



County of Monterey

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

Board Report

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- a. Receive a report on the outcomes of the cannabis industry focus groups facilitated by the Cannabis Program April 2022; and
- b. Support the revised cannabis compliance inspection process and request staff to return to the full Board with a comprehensive analysis of the compliance inspection staffing levels, including recommendations to ensure the Program and departments are rightsized; and
- c. Direct Housing and Community Development to create practical customer service expectations for staff that support the Monterey County Mission Statement while making that information available to the public; and
- d. Direct the Program to review required infrastructure improvements to obtain the land use permit entitlement and cannabis business permit and identify any that can be modified; and
- e. Direct HCD and EHB to create simple, easy-to-follow guides to assist the public in the permit process for land use, building, and environmental health permits; and
- f. Provide further direction as appropriate.

RECOMMENDATIONS:

It is recommended that the Board of Supervisors Cannabis Committee:

- a. Receive a report on the outcomes of the cannabis industry focus groups facilitated by the Cannabis Program in April 2022; and
- b. Support the revised cannabis compliance inspection process and request staff to return to the full Board with a comprehensive analysis of the compliance inspection staffing levels, including recommendations to ensure the Program and departments are rightsized; and
- c. Direct Housing and Community Development to create practical customer service expectations for staff that support the Monterey County Mission Statement while making that information available to the public; and
- d. Direct the Program to review required infrastructure improvements to obtain the land use permit entitlement and cannabis business permit and identify any that can be modified; and
- e. Direct HCD and EHB to create simple, easy-to-follow guides to assist the public in the permit process for land use, building, and environmental health permits; and
- f. Provide further direction as appropriate.

SUMMARY/DISCUSSION:

The Cannabis Program (Program) presented a similar report to the Board of Supervisors Cannabis Committee (Committee) on May 5, 2022. Staff were directed to present to the full Board and create meaningful recommendations based on the industry input.

During a discussion of the ongoing County-Industry Tax Sub-committee meetings at the Committee meeting on April 7, 2022, Program staff commented that they would like to conduct small focus groups with industry operators to further understand industry challenges with depressed wholesale price points and how they impact the industry's ability to meet local permitting requirements. Staff indicated that scheduling/coordinating these meetings would take time. The Committee directed staff to coordinate such meetings as soon as possible.

The Program scheduled 12 meetings in April, which included applicants that are currently operating and those that plan to become operational within the next year. 65% of the industry participated in these meetings. The

Program participated in a separate meeting with industry attorneys, agents, and consultants. The Monterey County Cannabis Industry Association Executive Director participated in most of the focus group meetings. Collectively, the planning and hosting of these meetings equated to approximately 120 hours of Program staff time. Staff have distilled the candid input of local operators and industry representatives, which should provide valuable insights into the state of the local cannabis industry. Additional meetings will be scheduled, one with applicants for the outdoor cultivation pilot program, and another for retail dispensary operators.

The Program Manager met with the Assistant County Administrative Officer (ACAO), Housing and Community Development (HCD) Director, Environmental Health Bureau (EHB) Chief and the Monterey County Regional Fire District (MCRFD) Chief on April 28, 2022, to review the outcomes, discuss recurring themes, and begin discussion of continuous improvement in key areas, specifically customer service levels.

INPUT BY TOPIC

The following is a summary of the input received from the industry by topic. This summary is not inclusive of all comments received.

1. Relationships between commercial cannabis operators and respective property owners.

Zoning restrictions for commercial cannabis activities were, in part, based on incentivizing the retrofitting of existing properties and structures. The County identified the dilapidated greenhouses once occupied by a thriving cut-flower industry as an opportunity for development, but the industry does not believe the high volume and intensity of infrastructure improvements related to supplying adequate electrical energy and treating contaminated water systems was fully considered when limiting commercial cannabis operations to these areas.

Operators believe that property owners significantly profited from tenants and should have some responsibility in contributing to the development of their properties, however the property owners are generally unwilling to renegotiate lease terms and agreements are often structured as triple net leases. Because property owners are reportedly not reinvesting their profits into the property, operators are forced to fund all operational expenses of the property, including infrastructure improvements, real estate taxes, building insurance, maintenance, and utilities.

