



CITY COUNCIL STAFF REPORT

TO: Honorable Mayor and City Council **DATE:** October 25, 2021
FROM: Matthew Bronson, City Manager
PREPARED BY: Matthew Bronson, City Manager
Deanne Purcell, Administrative Services Director
SUBJECT: Commercial Cannabis Tax Rates Policy Direction

RECOMMENDATION

Receive information about commercial cannabis tax rates and provide direction on potential changes to rates.

BACKGROUND

On May 10, 2021, staff presented an update to the Council on the City's efforts since 2016 to establish the commercial cannabis industry in a safe and responsible way and identify policy issues for Council input and direction. The industry is now firmly established in Grover Beach with 12 businesses currently operating which collectively generated \$2.4 million in FY 2020-21 in cannabis tax revenue and the industry is an important part of the City's Economic Development Major City Goal. The policy issues discussed by the Council were permitting requirements related to permit renewals and background checks, onsite consumption, and cannabis tax rates. The Council provided direction to align permit renewals with the fiscal year while retaining existing background requirements and schedule future Council items to further discuss onsite consumption lounges and tax rates. Staff indicated that these discussions would occur in this fiscal year beginning with the tax rate discussion this fall following the start of the new fiscal year.

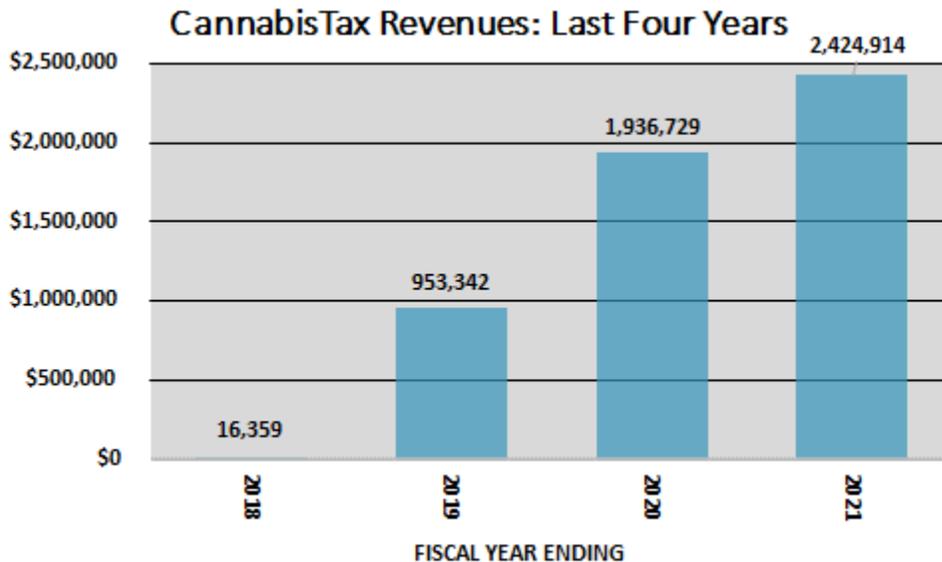
Cannabis Tax Rate Overview

The current cannabis tax rates are 5% of gross receipts for retailers and 3% of gross receipts for other cannabis businesses except for cultivators which are taxed at \$5 per square foot based on floor area of the business. These rates were established by Council resolution in May 2018 to lower the rates originally approved by voters with Measure L-16 in November 2016 which were 10% of annual gross receipts for adult use businesses and \$25 per square foot for cultivators. The Council's action in 2018 was taken after a review of other cannabis tax rates in nearby jurisdictions along with others statewide indicated that the voter-approved rates were higher than most jurisdictions and thus the City needed to create a more competitive tax structure as the first cannabis businesses were beginning to operate in Grover Beach.

