The Economics of Land Use

Draft Report

Wilson Gulch Road Evaluation of Public Financing Alternatives

Prepared for:

City of Durango

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1. INTRODUCTION

Project Overview

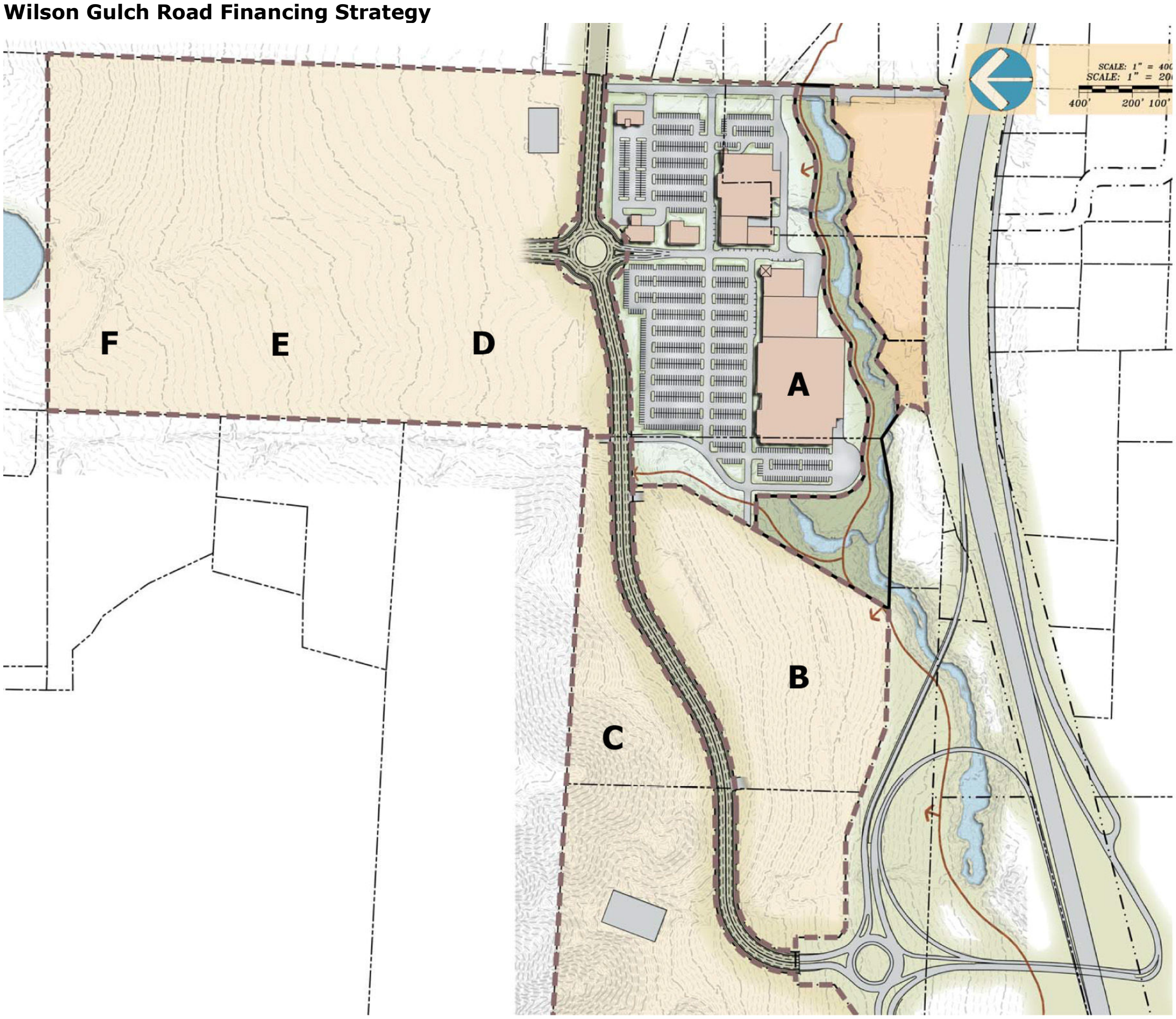
The proposed extension of Wilson Gulch Road will provide a link between the existing road network in the Three Springs area and the Highway 550/160 interchange currently under construction. When constructed, the new right-of-way and road will serve several commercial and residential development sites, as shown below in **Figure 1**. The access and visibility created by the road will increase the value of the land substantially; however, the road must be funded and constructed before development will occur. At this time, the Growth Fund is under contract with the Crader family to purchase 37 acres of the 160 acres to be annexed and intends to develop the site as a retail shopping area. This proposed transaction is shown as Parcel A in **Figure 1.** The Crader family intends to hold Parcels B through F for the near term, with plans to sell and/or develop in the future.

Establishing the appropriate revenue sources to fund the construction of the road is the focus of this analysis. This analysis is broken into four components:

- What are the La Plata County retail market conditions? How much additional retail can be supported over a 20-year planning horizon? What is the current retail leakage rate and how can that be reduced?
- What sources of revenue could be used for public financing?
- What is the appropriate bonding mechanism the City can use to generate sufficient review to construct the Wilson Gulch Road improvements? What types of bonds warrant consideration, recognizing that options other than General Obligation bonds may be a better fit?
- What is an equitable distribution of the financial burden among the stakeholders to achieve this goal?

