MEMORANDUM

TO: Ad Hoc Committee on Liquor Control
FROM: Craig Howard, Senior Legislative Analyst, OLO
       Leslie Rubin, Senior Legislative Analyst, OLO
       Justina J. Ferber, Legislative Analyst, Council Staff

SUBJECT: Worksession - Review of Alcohol Control in Montgomery County

March 6 will be the second meeting of the Ad Hoc Committee on Liquor Control. The following is the agenda for the meeting:

AGENDA
1. Review of follow-up items from February 27 Ad Hoc Committee meeting
   - OLO – Craig Howard and Leslie Rubin (pages 2 and 3 of this memo)
   - DLC Director George Griffin (page 4 of this memo)
2. Update from Inspector General Edward Blansitt and Deputy Inspector General Mollie Habermeier
   - Focus on Preliminary Inquiry Memoranda Issued on 12/23/14 and 1/12/15 (©A, B, C, & D)
3. Discussion with DLC Director George Griffin on DLC Management and Operations
4. Discussion with MCGEO President Gino Renne on DLC Management and Operations

Speakers have been invited to provide written materials for the Committee. Materials submitted after the packet deadline will be distributed as they are received.

Councilmembers should bring copies of OLO Report 2015-6 and the PFM Strategic Business Plan to the meeting. The list of 5 options presented in the OLO report can be found on ©4. The following are links to the OLO Report and Strategic Business Plan:
http://www.montgomerycountymd.gov/DLC/Resources/Files/MontCo_DLC_StrategicBusinessPlan.pdf

At the Committee's February 27th meeting, Councilmembers asked OLO for follow-up or additional information on two issues: I) obtaining additional licensee survey feedback; and II) estimating the potential value of “cross-border” alcohol sales based on Montgomery County consumption rates compared to neighboring jurisdictions.

I. Additional Licensee Survey Feedback

Per the Committee’s suggestion, OLO has requested from DLC an updated database of licensees that includes email addresses for each licensee. Upon receipt of this data, OLO will re-distribute our survey of liquor licenses holders requesting feedback on various components of DLC performance and operations.
II. Cross Border Alcohol Sales

OLO Report 2015-6 notes that, in FY14, Montgomery County residents consumed less alcohol per capita in FY14 than our three neighboring Maryland counties. OLO concluded that the comparatively low consumption rate likely reflects, at least in part, the purchase of alcoholic beverages in other jurisdictions by County residents.

Table 1 from page 83 of the report showing these differences is reproduced below, along with an additional row that shows the statewide average excluding Montgomery and Worcester Counties. Worcester County includes Ocean City, and as a result, the County’s per capita consumption rates – 55.6 gallons of beer, 5.6 gallons of wine, and 5.6 gallons of liquor in FY14 – are skewed due to non-County residents who travel to and purchase alcohol in Ocean City but are not included in the per capita calculation. A portion of alcohol consumption in Montgomery County, similarly, can be attributed to non-County residents either traveling to the area and staying in Montgomery County or frequenting venues in the County that sell alcohol, such as restaurants and theaters (e.g., the Fillmore, Strathmore).

The data show that Montgomery County’s per capita consumption rate for alcohol is 5.6 gallons less than the average of Prince George’s, Howard, and Frederick counties; and 10.7 gallons less than the statewide average.

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Beer</th>
<th>Wine</th>
<th>Liquor</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Montgomery County</td>
<td>9.5</td>
<td>2.4</td>
<td>1.1</td>
<td>12.9</td>
</tr>
<tr>
<td>Prince George’s County</td>
<td>13.7</td>
<td>1.5</td>
<td>1.7</td>
<td>16.9</td>
</tr>
<tr>
<td>Howard County</td>
<td>12.2</td>
<td>3.0</td>
<td>1.5</td>
<td>16.7</td>
</tr>
<tr>
<td>Frederick</td>
<td>17.6</td>
<td>2.7</td>
<td>1.7</td>
<td>22.0</td>
</tr>
<tr>
<td>Neighboring Counties’ Average</td>
<td>14.5</td>
<td>2.4</td>
<td>1.6</td>
<td>18.5</td>
</tr>
<tr>
<td>Statewide Average (excl. Montgomery and Worcester)</td>
<td>19.3</td>
<td>2.5</td>
<td>1.9</td>
<td>23.6</td>
</tr>
</tbody>
</table>

Source: Maryland Alcohol & Tobacco Tax Annual Report, Fiscal Year 2014

Additionally, as noted by Councilmembers at the Feb. 27 worksession, DLC’s Comprehensive Long-Range Strategic Plan (prepared by the PFM group) comes to a similar conclusion:

“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.” (DLC Long-Range Strategic Plan, pages 16-17).
Potential lost value from cross-border sales. Given Montgomery County’s population of approximately 1 million, the difference of 5.6 gallons per capita from the neighboring counties average equates to 5.6 million gallons less alcohol consumed. Because the specific amount and value of cross border sales are not known, OLO developed a range of estimates using: 1) Montgomery County’s consumption rates; 2) the average consumption rates of Prince George’s, Howard, and Frederick counties; and 3) DLC’s average retail price per gallon for beer, wine, and liquor.

Table 2 estimates a range of potential values based on different assumptions for the proportion of the per capita consumption difference that is due to cross border sales. The data show:

- If 25% of the per capita difference is due to cross border sales, County alcohol retailers could be losing approximately $46 million in alcohol sales each year.
- If 50% of the per capita difference is due to cross border sales, County alcohol retailers could be losing approximately $93 million in alcohol sales each year.
- If 75% of the per capita difference is due to cross border sales, County alcohol retailers could be losing approximately $139 million in alcohol sales each year.
- If 100% of the per capita difference is due to cross border sales, County alcohol retailers could be losing approximately $186 million per year.

Table 2. Estimates of Lost Value from Cross-Border Sales

<table>
<thead>
<tr>
<th></th>
<th>Beer</th>
<th>Wine</th>
<th>Liquor</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average DLC retail price per gallon</td>
<td>$29.72</td>
<td>$52.67</td>
<td>$58.77</td>
<td>--</td>
</tr>
<tr>
<td><strong>25% Assumption</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MoCo consumption difference</td>
<td>(1.3 million gallons)</td>
<td>+9,320 gallons</td>
<td>(0.1 million gallons)</td>
<td>(1.4 million gallons)</td>
</tr>
<tr>
<td>Estimated sales value</td>
<td>($38.2 million)</td>
<td>+$0.5 million</td>
<td>($8.8 million)</td>
<td>($46.4 million)</td>
</tr>
<tr>
<td><strong>50% Assumption</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MoCo consumption difference</td>
<td>(2.6 million gallons)</td>
<td>+18,639 gallons</td>
<td>(0.3 million gallons)</td>
<td>(2.8 million gallons)</td>
</tr>
<tr>
<td>Estimated sales value</td>
<td>($76.3 million)</td>
<td>+$1.0 million</td>
<td>($17.5 million)</td>
<td>($92.9 million)</td>
</tr>
<tr>
<td><strong>75% Assumption</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MoCo consumption difference</td>
<td>(3.9 million gallons)</td>
<td>+27,959 gallons</td>
<td>(0.4 million gallons)</td>
<td>(4.3 million gallons)</td>
</tr>
<tr>
<td>Estimated sales value</td>
<td>($114.5 million)</td>
<td>+$1.5 million</td>
<td>($26.3 million)</td>
<td>($139.3 million)</td>
</tr>
<tr>
<td><strong>100% Assumption</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MoCo consumption difference</td>
<td>(5.1 million gallons)</td>
<td>+37,278 gallons</td>
<td>(0.5 million gallons)</td>
<td>(5.6 million gallons)</td>
</tr>
<tr>
<td>Estimated sales value</td>
<td>($152.6 million)</td>
<td>+$2.0 million</td>
<td>($35.1 million)</td>
<td>($185.7 million)</td>
</tr>
</tbody>
</table>

Source: State and DLC data, OLO analysis

If Montgomery County consumption rates are more similar to the statewide average (excluding Worcester County), then the amount lost to cross-border sales would be even higher.
III. DLC Follow-up Items

At the Committee’s February 27th meeting, Councilmembers asked DLC for additional information on five items:

**Item** | **Status**
---|---
1) Wholesale price comparisons | Will submit prior to 3/20 Committee meeting
2) Identification of the components of the special order system and market | Will provide info on Friday 3/6
3) Particulars of what a Liquor Authority would look like | Researching and will provide info ASAP
4) Facts on the benefits to contracting out delivery operations | Waiting for results of the REOI
5) An expansion plan for opening an additional 10 retail stores | Contracting with Brown-Forman for a survey, Executive’s FY16 Operating Budget will Recommend opening 3 new stores

DLC is also working to provide OLO with an updated database of licensees.

**LIST OF ATTACHMENTS**

<table>
<thead>
<tr>
<th>Item</th>
<th>Begins At</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inspector General Update Preliminary Inquiry Memoranda 12/23/14 &amp; 1/12/15</td>
<td>©A, B, C, D</td>
</tr>
<tr>
<td>Executive Summary of OLO Report 2015-6</td>
<td>©1</td>
</tr>
<tr>
<td>Options Chapter</td>
<td>©5</td>
</tr>
<tr>
<td>Memorandum from Timothy Firestine, Chief Administrative Officer, February 4, 2015</td>
<td>©27</td>
</tr>
<tr>
<td>Letter from Councilmember Hans Riemer, Chair, Ad Hoc Committee on Liquor Control, to Timothy Firestine, CAO, February 13, 2015</td>
<td>©31</td>
</tr>
<tr>
<td>Strategies and Recommendations from DLC Comprehensive Long-Range Strategic Business Plan (Oct. 23, 2014) by the PFM Group</td>
<td>©35</td>
</tr>
</tbody>
</table>
Internal Control Matters
Montgomery County Department of Liquor Control
Focus on Preliminary Inquiry Memoranda issued on December 23, 2014 and January 12, 2015

IG PIMs 15-003 & 15-004
March 6, 2015
OIG Work at the Department of Liquor Control

Allegations Discussed in PIMs

- Allegation: The LRE Division Chief deposits funds issued for the Compliance Program into her personal, non-county bank account.
- Allegation: Caterers operating in Montgomery County have been awarded a Beer, Wine, and Liquor Caterers (CAT) License without paying the required county fee.
- Allegation: A company owned by the spouse of the LRE Division Chief was hired to cater DLC events.

Warehouse Operations

- Allegations Discussed in PIMs
  - Allegation: DLC warehouse security cameras are not operational and side doors are regularly left propped open, leaving warehouse product vulnerable to theft.
  - Allegation: DLC warehouse "checkers" were not properly checking the contents of returning DLC delivery trucks.
  - Allegation: DLC driver paperwork containing relevant information regarding truck shortages, overages, breakage, and returns was collected but not aggregated or analyzed.

Retail Operations

- FY14 Preliminary Inquiry: The OIG found that DLC retail clerks may not be properly trained in Visa gift card procedures.

OIG Report: One Day Alcoholic Beverage Licenses
May 14, 2014

OIG Report: Review of Management Controls Over Inspectors
January 13, 2014

OIG Draft Report: Warehouse Inventory Management
(Issued for CAO Comment)
Licensing, Regulation, and Education Division

Compliance Funds

- Compliance funds are issued to the LRE Division manager as a personal cash advance. ($6,100 for 600 Compliance Checks per fiscal year).
- Compliance expenditures were adequately supported, properly reconciled, approved by an LRE manager, and reviewed by MC Office of Finance.

