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**Report Pursuant to
Elections Code Section 9212
Regarding an Initiative Ordinance
Relating to Cannabis Businesses**

Prepared for
the
City of Marina
August 2nd, 2018

I. Introduction

The City of Marina has requested HdL's assistance in preparing a fiscal analysis for a citizens' initiative that is expected to be placed on the November 6th ballot. This initiative would establish a framework for regulating commercial cannabis activities in the City, would set a range of tax rates and fees for the various business types, and would require that cannabis businesses enter into development agreements with the City.

Under the initiative, all commercial cannabis business activities except outdoor cultivation would be allowed within the City for both adult use and medicinal use. Retailers (dispensaries) will be limited to 3 locations for medicinal and 3 locations for adult use. Retailers will not be allowed to be located within 1,000 feet of each other unless they are a medicinal retailer and an adult use retailer adjacent to each other. There are no limitations or caps on any other type of cannabis business, other than general zoning limits.

Cannabis retailers for both medical and adult use would both pay a business tax equal to a minimum of 2.5% of annual gross receipts, which may increase up to a maximum of 5% starting in 2022. Cannabis manufacturers and processors would be taxed at a minimum of 2%, which may also increase up to a maximum of 5% in 2022. All taxes would be paid quarterly. The Notice of Intent to Circulate Petition states *"These proposed businesses and related taxes and fees will generate an estimated \$40,000 to \$200,000 or more per year"*.

In addition to the above taxes, all cannabis businesses would be required to enter into an annual development/operating agreement with the City. Such agreements would set forth further mutually-agreed upon conditions of approval that will protect and promote the public health, safety and welfare of the community.

At its meeting on July 3rd, the City Council voted 4-1 to direct staff to prepare a report on the proposed ordinance, pursuant to Elections Code Section 9212, to be provided to the City Council no later than August 2. The Council directed that the report examine a number of potential impacts, including land use, general plan consistency, access to Federal funding, and risks arising from conflicts between State and Federal law. Specifically, the Council requested that the report examine the following 10 potential impacts:

- a. Areas designated for the various cannabis activities, including dispensaries, research and development, manufacturing, growing, and any other types of activities that are addressed by the initiative;
- b. Fiscal impact;
- c. Internal consistency with the City's general plan and specific plans;
- d. Effect on land use availability;
- e. Impact on funding for infrastructure;
- f. Ability to attract or retain businesses;
- g. Analysis of the impact of exclusion, if there is an impact, such as exclusion from the ability to secure federal grants;
- h. The risks of forfeiture or adverse impacts resulting from conflict of California law with Federal law;

- i. Whether the risks described in g and h would have different impacts based on authorization of cultivation, distribution, manufacturing or retail activities.
- j. Whether the impact of the risks described in g and h would have different impacts based on authorization of cultivation, distribution, manufacturing or retail activities.

Pursuant to the Council's direction, the City retained the services of HdL to provide a fiscal analysis of the measure, including an estimate of the number, size and gross receipts of each type of cannabis business that may be expected to locate in the City, as well as an estimate of the potential revenues that may be generated by the tax component of the measure. HdL was also requested to provide a discussion and analysis of the impact the measure may have on infrastructure funding and the ability to attract or retain businesses.

While HdL is able to provide assistance or general discussion of some of the other issues, many required either detailed land use expertise from City planning staff, or a legal opinion that HdL is not qualified to offer. These topics were referred to the City's Community Development Department and to the City Attorney.

The report contained herein includes sections prepared by HdL, City staff, and the City's legal counsel.

II. Common Tax Rates

The initiative being proposed for the City of Marina sets tax rates for cannabis retailers and manufacturers. Cannabis retailers for both medical and adult use would pay a business tax equal to a minimum of 2.5% of annual gross receipts, which may increase up to a maximum of 5% starting in 2022. Cannabis manufacturers would be taxed at a minimum of 2%, which may also increase up to a maximum of 5% in 2022. All taxes would be paid quarterly.

HdL is currently working with 25 local governments around California on tax measures for the November 2018 ballots. The proposed rates for manufacturers are generally consistent with these other ballot measures, and preview what we see as evolving statewide norms for the industry. The proposed rates for retailers are somewhat below these emerging norms, which generally range from 4% to 6% of gross receipts.

In addition to the above taxes, all cannabis businesses would be required to enter into an annual development/operating agreement with the City. Such agreements would set forth further mutually-agreed upon conditions of approval *“including, but not limited to payment of fees and other charges as mutually agreed, and such other terms and conditions that will protect and promote the public health, safety and welfare”* (Section 6).

The proposed ordinance goes no further in defining these development agreements, leaving it wide open as to what additional fees or charges may be agreed upon. Were the ordinance to be approved by the voters, the City may wish to key any development agreements to these common rates.

Cultivation is most commonly taxed by square footage, rather than by gross receipts. The common rates we are seeing for mixed-light cultivation are between \$4 and \$7 per square foot. Rates for indoor cultivation are somewhat higher at \$7 to \$10 per square foot, in recognition of the greater number of harvest cycles that are possible, and thus greater yield. The range for nurseries is between \$1 and \$2 per square foot. The rates for other cannabis businesses are commonly from 2% up to 6% of gross receipts.

Testing laboratories, as an exception, fall between 1% and 2%, in recognition of the quasi-regulatory function they provide. Some jurisdictions are choosing to not apply any tax to testing laboratories, as they provide a State mandated semi-regulatory function. These rates are shown in Figure 1.

Figure 1:

Common Local Tax Rates Among 2018 Ballot Measures		
Cannabis Business Type	Initial Rate	Maximum Rate
Cultivation (outdoor)	\$2 per square foot	\$4 per square foot
Cultivation (mixed-light)	\$4 per square foot	\$7 per square foot
Cultivation (indoor)	\$7 per square foot	\$10 per square foot
Nurseries	\$1 per square foot	\$2 per square foot
Manufacturing	2.5% of gross receipts	4% of gross receipts
Distribution	2% of gross receipts	3% of gross receipts
Retail	4% of gross receipts	6% of gross receipts
Testing	1% of gross receipts	2.5% of gross receipts

III. Cannabis Retailers

The Adult Use of Marijuana Act created a single license type for cannabis retailers (Type 10), though it is available in both M (Medical) or A (Adult Use) versions. The Bureau of Cannabis Control created an additional Type 9 license for non-storefront retailers which conduct retail cannabis sales exclusively by delivery. Local jurisdictions have the authority to allow either or both types of retailers, under either or both M and A designations.