Economic & Planning Systems (EPS) is a full-service land use economics firm with offices in Denver, Colorado and Berkeley, Sacramento and Los Angeles, California. The firm specializes in market analysis, fiscal and economic impact assessment, and public financing strategies. It often works with both public and private entities to develop partnerships to create solutions that work for the larger community as well as specific property owners. It has been retained by the City to evaluate options and define a strategy to fund the road.

Figure 1
Development Sites
Wilson Gulch Road Financing Strategy



2. *SUMMARY OF LA PLATA COUNTY RETAIL MARKET POTENTIALS*

This section provides an overview of the market trends, conditions, and factors used in developing the retail development potential forecasts. A county wide retail leakage and capture analysis was completed and grounded in a countywide demographic forecast, based on long-term historic averages in population, household, and housing unit growth, as well as ground in long-term historic averages of employment growth by industry.

The key findings of the market analysis and projections are the potential capture of retail growth and development in the Wilson Gulch Road area, as evaluated as a submarket within the La Plata County trade area. The findings of this analysis are applied to an infrastructure financing model used to determine and calibrate the optimal financing terms and revenue streams available to fund the Wilson Gulch Road link.

Market Analysis Methodology

Below is a brief description of each task related to developing a grounded forecast of retail development potential for the La Plata County market and specifically the Wilson Gulch Road area.

- **Population and Growth Forecast**: EPS analyzed historic population, household, and housing unit (residential and commercial building permit data) trends to develop low and high growth forecast factors. The forecasts also account for vacancy level adjustments, second homeownership rates, as well as average household size. In addition to grounding the forecasts in historic data, EPS calibrated the forecasts to account for conservative timing of an economic recovery. The forecast was bracketed over 20-year planning horizon, from 2010 through 2030. By 2030, EPS estimates the county population to range between 66,000 and 75,000, based on the addition of 15,000 to 24,000 new residents.

- **Other Forecast Sources**: For comparison purposes, EPS identified other reliable sources of population forecasts for La Plata County, including the Department of Local Affairs, Woods & Poole, and the Colorado Water Conservation Board. Compared to each of these sources, EPS' forecasts are conservative for population, households, and employment.

- **Rates of Growth**: Residential development activity in La Plata County (which includes all municipal activity such as Durango and Bayfield for the purposes of this analysis) averaged 420 dwelling units per year from 2001 through 2011. This factor has been used as the basis of the low forecast. The high forecast is also grounded in historical permit records, but captures the years 1999 through 2007. The annual permitting activity averaged 557 units per year.

Retail Potentials

The following section provides an incremental analysis of the La Plata County retail market potentials. A series of retail definitions is provided, followed by an evaluation of the local income available to support retail sales, concluding with an evaluation of sales flows within and outside the immediate trade area.

- **Retail Categories**: EPS uses a retail development potentials model that incorporates multiple types of store categories identified in the U.S. Census of Retail Trade and classified according to the North American Industrial Classification System (NAICS), which are used to identify employment industries. These industries include: convenience goods (supermarkets and grocery stores); shoppers goods (merchandise, e.g., Wal-Mart, Target, and Kmart); eating and drinking establishments; and building materials/nurseries.

  Community serving retail includes most convenience store and eating and drinking store space, and regional retail space is comprised primarily of shoppers goods and building material stores. For purposes of this study, large format retailers (also called big box stores) are defined as regional retail stores of about 80,000 square feet of space or greater, which generally include discount department stores (e.g., Target and Wal-Mart), supercenters (discounter with grocery store space), membership warehouse stores (e.g., Costco and Sam's Club), and home improvement centers (e.g., Lowe's and Home Depot).

- **Trade Area**: EPS calibrates each retail analysis by identifying the appropriate geographic area from which a store or collection of stores draws the majority of its business. For this analysis, La Plata County as a whole is considered to be the trade area. While the vast majority of the county's retail inventory is located within the City of Durango, much of the support for this retail comes from county residents who view the City as a retail hub. While some convenience retail exists in the communities of Bayfield and Ignacio, both communities support the concentration of retail found in Durango. Additionally, the La Plata trade area benefits from expenditure from tourists, second homeowners, and residents from Archuleta and Montezuma counties, sales which are referred to as "inflow." Purchases made outside the trade area by La Plata County residents are referred to as "outflow" or "leakage."

- **Total Personal Income**: The Total Personal Income (TPI) for La Plata County is estimated to calculate retail spending potential. TPI is calculated based on the population multiplied by the average per capita income, which grows proportionally to population growth and wage expansion. As EPS has forecasted population to grow conservatively over the next 20 years, the expansion of total personal income is also conservatively estimated.

- **Sales and Spending Patterns**: As mentioned previously, EPS uses data from the U.S. Census of Retail Trade to identify store sales by category. EPS also used historic data (at the aggregate store category level) from the City of Durango data to compare to Census of Retail Trade information to ensure consistency.

- **Retail Capture and Leakage**: TPI is multiplied by the percentage of household income spent on retail goods to calculate retail expenditure potential, as shown in columns A and B of **Table 1**. In column C, the percentage of expenditures in each category made in La Plata County is estimated to calculate resident expenditures. Resident expenditures are equal to store sales from local residents. Overall, capture of sales in the County is estimated at 83 percent of all potential sales. The higher categories include Convenience Goods, at 88 percent, and Eating and Drinking and Building Materials and Garden at 95 percent. Shopper's Goods captures 80 percent of potential sales. General Merchandise (including discount department stores, etc.), however, experiences significant leakage, with only 61 percent of sales captured locally. This is estimated to be nearly $40 million in sales lost annually.