$0 Caterers (CAT) Licenses

- At least 2 caterers received Montgomery County CAT licenses without paying the annual license fee. ($1,250 per year waived for each licensee.)
- A notation in one of the files states:
  
  "This license was issued so that [the caterer] (which holds a state catering license) can order alcoholic beverages from [DLC]. Licensees have not appeared before [the Board of License Commissioners] nor have they been fingerprinted through our offices."

Catering Conflict of Interest

- Over the past 5 years we found 3 instances (totaling $3,052) where a company employing the spouse of the LRE Division Chief was hired to cater DLC events.
- We found no evidence the spouse had any ownership in the company.
Internal Control Matters & Compliance Money
Montgomery County Department of Liquor Control

Operations Division

Security Issues
- A contracted security firm replaced or repaired non-functional cameras.
- DLC warehouse staff were provided a memo directing them not to leave doors propped open.

DLC Warehouse "Checker" Failure
- A limited review of DLC driver paperwork indicated that the content of DLC delivery trucks was not always properly inventoried upon return to the warehouse. (34% of wine/liquor trucks, 22% of beer trucks not checked)
- DLC has assigned a manager to the checker function and issued a memo to staff prohibiting drivers from leaving for the day prior to being properly checked in.

Delivery Truck Inaccuracies
- We observed that DLC driver paperwork containing was not aggregated or analyzed, leaving DLC vulnerable to drivers falsely reporting shorted product.
- Based on our limited analysis, drivers frequently report trucks as inaccurately packed. (9/206 reported as accurately loaded during June 2014)
- Both overages and shortages are concerns.
- DLC has begun to aggregate and possibly evaluate the available data.
Executive Summary

This report responds to the Council's request for an examination of the alcoholic beverage distribution system in Montgomery County and the County's Department of Liquor Control (DLC). Montgomery County is the lone "control" jurisdiction in Maryland – DLC controls the wholesale distribution of all alcoholic beverage products (with limited exceptions) and the retail sale of all packaged liquor products in the County. In so doing, the County generates annual revenue that funds DLC operations, pays debt service, and provides transfers into the County's General Fund. All other Maryland counties are "license" jurisdictions – where private sector businesses receive licenses to sell alcoholic beverages at wholesale and retail.

Based on our review, OLO finds that changes and/or improvements to the current structure are warranted. This report provides a continuum of five options for changing Montgomery County's alcohol control structure, and offers revenue alternatives because changes to the structure could reduce annual revenue available to the County.

Maryland Legal Framework for Sale of Alcoholic Beverage

Maryland law regulates all facets of the manufacture and sale of alcoholic beverages (beer, wine, and liquor/spirits) in the State. As a result, most changes to Montgomery County's alcohol control system require changes to State law. Maryland's alcoholic beverage control framework stems from the end of Prohibition in 1933 and consists of a complex patchwork of different structures for each county, with hundreds of specific county-by-county provisions.

Maryland's alcohol distribution system has three levels: 1) manufacturers/producers, 2) wholesalers/distributors, and 3) retail sellers. The Comptroller of Maryland has primary responsibility for administering and enforcing State laws related to alcoholic beverages, and issues licenses for alcoholic beverage manufacturers and wholesalers. Montgomery County's Board of License Commissioners issues licenses for retail sellers of alcohol in the County (beer and wine stores, restaurants, bars, etc.).

Some key Statewide and Montgomery County-specific provisions from Maryland law include:

<table>
<thead>
<tr>
<th>Statewide Provisions in Maryland State Law</th>
</tr>
</thead>
<tbody>
<tr>
<td>• License Limits: Limit of one alcoholic beverage license per person, with some exceptions.</td>
</tr>
<tr>
<td>• &quot;Grocery Store&quot; Prohibition: Supermarkets, chain stores, discount houses, and large stores (10K+ sq. ft.) are prohibited from receiving licenses for the retail sale of alcohol.</td>
</tr>
<tr>
<td>• Uniform Pricing: Producers/wholesalers must sell products at the same price to similar purchasers. Volume discounts are allowed if offered uniformly to all purchasers.</td>
</tr>
<tr>
<td>• Sales and Excise Taxes: Only the State can tax the sale of alcoholic beverages.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>MoCo-Specific Provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Restaurant License Limits: A single individual in the County can hold up to 10 alcoholic beverage licenses for restaurants (i.e., Class B beer/wine/liquor on-sale licenses).</td>
</tr>
<tr>
<td>• Gas Station Prohibition: Gas stations in Montgomery County cannot receive alcoholic beverage licenses.</td>
</tr>
<tr>
<td>• Wholesale Distribution: Licensees in Montgomery County can purchase alcohol only from DLC, and cannot purchase alcohol from private wholesalers (except as noted below).</td>
</tr>
<tr>
<td>• Limited Self-Distribution: Small beer or wine producers can obtain a limited wholesalers' license from the State to sell and distribute their products directly to licensees in Montgomery County only.</td>
</tr>
</tbody>
</table>
Department of Liquor Control – Financial, Product, and Program Data

Each year, the County Government’s Liquor Enterprise Fund receives revenue from DLC’s wholesale and retail alcohol sales, license and permit fees, and fines and penalties; pays expenditures for DLC programs and services, inventory costs to purchase alcoholic beverages, and other non-program obligations; and makes transfers to the General Fund and for debt service payments. From FY12-FY14, the Liquor Fund averaged a net profit (before transfers) of $32.2 million. At the end of FY14, the Liquor Fund had a fund balance of $37.2 million, or 15.5%.

FY12-FY14 Liquor Fund Financial Summary ($ millions)

<table>
<thead>
<tr>
<th></th>
<th>FY12</th>
<th>FY13</th>
<th>FY14</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$252.3</td>
<td>$258.9</td>
<td>$268.7</td>
</tr>
<tr>
<td>Expenditures</td>
<td>$220.2</td>
<td>$225.8</td>
<td>$240.4</td>
</tr>
<tr>
<td>Transfers</td>
<td>$28.5</td>
<td>$25.7</td>
<td>$26.4</td>
</tr>
</tbody>
</table>

Number of Licenses

Of the 1,000+ alcoholic beverage licenses issued in the County, approximately 80% are for restaurants and similar businesses and 15% are for retail beer/wine stores as of Sept. 2014.

Number of Products Sold by DLC

All DLC beer, wine, and liquor items are categorized as stock or special order. Stock products are stored in the DLC warehouse and typically are on-hand when ordered. Special order products are purchased on request and are not stored at the warehouse. Of the 29,000+ products available for order, approximately 15% are stock products and 85% are special order.

Gross Profit on Alcohol Sales

DLC’s gross profit on alcohol sales is the total sales revenue minus the cost of goods sold, and excludes operating expenditures. While DLC tracks the total gross profit, OLO estimated the gross profit for wholesale and retail sales.

DLC Program Costs

Personnel costs account for approximately 60% of DLC’s annual program costs. Costs are divided into six program areas – Wholesale Operations; Delivery Operations; Retail Sales Operations; Administration; Licensure, Regulation and Education; and Office of the Director.

DLC Personnel

DLC’s approved personnel complement for FY15 includes 337 FTE and over 400 positions. Among filled positions, 205 (50%) work in DLC’s 25 retail stores; 108 (26%) work in delivery operations; and 57 (14%) work in warehouse operations.

Transfer to General Fund

Annual transfers to the General Fund are used to help pay for other County programs and services. Over the past five years, DLC’s transfer to the General Fund has averaged $25.7 million – however the FY14 transfer of $20.9 million is the smallest over that time period.

Liquor Control Revenue Bonds

The County issued Liquor Control revenue bonds in 2009, 2011, and 2013 to fund transportation and DLC facility projects. DLC must make annual debt service principal and interest payments from alcohol sales net profits prior to making General Fund transfers.
Review of Alcohol Control in Montgomery County

DLC Wholesale and Retail Sales – by Alcohol Type and Category

DLC’s wholesale operations sells beer and wine (for on- and off-premise consumption) and liquor (for on-premise consumption) to alcoholic beverage license holders for resale to individual consumers. Beer products lead DLC’s wholesale sales, both in terms of sales revenue and quantity sold. DLC’s retail operations sell liquor, wine, and a limited selection of beer directly to consumers at DLC’s 25 retail stores for off-premise consumption. Liquor products drive DLC retail sales revenue, while wine products lead retail sales by quantity. DLC’s special order sales are small by quantity sold but account for approximately one-fifth of both wholesale and retail sales revenue.

<table>
<thead>
<tr>
<th>Alcohol Type and Product Category</th>
<th>FY16 Wholesale</th>
<th>FY16 Retail</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sales Revenue</td>
<td>Cases Sold</td>
</tr>
<tr>
<td>Beer</td>
<td>$69.9 million</td>
<td>3.5 million</td>
</tr>
<tr>
<td></td>
<td>51%</td>
<td>82%</td>
</tr>
<tr>
<td>Wine</td>
<td>$50.7 million</td>
<td>618K</td>
</tr>
<tr>
<td></td>
<td>37%</td>
<td>15%</td>
</tr>
<tr>
<td>Beer Kegs</td>
<td>$9.0 million</td>
<td>90K*</td>
</tr>
<tr>
<td></td>
<td>7%</td>
<td>2%</td>
</tr>
<tr>
<td>Liquor</td>
<td>$6.3 million</td>
<td>40K</td>
</tr>
<tr>
<td></td>
<td>5%</td>
<td>1%</td>
</tr>
<tr>
<td>Stock Products</td>
<td>$107.8 million</td>
<td>3.9 million</td>
</tr>
<tr>
<td></td>
<td>79%</td>
<td>93%</td>
</tr>
<tr>
<td>Special Order Products</td>
<td>$28.2 million</td>
<td>300K</td>
</tr>
<tr>
<td></td>
<td>21%</td>
<td>7%</td>
</tr>
</tbody>
</table>

*Number of kegs sold

Feedback on the Department of Liquor Control

Through informational interviews and a formal survey of Montgomery County alcohol license holders, OLD received feedback on the Department of Liquor Control’s performance and operations as well as the overall structure of liquor control in Montgomery County. Key feedback themes include:

<table>
<thead>
<tr>
<th>Feedback Theme</th>
<th>Perception</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall DLC Operations</td>
<td>In general, licensees are dissatisfied with DLC’s operations, processes, and performance as the wholesaler of alcoholic beverages in Montgomery County.</td>
</tr>
<tr>
<td>Product Availability</td>
<td>Licensees’ are dissatisfied with the availability of products from DLC, particularly wine and special order products, and with the time it takes to receive special order products.</td>
</tr>
<tr>
<td>Wholesale Prices</td>
<td>In general, licensees think DLC’s wholesale prices for beer and liquor are reasonable but prices for wine, especially special order wine, are too high.</td>
</tr>
<tr>
<td>Changes to Structure of Alcohol Control</td>
<td>Many licensees support changing Montgomery County’s liquor control system to allow some or all private wholesale distribution of alcoholic beverages.</td>
</tr>
</tbody>
</table>

DLC Improvement Initiatives

DLC is implementing a new warehouse management system (as of February 1, 2015) that will substantially change processes for product ordering, inventory management, financial tracking, and data reporting. DLC believes this system will improve communications and the ordering process for licensees, particularly for special order products. DLC also recently developed a draft long-range strategic business plan that offers strategies and recommendation to improve DLC’s fleet management practices, retail store operations, and overall operational structure.
Review of Alcohol Control in Montgomery County

Options for Changes to Montgomery County’s Alcohol Control Structure

In December 2014, the Council created an Ad Hoc Committee on Liquor Control to “review alternative models and construct a recommendation that better aligns Montgomery County’s alcohol regulations and policies with our economic development, quality of life, and public safety goals.” Potential benefits to changing the structure of alcohol control in the County include enhancing economic development opportunities for local businesses. At the same time, changing the structure could reduce annual revenue available to the County and impact County jobs.

