Memorandum

To: Mayor Jaray and City Council
CC:
From: Malcolm Fleming, Interim City Administrator
Date: 6/26/2018
RE: Ordinance No. 1318, an Ordinance of the City of Manitou Springs, Colorado Approving a Tax Incentive Program Agreement - 2nd reading - 60 minutes

Purpose:
To consider and adopt Ordinance No. 1318 regarding a Tax Incentive Program Agreement with the Manitou and Pikes Peak Cog Railway.

Background:
The Manitou and Pike's Peak Cog Railway is an international tourist attraction that generates significant economic activity in Manitou Springs and the Colorado Springs metro area. When operational, around 300,000 to 350,000 people ride the Cog annually. Since 2013, the 5% excise (amusement) tax the City of Manitou Springs collects on the Cog's ticket sales generated between $350,000 to almost $500,000 in tax revenue annually for the City. Staff estimates that retail activity generated by the Cog in Manitou Springs generates at least another $100,000 in sales tax revenue to the City annually.

The Cog has been closed since late fall 2017 while the Railway investigated the cost and feasibility of reconstructing the railway ballast and track, engines, cars, depot and other related facilities. At the request of representatives from the Cog and with the knowledge of City Council, Mayor Jaray, Mayor Pro Tem Fortuin—and in her absence, Council Member Todd—and Interim City Administrator Fleming have been working with the Cog to explore options to ensure the Cog reconstruction project is financially and logistically feasible, to implement measures to address traffic congestion issues caused by visitors driving to the Cog, and other partnership opportunities such as coordinated parking management, a joint parking structure and possibly a Historic Cog Railway Museum.

The Railway estimates the cost of the reconstruction work is likely $80 million to as much as $95 million. There are still many variables affecting this cost estimate including still to be finalized contract prices for all of the construction work and equipment, fluctuating material costs that may be affected by recently imposed tariffs and world economic conditions, labor costs in the very active construction sector, weather and the length of time it will take to complete construction. Any of these variables could dramatically affect cost and feasibility. There are also significant variables on the revenue side of the Cog's equation, especially the ability of the Cog to charge ticket prices that will cover the capital and operational costs of the railway. The Cog's ticket prices are subject to normal economic forces including supply, demand, alternatives, competition, perceived value and general economic trends over time.

The Cog is using 50-year projections of all factors to determine the feasibility of the project and whether investing the $80 million to $95 million in this project will provide sufficient returns relative to other investment opportunities. In addition to operating and routine maintenance cost during the 50-year timeframe, the Cog will also have to replace the cars, engines and other equipment at significant expense (tens of millions of dollars) to keep the Cog operational and attractive to visitors over time.

Gary Pierson, CEO of the Broadmoor-Sea Island Company, which owns the Cog Railway, advised the City that the Cog reconstruction project is not financially feasible unless they can limit and have certainty on the maximum amount of excise tax the Cog will pay on their ticket sales. Pierson says the Cog will also need the City's collaboration and help to expedite issues associated with the construction activity including permitting, logistics and other matters. Pierson also expressed his and the Cog ownership's understanding of how important the Cog is to the economic health of Maintou Springs and that they also value and want to preserve and maintain the Cog's unique, historic and iconic contributions to Manitou Springs and the region. Additionally, they regret the abrupt manner in which they had to close the Cog and the negative impact that had and continues to have on the City's finances and on the local economy. Further, they understand that for all the economic and cultural benefits associated with the Cog, there are also negative impacts, namely the traffic congestion the Cog contributes to in Manitou Springs. For all of these reasons, they want to work in partnership with the City to ensure the reconstruction project is financially and logistically feasible and to explore and implement measures to address the traffic congestion issues.