As a point of reference, EPS has previously evaluated the Farmington, New Mexico, sales flows and estimated that its General Merchandise stores capture $125 million from outside its immediate trade area. Given the regional nature of Farmington's retail store mix, this is to be expected. EPS believes that approximately two-thirds of this in-flow is generated from surrounding communities within New Mexico and one-third is provided by La Plata County shoppers. The resulting $41 million aligns with the $40 million estimate of leakage in this category.

- **Composition of Local Sales**: Store sales for La Plata County are listed in **Table 2,** which shows the composition of local resident shoppers in proportion to in-flow. La Plata County is an effective retail market, as it imports approximately 29 percent of it sales from out-of-county income. EPS estimated that approximately 18 to 20 percent can be attributed to transient guests as well as second homeowners (estimated to occupy approximately 13 percent of the County's housing inventory). The balance of approximately 9 percent of inflow can be attributed to residents from surrounding communities adjacent to La Plata County.

- **Supportable Retail Development**: Based on the analysis above and an application of regionally specific factors for sales per square-foot by store category, future TPI expenditure is translated into forecasts of supportable retail development by store category. Currently, there are approximately 1.67 million square feet of retail space in all store categories in La Plata County (using La Plata County Assessor records, which aligns with EPS' retail model, which estimates that the current County population could support approximately 1.79 million square feet of retail.) Using a blended low and high TPI and expenditure growth rate, EPS estimates demand for an additional 977,000 square feet of retail development in the County above the current inventory.

- **Leakage Capture**: In addition to the estimated 977,000 square feet of new retail development demand over 20 years, EPS estimates that approximately 107,000 square feet of additional retail space could be developed, based on leakage capture. A previously completed analysis of county level "inflow" and "outflow" by store category, provided in **Table 1** below, shows an estimated $40.0 million in shoppers goods expenditure that flows out of the county annually. This level of expenditure translates to approximately 134,000 square feet of supportable space, assuming $300 of taxable sales per square foot. EPS estimates that the County could capture approximately 80 percent, or approximately 107,000 square feet. Thus, EPS estimates that there is currently approximately 1,084,000 square feet of retail development potential in the County.

- **Wilson Gulch Road Potential**: EPS estimates that Wilson Gulch Road can capture between 250,000 and 400,000 square feet of retail over the 20-year planning horizon. These estimates are based on a detailed analysis of inventory and development patterns geographically. This amount accounts for between 23 and 36 percent of the total retail development potential. The remainder of development potential, as evaluated previously, is allocated to core areas of the City of Durango, which is estimated to capture approximately 474,000 square feet (44 percent), and approximately 180,000 square feet (17 percent) to the remainder of unincorporated La Plata County. The sub-county estimates are high-level and reflect retailer’s general goal to locate near concentrations of activity.

While EPS estimates that the Wilson Gulch Road area can capture up to 400,000 square feet of retail, the current model and memo describe financing results based on the estimate of 250,000 square feet to be conservative for the purposes of this analysis. This ensures that the infrastructure financing is fully achievable under limited and minimum development conditions. Furthermore, EPS' forecasts assume that leakage of expenditure potential (and therefore, supportable retail space in the County and Wilson Gulch Road area) remains constant over time. It is, therefore, likely that over time the critical mass of a more robust retail inventory in the County will encourage greater local expenditure than is currently present.

Table 1
Retail Capture and Leakage
City of Durango and La Plata County Retail Market Analysis

	A	B	C	D	E	F
	State of CO	**La Plata County**	**Local Capture**		**Outflow/Leakage**	
Store Type	**Pct. of TPI**	**Resident Expend. Poten.**	**Pct. of Expenditures**	**Resident Expenditures**	**Pct. of Expenditures**	**Resident Expenditures**
2007 City of Durango, TPI	**100.0%**	**$1,538,993,320**				
Convenience Goods						
Supermarkets and Other Food Stores	6.2%	$95,010,479	90%	$85,509,431	10%	$9,501,048
Convenience Stores [1]	1.9%	$29,007,842	90%	$26,107,058	10%	$2,900,784
Beer, Wine, & Liquor Stores	0.9%	$13,822,607	90%	$12,440,347	10%	$1,382,261
Health and Personal Care	1.7%	$25,530,374	80%	$20,424,299	20%	$5,106,075
Total Convenience Goods	**10.6%**	**$163,371,303**	**88%**	**$144,481,135**	**12%**	**$18,890,168**
Shopper's Goods						
General Merchandise						
Traditional Department Stores	0.7%	$10,833,188	65%	$7,041,573	35%	$3,791,616
Discount Department Stores	1.1%	$17,106,287	60%	$10,263,772	40%	$6,842,515
Warehouse Clubs & Supercenters, Other	4.7%	$72,659,311	60%	$43,595,587	40%	$29,063,725
Total General Merchandise	**6.5%**	**$100,598,786**	**61%**	**$60,900,931**	**39%**	**$39,697,855**
Other Shopper's Goods						
Clothing & Accessories	2.3%	$34,703,430	80%	$27,762,744	20%	$6,940,686
Furniture & Home Furnishings	1.5%	$23,401,417	70%	$16,380,992	30%	$7,020,425
Electronics & Appliances	1.3%	$20,327,225	80%	$16,261,780	20%	$4,065,445
Sporting Goods, Hobby, Book, & Music Stores	1.4%	$20,838,655	85%	$17,712,856	15%	$3,125,798
Miscellaneous Retail	1.4%	$21,212,905	85%	$18,030,969	15%	$3,181,936
Total Other Shopper's Goods	**7.8%**	**$120,483,631**	**80%**	**$96,149,341**	**20%**	**$24,334,290**
Eating and Drinking	**5.6%**	**$85,711,111**	**95%**	**$81,425,555**	**5%**	**$4,285,556**
Building Material & Garden	**4.2%**	**$64,071,954**	**95%**	**$60,868,357**	**5%**	**$3,203,598**
Total Retail Goods	**34.7%**	**$534,236,785**	**83%**	**$443,825,319**	**17%**	**$90,411,466**

