PS COMMITTEE #2
October 16, 2014
Update

MEMORANDUM

TO: Public Safety Committee

FROM: Justina J. Ferber, Legislative Analyst

SUBJECT: **Update – Department of Liquor Control Draft Final Comprehensive Long-Range Strategic Business Plan**

Those expected for this discussion:

George Griffin, Director, Department of Liquor Control

The Department of Liquor Control Director will brief the Committee on the contents of the Draft Final Comprehensive Long-Range Strategic Business Plan for the Department of Liquor Control (DLC) developed by The PFM Group.

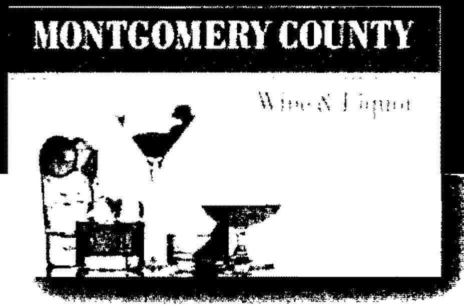
The Plan is composed of the following chapters:

I. Introduction – History of DLC and Scope of Work – p.1
II. Environmental Scan – Analysis of Economy, Demographics, Benchmarking and County Wholesale, Retail and Licensing Operations – p. 7
III. Strengths, Weaknesses, Opportunities and Threats Analysis – Rundown of SWOT issues – p. 55
IV. High-Level Findings – Current and forward-looking indicators that may impact DLC's future successes – p. 59
V. Mission, Vision, Values and Goals – Overview – p. 65
VI. Strategies and Recommendations – Recommendations of PFM Group for improving DLC operations – p. 67
VII. Implementation – Broad recommendations on transitional steps and action planning – p. 77

There are two sections of the plan in which DLC has requested clarification or modification; therefore, the Plan is not final.

Attachment: DLC Strategic Plan

rewrite
F:\FERBER\Liquor\PS COMM 10-16-14 DLC Strategic Plan.doc



Montgomery County, Maryland
Department of Liquor Control

Draft Final Report

Comprehensive Long-Range Strategic Business Plan

July 11, 2014

PFM
The PFM Group
Financial & Investment Advisors

Two Logan Square, Suite 1600
18th & Arch Streets
Philadelphia, PA 19103
215.567.6100 phone
215.567.4180 fax

www.pfm.com

Table of Contents

Appendices

I. Introduction

Introduction

History of DLC

Following the repeal of Prohibition in 1933, the states and their component jurisdictions were granted the authority to regulate the sale of alcohol. Many states made the decision that monopoly control over some portion of the alcohol distribution system – wholesale, retail or both – was the best method to balance the rights of individuals with the broader community interest. Among jurisdictions that opted for this method – the control method – was Montgomery County, Maryland.

On December 5, 1933, the Liquor Control Board for Montgomery County was established. For eighteen years, the Liquor Control Board was responsible for the sale and distribution of beverage alcohol in Montgomery County and served as the Board of License Commissioners. Then, on July 1, 1951, the Department of Liquor Control (DLC) was created, and the Board of License Commissioners became a separate entity.[1]

Today, the Board of License Commissioners is responsible for licensing and regulation in accordance with Article 2B of Maryland State law, and its office shares the responsibility for enforcement with the Police. The DLC is responsible for the wholesale of all alcoholic products to licensees for on-premise consumption (primarily bars and restaurants). The DLC also owns and operates twenty-five retail stores, which have the exclusive right to sell distilled spirits in the County for off premise consumption. These stores, along with private retail license holders, are responsible for the sale of beer and wine for off-premise consumption.

The mission of the Montgomery County Department of Liquor Control is to provide licensing, wholesale and retail sales of beverage alcohol products, enforcement and effective education and training programs, while promoting moderation and responsible behavior in all phases of distribution and consumption. In fulfilling this mission, the Department uses no general fund revenue, relying solely on the income from its operations. Indeed, in 2013, Montgomery County was able to issue bonds by pledging the revenue of the DLC.[2] In 2013, the DLC's charges for sales and services were over $256 million and the Department transferred over $25 million to the County General Fund.[3]

The DLC is organized into three divisions. The Operations Division contains both the DLC warehouse (overseen by the Warehouse Operations Manager) and its twenty-five retail stores (overseen by the Retail Operations Manager and two Retail Regional Managers). The Administration Division contains central office departments such as IT, Finance and Purchasing. In 2007, the County Executive moved some enforcement operations such as alcoholic beverage inspectors, into the Division of Licensure, Regulation and Education (LRE).[4]

For the Fiscal Year ending June 30, 2013, total DLC sales increased by 2.4 percent. County-run retail stores reported sales of $122.2 million, an increase of 2.5 percent over the prior year. Wholesale sales were also up by 2.3 percent. Distilled spirits was the growth leader, with the number of cases of distilled spirits sold up by nearly four percent (3.97 percent) over the prior year. This is consistent with national performance, where, in 2012, spirits sales rose 3.5 percent.

The DLC has identified 10 key performance measures:

1. Annual growth in the DLC's retail and wholesale sales (percent);
2. Gross profit margin of the DLC's retail and wholesale operations;

---

[1] http://www.montgomerycountymd.gov/DLC/history.html

[2] "Summary: Montgomery County, Maryland; Miscellaneous Tax" Standard & Poor's Rating Service, July 19, 2013.

[3] Montgomery County Certified Annual Financial Report 2013 p. 36.
http://www.montgomerycountymd.gov/BONDS/Resources/Files/PDF/CAFR/FY2013_Financial_Section.pdf

[4] "Department of Liquor Control: Review of Management Controls over Inspectors" OIG Report Number 14-003, Office of the Inspector General, January 13, 2014.

3. Retail customer satisfaction rating based on the DLC customer survey results;
4. Wholesale customer satisfaction rating based on the DLC customer survey results;
5. Rating of licensees satisfied with the licensing application process;
6. Percent of licensees that fail compliance checks;
7. Number of annual alcohol compliance checks for sales to minors;
8. Inventory as a percentage of Cost of Goods Sold;
9. Inventory as a percentage of the DLC's sales; and,
10. Rating of licensees satisfied with A.L.E.R.T. training.

Throughout this report, the Project Team has remained mindful of the DLC mission. The goal of these analyses and the resulting recommendations is not to change the fundamental make-up of the DLC but to identify opportunities to improve overall operations in ways that are consistent with its mission and in ways that best serve the County and its residents.

The DLC's willingness to engage an outside project team to assess its current operations – including weaknesses as well as strengths and threats as well as opportunities – should be recognized and commended. Self-discovery and internal reflection is a hallmark of a high performing organization. In the following analysis, the findings and recommendations should be taken in the context of an organization that does a lot of things right every day: the DLC runs a significant wholesale and retail operation, handles hundreds of millions of dollars of inventory and sales, regulates, educates and supports private licensees and does so while providing a significant ongoing revenue stream to the County. These aspects of a well-functioning operation should not be overlooked in the discussion of possible changes to improve on what is already an effective operation.

Introduction

Scope of Work

Earlier this year, the Montgomery County DLC sought a proposal and project team with proven experience in wholesale/retail beverage alcohol market analysis and long-range strategic planning to prepare a comprehensive strategic business plan, with particular emphasis on its wholesale and retail operations. In addition, this analysis was to consider alternatives to its vehicle fleet, particularly related to options for leasing its delivery fleet vehicles.

A project team led by Public Financial Management, Inc. (PFM) and including Bonneville Research was selected to assist the Department in preparing this strategic business plan. PFM is the nation's leading provider of independent financial and investment advisory services to state and local governments and agencies,[5] with over 500 employees in 35 offices throughout the United States. PFM has been actively engaged in various forms of financial analysis over the lifetime of the firm. As the name of the original corporation (Public Financial Management, Inc.) implies, PFM operates at the intersection of management and finance in the public sector. As the nation's top ranked independent financial advisory firm for the public sector,[6] PFM is relied upon by many of the largest state and local governments in the country (including Montgomery County) to model and analyze complex financial transactions on a daily basis. Both PFM's Financial Advisory and its Management and Budget Consulting practice have analyzed a wide variety of public sector service delivery systems, including wholesale and retail liquor operations in the States of Ohio, Pennsylvania, Vermont and Virginia.

Bonneville Research, located in Salt Lake City, Utah, has provided quality services and solutions for public and private sector clients for over 35 years. Bonneville Research is a leader in providing sound economic development and market assessment services for governments and private businesses, primarily in the Intermountain West. Bonneville Research offers a diverse array of economic analysis and tools to answer complex problems. For this engagement, Bonneville assembled an experienced team that has worked both as senior professionals in the food and beverage industry and in government. Bonneville also has experience working with liquor control operations, having conducted a similar strategic business planning project for the State of Utah.

At the outset, a project plan and approach was developed to provide significant interaction between the project team and the Department. The DLC leadership, management and key staff have been integral partners in all facets of the project and in the preparation of this report.

In March 2014, the project team conducted structured interviews with key DLC staff to gain a full understanding of current operations, processes and procedures and to identify strengths, weaknesses, opportunities and threats. At that time, the project team also performed site visits at all DLC retail store locations to assess current and determine optimal size, location, layout, product mix, facility parking, staffing etc.

At the outset, PFM identified key sales, operations, budget and financial information necessary to do market and financial analysis. PFM also identified other relevant entities for benchmarking relating to sales, operating expenses, profitability, number and types of store locations and more.

PFM used a variety of data sources for its analysis. Within the scope of this analysis, data falls into several categories. For purposes of analysis of consumption, there is readily accepted data available from federal sources, including the Bureau of Labor Statistics, Bureau of Economic Analysis and Census Bureau. The project team also incorporated into its analysis purchased reports and surveys by the National Alcohol Beverage Control Association (NABCA) as well as industry publications and reports, such as the Wine and Liquor Handbooks published by the Beverage Information Group.

[5] Thompson Reuters "Municipal Market Analysis: National: Financial Advisor: First Quarter" 2014, p. 35.

[6] Ibid.

Introduction

Among the most important and useful data, of course, was DLC's reports on store performance, including retail sales, sales velocity, inventory, cost of goods sold and operational costs. This data has been analyzed and used in a variety of the topics under discussion.

PFM also worked with DLC leadership to identify peer jurisdictions (primarily counties that operate in both control and license states and, for some operations, control states themselves) for benchmarking purposes. This benchmarking touched on differences in business environment, business performance and wholesale and retail operation practices.

PFM has also conducted numerous interviews with leaders and subject matter experts of leading private sector firms and industry groups engaged in both the retail and wholesale liquor businesses. PFM used this information to be generally informed on industry practices, expectations related to mark-up and profitability. While PFM does not solely rely on these discussions in developing its findings, they provide useful context for analysis and discussion.

The PFM team also performed (and built into its findings and recommendations) a general marketing study of the County, which analyzed County population (both in terms of density, location and prospects for growth), relevant demographics (which, for retail alcohol sales, include age, income and educational attainment) and trends in retail alcohol sales, as well as methods to market and retain growth and profitability.

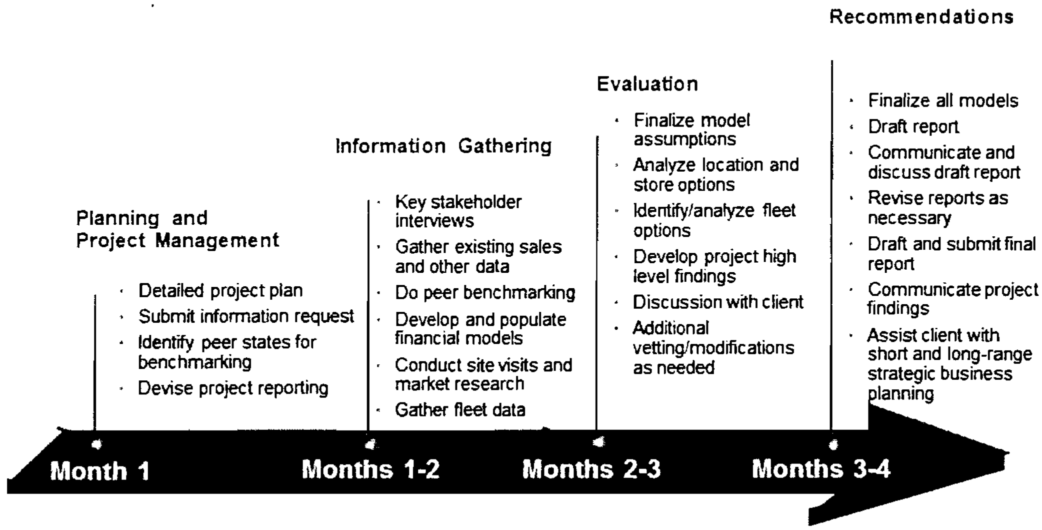
This analysis provided the foundation to build a business plan for the DLC's retail stores. In addition, the project team provided a framework for the DLC management to prepare short and long-term strategic plans for current and future retail store types and locations. In developing these strategic plans, a SWOT analysis, which looks at internal organizational strengths and weaknesses, as well as external opportunities and threats, was conducted. This is both an 'as is' assessment as well as a 'future state' planning process. As hockey legend Wayne Gretzky noted, "I skate to where the puck is going to be, not where it has been."

After interviews with DLC staff and the review of internal audits conducted by Montgomery County, the project team determined that the LRE Division was mostly outside the scope for developing a strategic business plan and primarily focused on the remaining two divisions for its analysis.

The market analyses were led by Bonneville Research, while PFM took the lead on benchmarking and model development. The internal 'buy or lease' cost benefit analysis was conducted by PFM. This included determining the total cost of ownership and identifying available lease/non-purchase options.

The preliminary timeline for the project was as follows:

Introduction



Some issues with data availability (which was complicated by the current County migration to new IT systems) slowed down the information gathering of the project. That said, the final draft report (given a March full project commencement) falls just beyond the original timeline.

II. Environmental Scan

Environmental Scan

Overview

The Environmental Scan identifies key County attributes that will be important for understanding the current state of the DLC operation as well as possible future developments. This information will be useful in the SWOT analysis that follows and will be also relied upon in analysis of recommendations related to the project's high-level findings.

Economy

The County economy was generally strong in 2013, with a 1.1 percent increase in resident employment, a decline in the average monthly unemployment rate to 5.1 percent, an estimated 3.6 percent increase in personal income and a 5.9 percent increase in average sales prices of existing homes. The County Comprehensive Annual Financial Report (CAFR) for 2013 also indicated that the outlook for FY2014 suggests a continuation of growth, 'tempered by the impact on employment and procurement by the current Federal government sequestration.' It is notable that the question marks associated with sequestration and federal budget questions have been significantly clarified since the release of the 2013 CAFR.

As noted in the CAFR, overall Greater Washington regional growth is also important to the economic health of the County. One area-leading index, computed at the Center for Regional Analysis at George Mason University, forecasts an increase in regional growth of 5.5 percent in FY2013 from its lowest point in March 2009. The CAFR notes, however, the importance of federal decision making to the long-term economic performance in the region.

Demographics

Montgomery County is Maryland's most populous county, with over one million residents in 2013. It is also among the wealthiest; according to the U.S. Census Bureau, its median household income from 2008-2012, $96,985, was second only to Howard County ($107,821). Between the two, Montgomery County had the higher per capita personal income (2012 dollars) at $48,690.

Montgomery County Current Demographic Information

Total Population	Population 21+	Median HH Income	Per Capita Income	Percent Population with Bachelor's Degree or Greater	Population Density (persons/sq.mile)
1,004,709	**725,066**	**$96,985**	**$48,690**	**56.9%**	**1,978.2**

Sources: American Fact Finder 2008-2012, U.S. Census Bureau.

While a wealthy county, Montgomery County's percentage of persons living below the federal poverty level, 6.5 percent, ranked behind five other Maryland counties; that said, it ranked much better than the state average, which was 9.4 percent. Montgomery's ranking below some other wealthy counties may be partially explained by its diversity: 38.7 percent of Montgomery residents over the age of five primarily speak a language other than English at home. This is over twice the Maryland state average of 16.5 percent.

Over the next five years, projections by the Maryland Department of Planning indicate that many of these demographic factors will persist and even grow. Between 2015 and 2020, Montgomery County is projected to grow more populous, older, wealthier and more diverse.

Environmental Scan

Montgomery County Demographic Projections (2015-2020)

Year	Population		Households		Average Household Size		Non-White Population	Per Capita Income (in 2009 $)		Total Personal Income (in thousands of 2009 $)		K-12 Enrollment	
2015	1,020,000		375,900		2.69		54.28%	$71,887		$73,324,740		150,010	
2020	1,067,000		397,700		2.66		59.13%	$79,011		$84,304,737		157,170	
+ / -	47,000	4.61%	21,800	5.80%	-0.03	-1.15%	4.85%	$7,124	9.91%	$10,979,997	14.97%	7,160	4.77%

Source: Maryland Department of Planning – Maryland State Data Center.

Montgomery County Age Cohorts Projections and Differences 2015-2020

Year	Montgomery County Age Cohorts									
	0-4	5-14	15-24	25-34	35-44	45-54	55-64	65-74	75-84	85+
2015	6.13%	13.01%	11.65%	13.81%	13.59%	14.64%	13.21%	8.02%	3.84%	2.11%
2020	6.31%	12.47%	11.18%	14.06%	13.92%	13.19%	13.16%	9.13%	4.47%	2.11%
+ / -	0.18%	-0.53%	-0.47%	0.25%	0.32%	-1.46%	-0.04%	1.11%	0.63%	0.00%

Source: Maryland Department of Planning – Maryland State Data Center.

Educational Attainment Projections for Montgomery County 2023

Educational Attainment	2013 Population	2023 Population
Graduate Degree and Higher	208,676	221,497
% Graduate Degrees	**29.87%**	**29.59%**
Bachelor's Degree	182,621	192,029
Total Bachelor's +	**391,297**	**413,526**
% With Bachelor's +	**56.02%**	**55.24%**
Some College	101,186	108,709
Associate's Degree	35,700	37,727
High School Diploma	101,038	108,885
9th Grade to 12th Grade	40,654	51,041
Less Than 9th Grade	28,626	28,649
Total (Ages 25+)	**698,501**	**748,536**

Source: Montgomery College Office of the Vice President for Planning and Institutional Effectiveness.[7]

As the next section will suggest, there are demographic factors that are important for the determination of the future sales growth of DLC retail stores. In general, these factors generally create a reason for optimism for continued sales growth.

[7] "Educational attainment data from the decennial census and the annual Current Population Statistics—both from the U.S. Census Bureau—are combined with EMSI demographics data to create past, current, and projected educational attainment data by gender, race, and ethnicity for all residents age 25 and up and indicate the highest level of education achieved." http://cms.montgomerycollege.edu/EDU/Department.aspx?id=45574

Environmental Scan

Alcohol Expenditures and Demographic Characteristics

Income Levels

It is generally accepted that there is a correlation between levels of income and expenditures on alcohol, with higher income cohorts having higher levels of expenditure per capita. This correlation has been found both in academic studies[8] and in the results from the U.S. Bureau of Labor Statistics (BLS) biennial Consumer Expenditure (CE) Survey.[9]

The BLS CE survey results are a useful starting point for a likely level of consumer spending on a variety of items. Purchased alcohol for household consumption is one of the reported items within the survey. It is notable that this encompasses purchases for beer and wine as well as distilled spirits. It is also national rather than state or county-specific survey data.

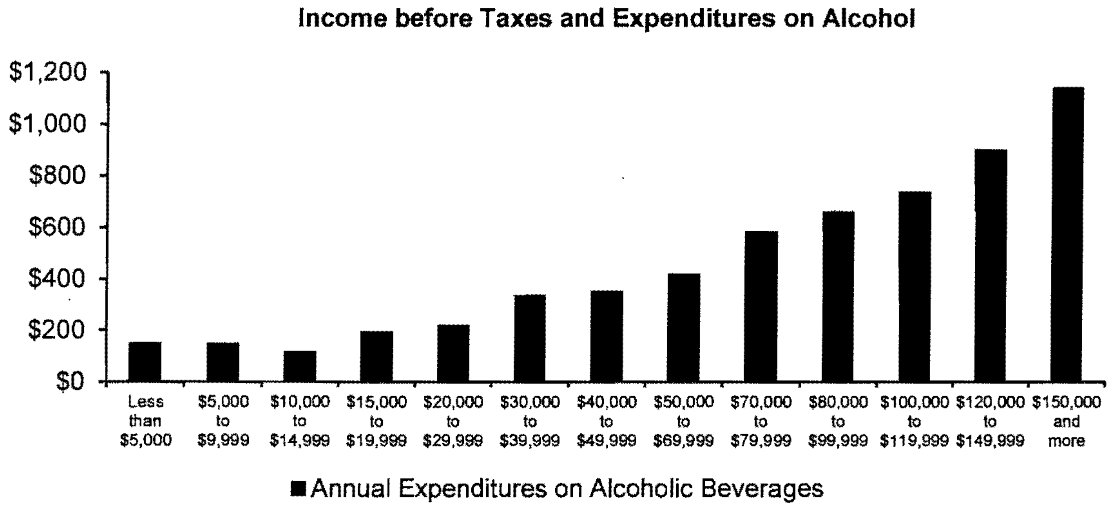
The following chart, from the October 2012 BLS survey, indicates that higher income consumers spend significantly more on alcohol than lower income cohorts.[10]

[8] *Exemplum gratia*, one multiple-model study found that the preferred model showed that income had a significant effect on alcohol expenditures, with a one percent increase in household income increasing the probability of consumption by 0.21 percent, the conditional level of expenditures by 0.13 percent, and the unconditional level of expenditures by 0.34 percent; the study concluded that "the effects of income on alcohol expenditures are small but positive." Steven T. Yen and Helen H. Jensen, "Determinants of Household Expenditures on Alcohol," Working Paper 95-WP 144, Center for Agricultural and Rural Development, Iowa State University, December 1995, p. 9. A recent study supported by a grant from the National Institute of Health, one of the first to examine the relationship between lifetime income trajectories and alcohol consumption, reported that across each of the three age cohorts they studied, level of income was the most important predictor of alcohol use. Magdalena Cerda, Vicki Johnson-Lawrence and Sandro Galea, New York Academy of Medicine, "Income and Alcohol Consumption: Investigating the Links Between Lifecourse Income Trajectories and Adult Drinking Patterns," Paper presented at the Population Association of America 2010 Annual Meeting, April 15-17, 2010. http://paa2010.princeton.edu/download.aspx?submissionId=101517

[9] The current CE began in 1980 and has been conducted continually since then. Its principal objective is to collect information on the buying habits of Americans. The survey consists of two components: a diary (or recordkeeping) survey completed by participating consumer units for two consecutive 1-week periods, and an interview survey where expenditures of consumer units are obtained during five interviews conducted at 3-month intervals. Results in this report are based on integrated data from both surveys. Survey participants record dollar amounts for goods and services purchased during the reporting period, regardless of whether payment is made at the time of purchase. Expenditure amounts include all sales and excise taxes for items purchased by the consumer unit (CU). All business-related expenditures are excluded from both surveys, as are expenditures for which the consumer unit is reimbursed.

Each component of the survey queries an independent sample of CUs that are representative of the U.S. population. For the Diary Survey, about 7,000 CUs are sampled each year. Each CU keeps a diary for two 1-week periods, yielding approximately 14,000 diaries a year. The interview sample, selected on a rotating panel basis, surveys about 7,000 consumer units each quarter. See [9] US Bureau of Labor Statistics, accessed electronically on March 28, 2014 at http://www.bls.gov/cex/

[10] United States Department of Labor, Bureau of Labor Statistics, "Consumer Expenditure Survey," September 2012, http://www.bls.gov/cex/



Source: US Bureau of Labor Statistics, Consumer Expenditure Study, September 2012.

The BLS data combines beer, wine and distilled spirits; that said, there is a decent correlation with income and consumption of distilled spirits, as the following table indicates.[11]

Percentage of Persons Who Drink Distilled Spirits by Income Group

$75,000 & over	$60,000 - $74,999	$50,000 - $59,999	$40,000 - $49,999	$30,000 - $39,999	Under $30,000
55.9%	49.6%	44.9%	48.4%	43.5%	38.8%

Source: The Liquor Handbook 2013.

