



CITY OF SALINAS COUNCIL STAFF REPORT

DATE: MARCH 3, 2020

DEPARTMENT: COMMUNITY DEVELOPMENT

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TITLE: COMMERCIAL CANNABIS INDUSTRY IN SALINAS

RECOMMENDATION:

There is no formal recommendation associated with this report. This report presents information and does not require action of the City Council.

EXECUTIVE SUMMARY:

Pursuant to Salinas Municipal Code (SMC) Sec. 5-07.49, City staff shall prepare reports to the City Council providing findings regarding the operations of commercial cannabis businesses within the City. The reports shall include information regarding employment, community benefits, tax revenue, crime, building/zoning compliance, and any other information requested by the Council. The first of these reports was presented on May 15, 2018 and the second was presented on February 19, 2019.

The legal commercial cannabis industry (“the industry”) matured considerably within the City of Salinas in 2019. The City’s cannabis business tax is currently generating over \$1 million annually for the City’s general fund. While the industry has grown, a high degree of uncertainty remains regarding the sustainability of the businesses that are in operation. Several factors have created market volatility such as the illegal cannabis trade and costs associated with operating a legal cannabis business. The City could consider steps such as lowering the cannabis business tax rate or reducing fees to improve the likelihood that businesses remain open, thus stabilizing long-term tax revenue. Consistent with the year prior, the industry continues to require a high degree of administrative staff resources due to the unique regulations, taxes, and fees that are imposed. However, the businesses maintain a high degree of security resulting in no criminal or nuisance activities on premises last year and required minimal police oversight.

BACKGROUND/ANALYSIS:

Of 482 California cities, an estimated 161 allow commercial cannabis activity. Among cities that allow commercial cannabis activity, Salinas has developed what could be considered a relatively

permissive stance by allowing for a broad variety of business types and a large number of available permits. Salinas has rapidly become an industry hub, with ten operational businesses as of the end of 2019 that include some of the industry’s most prominent businesses. Table 1 below provides a brief summary of significant state and local milestones in the industry’s development.

Table 1: State and Local Cannabis Industry Milestones

Date	Event
January 2016	City of Salinas adopts ordinance regulating cannabis businesses. A maximum of 12 businesses (three each of dispensary, manufacturing, cultivation, and delivery) are allowed.
June 2016	City of Salinas accepts applications for Commercial Cannabis Permits; 24 applications are received in this “Round 1” of permitting
August 2016	California passes Medical Cannabis Regulation and Safety Act (MCRSA)
November 2016	Proposition 64 passes, legalizing adult-use cannabis effective January 1, 2018
November 2016	Salinas Measure L passes, establishing a commercial cannabis business tax on specified businesses (Cultivation, Delivery, Dispensary, and Manufacturing)
May 2017	City of Salinas completes initial review of Commercial Cannabis Permits. Nine Permits are recommended for approval (3 each of Cultivation, Dispensary, and Manufacturing). Fourteen applications are not approved.
June 2017	California passes Medicinal and Adult-Use Regulation and Safety Act (MAUCRSA) implementing Proposition 64
August 2017	City adopts revisions to commercial cannabis ordinance. Distribution and Testing Laboratories are added as allowable businesses through Administrative Permits. Number of Permits increases from 12 to 23 (5 each for Cultivation, Dispensary, Distribution, and Manufacturing; 3 for Delivery). No maximum number of Administrative permits.
October 2017	City accepts revised permit applications from commercial cannabis businesses that were not approved in the previous permitting round. Thirteen permit reapplications are received in this “Round 1B” of permitting.
November 2017	City adopts revisions to commercial cannabis ordinance allowing businesses to participate in the adult-use market. Other changes made to streamline processes and align local laws with MAUCRSA.
November 2017	California releases regulations implementing MAUCRSA
December 2017	City issues 11 additional permits, bringing the total number of permits issued by the City to 20
January 2018	Proposition 64 takes effect – adult-use cannabis is legal. California begins issuing temporary licenses to businesses.
May 2018	City adopts Ordinance modifying processes for Nurseries and R&D businesses and lowering tax for Nursery-type Cultivation from \$15 to \$2 per square foot
December 2018	City transfers management of commercial cannabis business permitting from the Economic Development Division to the Community Development Department
January 2019	City adopts ordinance extending the allowed hours of operation for cannabis dispensaries and allowing for sales on Sundays
September 2019	City accepts new permit applications; 10 applications are received in this “Round 2” of permitting

This report provides a summary of the industry for the 2019 calendar year. Last year's annual report noted that the industry has been in a perpetual state of change since the passage of Proposition 64 in November 2016, and that it was difficult to compile or interpret the limited data available at that time. While that remains true, 2019 was marked by mutually beneficial coordination between the City and its permitted businesses, as well as improved data collection and a continued increase in fees and taxes collected.