[1]Does Not Include Gas Sales

Source: US Economic Census; Economic & Planning Systems

H:\21873-Durango Retail Study & Infrastructure Financing\Models\[21873-SalesFlows-TPI-Oct 11.xls]TABLE 3 INFLOW OUTFLOW

Table 2
Retail Spending Inflow
City of Durango and La Plata County Retail Market Analysis

		B	C	D	E
	La Plata County	**Sales to Residents**		**Inflow and Visitor Sales**	
Store Type	**Store Sales**	**% of Sales**	**Sales**	**% of Sales**	**Sales**
2007 City of Durango, TPI					
Convenience Goods					
Supermarkets and Other Food Stores					
Convenience Stores [1]					
Beer, Wine, & Liquor Stores					
Health and Personal Care					
Total Convenience Goods	**$160,881,000**	**90%**	**$144,481,135**	**10%**	**$16,399,865**
Shopper's Goods					
General Merchandise					
Traditional Department Stores					
Discount Department Stores					
Warehouse Clubs & Supercenters, Other					
Total General Merchandise	**$109,423,459**	**56%**	**$60,900,931**	**44%**	**$48,522,528**
Other Shopper's Goods					
Clothing & Accessories					
Furniture & Home Furnishings					
Electronics & Appliances					
Sporting Goods, Hobby, Book, & Music Stores					
Miscellaneous Retail					
Total Other Shopper's Goods	**$124,112,000**	**77%**	**$96,149,341**	**23%**	**$27,962,659**
Eating and Drinking	**$117,045,000**	**70%**	**$81,425,555**	**30%**	**$35,619,445**
Building Material & Garden	**$110,368,000**	**55%**	**$60,868,357**	**45%**	**$49,499,643**
Total Retail Goods	**$621,829,459**	**71%**	**$443,825,319**	**29%**	**$178,004,140**

[1]Does Not Include Gas Sales

Source: US Economic Census; Economic & Planning Systems

3. *PUBLIC FINANCING ALTERNATIVES*

The potential to expand the region's sales tax base provides new resources that can be used for potential revenue sources and debt service. There are many types of revenue streams cities can dedicate for debt service. Based on the findings of the market study, four potential sources are summarized below.

Following the discussion on revenue streams, the analysis covers the types of mechanisms the City can implement to issue bonds and generate sufficient proceeds to construct the proposed Wilson Gulch Road segment. In general, any number of revenue sources can be linked to various bonding mechanisms. As described in greater detail below, *the recommendation is that the City is create a one-cent set-aside and use this revenue to support a Certificates of Participation (COP) bond issue.*

Revenue Streams Dedicated for Debt Service

Among the numerous options for revenue sources, four are detailed below. These include the Public Improvement Fee (PIF), and Enhanced Sales Tax Incentive Program (ESTIP), Impact Fees, and a Set-Aside.

Public Improvement Fee

A Public improvement fee (PIF) is a fee imposed by the developer on commercial tenants; the tenants in turn typically pass on the fee to the consumers as a fee on sales of merchandise. A developer uses lease terms and other real estate agreements to impose the PIF. Thus, it is a private agreement. However, as a practical matter, the city works with developers to establish terms for the PIF and typically collects the PIF along with its sales tax, remitting the PIF back to the developer. In some cases, the city agrees to reduce its sales tax rate for a given project for a given time period, in what is called a "replacement PIF," to keep the total charge competitive with other retail outlets. A PIF is part of the cost of sales and services so it is subject to sales tax.

A PIF is established based on a development covenant or lease agreement between a development company and its tenants. Technically, it does not require public approval; however, it is in the best interest of the developer to work with a local government as it can collect the PIF as part of its sales tax collection process.

Enhanced Sales Tax Incentive Program (ESTIP)

An enhanced sales tax incentive program (ESTIP) is a tax incentive program for home rule cities to encourage establishment or expansion of retail projects. It is not limited to urban renewal or downtown settings and can be used in peripheral areas for new development. The ESTIP agreement exists between the city and the property developer. The city agrees to share a portion of future sales tax revenues to reimburse the developer for the expenses incurred providing eligible public improvements such as streets, sidewalks, pedestrian amenities, stormwater drainage, etc. Most cities with ESTIP agreements restrict the limit of shareback to 50 percent of net new sales tax revenue over a predetermined payback period.

Impact Fees

The City has an established Impact Fee program that generates revenue for capital improvements. The current program and fee for transportation improvements does not include the proposed segment of Wilson Gulch Road. As an option, the City could establish a smaller benefit district and create road impact fees from the adjacent properties to defray costs related to road construction.

Set Aside

An alternative financing mechanism that EPS recommends the City adopt is a set-aside. This option gives the City the most flexibility to determine how to service the debt, given market conditions and its own budgeting needs. The set-aside can be accomplished without the lengthy process of establishing a PIF, for example, but still provides an effective, robust, and timely source of revenue for debt service. As described in this memo, it is recommended to establish a ceiling of one-cent for the Wilson Gulch Road debt service, recognizing that it is an internal policy that could be amended if needed. This memo and the modeling results are based upon a one cent set-aside.