Having finished the third full fiscal year with operating cannabis businesses, cannabis tax revenues have been strong and generated approximately \$2,400,000 in FY 2020-21 compared with the initial budget estimate of \$1,500,000. Retail businesses represent approximately 70% of the cannabis tax revenue, followed by manufacturing (22%) and distribution (8%). These revenues reflect 12 businesses in operation last fiscal year including three retailers, six manufacturers, three distributors, and a cultivation that just began operating at the end of the

fiscal year. The City does not release tax generation by business due to confidentiality of business records. Table 1 shows the cannabis tax revenues for the last four fiscal years:

Table 1



For FY 2021-22, the City is estimating a continuation of this cannabis tax revenue amount of \$2.4 million in revenues which reflects an acknowledgement of the current level of revenue that not assume a significant increase at this time. Cannabis tax revenue is now the third largest revenue source for the City at 15% after sales and property tax revenues. Like these other revenue sources, cannabis tax revenues are general City revenues allocated by the Council to support City services and projects that benefit the community.

Staff would continue to note that the cannabis tax revenue estimates also recognize continued uncertainty as cannabis businesses begin operating in nearby cities and the industry still faces significant pressure from an illegal market that is not taxed or regulated. To this end, cannabis tax revenue received for the first two months of this fiscal year (July and August) are below the amounts received in July-August 2020 and more akin to amounts from 2019. While staff is monitoring this, these amounts only reflects two months of data and more information is needed to determine trends. Furthermore, this year's revenue estimate does not include additional businesses and there are three businesses under construction and planning to operate this year including a fourth retailer. Additional information on these revenue trends will be provided with the Council at the mid-year budget review in February 2022.

As shared with the Council in May, staff has researched cannabis tax rates in 35 jurisdictions both in the region and across the state. These comparisons are shown in Attachment 1 and include retail, manufacturing, distribution, testing, cultivation, nursery, and microbusiness tax rates. These rates have been updated since the May agenda item though still show that the City's tax rates remains below average among this group of jurisdictions unlike in 2018 where the City's rates were considered above average. Attachment 2 shows a chart comparing retail tax rates by city with the City's 5% rate below the average of 7% in this group.

The interest in bringing this discussion forward to the Council originated with concerns from industry representatives about the competitiveness of the City's tax rates and requests for the City to lower its rates particularly for distribution and manufacturing businesses. These requests

are often expressed with a belief that new businesses would locate in Grover Beach or existing businesses remain if there was a lower tax structure. As noted earlier, the City earlier lowered its rates in 2018 after a review of tax rates from other jurisdictions indicated that the City's initial rates were higher than average. In looking at the current rates in other jurisdictions shown in Attachment 1, the City is below average in each category of business use unlike in 2018 which may lessen the need to make significant changes to all rates under the current tax structure.

For the Council's reference, staff would note that reduction in tax rates could produce a revenue loss to the City from existing businesses with a presumption that new businesses would eventually offset if not increase revenues. For reference, a 1% reduction in the manufacturing tax rate could lead to an estimated \$190,000 in reduced tax revenue based on actual revenues last year for the existing manufacturers while a 1% reduction in the distribution tax rate could lead to an estimated \$70,000 in reduced tax revenue. A 1% reduction in the retailer rate could lead to an estimated \$320,000 in reduced revenue for further reference. These estimates collectively are sizeable as combined they would lead to \$585,000 in reduced tax revenue on an annual basis from existing businesses with the presumption that lower rates would lead to additional businesses.

Based on the comparison shown in Attachment 1, staff would note that the City is particularly below average in retail and manufacturing rates though closer to the average level for distribution and testing rates. However with the distribution rate, the City's rate of 3% is higher than several jurisdictions in the region including San Luis Obispo City (2%), Santa Barbara County (1%), Carpinteria (1%), and Lompoc which has a new tiered rate starting at 0.5% for businesses with up to \$10 million in gross revenues. In addition, distribution is more of a statewide industry as manufacturers reportedly use distributors farther away if lower rates led to lower costs.

This issue is timely as the Planning Commission recently approved a use permit for a business called El Dorado that plans to convert a vacant 16,500 square foot building at 921 Huston Street to a large-scale facility distribution/processing facility that would open this fiscal year. El Dorado has recently submitted its application for a building permit but has stated to staff that a reduction in the distribution rate is key for its business both in its current plans and expansion opportunities on the vacant lot they acquired next to their existing facility.