There is an even more compelling case for high-income consumption of distilled spirits when the sales are allocated by income distribution – nearly half of the dollar value comes from individuals with income of $75,000 and over.[12]

Income Distribution of Distilled Spirits Consumers

$75,000 & over	$60,000 - $74,999	$50,000 - $59,999	$40,000 - $49,999	$30,000 - $39,999	Under $30,000
45.5%	10.8%	7.5%	8.7%	8.7%	18.9%

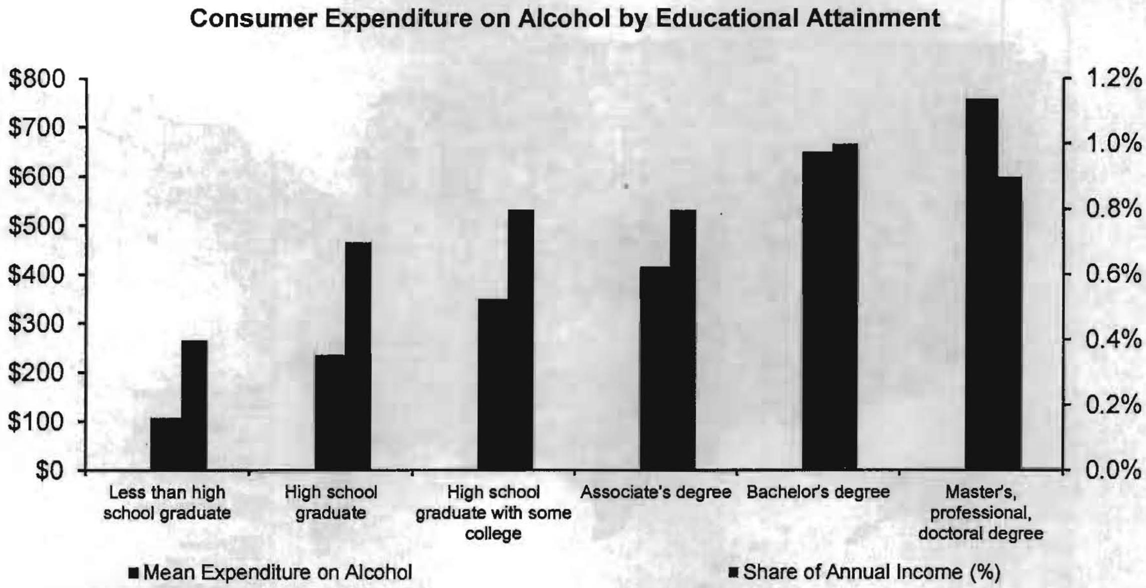
Source: The Liquor Handbook 2013.

Educational Attainment

As with income, educational attainment has also shown a positive correlation with increased levels of retail sales as a share of income (although there is a decline at educational levels beyond a bachelor's degree). This is not particularly surprising, as there is also a strong correlation between educational attainment and income level. The following chart is taken from the 2012 BLS Consumer Expenditure Survey.

[11] Liquor Handbook 2013, p. 301.

[12] Ibid, p. 302.



Source: Bureau of Labor Statistics 2012 Consumer Expenditure Survey.

Social Characteristics

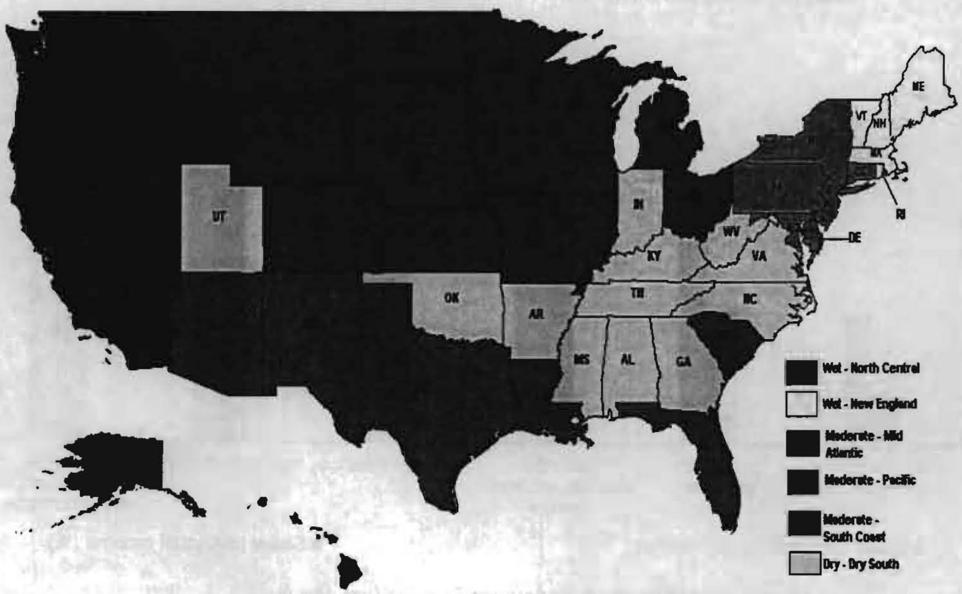
While income levels are generally a good predictor of expenditures on alcohol, social folkways (behaviors and customs of a social group) also play a role. Over the years, the National Alcohol Survey (NAS), which was conducted in 1964, 1979 and 1984, has identified Census-defined regions as either 'Wet' or 'Dry.'[13] More recent research has modified this categorization into three groups – Wet, Moderate and Dry. Within this context, Maryland, and its regional counterparts Connecticut, Delaware, New Jersey, New York and Pennsylvania are characterized as the 'Moderate Mid-Atlantic' region.[14] Based on the research around this group, it is reasonable to expect that Montgomery County's levels of total retail sales would approximate these other states on a per capita basis. The following map identifies the regions classified as Wet, Moderate and Dry.

[13] Wet areas were determined to be those with relatively high per capital consumption and percentage of heavy drinkers and low levels of abstention. See William C. Kerr, "Categorizing US State Drinking Practices and Consumption Trends," *International Journal of Environmental Research and Public Health*, 2010, Number 7, p. 269-283.

[14] Ibid, p. 272-276. It is notable that this classification analysis does not rely solely on consumption, but also takes into consideration the number of drinks, frequency of drinking, percentage of abstainers, etc.

Environmental Scan

Census Defined Regions



Source: International Journal of Environmental Research and Public Health.

Conclusion

Given Montgomery County's high income and educational attainment, there is a reasonable expectation that per capita retail sales levels will exceed those in many control jurisdictions. It is also likely that sales levels will be similar to other license jurisdictions within the region. This, of course, must also take into consideration in-border and cross-border competition and sales – not all sales for off-premise consumption attributed to Montgomery County residents occur at DLC stores.

Benchmarking Analysis

The benchmarking analysis assesses the performance of the DLC relative to other control and license counties. It is important to understand not only how the DLC operations compare to other control agencies but also how license state systems in comparable counties perform on similar measures. To accomplish this, PFM used a variety of state and industry data sources as well as phone and other survey methods.[15]

State Comparability Analysis

To benchmark the DLC operations, PFM examined two similar counties within control states and license states respectively. PFM also benchmarked the DLC relative to the State of New Hampshire and the Commonwealth of Virginia in instances where treating the system as an insular unit made sense.[16] While there is no such thing as a perfect twin when performing benchmarking analysis (among other things, population characteristics, regional variation, differences in control structure and many other factors vary greatly), benchmarking against different jurisdictions can reveal important insights. Benchmarked control counties were chosen by evaluating proximity to Montgomery County, population density, demographic make-up and control system similarity. License counties were chosen by evaluating proximity to Montgomery County, population density and demographic make-up.

The benchmarked control jurisdictions all represent a particular approach to liquor control. New Hampshire, Pennsylvania, Utah and Virginia all retain control of retail sales of some alcoholic beverages. Nevertheless, these states differ in their share of the market with private retailers as well as the mix of alcoholic beverages they control. Virginia retains full control of distilled spirits sales and does not compete with private retailers in any product. Similarly, with all but a few grandfathered exceptions, Pennsylvania is the only legal retailer of both wine and distilled spirits. Utah retains full control over every alcoholic product in the state. And New Hampshire (akin to Montgomery County) retails both wine and spirits, but competes against some private wine retailers.

PFM also examined counties in license states with similar demographic and economic profiles. Like Montgomery County, Baltimore County is a Maryland county which sits just outside a major American city; though slightly less populous and with lower per capita income than Montgomery County, Baltimore County is subject to the same Maryland State laws, which makes it an excellent subject for comparison. Nassau County, New York is closer to Montgomery County on a range of relevant demographic characteristics and, like both Baltimore and Montgomery Counties, borders a major American city.

---

[15] Benchmarking data was collected from agency annual reports, state budgets and other publically available documents. Sales and market data were obtained from the Beverage Information Group Wine and Liquor Handbooks. Operational and regulatory information was obtained from the 2012 National Alcohol Beverage Control Association (NABCA) handbook. Both the Beverage Information Group and NABCA data are accepted as industry standards. PFM also contacted state liquor agencies to gather workforce and operational data when necessary.

[16] PFM had intended to benchmark Montgomery County, Maryland against Fairfax County, Virginia; this was deemed impossible after numerous outreach attempts to the Virginia Alcoholic Beverage Commission for specific county-level data were not returned. Instead, PFM relied on publically available data, such as the Commonwealth of Virginia's Certified Annual Financial Report, and industry data, such as the Beverage Information Group's Liquor and Wine Handbooks. This data was unavailable at the county-level, so PFM instead chose to leave benchmarking analysis that included the Commonwealth's overall operation but remove Fairfax County from the county-level benchmarking.

Comparable Jurisdictions

License Counties	Control Counties
Baltimore County, Maryland	Bucks County, Pennsylvania
Nassau County, New York	Salt Lake County, Utah
	Control States
	Virginia
	New Hampshire

Demographic and Economic Profiles

Among benchmarked counties, Montgomery County has the third largest total population but the second largest drinking-age population. The State is well above average in both median household income and per capita income. Compared to the benchmarked states, Montgomery County is highly educated, ranking first in percent of population with a Bachelor's degree or greater.

Demographic and Economic Profiles: Benchmarked Counties

License or Control	Comparison Counties	Total Population	Population 21+	Median HH Income	Per Capita Income	Percent Population with Bachelor's Degree or Greater	Population Density (persons/sq.mile)
L	Baltimore County, MD	817,455	598,486	$66,068	$34,447	35.3%	1,345.5
C	Bucks County, PA	627,053	464,221	$76,859	$37,171	35.1%	1,034.7
C	**Montgomery County, MD**	**1,004,709**	**725,066**	**$96,985**	**$48,690**	**56.9%**	**1,978.2**
L	Nassau County, NY	1,349,233	985,911	$97,049	$42,286	41.4%	4,074.8
C	Salt Lake County, UT	1,063,842	701,115	$59,626	$25,905	30.8%	1,387.1

Sources: American Fact Finder 2008-2012, U.S. Census Bureau.

Demographic and Economic Profiles: Benchmarked States

Comparison State	Total Population	Population 21+	Median HH Income	Per Capita Income	Percent Population with Bachelor's Degree or Greater	Population Density (persons/sq.mile)
Montgomery County, MD	**1,004,709**	**725,066**	**$96,985**	**$48,690**	**56.9%**	**1,978.2**
New Hampshire	1,321,617	985,000	$64,925	$32,758	33.4%	147.0
Virginia	8,186,628	5,876,000	$63,636	$33,326	34.7%	202.6

Sources: American Fact Finder 2008-2012, U.S. Census Bureau.

The remainder of the benchmarking analysis focuses on three aspects of comparison: structural aspects of the business environment (namely consumption statistics); business results in the forms of operating costs, gross profit margins and profit as a percent of sales; and retail operations, examining the concentration of off-premise retail locations.

Business Environment

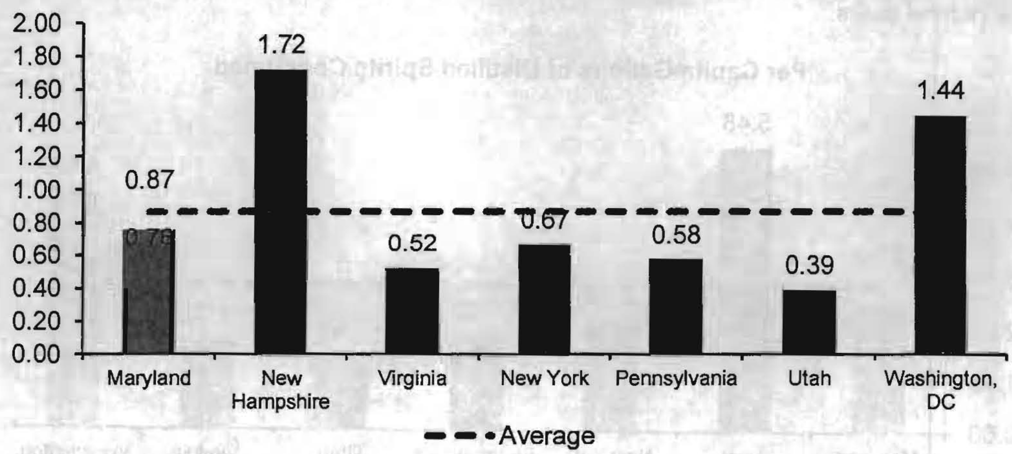
Per Capita Sales

As previously noted, the DLC has a monopoly on the sale of distilled spirits in the County. When a consumer wishes to purchase those products for off-premise consumption, they are faced with the choice of purchasing from the DLC or leaving the County. While it would be useful to focus on county-by-county when comparing the DLC to benchmark jurisdictions, quality data on sales or consumption of any alcoholic products are not widely available at the County-level. Instead, it is necessary to rely on per capita comparisons at the State-level.

Overall, liquor sales in Maryland are below the benchmarked average.[17] Given Montgomery County's proximity to the District of Columbia, it is quite possible that the County is underrepresented in the Maryland statewide numbers. In fact, both New Hampshire and Washington, D.C. are commonly cited as outliers in rankings of consumption on a per capita basis – based both on the influx of tourists and other travel-related visitors who drive up sales figures for both. It should be noted that Montgomery County likely also benefits somewhat from travelers to DC who choose to stay at hotels in the County.

Besides tourists and other travelers who purchase in Washington DC, for reasons of convenience or price, Montgomery County liquor customers may also purchase their alcohol in the District of Columbia rather than the County. It is hoped that this may offer an opportunity to the DLC to recapture some business without increasing consumption. Given the demographic and other factors previously cited, it is likely that Montgomery County per capita sales of distilled spirits exceed the Maryland figure of 0.76 9-Liter cases per adult, as well as the benchmark average of 0.87 9-Liter cases per adult.

Per Capita Sales of 9-Liter Cases of Distilled Spirits

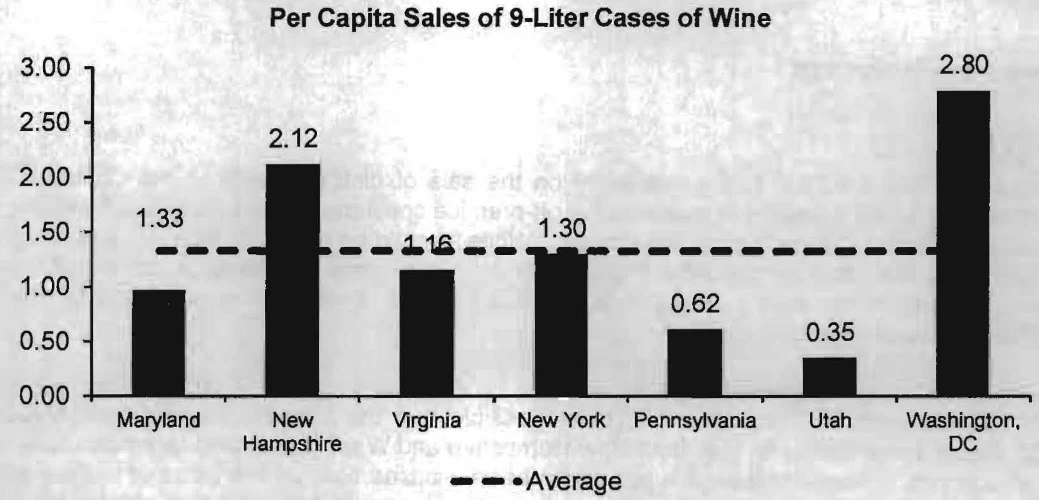


Source: The Liquor Handbook 2013.

When comparing the jurisdictions on per capita sales of wine, similar trends emerge. The Maryland blended value (0.98) is likely below the value of Montgomery County. Washington, DC (2.80 9-Liter cases per adult) and New Hampshire (2.12 9-Liter cases per adult) are likely to be statistical outliers (as

[17] In this comparison, the District of Columbia is included for analysis. Its proximity and prominence in the Metropolitan Statistical Area it shares with Montgomery County helps shed additional light on consumption, particularly given the lack of data at a County-specific level.

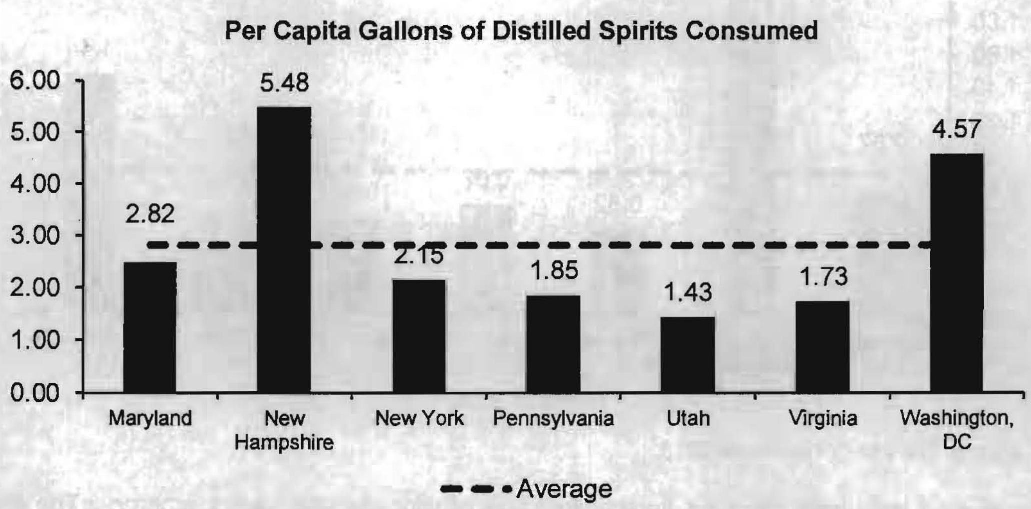
they were with distilled spirits). Montgomery County's likely level of sales probably lies between the benchmarked average (1.33 9-Liter cases per adult) and the Washington, DC value.



Source: The Wine Handbook 2013.

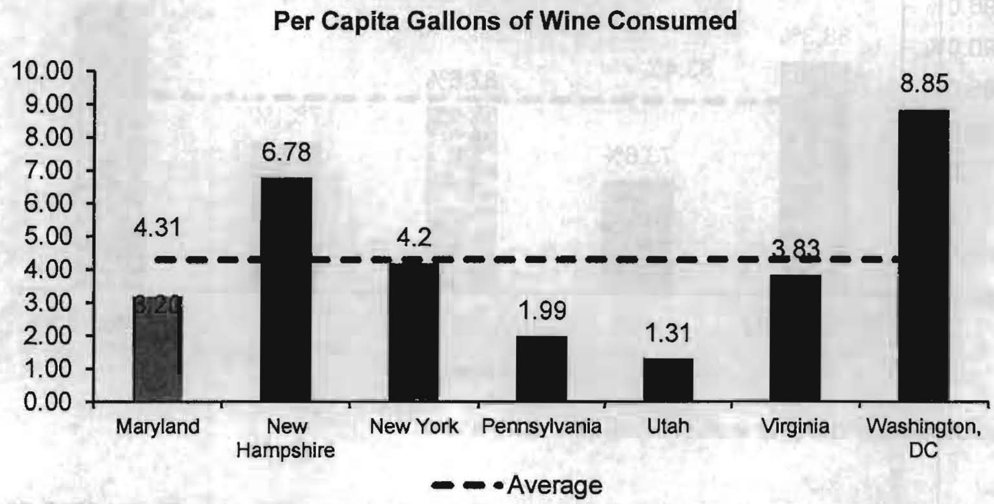
Per Capita Consumption

Available data suggests that Montgomery County outpaces much of the nation in consumption of distilled spirits. Data for the State of Maryland shows that on a per capita basis, Marylanders of drinking age consume 2.50 gallons of distilled spirits annually. This is below the average of the benchmarked jurisdictions; the benchmark average is high due to the inclusion of Washington, D.C. and New Hampshire. The blended average for Maryland likely understates the actual consumption level for Montgomery County – due, in varying degrees, to cultural norms, proximity to D.C., population levels and per capita income levels.



Source: The Liquor Handbook 2013.

A similar pattern emerges for consumption of wine. The data tend to suggest that border effects with Washington D.C. may be larger for Montgomery County, given the disproportionate consumption in the District. Of note is how close New York, a culturally similar state based on the social folkways identified by the International Journal of Environment Research and Public Health, comes to the benchmarked average in wine consumption; this suggests that Montgomery County has abnormally low wine consumption (seems unlikely) or experiences significant cross-border competition/sales.



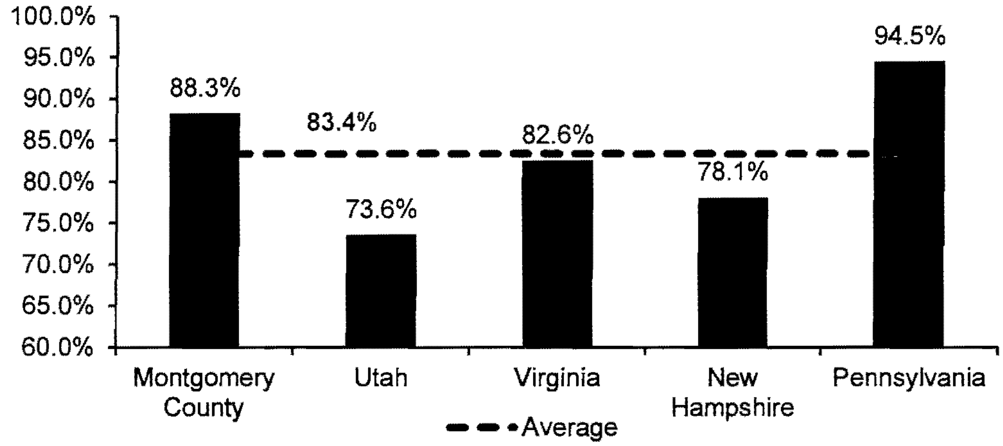
Source: The Wine Handbook 2013.

Business Results

Operating Costs

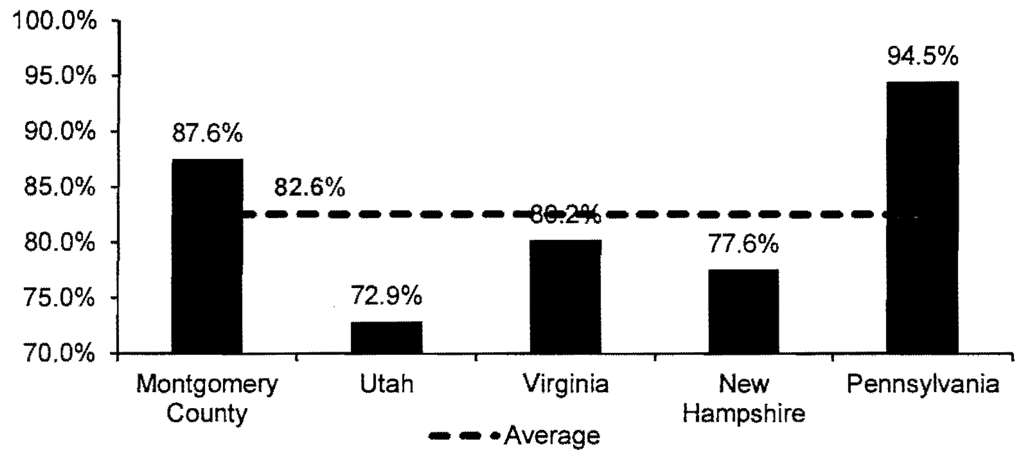
Comparatively, the DLC has high operating expenses among benchmarked control jurisdictions. Over the past four years, operating costs (including the cost of goods sold) as a percentage of total sales averaged 87.6 percent. This is above the average for benchmarked control states, which is 82.6 percent. However, the County's operating costs are similar to neighboring Virginia, whose operation experiences some of the same challenges in cross-border competition.