Public Finance Mechanisms

EPS has identified a range of public financing mechanisms that could be used to provide bond proceeds for the road construction costs. These include Certificates of Participation (COP), a Metropolitan District (Metro District), and a General Improvement District (GID).

Certificates of Participation

Certificates of Participation are bonding mechanisms used by public agencies to generate bond proceeds based on the combination of a dedicated revenue source, plus collateral pledged by the public agency. The collateral must equal the value of the bonds and can be provided using a wide range of facilities or instruments owned by the agency. The repayment schedule for the certificates are to be designed to match the additional sales tax revenues generated by the new project to be developed, in the form of a set-aside. While the certificates are payable from any source of revenue, the intent will be to use the new sales tax revenues to make the payments, so that existing commitments are not impacted. The City will need to identify collateral that has a value which is approximately the value of the principal amount of the certificates. The certificates are subject to annual appropriation. If the City should choose not to appropriate the annual payment, the City will lose the collateral.

Title 32 Metropolitan District

In the State of Colorado, Special Districts, including Title 32 Metropolitan Districts, are defined as political subdivisions of the state and quasi-municipal corporations formed for the purpose of funding necessary public infrastructure and services that a county or municipality cannot otherwise fund. Geographically, they may contain contiguous or non-contiguous parcels, and they may be assembled of parcels in multiple jurisdictions such as one or more counties, and/or one or more municipalities.

A Metro District is formed through an election adopting a Service Plan and establishing an initial board of directors. The elected board typically includes five to seven members, and the District may exist in perpetuity until specific steps are taken to dissolve it. The Service Plan of a District established with parcels in both a municipality and unincorporated parts of a county must be reviewed by city staff as well as a county's board of commissioners. Additionally, a District is subject to local government budgeting, auditing, and reporting requirements.

The Service Plan of a District identifies the purposes for which it was established: they can be organized for a single purpose (i.e., fire protection); or they can be organized for multiple purposes (i.e., a Metropolitan District which can provide multiple municipal services, such as street improvements). To fund infrastructure improvements and services, the District may establish property taxes, other fees, and charges to generate revenues. Once established, a Metro District has the authority to construct facilities, to operate and maintain them, as well as limited condemnation powers.

General Improvement District

A GID is a legal entity which is separate from the city, even though the same city council which governs the city sits as the board of directors of the general improvement district and governs the district. The city council, as governing board, must approve all activity within the GID, including all contracts for project construction, all terms related to costs and financing, and must be accountable for the day to day operations within the District. As a separate entity, a general improvement district is not liable for the city's debts, nor is the city liable for the debts of the district. The autonomy enables the property owners within the District as well as the City to focus on revenues and expenditures specific to the needs within the defined boundary. The GID has the authority to build improvements, provide services, charge fees, and impose taxes. The boundary of a GID typically includes multiple properties that do not need to be contiguous.

A general improvement district has the power to levy and collect ad valorem taxes on real and personal property within its boundaries in order to support the public improvements it was formed to provide. It may also collect fees from users of these improvements. It may issue general obligation, revenue, or special assessment bonds based on these revenues. To the extent required by TABOR, such bonds can not be issued unless first approved at an election held for that purpose. An election is not required for revenue bonds if the revenue bonds are for a TABOR-defined enterprise.

Bond Market Factors and Constraints

The bond market today is not funding 'dirt districts.' Historically, cities and/or developers could go to the market and, with sufficient documentation regarding prospective market demand, issue land-secured financing bonds based on the future performance of the district. In some cases, developers could subordinate the land and provide recourse to the title as a form of enhancement.

Because many districts have not performed in the recent past, bond investors are now evaluating districts based on proven records of cash flow. Some look for 10 to 20 percent of buildings to be complete prior to bond issuance. Recourse to the land is no longer a consideration, given the substantial drop in values, particularly raw land.

Cities face similar challenges. Without the full endorsement of a General Obligation bond, options are limited. For examples, bonds backed by a General Improvement District require forms of endorsement as the market is unwilling to invest based on projected real estate performance alone.

For the City of Durango to proceed with a GID, the bond market would require the City's commitment of a moral obligation. Even with a moral obligation commitment, bond terms will run 250 to 300 basis points higher than a metropolitan district alternative.

Developers also face challenges related to metropolitan district bonds. In recent transactions, Debt Coverage Ratio (DCR) requirements have been as high as 2.0. (The DCR is a multiplier on the development's revenue stream stipulated by an underwriter to serve as a debt service cushion. A ratio of 1.5, for example, would result in a 50 percent set-aside for debt service reserves. That is, the higher the DCR, the lower the cash flow available for debt service, resulting in lower bond proceeds.) Historically, DCRs have ranged from 1.3 to 1.4. The new levels reflect the extent to which investors want to mitigate risk.

Given the challenges of the current bond market, COPs provide an alternative which enables the City to generate sufficient proceeds to construct the road and eliminates much of the current hurdles associated with other public finance mechanisms. Due to the recourse provided by the City's pledge of collateral, the rate for these bonds is reasonable. Moreover, the collateral pledge provides an assurance that the bond market is expected to purchase bonds prior to construction of the retail development. Finally, Debt Coverage Ratios are not required, allowing a greater portion of the dedicated revenue stream to be used to support bond proceeds rather than risk mitigation.