Recommended Changes to Tax Rates

Given this information, staff is recommending that the Council consider the following changes to the cannabis tax rates:

- Reduce the distribution rate from 3% to 2% for distribution businesses and further reduce this rate to 1% for businesses with over \$10 million in annual gross revenues as verified by outside audits
- Keep the manufacturing rate at 3% for manufacturing businesses but reduce the rate to 2% for businesses with over \$10 million in annual gross revenues as verified by outside audits
- Reduce the testing lab rate from 3% to 1% for all testing lab businesses

Staff believes that these recommendations better align with rates in nearby communities and provide a viable incentive for targeted businesses to invest in Grover Beach without significant revenue loss to the City. Investment opportunities include the six vacant lots on Huston Street totaling 110,000 square feet that have been approved for cannabis businesses but have not yet been developed. These revised rates continue the City's approach of generally setting flat rates that are consistent and equitable without creating a series of tiers that can be difficult to communicate and enforce. This structure would establish one tier of \$10 million or more in gross

revenues for a reduced rate which currently no existing distribution or manufacturing businesses meets and thus represents an aspirational revenue threshold. Staff considered using \$20 million for this tiered rate which is the amount included in the City's economic development policy for providing financial assistance (shown in Attachment 3), but believed this was too high of an amount for businesses that would be closer to generating \$10 million in gross revenues in the foreseeable future.

Staff is also recommending lowering the rate for testing labs from 3% to 1% given lower rates in other regional cities with one testing lab currently entitled but not yet operational in the city. Lastly, staff is also not recommending changes in the retailer rate since the City's rates are significantly below the average level of retail rates and the revenue loss from such changes would likely be sizeable. Retailer rates are recommended to remain at 5% for all retail businesses.

Staff is seeking Council review and direction on these recommended changes or other changes the Council would want to make to the cannabis tax rates. Pending this direction, staff would return to the Council with a resolution to enact these changes with a recommended effective date of January 1, 2022.

FISCAL IMPACT

There is no specific fiscal impact from this agenda item as such impact would occur following future adoption of a resolution enacting changes in the tax rates. However, the recommended changes submitted by staff would lead to an annualized reduction in cannabis tax revenue of \$70,000 from existing distribution businesses with an undetermined increase in additional revenues from new businesses that may locate in the city. Staff would revise cannabis tax revenue estimates as part of the mid-year budget review provided to the Council in February 2022.

ALTERNATIVES

The Council has the following alternatives to consider:

1. Receive information about commercial cannabis tax rates and provide direction on potential changes to rates; or
2. Provide staff with further direction.

PUBLIC NOTIFICATION

The agenda was posted in accordance with the Brown Act.