2. Inconsistency of compliance inspections.

Feedback from operators has shown a frustration with the lack of a standardized compliance inspection process, particularly as it relates to correction notices. Inconsistency has resulted in operators being unable to trust the system to assist them in obtaining full compliance, which is not strictly a matter of fact when considering the level of discretion they have experienced firsthand. Operators have observed inspectors visiting a site several times before addressing a violation that was missed at the prior inspection. This has led operators to perceive the notification of violations as selective rather than universal.

Operators do not believe it is possible to receive a “clean” inspection and some believe there is a “luck of the draw” with inspectors, who are perceived as eager to find violations rather than assist operators with achieving compliance. Operators shared that those correcting violations require significant time and money and they do not agree with compounding these corrections with additional violations during follow up inspections. This frustration is exacerbated when items that have been resolved are not always removed from subsequent correction notices.

3. Costs and timelines associated with required infrastructure improvements.

Many operators reported that they had not met one or more requirements for infrastructure improvements,

which include: septic systems, fire sprinklers, firewalls, odor control, retention ponds, public water system, reverse osmosis system, drilling a well, or PG&E electrical panel upgrades. Operators report that pricing to complete these projects continues to rise at an unfavorable pace, sometimes as often as weekly. This is driven by material and/or specialized labor shortages, which can add several months to a project completion date; operators believe that the COVID-19 pandemic is a contributing factor.

Some operators have determined that it would be more cost effective to destroy and rebuild a structure than to retrofit it. The decline in wholesale pricing and/or access to capital compounds the issue further, as cash flow is a huge component of remaining solvent while completing these costly projects and operators have reported interest rates up to 25% for loans made to cannabis-related businesses. Below are the infrastructure improvement costs reported by operators as general estimates. (Staff has not verified or audited these figures).

- Fire suppression: \$200k - \$400k
- Septic: \$150k - \$300k
- Public water system: \$200k - \$300k
- Electrical panel: \$250k - \$500k

4. Responsiveness of County departments.

Many operators have concluded that delays in their land use and building permits are due to late or missing responses to questions or concerns related to moving the applicable land use and/or building permit status forward. This feedback was primarily in relation to permits under review by planning and building staff from HCD, but also included the EHB in a few instances of the timing of environmental health inspections or results of plan reviews.

Program staff believe that an overall lack of uniform customer service standards across inspection teams is a contributing factor to poor response times, in addition to chronic turnover and shortages being experienced by the Planning and Environmental Services divisions within HCD. Operators shared that they often feel forced to proceed with construction unguided and without direction from HCD and EHB, because the benefit of the opportunity to produce product and make profit outweighs any risk from remaining proactively compliant while waiting for a response from HCD and EHB.

In contrast, Program staff were acknowledged for their responsiveness, ability to redirect to the appropriate staff person, and willingness to help the applicant understand what is expected of them and/or explain a permit status. Industry members acknowledged that, to move their projects through the queue in a timely manner, they seek assistance from the Program when they feel that HCD and EHB are not responding to their inquiries.

5. Federal, state, and local taxes for cannabis operators.

Section 280E of the Internal Revenue code prohibits the deduction of business expenses, besides the cost of goods sold, for any businesses associated with trafficking substances identified by the Controlled Substances Act. Because cannabis is not federally legal and is classified as a Schedule 1 drug, 280E applies to cannabis-related businesses; these businesses typically pay an effective income tax rate of 70%. While federal legalization may benefit operators in this regard, operators are concerned about remaining competitive in a national market and the 5% excise tax proposed in the Marijuana Opportunity Reinvestment and Expungement Act.

Operators continue to report that the state cultivation tax represents a barrier to profitability at current wholesale prices. Production costs for a pound of cannabis ranged from \$500 - \$1,100, which varies due to cultivation type and the scale of the operation. The current state cultivation tax is \$161 per pound and the current wholesale price is \$571 for mixed-light and \$1,100 for indoor. After deducting the state cultivation tax

and accounting for current price points, operators may be losing \$90 to \$161 per pound. Due to the static nature of the cultivation tax, which does not factor in pricing, operators cannot overcome the cost burden through efficiency.