OLO developed a continuum of five options for changes to Montgomery County’s alcohol control structure for the Council’s review. Each option, described below, includes an estimate of the budgetary/fiscal impact and the estimated impact on County positions if DLC functions change. Most options would require State law changes.

### Option 1  Full Deregulation

- **Fully deregulate the alcohol control system in Montgomery County and allow private wholesale distribution and private retail sale of beer, wine, and liquor**
- **One-Time**:
  - +$66-$76
- **Ongoing Annual**:
  - ($32-$43)
- **Total**:
  - 393
  - **Full-Time**: 236
  - **Part-Time**: 157

### Option 2  Private Wholesale of Beer/Wine/Liquor

- **Allow private wholesale distribution of beer, wine, and liquor to alcoholic beverage licensees, while maintaining County control of the off-premises retail sale of liquor**
- **One-Time**:
  - +$29-$39
- **Ongoing Annual**:
  - ($18-$21)
- **Total**:
  - 165
  - **Full-Time**: 134
  - **Part-Time**: 31

### Option 3  Private Wholesale of Beer/Wine

- **Allow private wholesale distribution of beer and wine to alcoholic beverage licensees, while maintaining County control of the wholesale and off-premises retail sale of liquor**
- **One-Time**:
  - +$2-$3
- **Ongoing Annual**:
  - ($18-$23)
- **Total**:
  - 123
  - **Full-Time**: 99
  - **Part-Time**: 24

### Option 4  Private Wholesale of Special Order Beer/Wine

- **Allow private Wholesale distribution of special order beer and wine products, while maintaining County control of the wholesale and retail structures for all other alcohol products**
- **One-Time**:
  - +$0.17
- **Ongoing Annual**:
  - ($4-$6)
- **Total**:
  - 15
  - **Full-Time**: 11
  - **Part-Time**: 4

### Option 5  Increase Efficiency within Current Structure

- **Maintain the current structure of liquor control and enhance DLC’s effectiveness and efficiency by adopting recommendations made as part of DLC’s long-range strategic business plan**
- **None specified**

### Revenue Alternatives

Because Options 1-4 would reduce annual revenue generated by DLC by varying degrees, the table below identifies four alternatives to replace lost revenue if a structural change was made. Each would require State law changes.

<table>
<thead>
<tr>
<th>Revenue Alternative 1</th>
<th>Revenue Alternative 2</th>
<th>Revenue Alternative 3</th>
<th>Revenue Alternative 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Description</td>
<td>Enact a variable or flat fee wholesale distribution charge</td>
<td>Increase the licensing fee for private retail liquor sellers</td>
<td>Sell or auction the rights to operate liquor stores for a specified period</td>
</tr>
<tr>
<td>Estimated Annual Revenue</td>
<td>$7-$29 million</td>
<td>$229,000</td>
<td>$4.8-$5.3 million (per sale or auction period)</td>
</tr>
<tr>
<td>Applicable to Change Option(s)</td>
<td>1, 2, 3, 4</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>
Chapter 10. Options to Change Montgomery County's Alcohol Control Structure

Montgomery County is the only jurisdiction in Maryland that controls the wholesale distribution of all alcohol beverage products and retail sale of all liquor products. In so doing, the County generates annual revenue that funds the operations of the Department of Liquor Control, pays debt service on revenue bonds issued for facility and transportation capital projects, and provides an undesignated transfer into the General Fund.

Some believe that this structure, dating back to the end of prohibition, is outdated and inefficient, hurts the competitiveness of County restaurants and retail beverage establishments compared to neighboring jurisdictions, and inhibits potential economic development activity in the County. Others find that the government control of the alcoholic beverage system provides an important "check and balance" that benefits the entire community, and that the annual revenue generated is critical to help fund needed public services.

In December 2014, the Council formed an Ad Hoc Committee on Liquor Control to "review alternative models and construct a recommendation that better aligns Montgomery County's alcohol regulations and policies with our economic development, quality of life, and public safety goals." OLO recommends that the Ad Hoc Committee consider a continuum of five options to change Montgomery County's alcohol control structure. For each option, OLO describes required changes and outlines potential costs and benefits. Some of the costs and benefits are easily quantifiable, while others are more conceptual and difficult to measure. Of note, because the structure of alcohol control in Maryland is rooted in State law, the first four options would require State law changes and, as such, are not entirely within the County's direct sphere of authority.

As with other longstanding County issues, the form and structure of alcohol control in the County has been debated many times over the years. OLO believes that the continuum of options in this chapter, while certainly not the only possible options, provide the Council with the basis for a transparent and thorough review of potential changes to the structure of alcohol control.

Because changes to the structure of alcohol control could reduce annual revenue available to the County, this chapter also describes potential options to replace some or all of the revenue. The chapter is organized as follows:

- **Part A - Structural Change Options**, describes a continuum of five potential changes to the structure of alcohol control in the County and compares the potential costs and benefits of each in terms of budget and financial impact, impact on County employees, and discusses significant implementation issues or considerations.

- **Part B - Revenue Alternatives**, details four potential alternatives for replacing lost DLC revenue if structural changes are made to the alcohol system.

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1 December 2, 2014 memorandum to the County Council from Councilmember Reimer, Council President Leventhal, and Councilmember Elrich.
Part A – Options for Structural Change

Part A describes a continuum of five options for changes to the County alcohol control system. The options, ordered from largest to smallest structural change, are:

- **Option 1** Full deregulation of Montgomery County’s alcohol control system
- **Option 2** Private wholesale distribution of beer, wine, and liquor
- **Option 3** Private wholesale distribution of beer and wine
- **Option 4** Private wholesale distribution of special order beer and wine
- **Option 5** Increase efficiency within the current structure

Each option includes a section describing:

- **Changes to legal authority and DLC’s operations.** For each option, OLO includes a summary of how current operational authority would change and how DLC functions would change (i.e., which current functions would be eliminated, retained, or changed under each option).

- **Budgetary/fiscal impacts.** Options 1-4 all would impact annual County revenues and expenditures. Several options would result in the same types of impacts, but to differing degrees – such as loss of annual revenue, decreases in expenses from eliminating functions, etc. For each option, OLO estimates the potential fiscal impacts (one-time and ongoing) based on the most recently available data and describes assumptions underlying the estimates.

- **Impact on County jobs.** Changes to the structure of Montgomery County’s alcohol control system could have a substantial impact on County employees. For each option, OLO estimates the reduction in full-time, merit part-time (i.e., part-time positions eligible for benefits), and/or temporary part-time positions that could result. If the County pursues an option that reduces positions, some reductions could occur through natural attrition (retirements and other types of voluntary separations) while other employees could be placed in other County positions. However, many of DLC’s functions are not replicated in other County departments. At the same time, deregulating some or all of the alcohol control structure could increase the number of similar private sector jobs – as was Washington State’s experience when it deregulated its wholesale and retail monopoly of liquor in 2011. The pay and benefit structure of private companies, however, may differ from the County Government.

- **Implementation issues (if any).** A summary of additional issues or considerations, for example the impact an option may have on existing liquor revenue bonds.

In addition to the immediate impacts from each option referenced above, changes to the structure of the County’s alcohol control system could potentially create other indirect or long-term impacts on the County’s economy and/or on negative social costs associated with alcohol consumption. Because the specific impact of these changes and/or the degree to which they may occur are difficult to quantify, these impacts are described below but not repeated for each option.
Review of Alcohol Control in Montgomery County

Economic Development. Many stakeholders believe that removing or reducing government control of the County's alcohol system will have significant, positive impact on economic development in Montgomery County. Specifically, stakeholders assert that it would:

- Improve availability, selection, and pricing for alcohol products for both consumers and retailers;
- Enhance profitability and competitiveness of current restaurants and retail establishments in the County; and
- Enhance the desirability of Montgomery County as a location for new restaurant and retail establishments.

In turn, the County could achieve general economic benefits from a more profitable and vigorous food service and alcohol retail industry. While the exact nature and/or value of these benefits are impacted by multiple variables, benefits that could accrue include:

- Increasing private employment in the alcohol wholesale, retail sale, and/or restaurant sectors. Altering the structure for wholesale and/or retail sale of alcohol in Montgomery County could lead to increased employment from the establishment of new retail or dining locations, greater staffing needs for existing establishments, and/or a need for employees to cover a new Montgomery County wholesale distribution market.

- Recapturing alcohol sales and revenue currently lost to neighboring jurisdictions. Many stakeholders believe that county businesses lose sales revenue to stores and restaurants in neighboring jurisdictions (particularly Washington DC and Virginia) due to better availability, selection, and pricing of alcoholic beverages in those locations. Montgomery County's comparatively low per capita consumption rates compared to other Maryland counties may in part reflect lost sales.

- Enhance development of the County's "nighttime economy." A more vibrant food service industry could help the County's efforts to enhance its nighttime economy by providing new dining and entertainment options that encourage people to spend their time and money in Montgomery County instead of neighboring jurisdictions, and encourage millennials to live and work in the County.

Social Costs. Some stakeholders believe that deregulating County alcohol control at the wholesale and/or retail level can increase negative "social costs" associated with excessive alcohol consumption such as: underage and binge drinking; alcohol related deaths or accidents; and alcohol-related crime. The research and data on these issues, however, is mixed. Data in some studies show increases in these measure associated with varying degrees of regulation of alcohol control, while other studies indicate that status as a license or control jurisdiction is not a causal factor in these outcomes.

The experience in Washington State in its first year after changing from a control to license jurisdiction showed few indicators of increased negative public health or social impacts. However, the change in Washington State only impacted liquor – wine and beer were already distributed and sold entirely via the private sector. Despite the lack of clarity in the research, potential impacts on public health and safety should be considered with each option.
Option 1 FULL DEREGULATION

Fully deregulate the alcohol control system in Montgomery County and allow private wholesale distribution and private retail sale of beer, wine, and liquor

This option would deregulate the system of alcohol control in Montgomery County and make the County a full "license" jurisdiction like other Maryland counties. The wholesale and retail sale of alcoholic beverages would lie exclusively with private sector businesses. Implementing this model in Montgomery County would involve the following:

Changes to Legal Authority

- Removing the County's authority as the single wholesaler of alcoholic beverages, allowing private wholesale distribution of beer, wine, and liquor products.
- Removing the County's exclusive authority to sell liquor in its retail stores for off-premise consumption, allowing private retail licensees to sell all alcoholic beverage products (beer, wine, and liquor).