Operating Costs as a Percentage of Charges for Sales and Services (Average Fiscal 2010-2013)



Source: Various Comprehensive Annual Financial Reports.[18]

Operating Costs as a Percentage of Total Operating Revenue (Average Fiscal 2010-2013)



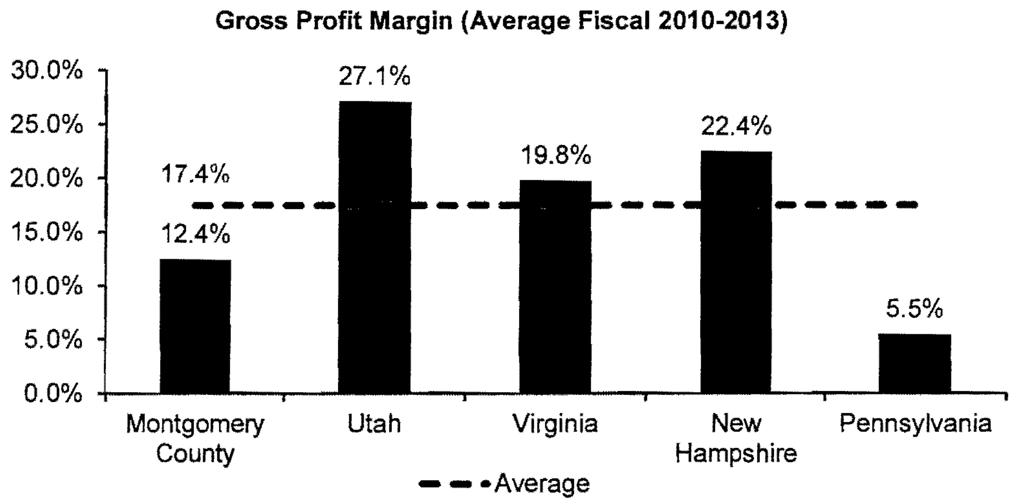
Source: Various Comprehensive Annual Financial Reports.[19]

<u>Gross Profit Margin</u>

Relative to other control states, the DLC has low gross profit margins. For each dollar of total sales revenue, the DLC retains approximately \$0.12; the average for benchmarked control states is \$0.17. Consequently, the DLC has a smaller percentage of total sales revenue to put toward other costs and obligations than comparable control states.

[18] Reporting methodologies vary among states, which affects comparability. Most recent available data for each state liquor control authority was used.

[19] Reporting methodologies vary among states, which affects comparability. Most recent available data for each state liquor control authority was used.

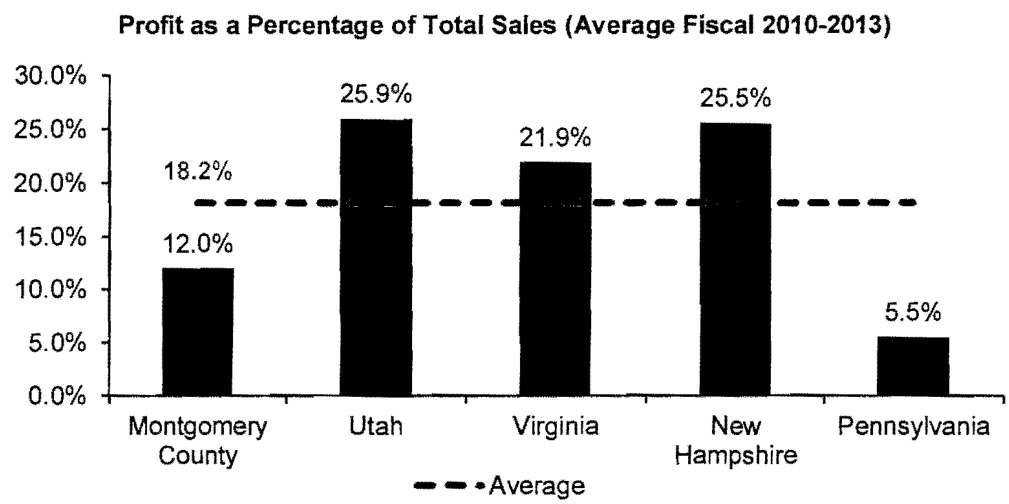


Source: Various Comprehensive Annual Financial Reports.[20]

In Fiscal Year 2012-2013, the DLC had one of the lowest gross profit margins (13.4 percent) compared to the group average (18.1 percent).

Profit as a Percentage of Total Sales

Profit as a percentage of gross sales is a key metric when evaluating financial performance of an operation. The DLC had lower profit margins (12.0 percent) than the benchmarked control states (average of 18.2 percent). Montgomery County's lower gross profit margin reduces its percentage of profit. The following table shows profit before transfers to the state or localities.



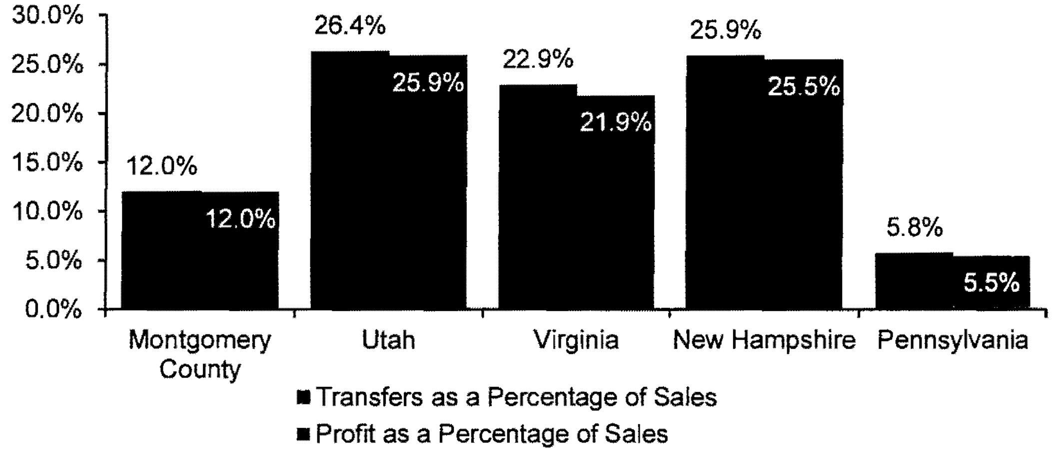
Source: Various Comprehensive Annual Financial Reports.[21]

[20] Reporting methodologies vary among states, which affects comparability. Most recent available data for each state liquor control authority was used.

[21] Reporting methodologies vary among states, which affects comparability. Most recent available data for each state liquor control authority was used.

On average, after transfers, the DLC is left with little to invest in its operation. When comparing the net profit numbers above to the amount transferred to the County general fund, the difference is not material. This appeared to be the norm across compared jurisdictions; in most cases, operations transferred more than their net profit to the jurisdiction's general operating fund.

Transfers as a Percentage of Sales (Average Fiscal 2010-2013) Compared with Profit as a Percentage of Sales (Average Fiscal 2010-2013)



Source: Various Comprehensive Annual Financial Reports.[22]

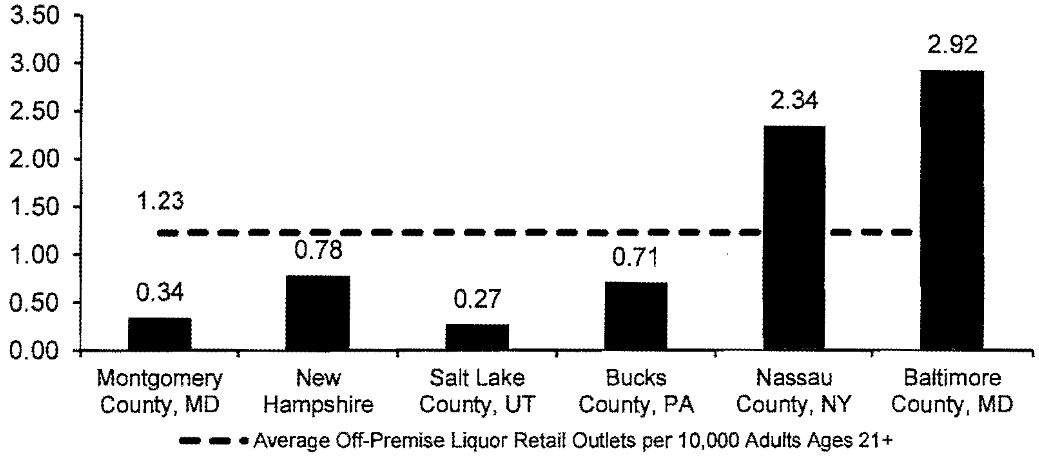
Retail Operations

Licenses Per Capita

Montgomery County has a low number of off-premise liquor stores per drinking-age resident relative to other jurisdictions, which are primarily license states. For every 10,000 residents over the age of 21, Montgomery County has 0.34 stores authorized to sell liquor for off-premise consumption, well below the average of 1.23.

[22] Reporting methodologies vary among states, which affects comparability. Most recent available data for each state liquor control authority was used.

Number of Off-Premise Liquor Outlets per 10,000 Drinking Age Residents (21+)

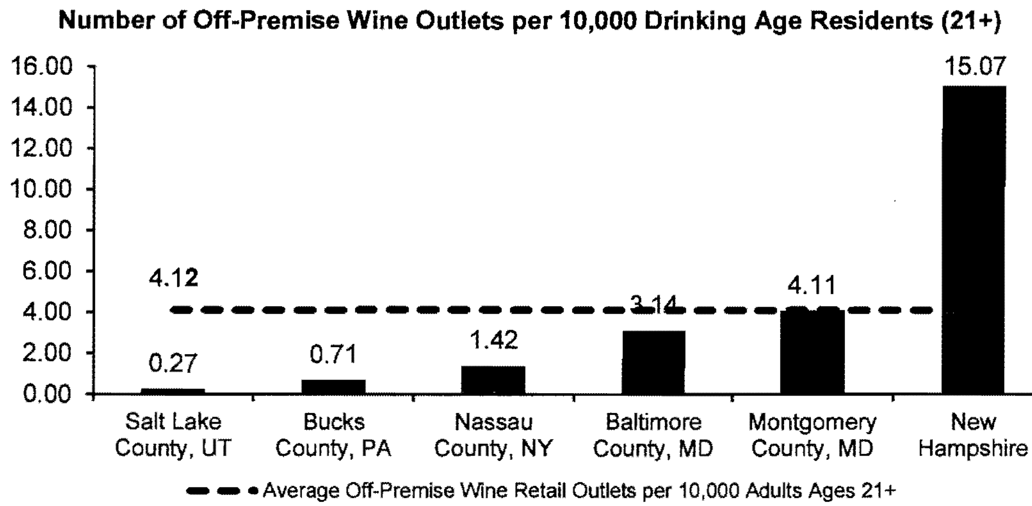


Sources: NABCA Survey Book p. 528; U.S. Census Bureau; Results of a survey conducted April 22 – May 9; New York State Liquor Authority; Baltimore County Alcoholic Beverage License Book.

Some of this relates to the difference between the comparable jurisdictions. Montgomery County is relatively densely populated and compact, with only a small amount of low density area. By contrast, States often have low density rural areas where the population may be small, but there is a need to provide outlets within reasonable proximity to the population – this will tend to increase the number of outlets per capita.

It is also notable that all control jurisdictions have a significantly lower number of outlets per 10,000 drinking age residents than their license counterparts. Since market conditions guide the placement of the number of retail locations in license jurisdictions, the data suggests that Montgomery County has areas that may be underserved, at least relative to market-driven jurisdictions.

This disparity does not exist when considering off-premise wine outlets. As the County does not control all off-premise wine sales, there are substantially more wine outlets than liquor outlets. Montgomery County's distribution of off-premise wine outlets (4.11 outlets per 10,000 adults ages 21+) is almost identical to the average of benchmarked jurisdictions (4.12 outlets per 10,000 adults ages 21+). This further underscores the difference that generally exists between license and control jurisdictions.



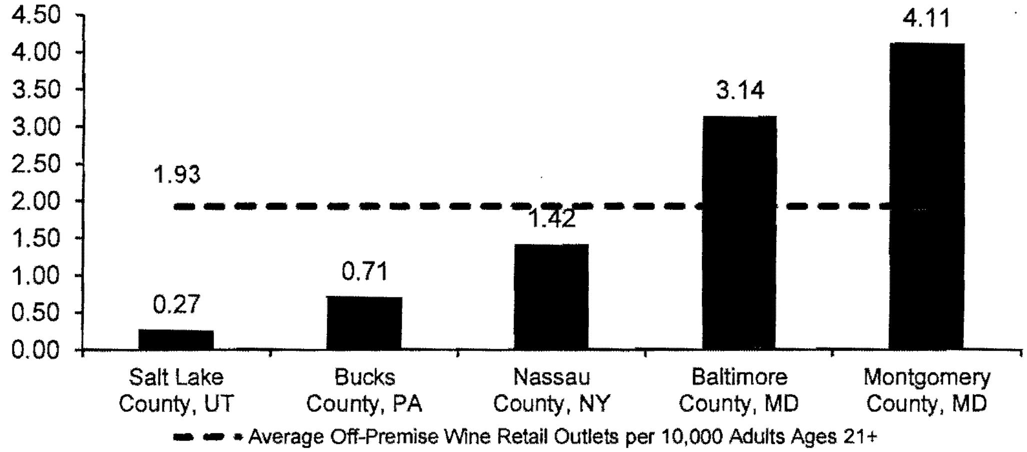
Sources: NABCA Survey Book p. 528; U.S. Census Bureau; Results of a survey conducted April 22 – May 9; New York State Liquor Authority; Baltimore County Alcoholic Beverage License Book.

New Hampshire's retail location density is significantly higher than any of the comparison counties. This is partially a result of significant in-migration of potential customers, which has led their liquor control department to respond by providing additional (or larger) store locations. It should be noted that a study of the Vermont liquor control system noted its proximity to New Hampshire, which it described as "the most competitive, most aggressively marketed of the control states."[23] New Hampshire, like the County, competes against private wine retailers for customers. Given Montgomery County's position near neighboring DC, this response may account for the discrepancy between the County's density of wine outlets and the density in all other benchmarked counties.

New Hampshire's high retail density may also be due to its low population density, requiring more retailers to serve smaller populations due to the sheer distance between population centers. In this respect, Montgomery County differs greatly from New Hampshire. Comparing the data without New Hampshire present shows Montgomery County's 4.11 outlets per 10,000 adults ages 21+ is well above the average (1.93 outlets per 10,000 adults ages 21+).

[23] Management Analysis, Incorporated, Business Process and Staffing Review of the liquor purchase, warehousing, and distribution operations for the State of Vermont's Liquor Control Board/Department of Liquor Control (DLC). January 2005 Vol. II Page 24.

Number of Off-Premise Wine Outlets per 10,000 Drinking Age Residents (21+) (excluding New Hampshire)



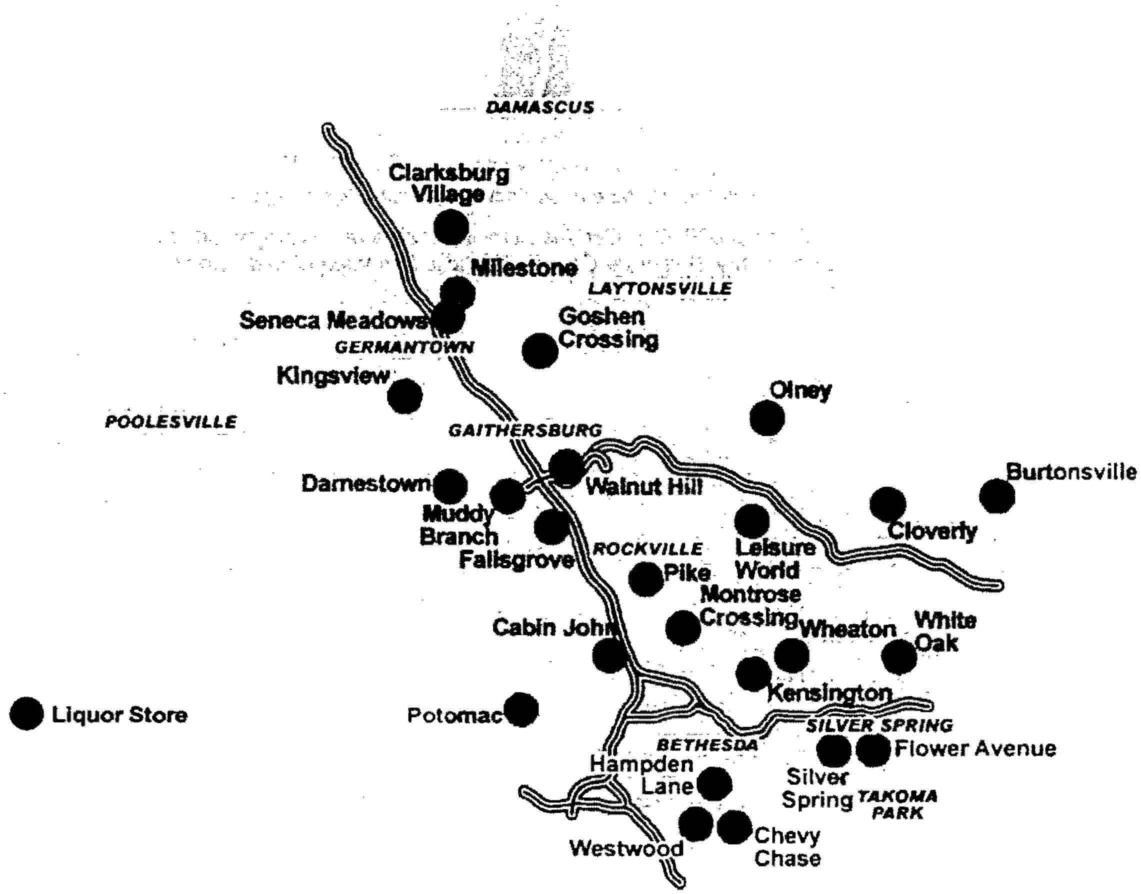
Sources: NABCA Survey Book p. 528; U.S. Census Bureau; Results of a survey conducted April 22 – May 9; New York State Liquor Authority; Baltimore County Alcoholic Beverage License Book.

Environmental Scan

County Retail Stores

As has been noted, Montgomery County is one of the jurisdictions that controls both wholesale and retail of distilled spirits, as well as wholesale of all liquor products for licensees for on premise consumption. In addition, the County retails wine products and competes with private beer and wine retailers. To retail liquor and wine, the County operates twenty-five retail locations. The map below details the locations of County-run stores.

Montgomery County Liquor Stores



Source: Montgomery County Department of Liquor Control

The DLC applies both a wholesale and a retail mark-up to arrive at the product shelf price. This helps ensure that County retail stores do not unfairly compete with private retailers who must pay the County wholesale mark-up and also apply their own retail mark-up. Of course, the wholesale and retail mark-up are also necessary to generate revenue, a portion of which ultimately flows to the County General Fund. The following details the wholesale and retail mark-ups that are applied to the FOB for County retail stores.

Wine Mark-Up Charges for County Retail Stores by Classification

	AL	HO	S	SC	ST
Description	**Allocated** - Available on in limited quantities that are less than DLC desires to purchase	**Holiday Only** - Seasonal and special packaging for holiday only	**Special Order** - Special products shelved in stores without needing approval	**Specialty Center** - Special products shelved in stores that need approval from retail management	**Stock**
Wholesale Markup	35%	25%	25%	25%	35%
Retail Markup	28%				

Source: Montgomery County Department of Liquor Control.

Beer Mark-Up Charges for County Retail Stores[24]

	ST
Description	**Stock**
Wholesale Markup	35% + 20 cents
Retail Markup	31%

Source: Montgomery County Department of Liquor Control.

Liquor Mark-Up Charges for County Retail Stores by Size

	1.75 L	1 L	750 mL	500 mL	375 mL	200 mL	100 mL	50 mL
Wholesale Markup	27%	30%	27%	51%	51%	60%	60%	60%
Retail Markup	18%	20%	18%	18%	18%	18%	18%	18%

Source: Montgomery County Department of Liquor Control.

[24] County retail stores are only allowed to offer regularly stocked beer products that are not sold individually. County retail stores do not sell kegs and are not allowed to sell chilled beer.

Environmental Scan

Sales per Square Foot

Several Montgomery County Liquor and Wine stores have sales per square foot for FY2013 that are well above the County average. Average sales per square foot for the County is calculated as $1,106.81. Milestone, the County's most profitable store, posts sales per square foot of $1,827.59. Likewise, the next two stores, Montrose and Potomac, are over $500 per square foot more profitable than the average. Conversely, the County operates a few stores that are substantially below the average. Cloverly has a sales-per-square-foot value of $554.29, or about half the average amount. Chevy Chase and Flower Avenue are also between $500 and $600 per square foot. The values for all County stores are listed in the following table.

Sales Per Square Foot (Fiscals 2010-2013)

Store Location	SF	Annual Sales				Sales PSF			
		FY10	FY11	FY12	FY13	FY10	FY11	FY12	FY13
Milestone	4425	$8,019,639	$7,217,914	$7,629,202	$8,087,087	$1,812	$1,631	$1,724	$1,828
Montrose	4670	$6,463,898	$7,090,551	$8,150,210	$7,946,578	$1,384	$1,518	$1,745	$1,702
Potomac	3904	$5,630,451	$5,587,169	$6,567,133	$6,634,029	$1,442	$1,431	$1,682	$1,699
Olney	4050	$5,682,132	$5,463,790	$6,072,914	$5,491,654	$1,403	$1,349	$1,499	$1,356
Hampden Lane	5000	$4,661,328	$4,803,656	$5,653,253	$6,428,634	$932	$961	$1,131	$1,286
Kensington	4850	$4,866,579	$4,783,898	$5,683,372	$6,083,118	$1,003	$986	$1,172	$1,254
Westwood	5815	$6,511,129	$6,242,010	$7,118,213	$7,260,399	$1,120	$1,073	$1,224	$1,249
Wheaton	3650	$3,820,995	$3,832,112	$4,523,679	$4,494,804	$1,047	$1,050	$1,239	$1,231
Fallsgrove	3865	$4,380,168	$4,218,544	$4,713,638	$4,754,097	$1,133	$1,091	$1,220	$1,230
Silver Spring	5025	$4,428,872	$4,425,173	$5,413,462	$5,786,470	$881	$881	$1,077	$1,152
Muddy Branch	6400	$5,487,373	$5,484,843	$6,598,303	$7,213,587	$857	$857	$1,031	$1,127
Leisure World	4000	$4,092,259	$3,921,246	$4,374,662	$4,395,848	$1,023	$980	$1,094	$1,099
Pike	6000	$5,009,752	$5,391,721	$6,171,703	$6,588,852	$835	$899	$1,029	$1,098
Cabin John	3965	$4,221,952	$3,801,490	$4,303,707	$4,341,208	$1,065	$959	$1,085	$1,095
Walnut Hill	4660	$4,132,501	$3,868,473	$4,470,402	$4,811,528	$887	$830	$959	$1,033
White Oak	5499	$4,092,788	$4,018,811	$4,640,088	$4,766,358	$744	$731	$844	$867
Darnestown	7721	$4,001,994	$4,438,857	$5,409,894	$6,168,042	$518	$575	$701	$799
Burtonsville	4400	$757,822	$1,266,635	$2,685,546	$3,294,774	$172	$288	$610	$749
Kings View	7251	$4,205,801	$3,951,647	$4,805,203	$4,923,682	$580	$545	$663	$679
Flower Avenue	5000	$2,281,471	$2,303,615	$2,804,966	$2,806,816	$456	$461	$561	$561
Chevy Chase	4224	$2,208,047	$2,220,273	$2,534,128	$2,347,463	$523	$526	$600	$556
Cloverly	6350	$3,718,874	$3,457,913	$3,334,104	$3,519,764	$586	$545	$525	$554
TOTALS/AVERAGE	110724	$106,150,692	$103,311,031	$120,157,984	$122,550,659	$959	$933	$1,085	$1,107

Source: Montgomery County Department of Liquor Control.

Net Income

Evaluating the DLC retail stores using net income reveals that most generate significant profit. Six stores generate over $1 million and another 12 generate over $500,000. Only one store posted a loss for FY2013 (Chevy Chase). At an average of 15 percent of retail sales, the DLC stores are generally generating a healthy profit. Net profit calculations for each store are provided on the following table.

