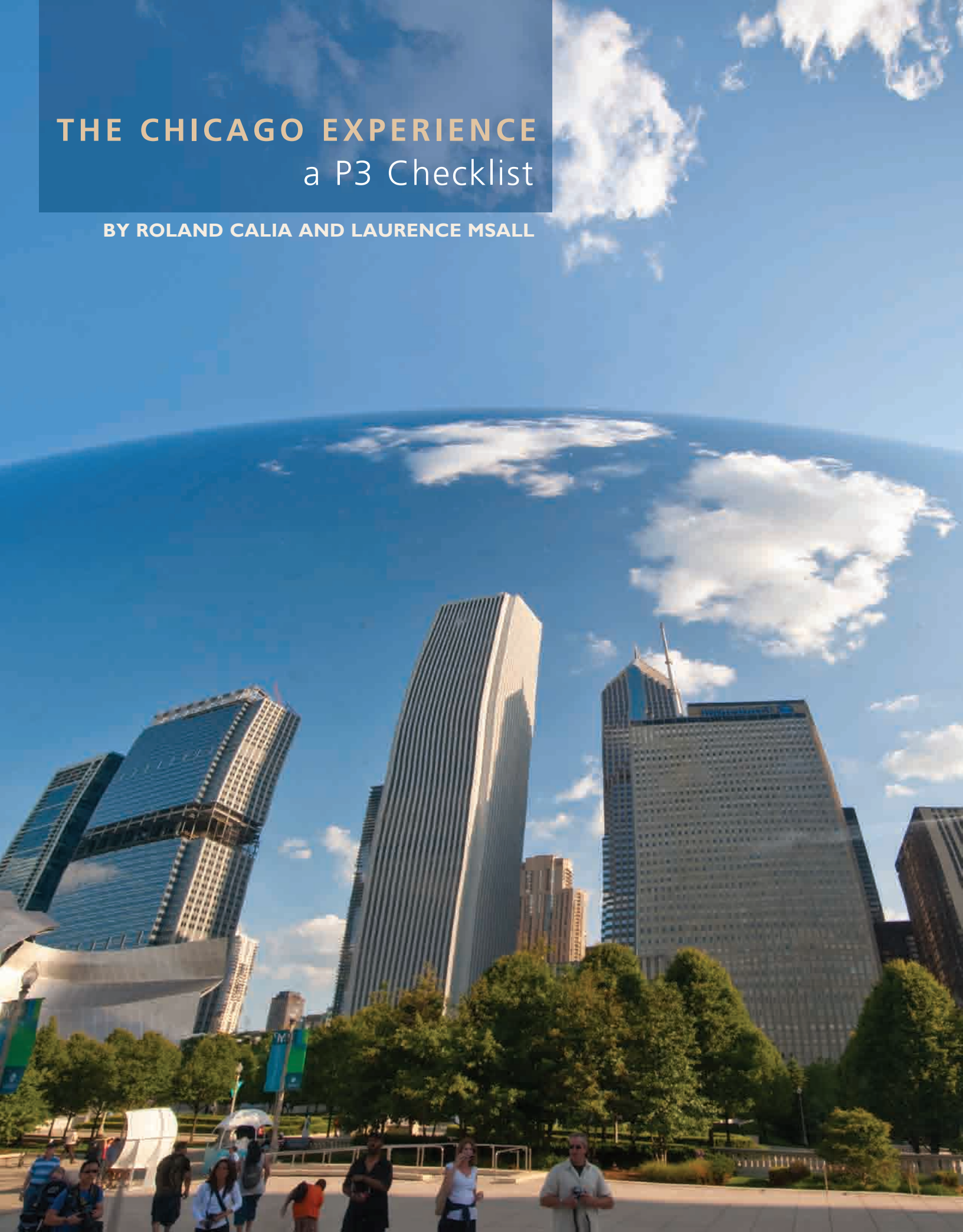


THE CHICAGO EXPERIENCE

a P3 Checklist

BY ROLAND CALIA AND LAURENCE MSALL





Governments can use public-private partnerships (P3s) to reduce costs, improve operating efficiency, shed non-core functions, transfer risk, and fund critical infrastructure needs. However, a successful P3 implementation strategy is a complex undertaking that requires careful planning and a complete evaluation of costs and benefits.