Changes in DLC Operations

- Eliminating the wholesale, retail, delivery, and associated functions of DLC.
- Retaining the functions performed by DLC's Licensure, Regulation, and Education Division and the Board of License Commissioners.

Implementation Issues

This option would require substantial legal changes at the State level. A change of this magnitude would also require detailed planning and a structured implementation, and would likely need a minimum transition period of three to five years. In Worcester County, the State initially established a five year transition period for eliminating the County's sole authority to wholesale wine and liquor, then subsequently reduced the period to three years.

Revenue Bonds. Montgomery County has issued revenue bonds that are backed by a pledge of annual revenue from the Liquor Fund. Options for deregulating the County's alcohol system would eliminate this source of revenue, in whole or part. Therefore, when considering any potential options for deregulation, the County must address the tax and legal requirements of the revenue bonds. The legal framework available for restructuring the bonds may also help shape how the various options could be implemented.

Representatives from the Department of Finance (Finance) note that the County's options regarding potential sale or disposition of the DLC warehouse are also subject to legal and tax considerations because the revenue bonds used to pay for the warehouse were issued as tax exempt debt—restricting the warehouse use to governmental purposes only (i.e., no "private use").
Review of Alcohol Control in Montgomery County

In exploring various sale or lease scenarios, Finance representatives note that the County will need to analyze the legal and tax options for removing private use restrictions based on the particular facts of each scenario; options involving redeploying the warehouse to another government use would generally not involve the same level of complexity.

Examples of options relating to the revenue bonds and warehouse provided by the Department of Finance include:

- Refund existing revenue bonds by issuing general obligation bonds payable from the County General Fund. This change would not remove restrictions on private use of the warehouse, but would remove the pledge of the revenues in the Liquor Fund.

- Sell the facilities (including the warehouse) financed with tax exempt debt to a private party and use the proceeds, as required under tax law, to purchase other similar tax exempt facilities for another County government use. This would leave the bonds outstanding with bond payments pledged from the Liquor Fund, requiring the flow of other revenue sources into the Liquor Fund to make the future debt payments. This option may require the County to make other pledges or guarantees for repayment of the bonds.

- Leave the bonds outstanding and enter into qualified management contracts with private parties to operate all or part of the County's alcohol system.

- Refund the outstanding bonds with taxable bonds (typically at higher interest rates) supported by the Liquor Fund, which would remove the restrictions on private use of the warehouse.

- Dedicate enough of the annual revenues of the Liquor Fund that normally would flow into the General Fund and place the funds in escrow to make future bond payments, thereby removing the pledge of revenues on the Liquor Fund and the private use restrictions on the warehouse.

As noted above, a variety of solutions are available to address the outstanding tax exempt revenue bonds and private use restrictions on the warehouse built with those bonds. The viability of any solution will depend on the specific facts of the options being considered, in consultation with the County's bond counsel.

**Budgetary/Fiscal Impacts**

Deregulating the County's alcohol control system would have a significant impact on the County budget – eliminating the majority of the Department of Liquor Control and ending the annual flow of DLC profits to the County's general fund and to pay for debt service. Under this option the Liquor Fund would no longer exist and remaining expenditures or revenue would accrue to the County's General Fund.

The data in the table on the next page estimate potential one-time profit of $66-$76 million and potential annual losses of $32-$43 million from this option. Information and assumptions used to estimate the fiscal impacts follow the table.
Option 1: Fully deregulate alcohol control system

<table>
<thead>
<tr>
<th></th>
<th>Estimated Fiscal Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>One-Time</td>
</tr>
<tr>
<td>Revenues</td>
<td></td>
</tr>
<tr>
<td>Loss of gross profit from DLC wholesale and retail sales</td>
<td>$(73-$76 million)</td>
</tr>
<tr>
<td>Maintain revenue from licenses, permits, fines, and penalties</td>
<td>+$2 million</td>
</tr>
<tr>
<td>Expenditures</td>
<td></td>
</tr>
<tr>
<td>Reduction in expenditures for eliminated DLC functions</td>
<td>+$43-$48 million</td>
</tr>
<tr>
<td>Maintain expenditures for remaining DLC functions</td>
<td>($1-$2 million)</td>
</tr>
<tr>
<td>Maintain debt service payments for Liquor Bonds</td>
<td>($8-$10 million)</td>
</tr>
<tr>
<td>Balance Transfer</td>
<td></td>
</tr>
<tr>
<td>Transfer of balance in Liquor Fund</td>
<td></td>
</tr>
<tr>
<td>Capital Assets</td>
<td></td>
</tr>
<tr>
<td>Sale of whole DLC vehicle fleet</td>
<td>+$26-$36 million</td>
</tr>
<tr>
<td>Sale of DLC warehouse/equipment</td>
<td></td>
</tr>
<tr>
<td>Lease of DLC warehouse/equipment</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>+$66-$76 million</td>
</tr>
</tbody>
</table>

Revenue impacts. Eliminating DLC’s wholesale and retail operations would eliminate the annual gross profit (sales revenue minus the cost of goods sold) from these functions. From FY12-14, DLC’s gross profit ranged from $72.9 million to $75.8 million. This option would not impact annual revenue from licenses, permits, fines, and penalties. These revenues totaled between $1.9 and $2.0 million from FY12-14.

Expenditure impacts. Annual expenditures for most DLC functions would be eliminated, and expenditures for remaining functions and debt service would need to be funded through the General Fund. Expenditures for DLC functions that would be eliminated – Warehouse, Delivery, Retail Sales, Administration, and Director’s Office Divisions – ranged from $42.9 million to $48.2 million from FY13-15. Expenditures for remaining functions of the Licensing, Regulation, and Enforcement Division totaled $1.3-$1.6 million from FY13-15.

The County Government uses a portion of the profits from alcohol sales in the Liquor Fund to pay debt service on the Liquor Control Revenue Bonds issued in 2009, 2011, and 2014. FY14 debt service payments totaled $7.9 million and the FY15 budget projects debt service costs of $10.1 million. Based on the most recent debt service repayment schedule for the liquor control revenue bonds, annual payments will remain at these levels until 2029.

Liquor Fund balance transfer. DLC maintains a fund balance in the Liquor Enterprise Fund of approximately 15% of annual operating expenditures – totaling $37.2 million at the end of FY14. Eliminating DLC’s revenue generating operations would make the Liquor Fund’s balance available for a one-time transfer into the General Fund.

Capital assets. DLC would no longer needs its fleet of 42 delivery vehicles or its liquor warehouse. The vehicle fleet – valued at $3.4 million in the FY14 CAFR – could be sold by the County, resulting in one-time revenue.
Review of Alcohol Control in Montgomery County

The County could transition the DLC warehouse to a different use or sell or lease it for private sector use, pursuant to the revenue bond tax and legal requirement noted in the implementation issues. Selling the warehouse would result in one-time revenue, while leasing the warehouse would result in ongoing revenue. The FY14 CAFR lists a value of $26.2 million for DLC “buildings” and $9.3 million for “furniture, fixtures, equipment, and machinery.”

Impact on County Positions

Fully deregulating the County alcohol control system would substantially impact DLC employees by eliminating the need for nearly all current DLC positions. Because the County would retain alcoholic beverage licensing, regulation, and enforcement functions, Option 1 would not eliminate the 11 full-time and eight temporary part-time positions in the LRE Division. The data in the table below show the potential full-time, merit part-time, and temporary part-time positions that could be eliminated under this option by affected DLC Division or Program (based on DLC’s filled positions as of November 2014).

<table>
<thead>
<tr>
<th>DLC Division/Program</th>
<th>Full-Time</th>
<th>Merit Part-Time</th>
<th>Temporary Part-Time</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail Operations</td>
<td>80</td>
<td>120</td>
<td>5</td>
<td>205</td>
</tr>
<tr>
<td>Delivery Operations</td>
<td>105</td>
<td>2</td>
<td>1</td>
<td>108</td>
</tr>
<tr>
<td>Warehouse Operations</td>
<td>29</td>
<td>16</td>
<td>12</td>
<td>57</td>
</tr>
<tr>
<td>Administration</td>
<td>20</td>
<td>1</td>
<td>–</td>
<td>21</td>
</tr>
<tr>
<td>Director’s Office</td>
<td>2</td>
<td>–</td>
<td>–</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>236</strong></td>
<td><strong>139</strong></td>
<td><strong>18</strong></td>
<td><strong>393</strong></td>
</tr>
</tbody>
</table>
Option 2  PRIVATE WHOLESALE DISTRIBUTION OF BEER, WINE AND LIQUOR

Allow private wholesale distribution of beer, wine, and liquor to alcoholic beverage licensees, while maintaining County control of the off-premises retail sale of liquor

Option 2 would allow private wholesalers to distribute beer, wine, and liquor in Montgomery County. DLC would retain its retail sales operations and control of all off-premises retail liquor sales. Implementing this model would involve the following:

**Changes to legal authority**

- Removing the County's authority as the single wholesaler of alcoholic beverages, and instead allowing private wholesale distribution of beer, wine, and liquor products.
- Retaining the County's exclusive authority to sell liquor in its retail stores for off-premise consumption.

**Changes in DLC operations**

- Eliminating DLC's wholesale, delivery, and associated functions.
- Retaining the County's retail sales operations to sell liquor, wine, and beer.
- Retaining the functions performed by DLC's Retail Operations Division; Licensure, Regulation, and Education Division; and the Board of License Commissioners.

**Implementation issues**

This option would require substantial legal changes at the State level. A change of this magnitude would also require detailed planning and a structured implementation, and would likely need a minimum transition period of three years. In Worcester County, the State initially established a five year transition period for eliminating the County's sole authority to wholesale wine and liquor, then subsequently reduced the period to three years.

**Revenue Bonds.** Montgomery County has issued revenue bonds that are backed by a pledge of annual revenue from the Liquor Fund. Options for deregulating the County's alcohol system would eliminate this source of revenue, in whole or part. Therefore, when considering any potential options for deregulation, the County must address the tax and legal requirements of the revenue bonds. See Option 1 for a further description.

**Budgetary/Fiscal Impacts**

This option would also have a significant impact on County revenues and expenditures, but to a lesser degree than Option 1. The data in the next table estimates potential one-time profit of $29-$39 million and potential annual losses of $18-$21 million. Information and assumptions used to estimate the fiscal impacts follow the table.
Option 2: Private wholesale distribution of beer, wine, and liquor products

<table>
<thead>
<tr>
<th>Estimated Fiscal Impact</th>
<th>One-Time</th>
<th>Ongoing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loss of gross profit from DLC wholesale sales</td>
<td>($33-$35 million)</td>
<td></td>
</tr>
<tr>
<td>Expenditures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reduction in expenditures for eliminated DLC functions</td>
<td>+$14-$15 million</td>
<td></td>
</tr>
<tr>
<td>Capital Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sale of whole DLC vehicle fleet</td>
<td>+$3 million</td>
<td></td>
</tr>
<tr>
<td>Sale of DLC warehouse/equipment</td>
<td>+$26-$36 million</td>
<td></td>
</tr>
<tr>
<td>Lease of DLC warehouse/equipment</td>
<td>value unknown</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>+$29-$39 million</td>
<td>($18-$21 million)</td>
</tr>
</tbody>
</table>

Revenue impacts. Eliminating DLC’s wholesale operations would eliminate the annual net revenue (sales revenue minus the cost of goods sold) from those functions. While DLC does not currently track profit by wholesale versus retail operations, OLO estimated the gross profit for wholesale sales between FY12-14 ranged from approximately $33.6 million to $35.2 million. Under this option, DLC’s annual net revenue from retail sales and from licenses, permit, fines, and penalties would not be impacted and would still accrue to the Liquor Fund. This revenue estimate assumes DLC revenues from retail operations remain the same, however this option could impact retail revenue if DLC costs for purchasing store inventory increase.