Net Income for Montgomery County DLC Retail Locations (Fiscal 2013)

Store	Retail Sales	Cost of Goods Sold	Salary and Wages	Contract and Services	Maintenance	Rental Leases	Other Supplies/ Materials/ Equipment	Data, Telephone	Utilities	Misc Operating Expenses	Net Income	Net Income %
Milestone	$8,087,087	($5,708,980)	($504,840)	($97,962)		($285,473)	($90)	($9,318)	($14,879)	($165)	$1,465,381	18%
Montrose	$7,946,576	($5,562,033)	($553,283)	($100,750)	($2,068)	($269,404)		($8,122)	($13,564)	$74	$1,437,428	18%
Westwood	$7,260,399	($4,993,630)	($483,416)	($115,232)		($347,364)	($150)	($8,448)	($15,819)	($90)	$1,296,250	18%
Muddy Branch	$7,213,587	($5,052,905)	($607,079)	($82,047)		($274,440)			($20,079)	($358)	$1,176,681	16%
Kensington	$6,083,118	($4,205,787)	($492,523)	($50,512)		($177,186)	($90)	($8,865)	($18,361)		$1,129,794	19%
Hampden Lane	$6,428,634	($4,524,266)	($367,604)	($71,841)		($342,582)	($304)	($942)	($16,464)	($18,395)	$1,086,236	17%
Pike	$6,588,852	($4,658,065)	($563,914)	($71,502)		($310,520)	($90)	($8,783)	($21,428)		$954,550	14%
Potomac	$6,634,029	($4,588,152)	($543,458)	($104,546)		($469,015)	($274)	($8,638)	($12,544)		$907,402	14%
Olney	$5,491,654	($3,858,173)	($526,020)	($65,351)		($106,049)		($8,384)	($27,095)	($90)	$900,491	16%
Darnestown	$6,168,042	($4,281,081)	($499,029)	($69,548)		($458,538)	($535)			($446)	$858,864	14%
Walnut Hill	$4,811,528	($3,382,603)	($402,133)	($51,872)	($195)	($110,214)	($90)	($8,037)	($15,546)	($2,070)	$838,769	17%
Silver Spring	$5,786,470	($4,060,766)	($583,454)	($66,174)	($1,096)	($205,623)	($290)	($7,893)	($17,485)	($13,934)	$829,756	14%
Kingsview	$4,923,682	($3,478,469)	($456,559)	($74,326)		($196,027)		($8,122)	($15,549)	($90)	$694,539	14%
Leisure World	$4,395,848	($3,081,035)	($461,265)	($45,100)	($4,209)	($99,718)	($90)	($8,760)	($13,943)	($55)	$681,673	16%
Cabin John	$4,341,208	($3,026,977)	($357,729)	($61,621)	($2,942)	($226,735)	($130)	($8,674)	($12,901)	($90)	$643,409	15%
Fallsgrove	$4,754,097	($3,321,522)	($506,840)	($62,740)	($7,876)	($233,961)	($723)	($314)	($11,045)	($1,460)	$607,617	13%
Wheaton	$4,494,804	($3,203,148)	($519,397)	($39,635)		($138,811)		($9,108)	($14,251)	($13,380)	$557,074	12%
White Oak	$4,766,358	($3,360,767)	($548,142)	($50,713)	($1,798)	($245,267)	($32)	($8,865)	($24,297)	($570)	$525,908	11%
Burtonsville	$3,294,774	($2,314,677)	($205,746)	($42,875)		($257,930)	($180)		($10,320)	($28)	$463,019	14%
Flower	$2,806,816	($1,948,822)	($11,748)	($278,247)		($162,207)	($90)	($16,829)	($16,133)		$372,740	13%
Cloverly	$3,519,764	($2,465,488)	($373,556)	($37,191)		($267,280)	($70)	($314)	($13,314)		$362,553	10%
Chevy Chase	$2,347,463	($1,643,870)	($561,487)	($29,813)		($362,951)		($8,356)	($9,362)	($10,055)	($278,431)	-12%

Source: Montgomery County Department of Liquor Control

Inventory Turnover Rate

The Inventory Turnover Rate shows how many times a company's inventory is sold and replaced in a period. In a typical year, a liquor store should expect to turn over their inventory at least six to eight times.[25] For FY2013, the inventory turnover rate for the Montgomery County Liquor and Wine stores showed all but five stores that met that benchmark. As a system, the average is with the range of the general norm. The five stores that fall below the benchmark are Flower Avenue, Burtonsville, Darnestown, Cloverly and Chevy Chase. Full calculations for each store are provided in the following table.

Inventory Turnover Rate

Store Location	Sales	Cost of Goods	Gross Margin	Average Inventory Investment	Inventory Turnover Rate
Milestone	$8,087,087	$5,708,980	$2,378,107	$486,387	11.74
Olney	$5,491,654	$3,858,173	$1,633,481	$334,633	11.53
Walnut Hill	$4,811,528	$3,382,603	$1,428,925	$327,334	10.33
Silver Spring	$5,786,470	$4,060,766	$1,725,704	$420,859	9.65
Montrose	$7,946,578	$5,562,033	$2,384,545	$592,639	9.39
Hampden Lane	$6,428,634	$4,524,266	$1,904,368	$500,466	9.04
Potomac	$6,634,029	$4,588,152	$2,045,877	$616,799	7.44
Pike	$6,588,852	$4,658,065	$1,930,787	$602,878	7.73
Fallsgrove	$4,754,097	$3,321,522	$1,432,575	$492,589	6.74
Muddy Branch	$7,213,587	$5,052,905	$2,160,682	$734,090	6.88
Leisure World	$4,395,848	$3,081,035	$1,314,813	$449,468	6.85
Wheaton	$4,494,804	$3,203,148	$1,291,656	$448,729	7.14
Westwood	$7,260,399	$4,993,630	$2,266,769	$797,539	6.26
Cabin John	$4,341,208	$3,026,977	$1,314,231	$465,153	6.51
Kingsview	$4,923,682	$3,478,469	$1,445,213	$523,155	6.65
Kensington	$6,083,118	$4,205,787	$1,877,331	$566,050	7.43
Flower	$2,806,816	$1,948,822	$857,994	$327,545	5.95
White Oak	$4,766,358	$3,360,767	$1,405,591	$550,781	6.10
Burtonsville	$3,294,774	$2,314,677	$980,098	$446,530	5.18
Darnestown	$6,168,042	$4,281,081	$1,886,961	$890,403	4.81
Cloverly	$3,519,764	$2,465,488	$1,054,276	$604,283	4.08
Chevy Chase	$2,347,463	$1,643,870	$703,593	$454,713	3.62
System Averages	$5,370,218	$3,760,055	$1,610,163	$528,774	7.32
System Totals	$118,144,792	$82,721,214	$35,423,579	$11,633,021	7.11

Source: Montgomery County Department of Liquor Control.

[25] The Retail Owners Institute®. Based on data from *Risk Management Association* *Annual Statement Studies*, *2013/2014*.

Gross Margin Return on Inventory Investment Rate

The Gross Margin Return on Inventory Investment (GMROII) shows how many dollars in gross margin are generated during the year for each dollar invested in inventory. Industry norms for Beer, Wine and Liquor Stores are a 2.03 GMROII rate. All but two of the Montgomery County Liquor and Wine stores (Clovery and Chevy Chase) show a rate higher than the industry norm. The details for each store are shown in the following table.

GMROII for Montgomery County DLC Retail Locations

Store Location	Sales	Cost of Goods	Gross Margin	Gross Margin %	Average Inventory Investment	GMROII Ratio
Milestone	$8,087,087	$5,708,980	$2,378,107	29.41%	$486,387	4.89
Olney	$5,491,654	$3,858,173	$1,633,481	29.74%	$334,633	4.88
Walnut Hill	$4,811,528	$3,382,603	$1,428,925	29.70%	$327,334	4.37
Silver Spring	$5,786,470	$4,060,766	$1,725,704	29.82%	$420,859	4.10
Montrose	$7,946,578	$5,562,033	$2,384,545	30.01%	$592,639	4.02
Hampden Lane	$6,428,634	$4,524,266	$1,904,368	29.62%	$500,466	3.81
Potomac	$6,634,029	$4,588,152	$2,045,877	30.84%	$616,799	3.32
Pike	$6,588,852	$4,658,065	$1,930,787	29.30%	$602,878	3.20
Fallsgrove	$4,754,097	$3,321,522	$1,432,575	30.13%	$492,589	2.91
Muddy Branch	$7,213,587	$5,052,905	$2,160,682	29.95%	$734,090	2.94
Leisure World	$4,395,848	$3,081,035	$1,314,813	29.91%	$449,468	2.93
Wheaton	$4,494,804	$3,203,148	$1,291,656	28.74%	$448,729	2.88
Westwood	$7,260,399	$4,993,630	$2,266,769	31.22%	$797,539	2.84
Cabin John	$4,341,208	$3,026,977	$1,314,231	30.27%	$465,153	2.83
Kingsview	$4,923,682	$3,478,469	$1,445,213	29.35%	$523,155	2.76
Kensington	$6,083,118	$4,205,787	$1,877,331	30.86%	$566,050	3.32
Flower	$2,806,816	$1,948,822	$857,994	30.57%	$327,545	2.62
White Oak	$4,766,358	$3,360,767	$1,405,591	29.49%	$550,781	2.55
Burtonsville	$3,294,774	$2,314,677	$980,098	29.75%	$446,530	2.19
Darnestown	$6,168,042	$4,281,081	$1,886,961	30.59%	$890,403	2.12
Cloverly	$3,519,764	$2,465,488	$1,054,276	29.95%	$604,283	1.74
Chevy Chase	$2,347,463	$1,643,870	$703,593	29.97%	$454,713	1.55

Source: Montgomery County Department of Liquor Control.

Environmental Scan

Lease Expense

Lease expenses as a percentage of sales is a good metric for determining if locations are performing at a level to justify the lease costs. The national average for Food and Beverage stores is around five percent. Six of the Montgomery County Liquor and Wine stores are above five percent, and the Chevy Chase store is three times the average, as well as three times the benchmark value. Taking into consideration the abnormally high lease rates in certain areas of Montgomery County, it would still appear that the Chevy Chase store is not performing to the level of its lease payment. Information related to leases for each of the stores is listed in the following table.

Lease As a Percent of Sales (Fiscal 2013)

	FY13 Sales	FY13 Lease Payment	Lease as % of Sales
Chevy Chase	$2,347,463	$362,951.47	15%
Burtonsville	$3,294,774	$257,930.04	8%
Cloverly	$3,519,764	$267,279.62	8%
Darnestown	$6,168,042	$458,538.30	7%
Potomac	$6,634,029	$469,014.64	7%
Flower	$2,806,816	$162,206.94	6%
Hampden Lane	$6,428,634	$342,582.03	5%
Cabin John	$4,341,208	$226,734.62	5%
White Oak	$4,766,358	$245,267.19	5%
Fallsgrove	$4,754,097	$233,960.68	5%
Westwood	$7,260,399	$347,363.50	5%
Pike	$6,588,852	$310,520.25	5%
Kingsview	$4,923,682	$196,026.78	4%
Muddy Branch	$7,213,587	$274,439.55	4%
Silver Spring	$5,786,470	$205,622.76	4%
Milestone	$8,087,087	$285,472.59	4%
Montrose	$7,946,578	$269,403.88	3%
Wheaton	$4,494,804	$138,810.88	3%
Kensington	$6,083,118	$177,185.84	3%
Walnut Hill	$4,811,528	$110,214.00	2%
Leisure World	$4,395,848	$99,717.98	2%
Olney	$5,491,654	$106,049.33	2%

Source: Montgomery County Department of Liquor Control.

Units per Transaction

Units per Transaction can provide insight into many different aspects of the retail location. It is possible that more units suggest the customer is spending a greater amount of time in the store, which may be related to the level of comfort and overall shopping experience (and can also lead to more or "impulse" purchases). It can also indicate how effective the store personnel are at suggestive sales and whether the store layout is conducive to product sales. Ten of the Montgomery County Liquor and Wines stores are above the system average with only a few showing significantly fewer units per transaction than the system average. The data for each store is found on the following table.

Units Per Transaction (Fiscal 2013)

Store Location	Total Transactions	Total Units Sold	Units Per Transaction
Potomac	127,227	445,991	3.51
Hampden Lane	130,319	448,281	3.44
Westwood	168,488	571,130	3.39
Darnestown	152,052	467,838	3.08
Pike	166,299	501,380	3.01
Cabin John	108,970	317,250	2.91
Muddy Branch	187,329	539,648	2.88
Fallsgrove	123,633	354,796	2.87
Montrose	217,946	617,238	2.83
Olney	161,922	443,207	2.74
Silver Spring	164,816	442,965	2.69
Cloverly	102,442	271,619	2.65
Chevy Chase	67,311	174,515	2.59
Milestone	251,851	652,021	2.59
Kensington	195,032	502,186	2.57
Leisure World	150,152	376,220	2.51
White Oak	160,480	389,164	2.43
Kingsview	165,752	394,744	2.38
Walnut Hill	175,731	415,250	2.36
Burtonsville	112,169	253,386	2.26
Flower	122,080	263,725	2.16
Wheaton	167,741	353,636	2.11
Goshen Crossing	179,218	375,389	2.09
Average	3,558,960	416,156	2.70

Source: Montgomery County Department of Liquor Control.

Transactions per Square Foot

Transactions per Square Foot may assist in determining whether there is a notable level of overcrowding or under-crowding in a particular store. In the case of the Montgomery County Wine and Liquor stores, there are a few outliers. The Milestone, Montrose, Wheaton and Kensington stores, not surprisingly, show a number of transactions per square foot that are well above the system average. The Darnestown and Cloverly stores are significantly below the system average. Chevy Chase is almost half the system average. The following table provides data for each store.

Transactions per Square Foot (Fiscal 2013)

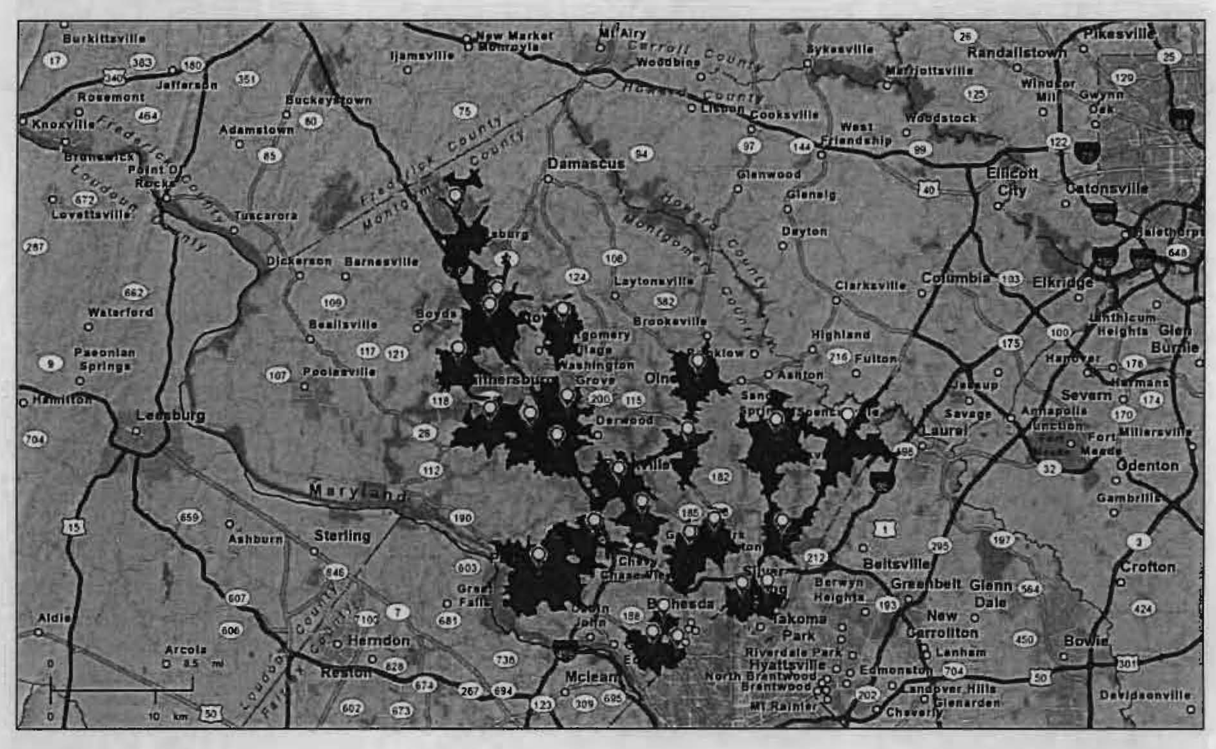
Store Location	Total Transactions	SqFt	Transactions PSF
Milestone	251,851	4,425	56.92
Montrose	217,946	4,670	46.67
Wheaton	167,741	3,650	45.96
Kensington	195,032	4,850	40.21
Olney	161,922	4,050	39.98
Walnut Hill	175,731	4,660	37.71
Leisure World	150,152	4,000	37.54
Flower	122,080	3,300	36.99
Silver Spring	164,816	5,025	32.80
Potomac	127,227	3,904	32.59
Fallsgrove	123,633	3,865	31.99
Muddy Branch	187,329	6,400	29.27
White Oak	160,480	5,499	29.18
Westwood	168,488	5,815	28.97
Pike	166,299	6,000	27.72
Goshen Crossing	179,218	6,477	27.67
Cabin John	108,970	3,965	27.48
Hampden Lane	130,319	5,000	26.06
Burtonsville	112,169	4,400	25.49
Kingsview	165,752	7,251	22.86
Darnestown	152,052	7,721	19.69
Cloverly	102,442	6,163	16.62
Chevy Chase	67,311	4,224	15.94

Source: Montgomery County Department of Liquor Control.

Environmental Scan

Market Service Area

The following map identifies the market service area for each of the Montgomery County Liquor and Wine stores. The market areas were determined using the total sales for FY2013 and national averages on money spent per household. This map shows some significant gaps within populated areas of the County. It also shows some areas, such as the southernmost portion of the County, that may be somewhat over served.



Environmental Scan

The following map indicates population density as well as the location of each of the Montgomery County Wine and Liquor stores (noted by a green flag). For population density, the darker the color on the map, the more densely populated the area. Taken with the previous Market Area map, this provides an indication of the underserved or "holes" in the market. Specifically, the area north of Gaithersburg, the area east of Aspen Hill and north of Wheaton-Glenmont, and the area north of Potomac and west of Rockville appear to be underserved areas that have sufficient population density to support additional retail locations.

Environmental Scan

County Wholesale Distribution

Warehouse

The DLC has one warehouse, located at its headquarters in Gaithersburg, Maryland with 210,000 square feet of usable storage. The warehouse is split into two halves: one half is dedicated to wine and distilled spirits, and one half is for beer. The warehouse is climate controlled and is equipped with a conveyor system that assists in picking orders for delivery.

Unlike nearly every control state, Montgomery County purchases its inventory from manufacturers and stores it in its warehouse prior to delivery to retail stores or licensees. The vast majority of control states operate bailment warehouses, and manufacturers provide their product for storage at the bailment warehouse. In this system, ownership is generally transferred to the State (and payment made to the manufacturer) when product is shipped and/or received at the retail location.

The current County wholesale distribution system requires appointments for deliveries from manufacturers. When a delivery arrives, pallets are unloaded, workers print a label which includes a barcode, scan the barcode and a corresponding barcode on the shelving units where the pallet will rest. Care is taken to put pallets of similar products together and to keep high volume merchandise closer to the picking stations.

Retail orders are expected two days before delivery and are recorded by workers in the warehouse office. These are assembled into a pick list for the following day's deliveries. The pick list is distributed to workers on the warehouse floor, who locate the correct product – aided by the barcode system – and begin to assemble a shipment. These shipments are loaded on to trucks at night. Beer shipments are separate from shipments of liquor and wine. The County has hired contractors to load beer shipments at thirty cents ($0.30) per case; County employees load shipments of liquor and wine.

A shipment leaves the warehouse the next morning. Drivers and at least one manager arrive at the warehouse between 6:00 and 6:30 am, when routes are distributed and drivers perform necessary pre-delivery operations. Trucks leave the warehouse at approximately 7:00 am. Due to shortages of delivery trucks, drivers or both, there are frequently "double loads" where a driver will return from one set of deliveries, reload the truck or exchange trucks and make another set of deliveries.

Deliveries are made Monday through Friday. Monday is the least popular day for delivery, while Thursday and Friday (in advance of weekend business) are the most popular. Most County-owned retail stores receive one shipment a week of beer and two shipments a week of wine and liquor.

Delivery Truck Fleet

The DLC operates an outdated fleet, which results in higher operational costs, lower employee morale and reduced customer confidence. Moreover, an outdated fleet represents an unfunded capital liability that poses a risk to future revenue transfers. The following presents an overview of the DLC truck fleet and an analysis of three forecasted expenditure scenarios.

<u>Overview of the DLC's Truck Fleet</u>

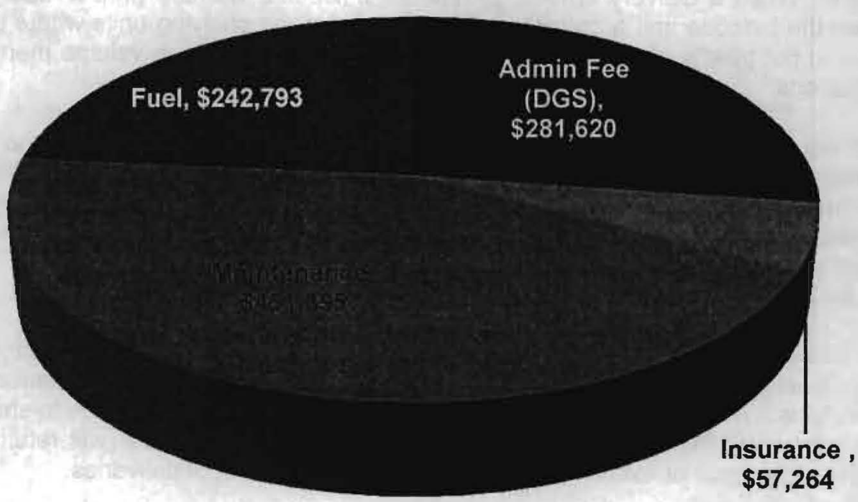
The DLC truck fleet represents a key component of the DLC operation. The DLC fleet consists of 42 delivery trucks that support the DLC's retail store operations and supply beer/wine retailers, as well as a wide range of hotel, bar and restaurant accounts. Within the DLC fleet, there are three classes of trucks: van-body trucks (four), tandem-axle trucks (27) and tandem-axle refrigerated-body trucks (11). The trucks are custom built from four manufacturers (Freightliner, Sterling, International and Ford).

Environmental Scan

There are peaks and valleys in truck usage, both throughout the week and the calendar year. As noted earlier, Mondays and Tuesdays tend to be the slowest days in terms of deliveries, while Thursdays and Fridays are the busiest days. Annually, demand spikes prior to the Independence Day, Thanksgiving and Christmas holidays. According to DLC officials, between 25 and 35 trucks are used in a normal week to accomodate delivery schedules. In peak weeks, up to 40 trucks are needed to meet heightened demand. It is notable that beer delivery loads are placed on separate trucks from wine and liquor, and beer deliveries are further divided between kegs and bottles/cans.

Operational fleet expenditures approximated $1,033,000 between May 1, 2013 and April 30, 2014. While the fleet is owned by the DLC, it is serviced by the Montgomery County Department of General Services (DGS). The DGS charges an administrative fee of $588.77 per month per vehicle, as well as $104.85 per month per vehicle for insurance. As illustrated in the figures below, during a recent one-year period, the DLC paid nearly $300,000 in administrative fees to the DGS, comprising more than 27 percent of total fleet-related expenditures.

The DLC's Fleet Expenditures by Category: May 1, 2013 – April 30, 2014

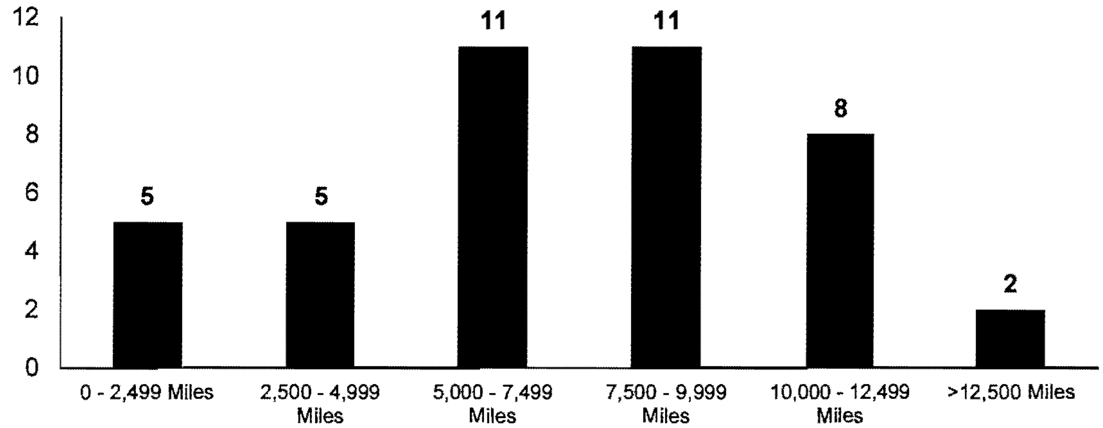


Source: Montgomery County Department of Liquor Control.