In May, California's three cannabis licensing agencies readopted their emergency regulations for another 180-day period, with a number of minor changes. Among these changes was a provision that applicants may now obtain a single license to conduct both medicinal and adult-use cannabis activity. Additionally, licensees may continue to engage in commercial cannabis activities with other licensees regardless of their A or M designation.

On July 13th, these agencies released their draft non-emergency regulations for a 45-day comment period. Included within these most recent revisions is a change to California Code of Regulations Section 5416(d) which now states that deliveries can occur in "*any jurisdiction within the State of California.*" This regulation took effect on June 6, 2018 and will remain in force at least until December 6, 2018[DM1]. If left unchallenged, it will [ML2]invalidate any local ban on deliveries currently in force and pre-empts any such future bans.

This may be a significant issue for the City of Marina, as Section 19.02.010 of the proposed ordinance effectively bans cannabis deliveries into the City unless the delivery service has a valid business permit issued by the City:

Pursuant to Chapter and Section 5.08, it is unlawful for any owner, operator, or association to own, conduct, operate or maintain, or to participate therein, or to cause or to allow to be conducted, operated, or maintained, any dispensary, delivery or delivery only dispensary in or into the City unless there exists a valid business permit in compliance with the provisions of Chapter 15.08 and a permit issued under this Chapter.

The change in the recently-issued draft regulations would effectively invalidate this requirement of the ordinance, allowing any licensed cannabis retailer to deliver cannabis to addresses within the city limits, without having to get a permit from the City¹.

Data collected for a Standardized Regulatory Impact Assessment conducted for the Bureau of Medical Cannabis Regulation (now Bureau of Cannabis Control)ⁱ found that 57% of cannabis retailers statewide use a storefront location, while 47% conduct business using a delivery service. The 4% overlap in the results represents retailers that sell through both a storefront and a delivery service. This 4% figure is believed to be an underestimate due to certain reporting requirements.

To estimate the number of cannabis retailers and/or delivery services that the City of Marina could support, we will first look for any existing available data about the existing unlicensed businesses currently serving the area. Confidential data from the California Department of Tax and Fee Administration (CDTFA) shows just one business in Marina reporting retail sales taxes related to cannabis. The amount reported is less than half of what we would expect to see for even the smallest of retailers.

The Weedmaps website (weedmaps.com) shows just one cannabis delivery businesses located in the City of Marina (not the one shown by the CDTFA report), with an additional 26 businesses in the neighboring

¹ HdL published an issue update on this subject in July, including guidance for cities and counties that may wish to express their opposition to this change.

cities of Salinas, Monterey and Del Rey Oaks. It is uncertain how many of these businesses may deliver into the City of Marina.

Estimates of the percentage of the population that uses cannabis on a regular basis vary from around 10% to 13%ⁱⁱ, up to as high as 22%ⁱⁱⁱ. For the City of Marina, this would mean somewhere between 2,037 and 4,481 potential cannabis consumers. Storefront recreational and adult-use cannabis retailers typically average around 120 customers per day^{iv}, with a total customer base of around 2,500 customers. From this, we can assume that overall cannabis consumers in Marina could support perhaps 1 or 2 retailers.

The gross receipts for retailers is variable depending upon the number of retailers serving a given population, so it's reasonable to expect that more retailers will mean fewer customers for each and, thus, lower gross receipts. Dispensaries are the only cannabis business that specifically serves the local community, rather than feeding into the statewide market, and so the number of dispensaries can be assumed to be somewhat proportional to the local population. Consumer demand for cannabis is assumed to generally be a constant, regardless of its legal status or the availability of dispensaries, and so it's reasonable to expect that more dispensaries will mean fewer customers for each and, thus, lower gross receipts.

However, there will always be an upper limit. We anticipate that providing greater access to dispensaries or retailers would initially facilitate a shift in cannabis purchases happening through legal, regulated means rather than through the black market, especially for non-medical cannabis. Eventually, though, the local cannabis market will reach saturation, at which point new cannabis retailers will simply cannibalize sales from existing retailers. The taxable amount of gross sales will likely plateau at some point, regardless of the number of retailers.

Under California's regulatory program, it is anticipated that consumers will have little reason to purchase cannabis in the medical segment rather than buying in the adult use segment. Both medical and adult use cannabis will pay the State cultivation tax and excise tax, with the only advantage being an exemption from regular sales tax for qualifying patients with a state-issued identification card. Currently there are only 6,172 such cardholders in California, and just 193 in Monterey County^v. Eligibility for this limited sales tax exemption will cost consumers approximately \$100 per year, plus time and inconvenience, for a savings of 8.75% in the City of Marina. It's anticipated that this will provide no price advantage for the vast majority of cannabis consumers^{vi}.

The Bureau of Cannabis Control projects that more than half of the adult use purchases currently in the black market will transition to the legal market to avoid the inconvenience, stigma and risks of buying unknown product through an unlicensed seller^{vii}. Essentially, the easier, cheaper and more reliable it is for consumers to access quality cannabis legally, the less reason they will have to purchase it through the black market. That same study projects that 60% of those currently in the legal, medical cannabis market will shift to the adult use market, for the reasons noted above. The availability of legal adult use cannabis is also anticipated to produce a small 9.4% increase in consumer demand.

The shift from medical to adult use sales is not expected to change the overall volume of sales, only the category into which they fall. Once the legal, adult use market is properly functioning, it is anticipated to capture about 61.5% of the overall cannabis market in California. The legal medical cannabis market is projected to decline to just 9% of the overall market. The other 29.5% is expected to remain in the black market^{viii}.