Operators believe that the recent reductions to local canopy rates were insufficient, and that they may not be able to maintain payroll. While the local tax relief is appreciated, the repayment required to avoid penalties and fines represents a huge cashflow hurdle at the end of the relief period due to cash flow shortages. One proposal was not to impose the local canopy tax when it is not profitable for cultivators, meaning when the price per pound reaches a certain point.

6. Applying regulations differently between traditional agriculture and commercial cannabis.

Despite decades of experience and prior success cultivating plants in traditional agriculture, some operators are now facing failure in the cannabis industry and attribute this to a different regulatory approach. The industry believes that a key contributing factor of this was when the County changed the requirement from a Use Permit to an Administrative Permit for commercial cannabis operations. Operators believe that the approach of other jurisdictions to principally permit cannabis cultivation is advantageous to local policy.

Traditional agricultural businesses are conducting comparable activities within similar structures but are not required to retrofit heaters or install septic systems, fire sprinklers, nonpermeable floors, odor control, or retention ponds. Operators are unaware of any other industries that are subject to quarterly compliance inspections, which are often accompanied by costly permits and construction to bring properties into compliance. The discrepancies are so severe that it was speculated that a separate building code was being applied to cannabis-related businesses. It was also reported that some new projects are being constructed as traditional agriculture under false pretenses during the initial build-out to avoid heightened requirements and scrutiny before converting the project to a cannabis operation.

Below are specific anecdotes that were shared by operators:

- Traditional agriculture utilizes portable restrooms in the field while cannabis operations are required to install permanent, flushable restrooms.
- Cannabis operators must obtain a permit to replace the plastic sheeting on a greenhouse, which they do not believe is required of traditional agriculture.
- Automatic weigh scales, which are identical to that used in traditional agriculture, require a permit if installed within a cannabis operation.
- Operators believe that the odor produced by broccoli and brussels sprouts may be as offensive as the odor produced by cannabis plants, but there are no odor control requirements for traditional agriculture.

CONCLUSIONS BASED ON INDUSTRY INPUT

1. Relationships between commercial cannabis operators and respective property owners.

- a. Most cannabis operators lease their buildings.
- b. Operators' leases are often structured as triple net leases, requiring the operator to pay all operational expenses of the property, including infrastructure improvement, real estate taxes, building insurance, maintenance, rent, and utilities.
- c. The previous director of the RMA sent out an Industry Memorandum dated June 19, 2018, stating that the County would proactively inspect sites for compliance and to identify the building permits required to legalize the existing structures on the property.

2. Inconsistency of compliance inspections.

- a. Operators are frustrated with the current compliance inspection process because they experience frequent inconsistencies between inspection staff.
- b. One inspector will not call out a violation while another believes it is a violation.
- c. Operators are unclear on what to expect during a site inspection.
- d. Inspection staff have visited their sites many times and even though no operational changes have been made, they constantly find new violations that were not identified in prior visits.
- e. There is a significant cost for operators to obtain permits and complete construction required to cure violations.

3. Costs and timelines associated with required infrastructure improvements.

- a. The requirements and infrastructure improvements required to legally build out a cannabis business operation and industry were unknown to the County and the industry at the time of Ordinance approvals.
- b. Complex land use permit process, including meeting conditions of approval.
- c. Building permit complexity involving professionals to prepare construction documentation packages and apply for multiple permits.
- d. Fire suppression related to F-1 occupancy processing areas.
- e. Heavy nitrate water levels requiring treatment.
- f. Energy requirements, including upgrades managed by PG&E.
- g. Estimated infrastructure improvement costs (Not verified/audited by staff):
 - Fire suppression: \$200k - \$400k
 - Septic: \$150k - \$300k
 - Public water system: \$200k - \$300k
 - Electrical panel: \$250k - \$500k
- h. Many operators have not met one or more requirements for infrastructure improvements.
- i. The uncertainty of commercial wholesale pricing has not improved to create cash flow, which impacts the ability of the operator to complete local jurisdiction requirements.
- j. Increases driven by material and/or specialized labor shortages, which can extend project completion dates by months.