ATTACHMENTS

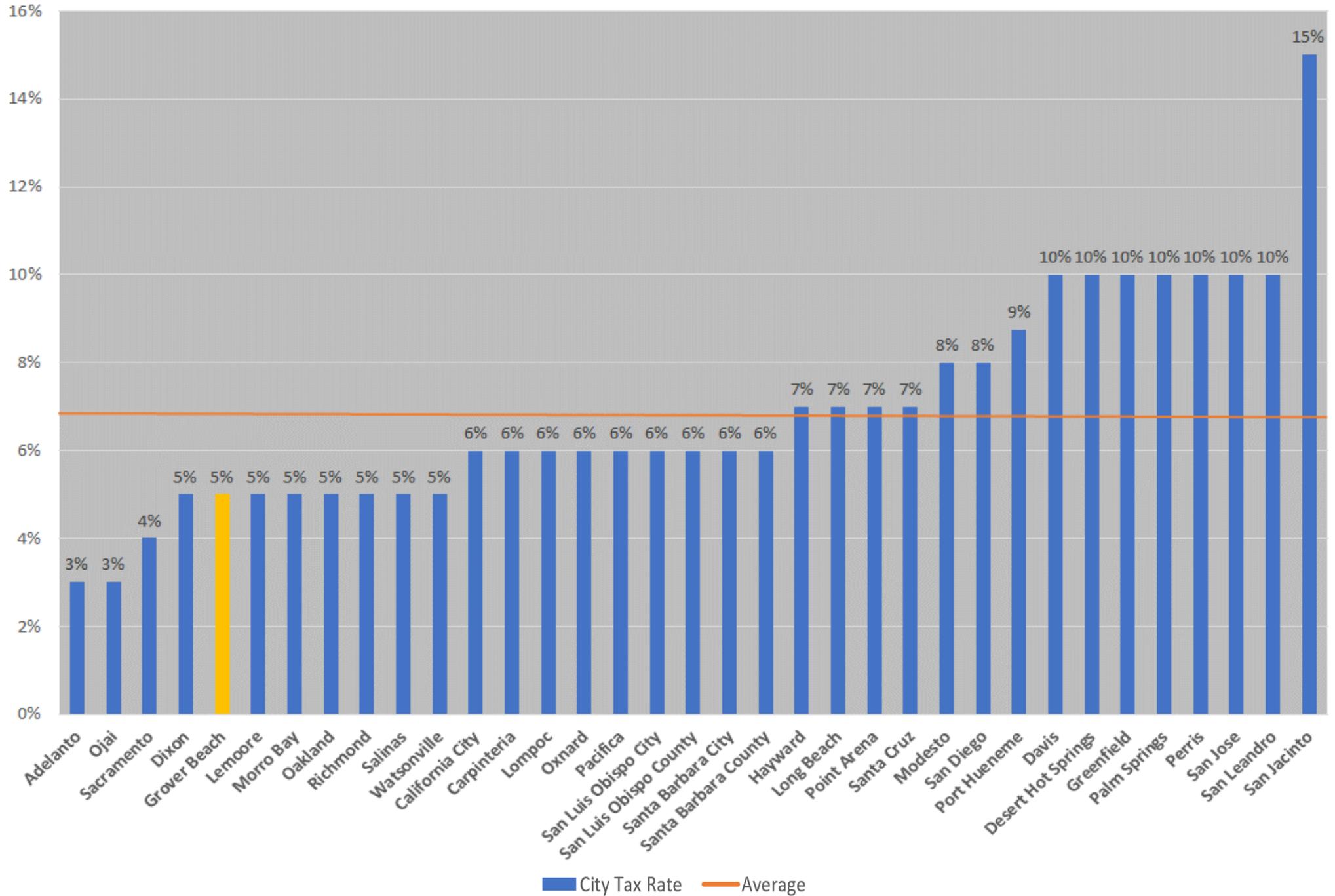
1. Comparison of Cannabis Tax Rates
2. Chart of Cannabis Retail Tax Rates
3. Economic Development Financial Assistance Policy

