Sale of the Century: Chicago's Infrastructure Deals and the Privatization State

Philip Ashton, Marc Doussard and Rachel Weber

Since 2004, the City of Chicago has been engaged in a new wave of infrastructure privatizations, selling concessions to financial institutions. Philip Ashton, Marc Doussard and Rachel Weber analyze the consequences of these transfers in detail, in terms of both public action and the impact on users, and identify lessons to be learned from this new way of doing things, whereby firms mine the city for potential revenue streams.

When the City of Chicago decided to privatize the Skyway, a 7.8-mile (12.5 km) bridge and toll road in the city's southern industrial section, its expectations were modest.[1] The Skyway had struggled to cover its operating costs and had only recently become profitable (Dyble 2013). The city's financial analysts anticipated that the bidding process would deliver a private toll-road operator willing to pay around $900 million for a long-term lease on the Skyway. After paying off outstanding debt, this return would net the cash-strapped city around $400 million—a good return for an aging and financially troubled toll road.

The city's estimates were off by nearly $1 billion. Cintra Macquarie, a multinational financial consortium led by the Australian investment bank Macquarie, bid $1.83 billion for the concession, resulting in a significant windfall to the city (Bel and Foote 2009). Granted, the concession deal gave Cintra Macquarie the right to substantial toll increases, and it protected their cash flow through a noncompete clause that restricted nearby road expansion. It also gave them control over the toll road for 99 years, much longer than standard contracts in regions like Europe or South America. However, the high price helped touch off a wave of infrastructure privatization that intensified with the mounting fiscal stress on city and state budgets. Within the next four years, Chicago alone would privatize its street parking meters and underground parking garages in separate deals; a deal to transfer Midway International Airport to private control collapsed in the wake of the September 2008 financial crisis.

Examples such as the Skyway offer a novel lens into "financialization" as an evolving yet persistent set of policy projects through which localities solve pressing policy problems by constructing the powers to work with, through, or against finance. Rather than relying on a false opposition between external financial markets and local institutions, this research examines individual deals as moments in a longer chain that actively engages and transforms public powers through experiments with finance.

Second-wave dealmaking

Whereas the private sector had a significant role in delivering urban services during earlier periods in US urban history (Sclar 2001), this role has re-emerged in new ways over the past 25 years. Through the 1980s, the privatization of public services and institutions was promoted by a

[1] In this article, we summarize findings of a multi-year research project focusing on the nature and effects of infrastructure dealmaking by the City of Chicago. Earlier versions of this research were published as Ashton, Doussard and Weber (2016).

network of think tanks focused on downsizing government; a 1987 Presidential Commission on Privatization proposed a comprehensive road map for selling or transferring control over federal functions to the private sector. These ideas were taken up within the infrastructure sphere through a first wave of state-authorized regional toll roads that employed a public–private partnership (or "P3") model to open parts of the design, building, operation, and/or maintenance to private-sector operators.

This first wave of infrastructure privatization was slow to trickle down to individual cities. Whereas the fiscal crisis in the 1970s promoted experiments with turning urban services over to private operators as part of an acute contraction of the local state, cities like Chicago learned how to privatize over a longer period of time and in response to more mundane budgetary and managerial pressures. In the mid-1990s, city officials started "low-level" privatization efforts focused on specific services such as janitors in public schools. These first steps helped the city hone the process of privatizing in several ways, both internally and alongside a network of interlinked investment banks, financial consultants, and law firms. This network came to form a thick structure of organized fiscal and political capacity—a "privatization state"—that turned early successes into models for subsequent deals and which could withstand both the changes in administration and frequent mergers and acquisitions in the banking sector.

The 2004 Skyway deal marked a significant inflection point in this privatization state. Not only did it turn dealmaking towards infrastructure, but it also transferred complete operating control of an existing or "brownfield" infrastructure asset to private hands for the first time. This groundbreaking deal involved at least two shifts that quickly became characteristic of the US infrastructure investment market in the mid-2000s. First, whereas earlier toll road projects were led by large civil-engineering conglomerates, the winning bidders for the Skyway and its successors were often the infrastructure subsidiaries of global investment banks. These firms specialize in capital market access, and they developed novel equity-investment models that "stapled" together geographically diverse infrastructure assets into portfolios, with equity stakes sold to a range of investors (Page *et al.* 2008).

Second, the large prices fetched by brownfield-asset leases reflect new techniques for mining value out of infrastructure investment, even in situations where the underlying asset produces low or even negative returns. One approach evident in the Skyway deal was the use of structured finance products to increase its book value. For instance, Cintra-Macquarie employed interest-rate "swaps" to fix the interest payments on variable-rate bonds. As this lowered the risk of interest-rate variations to investors' returns, Macquarie changed the internal risk-weighted cost of the capital it used to value the Skyway concession, increasing its book value from $882 million in 2004 to $1.2 billion by the end of 2007 (a 37% increase) (Zhang 2008). It then refinanced the project based on the higher valuation, replacing $1.1 billion in short-term financing used to pay for the concession with $1.5 billion in long-term bonds (Macquarie Analyst Package 2008, p. 44). This generated a $373 million windfall that it paid out as a distribution to equity investors. These approaches helped Macquarie generate a 21% internal rate of return for its Skyway equity investors (*ibid.*, p. 10).