The proposed ordinance generally uses the obsolete term "dispensary" rather than the proper term "retailer" throughout the text. The Bureau of Cannabis Control, which regulates cannabis retailers, no longer uses the word "dispensary" anywhere in its regulations, making the ordinance inconsistent with existing law and regulation. While one may argue that this is purely semantic, use of this now-defunct term does create confusion.

The definitions in Section 19.01.040 of the proposed ordinance provide confusing and conflicting language regarding dispensaries, retailers and cannabis deliveries. Subsection GG defines “dispensary” in a way which suggests that only medical cannabis is allowed to be delivered.

GG. “Dispensary” means a facility where medical Cannabis, medical cannabis products.² Adult cannabis. Adult cannabis products or devices for the use of medical or Adult cannabis or medical or Adult cannabis products are offered, either individually or in any combination, for retail sale, including an establishment that delivers medical Cannabis and medical Cannabis products as part of a retail sale.

Subsection FF defines “delivery” as applying to both medical or adult-use cannabis. However, it goes on to include transfer of cannabis to a testing laboratory within the definition of “delivery”.

FF. “Deliver” or “Delivery” means the commercial transfer of medical or Adult cannabis, or medical or Adult cannabis products from a Permittee, up to an amount allowed by the Bureau, to a primary caregiver, customer, qualified patient or adult as defined in Section 1 1362.7 of the California Health and Safety Code, or a testing laboratory.

This is in direct conflict with State law, which requires that only a licensed distributor may transport cannabis or cannabis products between licensees. However, California law requires that transportation to a testing laboratory is to be done by an employee of the testing laboratory, after obtaining the sample from the distributor at the distributor’s licensed premises.

Subsection HH directly contradicts Subsection FF (which contradicts subsection GG) by defining the transportation of cannabis goods between licensees as “distribution” instead of “delivery”.

HH. “Distribution” means the procurement, sale, and transport of Cannabis and Cannabis Products between State Licensees, including any City Permittees who are State Licensees.

The definitions in Section 19.01.040 of the ordinance do include “Retail Establishment”, “Retail Permit” and “Retail Permittee”, but not the term “Retailer”.

RRR. “Retail Establishment” means a premises where Cannabis or Cannabis Products are offered, either individually or in any combination, for retail sale or Delivery to customers, patients or primary caregivers pursuant to State Law.

SSS. “Retail Permit” means a City Permit to sell and Deliver Cannabis and Cannabis Products to customers, patients and primary caregivers in accordance with the terms and conditions of this Chapter and the conditions of approval for the applicable City Permit issued to the particular Retail Permittee. Such Permits shall be associated with State License type 10 or such other Retail license types created by the State.

TTT. “Retail Permittee” means a Person that has been issued a Retail Permit by the City pursuant to the terms and conditions of this Chapter.

The term “retailer” occurs only twice in the text of the ordinance; once in Section 2; Zoning, where “Cannabis Retailer” is added as a land use (with a conditional use permit) and again in Section 5; Business

² Here and throughout the ordinance, the text contains numerous spelling and punctuation errors that make strict interpretation difficult.

License, which requires Cannabis Retailers to pay a 2.5% business operations tax. As such, the zoning restrictions and the business tax both apply to at type of license that is not defined in the ordinance.

Though the terminology used in the ordinance is both internally inconsistent and inconsistent with State law, for purposes of our fiscal analysis we shall generally assume that the terms “dispensary” and “retailer” are interchangeable.

Under the proposed initiative, retailers (dispensaries) will be limited to 3 locations for medicinal and 3 locations for adult use. Retailers will not be allowed to be located within 1,000 feet of each other unless they are a medicinal retailer and an adult use retailer adjacent to each other. The language about adjacency creates uncertainty regarding retailers that may operate both M and A type licenses from a single location. While dual-licensed A/M retailers are not specifically precluded, the language is unclear.

This lack of clarity is a concern because single-licensed medical or adult-use retailers only account for around 20% of all cannabis retailers licensed by the Bureau of Cannabis Control. The vast majority of licenses are for retailers who will operate both medical and adult use from the same premises.

Cannabis retailers for both medical and adult use would both pay a business tax equal to a minimum of 2.5% of annual gross receipts, which may increase up to a maximum of 5% starting in 2022. Cannabis manufacturers and processors would be taxed at a minimum of 2%, which may also increase up to a maximum of 5% in 2022. All taxes would be paid quarterly. The Notice of Intent to Circulate Petition states *“These proposed businesses and related taxes and fees will generate an estimated \$40,000 to \$200,000 or more per year”*.

For purposes of revenue projections, we have provided two different models, each with three scenarios and three different tax rates. The first model, shown below in Figure 3, estimates revenues based upon the number of retailers. The ordinance allows for 3 medical retailers and 3 adult use retailers. Typically we would anticipate that a city with Marina’s population of 20,370 could support between one and two retailers, depending upon a number of factors such as social acceptance of cannabis and availability of cannabis retailers in the surrounding area. If two or more retailers serve the same population, we would expect that each of them would generate a smaller amount of gross receipts.

More commonly, our estimates would assume that all retailers are dual-licensed A/M retailers, averaging \$2.5 million in gross receipts each for a smaller city like Marina. As each license would be limited to either adult use or medicinal, we have assigned a smaller amount of average gross receipts for each. This model also recognizes that the amount of sales that cannabis retailers may generate is more a function of consumer demand, rather than supply. The more retailers serving a given population, the smaller the slice of the customer base for each retailer.

Figure 2 provides estimates for 2, 3 and 6 retailers. The gross receipts for each retailer decreases as the total number of retailers increases. For 2 retailers, we assume average gross receipts of \$2,000,000 each. For 3 retailers, we assume \$1,500,000. With 6 retailers, the average gross receipts for each drops to just \$1,250,000.