Financing Cash Flow

For the purposes of this analysis, the bond proceeds and debt service has been sized to cover half of the construction costs, understanding that La Plata County is currently considering covering half of the road costs. Unless the County changes its direction from recent conversations, the following terms and structure should be sufficient to finance the road improvements.

Revenue Forecasts

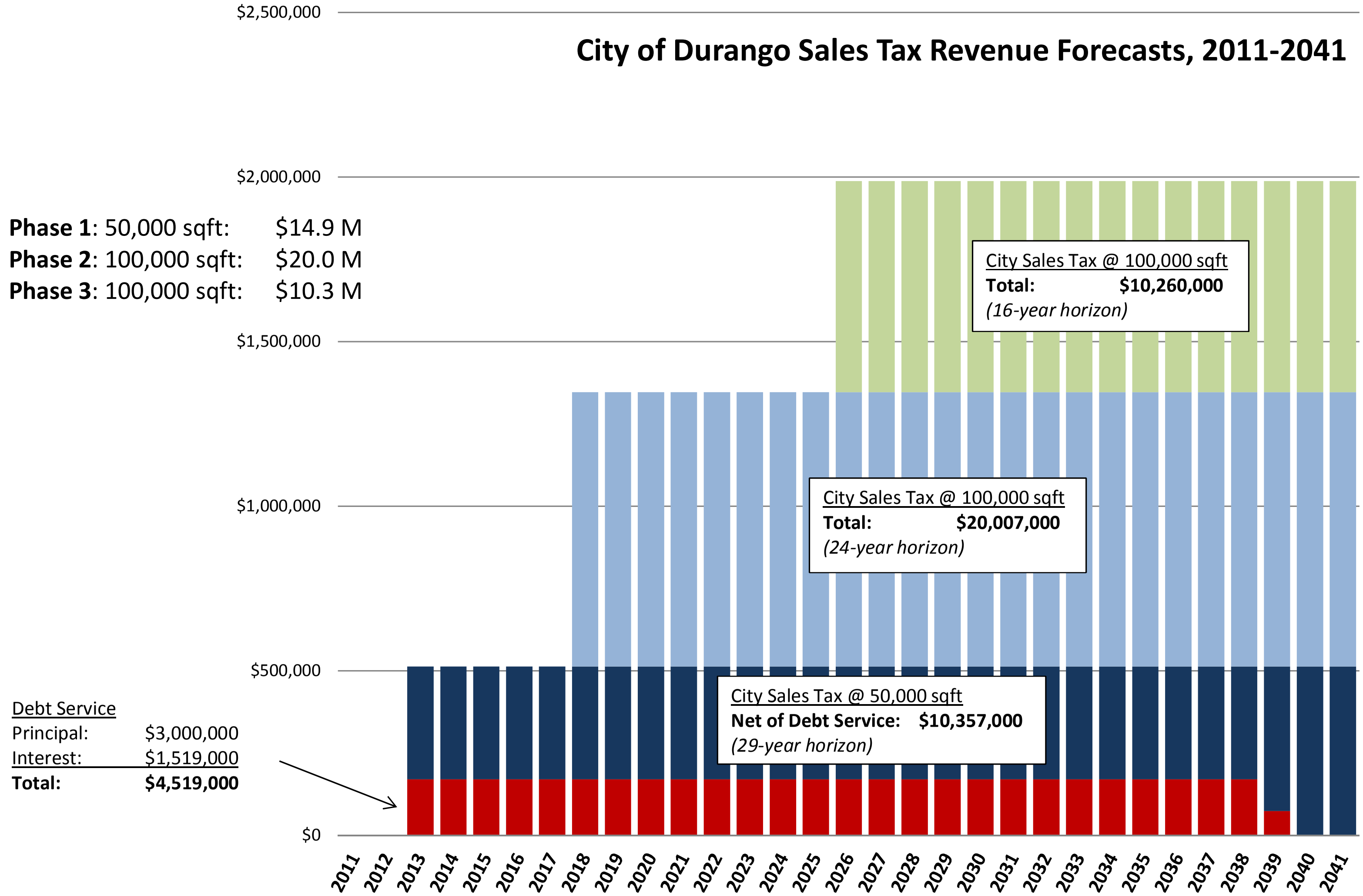
EPS has prepared forecasts of sales tax revenues for both the City of Durango and La Plata County, which are illustrated in **Figure 1** and **Figure 2**, respectively. The revenue forecasts are grounded in the market analysis results and the retail development potentials analysis outlined above. As mentioned previously, EPS uses a forecast estimate of 250,000 square feet of new retail development in the Wilson Gulch Road area over the next 20 years, phased in an increment of 50,000 square feet in the first year; 100,000 square feet in year 7; and another 100,000 square feet in year 15. These estimates are conservative, in that EPS estimates up to 400,000 square feet of retail space can be captured in this trade area, and in that expenditure leakage over time is likely to decrease.

- **City of Durango Sales Tax Revenues**: The forecast of sales tax revenues for the City includes the establishment of a one cent set-aside to cover debt service on the Wilson Gulch Road. This revenue stream, illustrated in red in **Figure 1**, is shown as a portion of the gross sales tax revenues generated by the first 50,000 square feet of development. In year 7, a second phase of development is estimated to occur with 100,000 square of development, from which the City would receive its full portion of the 3 percent sales tax rate. Similarly, in year 15, the City would receive gross sales tax revenues from the third phase of development which includes another 100,000 square feet of development. The first phase of development is estimated to bring in total gross revenues of approximately $14.8 million, which includes approximately $4.5 million dedicated to debt service (as shown) and net revenues to the City of approximately $10.3 million. In the second and third phases of development, gross revenues to the City are anticipated to be an additional $20.0 million from the second phase alone and an additional $10.3 million from the third phase. Variations in the dollar amounts for each phase are the result of calibrating the development forecasts to specific sales per square feet of different retail store types that are anticipated along Wilson Gulch Road.

