



Monterey County

Item No.23

Board Report

Board of Supervisors
Chambers
168 W. Alisal St., 1st Floor
Salinas, CA 93901

Legistar File Number: 22-442

May 17, 2022

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- a. Receive an update on the state of the commercial cannabis industry regarding current County tax rates and ongoing challenges to meet local requirements; and
- b. Review options to amend Monterey County Code 7.100; and
- c. Direct the Cannabis Program to present selected options to the Budget Committee to identify financial impacts to the current and future fiscal years; and
- d. Provide further direction as appropriate.

RECOMMENDATIONS:

It is recommended that the Board of Supervisors:

- a. Receive an update on the state of the commercial cannabis industry regarding current County tax rates and ongoing challenges to meet local requirements; and
- b. Review options to amend Monterey County Code 7.100; and
- c. Direct the Cannabis Program to present selected options to the Budget Committee to identify financial impacts to the current and future fiscal years; and
- d. Provide further direction as appropriate.

SUMMARY/DISCUSSION:

On December 14, 2021, the Cannabis Program (Program) presented a report to the Board of Supervisors (Board) outlining a significant decline in commercial cannabis wholesale price points that had severe financial impacts on the industry. The Board directed staff to return in January 2022 with proposed amendments to Monterey County Code (MCC) Chapter 7.100. The following amendments were approved by the Board approved and became effective as of March 31, 2022:

- Indoor cultivation to \$7/square foot.
- Mixed-light cultivation to \$3/square foot.
- Outdoor cultivation to \$1/square foot.
- Reduce the distribution tax to 0% gross receipts.
- For cultivation only, a stay on delinquent Fiscal Year (FY) 2022 Quarter 3 penalties so long as the unpaid amount is paid in full by the end of Quarter 4, July 31, 2022.

The Program meets monthly with a select group of industry representatives and County staff to discuss tax issues and implications. A memo summarizing the outcomes of these meetings was presented to the Board Cannabis Committee (Committee) on April 7, 2022. The Committee directed staff to present directly to the full Board and include recommendations for the Board to consider as soon as possible.

Also, the Committee directed staff to conduct industry focus groups to gain more information to current challenges. Findings of those focus groups were presented to the Committee on May 5, 2022 and a separate board report and presentation to the full Board on May 17, 2022.

The Program constantly monitors wholesale price points within the NCS Analytics platform provided by the California Cannabis Authority (CCA). The CCA remains an asset which assists the TTC in verifying and collecting taxes, the Program in administering Chapter 7.90 and ensuring DCC regulations are being met, and the Agricultural Commissioner in producing the Crop Report. It should be noted that, for the integrity of the data, the Program requires the industry to submit monthly data reports directly to CCA. The Program and the Treasurer-Tax Collector (TTC) consistently send reminders to those operators who are not complying. On average 18 operators are not submitting consistently which is becoming problematic.

Ongoing struggles of the cannabis industry.

Since August 2021, many news articles have reported similar information on the health of the commercial cannabis industry within California. According to a summary of Senate Bill 1326, "California's legal cultivators grow more than three times as much cannabis as is sold in the legal retail marketplace." For reference, the Department of Cannabis Control has more than 8,300 licensed cultivators and only about 1,200 retailers.

Oversupply, State taxes, licensing fees, and depressed wholesale prices are all contributing to cash-flow shortages. The decline in wholesale pricing began in the summer of 2021, with mixed-light prices dropping steadily from \$1,200/lb. in June to as low as \$400/lb. in October. Indoor prices showed signs of volatility throughout the year and trended downwards from a high of \$1,800/lb. in April down to a low of \$790/lb. in December. Prices have slightly trended upwards in 2022 though the industry continues to report difficulty in selling their inventory.

These factors are further compounded by the rising cost of materials, which remain in short supply and are often delayed. Operators are scrambling to revamp their operations to remain in the licensed market at a time where many are in danger of going out of business. Local cultivators are offering incentives to secure transactions, such as buy a certain amount and get a certain amount for free. Retail dispensaries are required to pay the State excise tax at the time the product is entered into their inventory, not at the point of sale. This creates a severe hardship in that these prepaid taxes do not consider if or when the retailer will be able sell the product.

Staff recognizes the County does not control: real property leases, professional fees, costs associated with required infrastructure improvements, waivers for State requirements, the legislative process to amend the current State tax rates or legalize interstate commerce, or the federal decriminalization of cannabis. The County could consider amending requirements and waiving fees locally, but this represents a lengthy process. A total of 24 businesses have shut down since 2019, and operators suggested that the County should anticipate more to follow.

The operator delinquency rate for Q1 of FY 21-22 was 14%. This rate has risen to 54% as operators have taken advantage of the Board's stay on Q3 and Q4 taxes, but the Program will not consider them delinquent unless they remain delinquent after this relief period ends. Staff will continue to monitor

this figure closely through the end of FY 21-22. Staff from the Monterey County Regional Fire District have reported a current delinquency rate of 59%, which was 10% in the prior year; this represents a 49% increase.