Figure 2:

Cannabis Retailers						
License Type	# of Licenses	Avg Gross Receipts	Total Gross Receipts	Revenue @ 2.5% Tax Rate	Revenue @ 3.5% Tax Rate	Revenue @ 5.0% Tax Rate
Retailers	2	\$2,000,000	\$4,000,000	\$100,000	\$140,000	\$200,000
Retailers	3	\$1,500,000	\$4,500,000	\$112,500	\$157,500	\$225,000
Retailers	6	\$1,250,000	\$7,500,000	\$187,500	\$262,500	\$375,000

To each of these scenarios we have attached tax rates of 2.5%, 3.5% and 5%, to reflect the range allowed by the proposed ordinance. With 2 retailers, we would estimate between \$100,000 and \$200,000 in annual revenue. With 3 retailers we estimate between \$112,500 and \$225,000, and with 6 retailers, we would estimate between \$187,500 and \$375,000.

The model in Figure 3 estimates gross receipts and potential revenue based upon consumer demand, rather than the number of retailers. For each assumption, we have provided a range of three estimates: low, medium and high. We estimate that cannabis consumers make up anywhere from 10% to 22% of the City's population, with a "best estimate" of 14%. For Marina's population of 20,370, this yields an estimate of cannabis consumers from a low of 2,037 to a high of 4,481, with a best estimate of 2,852.

The average cannabis transaction is \$73, and average frequency of purchases is twice a month^{ix}. Applying these figures to the customer base, above, we develop a range of annual gross receipts generated by Marina residents of between \$3,568,824 and \$7,851,413, with a best estimate of \$4,996,354.

The ordinance proposes that cannabis retailers be taxed at an initial rate of 2.5%, which may be increased to a maximum rate of 5%. When we apply these rates to the best estimate of gross receipts, we project that a tax of 2.5% would generate \$124,909 in annual revenue, a tax of 3.5% would generate \$174,872, and a tax of 5% would generate \$249,818 in annual revenue to the City. These estimates are shown in Figure 3, below.

Figure 3:

Revenue Projections for Cannabis Retailers in the City of Marina			
	Low Estimate	"Best" Estimate	High Estimate
City population	20,370	20,370	20,370
Percentage of population that uses cannabis	10.0%	14.0%	22.0%
Number of cannabis users	2,037	2,852	4,481
Average transaction amount	\$73	\$73	\$73
Transaction frequency (per month)	2	2	2
Monthly gross receipts	\$297,402	\$416,363	\$654,284
Annual gross receipts	\$3,568,824	\$4,996,354	\$7,851,413
Annual revenue by tax rate (below)			
2.5%	\$89,221	\$124,909	\$196,285
3.5%	\$124,909	\$174,872	\$274,799
5.0%	\$178,441	\$249,818	\$392,571

IV. Cannabis Manufacturers

The manufacturing sector is still evolving and expanding, which presents significant opportunities for innovation, business development and job growth. The range of products being produced includes an ever-increasing variety of edibles such as candies, cookies, dressings, and infused drinks. Manufacturers may produce their own extract on site, or they may buy extract from other Type 6 or Type 7 licensees. Much like any other industry, cannabis manufacturers often depend upon other businesses to supply them with the various materials or components that go into their final product. These suppliers do not have to be located in or even near the same jurisdiction as the final manufacturer, and may be located anywhere throughout the state.

Some manufacturers may handle all steps from extraction to packaging the end product in the form of vape pens or other such devices. Others may handle only discreet steps, such as making the raw BHO, which is then sold either directly to retailers or to a Type N manufacturer who will package it into vapor cartridges or other end consumer products. Manufacturers also produce a wide variety of tinctures, as well as topicals such as cannabis infused lotions, salves, sprays, balms, and oils.

As of June 4th, the Manufactured Cannabis Safety Branch (MCSB) of the California Department of Public Health has issued 668 temporary licenses statewide. Of these, 341 are for non-volatile extraction, 230 are for volatile extraction, 76 are for non-extraction manufacturing and 21 are for packaging and labeling. These 668 licenses are held by 398 unique businesses. Most of the duplicate licenses held by a single manufacturer are to allow for both “A” (Adult Use) and “M” (Medicinal Use) manufacturing.

The MCSB estimates that there may be as many as 1,000 cannabis manufacturing businesses in California, employing around 4,140 people. This is an average of 4 new jobs per manufacturer, though this figure likely varies significantly depending on the size and nature of each business.

HdL has reviewed pro-formas for numerous cannabis manufacturers seeking permits in counties and cities throughout California. From this review we have seen a range of gross receipts from around \$1 million to over \$5 million, with an average in the range of \$2 million to \$3 million. For our analysis, we assume that the City of Marina could support between 2 and 6 manufacturers, with a range of sizes. The number of manufacturers would most likely be limited by the availability of appropriately zoned properties.

We shall use an average of \$2.5 million for purposes of this analysis. When we apply the range of tax rates proposed by the ordinance, these businesses could generate between \$100,000 and \$750,000 in annual revenue for the City, as shown in Figure 4. The tax rate proposed by the ordinance would remain at 2% until January 1, 2022. For this reason, we would recommend using the midpoint estimate of 4 manufacturers taxed at the 2% rate for initial revenue projections, yielding \$200,000 in annual revenue.

Figure 4:

Cannabis Manufacturers						
Type 6/7/N/P Manufacturer	# of Licenses	Avg Gross Receipts	Total Gross Receipts	Revenue @ 2.0% Tax Rate	Revenue @ 3.5% Tax Rate	Revenue @ 5.0% Tax Rate
Manufacturers	2	\$2,500,000	\$5,000,000	\$100,000	\$175,000	\$250,000
Manufacturers	4	\$2,500,000	\$10,000,000	\$200,000	\$350,000	\$500,000
Manufacturers	6	\$2,500,000	\$15,000,000	\$300,000	\$525,000	\$750,000

V. Distributors and Testing Laboratories

The business model for distributors is based on a percentage markup on the price paid to their suppliers. This markup is commonly 20% to 30%. While there is not an abundance of data to determine the average gross receipts for distributors, HdL has reviewed a number of pro-formas for distributors seeking licenses in other jurisdictions. These indicate anticipated gross receipts in the range of \$2 million to \$3 million per year, with an average of \$2.5 million.

