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Deals

# 'You're just milking the system' - a decade on, Chicago Parking Meters is still controversial

*Legal disputes, annual calls to annul it and an anniversary that sets the stage for six decades of private-sector upside make the deal a case study in the dangers of misaligned interests.*

Jordan Stutts - 11 September 2018

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Scott Waguespack sat in a Chicago City Council meeting as a rookie alderman in December 2008 and waved financial projections that showed the city was about to agree to a very bad deal - nobody listened.

That meeting, nearly 10 years ago, came only two days after city officials for then-Mayor Richard Daley first notified council members they had reached a deal to lease Chicago's 36,000 parking meters to a Morgan Stanley-led group of investors.

Daley, in the second year of his sixth term, was facing budget pressure and saw leasing city infrastructure to the private sector, in exchange for handing over that asset's revenue, as a quick cash solution. He had already made Chicago a leader in public-private partnerships, leasing the 7.8-mile Skyway toll road to a Macquarie consortium four years earlier, as well as four parking garages to another Morgan Stanley venture in 2006.

The parking meter deal, however, came about a little differently.

With a \$1.16 billion sale offer, which Waguespack says was valued by the consulting firm William Blair & Company, the Daley administration put a 75-year decision, the length of the parking meter contract, in the City Council's hands and expected a vote immediately.

"[Daley administration officials] were so desperate to cut a deal, they simply signed off on it and moved forward," Waguespack, who represents Chicago's 32nd Ward, told *Infrastructure Investor*. "When we first got a whiff of the deal, it was pretty short notice."

That sent his own office "scrambling" to evaluate the 521-page concession agreement, he says, which was complicated further by the limited financial analysis of the parking meters' value that officials provided to council members. Still, his office modelled numbers that valued the metering system at \$2 billion to \$5 billion. "We never saw projected revenue, but we knew it wasn't even close," Waguespack explains.

At the City Council meeting when the aldermen voted, he made his case.

"I was waving my documents saying, 'Our projections show this,'" Waguespack recalls. "I was trying to get the budget director to answer some questions while there was a break. He literally ran off. I thought, 'OK, this must mean something's pretty bad.'"

Waguespack - now a prospective mayoral candidate - ended up being one of the few dissenters in a 40-5 vote that gave the Daley administration what he terms "rubber-stamp" approval of the deal.

Ten years later, the Morgan Stanley-backed Chicago Parking Meters is close to recouping its \$1.16 billion investment from a deal that was designed to last three generations. According to annual financial audits, investors are on pace to break even around 2021 - thanks in no small part to \$800 million of non-amortising debt due in 2020 and 2024, taken out to refinance the all-equity deal - which means a sale of the asset would mostly reap pure profit.

How this deal came together - and how quickly it broke down after, yet still endures - is a cautionary tale about the intersection of bad planning and misaligned interests, one worth revisiting as the US debates how it will pay for its infrastructure.

### **'No meaningful public review'**

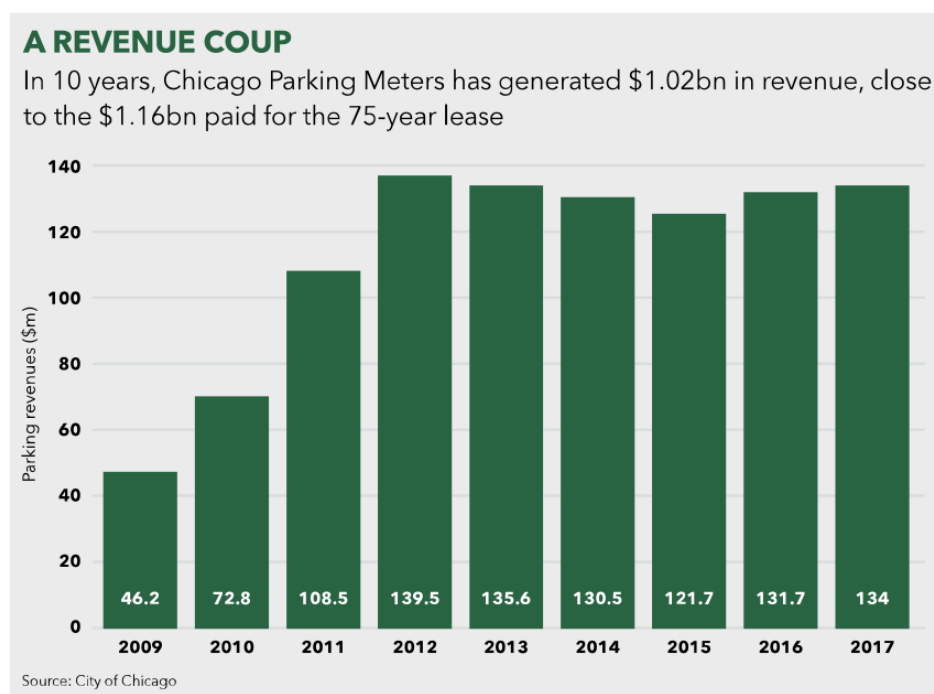
The simplest explanation for the troubles of Chicago's parking meters deal is a lack of transparency, but it doesn't stop there.

