



## Board Report

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**File #: 21-387, Version: 1**

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- a. Introduce, waive reading, and set May 25, 2021 at 10:30 a.m. as the date and time to consider adoption of an ordinance amending Chapter 7.100 of the Monterey County Code to suspend the Fiscal Year 2021-2022 automatic increases on the County's commercial cannabis business tax rates and resume the automatic increases in Fiscal Year 2022-2023 on July 1, 2022; and
- b. Provide direction to staff as appropriate.

### RECOMMENDATIONS:

It is recommended that the Board of Supervisors:

- a. Introduce, waive reading, and set May 25, 2021 at 10:30 a.m. as the date and time to consider adoption of an ordinance amending Chapter 7.100 of the Monterey County Code to suspend the Fiscal Year 2021-2022 automatic increases on the County's commercial cannabis business tax rates and resume the automatic increases in Fiscal Year 2022-2023 on July 1, 2022; and
- b. Provide direction to staff as appropriate.

### SUMMARY

Monterey County imposes an annual business tax on cannabis businesses pursuant to Monterey County Code Chapter 7.100 and such tax is collected by the Treasurer-Tax Collector. The Cannabis Program ("Program") staff recently presented a report to the Board of Supervisors Cannabis Committee ("Committee") on implications of the automatic cannabis tax escalator scheduled to take effect on July 1, 2021. The Committee recommended to freeze the automatic cannabis tax increases for a year and directed staff to return to the Board with an amendment to Chapter 7.100.

### DISCUSSION:

#### Implications of the Tax Escalator

Staff has conducted monthly industry meetings and received comments related to the commercial cannabis tax rate escalator where the industry presented various factors to be considered to suspend the automatic increases to tax rates.

While commercial cannabis state licenses and local permits, cultivation square footage, and gross sales have all steadily increased, Program staff acknowledges the concerns raised and continues to identify opportunities to work with operators and County leadership to support the growth and sustainability of the licensed cannabis industry.

#### Stabilization of the cannabis industry

In addition to the disruption caused by the COVID-19 pandemic, the commercial cannabis industry has not stabilized within Monterey County as evidenced by the following figures:

- Only 23% of cannabis land use applications have been approved.
- Only 12% of cannabis business permit applications have been approved.
- Infrastructure improvements related to the following have not been completed:
  - Life/health/safety issues and compliance with state and local building/zoning requirements.

- Intersection improvements for the Mitigated Negative Declaration.

Operators are still learning how to develop growing cycles efficiently and effectively to be profitable and continue to learn how best to handle grow cycles during the winter season when light and temperatures greatly affect growing cycles.

#### Impacts of the Hop Latent Viroid

The Hop Latent Viroid (“HpLVd”) has impacted the plants of many industry operators. As explained to the Committee by industry operators, the operative word with this viroid is “latent”, meaning that it is largely asymptomatic and will not be evident until later stages of cultivation where the harvest yields and potency of Tetrahydrocannabinol (“THC”), the psychoactive component generated by cannabis plants, are both greatly impacted.

The transmission of HpLVd is not fully understood, however it is suggested that it can be transmitted through the seed of an infected plant or through mechanical transmission. An example is when pruning tools are used on an infected plant and then on an uninfected plant. Although in-house testing can be performed, each individual test is approximately \$10. Depending on the size of the operator’s nursery, this could be hundreds of tests that are required to cull infected plants.

A survey inquiring about the impacts and outcomes of HpLVd was distributed to cannabis business owners, with 33 responses received at the time of writing this report. The identification of an operator affected by HpLVd could affect their reputation or business prospects negatively. As such, this survey was conducted anonymously, and outcomes are reported in aggregate rather than individual responses which could provide context to identify an operator.

- Operators attributed lost revenue to the overhead costs associated with testing and culling plants in addition to lower asking prices for their harvested product.
- One operator expressed concerns about laboratory standards and accountability of HpLVd testing: even if their own test returns a negative result, buyers err on the side of caution and will likely ask for a refund if their test returns a positive result.
- Operators shared that they have trained their staff on measures to prevent the spread of HpLVd and spot plants that are affected, but this requires ongoing diligence by staff.
- 20 provided figures for lost revenue ranging from \$0 to \$5,000,000.
  - 10 reporting losses from \$100k-\$1m.
  - 6 reporting losses from \$2m-\$3m.
- 7 provided figures for total cost of HpLVd testing ranging from \$15k-\$100k.
  - 4 reported that the economics did not support testing every single plant within their operation, prioritizing mother plants from which cuttings are taken.
- 13 provided figures for test positivity rates ranging from 10-100%.
  - 6 reporting percentages of 10-30%.
  - 5 reporting percentages from 50-80%.
- 29 provided figures for clone/immature plant pricing ranging from \$1-\$15.
  - 13 reporting from \$5-\$8.
  - 6 reporting \$10+.
- 21 provided figures for test pricing ranging from \$10-\$500.
- 15 provided figures for # of plants testing positive from 0-84k.