Due to its proximity to the cannabis cultivation center of Salinas, we believe that Marina could reasonably attract a small number of cannabis distributors, though we expect that they would probably be smaller businesses serving the coastal region from Santa Cruz to Carmel. Distributors reaching up into the Bay Area would likely be centered in Salinas or elsewhere along the 101 corridor. As with cultivation and manufacturing, distributors would likely be limited by the low availability of appropriately-zoned properties. For purposes of this analysis, we conservatively assume the City may attract 1 cannabis distributor with average receipts of \$2,000,000 per year.

The Bureau of Cannabis Control has so far only issued licenses for 28 testing laboratories in all of California. These laboratories tend to be located in areas with a large amount of commercial cannabis activity, such as Salinas, which has 2 such facilities. With so much commercial cannabis activity centered around Salinas, there is not a strong argument for why a testing laboratory would choose to locate 20 minutes further away. However, this is not entirely unreasonable.

We have included 1 testing laboratory in our analysis to show the amount of revenue that could potentially be generated, though we would recommend that the City not use this figure for any actual revenue projections. Pro formas reviewed by HdL suggest average gross receipts of \$2,000,000 for testing laboratories.

The proposed ordinance does not provide for a tax on either cannabis distributors or testing laboratories. However, the ordinance does require that all cannabis businesses must enter into development agreements, including fees or other charges to protect and promote public health, safety and welfare. While the terms for such agreements are left undefined in the ordinance, the City may wish to base any fees on the common tax rates shown in Figure 2, previously.

Figure 5 shows the revenues that could be anticipated by applying these rates through development agreements. We estimate that 1 distributor could generate between \$40,000 and \$60,000 for the City. Were the City to be home to a testing laboratory, we would expect it to generate between \$20,000 and \$50,000 in annual revenue.

Figure 5:

Distributors and Testing							
License Type	# of Licenses	Avg Gross Receipts	Total Gross Receipts	Revenue @ 1.0% Tax Rate	Revenue @ 2.0% Tax Rate	Revenue @ 2.5% Tax Rate	Revenue @ 3.0% Tax Rate
Distributors	1	\$2,000,000	\$2,000,000		\$40,000	\$50,000	\$60,000
Testing	1	\$2,000,000	\$2,000,000	\$20,000	\$40,000	\$50,000	

VI. Cultivation

The cannabis cultivation market in California has already exceeded its saturation point 3-times over, which suggests that there is not enough room for those growers already licensed, much less new entrants into the market. As of May 30th, the CalCannabis Division of the California Department of Food and Agriculture has issued 4,276 cultivation licenses statewide. 415 of these licenses are for cultivators in Monterey County; 316 of which are located in Salinas. However, nearly half of these are listed as either inactive, expired or about to expire, leaving just 215 active cultivation licenses countywide.

There are 164 active cultivation licenses in nearby Salinas and 17 in Moss Landing. The remainder are somewhat further away in Greenfield and Aromas, or elsewhere in unincorporated Monterey County. Of all of these, 140 are greenhouse “mixed-light” cultivation, 44 are nurseries, and 22 are indoors. The remaining 9 licenses are for processors. There are no licensed outdoor cultivation sites anywhere in Monterey County.

The proposed ordinance is strangely silent on cannabis nurseries. While nurseries are defined in the text, there is no other mention of them whatsoever. This is a peculiar omission, as Monterey County’s coastal plain is home to more than one-third of all licensed cannabis nurseries in the entire state.

In addition, Monterey’s coastal climate is far more conducive to cannabis nurseries than it is to greenhouse cultivation of mature, flowering plants. The same humidity and diffused lighting that protects and nurtures plant starts can cause issues with mold and slowed growth for mature plants. As a result, many of the greenhouse cultivators in Monterey County that HdL has spoken with are producing low-value “commercial grade” cannabis for extraction, rather than high quality flower.

The vast majority of cannabis cultivation in Monterey County has been accommodated through adaptive reuse of vacant industrial greenhouse space. Though the proposed ordinance allows for mixed-light greenhouse cultivation, the reality of the City’s urban land use patterns and the zoning limitations of the ordinance would likely limit cannabis production to indoor cultivation, only. In addition, the abundant availability of industrial greenhouse space elsewhere in the county (estimated at 10 million square feet^x) would likely make construction of new greenhouses an unnecessary and unprofitable venture.

The proposed ordinance does not allow outdoor or natural light cultivation of any kind, including cultivation in a greenhouse without the use of artificial light. Indoor and mixed-light cultivation are both allowed in districts zoned Airport (A-1, A-2, or A-3), Business Park (BP), Business Park Small Lot Combining District (BP/P), and Transitional Zoning District (T-B-5).

A map of the various zoning districts within the City of Marina indicates approximately 40 parcels zoned Airport (A-1/2/3) and 8 parcels zoned Business Park (BP). All but one of these parcels is located near the airport. The map shows 15 parcels zoned BP/P and 6 parcels zoned T-B-5, all located in the Northwest corner of the City along Del Monte Boulevard.

A parcel survey using Google Earth shows that of the 48 appropriately zoned parcels in the vicinity of the airport, only 10 contain existing structures that could conceivably be used for cannabis cultivation (not including airplane hangars or the UC Santa Cruz MBEST Center). Properties within the Airport zones may also fall within the authority of the FAA which, as a Federal agency, would be prohibited from allowing any cannabis-related use. The 15 properties zoned BP/P contain 11 buildings. There appear to be no buildings or structures on the properties zoned T-B-5.

As noted elsewhere in this report, the cultivation sector of the cannabis industry is already oversaturated, making new entries into the market a risky proposition. Due to this, we believe that new operators would likely seek to reduce the amount of capital they are putting at risk by leasing readily-available spaces, rather than paying for new construction. This analysis suggests that there are only perhaps 25 candidate

parcels in the City of Marina, nearly all of which appear to be currently occupied. 10 of these may be unavailable due to conflict with the FAA.

Our analysis of these buildings using Google Earth shows that only 3 of these existing structures are larger than 20,000 square feet in size. 8 structures appear to be between 10,000 and 19,999 square feet, and the remainder are less than 10,000 square feet.