4. Responsiveness of County departments.

- a. Customer service expectations and service levels need improvement, including but not limited to, standardized response times and tracking mechanisms for accountability.
- b. The time to process planning and building permits needs improvement.
- c. Industry acknowledges that they reach out to Program staff to gain assistance in understanding the status of their land use and/or building permit or for general assistance due to lack of responsiveness from department staff.
- d. Many suggested the Program should create a “Case Manager” to be assigned to each operator to work with them on compliance, requirements, navigating County departments, and to answer questions and ensure timely turnaround of work and reporting.

5. Federal, state, and local taxes for cannabis operators.

- a. Operators agree that the tax burden primarily lies at the state level, however there are opportunities to provide and maintain relief locally.
- b. The canopy tax, much like the flat state cultivation tax, does not consider the price that cultivators are able to sell their product for.
- c. Operators suggest a canopy tax that would trigger based on profitability.

- d. In providing tax relief, the County needs to account for the capital constraints of operators, particularly for the sustained period of depressed wholesale pricing.
- e. Extending the window to repay their outstanding tax liability would enable them to prioritize other expenditures necessary to remain operational.
- f. Wholesale price points have declined since July 2021 and remain volatile.
- g. State cultivation tax rates are untenable at current wholesale prices.
- h. Federal legalization may provide relief from Section 280E but would likely add another layer of taxation and introduce additional competition in the national market.
- i. At current wholesale prices, the State cultivation tax of \$161/lb. represents 37% of the overall value.
- j. Cultivators are required to pay the local canopy tax, which is an annual tax payable in quarterly installments through the end of the fiscal year.
- k. This assessment method does not consider the time required to cultivate and sell the product to offset this liability and cultivators would prefer to be billed in arrears.
- l. Monterey County reduced local tax rates, but the industry does not believe it was enough to remain competitive.

6. Applying regulations differently between traditional agriculture and commercial cannabis.

- a. Operators believe there is parity between traditional agriculture and cannabis and that the County's approach to regulating both industries should be similar.
- b. The cannabis regulatory framework requires compliance inspections, but operators believe the process to be inequitable when traditional agriculture is not subject to the proactive enforcement of health and building codes.
- c. Operators believe that the rigorous application of these codes to an emerging industry is affecting their ability to remain in business in Monterey County.

RECOMMENDATIONS

Staff recognizes that 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. Staff prepared a suggested course of action for the Board to consider.

1. The Program has gained agreement of a revised cannabis compliance inspection process. The details of the revised process will be reviewed in the HCD/Program report on its response to the Citygate & Associates, LLC report that follows this presentation. One outcome of these proposed revisions is a transfer of the responsibility to complete all research related to land use permits, building permits, related code enforcement cases, and any other subject that prevents the applicant from becoming locally compliant. This effort will be removed from the compliance inspection staff and transferred to Program staff, which will further increase their workload.
2. Department customer service levels and expectations need to be practical and managed. The Citygate report recommended creating SMART goals to share outcomes.
 - a. Currently HCD requests staff to respond to a phone call in 24 hours and e-mail correspondence within 48 hours but it is not mandated.
 - b. EHB generally require staff to respond to phone calls and e-mails within 24 hours of receipt.
3. The Program, HCD and EHB have met several times to discuss the requirement of permanent restrooms at cannabis operation sites that do not include outdoor grow including a recent meeting on May 12, 2022, to further discuss a cannabis policy for restroom facilities. EHB staff presented an overview of the requirement at the monthly Industry meeting on May 16, 2022 and gained further industry input. Staff feel

that we should continue to have these discussions on any other infrastructure requirement that could be reviewed for modification.

4. HCD and EHB should consider developing a simple process guide that walks the applicant through the processes related to land use, building, and environmental health permits that are available on their respective webpages.
5. The Program will continue to schedule small focus group meetings with the industry as they were found to be favorable and gleaned critical information about our operators and the industry in general.

FINANCING:

Monterey County's Cannabis Program is funded in County Administrative Office - Department 1050, Intergovernmental and Legislative Affairs Division - Unit 8533, Cannabis. The proposed recommendations will not incur additional expenses to the Program.

BOARD OF SUPERVISORS STRATEGIC INITIATIVES:

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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