Given that the DLC fleet operations are primarily limited to trips within Montgomery County, delivery trucks accumulated less than 7,500 miles, on average, during the one-year period of May 1, 2013 to April 30, 2014. Vehicle utilization across the fleet, however, is uneven. As illustrated in the table below, 10 trucks (approximately 24 percent of the fleet) ran fewer than 5,000 miles between May 1, 2013 and April 30, 2014, while 10 trucks accumulated more than 10,000 miles in the same period.

Uneven utilization suggests that a significant portion of the fleet is out of service at any given point in time, which places greater strain on the vehicles in-service. The following chart summarizes the distribution of trucks by mileage run between May 1, 2013 and April 30 2014.

DLC Truck Fleet by Mileage: May 1, 2013 – April 30, 2014

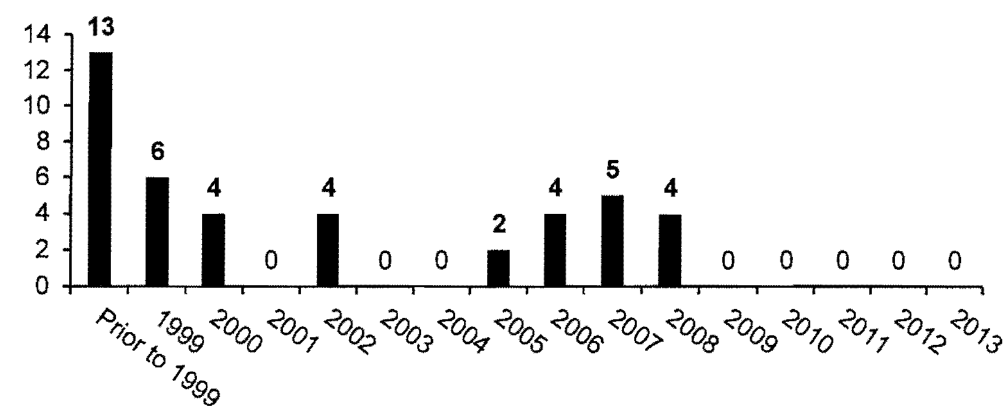


Source: Montgomery County Department of General Services.

One of the principal reasons for uneven utilization – and presumably, high levels of downtime for trucks within the DLC fleet – is the age of the vehicles within the fleet. The DLC has not purchased any new trucks since 2008. Moreover, nearly one in three trucks was purchased prior to 1999. Older vehicles require higher levels of maintenance and repairs. Because these older trucks are more frequently out of service, the DLC must operate a larger fleet than would otherwise be necessary in order to meet service demands from customers. Consequently, the older age of the fleet – and by the extension, the larger-than-necessary size of the fleet – places upward pressures on the DLC's cost structure.

Because the DLC does not have a formalized vehicle replacement plan or budget for the replacement of vehicles in a sinking fund or similar funding mechanism, the purchases of vehicles are "lumpy" or "sawtoothed." In other words, the number of vehicle purchases may vary considerably by year. The following chart summarizes the age of the DLC truck fleet by year and indicates that the DLC purchased six trucks in 1999, four trucks in 2000 and zero in 2001. Ideally, the DLC would purchase the same number of vehicles of each year according to a vehicle replacement plan, which would facilitate capital planning and minimize fleet lifecycle costs.

Year of Truck Purchase

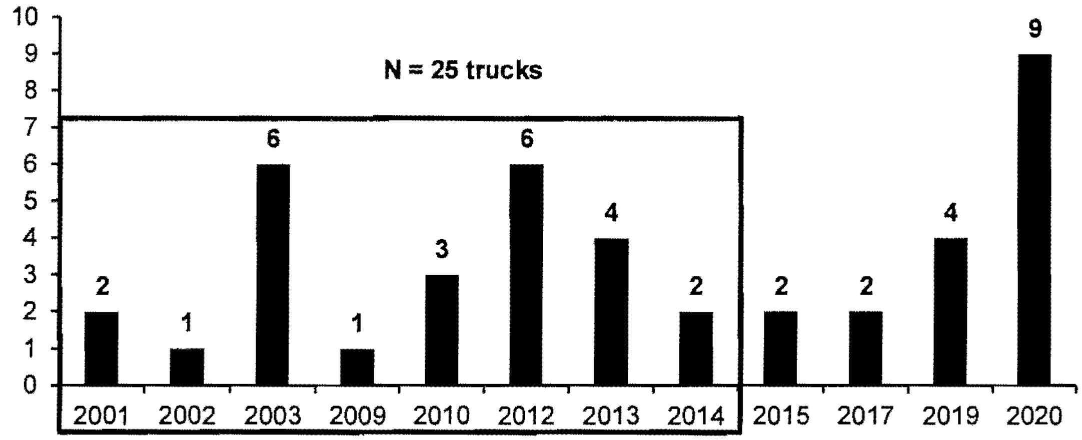


Source: Montgomery County Department of Liquor Control.

At present, a majority of the trucks within the DLC's fleet are beyond their useful economic life. A vehicle approaches the end of its economic useful life when operating costs exceed the vehicle's depreciation expense. Assuming a useful economic life of 12 years per truck, 25 trucks (approximately 60 percent of the fleet) in operation are beyond their useful lives. The remaining seventeen trucks will reach the end of their economic useful lives by 2020.

The figure below details what a vehicle replacement schedule for the DLC would look like if all trucks in the fleet were replaced after 12 years of service. A total of 25 trucks, illustrated by the orange box, should have been replaced between 2001 and 2014.

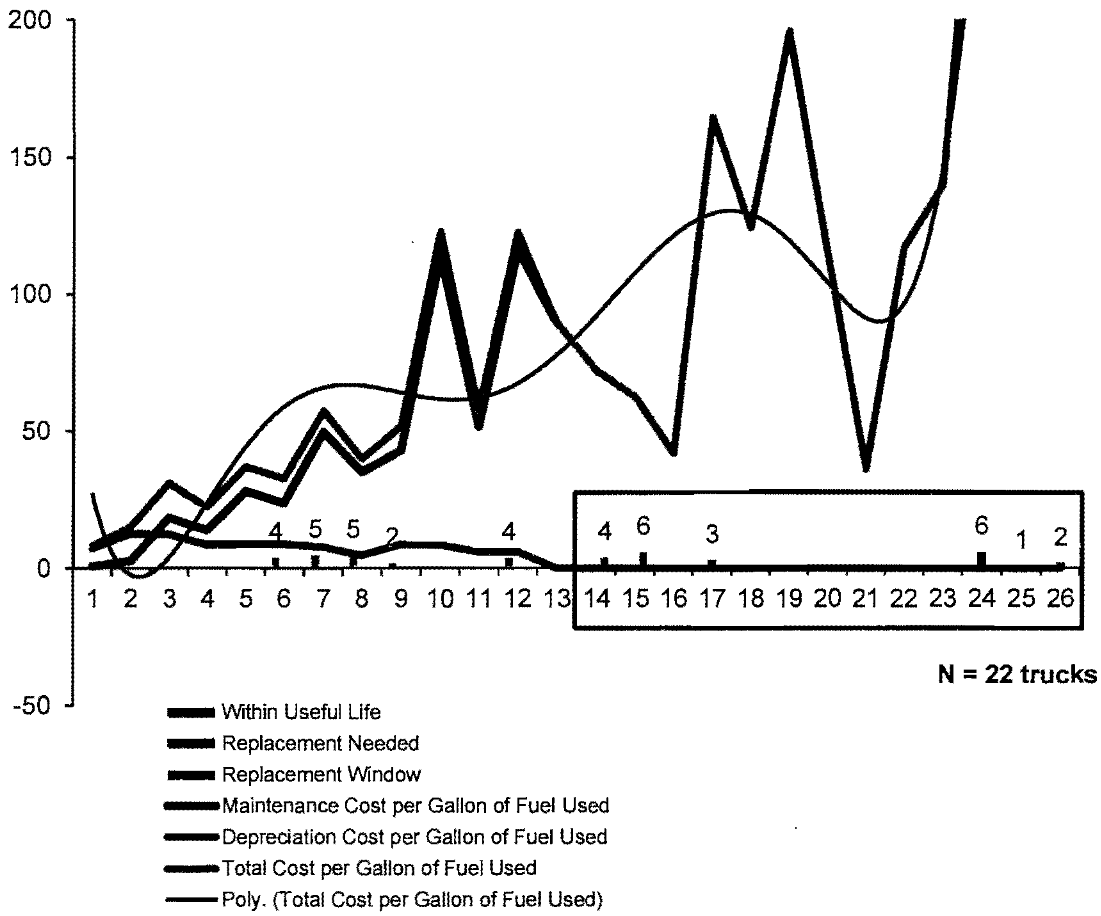
Vehicle Replacement Schedule by Year: Assuming Each Truck Replaced After 12 Years of Use



Source: Montgomery County Department of Liquor Control

It is notable that the DGS performed its own independent analysis and arrived at a similar conclusion regarding the age of the DLC fleet. The DGS found that 22 trucks (approximately 52 percent of the fleet) are either near the end or beyond their economic useful lives. In its analysis, the DGS derived a cost curve related to the number gallons of fuel consumed by vehicle. The following chart indicates that 10 trucks are near the end of their economic useful life (lifecycle costs are predicted to spike in the upcoming years) and should be funded for replacement. Additionally, 12 trucks are beyond their economic useful live based on lifecycle costs. These combined 22 vehicles are shown within the orange box:

The DLC's Truck Fleet Lifecycle Cost Regression Analysis



Source: Montgomery County Department of General Services.

Running a fleet with obsolete vehicles negatively affects the DLC's operating and capital cost structures. For operational expenses, the maintenance costs associated with vehicles purchased in 2008 are $0.60 per mile. In contrast, the maintenance costs associated with vehicles purchased prior to 2008 are more than twice as high at $1.45 per mile. For capital expenses, the deferral of vehicle purchases has resulted in the necessity for a large capital outlay in order to update the fleet.

Expenditure Forecasts

To evaluate the effects of the DLC's operational and capital cost structure on future expenditure patterns, PFM developed expenditure forecasts for three scenarios. Each scenario covers a 12-year period, reflecting the estimated useful economic life a newly purchased truck. The three scenarios are:

- *"Baseline Scenario"* – calls for a one-time recapitalization of the truck fleet in 2015, but otherwise, all fleet operations and ownership structure remain unchanged.
- *"Vehicle Replacement Fund Scenario"* – calls for the gradual recapitalization of the truck fleet over four years, with no more than six trucks replaced in a given year. The truck fleet size is reduced by five vehicles, to account for the decrease in down time by injecting new vehicles into the fleet. A vehicle replacement fund is set to help smooth out the requisite capital expenditures.
- *"Fleet Leasing Scenario"* – calls for the DLC to lease its entire fleet through a third party operator. The DLC pays a flat monthly rate per vehicle, as well as a mileage charge, charge for hour of refrigeration, and monthly charge for telematics. All maintenance costs are included in

the monthly rate charged by the vendor; the DLC pays for fuel and insurance. When a truck is out of service, the leasing company provides a substitute truck. Accordingly, the "Fleet Leasing Scenario" assumes the DLC can reduce its truck fleet by eight vehicles.

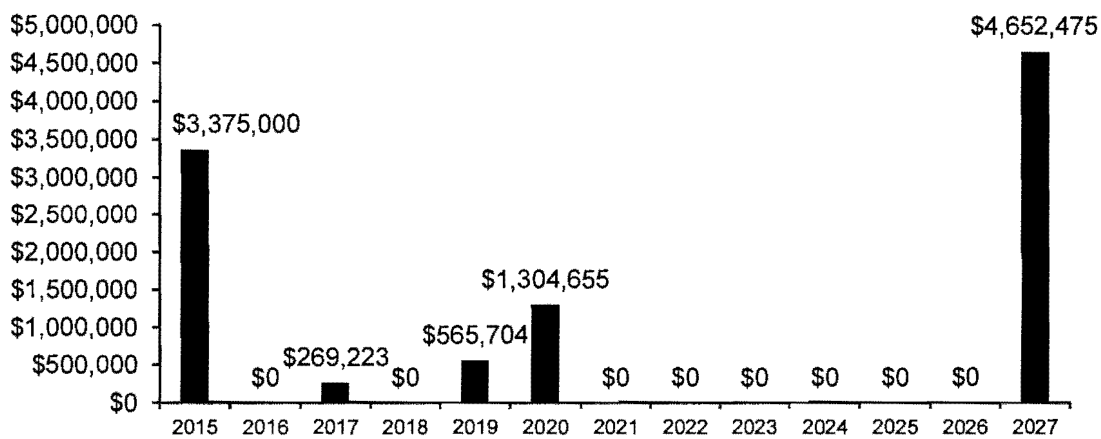
A comparison of these scenarios yields three important insights into the future cost structure of the DLC truck fleet.

- The DLC faces a potential large capital outlay in the very near future if it continues to own its truck fleet;
- The use of a vehicle replacement fund (i.e., a "sinking" fund) would help to smooth out capital expenditures; and
- The DLC can avoid large capital outlays and lower total fleet costs by leasing its truck fleet through a private vendor.

The DLC faces a potential large capital outlay in the very near future if it continues to own its truck fleet. As illustrated in the "Baseline Scenario," if the DLC would replace all trucks in its fleet that are 12 years or older, the Department would need to spend \$3.375 million in 2015, assuming a cost of \$125,000 per truck. Additionally, in the absence of a vehicle replacement plan to smooth out purchases in out-years, the DLC would need to spend an additional \$4.7 million in 2027 for trucks, assuming a 2.5 percent inflation escalator.

The following chart illustrates the capital expenditures required over the next 12 years to keep the DLC's rolling stock up-to-date. The absence of a capital replacement fund and the historical inconsistent funding of vehicle replacements result in large capital expenditures in 2015 and 2027, with a six year stretch (2021 through 2027) with no expenditures on vehicle replacement in between.

Projected Vehicle Replacement Expenditures 2015 – 2027: Baseline Scenario

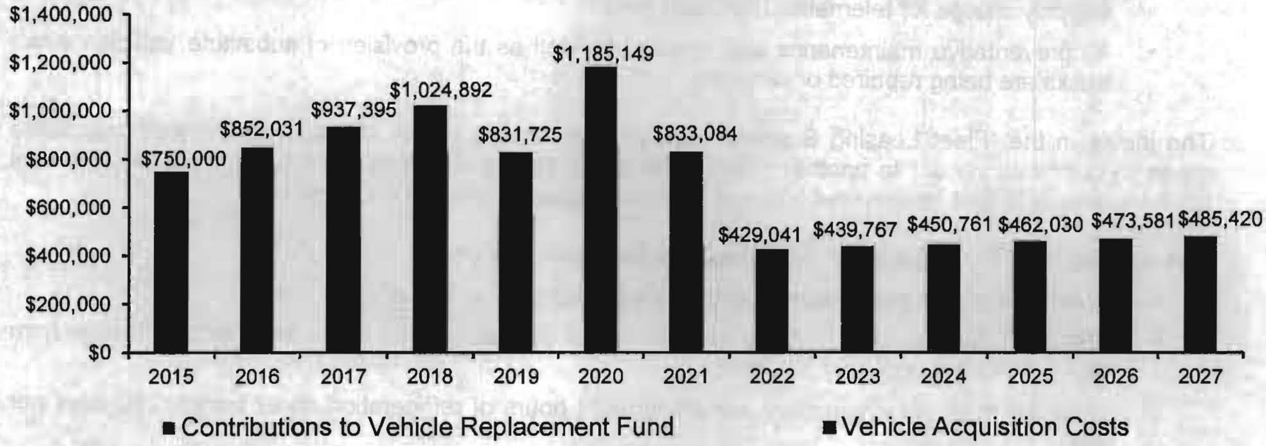


Source: Montgomery County Department of Liquor Control.

The use of a vehicle replacement fund (i.e., a "sinking" fund) would help to smooth out capital expenditures over the 12-year forecast period. With a vehicle replacement fund, the DLC would annually set aside a portion of the replacement cost of each truck it purchased. For example, if the DLC purchased a dual axle truck that cost \$125,000 with a useful economic life of 12 years, it would set aside \$10,416.67 (\$125,000 ÷ 12 years) annually. Over a 12-year purchasing cycle, the DLC would gradually build up a reserve fund that would cover all fleet-related capital costs.

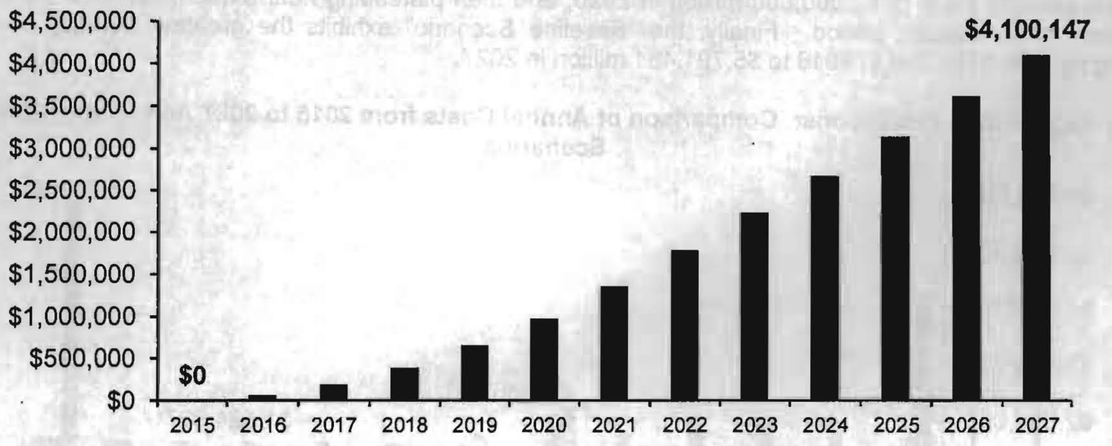
Consider the example below from the "Vehicle Replacement Fund Scenario." In this scenario, the truck fleet is reduced by five vehicles (newer vehicles require less down-time) and a vehicle replacement fund is created. Over the course of six years, the truck fleet is upgraded and a vehicle replacement fund is seeded. Annual capital costs range from $750,000 in 2015 to $1,185,149 in 2020, but the even larger one-time $3.375 million capital outlay in the "Baseline Scenario" is avoided. From 2022 onwards, the DLC continues to contribute to the vehicle replacement fund, even though no new vehicles are purchased.

Projected Vehicle Replacement Expenditures 2015 – 2027: Vehicle Replacement Fund Scenario



Further, as illustrated in the figure below, by 2027 the capital replacement fund records a balance of more than $4 million. From this point forward all truck acquisitions can be made from the vehicle replacement fund with no additional dollars spent on vehicle acquisitions, presuming that annual contributions continue to be made in future years. For example, in the previous figure, the DLC contributes $485,420 to the vehicle replacement fund in 2027. Yet, the DLC can still replace six trucks it purchased in 2015 (assuming 12-year economic useful life) at an estimated cost of approximately $1.033 million (when adjusted for inflation), because more than $4 million is available in the vehicle replacement fund.

Vehicle Replacement Fund Balance 2015 – 2027: Vehicle Replacement Fund Scenario



The DLC can avoid the large capital outlays of the "Baseline" and "Fleet Reduction" scenarios by giving up ownership of its trucks, and leasing them from a private vendor with experience in the beverage industry.

Features of a vehicle lease would include:

- Flat monthly rate per vehicle during the term of the lease (though lower monthly payments linked to CPI are available as well);
- Mileage charge;
- Charge per hour refrigerated box was in operation;
- Monthly charge for telematics (optional); and
- All preventative maintenance and repairs, as well as the provision of substitute vehicles when trucks are being repaired or serviced.

The inputs in the "Fleet Leasing Scenario" scenario are based on an actual six-and-a-half year lease made by a private vendor to another client. The quote covers a fleet of 2014 Freightliner tandem axel truckers, with a 26-foot refrigerated box and 250-horsepower Cummins ISL engine.

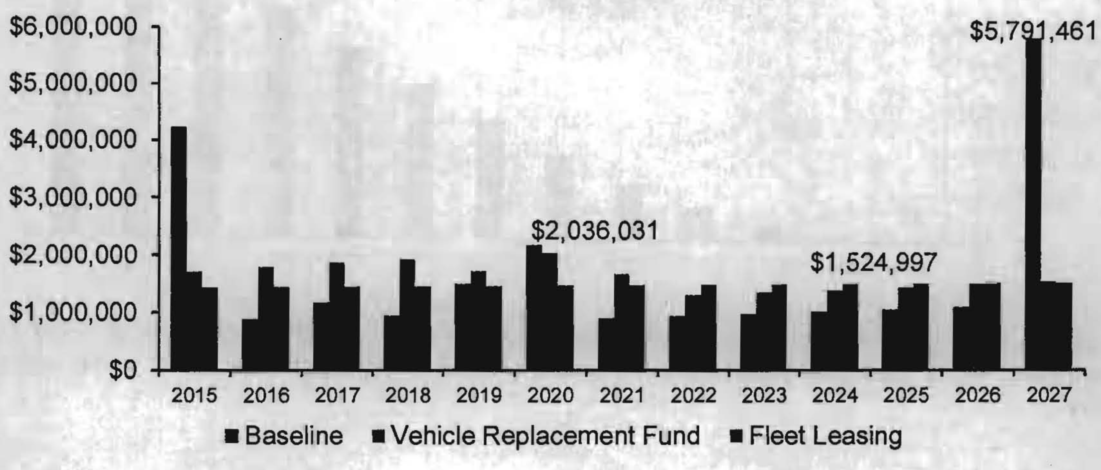
The cost inputs of the lease in the "Fleet Leasing Scenario" include:

- $2,700 per month per vehicle over the 12-year term of the lease;
- $.08 per mile, assuming 312,338 miles run each year across the entire fleet (actual mileage from May 1, 2013 through April 30, 2014);
- $0.69 per hour of refrigeration, assuming eight hours of refrigeration on all trucks; 260 days per year;
- $35 per month per vehicle charge for telematics.

These inputs are approximations – the DLC would use a different vehicle mix for a longer lease duration, which would likely result in a modified cost structure. Nonetheless, "the Fleet Leasing Scenario" provides a useful "ballpark" estimate for the costs associated with the leasing of the DLC truck feet.

The figure below summarizes the total projected expenditures – operating and capital costs – of each of the three scenarios over a 12-year period. The "Fleet Leasing Scenario" cost estimate is fixed at $1,524,997 per year – representing the fixed nature of the leasing arrangement. The "Vehicle Replacement Fund Scenario" has some volatility over the first six years of the forecast period, with annual costs peaking north of $2,000,000 million in 2020, and then plateauing near $1,500,000 for the final six years of the forecast period. Finally, the "Baseline Scenario" exhibits the greatest volatility in cost, ranging from $885,966 in 2016 to $5,791,461 million in 2027.

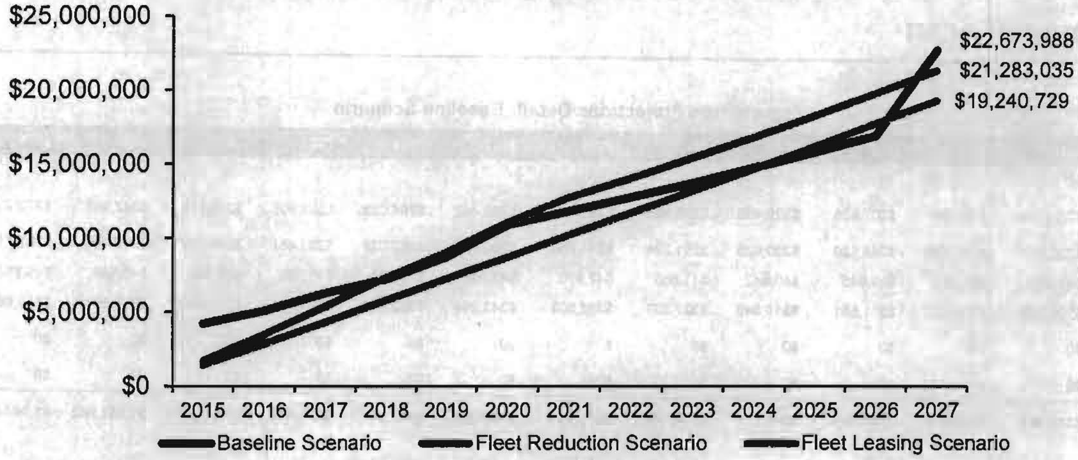
Expenditure Projections: Comparison of Annual Costs from 2015 to 2027 Across all Three Scenarios



Environmental Scan

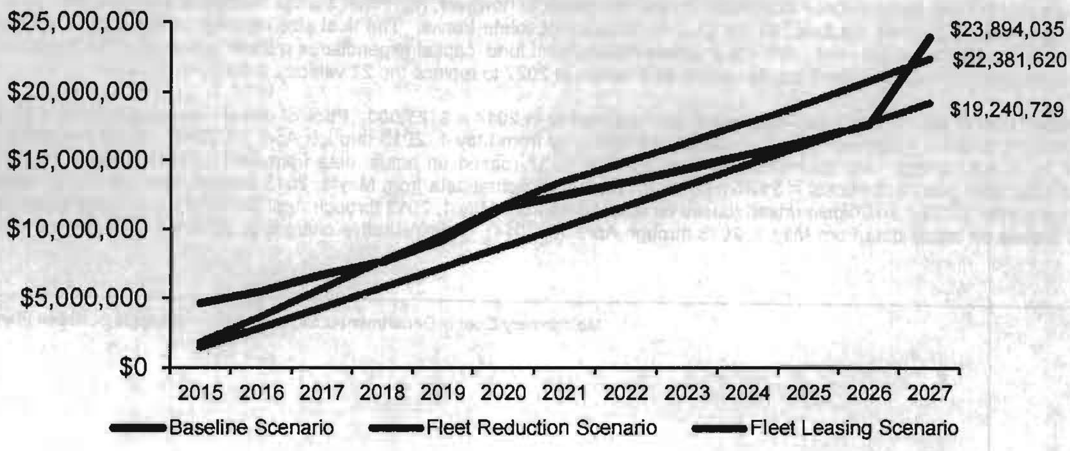
From a cumulative cost perspective – i.e., summing all the projected costs over the 12-year forecast period and comparing the results across the three scenarios – the "Fleet Leasing Scenario" represents the lowest cost option. All three scenarios assume a $1,250,000 acquisition cost in 2015, with the price rising 2.5 percent annually in out-years. With a 12-year estimated cost of $19,240,729, the "Fleet Leasing Scenario" represents a cost savings of more than $2 million relative to the "Vehicle Replacement Fund Scenario" and a savings of nearly $3.5 million relative to the "Baseline Scenario."

