

# **Bond Case Briefs**

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## **NYT: Public-Private Partnerships Could Be a Lifeline for Cities.**

Cities like Detroit with crumbling infrastructure and deteriorating public services could find help from private investors.

Detroit is fighting for its fiscal survival. Over the last four years, the city has spent \$100 million more each year than it has collected. Long-term liabilities are estimated to be as high as \$20 billion. Gov. Rick Snyder of Michigan installed an emergency manager, who most assume is preparing for a Chapter 9 filing, which would be the largest municipal bankruptcy in United States history.

In May, the manager, Kevyn Orr, was considering selling parts of the permanent collection at the Detroit Institute of Arts to pay creditors. Mr. Orr later backed off that threat, but no doubt he wanted to scare city fathers into getting serious about averting financial disaster. But new worries followed that he would have to unload the city's collection of 62 classic cars.

Detroit's plight may be extreme, but its problems are increasingly common in cities across the United States. Municipalities are struggling to make public payroll, maintain basic services or meet pension fund obligations. Many of the hard choices Detroit has to make will be repeated in towns in the Midwest, Rust Belt, California and throughout the Northeast.

In truth, Detroit does not have to part with its Diego Rivera murals or its vintage Mustangs and Cadillacs. Instead, it should be taking an inventory of revenue-producing public assets — including on-street and off-street parking systems, water systems, toll bridges, solid waste disposal plants, utilities and airports — to lease or divest with help from private partners willing to invest capital in improving them.

Public-private partnerships are the ideal solution for the fiscal problems plaguing many American cities. In a so-called P3 transaction, private equity investors make a large up-front payment to run a public service or utility — often for hundreds of millions of dollars. In return, they gain a concession to operate the service under a contract that can last for decades.

Gaining much needed cash and operating efficiency are prime incentives for municipalities to undertake such transactions. Chicago entered into a concession for 36,000 parking meters a few years ago through a 75-year contract valued at more than \$1 billion. Besides streamlining the costs of running the citywide program, the new concession exposed abuses of handicapped parking permits and led to the passage of a law preventing abuses. Today, the Chicago Metered Parking System is considered one of the world's best.

Does Detroit's lurch toward bankruptcy make it a less-desirable candidate for a public-private transaction? Not necessarily. A municipality that has already filed Chapter 9 may have greater impetus to privatize infrastructure assets to restructure its balance sheet just like any business trying to work through insolvency.

P3 deals are also effective for cities on the brink. Not only can they generate substantial revenue to

stave off defaults, but they need not involve an outright sale of assets. Ownership of the services often remains with the city, avoiding the prospect of a fire sale. As for cities in good financial shape, they should consider private partnerships as a means of undertaking long-term civic improvements at a time when the fiscal roof isn't leaking.

How does a city ensure that it's receiving fair value in a P3? These deals are subject to external market forces. Bidders for public infrastructure assign a value based on prospects for long-term revenue collection — will there be enough drivers crossing a toll bridge or parking their cars on city streets? In reality, infrastructure assets are in general relatively straightforward to value and represent a long-term, income-producing annuity for the right investor.

Privatization often ignites fears of price-gouging by Wall Street. In fact, your corner grocery store or nail salon has more power to raise prices than a private equity fund operating a public service. The assets at the center of these deals — parking garages, utilities, toll roads — operate under tight regulatory regimes. Rates are adjusted according to inflation and can't be raised without an arduous process of public hearings and agency approvals. Bayonne, N.J., contracted a 40-year concession for its water and waste system through a partnership with Kohlberg Kravis Roberts and United Water, which abides by a strict scheduled rate protocol.

Some people have a knee-jerk aversion to allowing private enterprise to manage public works. The truth is that cities have terrible track records in maintaining their bridges and roadways. Gas and electric utilities have long been run by private entities. If a city can trust private business to operate its nuclear power plant, it has nothing to fear in allowing an investment fund to manage its parking meters.

Privatizing municipal services is not a hand-off of the public trust. The assets in a P3 rely on millions of paying customers for their revenue stream, not city coffers. If the assets remain in the hands of near-bankrupt municipalities, crucial services and infrastructure will become melting ice cubes financed by a vastly shrinking tax base.

Harrisburg, Pa., has been teetering on the edge of bankruptcy for several years, having to service \$370 million in debt tied to a trash incinerator built a decade ago. Had the incinerator been developed through a concession with a private investor, Harrisburg's balance sheet would look a lot brighter today.

What about jobs? Don't private operators of public infrastructure torch contracts with municipal unions? In fact, the jobs needed to run these services remain unionized after a P3, typically governed by collective bargaining terms. Yet private concessions frequently create jobs through capital programs that had been sidelined by broke city governments.

Public-private partnerships have gotten a bad rap because of some highly publicized failures. In 2008, when Gov. Ed Rendell of Pennsylvania tried to lease the state's turnpike to an infrastructure fund, the legislature killed the \$12.8 billion deal. In Pittsburgh, the city council rejected a \$500 million bid for a municipal parking concession that would have more than covered a \$350 million shortfall in parking revenue.

These failures did not reflect inherent problems with the P3 structure — the transactions were derailed because of political grudges and fear-mongering. The reality is that government agencies are so constrained they can't meet their responsibilities to operate and maintain — much less build new — public infrastructure. P3s regularly replace aging infrastructure and provide state-of-the-art services. The private operator of the Chicago parking meter system replaced all coin operated meters with credit card devices, which will soon feature pay-by-cellphone options. This would not

have been possible had the city continued to manage the meters.

This should be a golden age of public-private partnerships — the need exists in cities across the country. And the capital is there, from private investors seeking long-term returns. American infrastructure has fallen behind countries like France, Italy, Spain, Portugal, Poland, Hungary and countries that have long embraced privatization of urban systems. Ironically, the United States has become an emerging economy when it comes to developing P3 projects — in which opportunity needs to be matched with political will and bold thinking to undertake.

Ultimately, Detroit and other stressed cities don't have much choice. They must land on solid ground and use new revenue to pay off existing debt. The marvel of public-private partnerships is that a significantly reduced debt load and shift of responsibility to the private sector can allow a city to turn to other priorities, like buying more textbooks for students or enhancing local parks that are a city's true public trust. Divesting noncore assets may be the best way for many towns — not just Motown — to regain their momentum.