The City of Chicago, Illinois, has negotiated three high-profile P3s that have generated billions of dollars in one-time asset lease proceeds. The Civic Federation, an Illinois-based fiscal policy research organization, has developed an eight-point checklist for evaluating these P3s. The checklist assesses whether transactions make use of maximum benefits, mitigate potential problems, are accountable to stakeholders, include effective oversight, and use proceeds prudently. It can

be adapted for use in other jurisdictions by taxpayers, financial managers, and elected officials as P3s are considered.

Governments should adopt a formal P3 policy to provide a framework for evaluating and entering into these arrangements and how they will use transaction proceeds.

CHICAGO'S SKYWAY, PARKING GARAGE, AND PARKING METERS

The Skyway is a 7.8-mile, six-lane toll bridge. In 2004, Chicago approved a 99-year concession agreement for a \$1.83 billion payment with a private firm. The city enforces operating, maintenance, and transportation safety standards, and Chicago police patrol the bridge. The concessionaire is responsible for operating and maintenance costs and collecting revenues. It can raise tolls up to prescribed limits.¹ The city allocated \$855 million in proceeds to retire debt, \$500 million to a long-term reserve fund to generate ongoing interest income, \$375 million to an eight-year annuity for operations, and \$100 million for human service programs.²

In 2006, the City of Chicago and the Chicago Park District concluded a \$563 million, 99-year lease of four downtown parking garages with a financial services firm.³ Chicago wanted to shed responsibility for the garages because fee revenues had been insufficient to pay for debt service, forcing the use of other revenues.⁴ The city used \$216 million in proceeds to retire existing debt and pay closing costs. The Park District used \$122 million for capital improvements, \$120 million to establish a reserve to generate ongoing interest income, \$35 million for park reconstruction, and \$70 million to pay off debt.⁵

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In 2009 the city negotiated a 75-year lease of its metered public parking system, receiving \$1.15 billion for 36,000 meters.⁶ In most Chicago neighborhoods, rates rose immediately from twenty-five cents per hour to \$1 an hour and will increase to \$2 an hour in 2013. Meter rates downtown increased from \$3 to \$3.50 an hour, which increases to \$6.50 an hour in 2013. The large rate increases, compounded by meter failures in the initial days of the contract, generated an enormous public backlash.⁷ Transaction proceeds were initially allocated for a \$400 million reserve to generate ongoing interest income, a \$325.9 million five-year annuity to fund operations, a \$326.3 million discretionary budget stabilization fund, and a \$100 million fund for human service programs.⁸

A CHECKLIST FOR EVALUATING P3S

How can stakeholders assess whether a P3 proposal is a cost-effective, efficient mechanism that protects the public interest? The Civic Federation has used the following eight guidelines to review Chicago’s experience with three major P3s.

Does the Government Have a Formal Policy Regarding P3s? Governments should adopt a formal P3 policy to provide a framework for evaluating and entering into these arrangements and how they will use transaction proceeds. This could be a stand-alone policy on the issue of large-scale P3 concessions, or it could be included as part of a broader alternative service delivery policy.⁹ The policy should be publicly discussed, approved by the governing body, and made available to stakeholders.¹⁰ Chicago has not approved a policy for P3 adoption or the use of proceeds.¹¹

Civic Federation P3 Evaluation Checklist

- Does the government have a formal P3 policy?
- Have all potential costs been considered?
- Does the asset under consideration for a P3 contract provide essential or non-essential services?
- How will P3 proceeds be used?
- Is there a competitive bidding process for operator selection?
- Are there contractual provisions for adequate management oversight?
- Is there full public discussion and review of the P3 proposal?
- Are there requirements for the public reporting of P3 results?

Have All Potential Costs Been Considered? Governments need reliable data on service delivery costs so they can make informed decisions about P3 transactions and assess performance over time.¹² A cost analysis must consider direct and indirect costs, short-term and long-term costs, oversight costs, the impact on outstanding debt and future grant eligibility, and long-term effects on rates or charges.¹³ There may also be transition costs to consider.

