

## • Akron Eyes P3 Lease For Sewers

*Deal Would Fund Scholarship Program*

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**CHICAGO** - Akron, Ohio, could raise up to \$250 million to fund a university scholarship program for the city's public school students by leasing its sewer system under a first-of-its-kind proposal floated by Mayor Donald Plusquellic.

The plan calls for the city to enter into a long-term lease of the system in a transaction that could launch a new front in the move by the nation's governments to privatize existing assets for an upfront cash windfall. Officials aim to close the deal by the end of the year, and to that end have recently hired a financial adviser and formed a 12-member advisory group charged with recommending the transaction's terms.

Though public-private partnerships of existing municipal assets to finance construction of new assets has gained in popularity across the country, Akron's plan would mark the first time that a city has leased a sewer system in order to generate an upfront cash payment. Working with Morgan Stanley as its financial adviser, the city is studying other long-term lease transactions, but finds itself in new territory with regard to the particular issues that affect a sewer system lease.

"This is the first time that a large city has undergone a lease of its wastewater system," said Rick Merolla, the city's public services director who has control over Akron's public utilities. "We don't have a lot of models out there. We're still reviewing all the implications."

Among the crucial issues that would affect the lease's terms and ultimately the price an investment or management group is willing to bid for the asset include rate controls and the funding of future environmental upgrades mandated by the U.S. Environmental Protection Agency for aging sewer systems across the country.

Plusquellic, who has been Akron's mayor for 22 years, first floated the idea in his state of the city address last February, saying the idea came from watching other American cities move to sell off their municipal assets.

"I've been watching cities around America reinvest in their infrastructure through the sale of publicly owned assets to private concerns," he said. Estimating the net proceeds of such a transaction at \$250 million, Plusquellic said the money would fund a scholarship fund for

Akron public school graduates to attend the University of Akron or an advanced trade school located in the city.

The mayor dubbed the program the "Akron Plan for the 21st Century," and declared it could transform the city for the rest of the century.

Located in the northeast section of the state, about 40 miles from Cleveland, Akron enjoys a fairly diverse employment center, including the University of Akron and Goodyear Tire & Rubber Co. The city has not escaped the state's sagging economy, though it has not been as hard hit as other cities like Toledo, say rating analysts.

Officials considered securitizing other assets, but decided that leasing the sewer system would have the least impact on residents, according to Merolla.

"Our goal is to create the scholarship fund and the mayor thought the best and fastest way to do that is to lease the sewer system," he said. "For the most part, once people flush their toilet they don't really care what happens to the waste as long as it's taken care of and the rivers are clean."

Issuers across the country have latched onto the idea of entering into long-term leases of their assets in exchange for a cash windfall over the last few years. Chicago was the first when it handed over the rights to operate the Chicago Skyway toll bridge to a private company for 99 years in exchange for \$1.82 billion in early 2005. The following year Indiana signed a \$3.84 billion lease of the Indiana Toll Road for 75 years.

Chicago has since privatized its parking garages and is working on leases involving Midway Airport, recycling centers, and its parking meter system. Chicago has used its funds for infrastructure and to establish a permanent reserve, and would use future revenues to help shore up its pensions. Indiana used its proceeds to fund transportation improvements.

Using the proceeds from privatization to set up a scholarship program for local high school graduates would mark another first for a city, market participants believe. The fund would serve as a repository of "last dollars" for any Akron public high school graduate who is unable to secure other financial aid for either the University of Akron or a local trade school.

The proposal comes as Akron is in the midst of a massive, \$800 million capital plan to replace every school building. To pay for its portion of the program, Akron implemented a 0.25% income tax increase - raising the city's income tax to 2.25% - becoming the Ohio city to tap into a matching fund program with the state for school construction.

"The city has already interceded on behalf of Akron's schools to help finance its capital program," said Fitch Ratings analyst Melanie Shaker. "Akron has already issued income-tax revenue debt for school projects, so adequate education capital funding seems to be a priority for the city administration."

City officials emphasize that they are still crafting terms of a final deal on the sewer lease. But partly in response to an early flurry of criticism over the proposal, Plusquellic recently promised that Akron would work to retain control over rates, as well as job losses, and other "performance standards" to ensure the sewer system doesn't deteriorate under private control.

Under the current proposal, the city would use proceeds to repay about \$73.1 million in outstanding debt. Of that \$73.1 million, \$37.4 million is revenue bonds, \$35.5 million is loans from the state revolving fund, and \$35,000 is general obligation bonds, according to Andre Blaylock, the business services administrator for the public utilities bureau.

Akron's sewer system serves the city's 210,000 customers as well as another 85,000 in nearby suburbs. It generated \$35.8 million in operating revenue in fiscal 2006, of which roughly \$3 million was profit, according to Blaylock. The city has an annual capital improvement program for the system, and last year spent \$7 million last year on capital improvements, rolling forward another \$3.3 million into the current fiscal year, with another \$13.9 million in the current budget for new projects.

The city hired Morgan Stanley, led by public finance banker William Daley Jr., a nephew of Chicago Mayor Richard Daley, as financial adviser last month after reviewing a handful of firms with experience in similar deals, Merolla said.

The city also recently formed a 12-member advisory group, led by Louise Gissendaner, president of Cincinnati-based Fifth Third Bank's Akron market, to study the transaction and recommend key terms of the deal. Plusquellic said the advisory group's goal would be to strike a balance between protecting ratepayers and maximizing the value of the sewer system.

Like many other Midwestern cities, Akron faces a series of costly capital upgrades to its system to meet environmental standards mandated by the EPA. Most municipalities like Akron with combined sewer systems - in which both sanitary sewage and stormwater are conveyed through a single pipe - are in the process of developing long-term overflow control plans to comply with the EPA order, first mandated in 1994.

Officials in Columbus for example, recently issued \$400 million in sewer revenue bonds as the first phase of an environmental update program that they estimate will cost \$2.5 billion over the next 40 years.

"These pending EPA issues are very expensive capital improvements," said Moody's Investors Service analyst Henrietta Chang. "These could be a hurdle."

Analysts said another significant concern involves the rate-setting authority in the ultimate deal.

"For Moody's bottom line, we would not want to see the city give up its rate-setting authority," Chang said.

The mayor has said he would not and in past leasing transactions, governmental units have set limits on rate increases.

Rate-setting authority has also emerged as a key concern from a newly-formed group of opponents to the deal that includes the local labor union that represents Akron's utility workers and other citizens. The Citizens to Save Our Sewers and Water has held a series of public meetings, put up a Web site, and is working to gather the 12,000 signatures necessary to put the issue on the ballot for voter approval. Under the current city charter, the City Council would need to approve the proposal. Among other criticisms, opponents say privatizing the system would lead to lost jobs and deterioration in customer service.

Plusquellic has promised that the city would protect against job losses and would hold public meetings on the lease before moving to secure the City Council's approval. The advisory council is scheduled to next meet in July. Officials expect to issue a request for qualifications for investors to test initial interest over the next few months, and then put out a detailed request for proposals later this year before negotiating a final bid. The goal is to close the deal by the end of the year, said Merolla.

Moody's rates Akron's GOs A1, while Fitch and Standard & Poor's assign AA-minus ratings to the city's limited-tax GO debt. There are no underlying ratings on the city's sewer debt.