Overview of Parking Privatization Financial Analysis

Bruce W. Weide, 29 May 2012

According to administration data, OSU currently collects about $30M in parking revenues each year and uses them to pay expenses related to Transportation and Parking. Under privatization, all these revenues—but less than half of the expenses they now pay for (the white piece of pie in the figure)—would be turned over to the private operator. The portion of revenues now used to pay other expenses (the red pieces of pie on the left) would become foregone revenues. Note that it doesn’t really matter what expenses these foregone revenues pay for now; they would be lost to OSU under parking privatization, so whatever they pay for now or in the future would need to be covered from other sources to make up for their loss.

To pay expenses that the foregone revenues would have paid over the next 50 years if OSU kept parking in-house, under privatization OSU would either need to (1) divert money annually from other funds, making it unavailable to the academic core or anything else; or (2) take annual distributions out of its returns from investing the parking privatization lump-sum funds. Option (1) would be a “shell game”: robbing Peter to pay Paul. However, option (2) would not actually cover all the foregone revenues for many years into the future, so option (1) would be needed during these years to make up the difference. The analysis described in the next paragraph projects these annual shortfalls.

The concession agreement offers bidders three “scenarios” with different caps on first-decade rate increases, and the foregone revenues are different for each one. Analysis of each scenario assumes: the administration’s example of a $400M bid that is 100% available to add to OSU’s endowment, or long-term investment pool (LTIP); annual 4% inflation, which turns out to be the best possible case for OSU; the administration’s predicted schedule of capital expenditures, which spikes slightly every five years; and the administration’s predicted 9% annual return on the LTIP. This leads to the results shown in the figure below. Distributions from parking privatization lump-sum funds in the LTIP, under the Board of Trustees’ current distribution policy, would fall short of covering foregone revenues every year except the first in each scenario, until at least 2042. This means option (1) would be needed to plug the gap for at least three decades. Note that figures here are reported in 2012 dollars so they make sense to people living now. Note also that the annual numbers—generally under $10 million per year, both positive and negative—are relatively small, being no more than about 0.2% of OSU’s annual budget of some $5 billion.
The administration has noted (correctly) that, in each of the three rate-cap scenarios analyzed under the above model, the value of the LTIP a half-century from now would be much greater than if parking were kept in-house. That estimated additional value is, in each scenario, about $952M in 2012 dollars. The cold and blunt financial question is then whether the net amount that would be diverted from other OSU funds to cover foregone revenues over the next several decades would be larger or smaller than the increase in the final value of the OSU endowment made possible by parking privatization.

The answer to this question is, unfortunately, complicated by the so-called time-value of money. And different people discount the future at different rates in order to estimate the present value of future cash flows (in this case, the annual foregone revenues that would need to be covered by a lump-sum payment collected now). The range of proposed discount rates runs from 6% to 9%. Any conclusion about the minimum bid that would permit OSU to break even on parking privatization relative to keeping parking in-house is extremely sensitive to one’s choice of discount rate. The figure to the right shows this. For instance, the minimum break-even bid for the middle 6.5% scenario might range anywhere from $421M to $731M depending on the discount rate chosen for the analysis. Estimating how much more than a break-even bid would be required to support the administration’s promised $16M in new annual commitments to various academic initiatives would require a detailed analysis of still more factors. My public records request for the administration’s own analysis of these factors has gone unanswered.

However, the qualitative nature of the trade-off OSU would face under parking privatization is clear. Absent a significant change in the Board of Trustees’ distribution policy for the LTIP, for most or all of the next 50 years millions of dollars per year in foregone revenues would need to be covered by diverting money annually from other OSU funds, making it unavailable to the academic core or anything else, i.e., the option (I) “shell game”. In exchange for this, OSU would have a larger endowment value in 2062.

The above trade-off raises an important public-policy question. State law allows OSU to borrow funds for capital expenditures but prohibits borrowing for current operations. Why? All who help make debt payments for the next 20-30 years may be expected to “enjoy” the results of borrowing to build structures now that will last longer than the time required to pay them off. On the other hand, only those who help make debt payments now may be expected to enjoy the results of borrowing for operations; so, creating this unfair situation for future generations is not permitted in Ohio. Requiring all who park on campus now and for decades to come to pay higher parking rates in order to embellish the value of the OSU endowment after 50 years, so future generations may enjoy the fruits of those payments, is similarly unfair. This is the dual of the problem with borrowing for current operations. The cold and blunt financial analysis based on the present value of foregone revenues simply ignores this problem. Some (not all) might find it acceptable to pay higher parking rates if they could hope to enjoy the results of paying higher rates. Yet here, current ratepayers face 30-50 years of suffering through option (I) in order that the OSU endowment might be larger in 50 years. This trade-off is simply unfair to those who would pay for it; hence, it should not be considered acceptable.

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1 The Board of Trustees current distribution policy “is intended to help preserve the purchasing power of the endowment” by making sure a significant fraction of recent annual returns are reinvested rather than being distributed (http://www.giveto.osu.edu/guiderogiving/endowments/about.html). This policy could be weakened, but such a move is not suggested in the administration’s official pronouncements about the merits of parking privatization.