City Jurisdiction of Commercial Cannabis Business Permitting

In December of 2018, responsibility over commercial cannabis business permitting was transferred from the Economic Development Division to the Community Development Department (CDD). This change was intended to improve efficiency by assigning permitting responsibility to the department best suited to manage the various needs of commercial cannabis businesses, such as building permits, inspections, and review/issuance/renewal of commercial cannabis permits.

The Community Development Department has contracted with Rincon Consultants, Inc. to assist on all cannabis-related tasks. The same Rincon staff member has spent one day per week on-site with City planning staff since December 2018, serving as the primary point of contact for current and prospective commercial cannabis permit-holders and assisting the Planning Manager on all tasks concerning the permitting and regulation of the industry. This long-term staffing consistency has resulted in improved communication between the permitted businesses and the City as well as improved record-keeping regarding permits and fee collection.

Commercial Cannabis Business Permitting

The City issues two types of commercial cannabis business permits: Commercial Cannabis Permits (CCP) and Administrative Permits (AP). CCPs are applicable to Cultivation, Delivery, Dispensary, Distribution, and Manufacturing. Administrative Permits are applicable to Testing Laboratories, Small Distribution (business premises under 500 square feet), Research and Development Facilities, and Nurseries.

The State of California has identified 20 different subtypes of cannabis businesses, organized by license type. Each commercial cannabis business type, as defined by the City, corresponds to a specified State license. The following chart lists the commercial cannabis business types recognized by Salinas, along with the corresponding state license and a description of that type's role in the industry.

Table 2. Commercial Cannabis Business License Types

Salinas Business Type	Corresponding State License	Role
Cultivation (CCP)	Cultivation (Types 1-5; 14 different subtypes in total)	Growing of cannabis plants for sale to Manufacturing, Delivery, or Dispensary businesses
Manufacturing (CCP)	Manufacturer (Type 6-7)	Processing of cannabis into cannabis products
Distribution (CCP)	Distribution (Type 11)	Transports cannabis and cannabis products between licensees; collects and remits State taxes from other businesses.
Dispensary (CCP)	Retailer (Type 10)	Sells cannabis and/or cannabis products via a fixed location storefront
Delivery (CCP)	Retailer, Non Store-front (Type 9)	Sells cannabis and/or cannabis products exclusively through delivery; must have a licensed business address, but the premises are not open to the public
Testing Laboratory (AP)	Testing Laboratory (Type 8)	Tests to ensure product safety
Nursery (AP)	Nursery (Type 4)	Grows immature plants from cuttings and seeds for internal use or sale to other Cultivation, Delivery, or Dispensary companies
Research and Development (AP)	Case-by-case	Conducts research on cannabis and/or cannabis products; excludes testing facilities
Small Distribution (AP)	Distribution (Type 11)	Transports cannabis and cannabis products between licensees; collects and remits State taxes from other businesses.

Commercial Cannabis Permits

The City allows for issuance of a maximum of 23 CCPs. Because the available permits are limited, the City accepts applications only during designated “rounds”, allowing for applicants to competitively vie for permits. The City has conducted three such rounds: Round 1 in June 2016; Round 1B in October 2017 (reapplication for applicants that were denied in Round 1); and Round 2 in September 2019. Applications are reviewed by the Cannabis Selection Committee, which is made up of one staff member from five different City departments. The City received a total of nine CCP applications in Round 2. As of the writing of this report, applications received for Round 2 are still under review and are therefore not discussed further in this report. Table 3 below shows permit quotas, active, and operational businesses as of January 2019.

Table 3. CCP Quotas

Business Type	Permit Quota	Active Permits*	Operational Businesses*
Cultivation	5	2	0
Delivery	3	3	3
Dispensary	5	4	3
Distribution	5	2	2
Manufacturing	5	4	2
Total	23	15	10

Each CCP stipulates that a business must begin commercial cannabis business operations within one year of the date in which the permit is granted. Applicants who do not meet this deadline are able to apply for a permit amendment to grant a single 90-day extension. Subsequently, a permit can be amended for a second time only by a Cannabis Selection Committee vote. Both amendments require that businesses demonstrate diligence towards reaching operational status.

Table 4 below shows the 15 businesses that were awarded permits in 2017 and are currently either operational or pursuing operational status. A total of five permits (not listed) were revoked in 2019 due to permittees abandoning the business pursuit. As of last year's annual report, a total of eight businesses with a CCP had initiated commercial operations and seven businesses were in the building permit process. The updated status of the City's 15 active CCPs is shown below.