The Daley administration allowed for "no meaningful public review" of the deal, Chicago's inspector-general found in a report published just four months after the city handed over management in February 2009. Daley's rush to complete the deal, which came as the Global Financial Crisis ground the US economy to a halt, led to "failures" in evaluating Morgan

Stanley's offer. The inspector-general argued that Chicago had undervalued its parking meter system by at least \$974 million.

Daley pitched the deal as a means to meet short-term budget ends, allocating the upfront lease payment in four ways: \$150 million to plug holes in his 2009 budget; \$325 million to support budgets through 2012; \$320 million for a budget-stabilisation fund to ride out the Great Recession; and \$100 million to fund programmes for low-income residents.

The quick approval and short time to implementation meant council members, let alone their constituents, were not able to fully grasp what the deal could mean for them. What came next would reinforce the image of politicians wasting taxpayer dollars and a rapacious private sector motivated solely by profit.



In the first year of the deal, hourly parking rates doubled, and in some places quadrupled. Waguespack says there was discussion in the City Council to raise rates before the deal was approved, but a new private operator and skyrocketing meter rates created an easy target.

“It was something people felt in their pocket instantly,” he explains. “It wasn’t some bond deal that they might not realise hits them until five or 10 years later. This was literally money out of people’s pockets.”

### **Rate rises and vandalism**

Public sentiment for the deal soured over rising parking rates. As Chicago residents fumed, reports of parking meter vandalism spiked over the following months. Some Chicago residents

boycotted parking meters as well, after they began malfunctioning from the amount of coins now needed to pay higher rates and a slow response to emptying them from LAZ Parking, the company hired to manage the system.

Transparency about how the deal came together was questioned further when it began to surface who exactly owned the city's meters.

The Daley administration had emphasised Morgan Stanley's role in leading the investment and arranging the financing. However, economic disclosure statements filed three months after the City Council approved the transaction tell a different story.

Disclosure statements filed in December 2008 show the \$4 billion fund Morgan Stanley Infrastructure Partners LP and a subsidiary of that vehicle owning a 99 percent stake in Chicago Parking Meters. Investors in those funds include the Teachers Retirement System of Texas and the Victoria Fund Management Corporation of Australia.

But statements filed in February 2009, when the deal closed, show a vehicle named Deeside Investments - which is split near evenly between the Abu Dhabi Investment Authority and Allianz SE - now owned a 49.9 percent stake in Chicago Parking Meters. Morgan Stanley-managed funds held a 50.1 percent stake. The most recent disclosure statement Chicago has made public was filed in 2013 and shows the same structure.

Kent Rowey, a lawyer with Allen & Overy who has worked on legal matters for Chicago Parking Meters since the agreement came together, says the investors' involvement in the deal has been as open as possible.

"The PPP contracts that I've worked on, almost without exception, including Chicago Parking Meters, have fairly extensive reporting requirements," Rowey says. "It's really as transparent as we can be."

