



CITY OF SALINAS

COUNCIL STAFF REPORT

DATE: **OCTOBER 18, 2022**

DEPARTMENT: **COMMUNITY DEVELOPMENT DEPARTMENT**

FROM: **MEGAN HUNTER, COMMUNITY DEVELOPMENT DIRECTOR**

TITLE: **AMENDMENT OF COMMERCIAL CANNABIS TAXATION RATES**

RECOMMENDED MOTION:

A motion to approve a Resolution to amend Commercial Cannabis taxation rates to 2.5% of gross receipts for manufacturing and \$7 per square foot of canopy for cultivation pursuant to Section 19A.10.330 of the Salinas Municipal Code.

EXECUTIVE SUMMARY:

On February 15, 2022, City Council directed staff to hire a consultant to prepare a report on recommended taxation rates after hearing testimony of multiple cannabis business owners concerned about long-term financial viability of the industry in the City. The City contracted with SCI Consulting Group which completed the report and presented findings to the City Council on August 23, 2022. During the meeting there was no clear consensus among Councilmembers on recommended rates. Some Councilmembers expressed support for a more moderate approach to reducing rates, and even requiring community benefits for such a reduction (Council members Barrera, González, Osornio, and Rocha expressed support for the idea of community benefits agreements tied to rate adjustments). Other members proposed an even more aggressive reduction than the SCI Group report. Ultimately, staff was directed back to the Cannabis Committee for guidance. On September 22, 2022, the Cannabis Committee met and Councilmembers McShane and Osornio recommended that staff return to City Council with a rate reduction of 2.5% of gross receipts for manufacturing and a rate of \$7 per square foot of canopy for cultivation. No other rates were recommended for amendment.

BACKGROUND:

On February 15, 2022, the City Council received an annual report on the commercial cannabis industry in Salinas. During the meeting, several business owners provided testimony expressing concern about the taxation rates for cultivation and manufacturing given the changing environment of the cannabis industry. As a result, City Council directed staff to hire a consultant to prepare a report on recommended taxation rates. After conducting an RFP process, City Council approved a resolution authorizing the City Manager to enter into an agreement with SCI Consulting Group to complete the study and provide cannabis monitoring services. SCI Consulting Group completed the study in August and presented the findings to City Council on August 23, 2022.

The report included a table (Table 1) that outlined tax revenue collected through commercial cannabis by business type. Although total tax revenue for 2022 is not complete, the report noted that 2022 revenue is likely to decline from 2021. During the presentation, SCI Group stated that this was occurring across the state and that inflation was impacting overall revenue across the industry.

Table 1 - Salinas Cannabis Industry Tax Revenue by Business Type (2017-2022)

Business Type	2017	2018	2019	2020	2021	2022
Delivery	\$38,989	\$102,917	\$117,138	\$197,395	\$134,572	\$16,600
Dispensary	IA	\$285,475	\$949,762	\$1,124,674	\$1,221,626	\$333,647
Cultivation	IA	IA	IA	\$8,679	\$73,539	\$19,200
Manufacturing	\$335,380	\$482,057	\$561,413	\$511,284	\$669,760	\$168,926
Total	\$374,369	\$870,449	\$1,628,314	\$1,842,033	\$2,099,497	\$538,373

IA = business type was inactive during this term, i.e. not yet conducting commercial operations and paying the cannabis business tax

Despite the projected decline of revenue in 2022, the report found that the City's "current rates, rate structure, number and types of businesses are generally appropriate and well within California norms". The report, however, did recommend a reduction to the tax rates for manufacturing to between 2.5% and 3% of gross receipts and for cultivation to between \$7 to \$10 per square foot of canopy and cultivation. While Council did not achieve a consensus on the recommended rate, staff was directed back to the Cannabis Committee for guidance.

DISCUSSION:

On September 22, 2022, the Cannabis Committee met. Councilmembers McShane and Osornio discussed the proposed rates, and it was recommended that staff return to City Council with a recommended rate reduction of 2.5% of gross receipts for manufacturing and a rate of \$7 per square foot of canopy for cultivation. No other rates were recommended for amendment.

Based on this recommendation, staff drafted a public hearing notice outlining the proposed amendment to the commercial cannabis taxation rates. This notice was published in the Monterey Herald on October 4, 2022, in compliance with the required 14 day minimum. Additional notification was also provided in the Monterey County Weekly on October 6 and 13, 2022.

Table 2 below highlights the current and proposed rates by business type and the maximum rate allowed by Salinas voters. The City Council by resolution can amend the commercial cannabis rates as long as they do not exceed the maximum authorized by voters.