Expenditure impacts. This option would reduce current DLC personnel and operating expenditures for wholesale and delivery operations. Annual expenditures for these functions between FY13-15 ranged from $13.8 million to $14.9 million. Additionally, a portion of annual expenditures from the Office of the Director and Administration Division may no longer be needed under this option. Annual expenditures for DLC’s remaining functions and debt service would not be impacted and would still accrue to the Liquor Fund.

Capital assets. DLC would no longer needs its fleet of 42 delivery vehicles or its liquor warehouse. The vehicle fleet – valued at $3.4 million in the FY14 CAFR – could be sold by the County, resulting in one-time revenue. The County could transition the DLC warehouse to a different use or sell or lease it for private sector use, pursuant to the revenue bond tax and legal requirement noted in the implementation issues. Selling the warehouse would result in one-time revenue, while leasing the warehouse would result in ongoing revenue. The FY14 CAFR lists a value of $26.2 million for DLC “buildings” and $9.3 million for “furniture, fixtures, equipment, and machinery.”
Impact on County Positions

Deregulating the wholesale sale and distribution of beer, wine, and liquor would have a substantial impact on current County DLC employees, potentially eliminating 165 filled positions, or 40% of DLC’s current workforce. Specifically, positions associated with warehouse wholesale operations and delivery operations would no longer be needed. The data in the table below show the potential full-time, merit part-time, and temporary part-time positions that could be eliminated under this option by affected DLC Division or Program (based on DLC’s filled positions as of November 2014).

<table>
<thead>
<tr>
<th>DLC Division/Program</th>
<th>Full-Time</th>
<th>Merit Part-Time</th>
<th>Temporary Part-Time</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Delivery Operations</td>
<td>105</td>
<td>2</td>
<td>1</td>
<td>108</td>
</tr>
<tr>
<td>Warehouse Operations</td>
<td>29</td>
<td>16</td>
<td>12</td>
<td>57</td>
</tr>
<tr>
<td>Total</td>
<td>134</td>
<td>18</td>
<td>13</td>
<td>165</td>
</tr>
</tbody>
</table>

Additionally, other positions within the Administration Division that provide internal service functions may no longer be needed if DLC is not involved in wholesale distribution.
Option 3  PRIVATE WHOLESALE DISTRIBUTION OF BEER AND WINE

Allow private wholesale distribution of beer and wine to alcoholic beverage licensees, while maintaining County control of the wholesale and off-premises retail sale of liquor

This option would limit DLC's wholesale authority to liquor, allowing the private wholesale distribution of beer and wine in Montgomery County. DLC would retain control of all off-premises retail liquor sales, and retain its current retail store operations. Implementing this model would involve the following:

Changes to legal authority

- Removing the County's authority as the single wholesaler of beer and wine products—allowing private wholesale distribution.
- Retaining the County's authority as the sole wholesaler of liquor/distilled spirits products.
- Retaining the County's exclusive authority to sell liquor in its retail stores for off-premise consumption.

Changes in DLC operations

- Eliminating the wholesale, delivery, and associated functions of DLC for wine and beer products.
- Retaining the wholesale, delivery, and associated functions of DLC for liquor/distilled spirits.
- Retaining the County's retail sales operations to sell liquor, wine, and beer.
- Retaining the functions performed by DLC's Licensure, Regulation, and Education Division; and the Board of License Commissioners.

Implementation Issues

This option would require substantial legal changes at the State level. A change of this magnitude would also require detailed planning and a structured implementation, and would likely need a transition period. In Worcester County, the State initially established a five year transition period for eliminating the County's sole authority to wholesale wine and liquor, then subsequently reduced the period to three years.

Revenue Bonds: Montgomery County has issued revenue bonds that are backed by a pledge of annual revenue from the Liquor Fund. Options for deregulating the County's alcohol system would eliminate this source of revenue, in whole or part. Therefore, when considering any potential options for deregulation, the County must address the tax and legal requirements of the revenue bonds. See Option 1 for a further description.
Budgetary/Fiscal Impact

OLO estimates that Option 3 would produce one-time revenue of $2-$3 million, and potential annual losses of $18-$23 million from elimination of DLC’s beer and wine wholesale sales. Information and assumptions used to estimate the fiscal impacts follow the table.

<table>
<thead>
<tr>
<th>Revenues</th>
<th>Estimated Fiscal Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>One-Time</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Loss of gross profit from DLC beer and wine wholesale sales</td>
<td>($31-$33 million)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenditures</th>
<th>Estimated Fiscal Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduction in expenditures for beer and wine warehouse/delivery functions</td>
<td>+$10-$12 million</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital Assets</th>
<th>Estimated Fiscal Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale of a portion of DLC vehicle fleet</td>
<td>+$2-$3 million</td>
</tr>
<tr>
<td>Lease of DLC warehouse/equipment</td>
<td>value unknown</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total</th>
<th>Estimated Fiscal Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>+$2-$3 million</td>
<td>($18-$23 million)</td>
</tr>
</tbody>
</table>

Revenue impacts. Eliminating DLC’s beer and wine wholesale operations would eliminate the annual gross profit (sales revenue minus the cost of goods sold) from those functions. While DLC does not currently track profit by product type, OLO estimated that the gross profit margin on wholesale sales over the past three years ranged from 24.5% to 26.2%. Applying these ratios to DLC’s annual wholesale beer and wine sales data, OLO estimates that this option would reduce gross profit by a range of $31.4-$32.8 million annually. DLC’s annual gross profit from retail store sales and the wholesale of liquor products, and the revenue from licenses, permit, fines, and penalties would not be impacted and would still accrue to the Liquor Fund.

Expenditure impacts. This option would reduce DLC personnel and operating expenditures by an estimated $10-$12 million annually by eliminating beer warehouse and delivery operations and reducing liquor/wine warehouse and delivery operations. Total DLC beer warehouse and delivery expenditures ranged from $6-$8 million between FY13-15. Wine accounted for 70% of all liquor/wine cases processed through DLC’s warehouse and delivered to DLC retail stores or licensees in both FY13 and FY14. Based on total liquor/wine warehouse and delivery expenditures per case ($3.73 in FY13, $4.10 in FY14), OLO estimates that eliminating wine wholesale operations would reduce annual expenditure by $3.8-$4.2 million. Annual expenditures for DLC’s remaining functions and debt service would not be impacted and would still accrue to the Liquor Fund.

Capital assets. DLC would no longer needs its entire delivery fleet of 42 delivery vehicles and could achieve one-time revenue by selling a portion of the fleet. Because beer and wine products account for 99% of all cases delivered by DLC in FY14, OLO estimates DLC could reduce its fleet and potentially achieve approximately $2-3 million in one-time revenue. DLC would still use the warehouse to stock and distribute liquor products, but part of the warehouse could be transitioned to use for a different County function, or could be leased for private-sector use pursuant to the revenue bond tax and legal requirement noted in the implementation issues.
Impact on County Positions

If Montgomery County no longer provided wholesale sale and distribution of beer and wine products, an estimated 123 DLC positions (30% of its current workforce) would no longer be needed. OLO assumes that all beer warehouse and delivery positions would be eliminated and that 70% of liquor/wine warehouse and delivery positions could be eliminated (because wine accounts for 70% of all liquor/wine cases processed and delivered by DLC in FY14). The data in the table below show the potential full-time, merit part-time, and temporary part-time positions that could be eliminated under this option by affected DLC Program (based on filled positions as of November 2014).

<table>
<thead>
<tr>
<th>DLC Division/Program</th>
<th>Full-Time</th>
<th>Merit Part-Time</th>
<th>Temporary Part-Time</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beer Warehouse Operations</td>
<td>5</td>
<td>7</td>
<td>–</td>
<td>12</td>
</tr>
<tr>
<td>Beer Delivery Operations</td>
<td>53</td>
<td>2</td>
<td>–</td>
<td>55</td>
</tr>
<tr>
<td>Liquor/Wine Warehouse Operations</td>
<td>5</td>
<td>6</td>
<td>8</td>
<td>19</td>
</tr>
<tr>
<td>Liquor/Wine Delivery Operations</td>
<td>36</td>
<td>–</td>
<td>1</td>
<td>37</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>99</strong></td>
<td><strong>15</strong></td>
<td><strong>9</strong></td>
<td><strong>123</strong></td>
</tr>
</tbody>
</table>


### Option 4  PRIVATE WHOLESALE DISTRIBUTION OF SPECIAL ORDER BEER AND WINE

Allow private wholesale distribution of special order beer and wine products, while maintaining County control of the wholesale and retail structures for all other alcohol products.

This option would allow private wholesalers to distribute special order beer and wine products directly to licensees. DLC would remain the exclusive wholesaler of all liquor products and for stock beer and wine. This option addresses feedback from licensees that the beer and wine special order process is one of the most problematic areas of DLC’s operations. Implementing this model would involve the following:

**Changes to legal authority**

- Removing the County’s authority as the single wholesaler of certain beer and wine products, allowing private wholesale distribution of items designated as special order by the County.
- Retaining the County’s authority as the sole wholesaler of liquor/distilled spirits products.
- Retaining the County’s exclusive authority to sell liquor in its retail stores for off-premise consumption.

**Changes in DLC operations**

- Eliminating the wholesale, delivery, and associated functions of DLC for special order wine and beer products.
- Retaining the wholesale, delivery, and associated functions of DLC for stock beer and wine and all liquor/distilled spirits.
- Retaining the County’s retail sales operations to sell liquor, wine, and beer.
- Retaining the functions performed by DLC’s Licensure, Regulation, and Education Division and the Board of License Commissioners.

**Implementation Issues**

Allowing private wholesalers to sell special order items to licensees would necessitate a structured process for designating products as special order vs. stock in order to avoid conflict or confusion. This could involve allowing DLC to continue to decide which items are stock and which are special order, or it could be based on a different factor that would qualify a product as stock or special order (such as the volume of a product produced, or the volume of a product available for distribution in the County).
Review of Alcohol Control in Montgomery County

Budgetary/Fiscal Impact

OLO estimates that Option 4 would lead to annual losses of $4-6 million, and a minor amount of one-time revenue. Information and assumptions used to estimate the fiscal impacts follow the table.