As noted below **Figure 1**, these estimates do not include a reduction for sales transfers. These estimates are gross sales tax revenues to the City. EPS estimates that under current conditions, which will change over time, approximately 50 percent of sales may be considered transfers to the Wilson Gulch Road retail development from other retail locations in the County. As the population and TPI of the County grow, and as the leakage of expenditure outside the County decreases, the portion of gross sales that are transfers will decrease over time. In phase one, assuming 50,000 square feet of floor area, a one cent set-aside, and 50 percent sales transfers, the City can nevertheless expect to see a modest increase in net revenues. Later phases, which are not subject to the one cent set-aside, will provide more substantial revenues to the City.

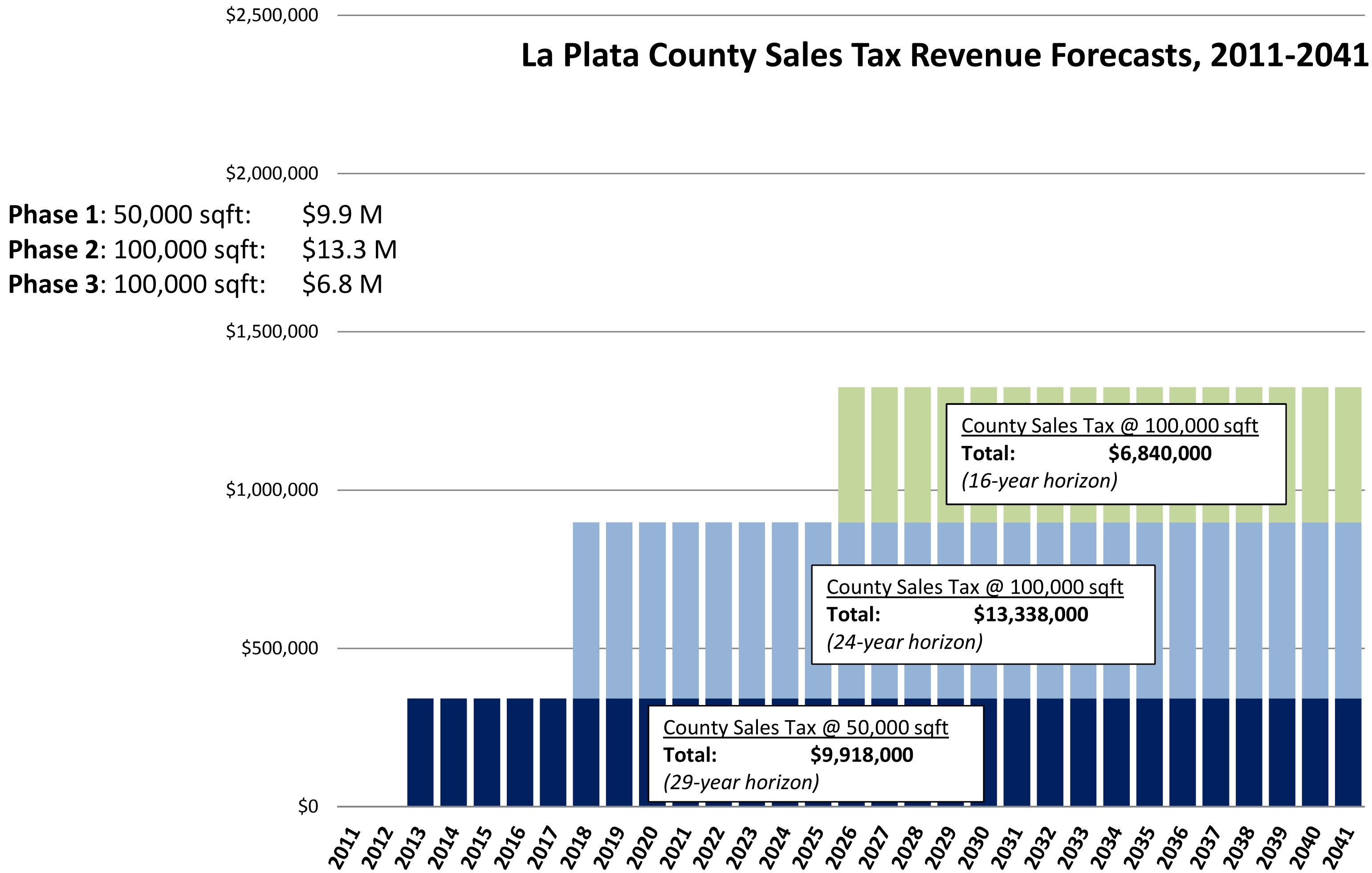
- **County Sales Tax Revenues**: The forecast of sales tax revenues for the County is based on the 2 percent portion of the total sales tax. From the first phase of development, the County is estimated to receive approximately $9.9 million in gross sales tax revenues. From the second phase of development with 100,000 square feet, EPS estimates revenues to the County of approximately $13.3 million. From the third phase and additional 100,000 square feet in year 15, there is an estimated additional $6.8 million in gross sales tax revenues to the County. Figures shown are gross and do not reflect sales transfers, which could average as much as 50 percent of total sales in the near term.