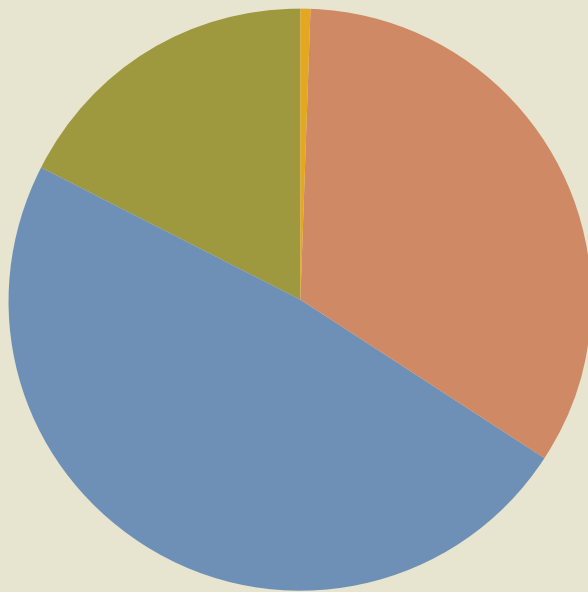
Governments entering into a P3 arrangement may be forgoing other economic and financial opportunities. They should evaluate these opportunity costs. A recent study found that Chicago could have earned \$1.5 billion instead of \$1.2 billion if it had kept its parking meters and raised rates to the same levels as the concessionaire.¹⁴ The city’s inspector general valued the parking meters at approximately \$2.13 billion.¹⁵ But there are issues with these analyses. Revenues from rate increases may be received over a lengthy period of time, so they may not be sufficient to affect current financial situations. Most significantly, there might not be the political will to raise rates to the same degree.¹⁶

Finally, governments need to consider political costs. A concessionaire is responsible for operations, but public officials will bear the brunt of complaints for poor service or increased rates. Public unhappiness over steep fee hikes and service problems related to the parking meter transaction was been a major issue in Chicago’s 2011 mayoral and council elections.¹⁷

Does the Asset Under Consideration for a P3 Contract Provide Non-Essential Services? A P3 may be a good way for a government to shed non-core functions. What is considered a non-core function will vary in different communities. The Skyway was considered a non-core asset because it had only 130 employees and was not organized as a transportation authority or taxing body. Tolls were not set by market forces, but operated on a cost recovery system.¹⁸ The parking garages were considered non-core assets because they were losing money and there are many qualified private-sector operators. In contrast, the parking meter concession has generated considerable controversy. A lawsuit has been filed alleging that the city unconstitutionally gave up control of its policing powers and the ability to set traffic and parking policies, both core public functions.¹⁹

How Will P3 Proceeds Be Used? There is a strong temptation for governments to use asset lease proceeds to close current-year budget deficits. However, this is a short-sighted strategy that can rapidly deplete resources accumulated over

Exhibit I: Chicago Asset Lease Proceeds



Project Use and Balance of Principal FY2011 Year-End

- Remaining Balance Long-Term Reserves
\$554 million, 17.3 percent
- Remaining Balance Allocated for Operations
\$22 million, 0.7 percent
- Retire Debt and Closing Costs
\$1,070.2 million, 33.5 percent
- Budgeted or Spent for Operating Expenses
\$1,550.4 million, 48.5 percent

Notes: Does not include downtown parking garage proceeds distributed to the Chicago Park District. Use of funds calculated by taking original balances subtracted by projected balances at FY2011 year-end. Does not include use of interest earnings generated by asset leases. Original distribution of lease proceeds differs from the current allocation.

Source: Civic Federation analysis of data from the City of Chicago FY2011 Overview Revenue Estimates p. 62; City of Chicago, Asset Lease Agreements: Government Accountability Office, Highway Public-Private Partnerships, February 2008, p. 85.

decades. One-time asset lease revenues should not be used for recurring expenditures, but rather to reduce long-term obligations such as debt or unfunded pension liabilities, make capital investments, and/or fund reserves.²⁰ Only interest earned on proceeds should be used for operating expenses.

The city appropriately used parking garage proceeds for non-recurring expenses. However, much of the proceeds from the Skyway and parking meter leases to date have been used to close deficits and fund operations.²¹ A total of \$1.5 billion, or 49.2 percent of proceeds, will have been used for operations — \$1.5 billion has been spent and \$22 million is allocated for future spending. Remaining proceeds have been earmarked for long-term reserves (\$554 million) or debt retirement (\$1 billion). (See Exhibit 1.)

Is There a Competitive Bidding Process for Operator Selection?