**Comparison of Cannabis Tax Rates
Per Gross Receipts Unless Noted
October 25, 2021**

Attachment 1

City	Retail	Manufact.	Distribution	Testing	Cultivation	Nursery	Microbusiness	Comments
Adelanto	3%	1%	0.5%	1%	\$.415 sq ft	\$1.25 sq ft		Increased manufacturing, distribution, and testing rates from 1% on 9/9/20. Non storefront delivery rate of 3%.
California City	6%	1%	0.5%	2%	\$1-\$7 sq ft	\$.50 sq ft	6%	
Carpinteria	6%	3%	1%		4%	1%	6%	
Davis	10%	3%-5%	10%	3%-5%	10%	10%		
Desert Hot Springs	10%				\$25.50 sq ft			\$25.50 first 3,000 sqft, \$20.20 sq ft > then 3,000 sq ft
Dixon	5%	5%	5%					Cannabis business required to enter into a development agreement with City. The tax rate is established by the agreement. The rates are up to 15% currently it is a set amount or 5% of gross receipts, whichever is greater.
Greenfield	10%				\$25 sq ft.	.50 sq ft		
Grover Beach	5%	3%	3%	3%	\$5 sq ft		*	Microbusinesses taxed at respective rates for different uses
Hayward	7%	7%			7%			
Lemoore	5%	\$15 sq ft*			\$6 sq ft	\$2 sq ft		* With a minimum fee of \$45k. Other non-dispensary commercial cannabis operations: \$10sq ft for the first 3,000sqft; \$8 sq ft for 3,001-5,000sq ft, and \$6 sq ft over 5,000sq ft.
Lompoc	6%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5% of gross receipts for \$10 million or less, 1% for \$10-25 million, 1.5% for \$25-40 million, 2% for \$40-55 million, and 2.5% for more than \$55 million
Long Beach	7%	1%	1%	1%	13%			Amended rates 1/7/20 lowering the business license tax rate for medical and adult-use cannabis, manufacturers, distributors, and lab testing facilities from 6% of gross receipts to 1% of gross receipts.
Modesto	8%	4%	6%	2.5%	2.5%		4%	
Morro Bay	5%				\$25 sq ft.			Retail only
Oakland	5%	5%	4.50%		5%			Below \$500k .12% for all categories
Ojai	3%	3%			3%			
Oxnard	6%	4%	4%	4%	\$10 sq ft.	4%		Up to \$10 sq ft for cultivation
Pacifica	6%	6%	6%	6%	6%	6%	6%	After 2nd year of operation, tax may increase or decrease up to 10%
Palm Springs	10%	2%			\$10 sq ft.			
Perris	10%	10%	10%		\$25 sq ft			
Pittsburgh		10%		10%				Retail & cultivation prohibited
Point Arena	7%	7%	7%	7%	7%	7%	7%	Retail is 7% recreational and 3% medical
Port Hueneme	8.75%							
Richmond	5%	5%			5%			
Sacramento	4%	4%			4%			
Salinas	5%	5%			\$15 sq ft	\$2 sq ft		Delivery 5%, Nursery may be increased to \$5 sq ft 1/1/21
San Diego	8%	8%			8%			Initially 5%, increased to 8% on 7/1/19
San Jacinto	15%	15%	\$10 sq ft	\$10 sq ft	\$5-\$15 sq ft		15% + \$10 sq ft	Outdoor cultivation \$5 sq ft, Indoor cultivation \$15 sq ft
San Jose	10%	3%	2%		4%			
San Leandro	10%	10%						Cultivation prohibited
San Luis Obispo City	6%	3%	2%	1%			6%	Delivery 6%, Microbusiness non retail 2.5%
San Luis Obispo County	6%	6%			6%			Raised 2% every year for 10% max though 7/1/21 increase to 8% was postponed
Santa Barbara City	6%	4%	4%	4%	2%			Delivery 6%
Santa Barbara County	6%	3%	1%		4%	1%	6%	
Santa Cruz	7%	6%	2%	1%	6%			
Watsonville	5%	3%			\$1 & \$10sq ft			Cultivation Nursery \$1 sq ft, Cultivation flowering \$10 sq ft.
Average 7% Sq Ft Average		5%	4%	3%	5%	4%	5%	\$8.86 \$1.25

Cannabis Tax Rate by City - Retail



RESOLUTION NO. 18-27

**A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF GROVER BEACH,
CALIFORNIA, APPROVING A POLICY FRAMEWORK FOR PROVIDING FINANCIAL
ASSISTANCE FOR CATALYST ECONOMIC DEVELOPMENT PROJECTS**

WHEREAS, the Grover Beach City Council has identified Economic Development as a Major City Goal to strengthen the City's economic base by implementing an economic development strategy that includes construction of the Grover Beach Lodge and other hotels, establishment of commercial cannabis businesses, implementation of broadband fiber in industrial and commercial areas, and opportunities to generate additional transient occupancy and business tax revenues; and

WHEREAS, to assist in this implementation, the City Council has adopted the following policy framework for providing City assistance and incentives for catalyst economic development projects; and

WHEREAS, this framework consists of policy goals, definition of applicable project types, and potential tools that can be used to facilitate private investment in Grover Beach; and

WHEREAS, the goals of this framework are to provide economic incentives to facilitate private development projects implemented in a timely manner that generate economic activity and tax revenue, consider public investments such as infrastructure improvements that are feasible, fiscally responsible, appropriately timed, and able to be implemented, and incorporate impacts on public safety and other City services; and

WHEREAS, project types to be considered under this framework are hotels or other visitor-serving uses or large-scale commercial developments with a minimum of either \$20 million in private investment or generation of \$300,000 in additional annual tax revenues to the City or projects with demonstration of other public benefits; however, the Council may consider projects below the identified minimum threshold that demonstrate other public benefits; and

WHEREAS, tools that could be used under this framework include infrastructure investment, revenue deferral, fee deferral, direct funding, development and reimbursement agreements, permit streamlining, and third-party assessments.