Table 4. Permits Awarded in 2017 Round 1 and Round 1B

	Business Name	Address	Type	Business Status
1.	CannaCruz	1156 Abbott Street	Dispensary	Operational
2.	Compassionate Bay	1051 Terven Avenue	Delivery	Operational
3.	Golden Essentials	1020 Merrill Street	Delivery	Operational
4.	Purple Trilogy	1020 Merrill Street	Delivery	Operational
5.	Cypress Manufacturing	1353 Dayton Street	Distribution	Operational
6.	Cypress Manufacturing	20 Quail Run Circle	Manufacturing	Operational
7.	Emerald Skyway	1610 Moffett Street	Dispensary	Operational
8.	710 Combinator (Grupo Flor)	518 Work Street	Manufacturing	Operational
9.	East of Eden (Grupo Flor)	514 Work Street	Dispensary	Operational
10.	Flor X (Grupo Flor)	516 Work Street	Distribution	Operational
11.	Flor Cultivation	1155 Harkins Road	Cultivation	Not Operational
12.	Emerald Skyway	1610 Moffett Street	Manufacturing	Not Operational
13.	Emerald Skyway	1610 Moffett Street	Cultivation	Not Operational
14.	Griffin Holistics	1072 Industrial Street	Dispensary	Not Operational
15.	Griffin Holistics	1072 Industrial Street	Manufacturing	Not Operational

Ten businesses are now operational, and five businesses are still working towards operational status. Each of these five permittees have amended their permit to extend the deadline at which

they are required to initiate business operations. The delays have involved challenges related to physical building improvements as well as state licensing.

Administrative Permits

Unlike CCPs, there are no limits on how many administrative permits can be issued for commercial cannabis businesses. Administrative permits can be applied for at any time and do not require review by the Cannabis Selection Committee. Obtaining and maintaining an administrative permit is considerably simpler and less expensive in comparison to the CCP process. However, applicants for administrative permits must also obtain a state license. Table 5 below shows the administrative permits that have been issued and remain active (business is operational or is working towards operational status).

Table 5. Administrative Permits: Operational Status

	Business Name	Address	Type	Business Status*
1.	OPM Holdings	743 Sanborn Place	Small Distribution	Operational
2.	American Biotech Testing	607 Brunken Avenue	Testing Lab	Not Operational
3.	ProForma Labs	1514 Moffett Street	Testing Lab	Not Operational
*As of January, 2019				

The two permitted testing labs listed above are concluding their building permit and state licensing processes and anticipate opening for business in 2020. In addition to the three businesses listed above, several other applicants have pending applications or inquiries. A number of other applicants have been awarded Administrative Permits but have abandoned the venture prior to achieving operational status.

Impacts on City Resources

In September 2017, the Council adopted ongoing monitoring fees to compensate the City for the ongoing costs relating to monitoring of commercial cannabis businesses and enforcement of regulations. These fees are intended to cover services for which fees are not typically charged, and that would go beyond the services typically rendered to businesses. Monitoring fees are first charged prior to issuance of a certificate of occupancy and are subsequently charged annually as part of the permit renewal process. Monitoring fees are collected for three City departments: Community Development, Police, and City Attorney. In addition, a monitoring fee is charged to cover the cost for a third party regulatory and financial assessment of the businesses performed by the firm Macias Gini & O'Connell (MGO).

Table 6 shows monitoring fee rates and Table 7 shows the total monitoring fee payments received in 2019.

Table 6. Salinas Cannabis Industry Monitoring Fee Rates

Monitoring Department	Monitoring Fee Rate Per Permit (2019)*
Community Development Department	\$2,202.50
Police Department	\$8,272.00
City Attorney's Office	\$722.00
Financial Consultant (MGO)	Varies based on business type and revenue; between \$5,600 and \$16,000
*Fees increased in July 2019	

Table 7. Salinas Cannabis Industry Monitoring Fees Collected in 2019

Monitoring Department	2019 Total
Police	\$65,244.50
Community Development Department	\$17,373.75
City Attorney's Office	\$5,697.50
Financial Consultant (MGO)	\$99,954
Total:	\$188,268

As shown above, a total of \$188,268 in monitoring fees was collected in 2019. The largest sum was collected to pay for the assessments performed by MGO. The financial consultant monitoring fees are collected at-cost from the businesses. Future adjustments to monitoring fees may be needed in order to more appropriately allocate funds in accordance with staff demands, particularly as it relates to overall administration.