Expenditure Projections: Comparisons of Cumulative 12-Year Cost Estimates Across all Three Scenarios with Vehicle Acquisition Cost of $125,000



As the assumed vehicle acquisition price rises, so do the cost savings generated from leasing of the truck fleet. The figure below assumes a vehicle acquisition price of $140,000. Consequently, the cost differential between the "Fleet Leasing" and "Vehicle Replacement" scenarios grows to more than $3.1 million over 12 years. Moreover, the cost differential between the "Fleet Leasing" and "Baseline" scenarios grows to more than $4.6 million over the same time period.

Expenditure Projections: Comparisons of Cumulative 12-Year Cost Estimates Across all Three Scenarios with Vehicle Acquisition Cost of $140,000



The proceeding pages that follow provide additional detail about each of the three expenditure forecast scenarios.

Expenditure Projections Detail: Baseline Scenario

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Operating Costs													
Maintenance & Repairs	$282,226	$301,981	$307,928	$329,483	$315,985	$248,077	$265,442	$284,023	$303,905	$325,178	$347,940	$372,296	$398,357
Fuel	$235,277	$241,159	$244,520	$250,633	$251,294	$244,650	$250,766	$257,035	$263,461	$270,047	$276,799	$283,719	$290,812
Insurance	$37,926	$38,874	$39,846	$40,842	$41,863	$42,910	$43,983	$45,082	$46,209	$47,364	$48,548	$49,762	$51,006
Administrative Charge	$296,538	$303,952	$311,551	$319,340	$327,323	$335,506	$343,894	$352,491	$361,303	$370,336	$379,594	$389,084	$398,811
Vehicle Replacement Fund	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Leasing Cost	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Total Operating Costs	**$851,967**	**$885,966**	**$903,845**	**$940,298**	**$936,465**	**$871,142**	**$904,084**	**$938,631**	**$974,878**	**$1,012,926**	**$1,052,882**	**$1,094,861**	**$1,138,986**
Capital Costs													
Trucks Purchased	27	0	2	0	4	9	0	0	0	0	0	0	27
Acquisition Cost	$3,375,000	$0	$269,223	$0	$565,704	$1,304,655	$0	$0	$0	$0	$0	$0	$4,652,475
Total Capital Cost	**$3,375,000**	**$0**	**$269,223**	**$0**	**$565,704**	**$1,304,655**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$4,652,475**
Total Truck Fleet Costs	**$4,226,967**	**$885,966**	**$1,173,068**	**$940,298**	**$1,502,169**	**$2,175,797**	**$904,084**	**$938,631**	**$974,878**	**$1,012,926**	**$1,052,882**	**$1,094,861**	**$5,791,461**

Summary: In this "Baseline Scenario" operating costs decline, as newer vehicles require less maintenance and upkeep. Because newer vehicles are injected into the truck fleet, operating costs actually decline from more than $1,000,000 in 2014 to approximately $850,000 in 2015, as maintenance costs decline and fuel economy increases. These cost savings, however, represent a mere fraction of the more than $3.3 million in required capital spending to upgrade the fleet, as the DLC replaces 27 obsolete trucks. The fleet size remains constant at 42 vehicles, and a vehicle replacement sinking fund is not used. Without a vehicle replacement fund, capital expenditures remain "sawtoothed" or "lumpy" on a year-to-year basis and the DLC will need to spend approximately $4.6 million in 2027 to replace the 27 vehicles purchased in 2015.

Key Assumptions: Size of fleet = 42 trucks. Acquisition cost per vehicle in 2014 = $125,000. Price of diesel per gallon in 2014 = $3.50. Miles per gallon of pre-2015 trucks = 4.05/mpg (based on actual fuel efficiency from May 1, 2013 through April 30, 2014). Miles per gallon of trucks purchased after 2015 = 5.05/mpg. Annual miles driven per truck = 7,437 (based on actual data from May 1, 2013 through April 30, 2014). Maintenance cost per mile (pre-2015 trucks) = $1.45/mile driven (based on actual data from May 1, 2013 through April 30, 2014). Maintenance cost per mile (trucks after 2015) = $0.60/mile driven (based on actual data from May 1, 2013 through April 30, 2014). Insurance costs per vehicle in 2015 = $903 (based on actual data from May 1, 2013 through April 30, 2014). Administrative charges in 2015 = $7,060 per vehicle annually (based on 2014 administrative charges). Insurance = $903 per vehicle (based on 2014 rates charged by DGS). Growth rates = 7.0 percent annually for maintenance costs per mile (based on actual data from May 1, 2013 through April 30, 2014) and 2.5 percent assumed for inflation for all other costs. Mileage constant assumed to be constant at 312,338 annually, based on mileage of fleet from May 1, 2013 through April 30, 2014.

Expenditure Projections Detail: Vehicle Replacement Fund Scenario

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Operating Costs													
Maintenance & Repairs	$408,722	$390,298	$365,884	$334,697	$316,623	$267,975	$249,507	$266,973	$285,661	$305,657	$327,053	$349,947	$374,443
Fuel	$260,907	$258,567	$255,947	$253,035	$252,998	$249,541	$250,766	$257,035	$263,461	$270,047	$276,799	$283,719	$290,812
Insurance	$33,411	$34,246	$35,102	$35,980	$36,879	$37,801	$38,747	$39,715	$40,708	$41,726	$42,769	$43,838	$44,934
Administrative Charge	$261,236	$267,767	$274,461	$281,323	$288,356	$295,565	$302,954	$310,528	$318,291	$326,248	$334,405	$342,765	$351,334
Vehicle Replacement Fund	$0	$64,063	$129,727	$197,032	$266,021	$315,379	$387,326	$429,041	$439,767	$450,761	$462,030	$473,581	$485,420
Leasing Cost	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Total Operating Costs	**$964,276**	**$1,014,941**	**$1,061,122**	**$1,102,067**	**$1,160,877**	**$1,166,261**	**$1,229,300**	**$1,303,291**	**$1,347,887**	**$1,394,439**	**$1,443,055**	**$1,493,849**	**$1,546,942**
Capital Costs													
Trucks Purchased	6	6	6	6	4	6	3	0	0	0	0	0	6
Acquisition Cost	$750,000	$787,969	$807,668	$827,860	$565,704	$869,770	$445,757	$0	$0	$0	$0	$0	$0
Total Capital Cost	**$750,000**	**$787,969**	**$807,668**	**$827,860**	**$565,704**	**$869,770**	**$445,757**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**
Total Truck Fleet Costs	**$1,714,276**	**$1,802,910**	**$1,868,790**	**$1,929,927**	**$1,726,581**	**$2,036,031**	**$1,675,057**	**$1,303,291**	**$1,347,887**	**$1,394,439**	**$1,443,055**	**$1,493,849**	**$1,546,942**

Summary: In the "Vehicle Replacement Fund Scenario" operating costs decline, as newer vehicles require less maintenance and upkeep, but at a slower rate relative to the "Baseline Scenario." In the "Baseline Scenario," twenty-seven vehicles are replaced in 2015, but in this scenario, vehicle replacement is capped at six trucks per year. Total truck fleet costs peak at just over $2 million in 2020. In 2027, the vehicle replacement fund has a balance of more than $4 million (balance not shown; only contributions to vehicle replacement fund), which allows the DLC to purchase six vehicles while only contributing $485,420 to the vehicle replacement fund.

Key Assumptions: Size of fleet = 37 trucks. Vehicle Replacement Fund formula = # of vehicle purchased in prior year x acquisition cost ÷ 12 years of useful economic life. All other assumptions the same as "Baseline Scenario."

Expenditure Projections: Fleet Leasing Scenario

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Operating Costs													
Maintenance & Repairs	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Fuel	$218,637	$224,103	$229,705	$235,448	$241,334	$247,367	$253,552	$259,890	$266,388	$273,047	$279,874	$286,870	$294,042
Insurance	$30,702	$31,470	$32,256	$33,063	$33,889	$34,736	$35,605	$36,495	$37,407	$38,343	$39,301	$40,284	$41,291
Administrative Charge	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Vehicle Replacement Fund	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Leasing Cost	$1,189,664	$1,189,664	$1,189,664	$1,189,664	$1,189,664	$1,189,664	$1,189,664	$1,189,664	$1,189,664	$1,189,664	$1,189,664	$1,189,664	$1,189,664
Total Operating Costs	**$1,439,003**	**$1,445,236**	**$1,451,625**	**$1,458,174**	**$1,464,887**	**$1,471,768**	**$1,478,820**	**$1,486,049**	**$1,493,459**	**$1,501,054**	**$1,508,839**	**$1,516,818**	**$1,524,997**
Capital Costs													
Trucks Purchased	0	0	0	0	0	0	0	0	0	0	0	0	0
Acquisition Cost	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Total Capital Cost	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**
Total Truck Fleet Costs	**$1,439,003**	**$1,445,236**	**$1,451,625**	**$1,458,174**	**$1,464,887**	**$1,471,768**	**$1,478,820**	**$1,486,049**	**$1,493,459**	**$1,501,054**	**$1,508,839**	**$1,516,818**	**$1,524,997**

Summary: In the "Fleet Leasing Scenario" capital costs are set to zero as the DLC leases all vehicles. Accordingly, no vehicle replacement fund is necessary. All maintenance and repairs are included in the leasing cost. There is no administrative charge, as the vehicles will no longer be serviced by the DGS (they are serviced by the lessor). Operating costs are higher in this scenario, but overall truck fleet costs – when accounting for the impact of capital expenditures – are lowest relative to the "Vehicle Replacement Fund" and "Baseline Scenarios."

Key Assumptions: Size of truck fleet = 37 trucks. Leasing base cost = $2,700 per month per vehicle + $0.08 per mile drive + $0.69 per hour per vehicle (assumes all vehicles are refrigerated, eight hours per day, 260 days per year), and charge of $35/month per vehicle for telematics. All other assumptions the same as "Baseline Scenario."

Fleet and Operational Issues

As the prior analysis underscores, a number of fleet-related issues pose risks to the DLC's ability to service its customer base over the next decade. Additionally, certain operational reforms and process improvements should be considered to improve performance and maintain a high level of customer service.

Delivery Scheduling and Polices

An organizational priority for the DLC is to maintain a high degree of customer service, both for the County-operated retail outlets and for the more than 1,000 on- and off-premises licensed establishments. This high standard has placed a strain on the Department's delivery infrastructure.

- **Multiple Deliveries**. Many of the DLC's stores receive more than one delivery a week because of limitations of in-store capacity. Better inventory planning, use of shelving and other techniques to increase the density of storage space and on-floor placement of inventory may be able to reduce the number of stores that require multiple deliveries in normal weeks. Future store locations should accommodate inventory commensurate with sales volume to minimize, if not eliminate, the need for multiple weekly deliveries.
- **Very Accommodative Delivery Policy for Licensees**. These vendors are allowed to schedule the day of the week for deliveries. Moreover, when they it deem necessary, licensees may obtain two or more deliveries from the DLC warehouse in the same week. In addition, vendors are allowed to come to the warehouse and pick up items at any time during warehouse operations.
- **Cash on Delivery.** The DLC's managers relate that a contributing factor to delivery "peaks" in the latter days of the week is the policy that requires cash on delivery (COD) for all licensee shipments. For cash-flow reasons, some of these vendors try to minimize the amount of time they hold paid-for inventory before resale during the high-volume sales times of weekend days and nights.

There is insufficient available data to support a conclusion that some or most of these multiple deliveries could be avoided through better inventory management. However, to the extent the customer service philosophy permits, the Department should consider imposing some forms of scheduling discipline. Measures may include assigned delivery days and charges for multiple deliveries in the same week. Additional scheduling discipline, in concert with other recently implemented process improvements such as expedited procedures for licensee pick-ups at the warehouse, will help smooth out peaks in delivery demand.

Efficiency Workers' Compensation Issues

New vehicles can be equipped with labor-savings configurations and devices that have the potential to increase loading/delivery efficiency. For example, the use of hydraulic lifts and specialized cargo-moving equipment, coupled with specific employee training on their use, may reduce work-related injuries among delivery personnel.

Monolithic Fleet Type

The DLC operates a relatively uniform truck fleet: Of the 42 fleet vehicles, 38 are tandem-axel trucks. Prospectively, the DLC should examine if a different mix of truck types will improve operations. For example, a mix of smaller model may be appropriate for smaller customers, while a handful of larger 29-foot beverage trailers may better serve larger customers.

In this context, the large capital outlay required to update the truck fleet represents an opportunity for the DLC to reconfigure its fleet vehicle mix, size and ownership structure. For example, the DLC may consider leasing of vehicles to save costs, or introduce different vehicle types into the truck fleet. Of note, the adoption of certain larger vehicles may require drivers to obtain a commercial drivers' license, which may require consultation or negotiation with the appropriate union.

Vehicle Replacement

The DLC's investment in fleet vehicle replacement has been sporadic – leading to an aging truck fleet where a majority of vehicles have out-lived their useful economic lives. Even though the estimated useful life for most of the DLC's trucks is 12 years according to the DGS, some trucks in active use were built in the late 1980s and early 1990s. The last significant purchase of new equipment was in 2009.

DLC trucks are exempt from the DGS's requirement to make monthly replacement payments. As a result, large allocations of cash for replacement vehicles have become an issue in the Department's annual budget planning and no acquisition funds have been approved in the past five years.

As a result, an increasing number of trucks in the fleet are suffering from high down-time and increasing maintenance costs. Moreover, the deferral in capital purchases translates into a required large capital outlays every 12 years in order to keep its vehicle stock current.

Vehicle Ownership Structure

Because of deferred capital expenditures, the cost of maintaining a fleet where the DLC owns its own vehicles is poised to rise dramatically. The DLC currently does not lease vehicles in its truck fleet, but doing so may generate meaningful cost savings. As a public entity, the DLC does not realize depreciation tax benefits. Further, leasing provides multiple potential operational benefits, including:

- Controlling costs by providing predictable monthly budgets;
- Specifying the right vehicle for efficient operations;
- Maintaining high customer service standards through rigorous preventive maintenance;
- Promoting highway and worker safety; and,
- Less costly/environmentally friendly fuels such as bio-diesel, natural gas, propane and ethanol.

Leasing would also allow more capital to be invested in stores. Auctioning of existing fleet assets could capitalize fixture refits, specialized lighting, etc.

Fleet Size

The DLC truck fleet is likely too large. Because older vehicles are out of service for larger periods of time, the DLC must maintain extra vehicles in reserve. As the DGS charges an administrative fee on a per-vehicle basis, the DLC incurs additional charges each month for every additional vehicle in its fleet – even if the vehicle runs only a few thousand miles each year. Reducing the size of the fleet would yield immediate cost savings.

Fuel Efficiency/Cost

The current fleet is powered by diesel engines. At present, the county is paying approximately $3.50 per gallon for diesel fuel, but only about $2.00 per equivalent gallon for Compressed Natural Gas (CNG). While configuring trucks for CNG adds to the acquisition cost, lower fuel costs may partially compensate for the upset cost.

Preliminary conversations with a leasing vendor suggest that the DLC would need to expand its mileage considerably – upwards of 50,000 miles annually per truck – in order for fuel savings to cover the costs associated with CNG upgrades. Yet while the DLC may not recoup the entirety of CNG retrofit costs, the use of CNG-powered vehicles would reduce the Department's carbon footprint and advance the County's sustainability objectives. Based on diesel consumption between May 1, 2013 and April 30, 2014 (approximately 77,015 gallons) switching to CNG would result in a net reduction of between approximately 150 (assuming use of B20 diesel) and 230 metric tons (assuming no bio diesel additives) of carbon. This is roughly equivalent to the carbon output of 30- to 50-passenger vehicle in 2013 according to the U.S. Environmental Protection Agency.

Environmental Scan

Licensure, Regulation and Education

The DLC is committed to creating a safe environment for the enjoyment of alcoholic beverages within the scope of applicable federal, State and local laws. The Division of Licensure, Regulation and Education fulfills this goal from three different angles. The Division licenses applicants, oversees approximately 400 inspections annually and, when violations are found, works with licensees to correct mistakes and instruct on proper alcohol distribution. The Division was added to the DLC in 2007. Since that time, the Division has operated several federal grants to improve store operations. Additionally, the Division won recognition from the National Association of Counties for innovation using iForm for liquor inspections. The free ALERT training for licensees is considered to be a success and is used to monitor the Division in the CountyStat program. In 2013, licensees ranked their satisfaction with the ALERT program an average 4.69 out of 5.[26]

[26] "FY2013 Performance and Accountability Report: Montgomery County Department of Liquor Control" CountyStat p.13.

On-Premise Licensees

As the sole supplier to County establishments licensed for on-premise consumption, the DLC has to deal with varying constituencies – everything from bars that primarily require kegs of beer to high-end restaurants seeking to maintain a comprehensive selection of wines from around the world. It is not surprising that this can, at times, create friction and in some instances require the DLC to go to great lengths to maintain consumer satisfaction. Besides selection, service can be an issue for licensees, particularly when they arrive for a large purchase while the store is short-staffed. In other instances, shortages (whether because product is not available or lack of storage makes it temporarily out of stock) can be a source of concern for licensees.

Montgomery County has nearly six hundred establishments licensed to serve alcohol.[27] These licensees purchase all their alcohol from the County at the wholesale price. Licensees may purchase this alcohol at County-operated stores, receive delivery from County trucks or pick-up their orders from the County warehouse. Some licensees have escrow accounts at County-operated stores.[28]

Montgomery County DLC has several classifications it uses to describe its wine products. The mark-up and pricing structure for both wholesale and retail products differs according to its classification. The following are the mark-up percentages that on-premise licensees pay above the FOB price according to each classification.

Wine Mark-Up Charges for On-Premise Licensees by Classification

	AL	HO	LS	S	SC	ST	SW
Description	**Allocated** - Available on in limited quantities that are less than DLC desires to purchase	**Holiday Only** - Seasonal and special packaging for holiday only	**Licensee Special** - Ordered for licensee either by licensee or sales rep. Bottle Cost up to $17.99	**Special Order** - Special products shelved in stores without needing approval	**Specialty Center** - Special products shelved in stores that need approval from retail management	**Stock**	**Licensee Special** - Ordered for Licensee either by licensee or sales rep. Bottle cost $18.00 or higher
Wholesale Markup	35%	25%	25%	25%	25%	35%	15%

Source: Montgomery County Department of Liquor Control.

As the County is the sole wholesaler of beer, licensees pay the County for their beer stock. The County's mark-up and pricing structure differ according to both classification and size. The following are the mark-up percentages that on-premise licensees pay above FOB prices according to both classification and size.

[27] NABCA Survey Book 2012, p. 540.

[28] "Retail Management Systems Store Management Reference Manual for Advanced Users" Montgomery County Department of Liquor Control p. 74, December 6, 2013.

Beer Mark-Up Charges for On-Premise Licensees by Size and Classification

	1/2 K	1/4 K	1/6 K	SB	ST
Description	**Size**	**Size**	**Size**	**Special Order Beer**	**Stock**
Wholesale Markup	43%	43%	43%	35% + 20 cents	35% + 20 cents

Source: Montgomery County Department of Liquor Control.

The County's mark-up and pricing structure for liquor varies according to the size of the bottle. Smaller and less frequently purchased bottles carry with them a higher mark-up than higher-volume products. Below are the mark-up percentages that on-premise licensees pay above FOB prices according to size.

Liquor Mark-Up Charges for On-Premise Licensees by Size

	1.75 L	1 L	750 mL	500 mL	375 mL	200 mL	100 mL	50 mL
Wholesale Markup	27%	30%	27%	51%	51%	60%	60%	60%

Source: Montgomery County Department of Liquor Control.

Private Beer and Wine Stores

While County retails stores are the only locations to purchase distilled spirits for off-premise consumption, private retail stores may (with typical restrictions) sell beer and wine for off-premise consumption. These retailers must be licensed and are regulated by the County, and they then compete with the County retail stores for market share and customers. The County is home to approximately 275 private beer and wine retailers.[29] These can be independent retailers or big box grocery store chains (although each chain is limited to one store license within the County). This situation creates challenges – and in some instances, opportunities. For example, in instances where the DLC is looking for new locations, private beer and wine stores may be problematic should they be in proximity to existing wine and beer locations. In fact, the DLC has encountered locations where private beer and wine store leases preclude the location of other stores that sell these products in the same shopping center. On the other hand, large grocery chains – with the traffic they generate – are often an advantageous location, even with competition on beer and wine sales.

Montgomery County DLC has several classifications it uses to delineate its wine products. The mark-up and pricing structure for wholesale products differs according to its classification. The following are the mark-up percentages that private beer and wine stores pay above the FOB price according to each classification.

Wine Mark-Up Charges for Private Beer and Wine Stores by Classification

	AL	HO	LS	S	SC	ST	SW
Description	**Allocated** - Available on in limited quantities that are less than DLC desires to purchase	**Holiday Only** - Seasonal and special packaging for holiday only	**Licensee Special** - Ordered for licensee either by licensee or sales rep. Bottle Cost up to $17.99	**Special Order** - Special products shelved in stores without needing approval	**Specialty Center** - Special products shelved in stores that need approval from retail management	**Stock**	**Licensee Special** - Ordered for Licensee either by licensee or sales rep. Bottle cost $18.00 or higher
Wholesale Markup	35%	25%	25%	25%	25%	35%	15%

Source: Montgomery County Department of Liquor Control.

As the sole wholesaler of beer, licensees pay the County for their beer stock. The County's mark-up and pricing structure differ according to both classification and size. The following are the mark-up percentages that private beer and wine stores pay above FOB prices according to both classification and size.

[29] NABCA Survey Book 2012, p.528.

Beer Mark-Up Charges for Private Beer and Wine Stores by Size and Classification

	1/2 K	1/4 K	1/6 K	SB	ST
Description	**Size**	**Size**	**Size**	**Special Order Beer**	**Stock**
Wholesale Markup	43%	43%	43%	35% + 20 cents	35% + 20 cents

Source: Montgomery County Department of Liquor Control.

III. Strengths, Weaknesses, Opportunities and Threats Analysis

Strengths, Weaknesses, Opportunities and Threats Analysis

Overview

A key component of a strategic planning exercise is an examination of an organization's strengths, weaknesses, opportunities and threats. This is often known by the acronym 'SWOT.' The SWOT analysis examines the organization from both an internal perspective (its strengths and weaknesses) as well as an external focus on possible future events and impacts (opportunities and threats). This multi-dimensional perspective is important, as nearly all organizations have to be focused on both their internal operations and the external environment in which they operate.

In many respects, the previous chapter's Environmental Scan provides a glimpse of many of the internal and external issues that may arise and/or impact the DLC. How the DLC can react/cope with these external issues is often closely tied to its internal 'fundamentals.' The following discussion expands on these internal and external issues.