Pursuant of MCC 7.100.160, the TTC has the authority to take enforcement actions to resolve the delinquency of any uncollected taxes, penalties, and/or fees required to be paid under the provisions of Chapter 7.100. These actions include recording a certificate of lien, issuing a warrant for the enforcement of liens, and seizing operator assets or property for sale at public auction. Staff from the TTC have reported that liens have been filed for uncollected cannabis tax in the amount of \$2,632,314.60, where \$2,085,272.95 of that amount remains uncollected and continues to accrue additional penalties.

Tax relief measures of other local jurisdictions.

In Humboldt County, the assessments for a tax year are billed in arrears the following calendar year and collected in two installments in March and October. In early February, their Board voted to defer the second installment of 2021 taxes to September of 2022 without penalties and reduce taxes imposed in 2022 by 85%. Below are the current tax rates after this adjustment:

- Indoor \$0.45/sq. ft.
- Mixed Light \$0.30/sq. ft.
- Outdoor \$0.15/sq. ft.

The cannabis tax of Santa Barbara County is currently based on gross receipts. In mid-April, their Board discussed a transition to a canopy-based model. This discussion was prompted by a 30% shortfall of estimated tax revenue, which was driven by the decline in wholesale price points. A shift to a canopy-based model would require balancing certainty and fairness in support of subjecting their budget to less volatility. This change was supported within the 2019-20 Santa Barbara County Grand Jury report on local cannabis policy. A change to the taxation method would require a ballot measure in the upcoming 2022 election and staff was directed to return with their findings.

In Lake County, the assessments for a tax year are billed in the current calendar year and collected in two installments in September and January of the following year. In April, the Board of Lake County adopted two resolutions to provide tax relief to local operators. The first postponed the second installment of 2021 taxes to October of 2022 without penalties and established new installments which will be collected January and May of the following year. The second ordinance changed the taxable area from total cultivation area to canopy area and reduced cultivation rates for 2021 and 2022 by 50%. Below are the current tax rates after this adjustment:

- Indoor \$1.50/sq. ft.
- Mixed Light \$1.00/sq. ft.
- Outdoor \$0.50/sq. ft.

Providing additional local cannabis tax relief.

The industry is seeking immediate relief to allow them to remain solvent and continue operating in the

marketplace while pursuing state and local requirements to become eligible for their respective State Annual License(s). Staff has prepared the following tax-relief options for Board consideration:

1. Extend the payment of FY 22 commercial cannabis tax to December 31, 2022.
 - a. No penalties or interest will be accrued if the account is paid in full on or before December 31, 2022.
 - b. This option would not have any impacts on FY 22 tax revenue other than a delay of payments.
2. Reduce the mixed-light and indoor cultivation tax rates to \$2 per square foot and \$3 per square respectively or agree on alternative rates.
 - a. Like the previous ordinance to reduce tax rates (Attachment B), the Board may desire for these rates to be applied retroactively.
 - b. This option would reduce FY 23 tax revenue by approximately \$3.3m.
3. Reduce cultivation rates to maintain recovery of Program costs, which are projected at \$6.5m for Fiscal Year 2022-2023.
 - a. Indoor at \$2.55 per square foot
 - b. Mixed-light at \$1.70 per square foot
 - c. Nursery at \$0.85 per square foot
 - d. This option would reduce FY 23 tax revenue by approximately \$4.4m.
4. Reduce all cultivation tax rates to \$0 and zero percent for all other business tax rates until the wholesale price point reaches an agreed amount.
 - a. This option could reduce FY 23 tax revenue by approximately \$11.9m, depending on the agreed upon price point and if/when it is reached.
5. Forgive FY 22, Quarters 3 and 4 commercial cannabis taxes due.
 - a. Staff estimates a total FY 22 cannabis tax liability of \$16 million dollars.
 - b. This option would reduce FY 22 tax revenue by approximately \$6.2m.
6. Retain existing version of MCC Chapter 7.100.
 - a. This option would not have any impacts on FY 22 or FY 23 tax revenue.

Since the market downturn, staff has continuously monitored the pricing outlook and tax relief measures taken by other local jurisdictions. Additionally, the Board of Supervisors have submitted letters of support requesting tax reform at the State level. The Program acknowledges the crisis the industry faces and desires to assist them as much as possible within the authority of Chapter 7.90, however this assistance is limited locally and beyond. Staff is requesting policy direction from the Board that will contribute to the survival of the cannabis industry within Monterey County.

FINANCING:

Further amendments to Chapter 7.100 could reduce the estimated commercial cannabis tax revenue for FY 21-22 and FY 22-23 by an amount to be determined by the policy direction provided by the Board. The impact of additional tax relief options provided in this report are FY specific: FY 22 ranges from no impact to a \$5.4m reduction-which is inclusive of any applicable refunds owed to operators who have already made cannabis business tax payments-and FY 23 ranges from no impact to a \$11.9m reduction.

BOARD OF SUPERVISORS STRATEGIC INITIATIVES:

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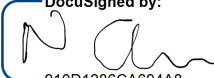
The Monterey County Cannabis Program addresses each of the Strategic Initiative Policy Areas that promote the growth of a responsible and legal Monterey County cannabis industry.

Mark a check to the related Board of Supervisors Strategic Initiatives

- X Economic Development
- X Administration
- X Health & Human Services
- X Infrastructure
- X Public Safety

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5/11/2022 | 4:13 PM PDT

Attachments:

- A. Current Cannabis Tax Rates
- B. Ordinance 5371