### Historical and Current Commercial Cannabis Tax facts to consider

In Fiscal Year (“FY”) 2016-17, Ordinance 5274 was adopted which imposed County general taxes for commercial cannabis businesses in the unincorporated area, contingent upon voter approval of Measure Y. In the November 2016 General Election, Measure Y was approved by nearly 96,000 Monterey County residents, or approximately 74% of the vote. The maximum tax rates as approved are as follows: twenty-five dollars (\$25.00) per square foot on cultivation with an annual adjustment thereafter by Consumer Price Index (“CPI”); five dollars (\$5.00) per square foot on nurseries with annual CPI adjustment thereafter; and ten (10) percent of gross receipts on manufacturing, distributing, testing, dispensing, and delivering commercial cannabis with no CPI adjustment.

The amount of square footage taxed is based on the amount of square footage allowed under the commercial cannabis business permit (“CNB”) the business obtains pursuant to Monterey County Code Chapter 7.90. Measure Y went into effect on January 1, 2017 and the TTC began collecting commercial cannabis business taxes at the following rates: \$15.00 per square of canopy of cultivation of mature plants; \$2.00 per square foot of canopy of cultivation of immature plants; and 5% of the gross receipts of dispensaries/deliveries, manufacturers, testing laboratories, distributors, and transporters.

In FY 2017-18, the taxes adopted in Measure Y were modified with Ordinance 5305 to substantially reduce cultivation tax rates and penalties beginning in FY 2018-19 and establish specific tax rates for other commercial cannabis activities.

In FY 2019-20, the Board suggested the outdoor grow pilot program cannabis tax rate be set at \$2.50 per square foot with an escalator of \$0.25 per year. Staff received direction to return to the Board of Supervisors with an ordinance amending Chapter 7.100 to add the rate. Staff has been waiting to move forward with the amendment due to other priorities and a lack of participation in the outdoor cannabis pilot program. This amendment is being considered now and will return to the Board soon.

In April 2020, the Board of Supervisors adopted Ordinance Number 5326, a COVID-19 pandemic related urgency ordinance that directed the TTC to temporarily waive all penalties and interest on unpaid installments of the annual commercial cannabis business tax for the third quarter of FY 2019-20.

In May 2020, the Board of Supervisors adopted Ordinance Number 5330 to suspend the FY 2020-2021 automatic increases of the County’s commercial cannabis business tax rates and resume the automatic increases in FY 2022 effective on July 1, 2021. Specifically, it prescribes the following:

- Taxes on indoor and mixed light cultivation and nurseries will automatically increase by \$1.00 per square foot of canopy on July 1, 2021.
- Taxes on manufacturers and distributors will automatically increase by 1% of gross receipts on July 1, 2021.
- Tax on retail facilities will automatically increase by 0.5% of gross receipts on July 1, 2021.

Since the Program and the Treasurer-Tax-Collector’s Office have visibility to data from the California Cannabis Authority (“CCA”) to enable analysis of seed to sale transactions, monthly gross receipts have trended downwards trend since July of 2020. Monthly gross receipts averaged \$11.8m across Q1 and Q2, with Q3 coming in 25% lower at \$8.9m.

While commercial cannabis state licenses and local permits, cultivation square footage, and gross sales have all steadily increased, Program staff acknowledges the concerns raised above and continues to identify opportunities to work with operators and County leadership to support the growth and sustainability of the licensed cannabis industry.

Apart from cultivation, Monterey County's tax rates for most commercial cannabis activities are average when compared to other counties. (Attachment A) As compared to other counties imposing canopy-based taxes, here is the breakdown of Monterey County rates by cultivation type: indoor cultivation is approximately \$3.00 above average; mixed light cultivation is \$2.00 above average; and nursery is \$1.00 below average.

Ordinance to suspend the Fiscal Year 2021-2022 automatic increases

The draft ordinance modifies the automatic increases to commercial cannabis tax rates. Specifically, it prescribes the following:

- Taxes on indoor and mixed light cultivation and nurseries will automatically increase by \$1.00 on July 1, 2022.
- Taxes on manufacturers and distributors will automatically increase by 1% on July 1, 2022.
- Tax on retail facilities will automatically increase by 0.5% on July 1, 2022.

A redlined and clean version of the ordinance are attached to this report as Attachment B and C.

OTHER AGENCY INVOLVEMENT:

The Office of the County Counsel and Treasurer-Tax Collector's Office were involved in the preparation of the ordinance and report. The Office of the County Counsel approved the ordinance as to form.

FINANCING:

The proposed amendments to Chapter 7.100 will impact the estimated commercial cannabis tax revenue for FY 21-22 by approximately a loss of \$6.2 million dollars. (Attachment D) The automatic escalators that were supposed to take place in FY 21-22 will not be recovered in later years.

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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Approved by: Nicholas E. Chiulos, Assistant CAO

Attachments:

- A: Commercial Cannabis Business Tax Rates by Jurisdiction
- B: Draft ordinance (redline version)
- C: Draft ordinance (signed clean version)

D: Commercial Cannabis Business Tax Revenue by Current and Scheduled Rates