Strengths

- **Experienced leadership and staff** – Nearly all of the DLC leadership has significant experience (in many instances, measured not just in years but in decades), both at the DLC and in related fields. This also applies to many of the managers and assistant managers within the retail stores and key staff in the warehouse and transportation functions.
- **Recognized for excellence in multiple program areas** – The DLC has received multiple achievement awards in recent years from the National Association of Counties (NACo), including two in 2013. It has also been recognized by the National Alcoholic Beverage Control Association (NABCA) for several of its innovative programs, which often include partnering with businesses to promote responsible drinking and prevent sales to minors.
- **Physical infrastructure** – The DLC has recently relocated to a new facility, with a 210,000 square foot warehouse that is significantly larger than its prior location and entirely climate controlled.
- **Dedicated leadership and staff** – Besides national awards and recognition, the dedication of the staff is exemplified by the fact that the relocation to its new facility was planned and performed by existing DLC staff while simultaneously maintaining its normal day-to-day business operations.
- **New retail locations** – The DLC has opened new stores, such as those in Seneca Meadows and Clarksburg, that are excellent facilities, serve underserved areas and provide an excellent shopping experience for its customers. There is a general expectation that the DLC will continue to seek these opportunities in the future.
- **County demographics** – Montgomery County is a diverse, growing, higher-income county. It is likely that this has helped grow total sales of alcoholic beverages in the county in every year since 2001. As Standard and Poor's noted in 2013, "The DLC has consistently generated positive operating results and has contributed more than $244 million to the County's General Fund in the past ten years."

Weaknesses

- **Lack of administrative flexibility** – Unlike most County functions, DLC operates in a wholesale/retail sales environment. In many instances, it lacks the flexibility and ability to respond quickly, which is necessary for it to best serve its customers and do so profitably. This lack of control over key decisions also manifests itself in other identified weaknesses.
- **Staffing** – The DLC often lacks the ability to apply normal staffing techniques found in private retail. For example, there are generally two peak seasons for liquor retail operations: the Winter Holiday season and Summer Fourth of July season. Most DLC stores would, for comparison purposes, be similar to an independent liquor retail store (as opposed to a 'Big Box' chain store or grocery store). In these establishments, it would be likely that rather than adding permanent full-

time staff to handle these peak seasons, the business would hire temporary staff. However, because of County collective bargaining agreements, they generally do not have this flexibility, which either leads to staffing shortages (which can negatively impact sales) or a working environment for existing staff that hampers morale and productivity.

- **Capital budget for delivery trucks** – Nearly all of the DLC fleet of delivery trucks is at or near the end of its economic useful life. This negatively impacts the operation in a variety of ways, including staff morale, increased repair costs, increased downtime, impaired deliveries and reduced consumer confidence/customer service.
- **Older stores/locations/rental contracts** – In several instances, stores are in obvious need of basic repairs or refurbishment – including scarred floors and counters, old racks, lighting and entrances. Given that the DLC leases all of its locations, in many instances it has little leverage to demand improvements prior to the end of the lease.
- **Retailer of last resort** – While consumers may have alternatives in the purchase of beer and wine, the DLC is the 'only game in town' for licensees and for the purchase of distilled spirits. As a result, there is great pressure on the DLC to provide regular access to specialty products, such as foreign wines, specialty spirits and craft beers. This puts pressure on the logistics side of the operation, in terms of the need to procure and transport these products. It also puts pressure on the retail operations, which often have to store (or put on the shelf) a large number of products that will not move quickly.
- **Identity** – The DLC competes with independent stores as well as a number of large chain grocery stores that sell beer and wine. In some locations, it is difficult to determine, at least from outer store signage, that the location is a Montgomery County retail store. There is also no semi-consistent 'look' to a DLC store that would generally make a shopper who frequents one location comfortable with the lay-out of another store.

Opportunities

- **Additional retail locations** – Given that the County continues to grow – and communities are shedding their 'blue' status – there will be additional opportunities to locate new stores in under-served areas.
- **New retail approaches** – Other control jurisdictions have experimented with approaches to retail outside of the 'one size fits all' store. Larger superstores can provide a broader array of products that may alleviate some of the need for other stores to carry these products. Likewise, alternate locations for serving only licensees might alleviate storage and other pressures in some of the other retail stores.

Threats

- **County IT changes** – The County is going through a major change to its systems and migrating to an Oracle 'one size fits all' approach. While these systems work well for certain operations, it is unclear how well it will be able to accommodate the unique needs of the DLC. At this point in time, the go-live date has been pushed back on numerous occasions, and it is not known exactly when the DLC will be migrated to the new system. How this will ultimately play out in terms of the Warehouse Management System is unclear.
- **County financial challenges** – There is always a risk to entities that more or less operate as an enterprise fund that their financial decisions (and other, such as personnel decisions) will get tied to broader county decisions, particularly during difficult budget years.
- **County political changes** – In recent years, voters in the State of Washington mandated that it switch from a control to a licensee jurisdiction for both wholesale and retail liquor sales. Efforts have also been made (although unsuccessful to date) to switch from a control to a license jurisdiction in the States of Oregon, Pennsylvania and Virginia.

IV. High-Level Findings

High-Level Findings

Overview

As noted during the discussion of the DLC's strengths, there are many areas in which the organization already functions well – and in many cases excels. The challenge, of course, is to continue to move in the right direction as the world around the DLC changes. Strategic planning is often described as charting a future course to ensure that an organization is doing the right things.

The following high-level findings are indicative of the world in which the DLC lives – and how it may change in the future. These are what the project team views as current and forward-looking indicators that may have a material impact on the organization's future successes. In many instances, the findings are (at least at present) largely out of the direct control of the DLC. Determining appropriate strategies to alter that fact is a key part of the recommendations that follow later in this report.

There are no perfect organizations or operations – in either the public or private sector. While some of the discussion may appear critical of current operations, they should be viewed in the context of the DLC performing far above ordinary expectations. The DLC is (rightly) focused on maintaining and/or attaining a very high level of performance. The project team views these high-level findings – and the recommendations that follow – as important steps toward attaining or maintaining that level of performance in key operational areas.

Business Environment

1. Limited Enterprise Flexibility

The Department of Liquor Control (DLC) competes in a space with private retailers and is constrained by public sector requirements. For example, County rules that apply to its other, non-retail functions, apply to the DLC. Purchasing, hiring, compensation, investment in retail operations and other functions essential to operating a business-function like liquor retail are different from other types of public sector operation.

For example, private retailers can hire staff for short periods of time to fill temporary or seasonal changes in business. However, County negotiations with public-sector unions have significantly constrained the DLC in terms of staffing flexibility. While many (if not most) private sector retailers would 'staff up' with temporary workers for the Holiday season, DLC does not have that option.

Each restriction necessarily means that DLC will be less nimble than its private competition. Some restrictions on DLC operations are prudent, some are the intention of public policy about which there can be reasoned debate concerning competing values; nevertheless, our observations suggest that DLC is hindered by restrictions that go above and beyond justifiable, which are neither prudent nor policy-based considerations.

2. Multiple Constituencies

The DLC has a tricky balancing act that can impact on key decisions. As a control jurisdiction, the County has determined that it is in the public interest to exert greater system control than may exist in a licensee system. At the same time, this control environment is complicated by the fact that private retailers sell beer and wine for off-premise consumption. At the other end of the spectrum, the County is reliant on the revenue generated from its liquor operation. In the middle, there can be friction with other private retailers if it is perceived that the County DLC operations are taking a bigger share of the available sales of beer and wine for off-premise consumption.

High-Level Findings

Business Results

3. Higher Operating Costs than Benchmarked Jurisdictions

PFM examined operations in New Hampshire, Pennsylvania, Utah and Virginia and compared them to Montgomery County. The results indicate that operating costs as a percentage of total operating revenue, as well as operating costs as a percentage of liquor receipts are above the benchmarked average. Only Pennsylvania has higher operating costs.

There are some factors that come into play. Cross-border competition is an issue in some areas, because neighboring jurisdictions do not operate under a control structure, and private retailers can seek to siphon off DLC sales by locating in close proximity to Montgomery County. That said, Virginia operates under some of the same pressures as Montgomery County (notably from the District of Columbia) and has lower operating costs – 7 percent lower when judged against total operating revenue.

4. Lower Gross Profit Margins than Benchmarked Jurisdictions

As in the area of operating costs, PFM compared Montgomery County to New Hampshire, Pennsylvania, Utah and Virginia. For each dollar in total sales revenue between fiscal years 2010 and 2013, Montgomery County earned $0.12 profit. The average among the benchmarked jurisdictions was $0.17. There is a range of explanations for lower profit margins – higher operating costs, lower mark-ups, decreased economies of scale based on the volume purchased by the DLC. However, lower profits translate into lower revenue to invest in operations, which can affect the quality of service provided to the end client over time.

General Operations

5. Technology is a Wild-Card

The DLC is a component part of a large County-wide upgrade to technology systems. This continues to be an important effort, and staff of the DLC have been dedicated to tasks associated with it for some time. It is likely that the rollout of those changes will be an important milestone, and other changes may have to be placed 'on hold' for its successful implementation. At the same time, there are other opportunities presented to use technology – such as for route delivery scheduling – that should be considered.

Wholesale Operations

6. Age of the Fleet Hampers the Overall Operation

The DLC's fleet of delivery trucks is an important component of its operations. On-premise retailers, private off-premise retailers and County stores alike rely on the DLC fleet. Despite owning trucks that were purchased in the early 1990's, the last vehicle purchase for the DLC was in 2008. This translates into longer down times, more expensive parts procurement and more frequent breakdowns.

Additionally, older trucks may affect both driver morale and customer confidence (particularly on-premise licensees). Some licensees have noted quality issues on product that is delivered by the County fleet, as some trucks have sprung leaks from the wear and tear.

Finally, the DLC's trucks were not purchased with the County's "Green" objectives in mind (perhaps, because they were purchased before those objectives were drafted). As a result, they do not assist the County with its goals of reducing both fuel costs and greenhouse gas emissions.

7. Significant Capital Liability in Fleet Replacement Poses a Risk to Future Revenue Transfers

Approximately two-thirds of the DLC's trucks are at or near the end of their economic useful life. This accumulation of a large and growing capital liability for fleet replacement – if capitalized through the traditional manner of cash expenditures – would pose a significant one-time reduction in future revenue transfers. If all vehicles at or near the end of their useful lives were replaced in 2015, the DLC would need to replace twenty-nine vehicles at a capital expense of roughly $4.3 million. Further, without smoothing out the fleet replacement schedule, creating sinking funds (or similar budgeting mechanism) or adopting a leasing option, the DLC will be responsible for another significant capital expenditure when the newly purchased vehicles reach the end of their useful economic lives.

8. Differing Processes for Product-loading at the Warehouse

The DLC's warehouse is organized into two different sections, one for beer and one for wine and liquor. While this organization may make sense for the placement of product within the warehouse, the DLC extends the distinction into the labor used to move products onto the trucks. Beer trucks are loaded at thirty cents ($0.30) per case by contractors while liquor and wine are loaded by hourly employees of the County. This division offers two different operating costs for warehouse operations, one of which would seem to have to be cheaper.

9. Significant Pressure Delivering Special Order Products

As the sole source of alcoholic beverages in Montgomery County, the DLC works to ensure that any product a licensee wishes to serve is available to them. Many licensees, particularly restaurants, wish to serve a unique selection of wine and spirits to help distinguish themselves from their competition. Licensees thus drive the DLC to purchase many items they do not normally stock. While these items must be purchased by the case rather than the bottle, often the DLC will cooperate with a licensee who only wishes to purchase a few bottles, and the remainder of the case will be placed on the DLC store shelf for retail sale. Warehouse operators consider special orders to require additional effort and time. Thus, special order products currently demand more attention than their share of business profits, reduce County store profitability and can sometimes hinder storage and inventory management. In addition, some licensees grow disenchanted with the DLC when they learn that consumers can purchase the same product in County stores.

Retail Operations

10. Fewer Off-premise Liquor Retail Stores Per Capita than Benchmarked Jurisdictions

The DLC operates the only off-premise liquor retail establishments in the County. While private wine retailers can compensate for any unmet demand in the market created by lower store density, that is not the case in the liquor market. Compared to other benchmarked jurisdictions, the number of off-premise liquor retail locations is low.

The Distilled Spirits Council of the US (DISCUS) conducted a study on market saturation and found that the optimization curve of the distribution of licenses begins to flatten at approximately 2 outlets per 10,000 adults, and an incremental increase is largely diminished at 3 outlets per 10,000 adults. License jurisdictions benchmarked fall within this 2 to 3 outlets per 10,000 adults range (Nassau County, NY at 2.34 and Baltimore County, MD at 2.92). And while all control counties were lower, Montgomery County's 0.34 outlets per 10,000 adults is likely too low. It suggests that there is substantial room for expansion within the liquor market. For comparison purposes, the benchmarked average is 1.23 outlets per 10,000 adults.

11. No Regular Schedule or Cycle for Store Refurbishment, Refreshment or Replacement

The DLC is proud of the layout and look of its most recent stores, and rightly so. However, several older stores need significant renovations or refreshment to ensure that they look and feel appropriate. While the County often takes advantage of lease negotiations to convince landlords to touch up store locations, the County lacks an official policy and strategy towards these improvements.

The DLC's reliance on other County departments to negotiate leases is likely a part of the problem. Since retail stores are the only representation to the general public the DLC has, it is important to ensure that they represent the best the DLC can offer, especially if they carry the DLC's brand.

12. No Standard Methodology for New Store Locations

The DLC continues to look towards expanding its footprint in the county with additional retail stores; given its number of locations per capita, we believe this is a logical approach. As it works to do so, developing a common criteria to establish both the need for and the location of a store will be important on several levels. First, it develops logical criteria that justify the decision to add a new store location. This is useful for business community discussions. Second, it can help 'tell the story' with County officials who may be hesitant to make the necessary investments in new locations and personnel.

This can also assist in the area of leasing. Since leasing negotiations are conducted in a County department other than DLC, a solid location methodology can assist the DLC in educating other County staff on the necessity to secure attractive locations.

Additionally, given the competitive nature in the County, decisions on where to locate a store can often be political, and there is a sense within the DLC that decisions concerning locations are made based on political calculations and without input by the Retail Division. Without an objective rubric to shield the DLC from such criticism, the DLC is vulnerable to criticism – warranted or not.

13. Stores with Limited Storage Capacity

DLC policy is to maintain a high degree of customer service, both for the County-operated retail outlets and for the more than 1,000 on- and off-premises licensed establishments. This standard has placed a strain on the DLC's delivery infrastructure. Many DLC stores receive more than one delivery a week. This may be the result of limited in-store storage capacity. In addition, frequent use of the "special order" system by store managers for the purpose of putting special order items on store shelves decreases the storage capacity for other items within stores. "Special order" items increase inventory expense thereby decreasing profitability.

While storage capacity is a limitation, the solution is not necessarily to increase storage – which comes at a cost, both in terms of rent and display space. Other ways of remedying the situation are a reduction in the number of SKUs at a location, greater delivery capacity or some combination of the three.

14. Branding Opportunities

The DLC adopted a new sign logo for many of its stores that should be considered a "brand." Brands offer significant advantages to companies, including customer loyalty and increased purchasing. The "Liquor Wine" brand that Montgomery County has is underutilized. Benchmark jurisdictions like Pennsylvania use their brand widely, on everything from staff uniforms to delivery trucks to social media profiles. In some instances, the PFM team found that neither Montgomery County's brand, nor its name, appeared on monument signage at store locations. When used above storefronts, the brand was inconsistent in its placement of the County seal. This inconsistency in brand use can detrimentally affect brand recognition and decreases the value of the brand.

15. Store 'Look' Opportunities

As with brands, a standard look and feel to retail stores can make them attractive and appealing to consumers. A customer who regularly shops at a Target, Walmart or chain convenience store will generally know where to go to find the items that they have come to purchase. They will enter the store through wide entrances and aisles and encounter familiar colors and signage. There are ample opportunities for the DLC to establish some consistent standards for placement, signage and displays. While it will be impossible (given the nature of leased space) to make every location the same in size and lay-out, there are opportunities as simple as opening up the front of stores, keeping stacks of boxes and beer cases away from entrances, etc. that can improve the customer experience, particularly on store entry.

16. Chevy Chase Significantly Underperforms the Remainder of the County Stores

Across nearly every metric, Chevy Chase struggles against other County stores and national benchmarks. Sales per square foot are half the County average, the inventory turnover rate is the County's lowest level and half the industry standard and Chevy Chase is the only store to post a loss in Net Income in FY 2013. Given the store's location, and its subsequent high lease rate, data suggests the store ought to be generating three times its annual revenue to be profitable. Chevy Chase is located in a challenging retail environment and its location is, in our opinion, the primary reason for its poor performance.

V. Mission, Vision, Values and Goals

Mission, Vision, Values and Goals

Overview

Most organizations adopt a Mission Statement and a Vision Statement. These are key frames of reference that help internal and external stakeholders understand the fundamental rationale for the organization's existence, and what it seeks to be in its most optimal state.

Mission

Background

The mission statement defines the organization in terms of why it does what it does – the organization's reason for being, and its fundamental purpose. In general, an effective mission statement is short and focused.

Montgomery County Mission

We pursue the common good by working for and with Montgomery County's diverse community members to provide:

- A Responsive and Accountable County Government
- Affordable Housing in an Inclusive Community
- An Effective and Efficient Transportation Network
- Children Prepared to Live and Learn
- Healthy and Sustainable Communities
- Safe Streets and Secure Neighborhoods
- A Strong and Vibrant Economy
- Vital Living for All of Our Residents

DLC Mission

"We will provide efficient and quality wholesale and retail sales of beverage alcohol products while promoting moderation and responsible behavior in all phases of distribution and consumption. We will diligently promote and obey all laws and regulations governing beverage alcohol while generating revenue for the benefit of Montgomery County's General Fund."[30]

Vision

Background

Vision statements identify the ideal future state of the organization – a sort of perfect realization of the organization's mission. Well-conceived vision statements are meant to answer the question 'what do we seek to be in the future?' It sets direction. It is a statement of a compelling image and should inspire the organization and its internal stakeholders.

[30] http://www.montgomerycountymd.gov/dlc/#

Mission, Vision, Values and Goals

DLC Vision

The vision and philosophy of the DLC is success in balancing the promotion of moderation in the consumption of beverage alcohol with the offering of a wide variety of products at reasonable prices while returning a generous profit to the General Fund for use in paying for other citizen services such as police, fire and education.[31]

Values

Background

Many organizations also identify key values that will guide the organization's actions in seeking to accomplish its mission and achieve its vision. These values are then used to develop strategies and action steps to accomplish the organization's goals.

Montgomery County Values

The County identifies the following as its core values:

▪ Collaboration	▪ Inclusiveness	▪ Knowledge
▪ Competence	▪ Innovation	▪ Respect for the Individual
▪ Fiscal Prudence	▪ Integrity	▪ Transparency

Goals

Background

To further the mission, there must be action today and specific aims for the future. Goals are the fundamental long-range direction for the organization, today and in the future. Goals are overarching and few in number – as Peter Drucker put it, 'if you have more than five goals, you have none – you're simply spreading yourself too thin. Goals make it absolutely clear where you will concentrate your resources for results – the mark of an organization serious about results."

In general, goals are developed at the organizational leadership level. They are the guiding lights that help ensure that an organization is 'doing the right things.' This strategic business plan should, ultimately, help DLC leadership identify those overarching organizational goals for both the short (one to two years) and longer term (two to five years).

[31] http://www.montgomerycountymd.gov/DLC/history.html

VI. Strategies and Recommendations

Fleet Recommendations

The current ad hoc approach to vehicle replacement is not working and needs to be revamped. It has resulted in:

- Sporadic capital expenditures that have caused fluctuations in the Department's revenue transfer to the County General Fund;
- The accumulation of a large and growing capital liability for fleet replacement that, if capitalized in the traditional cash expenditure manner, would pose a significant one-time reduction in future revenue transfers and ongoing diminishment of the revenue stream going forward; and
- An aging fleet that has:
  - High maintenance costs;
  - Protracted downtime for older trucks;
  - Reliability risks, especially during peak periods of the week and year when delivery demand is highest;
  - Lower fuel efficiency; and
  - Possibly contributed to the level of time-lost injuries through lack of most current labor-saving and risk reducing technology.

Resolution of this situation is more than a fiscal issue. It requires a management approach to:

- Define the boundaries of reasonable and efficient customer service;
- Make judgments about the future delivery workload based on other strategic business recommendations;
- Determine the optimal size and configuration of the fleet;
- Assess the potential for cost savings through employment of alternate fuels;
- Identify the most efficient and safest technology to support delivery tasks; and then
- Determine the most cost-feasible and cost-efficient way of recapitalizing the fleet in a way that is sustainable over time.

PFM recommends a management process that defines the needs of the DLC followed by an analytical process to engage the DGS's Division of Fleet Management and the private sector to determine the optimal process to recapitalize the fleet.

1A) Revise Delivery Priority Policies

New delivery policies should be considered with the aim of minimizing the number of deliveries per week. The DLC should keep free delivery once per week, as well as consider: a fuel surcharge per case to offset the cost of distribution operations, charging for additional deliveries in the same week, and congestion pricing – higher delivery charges for peak times of week/year – encouraging customers to purchase in advance and maintain higher inventory levels.

1B) Review Fleet Configuration and Size

The DLC should analyze utilization, routes and vehicle mix to determine the vehicular needs of the Department. A newer fleet will have higher "uptime" and can deliver the same level of service with fewer vehicles. As part of the fleet configuration review, the DLC should evaluate whether a different mix of vehicles would improve operations and develop updated vehicle specifications in coordination with the DGS's Division of Fleet Management.

1C) Develop a Comprehensive Plan for Vehicle Placement

If the DLC is to own its own fleet vehicles, it must create a comprehensive vehicle replacement plan as well as a vehicle replacement fund that is funded annually. Information from the fleet configuration review (recommendation 1B), as well as information collected from the marketplace during with a Request for Information or Request for Proposals (see recommendation 1H) can inform the development of a plan to smooth out vehicle replacement costs.

1D) Determine Approach to Fleet Recapitalization

If the DLC is to own its own fleet vehicles, it should assess its revenue-based debt capacity in the context of the recommended future business plan to determine the ability to finance recapitalization of the fleet with debt instruments. This approach could include shorter-term bonds (less than 12 years maturity) or Certificates Of Participation (COPs), etc.

1E) Evaluate Outsourcing the Delivery Function

Other liquor control jurisdictions outsource the delivery function entirely. Outsourcing the delivery function for the DLC would entail a restructuring of current operations and have impacts within the unionized workforce. Yet, outsourcing may also provide meaningful cost savings and operational flexibility to handle peaks in delivery demand.

1F) Consider "mini-warehouse" in Regional SuperStore

If the Department pursues the development of a regional "SuperStore," it should consider building in sufficient storage space to accommodate a satellite distribution center that could allow other stores to resupply during the week, centralize some special orders and/or otherwise support the logistics needs of the retail operation. The goal of this effort would be to reduce the need for multiple/special deliveries from the warehouse.

1G) Consider Delayed Posting of Licensee Accounts to Smooth Deliveries

According to officials of the Department, licensees often order inventory late in the week to minimize the cash flow between payment and sale of products. The agency is implementing a debit account system to replace the necessity for COD deliveries. When this system is operational, the DLC may wish to consider a set-day delivery schedule, but allowing deliveries earlier in the week to not be posted against debit accounts until later in the week. This approach could reduce the late-week peak in deliveries without creating cash flow issues for licensees.

1H) Tap the Knowledge and Experience of the Private Marketplace

The DLC should consider issuing a series of Requests for Information (RFIs) to gain market information and cost of service information. With this knowledge, the DLC will have more access to industry advice and best practices, as well as, determine which operational areas – if any – the private sector can support the DLC's fleet-related services. RFI's can be written to cover the following areas:

- Cost of purchasing new vehicles for fleet (i.e., fleet recapitalization);
- Leasing and configuration of fleet;
- Options for outsourcing of delivery; and,
- Technology upgrades for delivery trucks: particularly for routing and telematics.

Operations Recommendations

2A) Seek Opportunity to Become an Authority

Given its unique roles and responsibilities, particularly as it relates to retail operations, the DLC would benefit from an increase in flexibility from typical County requirements applied to other operations. As currently chartered, the DLC faces restrictions in hiring and personnel management, purchasing, capital management and investment that hinder smooth and profitable operations. Many, if not all, of these restrictions are reasonable for other County functions and represent good governance by the County over its various departments. Yet, as the DLC is not a typical County department, what represents wise management of, for example, the Department of Finance is overly restrictive for a business enterprise that functions separate and distinct from General-Fund-funded operations.

