



CITY COUNCIL STAFF REPORT

TO: Honorable Mayor and City Council **DATE:** December 13, 2021

FROM: Matthew Bronson, City Manager

PREPARED BY: Matthew Bronson, City Manager
Deanne Purcell, Administrative Services Director

SUBJECT: Commercial Cannabis Tax Rates Amendments

RECOMMENDATION

Adopt a Resolution to amend the Commercial Cannabis Tax Rates affecting distribution, manufacturing, and testing businesses.

BACKGROUND

On October 25, 2021, the Council received information about the commercial cannabis tax structure which has been in place since May 2018. 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 other jurisdictions both nearby and 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.

Over three years later, the industry is 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. These businesses reflect a broad industry within the city and include three retailers, six manufacturers, three distributors, and a microbusiness cultivator. 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 recently researched cannabis tax rates in 35 jurisdictions throughout the region and state and included retail, manufacturing, distribution, testing, cultivation, nursery, and microbusiness tax rates. This comparison provided to the Council on October 25 showed that the City's tax rates remain below average among this group of jurisdictions particularly in retail and manufacturing rates. However, the City is closer to the average level for distribution and testing rates and the distribution 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 (tiered rate starting at 0.5%). In addition, distribution is more of a statewide industry as manufacturers often use distributors farther away if lower rates led to lower costs.

Given this information, staff recommended 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 believed that these recommendations better aligned 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 meet and thus represents an aspirational revenue threshold for future investment.

The Council concurred with these recommendations and provided direction to staff to return to the Council to adopt a resolution to enact these changes. Pending adoption, the recommended effective date of these changes would be January 1, 2022.

FISCAL IMPACT

The recommended 1% reduction in the in the distribution tax rate could lead to an estimated \$70,000 in reduced tax revenue on an annual basis based on actual revenues from last year or prorated to \$35,000 this fiscal year. The actual revenue impact for this year will be further determined later this fiscal year. There would be no loss of revenue from the changes affecting manufacturing and testing businesses as no manufacturing business currently generates \$10 million in revenue and there are no testing businesses currently operating. However, staff anticipates additional revenue to the City ultimately generated through these changes from new or expanded businesses operating in the city.

ALTERNATIVES

The Council has the following alternatives to consider:

1. Adopt a Resolution to amend the commercial cannabis tax rates affecting distribution, manufacturing, and testing businesses; or
2. Provide staff with further direction.

PUBLIC NOTIFICATION

The agenda was posted in accordance with the Brown Act.

ATTACHMENTS

1. Resolution

RESOLUTION NO. 21-

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF GROVER BEACH, CALIFORNIA, REDUCING COMMERCIAL CANNABIS TAX RATES ASSESSED FOR PERMITTED COMMERCIAL CANNABIS DISTRIBUTION, MANUFACTURING, AND TESTING BUSINESSES OPERATING IN THE CITY

WHEREAS, the Grover Beach City Council has continued to identify Economic Development as a Major City Goal to strengthen the City's economic base that includes commercial cannabis businesses; and

WHEREAS, the City has worked since 2016 to establish the commercial cannabis industry as an economic opportunity in a safe and responsible manner; and

WHEREAS, the City of Grover Beach seeks to appropriately regulate cannabis facilities and seeks adequate funding through a cannabis tax to provide essential public services, with all revenues received from the tax to be deposited in the General Fund of the City to be expended for general purposes; and

WHEREAS, the City Council placed Measure L-16 on the ballot at the November 8, 2016 General Municipal Election that proposed the City enact a tax on commercial cannabis businesses which may establish in Grover Beach. The tax would apply to both medical cannabis businesses and non-medical cannabis businesses; and

WHEREAS, Measure L-16 was approved by 70% of voters and the City Council subsequently adopted Ordinance No. 17-04 establishing the commercial cannabis tax and initial rate structure on February 21, 2017; and

WHEREAS, the initial rate structure under Measure L-16 consisted of a 5% tax on all gross receipts of the business for medical cannabis products and a 10% tax on all gross receipts of the business for non-medical cannabis products along with an initial rate for cultivation businesses of \$25 per square foot for the first 5,000 square feet of canopy space and \$10 per square foot for the remaining space licensed by the City; and

WHEREAS, the City Council amended the commercial cannabis tax rate structure on May 7, 2018 to establish a 5% tax of gross receipts for retail businesses and a 3% tax for non-retail businesses except for cultivation businesses which would be taxed at a rate of \$5 per square foot based on floor area of the business with no corresponding tax revenue cap; and

WHEREAS, the City has adopted and periodically amended comprehensive land use and regulatory ordinances to allow commercial cannabis businesses and to date has issued 30 permits with 12 businesses currently operating including three retailers, six manufacturers, three distributors, and a microbusiness cultivator that collectively generated \$2.4 million in tax revenue in FY 2020-21; and

WHEREAS, the City Council has provided policy direction to further amend the commercial cannabis tax structure to reduce the tax rates for identified segments of the cannabis industry to keep the City's tax rates competitive with other cities and to incentivize additional investment by cannabis businesses to operate within the city; and

WHEREAS, commercial cannabis distribution businesses permitted to operate within the city will be taxed at a rate of 2% of all gross receipts for the business while distribution businesses that generate over \$10 million in annual gross revenue as verified by outside audits would have a tax rate of 1%; and

WHEREAS, commercial cannabis manufacturing businesses permitted to operate within the city will continue to be taxed at a rate of 3% of all gross receipts for the business while manufacturing businesses that generate over \$10 million in annual gross revenue as verified by outside audits would have a tax rate of 2%; and

WHEREAS, commercial cannabis testing businesses permitted to operate within the city will be taxed at a rate of 1% of all gross receipts for the business; and

WHEREAS, other provisions and procedures associated with collection of commercial cannabis tax revenue will be carried out consistent with Ordinance No. 17-04; and

WHEREAS, the Council retains the ability to create a different rate structure for an individual business through a development agreement or other mechanism based upon the scale of private investment or other economic activity of the particular business consistent with the City's adopted financial assistance framework for significant economic development projects, but not to exceed the maximum tax rate approved by Measure L-16; and

NOW, THEREFORE, BE IT RESOLVED that the City Council of the City of Grover Beach, does hereby approve this reduced tax structure assessed at this time for commercial cannabis businesses permitted to operate in the city.

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

AYES:	Council Members –
NOES:	Council Members –
ABSENT:	Council Members –
ABSTAIN:	Council Members –
RECUSED:	Council Members –

the foregoing Resolution was **PASSED, APPROVED**, and **ADOPTED** at a regular meeting of the City Council of the City of Grover Beach, California this 13th day of December, 2021.

JEFF LEE, MAYOR

Attest:

WENDI B. SIMS, CITY CLERK