Transparent, competitive P3 bidding processes protect the public interest by ensuring that governments receive maximum financial benefit and that it is easier to uncover unethical behavior

by bidders. An auction bidding process allows pre-qualified vendors to bid on the same terms so the winning award is based primarily on the highest concession fee offered.²² Having a pool of at least three to five qualified bidders can help insulate the government from pressure to favor local bidders. For larger deals, consortia are likely to bid. All consortium firms must possess complementary skills and operations expertise.²³

Thirteen firms bid on Chicago's parking garage leases, reflecting the large pool of private operators. Other P3s with more complex financing and expertise requirements had fewer qualified bidders. Three consortia submitted viable Skyway bids.²⁴ Only two vendors met the city's requirements for the parking meter transaction.²⁵

Governments need reliable data on service delivery costs so they can make informed decisions about P3 transactions and assess performance over time.

Are There Contractual Provisions for Adequate Management Oversight?

Government should protect the public interest by including management oversight provisions in P3 concessions. This helps ensure that the concessionaire provides quality service and that the govern-

ment can take remedial action if there are service disruptions or failures. The contract should also include provisions for the asset reverting to public control if the lessee fails to fulfill contractual obligations.

The Skyway concession agreement requires that the city review financial statements and incident reports and that independent engineers be hired to oversee construction projects. The concessionaire reimburses the city for oversight expenses. The city regains control of the Skyway at no cost if the concessionaire is found to be in material breach of contract.²⁶ When a subcontractor for the parking meters was unable to effectively reprogram and operate the meters or to handle writing parking tickets, the city had the contractual authority to move quickly and rectify the problems. The company was billed for the time spent by city workers.²⁷

Is There Full Public Discussion and Review of the P3 Proposal? P3 proposals generate questions about service delivery quality, rate or fee increases, and the use of proceeds. The confidentiality of concession negotiations may limit how much information can be divulged at certain points in the process. However, stakeholders need accurate and complete information about costs and benefits, contractual obligations, and the use of proceeds to make an informed decision. Governing bodies need adequate time to consider the financial and operational implications of a P3.

Public review was limited for Chicago's Skyway and parking meter leases. The city council approved the Skyway lease two weeks after the deal was announced.²⁸ The metered public parking system lease was approved after approximately one hour of debate just two days after the plan was unveiled.²⁹ The Chicago inspector general noted that very limited financial information was provided to the council. No financial analysis of the parking meter system's value was provided. No public comment or expert testimony was given, nor was there any presentation of comparable studies or alternative lease terms.³⁰

Are There Requirements for the Public Reporting of P3 Results? Governments should provide stakeholders with accessible reports on P3 lease agreements, the use of asset lease proceeds, and the results of performance and financial audits. The Chicago City Council approved an ordinance in June 2009 requiring that the city's finance department include information in a searchable format on its Web site for all major lease agreement files for transactions valued at more than \$10 million; lease asset ordinances; a financial report,

updated quarterly, detailing lease proceed allocation; and the identification of consultants and institutions involved in management or investment activities.³¹

CONCLUSIONS

P3s can be a good policy opportunity for governments seeking to cut costs, improve operational efficiency, fund capital costs, and reduce risk. However, a careful and comprehensive review of the fiscal, management, and policy implications of a P3 is essential to protect the public interest. Public discussion of proposals, assessment of the potential costs of the transaction, a decision on how asset proceeds will be used, and an evaluation of whether there will be adequate management oversight of concession operations is required. Ensuring accountability of the concessionaire and the government to the public also requires public reporting of P3 activities and performance. ■