Additional fees collected during 2019 included over \$28,000 in CCP application fees and over \$11,000 in CCP renewal fees. These fees are intended to cover the cost of application processing.

Employment/Community Impacts

There were no crime or nuisance events at the premises of a commercial cannabis business in Salinas in 2019. CCP permittees report affiliation with or donations to a number of nonprofit groups, including the Boys and Girls Club of Monterey County, the Mixed Roots Foundation, and the National Alliance for Mental Illness.

As shown in Table 8, Salinas's commercial cannabis businesses directly employ approximately 321 individuals.

Table 8. Salinas Cannabis Industry Employment

	Business Name	Business Type	Employees*
1.	Cypress Manufacturing	Manufacturing	134
2.	710 Combinator	Manufacturing	10
3.	Emerald Skyway	Dispensary	25
4.	East of Eden	Dispensary	35
5.	CannaCruz	Dispensary	25
6.	Compassionate Bay	Delivery	7
7.	Golden Essentials	Delivery	5
8.	Purple Trilogy	Delivery	17
9.	Cypress Manufacturing	Distribution	52
10.	Flor X	Distribution	10
11.	OPM Holdings	Small Distribution	1
	Total:	Industry-wide	321
*Employee tallies are self-reported by business or estimated by City staff			

Tax Revenue from the Commercial Cannabis Industry

Measure L, adopted by the voters of Salinas in November 2016, requires certain commercial cannabis businesses to pay a commercial cannabis business tax every quarter, beginning January 1, 2017. The original tax rates were scheduled to increase in 2020; however, in December 2019 Council voted to forgo the scheduled increase. Therefore, the rates listed below remain in effect. Table 9 lists the rates levied on each business type. Business types not listed are not taxed.

Table 9. Cannabis Business Tax Rates

Business Type	Current Rate
Delivery	5% of gross receipts
Dispensary	5% of gross receipts
Manufacturing	5% of gross receipts
Cultivation	\$15 per square foot
Nursery	\$2 per square foot

The Community Development Department coordinates with the Finance Department to monitor tax collection and the good standing of each business. The annual assessments performed by MGO provide detailed auditing of tax payments.

Table 10 below shows cannabis revenue by businesses that conducted commercial cannabis operations from 2017 through 2019. Table 11 compares tax revenue per quarter from 2018 and 2019.

Table 10. Salinas Cannabis Industry Tax Revenue by Permittee: 2017-2019

	Business Name	Business Type	2017 Total	2018 Total	2019 Total
1.	Cypress Manufacturing	Manufacturing	\$335,379.85	\$482,057.10	Pending
2.	710 Combinator	Manufacturing	IA	IA	Pending
3.	Emerald Skyway	Dispensary	IA	\$226,967.12	Pending
4.	East of Eden	Dispensary	IA	\$58,508.00	Pending
5.	CannaCruz	Dispensary	IA	IA	Pending
6.	Compassionate Bay	Delivery	\$14,955.00	\$43,067.63	Pending
7.	Golden Essentials	Delivery	\$24,034.00	\$46,029.48	Pending
8.	Purple Trilogy	Delivery	IA	\$13,819.54	Pending
9.	Cypress Manufacturing	Distribution	E	E	E
10.	Flor X	Distribution	E	E	E
11.	OPM Holdings	Small Distribution	E	E	E
	Total:	Industry-wide	\$374,368.95	\$870,448.87	Pending
IA = business was <i>inactive</i> during this term, i.e. not yet conducting commercial operations and paying the cannabis business tax					
E = business type is <i>exempt</i> from local cannabis tax					

Table 11. Salinas Cannabis Industry Tax Revenue by Quarter: 2018 and 2019

Year	Q1	Q2	Q3	Q4
2018	\$120,736	\$143,838	\$328,894	\$276,979
2019	\$332,421	\$357,791	\$347,545	Pending
Q = quarter (four month period)				

Tax revenue increased by 133 percent from 2017 to 2018. Fourth quarter 2019 revenue data was not available as of the writing of this report; however, tax revenue from the first three 2019 quarters exceeds the entire 2018 total. Taxes collected to date have been generated by just seven businesses. It is unclear whether tax revenue will increase again in 2020 as instability in the market has impacted sales and may lead to the closure of some businesses. Hopefully, as additional businesses began operating for their first full year, revenues will increase, but it is too early to predict.

Late payment of taxes has been a recurring issue for the Finance Department. To date, no enforcement has occurred other than fines; no business permits have been revoked as a result of delinquent taxes. It is suggested that the City's procedure for enforcing tax payments be refined in order to conduct fair and consistent enforcement. The City may also consider a reduction in tax rates, as the current rates contribute to the overall expense burden (described below in the next section) that threatens the sustainability of the industry.

