Addendum to

Opinion Letter

Dated September 28, 2018

on the Reasonableness & Fairness

of Incentive Agreement between

City of Manitou Springs

and

Cog Railway

November 1, 2018

Data → Reasoning → Conclusions

- Empirical Research
- Computer Modeling
- Rigorous Analysis

For Strategic & Tactical Decision-Making

This addendum to our original Opinion Letter dated September 28, 2018, incorporates the latest proposal both parties are considering as well as the recent progression of negotiations. Our original opinion concluded:

1. Given the magnitude of the investment and expected rate of return for this class of investment, the Cog's request for incentives appears legitimate. Without incentives there is a reasonably high probability the needed investment will not take place.
2. Manitou Springs has benefitted substantially from the Cog's presence in the City for over a century. These benefits would continue with the Cog and could be expanded if there is a close working relationship between the Cog and City. Furthermore, the City of Manitou Springs looks forward to a less certain fiscal future due to marijuana market conditions that could change radically in the coming few years; changes in consumption patterns and delivery of taxable sales; aging infrastructure; greater uncertainty of revenue sharing among state, federal, and local governments; and greater risk of natural disaster.
3. A capped tax structure proposed in the original agreement exposes the City of Manitou to inflation risks and a 50-year incentive term is not typical under the proposed circumstances.
4. Failing to reach an agreement to keep the Cog operating for another half century (at least) would be a "grave" mistake.

Our use of the term "grave" was intentional as infrastructure, especially harsh climates (such as going from 6,400 feet to 14,100 feet), is subject to erosion and likely to experience rapid deterioration. In addition, given the current trade environment, key materials prices may escalate due to tariffs. The result is likely to be a replacement cost curve that grows exponentially. Given the proposed investment already appears questionable using traditional investment analysis, significantly higher costs a few years down the road could result in a permanent closure of the Cog. That would be "grave" given the Cog's relationship to Manitou Springs directly and the Pikes Peak region in general. Furthermore, it serves as one of three transportation methods to the top of Pikes Peak, and it may be the most environmentally sustainable of the three (Barr Trail, Pikes Peak Highway, and the Cog Railway) if properly maintained.

We encouraged the parties to reach agreement. The current proposal includes:

1. A fixed annual cap on taxes retained by the City for 25 years instead of the originally proposed 50 years.
2. An uncapped tax rate of 3.8% on sales in the second 25 years of a 50-year term.
3. A 5% tax rate, which is the historical rate, on passengers above 375,000 per year.
4. $1.25 million in "voluntary" payments to Manitou Springs by the Cog to assist the community while the Cog Railway is closed for repairs,
5. The City of Manitou Springs will refund use tax collections on both the initial investment and the replacement of trains in years 15 to 20.
6. A partnership approach with joint financial commitment to developing adequate parking and transportation systems to lessen the negative impacts on Ruxton Avenue and the railway and to increase the positive impacts in the historic shopping district.
7. A partnership approach to periodically reviewing impacts to improve processes and approaches as needed.

The current proposal has a modified cap on taxes received by Manitou Springs. The cap is for $507,900 in the first year growing to $565,911 in the 25th year. This equates to an 0.43% average annual increase.

If there were no cap and the City of Manitou Springs received 3.8% of revenues in the first 25 years and the average ticket price started at $32 and grew at 1% per year, $599,000 would be generated in taxes by year 25 on 375,000 visitors. Hence, the cap in the 25th year is consistent with a what might otherwise be expected without a cap.

The cap does not specifically adjust to inflation. However, the cap starts at approximately the highest level recorded in the past and is consistent with Tax Increment Financing (TIF) schemes whereby tax receipts by government are locked into historical levels and the developer gets the "potential" increase. Furthermore, the cap only exists for 25 years (rather than 50 in the original proposal) which is more typical with incentives and allows for tax revenues above the cap to be retained by the City if the number of Cog riders increases above 375,000 annually.

Refunding of use taxes is typical in incentive packages and in this case are estimated by City staff to total approximately $1 million during the reinvestment phase and then another $1 million when the trains are replaced. The Cog's voluntary payments to the City during the reinvestment period and planned investment in parking and transportation solutions appear to be roughly equal use tax refunds on a present value basis.

The Cog Railway has remained steadfast insisting upon a 50-year agreement with the City of Manitou Springs. Our original conclusion regarding the 50 year incentive agreement was based upon basic return on investment analysis over different time periods. Relatively little present value benefit (1.1% of the amount invested) is received by returning capital investment over 35-50 years versus 30 years. The low incremental financial benefit to the Cog over 50 years leads us to conclude their position is predicated on principle and not money. One does not have to look very far to see why. The incline has survived for well over a century by being privately maintained and by remaining in the good graces of multiple governments including the federal government (Forest Service), Colorado Springs (the utility enterprise and Summit House), El Paso County, and Manitou Springs. The Cog's insistence appears to be an acknowledgment of their vision to keep this unique railroad in service for another half century and they want the same level of commitment from Manitou Springs as a show of long-term support. This principled perspective is consistent with both Manitou Springs and the Cog Railway wanting to partner to provide a greater net positive impact on both the community and the investment.

Given the above analysis and the fact that the Cog Railway and City of Manitou Springs appear to have negotiated in good faith, we conclude the current proposal is both fair and reasonable to both parties. We recommend the City of Manitou Springs accept the current offer.