<table>
<thead>
<tr>
<th>Option 4: Private wholesale distribution of special order beer and wine products</th>
<th>Estimated Fiscal Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>One-Time</td>
</tr>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
</tr>
<tr>
<td>Loss of gross profit from DLC special order beer and wine wholesale sales</td>
<td>$(5-$7 million)</td>
</tr>
<tr>
<td><strong>Expenditures</strong></td>
<td></td>
</tr>
<tr>
<td>Reduction in expenditures for beer warehouse/delivery functions</td>
<td>+$1 million</td>
</tr>
<tr>
<td><strong>Capital Assets</strong></td>
<td></td>
</tr>
<tr>
<td>Sale of a portion of DLC vehicle fleet</td>
<td>+$170,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>+$170,000</td>
</tr>
</tbody>
</table>

**Revenue impacts.** Eliminating DLC’s special order beer and wine wholesale operations would result in the loss of annual gross profit (sales revenue minus the cost of goods sold) from these products. While DLC does not currently track profit by product category, total special order beer and wine wholesale sales ranged from $24.6-$27.5 million from FY12-14. Based on OLO’s estimate of DLC gross profit margin for all wholesale sales over the past three years (ranging from 24.5% to 26.2%) and DLC’s wholesale markups for special order beer and wine, OLO estimates the reduction in gross profit from this option would be around $5-7 million annually. Revenue could be reduced further if licensees choose to substitute current purchases of stock items from DLC for special order items from private distributors. DLC’s annual gross profit from retail store sales and the wholesale of liquor, stock beer, and stock wine products; and the revenue from licenses, permit, fines, and penalties would not be impacted and would still accrue to the Liquor Fund.

**Expenditure impacts.** This option would reduce DLC personnel and operating expenditures related to special order beer and wine products by an estimated $1 million annually. DLC does not track expenditures directly associated with special order products, and does not assign staff specifically to special order versus stock products. Because special orders represent only 2% of beer cases/kegs processed through the DLC warehouse and delivered to licensees or DLC retail stores in FY14, OLO estimates that the expenditures for beer warehouse and delivery operations would be relatively unchanged – a reduction of approximately $100K. Wine special orders accounted for 19% of all liquor/wine cases processed through DLC’s warehouse and delivered to DLC retail stores or licensees in FY14. Based on total liquor/wine warehouse and delivery expenditures per case ($4.10 in FY14), OLO estimates that reducing wine wholesale operations would reduce annual expenditure by $1.1 million. Annual expenditures for DLC’s remaining functions and debt service would not be impacted and would still accrue to the Liquor Fund.

**Capital assets.** OLO estimates that under this option DLC could reduce its fleet by approximately 5% to reflect fewer deliveries. The extra vehicles could be sold, equating to approximately $170K in one-time revenue, or DLC could reduce future vehicle expenditures by this same amount by replacing fewer vehicles and maintaining a smaller fleet.
Impact on County Positions

If Montgomery County no longer provided the wholesale sale and distribution of special order beer and wine products, it would likely have a smaller impact on County jobs compared to the other options. Beer special orders only represent 2% of cases sold and delivered in FY14, so the staffing needs for the beer warehouse operations and beer delivery operations would likely be unchanged. Wine special orders represent 19% of all wine/liquor processes and delivered in FY14. If staffing needs were reduced by an equivalent 19% in liquor/wine warehouse and delivery operations, it could result in eliminating approximately 15 positions (4% of DLC's current workforce). The data in the table below show the potential full-time, merit part-time, and temporary part-time positions that could be eliminated under this option by affected DLC Division or Program (based on DLC's filled positions as of November 2014). It is also possible the DLC could reduce these positions over time through natural attrition.

<table>
<thead>
<tr>
<th>DLC Division/Program</th>
<th>Full-Time</th>
<th>Merit Part-Time</th>
<th>Temporary Part-Time</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquor/Wine Warehouse Operations</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Liquor/Wine Delivery Operations</td>
<td>10</td>
<td>-</td>
<td>-</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>11</strong></td>
<td><strong>2</strong></td>
<td><strong>2</strong></td>
<td><strong>15</strong></td>
</tr>
</tbody>
</table>
Option 5  INCREASE EFFICIENCY WITHIN CURRENT STRUCTURE

Maintain the current structure of liquor control and enhance DLC’s effectiveness and efficiency by adopting recommendations made as part of DLC’s long-range strategic business plan.

This option would maintain the current structure and legal authority for alcohol distribution and sale in Montgomery County, while working to enhance DLC’s effectiveness and ability to act as a “business” by adopting changes to its business practices. One measure already under way that may improve DLC’s effectiveness and efficiency is the Oracle inventory management and ordering system. Many potential changes were identified in DLC’s draft long-range strategic business plan that was released in July 2014, including:

<table>
<thead>
<tr>
<th>Recommendations in DLC's Draft Comprehensive Long-Range Strategic Business Plan, July 2014 (Prepared by the PFM Group)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fleet Recommendations</strong></td>
</tr>
<tr>
<td>• Revise delivery priority policies</td>
</tr>
<tr>
<td>• Review fleet configuration and size</td>
</tr>
<tr>
<td>• Develop a comprehensive plan for vehicle replacement</td>
</tr>
<tr>
<td>• Determine approach to fleet recapitalization</td>
</tr>
<tr>
<td>• Evaluate outsourcing the delivery function</td>
</tr>
<tr>
<td>• Consider “mini-warehouses” in regional superstore</td>
</tr>
<tr>
<td>• Consider delayed posting of licensee accounts to smooth deliveries</td>
</tr>
<tr>
<td><strong>Operations Recommendations</strong></td>
</tr>
<tr>
<td>• Seek opportunity to become an Authority</td>
</tr>
<tr>
<td>• Obtain dedicated, in-house resources for building supervision and management</td>
</tr>
<tr>
<td>• Perform a cost-benefit analysis on different methods of overnight loading</td>
</tr>
<tr>
<td><strong>Retail Recommendations</strong></td>
</tr>
<tr>
<td>• Adopt new store opening and store location criteria</td>
</tr>
<tr>
<td>• Create one or more regional superstore</td>
</tr>
<tr>
<td>• Close or relocate the Chevy Chase store</td>
</tr>
<tr>
<td>• Locate additional stores to split over-extended markets</td>
</tr>
<tr>
<td>• Develop a plan to open three to five additional store locations</td>
</tr>
<tr>
<td>• Expand the consistent use of the DLC brand</td>
</tr>
<tr>
<td>• Establish store look guidelines to be incorporated into store design and refurbishment</td>
</tr>
</tbody>
</table>

Additionally, based on feedback from licensees, OLO recommends that DLC work to enhance its customer service operations. Specifically, issues to consider include:

- With appropriate safeguards, allowing a 30 day grace- or float-period between ordering and payment as is done by some private wholesale distributors in other locations;
- Decreasing the timeframe between ordering and delivery for items that are in stock;
- Providing proactive and timelier communications on pricing changes, inventory changes, ordering changes, etc.
- Improving the timeliness for resolving problems or mistakes in orders or deliveries.
Implementation Issues

Many of the potential changes or efficiency improvements could be implemented by DLC directly, while others would require more work. For example, improving DLC's operational flexibility by reorganizing DLC as an independent revenue authority, similar to the Montgomery County Revenue Authority that operates golf courses and the County's airpark, would require legislative changes at the State and/or County level.

Budgetary/Fiscal Impact

The specific impact would vary for each potential change. Some recommended changes related to DLC's retail operations and customer service operations would likely require additional expenditures, at least initially. The PFM report notes the potential for long-term savings from different models for fleet management compared to the current practices.

Personnel Impact

Unlike Options 1-4, this Option would not eliminate any of DLC's current function and therefore would not directly impact existing jobs. One of the fleet recommendations from the strategic plan is to evaluate outsourcing of DLC's delivery function. This recommendation, if pursued, would have a substantial impact on current DLC positions.
Because profits from the County's sale of alcoholic beverages fund all DLC operations, pay debt service costs, and contribute to the General Fund each year, the second part of this chapter reviews potential options to replace some or all of that revenue if structural changes are made to the County's alcohol control system. As with the options for structural change, the potential revenue alternatives would also require changes to State law.

Other states that have transitioned away from government control of alcohol sales have sought to replace lost revenue with new or additional taxes and/or new or additional fees for licensing or distribution rights. In Maryland, the State collects excise and sales tax revenue from the sale of alcoholic beverages – counties and municipalities are not allowed to tax the sale of alcoholic beverages.

### Revenue Alternative 1

#### Wholesale Distribution Charge

The County could enact a wholesale distribution charge that would require private distributors to pay a fee to distribute alcoholic beverage products in the County. The County could set the fee as a flat annual charge or as a variable charge based on the quantity of products distributed to County licensees during the year.

To estimate possible revenue from a variable fee, the data in the table projects revenue based on three different fee levels assessed per ounce of alcohol delivered in the County. State data show that 13.2 million gallons (1.7 billion ounces) of alcohol were delivered to the County in FY14. The data show that a fee of one cent per ounce would yield $16.8 million in revenue and a fee of one and a half cents per ounce would yield $25.3 million, based on FY14 delivery data.

<table>
<thead>
<tr>
<th>FY14 Volume Delivered in Montgomery County</th>
<th>Fee Rate per Ounce</th>
<th>Estimated Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.7 billion ounces</td>
<td>$0.01</td>
<td>$16.8 million</td>
</tr>
<tr>
<td></td>
<td>$0.0125</td>
<td>$21.1 million</td>
</tr>
<tr>
<td></td>
<td>$0.015</td>
<td>$25.3 million</td>
</tr>
</tbody>
</table>

Instituting a wholesale fee on private distributors in Montgomery County that differs from fees in other Maryland counties may provide an incentive for distributors to raise the wholesale price of products for Montgomery County businesses. State law, however, requires distributors to charge all customers the same price for products, which would prevent distributors from increasing prices only in Montgomery County.
The County Government could also establish a flat fee structure with a fixed fee per product offered for sale in the County. In FY14, DLC had over 29,000 products available for sale. However, many of the products are the same item (e.g., the same brand and type of beer) sold in different sized containers. Without knowing the exact number of different products for sale, the table below exemplifies the amount of revenue that could be generated from a flat fee of $1,000 per product offered based on 25% increments of the 29,000 products.

<table>
<thead>
<tr>
<th>Flat fee per Product</th>
<th>Products Offered for Sale</th>
<th>Estimated Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,000</td>
<td>7,250</td>
<td>$7.3 million</td>
</tr>
<tr>
<td></td>
<td>14,500</td>
<td>$14.5 million</td>
</tr>
<tr>
<td></td>
<td>21,750</td>
<td>$21.8 million</td>
</tr>
<tr>
<td></td>
<td>29,000</td>
<td>$29.0 million</td>
</tr>
</tbody>
</table>

The County could establish a new license that would give new or existing off-premises beer and wine stores the ability to sell liquor (distilled spirits) and charge an accompanying licensing fee. If the County instituted an additional liquor licensing fee for Class A, B and D licenses and quadrupled the cost of the current license fees for those classes, OLO estimates that the County could raise approximately $229,000 in revenue annually if all current eligible license holders applied for a liquor license. The next table summarize these data.