Cannabis Industry Challenges

The following discussion is based on the experiences of City staff that have worked on commercial cannabis business permitting, including input from consulting staff, interagency coordination, and discussions with permittees and applicants. This analysis is anecdotal and has not been independently verified.

In last year's annual report, the primary concerns for both business applicants and City staff were described as largely related to costs; for businesses, concerns involved the ability to maintain profitability while managing industry-specific taxes, fees, and operating expenses; while for City staff, the concern was that fee collection would not cover the demand on staff time. For businesses, concerns remain focused on expenses. Commercial cannabis businesses pay a state excise tax and state licensing fees as well as local taxes and fees, all of which are unique to the industry. In addition, operating expenses are high for maintaining compliance with strict product testing and security requirements. Throughout the state, these expenses have proven to be a barrier to entry and sustainability, resulting in lower than expected state tax revenue and a persistent black market.

For City departments, cost/expense ratios have improved, thanks to fee increases, improved efficiency, and more businesses paying monitoring fees and application fees. The following four items describe notable challenges related to the City's regulation of the industry.

Salinas Municipal Code Updates

A number of the City's commercial cannabis industry regulations and procedures have proven challenging to interpret and implement. The majority of the SMC section that regulates the industry (Chapter 5, Article VII) has not been recently updated. The section includes a number of provisions that should be reviewed and revised, including, but not limited to, specific regulations that are either out of date or may be considered unnecessary. The section also designates various City responsibilities to different entities, such as the City Manager, the Police Department, and the Cannabis Selection Committee. Revisions to the section could be utilized to clarify and reorganize these responsibilities to best suit the needs of the City and the permittees.

Application Review Process

The City's procedure for receiving and reviewing CCP applications could be reconsidered. The SMC stipulates a Cannabis Selection Committee to review and award permits; however, limited detail is provided as to how the application rounds should be conducted. The competitive permitting process is complicated and unique from how other City permits are awarded, resulting in a lengthy and time-intensive process. The SMC could be revised to ensure consistency and best practices in future permitting rounds; or, the City could consider an alternate method for awarding CCPs.

Siting of Commercial Cannabis Businesses

The City should reconsider the restrictions that govern where commercial cannabis businesses may be located. The zoning code does not address commercial cannabis uses; therefore, planning staff must equate commercial cannabis uses to other uses in order to evaluate zoning compliance. This methodology is difficult for prospective applicants to understand. Furthermore, the SMC places “sensitive use” restrictions on the siting of cannabis businesses. These prohibit cannabis businesses from being located within 1,000 feet of various sensitive uses, such as schools, parks, or alcohol sales. The restrictions have proven difficult for applicants. In particular, dispensary applicants are effectively barred from commercial districts due to the prevalence of alcohol sales in those areas. Therefore, a dispensary is a commercial use that is challenging to permit in a commercial zone. Reconsideration of sensitive use restrictions could allow for more appropriate and flexible siting of businesses. However, the City must carefully consider the siting of these businesses as is currently the case with liquor stores to ensure land use compatibility and minimize impacts to sensitive receptors.

Industrial Hemp Regulations

Industrial hemp is considered to be distinct from cannabis, based on differing tetrahydrocannabinol (THC) content. There is a great deal of interest throughout the State in the cultivation, manufacture, and sale of hemp products, including edible products containing hemp-derived cannabidiol (CBD). However, State-level regulatory guidance for hemp has lagged behind that developed for cannabis. Cannabis regulations are generally not applicable to hemp. The Salinas Municipal Code mentions hemp just once, to note that the definition of cannabis excludes industrial hemp (Section 5-07.07(b)). Monterey County has determined that the cultivation and manufacture of industrial hemp is of a similar character to commercial cannabis and shall therefore be regulated similarly. The City should consider this course of action and/or clarify its stance on regulation of industrial hemp.

CEQA CONSIDERATION:

This Report is informational only and does not constitute a “project” under CEQA.

DEPARTMENT COORDINATION:

Community Development Department coordinates frequently with the City Attorney’s Office on matters related to commercial cannabis permitting. Additional coordination occurs with the departments of Finance, Police, and Fire, and the Economic Development Manager in the City Manager’s Office.

STRATEGIC PLAN INITIATIVE:

The effective management of the Commercial Cannabis Industry is consistent with the City Council’s Strategic Plan, specifically the goals of generating new revenue, improving operational efficiencies, and protecting public safety.

FISCAL AND SUSTAINABILITY IMPACT:

This Report includes discussion of tax revenue, but is not an independently verified financial reporting document, and should be used for informational purposes only.