The DLC should seek authorization from the County Council and Executive to form a public benefit corporation or authority to oversee the wholesale distribution of all alcoholic beverages in Montgomery County, the retail of alcoholic beverages in Montgomery County, the licensure and regulation of private businesses wishing to serve alcoholic beverages for on- or off-premise consumption and the education and enforcement of State and County laws pertaining to the sale and consumption of alcohol.

Incorporation as a public benefit corporation offers the DLC several benefits. As a public authority, the DLC can create a sinking fund or other capital replacement budget for the continued maintenance of the DLC's fleet of trucks. Under a new structure, the DLC could independently bargain with public sector unions to tailor the hundreds of pages of job classifications and work rules to the specifics of the liquor distribution operations. Likewise, the DLC could seek to reinstitute the ability to hire temporary employees to manage predictable changes in the business cycle around Holiday sales and could work to institute a performance compensation package, such as those available in Utah and New Hampshire.[32] Becoming an authority would also respond to some voices in the public calling for privatization and others who have asked for change in how the County administers alcoholic distribution. These, among other benefits, suggest that DLC has much to gain as a public benefit corporation.

Complicating the implementation is a series of bonds issued in 2013 backed by the profits from the DLC operation. Currently, and under State law, all net profits from the DLC's operations are first applied to maintain the working capital reserve, and the remaining profits are subject to transfer to the County's General Fund. Pledged revenues for debt service on the 2013 series of bonds consist of the funds transferred to the General Fund.[33] Standard and Poor's voiced concern over the weak legal structures surrounding the bond series but noted that they were reassured by the DLC policies governing profit margins and working capital contributions.[34] As the DLC works towards a transition to a public benefit corporation, it is imperative that it work with bond counsel to ensure that the County and DLC fulfill their duty to bondholders. That said, the new structure may actually reassure bondholders that the DLC has the tools necessary to maintain (or enhance) profitability – which ultimately benefits the bondholders.

2B) Obtain Dedicated, In-House Resources for Building Supervision and Management

Findings eleven through fifteen all, to differing extents, highlight the need to focus on building supervision and management. Some current stores need significant refurbishment to ensure their customer-facing appearance reflects a clean, comfortable, pleasant and safe experience. Other stores face challenges with storage space. The DLC intends to expand its footprint in the County and will require new leases to do so. The DLC will also be expected to appropriately brand and define a "look" for its retail locations. To

---

[32] New Hampshire's response to a survey question on a survey conducted April22 – May 9 indicates they are in the process of creating a performance compensation plan for employees.

[33] Wilhelm, Lindsay and Danielle L Leonardis "Montgomery County, Maryland; Miscellaneous Tax" Standard & Poor's Rating Services July 19, 2013.

[34] Ibid.

properly support each of these undertakings, it is recommended that the DLC obtain resources for building supervision and management.

Foremost among these resources should be a position within the Retail Division to identify opportunities and locations for new stores, oversee lease negotiations, create and monitor a cycle of store refurbishment and ensure new and old stores alike meet County standards for their retail experience. While the DLC has noted improvements in the lease process under the County's current contractor, Jones Lang LaSalle, the processes for retail leasing negotiations and lease negotiations for County buildings are distinct enough – with vastly different goals and requirements – to warrant hiring personnel to fulfill the specialized requirements in-house.

Therefore, the DLC should seek additional appropriations or set aside funds for hiring a professional to provide building supervision and management services, including negotiation of leases for retail space. When reviewing potential candidates, the DLC should strongly prefer candidates with substantial experience in specifically retail lease negotiations. This position should fall under the supervision of the Retail Operations Manager and duties should include:

- Store site locating;
- Lease negotiation;
- Lease renewal negotiation;
- Store layout design;
- Store build-out management;
- Store remodel management;
- Store remodel schedule creation and management;
- Development of strategic asset plans for existing stores;
- Capital expenditure management;
- Construction coordination with architect, contractors, landlord, suppliers and local authorities;
- Construction contract negotiation and bid management;
- Development of scope of work, cost analyses and budget projections necessary to maintain location standards;
- Management of existing leases for compliance;
- Management of budgets and processing of invoices;
- General store maintenance issues; and,
- Proactively communicate with store managers, field supervisors and Retail Operations Manager.

2C) Perform a Cost-Benefit Analysis on the Differing Methods of Overnight Loading

As the eighth finding indicates, between the two methods of overnight product loading, one is likely a more efficient use of resources. As the DLC's current contract regarding beer loading expires in September, with a possible six-month extension, the DLC is excellently positioned to evaluate which of these methods is best operationally and financially.

We recommend that the DLC issue an RFQ for a loading contract containing beer as well as liquor and wine. Simultaneously, the DLC should perform a financial analysis of the cost of the current staff loading, including direct costs (such as salaries, benefits payments and worker's compensation) and indirect costs (such as portions of Human Resources and administrative costs). The DLC may also wish to invite the public-sector unions to participate in the competitive bid process. The two processes should give the DLC a financial basis on which to make an informed decision of the best and most efficient method for loading product. The DLC should then, using a cost-benefit analysis, select an option for loading product.

Strategies and Recommendations

Retail Recommendations

3A) Adopt New Store Opening and Store Location Criteria

We noted in finding twelve that the DLC lacks official criteria for opening and locating new stores. The two scenarios in which opening a new store would be warranted are populated areas currently underserved or "holes" in the market, and stores exceeding their optimal sales volume.

When the choice has been made to open a new store, the site location decision needs to be made based on established criteria or location standards. Private sector retailers generally establish building and site requirements to follow when identifying a new store location, as well as the preferred general parameters of the demographic criteria. DLC stores would typically have the following location standards:

- Be on the side of the street with traffic going home from work.
- Be in a grocery anchored center or County-retail-store-anchored, multi-tenant building.
- Co-tenancy – High-traffic, grocery stores, theaters and restaurants; not office supply, pet stores, pawn, thrift or dollar stores.
- Provide visibility, access and significant traffic counts.
- If a freestanding location, be at a signalized intersection of two main streets with significant traffic counts.
- Provide direct access to service to the site.
- Provide at least 4.0 well lit and convenient parking stalls for each 1,000 sq. ft. or store space.
- Provide visible, illuminated and unblocked pylon and storefront signage.
- Political support from local government and community.
- Proximity analysis of existing stores based on drive time analysis of primary market areas.
- Size of proposed store to be determined by market demographics rather than real estate opportunities where possible.
- Presence of privately owned wine and beer stores needs to be considered but should not be a "deal breaker."

Site selection needs to be more than simply a question of what real estate is available. It is an analytic challenge that requires an understanding of the market potential and opportunities. In this case, the old term of "location, location, location" is very accurate.

3B) Create One or More Regional "SuperStore"

The opportunity analysis indicates that there is increasing dynamism in the market for innovative ideas, and a variety of factors suggest that regional "SuperStores" may assist the DLC with addressing a variety of internal weaknesses and external opportunities and threats." Among these are:

- Competition from private wine and beer operations within the County, both independent and grocery stores
- Competition from private operations outside of the County, particularly in the District of Columbia
- Status as the only provider of liquor at wholesale for Montgomery County licensees for on-premise sales
- Supply chain pressure from special order products
- Lack of storage and shelf space in many retail store locations
- Staffing issues that put pressure on retail store's ability to service both licensees and other consumers

In looking for a method to better serve customers and ameliorate weaknesses and threats, a SuperStore model appears promising. Under this approach, one or more stores would be strategically located to serve underserved or growing populations. These stores should be located to serve multiple roles. The facilities should be larger in square footage and storage space than other locations, and they should provide a fully array of products that may not be readily available at other locations within proximity. These become the 'go-to' store for licensees and others seeking the broadest possible product mix. These stores should also serve as the outlet of choice for licensees – they should allow licensees to pre-order and use a 'backdoor' for receiving their product. This will take pressure off other locations, both in terms of product availability and dealing with licensees who need order fulfillment during business hours when other consumers are also in the stores.

A proposed regional SuperStore for the DLC should have a number of characteristics. The DLC should seek to locate their SuperStore in a regional shopping center, alongside other regional stores, such as Walmart, Target, Home Depot, Best Buy or Costco. These should be regionally located – approximately a 10-minute drive time from the primary market area. The DLC will wish to take into consideration the number of off-premise licensees in the area which may be displaced and should seek to reasonably reduce their impact without sacrificing prime positioning. The regional store should be at least 10,000 to 12,000 square feet and should include an area in back of the store for licensee pick-up.

A prime location for the first SuperStore would be the shopping center where Milestone is currently located. To utilize this space, DLC would need to choose to close the Milestone store and use the SuperStore and Seneca Meadows absorb the market in that area.

3C) Close or Relocate the Chevy Chase Store

As our sixteenth finding notes, the Chevy Chase store underperforms the rest of the County. In our opinion the size of the store, the awkward layout of the store (entrance from a parking garage, no adequate loading dock) and the store's location in the shopping district all contribute negatively to its profitability. In addition, the lease rate is high, the salary wages are 4th highest among DLC stores, and it has the lowest turnover rate and the lowest GMROII rate. There is little within the DLC's power that could change the profitability superstructure of the store. Given that the store is actively losing money – Chevy Chase posted a net loss of a quarter million dollars in FY2013 – we recommend closing or relocating the store at the termination of the lease.

Closing an existing store can be a difficult decision and can have an adverse effect on customer satisfaction. However, sometimes this difficult decision needs to be made for the benefit of the entire system. Conditions that may warrant a store closure are:

- A store that is showing a net loss in revenue, such as the Chevy Chase location.
- Stores which have exceeded their "useful life" which for retail is usually 12-15 years, and are in aged or dilapidated centers, such as the Cabin John location.
- Stores located in market areas that have seen dramatic shifts in demographics from employment loss, population declines or other economic factors.

It should be noted that store closure does not always mean abandoning the market area entirely, but rather moving to a newer location within the market area that is better suited, either because of conditions and age of location or because of proximity to the target population.

3D) Locate Additional Stores to Split Over-Extended Markets

The DLC has already sought to divide the market around Milestone with the Seneca Meadows store and given how few off-premise liquor retail outlets exist within the County, there is an opportunity to split two additional markets: Montrose and Potomac. Both of these stores are generating over $1,500 per square foot. Stores that show sales considerably higher than the average among the DLC system may actually be experiencing a loss of sales opportunity due to the overcrowded conditions at the existing store. In this case, opening a new store can be a net gain in sales to the system even if sales from the existing store decline. For example, a store that has annual sales of $8 million has its market "split" resulting in two stores that each have $5 million in annual sales.

The decision to open a new store to relieve pressure from an overburdened store or "splitting the market" can be simpler than opening a new store, but much of the same analysis needs to be considered.

When considering the opening of an additional store within a market area, the following factors should be determined:

- Determination of what constitutes an overcrowded store such as stores showing annual sales per square foot at 150% of the DLC average.
- Projected net gain in sales from new store will justify the increased employee and lease expenses from opening an additional store.
- Availability of site that meets location standards.
- Physical and lease conditions of existing store to determine whether the best course of action is to close the existing store and open two new stores within the market area at optimal locations.

3E) Develop Plan to Open Three to Five Additional Store Locations

Finding number ten indicates there is substantial room for the DLC to open additional stores without an adverse effect on market dynamics. Indeed, industry standard data, benchmarking data, and mapped representations of market coverage indicate that the DLC should open additional stores.

Following the criteria we propose above, we identified general locations in need of additional store locations:

- the area north of Gaithersburg;
- the area east of Aspen Hill and north of Wheaton-Glenmont;
- the area north of Potomac and west of Rockville; and
- the area around Damascus.

We believe that DLC would be best served in seeking to expand in these locations across a three to four year period.

3F) Expand the Consistent Use of the DLC Brand

The DLC has adopted a brand logo (which can be found on page 60); this is a clever and visually interesting logo that can and should be widely used to identify the DLC, its stores and its products. Given that the DLC operates in a retail environment with a variety of other retail competitors, it is important that it consistently identify its stores with this brand. It is clear from examining any successful retail store that this is commonly accepted best practice – one need only view the distinctive logo of a Target store to understand the visual power of a distinctive (and ubiquitous) logo.

There are a variety of ways that the DLC logo can be displayed. It should be used on DLC letterhead, the DLC website and other social media (Twitter, Facebook, etc.). It can be used on items that the DLC may distribute as give away items; it may be used on DLC uniforms, vehicles and other public-facing opportunities.

Most critically, the DLC stores should all display this logo on its signage. At present, there are multiple DLC retail locations with a variety of different signs, and many (if not most) do not include the DLC logo.

In some instances, there are beer and wine stores in close proximity to the DLC store, and there is little or no way for the consumer to understand the difference between these retail locations.

There are, no doubt, practical impediments to some of the issues related to store signage; in some instances, this will require negotiation with landlords, seeking County approval for certain sign locations, etc. An implementation plan should be developed that provides the greatest possible uniform use of the DLC brand on signage in the least amount of time. Going forward, all new store locations should use the new brand and use it as consistently and effectively as possible. An implementation plan should also identify all opportunities to use the brand on consumer-facing communications and also develop a plan for the effective use of the brand.

3G) Establish 'Store Look' Guidelines to be Incorporated into Store Design and Refurbishment Plans

As with effective use of a common brand, effective retailing generally relies on developing a certain 'look' for retail stores. While this is generally not a 'cookie cutter' approach with every store of a particular brand having the exact same lay-out, there are aspects of the store lay-out, the store furnishings, store colors, etc. that tend to not materially vary from location to location.

Indeed, there are some characteristics of retail store layout that are so well accepted that they are generally the same even among competing retailers. For example, it is well accepted in the grocery store world that dairy products (a common denominator in the basket of goods of most shoppers) will be located at the back of the store, which requires shoppers to go through various other aisles to reach them. Other common techniques include pairing items that are commonly purchased together (such as items to make pancakes and syrup, or bread near peanut butter, jelly or honey). It should be noted that the DLC already understands this basic concept – you will find, for example, margarita mixers near tequila).

Besides some of these common pairings, however, there is very little among the DLC stores that create any commonality among locations. The one common denominator is that spirits are on the outer walls and wine is in the middle of the store on shelves and racks. Even in this common scheme, there is no common thread as to where types of spirits will be located. Along the grocery theme of 'common items in the back' it would, in most locations, make sense to locate vodka, which is generally the spirits category with the most sales volume, in a location in the back, but this is not always the case.

There is, of course, much more to look than just product placement. In many cases, it also reflects the basic features of the store. In the retail grocery world, this currently includes wide aisles, polished concrete floors, higher ceilings, specialty racks and lighting. By contrast, the DLC locations mostly have narrow aisles (which are probably not ADA compliant in some locations), tile floors (which in many locations is worn and in need of replacement), drop down low ceilings, florescent lighting, drab colors and narrow shelving.

There are some locations that have created a more compelling look and features – with appealing displays, diagonal aisles, space-saving wine racks and attractive signage – but these are more the exception than the rule. Without a doubt, some of the shortcomings relate to the fact that the DLC is a renter rather than an owner of retail store locations, which can limit its ability to make dramatic changes. At the same time, as store leases come up, these opportunities should be a key decision making point.

Even beyond these major changes in store look, there are a variety of intermediate changes that can be incorporated into the existing stores. For example, hand-written signs (such as those for sale items) should be replaced with computer-generated signs that can be more consistent and visually appealing. Second, the front of stores, where customers enter and exit, should, for all locations, be decluttered to give a more open feel. Stacked items like beer cases should be kept at levels that do not interfere with customer sight lines throughout the store as well.

There is also a very real concern that the cramped and cluttered feel to many of the stores is the result of too many products being shoehorned into the location. It is understandable that the DLC feels the need (particularly in the area of spirits) to carry a wide selection – for many items, they are the only outlet within the County for consumers to purchase their favorite brand of, for example, flavored vodka. It is our belief, however, that other recommendations (such as developing further store locations or going to a 'superstore' model) could alleviate some of these concerns. In this model, a large regional store could serve as the location for the broadest possible variety of products, while locations with smaller square footage can focus on more popular items. This will allow those stores to improve traffic flow and 'open up' the store. It may also reduce some of the need for storage and delivery.

Another approach would be to focus attention on those items that are not readily available at other retail establishments. In the case of DLC stores in close proximity to private beer and wine retailers, this can include reducing the amount of commonly available beer and wine and focusing on specialty items within these categories while maintaining a primary focus on spirits. Of course, this strategy should be modified for stores with a large volume of wine sales, but in general this can also free up space and reduce store clutter. Ultimately, this is a multi-pronged approach that should involve consideration of a variety of factors on a case-by-case basis, but with a common DLC goal of achieving a store 'look' and feel that appeals to consumers.

VII. Implementation

Implementation

Transition Steps and Action Planning

While the project team has spent significant time examining the DLC operations and providing recommendations based on experience with this and similar projects, ultimately, the course of action the Department pursues relating to the recommendations will be made by its leadership. Given that reality, the following recommendations on transitional steps and action planning will be largely driven by the course leadership steers. From the project team's vantage point, that choice will be driven by several key factors:

- Internal (or external) resources that can be committed to the projects;
- Projected impact of individual initiatives; and
- Timeframe for completion of the project.

It is likely that the assessment of the importance of each of these factors will vary from initiative to initiative. Because these will occur based on information that is not and cannot be fully identified or assessed by the project team (particularly for initiatives that may not be implemented immediately), the report does not seek to analyze each recommendation from these perspectives.

When approaching implementation, transitional steps and action planning more broadly, the project team makes the following recommendations:

- **Identify short-term projects that are confined to specific components of the operation.** For these projects, individual department managers may be tasked with identifying the resources (staff, time, systems and money) necessary for implementation and timeframe. They should also determine action steps, responsible individuals and project implementation reporting requirements. Project status reports would then be provided to the Executive Director on a regular basis (such as quarterly).
- **Develop an assessment methodology for projects that involve multiple operations.** In similar projects, this has sometimes been handled by an executive leadership team. In other cases, a smaller group, containing, for example, the Executive Director's designee and designees from impacted parts of operations have determined those initiatives that should be the primary targets for short-term implementation.
- **Make longer-term initiatives an integral part of an on-going strategic planning process.** Many of what may be higher impact recommendations are enterprise-wide initiatives that do not readily lend themselves to separation into distinct implementation plans. They generally need to be discussed in terms of setting organizational direction and broad-based allocation of resources.
- **Develop a regular initiatives reporting system.** In some organizations, implementation reporting has been done on a quarterly, semi-annual or annual basis. This should include specific action steps taken, responsible parties, completion level and any associated measures of program performance.
- **Revisit the initiatives and implementation decisions on a regular basis.** Over time, some initiatives may grow in importance – or become more easily implementable because of other system or process changes. It makes sense to review these decisions at some regular interval, even if it is every 12 months.

Besides this framework for decision-making, there are other recommendations for implementation that may improve overall effectiveness. These would include:

- **Develop project charters for each initiative.** To help ensure clarity around purpose and expected end results, each initiative should have a written project charter associated with it. At a minimum, the charter should identify the project manager, the project sponsor, key team members, project purpose, interim and final outcomes. It should also include a project timeline, budget, and individual duties and responsibilities.
- **Develop formalized reviews for projects.** While project duration is often perceived as a factor for success (with longer projects seen at risk of failure because of loss of inertia, burn-out, etc.), a

more critical factor may be the time between regular reviews by the DLC leadership. One study of over 1,200 business transformation efforts identified regular reviews at least every eight weeks as a critical factor in project success.

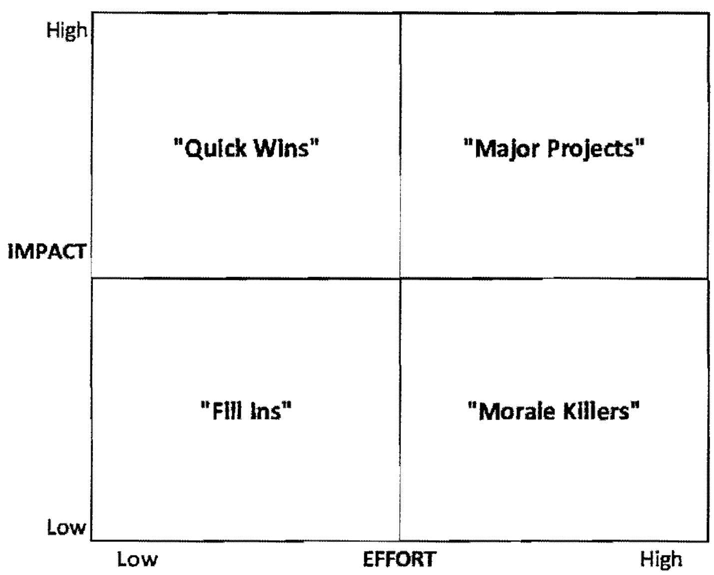
- **Gauge the level of staff effort necessary for project completion.** A generally useful rule of thumb is that a new project should not increase staff workload by more than 10 percent. If this is the case, it is likely that resources will be stretched and either threaten the new initiative or existing operations. In these cases, either existing less important projects and duties should be transferred or put on hold, or outside assistance should be enlisted for the project.

Prioritization

It goes without saying that nearly every strategic plan contains a variety of useful recommendations that are often constrained by an organization's internal capacity to initiate, manage and complete multiple major change efforts at the same time. As noted in the previous discussion, the level of staff effort necessary for project completion must be taken into consideration, and in many instances it is impossible to undertake multiple major new initiatives in the same time frame.

In most cases, an organization will have to prioritize its efforts and focus on managed, staged change processes. In determining where, exactly, the organization should focus its time and effort, it is useful to determine the level of effort and the impact of likely outcomes from each initiative. In essence, this creates a mechanism for prioritization of change efforts. The following matrix is useful for discussing and prioritizing change efforts.

Action Priority Matrix



This matrix focuses on the effort necessary to complete a project and the likely impact from a successful completion of the project. In this case, the goal will be to identify high impact, low effort projects (quick wins) in the early stages of implementation. Not surprisingly, these projects are generally small in number – opportunities for major impact with minimal effort have often already been accomplished or are, upon further review, not as readily achievable as originally thought. Often, these projects gravitate into the 'major projects' category. That said, these are often the primary areas of focus, because they do come with an opportunity for tangible, real benefits.

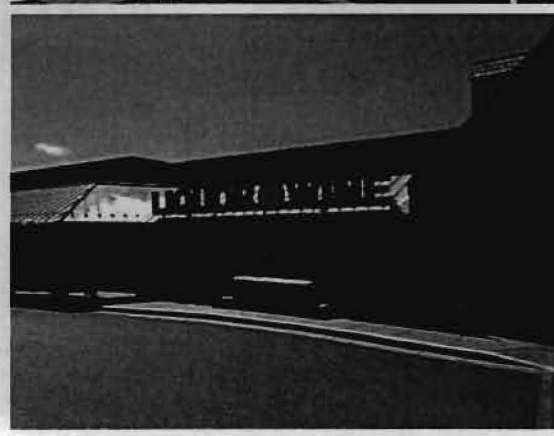
The value of this analysis is often in identifying those projects that come with significant effort and little ultimate impact. These 'morale killers' should be sought out and avoided at most any cost.

Appendices

Appendix A

SIGNAGE

Appendices




LIQUOR
WINE

Appendices

FLOORING

CLUTTER

Appendices

NARROW AISLES

Appendices

GOOD DISPLAYS

OPEN LOOK AND WIDE AISLES

HAND WRITTEN SALE SIGNS

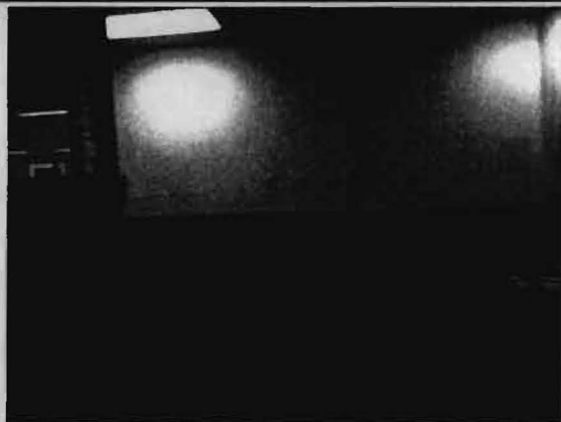
MISCELLANEOUS

Photo	Comments
	▪ Open, un-covered storage entrance
	▪ Open, un-covered storage entrance
	▪ Non-descript walls

Appendices

Photo	Comments
	▪ Good walls
	▪ Drop Downs
	▪ Drop down signs

Photo	Comments
	▪ Computer Generated Sale Signs
	▪ Nice computer generated signs ▪ Open, uncovered entrance to storage area
	▪ Bad back entrance

Photo	Comments
	▪ Bad back entrance
	▪ Old style shelving
	▪ Non-fluorescent light fixtures not functioning

Appendix B






Appendices