Figure 2
City Sales Tax Revenue Forecasts and Debt Service
Wilson Gulch Road Financing Strategy



Note: This figure presents estimated sales tax revenues to the City of Durango from 250,000 square feet of retail development over 30 years and the portion which is estimated to be dedicated to debt service for the City's portion of the Wilson Gulch Road. Sales transfers, which would redue the estimates shown, are not included in these estimatese. Under current conditions, approximately 50 percent of sales are estimated to be transfers, but over time, EPS estimates this figure to reduce substantially, whereby the City would receive more sales tax revenues.

Figure 3
County Sales Tax Revenue Forecasts
Wilson Gulch Road Financing Strategy



Note: This figure presents estimated sales tax revenues to La Plata County from 250,000 square feet of retail development over 30 years . Sales transfers, which would redue the estimates shown, are not included in these estimatese. Under current conditions, approximately 50 percent of sales are estimated to be transfers, but over time, EPS estimates this figure to reduce substantially, whereby the County would receive more sales tax revenues.

Evaluation Criteria

This section outlines EPS' process for evaluating and identifying the optimal public financing structure. These factors have been used to review various options that have been evaluated, including those options identified in this memo. They provide specific criteria that the City of Durango and its partners can use, and they also provide material that can be used to communicate how decisions have been made to a broader audience.

Table 3
Criteria for Evaluation
Wilson Gulch Road Financing Strategy

Term	Definition	Measure
Governance	Simplicity and reasonable cost to City for district administration	Staff time and direct costs
Equity	Ability to ensure that benefits and costs are equally proportioned among property owners	Benefit analysis
Timing	Flexibility to treat current and future property owners consistently	Capability of district to establish present values
Protection of City Interests	Appropriate balance of risk and reward by City	Return on Investment and opportunity cost analysis
Fit	Complexity of district(s) is appropriate for scale and cost of public improvements	Steps required to establish district

Source: Economic & Planning Systems
H:\21873-Durango Retail Study & Infrastructure Financing\Data\[21873-Financing Options Durango Criteria.xls]Durango Criteria

- **A) Governance**: In terms of time and cost to the City, a COP is one of the simplest options. The one-cent set-aside described in this analysis provides an internal target that addresses the goal of expanding net sales tax revenue for the City. As a funding source, it requires no staff time to establish or administer (as other bond mechanisms require) as it is an internal target.
- **B) Equity**: Equity addressed the distribution of costs over the larger community. At this time, road costs are to be paid by retail expenditure on sites adjacent to the new roadway. While the Three Springs development team is likely to construct retail development prior to the Crader family, all retail development within the proposed annexation will participate in the one cent set-aside and all will contribute to the road costs.
- **C) Timing**: Application of the one cent set-aside to developed parcels within the annexation area ensures that all property owners are treated equitably over time. In this memo, the findings are representative of one cent set-aside revenues dedicated to debt service at a constant interest rate. A developed parcel will participate in the one cent set-aside structure to generate debt service at the time of construction and tenanting.

- **D) Protection of City Interests**: Cost and revenues are central concerns to the City. The COP option provides one of the least expensive options for the City in terms of interest rates.

- **E) Fit**: The recommended COP supported by one cent set-aside revenue is the simplest and most effective public financing mechanism that can be applied to fund Wilson Gulch Road improvements. The market is prepared to buy bonds in this form and the size of issue, complexity of funding sources, and overall cost to the City are reasonable.

4. RECOMMENDATION

EPS recommends that the City, in cooperation with the County, proceed with a bond issue using Certificates of Participation, based on the following factors:

- Given the challenges of the current bond market, COPs provide an alternative which enables the City to generate sufficient proceeds to construct the road and eliminates much of the current hurdles associated with other public finance mechanisms.
- Due to the recourse provided by the City's pledge of collateral, the rate for these bonds is reasonable. The collateral pledge provides an assurance to the bond market, resulting in lower interest rates. Thus, the cost to the City is lower than any other alternative considered.
- The structure provides a simple approach for the City that does not involve new governance structures, such as metro districts or general improvement districts. While these are not problematic, a simpler structure is better.
- Securing debt through conventional routes used for the past few decades has been made substantially more complex recently due to the slow economic recovery. COPs provide a path forward that clears many of the hurdles facing other forms of bond mechanisms.

It is recommended that the City move forward with the following conditions that form the basis for terms.

- *Concurrency*: The City should require the developer to provide assurances regarding tenanting prior to bond issuance. Specifically, the City will require the Three Springs developer to provide Open Guarantees for the first phase of development prior to the issuance of COPs. The revenue stream for debt service must be guaranteed before the City commits its resources to the project. The Open Guarantee commits the retailers within the development to merchandise, staff, and open the store for a minimum of one day. Continued operations in the future will not be part of the guarantee.
- *Size of Phase I:* In the event bond market conditions change and additional revenue is needed to make the bonds viable, the City may seek a greater threshold of floor area in phase one. Based on the bond market terms and achieving a reasonable interest rate and amortization period, the developer may have to secure Open Guarantees for more space, resulting in greater sales tax generation and more revenue for debt service.
- *COB Bond Purchase:* To eliminate the need for debt service and capitalized interest for the time period between bond issuance and sales tax revenue generation, the City and the Southern Ute Indian Tribe (SUIT) agree that the SUIT will purchase the COP bond and waive debt service requirements until the retail development is operational and generating sales tax revenue.