From this analysis, it seems very likely that any cannabis cultivation in the City of Marina in accordance with this ordinance would almost certainly be limited to indoors and would encompass no more than 10,000 square feet of canopy, falling within the definition of a Type 2B “Small Indoor” license. Given the very small number of candidate parcels, the overabundance of available greenhouse space in nearby Salinas, and the oversaturation of cannabis cultivation in Monterey County and statewide, we believe the City would be unlikely to attract more than perhaps 2 indoor cultivation operations, averaging 10,000 square feet each.

Due to the very small number of candidate parcels that would allow for cannabis cultivation, it is possible that owners of these parcels could demand a premium price for lease space. This raises the concern that existing tenants or other non-cannabis businesses may be pushed out or find it difficult to compete with well-capitalized cultivation operations that are willing to pay any price for this precious cultivation space. However, this concern assumes that the City of Marina is an island, and that there are no similar indoor cultivation spaces available in the surrounding area. This is not the case, as the prevalence of cannabis cultivation in nearby Salinas can attest. CalCannabis shows 13 active indoor cultivation licenses in the surrounding area of Salinas, Moss Landing and unincorporated Monterey County. While there may be a short-term impact due to landowner speculation, we believe that this will be short lived.

The proposed ordinance does not provide for a tax on cannabis cultivation. However, the language of the ordinance creates some confusion regarding cannabis processors. Section 5(2) reads:

2. Section 5.20.030 shall be added to the Marina Municipal Code and state the following:

Non-Retail Cannabis Uses: All establishments manufacturing Cannabis related products or processing Cannabis related products, shall pay a business operations tax equal to a minimum of 2% of annual gross receipts prior to January 1, 2022, and no more than 5% (at the discretion of City Council) beginning January 1, 2022. Payments are due quarterly on July 1, October 1, January 1, and April 1 each year.

The word “processing” appears 5 times in the text of the ordinance yet is not defined, other than to note that it is among the activities considered “commercial medical cannabis activity” (19.01.040 K) or “commercial cannabis activity” (19.01.040 AA).

This is an issue, though, because the word “processor” is defined as a specific license type by CalCannabis. Section 8201 “Cultivation License Types” of the agency’s draft regulations released on July 13th state:

(f) “Processor” is a cultivation site that conducts only trimming, drying, curing, grading, packaging, or labeling of cannabis and nonmanufactured cannabis products.

It is unclear whether the ordinance intends that licensed processors should be subject to the tax provisions of the ordinance. Trimming, drying, curing, grading, packaging or labeling of cannabis are activities that may commonly be carried out by cannabis cultivators, but they may also be done by a separately licensed processor. These licensed activities would fall under the authority of CalCannabis, which regulates cultivation.

In addition, the Manufactured Cannabis Safety Branch (MCSB) of the California Department of Public Health, which regulates cannabis manufacturers, specifically excludes “processing” from the definition of manufacturing. Section 40100 (dd) (2) of the MCSB’s draft regulations states:

The term “manufacture” does not include the following:

(D) The processing of non-manufactured cannabis products, as defined in Section 8000 of Title 3 of the California Code of Regulations, by a licensed cultivator in accordance with the requirements of the California Department of Food and Agriculture specified in Article 4 of Chapter 1 of Division 8 of Title 3 of the California Code of Regulations.

The MCSB does, however, provide a Type P license that is limited to the packaging or labeling of cannabis products. Section 40118 (a)(4) reads:

“Type P,” for manufacturers that only package or repackage cannabis products or label or relabel cannabis product containers or wrappers.

The definition of “manufacturing permit” in section 19.01.040 of the ordinance does not specifically list the Type P license by name (nor does it specifically list the Type N³ or Type S⁴ licenses), but it is incorporated by the reference to “such other Manufacturing license types created by the State”.

YY. “Manufacturing Permit” means a City Permit to Manufacture in accordance with the terms and conditions of this Chapter and the conditions of approval for the applicable City Permit issued to the applicable Manufacturing Permittee. Such Permits shall be associated with State License types 6 or 7 or such other Manufacturing license types created by the State.

It is very unclear what the ordinance intends regarding the word “processing”. For purposes of estimating tax revenue, we will assume that “processing” is related to manufacturing, and not to the “processor” license available through CalCannabis.

Though the proposed ordinance does not allow for a tax on cannabis cultivation, the requirement that all cannabis businesses enter into development agreements with the City allows the opportunity to generate a level of revenue that may be consistent with a cannabis tax. Figure 2 showed common cannabis tax rates being developed by 25 local governments around California. The rates for indoor cannabis cultivation range from \$7 per square foot up to \$10 per square foot.

Figure 6 shows the range of revenues that could be generated from a development agreement fee of \$7 per square foot, \$8 per square foot or \$10 per square foot. The annual revenues from such a fee could range from \$140,000 to \$200,000.

Figure 6:

Cannabis Cultivation						
License Type	# of Licenses	Average Square Footage	Total Square Footage	Revenue @ \$7/sf	Revenue @ \$8/sf	Revenue @ \$10/sf
Indoor	2	10,000	20,000	\$140,000	\$160,000	\$200,000

³ “Type N,” for manufacturers that produce cannabis products other than extracts or concentrates that are produced through extraction.

⁴ “Type S,” for manufacturers that conduct commercial cannabis manufacturing activities at a registered shared-use facility.

Appendix

Legal and Regulatory Background for California	Page 16
State Tax Considerations	Page 20
General Economic Impacts	Page 22
Land Use Maps	Page 24
Analysis of Items g, h, i and j	Page 27
References	Page 30

Legal and Regulatory Background for California

The legal and regulatory status of cannabis in the State of California (“State”) has been continually evolving ever since the passage of Proposition 215, the Compassionate Use Act of 1996 (“the CUA”), which decriminalized the use, possession and cultivation of cannabis for qualifying patients and their primary caregivers when such use has been recommended by a physician. The CUA did not create any regulatory program to guide implementation, nor did it provide any guidelines for local jurisdictions to establish their own regulations.

The lack of legal and regulatory certainty for medical marijuana (or cannabis) continued for nearly 20 years, until the passage of the Medical Cannabis Regulation and Safety Act (“MCRSA”) in October of 2015. MCRSA created a State licensing program for commercial medical cannabis activities, while allowing counties and cities to maintain local regulatory authority. MCRSA required that the State would not issue a license without first receiving authorization by the applicable local jurisdiction.