NOW, THEREFORE, BE IT RESOLVED that the City Council of the City of Grover Beach, does hereby approve this policy framework as outlined in Exhibit A to this Resolution for providing financial assistance for catalyst economic development projects.

On motion by Council Member Peterson, seconded by Council Member Nicolls, and on the following roll-call vote, to wit:

AYES: Council Member Nicolls, Peterson, Shah, Mayor Pro Tem Lee, and Mayor Shoals.

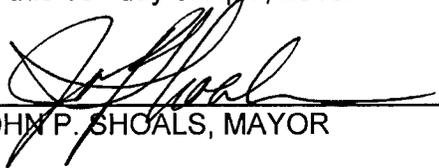
NOES: Council Member – None.

ABSENT: Council Member – None.

ABSTAIN: Council Member – None.

RECUSED: Council Member – None.

the foregoing Resolution was **PASSED, APPROVED, and ADOPTED** at a regular meeting of the City Council of the City of Grover Beach, California this 16th day of April, 2018.

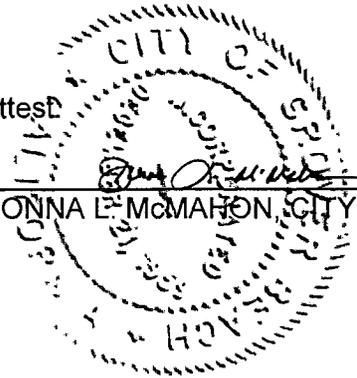


JOHN P. SHOALS, MAYOR

Attest



DONNA E. McMAHON, CITY CLERK



City of Grover Beach
City Assistance for Economic Development Projects
Policy Framework
April 2018

The Grover Beach City Council has identified Economic Development as a Major City Goal to strengthen the City's economic base by implementing an economic development strategy that includes construction of the Grover Beach Lodge and other hotels, establishment of commercial cannabis businesses, implementation of broadband fiber in industrial and commercial areas, and opportunities to generate additional transient occupancy and business tax revenues. To assist in this implementation, the City Council has adopted the following policy framework for providing City assistance and incentives for catalyst economic development projects. This framework consists of policy goals, definition of applicable project types, and potential tools that can be used to facilitate private investment in Grover Beach.

Policy Goals

- Provide economic incentives to facilitate private development projects implemented in a timely manner that generate economic activity and tax revenue
- Consider public investments such as infrastructure improvements that are feasible, fiscally responsible, appropriately timed, and able to be implemented
- Incorporate impacts on public safety and other City services

Project Types

- Hotels or other visitor-serving uses or large-scale commercial developments
- Minimum threshold of either \$20 million in private investment or generation of \$300,000 in additional annual tax revenues to the City
- Council may consider projects below the minimum threshold that demonstrate other public benefits

Tools

- Infrastructure investment
 - Utilities including water, sewer, and electrical undergrounding
 - Street and sidewalk improvements including those implemented as part of Measure K-14
- Revenue deferral
 - Defer project-related revenues over time (typically up to five years)
 - Examples include sales taxes, transient occupancy taxes, or other revenues
- Fee deferral
 - Deferral of project fees (e.g. Development Impact Fees) from permitting to project completion or occupancy
- Direct funding
 - Direct funding to developer up to a Department of Industrial Relations de minimus threshold of 1.75% of project construction costs

- Funding cannot exceed half of the additional tax revenue generated to the City in a given year
- Development and reimbursement agreements
 - Use of development agreement when applicable to document project expectations, public investment, and public benefits
 - Use of reimbursement agreement when applicable to document direct funding support from the City if indexed to TOT revenues
- Permit streamlining
 - Expedited development application and environmental review to reduce processing time for project application review and permitting issuance
- Third-party assessment
 - Outside assessment of project financials and economic impacts