While the concession gives Chicago approval of potential new investors, it's unclear on what grounds the city would force a rejection. Waguespack, for his part, thinks it's "mind-boggling" that city officials would enter a 75-year agreement knowing well in advance a public asset could change hands five or six times.

That almost got put to the test two years ago when Morgan Stanley considered exiting, according to a source with knowledge of the investment bank's thinking. Morgan Stanley did not launch an official sale process, the source said, but scouted the market for a good deal.

After "initial market soundings," it decided to hold. It seems likely an exit will come sooner than later, though, considering the \$4 billion Morgan Stanley Infrastructure Partners LP closed in 2008 and the normal lifespan for such vehicles is 10 to 12 years.

**Pay not to play**

Problems with the deal came to a head in 2013, two years after a new mayor, Rahm Emanuel, took over from Daley. By then, a major point of contention concerning a mechanism called “true-up payments” was reaching boiling point.

True-up payments were designed to account for changes in parking-meter utilisation caused by the city. The payments reimburse Chicago Parking Meters for meters taken offline due to street maintenance or for events such as parades. The problem with that, city officials argued, was how the company was calculating payments.

Chicago Parking Meters used a computer programme that calculated payments based on utilisation and how many meters the city added or took out of service, according to a source familiar with how the company handled the true-up dispute. However, the city contested that the programme didn’t account for outside influences that may lead to people driving less, such as gas-price increases, the source says. By 2013, Chicago had racked up a \$103.9 million bill owed to investors.

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The source added that city officials from the Emanuel administration misunderstood how the contract worked, which was arranged during the Daley years, was supposed to work. “The city’s level of sophistication to understand the data and calculations that were provided took a while to catch up,” the source told *Infrastructure Investor*.

Another source familiar with how Chicago Parking Meters handled the dispute called how the computer programme calculated true-up payments “the world of unintended consequences,” but stressed they had been “calculated to the letter of the agreement.”

A budget officer for the Emanuel administration during that time argues it isn’t that simple. The officer, who no longer works for the mayor’s office, told us Morgan Stanley’s “interpretation” of how true-up payments should be calculated is what became “problematic.”

For Waguespack, unintended consequences did not justify the millions of taxpayer dollars investors were seeking without what he believes was an adequate explanation. “They couldn’t even prove what they were billing us on. To me, they were, in a way, kind of committing fraud,” he says.

One of the sources close to Chicago Parking Meters counters: “People enter into complex deals and may end up with differences of opinion on interpretations [...] but that’s not fraud.”

In an emailed statement, Emanuel’s office told *Infrastructure Investor* the mayor had “inherited a flawed parking meter contract that short-changed Chicago taxpayers.”

According to the mayor’s office, Chicago settled a “legal dispute” that reduced two years of true-up payments from \$49 million to \$8.9 million. “The savings were in line with the City’s accounting of the amounts due to [Chicago Parking Meters] under the original contract,” the statement says.

The renegotiation also included a “meter swap,” which gave residents free parking on Sunday throughout much of the city in exchange for extended metering hours during the week. Investors also agreed to install a pay-by-cellphone feature.

Emanuel claimed at the time he saved the city around \$1 billion, but it’s true-up bill has been on the rise in recent years. In 2012, the year before the renegotiation, Chicago owed \$26. Million, according to financial audits of Chicago Parking Meters. The following year, the true-up payment fell to \$14.6 million and then \$6.5 million the year after. But after 2017, the bill shot up to \$21.7 million.

### **‘Milking the system’**

When this year’s audit is published, Chicago Parking Meters will be even closer to recouping its \$1.16 billion at the deal’s 10-year anniversary. Waguespack believes this makes for a fair time for the city to try to nullify the contract.

“When you’ve earned what you said the value was, it gives a good opening to say, ‘You’ve earned your money back. Now, you’re just milking the system and we’re going to break the deal,’” he says.

Waguespack knows there is little to no chance Emanuel does this, but it’s a measure he and other council members bring up every year “just to get it on the record.”

Being one of the first to recognize the problems this deal would bring, he is also aware of the lasting impact it will have as it moves into its second decade. “The best thing is for the rest of the United States to look at this and learn how not to do a deal,” Waguespack says.

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