With all of these issued in mind, and as the culmination of several discussions between representatives of the Cog and the City, on June 8 the Cog proposed an agreement including the following provisions:

1. The Cog will pay the City of Manitou Springs ("Manitou") $500,000 in each of 2018 and 2019.
2. Manitou will amend the Amusement tax ordinance to place a $500,000 cap on any single or directly related taxpayer for any single year. This maximum amount will increase by 1.5% every fourth year.
3. The cap will stay in place for 50 years if we collectively believe that such a provision will be enforceable under the Colorado Constitution.
4. The Cog and Manitou will work closely together to coordinate construction logistics so as to avoid as much as practical creating traffic congestion.
5. The Cog and Manitou will work closely together to coordinate and expedite plans to renovate and/or demolish and/or expand the existing Depot and related structures with any rebuilt, expanded, or remodeled buildings maintaining architectural consistency with the historical appearance of the Depot and related buildings.
6. The Cog and Manitou will work together to help alleviate traffic congestion within Manitou, including on Ruston Avenue. This may include entering into a joint venture for overflow parking at Hiawatha Gardens or elsewhere. This will also include the Cog shuttling customers during high season from offsite parking.
7. The Cog will donate certain historical "rail related" assets to a Manitou owned Cog rail museum.
8. Manitou will waive all Use Taxes on capital assets purchased by the Cog in its operations.
9. The Cog's Conditional Use permit will be amended to fully accommodate its operations and any existing controversy related to the same will be forever concluded.
10. Waiver of all tap fees associated with construction work at the Depot.

On Monday, June 11, the City held a Public Open House to discuss this matter. During that meeting, which about 80 people attended, Mayor Jaray and Gary Pierson discussed the Cog's reconstruction project and the framework of the proposed tax incentive program agreement between the City and the Cog.

The following evening, during the June 12 City Council meeting, staff presented a proposed Ordinance regarding the tax incentive program agreement. In summary, under the proposed agreement (1) the Cog would pay the City $500,000 in 2018 and again in 2019, (2) the City would waive the estimated $900,000 to $1.1 million Use Tax that would otherwise be due on the reconstruction project, (3) for a period of 50 years, the City would rebate to the Cog Excise Taxes paid by the Cog if the amount of those Taxes exceeds a "Base Excise Tax" level specified in the agreement; the level would start at $500,000, which is slightly more than the Cog's 2016 Excise Tax payment, and increase by 1.5% to 2.5% every fourth year.

Council discuss the matter again during the Council's June 19 Work Session. During that meeting, and in response to Council's June 12 direction, staff reviewed financial models of the proposed "Base Excise Tax" that is specified in the tax incentive program agreement to reflect changes the parties had worked out immediately prior to the Council meeting and which Council had no opportunity to consider previously. Staff also noted Gary Pierson confirmed the Cog would continue to use the commonly referred name of the Cog Railway as the "Manitou and Pike's Peak Cog Railway", which was an issue raised in the Public Open House concerned the importance to the community of retaining "Manitou" in the title of the "Manitou and Pike's Peak Railway Company".

Since June 19th, Mayor Jaray, Council Member Todd, Interim Administrator Fleming and City Attorney Parker have continued to work with Gary Pierson to resolve issues and concerns with the proposed agreement. Attachment 2 reflects the final draft of the agreement for Council consideration, while Attachment 3 reflects in red highlighting and underline/strikeout font, the changes the negotiating teams have agreed to, subject to Council approval.

Fiscal Impact:
City staff projects that the closing of the Cog Railway will reduce City excise tax revenue by about $500,000 annually, and may indirectly reduce sales tax revenue by an additional $100,000 annually. This represents about 7.2% of the City's projected 2018 General Fund <u>tax</u> revenue and about 5.6% of the City's projected 2018 General Fund <u>total</u> revenue.