<table>
<thead>
<tr>
<th>License Class</th>
<th>Estimated # of Existing Businesses</th>
<th>Current License Fee</th>
<th>Additional Liquor Licensing Fee</th>
<th>Estimated Additional Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Class A</td>
<td>155</td>
<td>$250</td>
<td>$1,000</td>
<td>$155,000</td>
</tr>
<tr>
<td>Class B</td>
<td>1</td>
<td>$2,500</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Class D</td>
<td>40</td>
<td>$400</td>
<td>$1,600</td>
<td>$64,000</td>
</tr>
<tr>
<td>Total</td>
<td>196</td>
<td></td>
<td></td>
<td>$229,000</td>
</tr>
</tbody>
</table>
Review of Alcohol Control in Montgomery County

Revenue Alternative 3
Sell/Auction Rights to Operate County Retail Stores

The County could sell via a fixed price or auction off the right to operate the County's 25 retail stores. The right to operate these stores could be an attractive investment for entrepreneurs if these stores retain the exclusive right to sell liquor in the County. When Washington State deregulated liquor sales in 2011, it auctioned off the right to take over and operate 167 state-run liquor stores. Similarly, the State of West Virginia auctions off every 10 years the right to privately operate liquor stores – the most recent auction happening in 2010.

In Washington State, other retail stores also received licenses to sell liquor (for a total of approximately 1,406 retail liquor stores in the state in Nov. 2014) whereas in West Virginia, the 178 licenses auctioned off in 2010 are the only liquor stores in the state. If Montgomery County opened up the right to sell liquor to existing beer and wine stores, in addition to the 25 County-operated stores, the value of the County-operated stores would decrease. Washington State received $31.9 million in one-time revenue from the auction of its state-owned stores. In its most recent auction, the State of West Virginia received $38.0 million in revenue. The next table summarizes these data.

<table>
<thead>
<tr>
<th>State Auction</th>
<th># of Retail Stores</th>
<th>Total Auction Revenue</th>
<th>Average Auction Revenue per Store</th>
</tr>
</thead>
<tbody>
<tr>
<td>Washington</td>
<td>167</td>
<td>$31.9 million</td>
<td>$191,018</td>
</tr>
<tr>
<td>West Virginia</td>
<td>1990 not available</td>
<td>$15.3 million</td>
<td>n/a</td>
</tr>
<tr>
<td></td>
<td>2000 168</td>
<td>$22.4 million</td>
<td>$133,308</td>
</tr>
<tr>
<td></td>
<td>2010 178</td>
<td>$38.0 million</td>
<td>$213,660</td>
</tr>
</tbody>
</table>

Source: Washington State Liquor Control Board Annual Report FY12; West Virginia Alcohol Beverage Control Administration Annual Report FY12

If Montgomery County auctioned off licenses to privately operate its 25 liquor stores with auction proceeds approximating those in Washington State or West Virginia, the County could expect to generate approximately $4.8 million to $5.3 million. Granting a liquor license for a limited period of time, like West Virginia, would provide ongoing, as opposed to one-time, revenue.

<table>
<thead>
<tr>
<th># of DLC Stores</th>
<th>Estimate of Revenue Per License</th>
<th>Estimated Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>25</td>
<td>$191,018</td>
<td>$4.8 million</td>
</tr>
<tr>
<td></td>
<td>$213,660</td>
<td>$5.3 million</td>
</tr>
</tbody>
</table>

Estimate of Revenue from Sale/Auction of Liquor Store Operating Rights
Montgomery County could ask the State to authorize a local sales tax on alcoholic beverages with the tax revenue going to the County. Currently, individuals pay a 9% state sales tax on the purchase of alcoholic beverages at the point-of-sale. A County "piggyback" alcohol sales tax would be in addition to the current 9% tax. To illustrate the revenue that could be collected under this option, OLO estimated sales tax revenue generated from DLC FY14 wholesale and retail sales.

In FY14, DLC generated sales revenue of $266.7 million – $137.8 million from wholesale sales and $128.9 million from retail stores. DLC retail stores would have collected $11.6 million in sales tax (at 9%) from the $127.4 million in sales. Using the $128.9 million in wholesale sales as a proxy for sales generated by Montgomery County licensees, licensees would have collected an additional $12.4 million in sales tax on $139.3 million.

The data in the table below estimate that each addition 1% of sales tax would generate approximately $2.7 million in sales tax revenue. Note that these calculations do not assume any retail price markup by licensees on the wholesale sale. The revenue estimate, therefore, is low.

<table>
<thead>
<tr>
<th>FY14 DLC Sales Revenue</th>
<th>Sales Tax Rate</th>
<th>Total Tax Revenue</th>
<th>Additional Revenue to County</th>
</tr>
</thead>
<tbody>
<tr>
<td>$266.7 million</td>
<td>9%</td>
<td>$24.0 million</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>10% (9% MD, 1% County)</td>
<td>$26.7 million</td>
<td>$2.7 million</td>
</tr>
<tr>
<td></td>
<td>12% (9% MD, 3% County)</td>
<td>$32.0 million</td>
<td>$8.0 million</td>
</tr>
<tr>
<td></td>
<td>14% (9% MD, 5% County)</td>
<td>$37.3 million</td>
<td>$13.3 million</td>
</tr>
</tbody>
</table>
TO: Chris Cihlar, Director, Office of Legislative Oversight  
FROM: Timothy L. Firestine, Chief Administrative Officer  
SUBJECT: OLO Draft Report 2015-6: Review of Alcohol Control in Montgomery County

Thank you for providing a copy of the Office of Legislative Oversight’s (OLO’s) Draft Report 2015-6, Review of Alcohol Control in Montgomery County. The report recommends options to privatize the sale of alcohol in Montgomery County. However, in our opinion, local liquor control has served Montgomery County well. The Department of Liquor Control (DLC) contributes an average of $30 million in annual profit to the County – helping us to fund schools, transportation, help for the vulnerable in our midst, and more. It helps to keep taxes lower. We have lower alcohol consumption and higher revenue for public purposes than other jurisdictions. There are not liquor stores on every corner. Our system makes it harder for underage individuals to purchase alcohol and provides more education for the public and for servers as well. It protects the public health. DLC continues to work hard to improve its operations and to provide better service and better products. There are a number of other efficiencies that we will be capturing through the implementation of the ERP system that will improve service at both the retail and wholesale levels.

We agree with the report’s recommended Option #5, “Increase efficiency within current structure,” which is consistent with the recommendations found in The PFM Group’s Strategic Plan Report, the County "Nighttime Economy Task Force Report," and the County Council’s own Organizational Reform Commission. Additionally, one option that is unstated in the OLO report – but worth exploring – is the possibility of leasing rather than buying DLC delivery trucks and, indeed, contracting out DLC’s delivery operation to the private sector. However, we have concerns with some of the information and methodology in the draft report.

1. The report does not acknowledge that the overwhelming body of evidence supports the positive public health and safety benefits of public control of alcohol. The widely-accepted public health and safety advantages of local Liquor Control are supported by the extensive public health body of evidence consistently developed over a long period of time. This body of evidence is primarily scientifically-based, peer-reviewed, published studies.
from a wide variety of sources, presented in respected journals and venues, which have become accepted and established sources of public policy information.

While the OLO does cite in Chapter 3 of the report (beginning on page 10) a few recognized reports and studies on the subject, it also cites studies commissioned by the Commonwealth Foundation of Pennsylvania disputing the overwhelming body of evidence. The Commonwealth Foundation is a conservative, free-market political advocacy group. It is not primarily an alcohol research group, and has generated no known studies of the subject on its own.

While the Commonwealth Foundation certainly represents one point of view on the deregulation debate, it hardly provides an equal counter weight to the established science. It seems that giving undue influence to the non-science based minority viewpoint also leads to the report’s “Finding #3,” found on page 73, which we believe to be misleading.

2. **The report contains inaccurate information on DLC pricing.** On page 20 of the report, a clarification regarding DLC pricing is needed. DLC pricing does not incorporate any sales tax in the price of products. Excise taxes are included in the wholesale price of products in Montgomery County, just as they are with every other wholesale distributor. Also, page 58 states “DLC does not offer volume discounts to licensees.” In fact, DLC routinely does offer these discounts to all licensees.

3. **The survey results described in Chapter 6 of the report, beginning on page 42, are questionable.** The feedback for this report is based upon interviews and survey responses with a selected group of Montgomery County licensees. However, only 12 licensees were interviewed. Well less than half of the nearly 1,000 licensees were sent the survey, and only 96 out of the nearly 1,000 responded. Indeed, page 42 states that even “…OLO does not consider the response rate to be high enough to draw statistically valid conclusions.” The information presented in this section is, therefore, strictly anecdotal. The identity and location of each Montgomery County licensee is known. More representative feedback from the business community could have been captured and presented for this report.

4. **The report does not include the discussion, debate, and recent decisions by our neighboring states of Pennsylvania and Virginia to reject privatization.**

5. **The pricing comparison section of the report, beginning on page 55, does not compare wholesale prices under the current system or potential future systems on an “apples to apples” basis, despite readily available access to such information.** The wholesale price of each product sold to licensees by DLC is documented and published. Each Montgomery County licensee pays the exact same price for each identical item sold at wholesale. Each of
those products is also currently represented and distributed by a licensed Maryland wholesaler. Those prices are also readily available from each wholesaler. Therefore, the comparison data that would be most useful for this report (and the anticipated discussion it will generate), would be a detailed side-by-side display of wholesale prices from DLC and the private Maryland wholesalers for the same items. Such a comparison would show where comparable prices are lower, higher, or about the same.

Instead, OLO researched the retail prices of similar products offered by licensed establishments in various jurisdictions. Listed menu or retail shelf prices for similar products introduces a wide array of potential additional variables that are not the subject of this report (rents, taxes, non-product overhead costs, market forces, business models, etc.). The retail prices charged to the consumer by licensees does not directly reflect the wholesale cost of products. Indeed, five Montgomery County businesses could very likely charge five different prices on the same day for the exact same item, yet we know each of those businesses paid the exact same price at wholesale for those identical items.

6. The report contains invalid assumptions about County per capita alcohol consumption. On page 61, the report cites higher per capita consumption in Howard, Frederick, and Prince George Counties as evidence that County businesses lose alcohol beverage sales to stores in neighboring jurisdictions. Yet there is no evidence presented by OLO to support this assumption. Possible demographic and venue location differences with these jurisdictions are not addressed. Fairfax County per capita consumption of distilled liquor is even lower than that of Montgomery County.

7. To operate outside of the current DLC structure and authority could have the immediate as well as long-term effect of raising product cost. The first four options that OLO advances to “make up” for the $30 million in revenue lost for the County, in part or whole, involve increasing fees and costs to County licensees and/or imposing (requiring State approval) a County liquor “piggyback” tax. Though all would raise product costs in the County, no mention is made that this might reduce the competitiveness of Montgomery County in comparison to other jurisdictions.

8. The potential impact of each of the five options presented at the end of the report will have to be explored and developed in detail. Legal, legislative, regulated trade practice provisions, operational, and logistical elements will all have to be researched in detail to provide a realistic forecast of any structural business changes. Of critical importance is ensuring that any analysis of Options 1 through 4, which involve privatization in whole or part, involves a thorough and complete analysis of the complex legal and tax considerations involving the outstanding revenue bonds, and the private use restriction on the warehouse built with the bonds. That analysis should integrally involve the County’s bond counsel, to ensure the specific provisions of this revenue bond structure are considered. There is also
approximately $1.6 million of short-term debt outstanding that was used to pay for certain DLC equipment and systems. The legal and tax implications of that debt would need to be considered under Options 1 through 4 which involve the sale of all or part of the fleet.