Notes

1. Chicago Skyway Concession and Lease Agreement, October 27, 2004, Schedule 6 — Tolling Regulation.
2. City of Chicago, Asset Lease Agreements, http://www.cityofchicago.org/city/en/depts/fin/supp_info/public_private_partnerships/asset_lease_agreements.html; Government Accountability Office, Highway Public-Private Partnerships, February 2008.
3. William Blair & Company, "Public Infrastructure Privatization Services," <http://www.williamblair.com/documents/ChicagoParkingPrivatizationSummary.pdf>.
4. Yvette Shields, "Chicago RFQs Seek Firm to Lease Garages," The Bond Buyer, May 16, 2006.
5. Chicago Park District FY2008 Budget Summary.
6. Chicago Meters FAQ, <http://chicagometers.com/faq.aspx>.
7. Stephen Goldsmith, "Chicago's Parking Meter Mishap: Successful Fiasco," *Governing.com*, January 20, 2010.
8. City of Chicago, FY2011 Overview and Revenue Estimates.
9. For example, the City of Toronto has adopted a service improvement and alternative service delivery work program that provides a framework for how that government evaluates and moves forward on alternative service delivery proposals; see <http://www.toronto.ca/asd/info.htm>.
10. Governments might consider including a provision for the use of certain asset proceeds in extraordinary fiscal or economic circumstances. This should only be for emergency situations, however, as it is not prudent or fiscally responsible to use long-term asset lease proceeds for operating expenses.
11. However, it has adopted a financial reserve policy, setting aside \$500 million in long-term reserves from the proceeds of the Skyway deal. The interest from this reserve is included as part of the city's budget each year, according to the City of Chicago FY2011 Overview and Revenue Estimates.
12. Government Accountability Office, "Privatization: Lessons Learned by State and Local Governments," Report to the Chairman, House Republican Task Force on Privatization, March 1997.
13. See NACSLB Recommended Practice 6.1: Develop Programs and Evaluate Delivery Mechanism (1997) and GFOA Best Practice, *Measuring the Cost of Government Services* (2002).
14. Hal Dardick, "Economist Says Leasing Meters Gave Up Millions," *Chicago Tribune*, February 5, 2009.
15. Office of the Inspector General, City of Chicago, *Analysis of the Lease of the City's Parking Meters*, June 2, 2009.

16. Iris N. Ortiz and Jeffrey N. Buxbaum, Protecting the Public Interest in Long-Term Concession Agreements for Transportation Infrastructure, Public Works Management Policy 2008; 13. Tolls were not raised on the Illinois Toll Highway between 1983 and 2005; see http://www.illinoistollway.com/portal/page?_pageid=133,1&_dad=portal&_schema=PORTAL.
17. Kristen Mack. "Chicago's parking-meter lease draws lawsuit," Chicago Tribune, August 20, 2009.
18. Walter Knorr. "Chicago Skyway Public Policy Issues: A Template for Asset Privatization," A Presentation to the National Association of State Treasurers, September 20, 2005.
19. Kristen Mack, "Chicago's parking-meter lease draws lawsuit," Chicago Tribune, August 20, 2009.
20. NACSLB Recommended Practice 4.4: *Develop Policy on Use of One-time Revenues, and Civic Federation*, "City of Chicago FY2011 Budget Analysis," November 3, 2010.
21. The City of Chicago has stated that monies from the parking meter lease long-term reserve fund used to help reduce operating budget deficits in recent years were loans that will be repaid at some point in the future. The city has not disclosed a plan to achieve this goal.
22. General Accountability Office, Highway Public-Private Partnerships: More Rigorous Up-Front Analysis Could Secure Potential Benefits and Protect the Public Interest, GAO-08-44, February 2008.
23. Aidan R. Vining and Anthony E. Boardman, Public Private Partnerships: Eight Rules for Governments, Public Works Management Policy 2008.
24. Federal Highway Administration, Agreement Review: Chicago Skyway Concession and Lease Agreement, http://www.fhwa.dot.gov/ipd/p3/agreements/chicago_skyway.htm.
25. Office of the Inspector General, City of Chicago, *Analysis of the Lease of the City's Parking Meters*, June 2, 2009.
26. Chicago Skyway Concession and Lease Agreement, October 27, 2004, Article 16, Defaults; Letters Of Credit; and General Accountability Office, *Highway Public-Private Partnerships: More Rigorous Up-front Analysis Could Secure Potential Benefits and Protect the Public Interest*, GAO-08-44, February 2008.
27. Hal Dardick, "Private operator to resume writing Chicago parking tickets," Chicago Tribune, June 18, 2010.
28. Yvette Shields, "Chicago City Council Unanimously Approves Privatization of Skyway Toll Road," The Bond Buyer, October 28, 2004.
29. Dan Mihalopoulos and Hal Dardick, "Aldermen approve Chicago parking meter lease," Chicago Tribune, December 4, 2008.
30. Office of the Inspector General, City of Chicago, *Analysis of the Lease of the City's Parking Meters*, June 2, 2009.
31. City of Chicago City Asset Lease Agreements Disclosure Ordinance, adopted June 3, 2009.

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