The proposed agreement provides for two $500,000 payments from the Cog, one in 2018 and the second in 2019. These payments would significantly reduce the negative impact of the Cog's closure until it reopens. If the Cog proceeds with the reconstruction project, the Cog management hopes to complete the project by late spring in 2020. If the Cog reopens in 2020, staff estimates, based on comments from Cog management, the excise tax revenue for the first partial year of operations might be about $350,000. After that, the Cog's excise tax revenue payments could increase, depending on the Cog's ability to increase ticket prices, to the amount of the agreed on cap, which the Cog proposes to initially set at $500,000. Under the final draft of the agreement, the $500,000 cap would increase by 1.5% every 4 years during the first 30 years plus an additional 1.0% (a total of 2.5%) in years 12 and 24, and then by specified amounts in years 30 through 50. Attachments 4 and 5 are tables that reflect the cap (the "Base Excise Tax Amount") as well as the Excise Tax and Tax Rebate amounts that could occur under different hypothetical ticket prices.

The first table (Attachment 4) shows the revenue streams assuming a maximum average ticket price of $40, annual increases of 5% to get to that max price, and max ticket sales of 350,000 annually (assuming there are two years of lesser sales due to partial year operation and slower sales in the first year). Under those assumptions, the City would retain a total of about $30 million in excise tax from the Cog over 50 years, and the City would rebate a total of about $4 million over that same 50 years. This scenario represents a $4 million incentive to support the Cog's reconstruction project. In net present value, and using a discount rate of 3%, the stream of rebates is worth $2.3 million in today's dollars. The table also reflects that under this scenario, the Cog would pay an average effective (net of rebates) excise tax rate of 4.4% over the 50-year term of the proposed agreement.

The second table (Attachment 5) assumes the Cog is able to increase the maximum average ticket price to $55 within 5 years (20% increases each year until the max). Under these assumptions, the City would retain the same total of about $30 million in excise tax from the Cog over 50 years, but the City would rebate a significantly higher amount, a total of about $ 16 million over 50 years. This scenario represents a roughly $16 million incentive to support the reconstruction project. In net present value, and using a discount rate of 3%, the stream of rebates is worth $8.1 million in today's dollars. The table also reflects that under this scenario, the Cog would pay an average effective (net of rebates) excise tax rate of 3.3% over the 50-year term of the proposed agreement.

As noted previously in the communication, the potential for the Cog to increase ticket prices very rapidly and to high levels, perhaps higher than the scenarios in these tables, would be subject to normal economic forces including supply, demand, alternatives, competition, perceived value and general economic trends over time.

The proposed agreement would also involve the City waiving the City's 3.8% use taxes on the project. City staff estimate, assuming that 30% of project costs would be subject to use taxes, that this could amount to $900,000 to as much as $1.1 million.

If the Cog reopens, it would contribute to the long term economic health of Manitou Springs and the region. If the Cog does not reopen, it would likely have a profound negative impact on the City's finances and the local economy. The negative impact on the City would likely exceed over $600,000 annually.

Workload Impact:
There will be a significant impact on staff to coordinate all City activities associated with this project. Staff has not had the time to make any detailed estimates of the potential impact at this time.

Recommended Action:
This is a policy decision for City Council whether to (1) approve the Ordinance and agreement as proposed, (2) make changes to the proposed agreement before approving it, or (3) take other action. Some people may think the economics of the reconstruction project are such that it may not be feasible even under incentives more significant than those proposed. Others have suggested the Cog is likely to proceed with the railway reconstruction without incentives.

Staff believes the proposed incentive package reflects a balance between competing interests and will help ensure the Cog's viability and significant positive economic impact in Manitou Springs over time. It also clarifies in important ways both the Cog's and the City's roles in facilitating the reconstruction project and mitigating the adverse impacts created by patrons enjoying the Cog. It also fosters an important partnership between the City and one of the City's largest businesses and in doing so will promote collaborative approaches to improving business conditions throughout the City and the region and to managing difficult issues like traffic congestion. Finally, it represents a reasonable balance between the taxes the Cog pays, and costs to the City of providing services that directly benefit the Cog, as well as the costs to the City for the various regulatory and programmatic actions required to address the negative impacts that come with Cog's operations.

ATTACHMENTS:

Description	Type	Upload Date
Proposed ordinance	Ordinance	6/26/2018
Final Draft of Incentive Agreement	Cover Memo	6/22/2018