City powers and exposures

It is common to decry these deals as evidence of a financial sector run amok, and to criticize a lack of transparency around the deals as proof that city administrations are increasingly beholden to banks. However, it is also important to note how the same financial tactics that produce high bid prices also increase the payoffs of privatization for the city. This is not to dismiss the many critiques; rather, the goal here is to highlight the dynamics that shape infrastructure privatization as a persistent and mobile political strategy.

A wider lens of the politics of the deals reveals three such dynamics. First, in addition to generating immediate budgetary benefits through an influx of cash, infrastructure concessions progressively formed part of the city's overall management of its fiscal position as access to municipal debt markets has become far more important for city management (Omstedt 2019). By transferring what were often problematic assets to private operators, the City of Chicago was able to pay off outstanding bonds and improve its overall balance sheet in support of future borrowing. For instance, in February 2006, the credit-rating agency Moody's upgraded Chicago's bond rating from A1 to Aa3, citing the Skyway deal as a primary influence (Shingore 2009).

Second, the influx of cash associated with these deals allowed the city to produce selective benefits to distribute to various political constituencies. Some of these benefits flowed from the new funds generated by the deals; the ordinance approving the Skyway, for instance, created a $100 million "neighborhood human infrastructure fund" to funnel resources to community and economic-development projects across the city. Some of the benefits were embedded in the deals themselves. All the major infrastructure agreements, including the Skyway, mandate that private operators abide by city living wage requirements for employees, and that any subcontracting conform to city mandates regarding the hiring of minority- and women-owned businesses.

Notwithstanding these payoffs for the city, infrastructure asset deals have altered the nature of policymaking in some fundamental (and detrimental) ways. Even as the deals were sold by the mayor's office to the city council and the public as a transfer of risks to the private sector, the city's own risks and exposures have been heightened as a result of its "entanglement" with investment banks. In the case of the citywide parking-meter system, for example, the concession deal required that the city reimburse the Morgan Stanley–led partnership for any revenue lost from "adverse" events—street closures due to parking waivers, public-works projects, street festivals, or other public events. Under earlier modes of service delivery, the city never had to systematically calculate the aggregate costs of street repairs, disabled-parking concessions or other parking disruptions. Imagine the administration's surprise when Morgan Stanley presented a bill for $55 million in revenue lost to adverse events *in the first two years of the deal alone*. Everyday planning activities such as zoning and permitting have also been flagged as problematic, as evidenced by a $200 million lawsuit from Morgan Stanley claiming that the city's approval of a private parking garage violated the terms of a noncompete clause in the bank's lease for the public underground parking garages (Mihalopoulos and Fusco 2012). As Farmer (2013) notes, key elements of the city's sustainability action plan, including bus rapid transit and bike lanes, target the same curbside spaces transferred to Morgan Stanley under the parking-meters concession. As the city would now need to effectively repurchase street-level rights-of-way from the bank to implement those transportation initiatives, raising their implementation costs to unfeasible levels, the deal has produced insurmountable obstacles for planners seeking innovative solutions to problems related to auto congestion.

These exposures have quickly produced a consolidation of control over infrastructure management in the Department of Revenue, centralizing responsibility within the risk management apparatus of the executive branch, while subordinating the planning functions and knowledges traditionally wielded by frontline departments (such as the Commissioner of Transportation). Tasking the agencies responsible for city finances to lead the privatization efforts signifies a shift in both the meaning and the practice of infrastructure management from something operated for its use value to a commodity valued for its ability to be circulated and exchanged. One aspect of this shift has been an increase in traffic fines and license suspensions targeting Chicago drivers. Whereas enforcement of parking rules and regulations through ticketing is a longstanding transportation management function, the parking-meters agreement mandated that the city's Department of Revenue employ vehicle immobilization (the costly "boot" vehicle clamp) and license suspensions for drivers who repeatedly did not pay parking fees, with fines to be set at a level "necessary to deter parking violations" (City of Chicago and Chicago Parking Meters LLC 2008). Recent research has highlighted not only the dramatic increase in those fines and suspensions since the deal was signed, but also their disproportionate impact on low-income and minority drivers, many of whom end up in bankruptcy owing to their inability to pay (Sanchez and Kambhampati 2018).

Conclusion

This remapping of city powers highlights how one of the most important products of Chicago's brief experiment with selling off infrastructure may be an underlying shift in the very notion of urban infrastructure, from a public good with free positive externalities to a set of earnings packages derived from urban flows capable of being bundled into repeated earnings-generated financial products (O'Neill 2009). Even as the market for marquee-infrastructure deals appeared to collapse with the 2008 financial crisis and increasing political scrutiny of Chicago's deals, the approach to dealmaking honed by the "privatization state" did not so much fail as "fail forward" (Peck 2010) into new areas of urban governance. These experiments, in areas such as public building retrofits, smart-city investments in public transit, or solar energy production (Chicago Infrastructure Trust 2018), are still too young to fully profile; nevertheless, they witness an approach to scouring the city for potential revenue streams that can be unlocked through selective financial investments in the built environment. The deals may be smaller and may garner fewer headlines, but their implications for urban governance will be no less profound.

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