Table 2 – Cannabis Tax Rates (Current & Proposed)

Business Type	Current Rate	Maximum Rate	Proposed Rate
Retail (Dispensary)	5% of Gross Receipts	10% of Gross Receipts	No Change
Retail Delivery	5% of Gross Receipts	10% of Gross Receipts	No Change
Manufacturing	5% of Gross Receipts	10% of Gross Receipts	2.5% of Gross Receipts
Cultivation	\$15/sf of Canopy	\$25/sf of Canopy	\$7/sf of Canopy
Nursery	\$2/sf of Canopy	\$5/sf of Canopy	No Change
Distribution	No Tax	No Tax	No Change
Testing	No Tax	No Tax	No Change

The rates recommended by the Cannabis Committee are consistent with the SCI Group report that recognizes some of the ongoing challenges among manufacturing and cultivation businesses because of greater volatility and higher operational expenses. In consideration of these barriers and public comment from the August 23rd meeting, the Committee recommended the more aggressive rate change of 2.5% of gross receipts for manufacturing and \$7/sf of canopy for cultivation.

Both City Council and the Cannabis Committee recognize that reduce taxation rates is not enough, and further directed staff to work on additional amendments to the Commercial Cannabis Ordinance to remove obstacles such as non-operational businesses with permits or limited vacant land/properties that are also likely affecting revenue. This work has already begun at the Committee level, and it is anticipated that other amendments will be presented to City Council for consideration in January 2023.

Community Benefits Agreements

The City may add a “community benefit” consideration to the cannabis tax calculation. This would be an alternative to the approval of a Resolution reducing the overall tax rate for either or both of the business types discussed in this Report and the proposed Resolution (manufacturing and cultivation). As a policy matter, community benefits are generally those above and beyond normal good design, responsible business operation, and minimal compliance with City requirements. Community benefits from other jurisdictions that the City may adopt include:

- Employment for residents of the City, paid a living wage and benefit;
- Improvements to the property where the cannabis business is proposed to be operated and adjoining properties;
- Public outreach and education/community service;
- Hiring partners and employees from marginalized communities and/or rehabilitated persons or employees with cannabis criminal arrest history;
- Green Business certification;

- Living wages for employees;
- Contributions to non-profits; and
- Community security patrols in the vicinity of the business.

The tax relief could be granted immediately based on future community benefit promised in an agreement or permit condition. Alternatively, and for greater security for the City, the tax relief would be provided as a tax refund after the tax is paid and the community benefit has been provided. Businesses that want to be eligible for the community benefit refund could apply either when they apply for their original permit or when they apply for a renewal.

The approximate process for a community benefit tax refund could be: (1) the identified type and amount of community benefit would be approved with the application for approval or renewal; (2) the full quarterly tax payments would be made; (3) at the end of the year, the cannabis business would verify that all approved community benefits had been provided and request the tax refund; and (4) the City would process the tax refund either as a payment or as a credit against the next quarterly tax payment.

CEQA CONSIDERATION:

The City of Salinas has determined that the proposed action is exempt from environmental review under the California Environmental Quality Act (CEQA) because it can be seen with certainty that there is no possibility that the activity in question may have a significant effect on the environment. [CEQA Guidelines Section 15061(b)(3)].

STRATEGIC PLAN INITIATIVE:

The recommendations are consistent with those in the SCI Consulting Group Commercial Cannabis Taxation Recommendation Report and will help meet the City Council Strategic Goal of Effective and Culturally Responsive Government as it will help apply data-driven management to decision-making. The recommendations will also advance the Goal of Economic Development by encouraging a diverse and thriving economy around the commercial cannabis industry.

DEPARTMENTAL COORDINATION:

City departments coordinate on cannabis taxation as it involves both revenue and land use. The Community Development Department (CDD) coordinates regularly with the Finance Department regarding cannabis taxation and the Legal Department as it relates to the Salinas Municipal Code and Commercial Cannabis. If City Council recommends action to adjust taxation rates, CDD will work with the Legal Department to amend the Code.

FISCAL AND SUSTAINABILITY IMPACT:

It is hard to quantify the overall impact on the reduction in tax rates on revenue over time because it remains to be seen if reducing these rates will promote greater growth and stability in Salinas'

commercial cannabis industry. The immediate impact can be extrapolated as shown in Table 3 below.

Table 3 - Potential Tax Revenue Loss by Business Type Based Upon 2021

Business Type	Base Year 2021	\$7 sq ft/ 2.5%
Cultivation	\$73,539	\$34,318
Manufacturing	\$669,760	\$334,880
Total	\$743,299	\$369,198

Using 2021 revenues for illustration, a tax rate of 2.5% of gross receipts for manufacturing would result in a \$334,880 reduction in revenue per year. A decrease in the rates for cultivation will have a less dramatic impact on current revenue since this business type is less developed in the City. At \$7 per sq ft, the potential revenue loss is \$39,221. In total, the potential annual loss of revenue in the immediate short term could be approximately \$374,101 per year.

It should be noted that the level of revenue is never guaranteed, and it is possible the reduction in rates will stabilize these business types and result in new cannabis ventures, which could ultimately result in a more stable revenue source for the City.

ATTACHMENTS:

1. Commercial Cannabis Taxation Amendment Resolution
2. [August 23, 2022 Report and Attachments](#)
3. SCI Consulting Group Commercial Cannabis Taxation Recommendation Report
4. Commercial Cannabis Taxation Amendment Powerpoint