/Org.</th>
<th>Fixed rate paid</th>
<th>Rate received from banks</th>
<th>Total Net Swap Payments</th>
<th>Termination Fees Paid</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>APMG/MPR</td>
<td>2.6%</td>
<td>1-Mo. LIBOR</td>
<td>$4.5 M</td>
<td>N/A</td>
<td>$4.5 M</td>
</tr>
<tr>
<td>St. Olaf</td>
<td>4.4%</td>
<td>1-Mo. LIBOR</td>
<td>$4.1 M</td>
<td>$583,000</td>
<td>$4.7 M</td>
</tr>
<tr>
<td>Wilder Foundation</td>
<td>3.7%</td>
<td>65% 1-Mo. LIBOR</td>
<td>$3.2 M</td>
<td>$4.4 M</td>
<td>$7.6 M</td>
</tr>
<tr>
<td>Hazelden Foundation</td>
<td>3.8%</td>
<td>70% 1-Mo. LIBOR</td>
<td>$3.6 M</td>
<td>N/A</td>
<td>$3.6 M</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td></td>
<td><strong>$15.4 M</strong></td>
<td><strong>$5.0 M</strong></td>
<td><strong>$20.4 M</strong></td>
</tr>
</tbody>
</table>
RECOMMENDATIONS

The public and non-profit entities in this report should:

- **Conduct full and independent audits of their bond deals that involved interest rate swap deals.** This should include an investigation of any possible conflicts of interest and of whether the underwriters had adequately disclosed the risks of these deals.

- **Demand that Piper Jaffray renegotiate interest rate swap deals,** including ending swap contracts with no penalties or termination fees.

- **Investigate legal options.** The banks that sold interest rate swaps to public and non-profit entities often misrepresented the risks inherent in the deals. These entities should pursue any legal options that would allow them to get out of existing swaps without penalty, or even to recoup past costs.

- **Enact stronger conflict of interest policies.** Non-profit entities should protect their financial interests by avoiding entering into financial deals with firms represented on their own boards.
1 We calculated costs to date, through 2015, by calculating the monthly payments made by these entities and subtracting the banks' payments from that, and totaling the monthly payments made during the history of the swap. To calculate the monthly payments by the entities covered in the report, we multiplied their fixed interest rate by the swaps' notional amounts. For the banks' payments, we used historical LIBOR and SIFMA interest rates to calculate the variable interest rate paid by the banks and multiplied that by each swap's notional amount.

2 Based on fair value figures reported in the 2015 Annual Financial Reports from each entity.

3 Annual net payment estimates are based on the total monthly net payments in 2015.

4 We determined the projected future payments by multiplying the annual net payments over the life of existing swaps.

5 August 24, 2016 letter from St. Paul Mayor Chris Coleman to St. Paul City Council


8 "Statewide Analysis of Gaps in Affordable Rental Housing," Minnesota Housing Finance Agency March 2015

9 Miller, Justin, "Minneapolis renters face huge affordable-housing storage," MinnPost, January 14, 2014


13 Gillers, Heather and Jason Grotto, "Illinois lawmakers opened door to risky CPS bond deals." Chicago Tribune. 11 Nov 2014.


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17 "Black, Sam," "Piper Jaffray signs Nicollet Mall HQ lease for $44.5 million," Minneapolis-St. Paul Business Journal, June 4, 2012

18 http://access.minnesota.publicradio.org/aboutMPR/docs/board.htm, accessed September 8, 2016


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21 Casey, Jack, "Six firms to pay $103.5M in preliminary settlements over bid-rigging," The Bond Buyer, February 24, 2016

22 Official Statement, CUSIP 01959LAA0, Allina Health System taxable Bonds, Series 2015, September 9, 2015

23 Official Statement, City of Minneapolis, MN and Housing and Redevelopment Authority of the city of Saint Paul, Minnesota Health Care System Revenue Bonds (HealthSpan) Series 1993, October 1, 1993

24 Official Statement, City of Minneapolis and Housing and Redevelopment Authority of the City of Saint Paul, Minnesota Variable Rate Demand Revenue Bonds (Allina Health System) Series 1998A, September 29, 1998

25 Official Statement, CUSIP 603695 FL6 and CUSIP 603695 FM4, City of Minneapolis and Housing and Redevelopment Authority of the City of Saint Paul, Minnesota Health Care System Revenue Bonds (Allina Health System) Auction Rate Securities, Series 2007
27 Business Alliance Agreement by and between U.S. Bancorp and Piper Jaffray Companies, dated as of December 23, 2003
29 Official Statement, CUSIP 01959LAA0, Allina Health System taxable Bonds, Series 2015, September 9, 2015
30 Children’s Health Care Consolidated Financial Statements December 31, 2015 and 2014,
31 Ibid
32 Official Statement, City of Minneapolis, Minnesota and Housing and Redevelopment Authority of the City of Saint Paul, Minnesota Health Care Facilities Revenue Bonds (Children’s Hospitals and Clinics) Series 2004, August 15, 2004
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34 Official Statement, CUSIP 603695 FL6 and CUSIP 603695 FM4, City of Minneapolis and Housing and Redevelopment Authority of the City of Saint Paul, Minnesota Health Care System Revenue Bonds (Allina Health System) Auction Rate Securities, Series 2007
35 Case 0:12-cv-02090-MJD-JJG, Allina Health System v. UBS Securities
36 City of Saint Paul Comprehensive Annual Financial Report, For the Fiscal Year Ended December 31, 2015
37 Ibid
38 2015 Minnesota Housing Audit Report
39 Ibid
40 Ibid
41 Consolidated Financial Report, June 30, 2015, American Public Media Group and Affiliates
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44 http://access.minnesota.publicradio.org/aboutMPR/docs/board.htm, accessed September 8, 2016
46 Ibid
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48 Ibid
49 Official Statement, City of Center City, Minnesota Variable Rate Demand Health Care Revenue Bonds (Hazelden Foundation Project) Series 2005, October 4, 2005