Particularly in need of expert analysis are the “Estimated Fiscal Impact” sections associated with the various option scenarios. The potential financial benefit to be captured by the sale of the existing delivery fleet, for instance, appears to be questionable. The report cites the value of the fleet from the County’s annual financial statements; however, those reported values are depreciated values required for financial reporting, and may bear no reasonable relationship to the estimated market value of the fleet that could be generated upon sale. As noted above, the report also does not reference the fact that equipment notes are outstanding, which may affect the fiscal impact cited. Also, under Option 1, all administrative costs are assumed to be eliminated; however the report does not address whether the administrative support functions currently provided to the Licensing, Regulation, and Enforcement Division would be absorbed at no cost by another County department, or if additional support costs could be required. We believe that input or analysis from private sector experts would be valuable to this discussion.

The Maryland wholesalers, who would automatically assume operational control of the Montgomery County market under several of the proposed options, are currently operating in other parts of the State under existing state law, and are regulated by the Office of the Comptroller of Maryland. Their wholesale prices are published, and their sales and delivery practices are well-known and experienced by Maryland licensees every day. Similarly, the role and business practices of product suppliers are well established in the Maryland marketplace. These private sector entities and other interested parties could have been included in the development of this OLO study, and should be invited to provide input to the County Council Ad Hoc Committee.

We stand ready to assist OLO and the Council’s Ad Hoc Committee on Liquor and look forward to providing more detailed information and analysis as needed. Thank you for the opportunity to review the draft report and present our comments.

TLF:gg

cc: Joseph Beach, Director, Department of Finance
    George Griffin, Director, Department of Liquor Control
    Jennifer Hughes, Director, Office of Management and Budget
    Fariba Kassiri, Assistant Chief Administrative Officer
    Patrick Lacefield, Public Information Officer
February 13, 2015

Dear Mr. Firestine,

As you know, I am chairing the Council’s newly created Ad Hoc Committee on Liquor Control. Our charge is to review the Office of Legislative Oversight’s (OLO) report on Liquor Control and the performance of the County’s Department of Liquor Control (DLC) and craft a package of recommended changes. Of course, almost any potential change will ultimately require state legislation, executive action, or both.

I requested the OLO report and the formation of the Ad Hoc Committee because, whether due to management or structural failures, our current system is not working for Montgomery County. We are the last county in Maryland that maintains a complete government monopoly on wholesale alcohol sales, along with a monopoly on the retail sale of spirits. When this system was created in Maryland state law, following the repeal of prohibition in 1933, Montgomery County had a population of 50,000 people, was largely agricultural, and there were only 331 breweries and fewer than 100 wineries in the entire United States. The stated purpose of the law was to “promote temperance.”

It was easy for a single entity to handle all alcohol sales in 1933. Today, our County has evolved from a quiet bedroom community to a vibrant job center in its own right. Public safety and public health remain the primary driver of alcohol regulation, but we need a policy that also allows a robust restaurant and entertainment sector if we want to achieve our economic development and quality of life goals. Even if DLC had sound management or became an independent authority, can any single, centralized wholesale distribution system adequately serve a diverse population of over one million County residents in a market that is exploding with variety and choice? Will restaurants and entertainment venues locate here if they aren’t sure whether they can get the products consumers want? And how will we be able to attract and keep the workforce, companies, and residents that power our economy if we can’t compete with the rapidly improving quality of life across the Potomac and across the District line?
I am confident that, by conducting a thorough review of all options, we can strike the right balance of public safety, public health, economic development, quality of life, revenue, good jobs, and fair treatment for public employees. I am writing this letter to initiate a dialogue about how we can move forward on any ideas to improve alcohol regulation in this County. The administration has brought forward some options beyond those in the OLO report, but we need a far more detailed understanding of what would be involved in their implementation. To aid in our review, I respectfully request that the appropriate executive branch staff provide the following information:

1. In your February 4, 2015 response to the OLO report you state that “we agree with the report’s recommended Option #5, ‘Increase efficiency within current structure.’” Could you provide a list of specific actions that the administration is prepared to implement, along with any estimated fiscal and economic impacts and impacts on County employees?

2. Does the administration agree with and plan to implement the recommendations in the PFM Strategic Business Plan? If there are recommendations in the PFM Plan you do not plan to pursue, please explain why.

3. In your February 4 response, you specifically mention the possibility of contracting out DLC’s delivery operation to the private sector. Please provide the committee with the costs and benefits of this approach, an estimate of any fiscal and economic impacts, and potential impacts on County employees.

4. The PFM report recommends that DLC seek authorization to become a public benefit corporation or authority. Does the administration plan to pursue this recommendation? If so, please provide more detail about what this would entail. Would the County still have control over DLC’s contribution to the General Fund and other aspects of DLC’s budget? Would the regulatory and enforcement functions be in the new authority or be transferred to a different department? What relationship would the Authority have with the Board of License Commissioners? What impact would this have on the current DLC employees? Would duplicating HR, legal, procurement, and other functions inside the new authority lower DLC’s annual contribution?

5. The PFM Plan recommends “there is substantial room for the DLC to open additional stores.” Do you believe there is a need for additional County retail stores? If so, how many additional stores would you propose, approximately how much additional revenue would you expect to generate, and approximately how many new employees would be required?

6. The PFM Report, based on a study of Bureau of Labor Statistics data on consumption habits correlated with income levels, educational attainment and “folkways,” concluded that “[g]iven Montgomery County’s high income and educational achievement, 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.” (Page 12 of PFM Report). Yet according to the OLO Report, Montgomery County’s per capita alcohol consumption is 30% less than the average of neighboring Prince George’s, Howard, and Frederick Counties. What do you think accounts for this large difference? You indicate that this analysis does not account for “possible demographic and venue location differences.” Are you referring to the presence of FedEx Field and the University of Maryland in Prince George’s
County? If so, what do you think accounts for the large gap between Montgomery consumption and that in Frederick and Howard Counties?

7. In item #1 of your February 4 response you point to “[t]he widely-accepted public health and safety advantages of local Liquor Control.” In the studies you reference, can you identify a difference between the many “control” jurisdictions, like Virginia, which control only the retail sale of spirits and much rarer control jurisdictions like Montgomery County, which also control wholesale sales of all spirits, beer, and wine? Are there any scientifically-based, peer-reviewed, published studies which demonstrate a public safety benefit from government control of wholesale distribution of alcohol?

8. Does DLC in any way limit the amount of alcohol which is consumed in Montgomery County through its wholesale operation?

9. In items 2 and 5 you criticize OLO’s analysis of DLC and private sector pricing and suggest an alternative analysis. I would appreciate if the administration would provide us with a fuller comparison of prices from DLC and from private Maryland distributors, for both common and less common, special order brands.

10. In item number 8 you indicate that “input or analysis from private sector experts would be valuable.” I am of course very interested in getting as much timely analysis as possible -- could you provide specific recommendations of individuals or organizations we should contact?

11. You question the value OLO ascribes to the existing delivery fleet. Could you provide an estimate of the market value of the fleet we could reasonably expect upon sale?

12. I am eager to engage Maryland distributors and other private sector entities in the Committee’s work, along with licensees, public health and safety officials, employee representatives, and the general public. Any assistance you could provide in making contact with these entities would be greatly appreciated.

13. Your response does not address the section of the OLO report that discusses options for raising revenue in a fully or partially privatized market. Do you agree with OLO’s analysis that a permit fee of $0.0125 per ounce of alcohol sold in Montgomery County would have raised $21.1 million based on FY14’s sales?

The Committee’s first meeting will be on February 27, when we will receive an overview of OLO’s report. A reply to this letter before that date would be very helpful to the work of the Committee. If any information is not available by that time, I would appreciate an estimate of when we can expect those responses.
Sincerely,

[Signature]

Hans Riemer
Chair, Ad Hoc Committee on Liquor Control

CC:
Council President George Leventhal
Councilmember Marc Elrich
Justina Ferber, Council Staff
Chris Cihlar, Craig Howard and Leslie Rubin, Office of Legislative Oversight
George Griffin, Director, Department of Liquor Control
Joseph Beach, Director, Department of Finance
Jennifer Hughes, Director, Office of Management and Budget
Fariba Kassiri, Assistant Chief Administrative Officer
Patrick Lacefield, Public Information Officer
VI. Strategies and Recommendations
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.
Strategies and Recommendations

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.
Strategies and Recommendations

In particular, there is a strong case that can be made for non-County ownership of the fleet. This is not an isolated case that only makes sense in relationship to DLC's specific set of circumstances: in a variety of similar situations, the public sector is opting out of ownership and instead leasing or paying for service on a unit cost basis. There are a variety of examples from the IT world – many government IT systems are now hosted by private vendors. This can solve for some of the concerns that are raised with operations in the current system (see the discussion on pages 37-46). As noted there, the current system has not replaced fleet vehicles on a regular basis and has most of its vehicles at or beyond their useful life.

By contrast, a leased fleet places responsibility for replacement and maintenance on the private vendor, which ensures that these costs are spread over the lifetime of the contract. This removes the 'lumpy' nature of the high costs of vehicle replacement and provides a cost structure that can be planned for over a multi-year period.

While it is true that the cost charged to DLC by a private vendor will include a necessary mark-up for their own profitability, private vendors also have some competitive advantages over County procurement and provision of service that can balance out this factor. For one, private vendors have greater purchasing power and can most likely get better pricing for vehicles (and better re-sale value on replacement). This same pricing advantage can carry over to other services that may be included in the cost of a lease. Second, private vendors may have lower overhead costs related to employees and employee benefits. Finally, private vendors provide the DLC the ability to 'shop around' for the services and the cost structure that best meets its needs. This autonomy is in line with other recommendations contained within the strategic business plan.

As noted above, this is an approach that is becoming more prevalent in the public sector. It is also an approach that is frequently used in the liquor distribution world. Several state liquor control operations either lease their fleet or have adopted other private vendor approaches. Many private wholesalers do the same. In short, this is an option that is already in place and understood by the market.

The strategy does require planning and execution. Any decision to go forward with a lease option should be competitively bid and the resulting proposals subjected to a rigorous cost benefit analysis. In particular, any agreement should include a well-developed set of performance metrics with financial penalties for failure to adhere to these standards and/or requirements. While it is impossible to make a projection of the outcome of an RFI or RFP, it is our professional opinion that a well-crafted process have great potential to increase effectiveness and customer satisfaction at a reasonable cost.

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32 Many systems, such as email systems, are now hosted "in the cloud" by major vendors, including Microsoft and Google. For a discussion of the advantages and challenges of that approach in the public sector, see Rob Roque, 'Grabbing the Silver Lining: Purchasing Cloud-Based Solutions in the Public Sector,' Government Finance Review, December 2013, accessed electronically at http://www.gfoa.org/sites/default/files/GFR_DEC_13_12.pdf.
Strategies and Recommendations

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. 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. 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. 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

33 New Hampshire's response to a survey question on a survey conducted April 22 - May 9 indicates they are in the process of creating a performance compensation plan for employees.

34 Wilhelm, Lindsey and Danielle L Leonidas "Montgomery County, Maryland; Miscellaneous Tax" Standard & Poor's Rating Services July 19, 2013.

35 Ibid.
Strategies and Recommendations

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 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
Strategies and Recommendations

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 preorder 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 GMROI 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
Strategies and Recommendations

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.
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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.
Strategies and Recommendations

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.