Under MCRSA, commercial medical cannabis activities are regulated by a variety of State agencies. The California Department of Food and Agriculture (CDFA) established a new CalCannabis division, which will create, issue, and suspend or revoke licenses for the cultivation of medical cannabis. The Bureau of Medical Cannabis Regulation (later renamed the Bureau of Cannabis Control, or BCC) in the Department of Consumer Affairs, will administer, enforce, create, issue, renew, discipline, suspend, and/or revoke licenses for distributors, testing laboratories, and retailers. The California Department of Public Health’s newly created Manufactured Cannabis Safety Branch (MCSB), will license cannabis product manufacturers, and will develop standards for the production and labeling of all medical cannabis products.

On November 8, 2016, the voters of the State of California approved Proposition 64, the Adult Use of Marijuana Act (“the AUMA”), which allows adults 21 years of age or older to legally grow, possess, and use marijuana for non-medical purposes, with certain restrictions. The AUMA requires the State to regulate non-medical marijuana businesses and tax the growing and selling of medical and non-medical marijuana. Cities and counties may also regulate non-medical marijuana businesses by requiring them to obtain local permits or restricting where they may be located. Cities and counties may also completely ban marijuana related businesses if they so choose.

On June 27, 2017, the State of California passed SB 94, which repealed MCRSA and incorporated certain provisions of MCRSA into the licensing provisions of AUMA. These consolidated provisions are now known as the Medicinal and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA). MAUCRSA revised references to “marijuana” or “medical marijuana” in existing law to instead refer to “cannabis” or “medicinal cannabis,” respectively. MAUCRSA generally imposes the same requirements on both commercial medicinal and commercial adult-use cannabis activity, with certain exceptions.

All State license types other than Type 8 Testing Laboratories shall be designated either “A” for Adult Use or “M” for Medical”. A single licensee will be allowed to hold both A and M licenses, but it’s unclear whether they will be able to operate both on the same premises.

MAUCRSA incorporated the Type 5, 5A and 5B cultivation licenses from AUMA, which will allow for cannabis farms of unlimited size. No Type 5 licenses will be issued before 2023, however, and local jurisdictions will still retain the authority to disallow or limit the size of cannabis cultivation. It is anticipated that CDFA will limit the number of Type 5 licenses, but this is not yet clear.

AUMA and MAUCRSA eliminated the Type 12 Cannabis Transporter license type from MCRSA. Instead, cannabis cultivators, manufacturers and retailers (but not testing laboratories) are now allowed to

transport their own product, provided they have a separate distributor license. Independent cannabis distributors will likely pick up a larger portion of that business, too. In its place, MAUCRSA incorporated the Type 12 license for cannabis “Microbusinesses” from AUMA, which allows a combined non-medical cannabis business with up to 10,000 square feet of cultivation, and which can manufacture, distribute and sell their product on-site to retail customers, provided they meet all of the individual license requirements for all of the activities they choose to undertake.

MAUCRSA also made a fundamental change to the local control provisions. Under MCRSA, an applicant could not obtain a State license until they had a local permit. Under MAUCRSA, an applicant for a State license does not have to first obtain a local permit, but they cannot be in violation of any local ordinance or regulations. The State licensing agency shall contact the local jurisdiction to see whether the applicant has a permit or is in violation of local regulations, but if the local jurisdiction does not respond within 60 days, then the applicant will be presumed to be in compliance and the State license will be issued.

On September 16, 2017, Governor Brown signed AB 133, which makes a number of major and minor “clean up” changes to the State’s regulations, most notably regarding vertical integration. MAUCRSA authorizes a person to apply for and be issued more than one license only if the licensed premises are separate and distinct. With the passage of AB 133, a person or business may co-locate multiple license types on the same premises, allowing a cultivator to process, manufacture or distribute their own product from a single business location. This includes the allowance to cultivate, manufacture, distribute or sell cannabis for both medical and adult use from a single location. However, these allowances are still subject to local land use authority, so anyone seeking to operate two or more license types from a single location would be prohibited from doing so unless local regulations allow both within the same zone.

Most recently, on November 16th, the three State licensing agencies simultaneously issued emergency regulations to implement these many new laws. These emergency regulations were closely based upon draft regulations that had been released for review the previous Spring. Those draft regulations were withdrawn after the passage of SB 94, as they had been based upon the now-defunct MCRSA. The draft regulations made a number of interpretive changes to the regulatory framework defined by the various pieces of legislation. Most of these were small, but some are more significant.

Figure 11 (next page) lists the 30 different license types currently available from the State. Of these, 29 are available under either A (Adult Use) or M (Medical). Only the Type 8 Testing license does not distinguish between these categories. All told, there are 59 different licenses and variations available.

Figure 11:

State License Types Under MAUCRSA					
Type	Activity	Description	Details	Licensing Agency	Notes
1	Cultivation	Outdoor; Specialty, Small	Up to 5,000 sf, or 50 plants on non-contiguous plots	CDFA	A, B
1A	Cultivation	Indoor; Specialty, Small	501 sf - 5,000 sf	CDFA	A, B
1B	Cultivation	Mixed-Light; Specialty, Small	2,501 sf - 5,000 sf	CDFA	A, B, C
1C	Cultivation	Outdoor/indoor/mixed; Specialty Cottage, Small	Up to 25 plants outdoor; up to 2,500 sf mixed light; up to 500 sf indoor	CDFA	A, B, C
2	Cultivation	Outdoor; Small	5,001 sf - 10,000 sf	CDFA	A, B
2A	Cultivation	Indoor; Small	5,001 sf - 10,000 sf	CDFA	A, B
2B	Cultivation	Mixed Light, Small	5,001 sf - 10,000 sf	CDFA	A, B, C
3	Cultivation	Outdoor; Medium	10,001 sf - one acre	CDFA	A, B, D
3A	Cultivation	Indoor; Medium	10,001 sf - 22,000 sf	CDFA	A, B, D
3B	Cultivation	Mixed-Light; Medium	10,001 sf - 22,000 sf	CDFA	A, B, C, D
4	Cultivation	Nursery	Seeds, clones, immature plants only	CDFA	A, B
5	Cultivation	Outdoor; Large	Greater than 22,000 sf	CDFA	A, B, E
5A	Cultivation	Indoor; Large	Greater than 22,000 sf	CDFA	A, B, E
5B	Cultivation	Mixed-Light; Large	Greater than 22,000 sf	CDFA	A, B, C, E
	Cultivation	Processor	Trimming, drying or packaging of non-manufactured cannabis only	CDFA	A, B, F
6	Manufacturer 1	Extraction; Non-volatile	Non-volatile extraction only, infusion, packaging and labeling	MCSB	A, B
7	Manufacturer 2	Extraction; Volatile	Volatile or non-volatile extraction, infusion, packaging and labeling	MCSB	A, B
N	Manufacturer	Infusion for Edibles, Topicals	No extraction allowed	MCSB	A, B, F
P	Manufacturer	Packaging and Labeling	No extraction allowed	MCSB	A, B, F
S	Manufacturer	Mfg. in a shared use facility	Cannot exceed \$1 million/year	MCSB	A, B, F
8	Testing		Shall not hold any other license type	BCC	A
9	Retailer	Delivery only	No storefront allowed	BCC	A, B
10	Retailer	Retail sale and delivery		BCC	A, B, F
11	Distributor		Various categories based on size	BCC	A, B
12	Microbusiness	Cultivation, Manufacturer 1, Distributor and Retailer	< 10,000 sf of cultivation; must meet requirements for all license types	BCC	A, B
	Self-Distribution		Distribution of own cannabis or cannabis products only	BCC	A, B, F
	Event Organizer		Up to 10 cannabis events annually	BCC	A, B, F
CDFA	California Department of Food and Agriculture, CalCannabis Division				
MCSB	California Department of Public Health, Manufactured Cannabis Safety Branch				
BCC	Bureau of Cannabis Control				
A	All license types valid for 12 months and must be renewed annually				
B	All license types except Type 8 Testing must be designated either "A" (Adult Use) or "M" (Medical)				
C	Mixed-light cultivation licenses classified as either Tier 1 (6 watts/sf or less) or Tier 2 (6 watts/sf up to 25 watts/sf)				
D	A person shall be limited to 1 Medium license of any type until January 1, 2023				
E	No Type 5 licenses shall be issued before January 1, 2023				
F	Established by licensing agencies through rulemaking process				

The emergency regulations established a number of new license types, which fill in some gaps in the industry chain. CalCannabis established a separate Processor license for facilities which conduct only the drying, curing, trimming, grading, packaging or labeling of non-manufactured cannabis products. CalCannabis also established two tiers for all Mixed-Light cultivation sizes. Tier 1 applies to cultivators which use 6 watts per square foot of supplemental light or less, while Tier 2 applies to cultivators which use between 6 watts and 25 watts per square foot.

The Bureau of Cannabis Control established a new Type 9 license for Non-Storefront Retailers which conduct cannabis sales exclusively by delivery, as well as a Self Distribution license for cultivators or manufacturers which wish to distribute only their own product. The Bureau also created a system for permitting cannabis events, where cannabis will be sold or consumed, and a license type for Event Organizers. Permits for cannabis events may only be issued to persons or businesses holding an Event Organizer license.

The Manufactured Cannabis Safety Branch created three additional manufacturing license types. The Type N license is for manufacturers that produce edible or topical products using infusion or other processes, but that do not conduct extractions. The Type P license is for manufacturers that only package or repackage cannabis products or label or relabel the cannabis product container. The Type S license is for manufacturers who conduct commercial cannabis activities at a shared use facility, as defined in Section 40190.

State Tax Considerations

To determine what local tax rates might be most appropriate, they must be considered in the context of other taxes imposed by the State. Any local taxes will be in addition to those taxes applied through the Adult Use of Marijuana Act (AUMA), which imposes both a 15% excise tax on purchases of cannabis or cannabis products and a separate cultivation tax on harvested cannabis that enters the commercial market, as well as sales tax. Taxes are most commonly expressed as a percent of price or value, so some method of conversion is necessary to allow development of an appropriate cultivation tax based on square footage.

Figure 4:

Cumulative Cannabis Taxes- HdL Companies			
Category	Amount	Increase	Cumulative Price
Producer Price	\$1,000	\$1,000	\$1,000
State Cultivation Tax	\$9.25/oz	\$148	\$1,148
Local Tax	2.50%	\$25	\$1,173
Batch Testing	\$50/lb, + 0.50%	\$55	\$1,228
Wholesale Price w/ Taxes		\$1,228	
Total Tax at Wholesale		\$228	
Tax as %		22.80%	
Manufacturer Markup	20.00%	\$246	\$1,474
Local Tax	4.00%	\$59	\$1,533
Total Manufacturer Price		\$1,533	
Total Taxes at Manufacturer		\$287	
Total Tax as %		18.72%	
Distributor Markup	30.00%	\$460	\$1,992
Local Tax	3.00%	\$60	\$2,052
Total Distributor Price		\$2,052	
Total Taxes at Distributor		\$347	
Total Tax as %		16.90%	
Retailer Markup	100.00%	\$2,052	\$4,104
Local Tax	6.00%	\$246	\$4,350
State Excise Tax	15.00%	\$616	\$4,966
Total Retailer Price		\$4,966	
Total Taxes at Retail		\$1,209	
Total Tax as %		24.34%	
CA Sales Tax (non-medical)	6.25%	\$310	\$5,276
Local Sales Tax	1.00%	\$50	\$5,326
Total Taxes at Retail		\$1,569	
Total Tax as %		29.45%	
Total Local Tax		8.25%	\$439.62

The State cultivation tax is set at a rate of \$9.25 per ounce of dried flower or \$2.75 per ounce of dried leaf. Because these rates are set per ounce, rather than as a percentage of price paid, the tax is the same whether the cultivator is producing commercial-grade cannabis at \$500 per pound or top-grade cannabis at \$2,500 per pound. The cultivator is generally responsible for payment of the tax, though that responsibility may be passed along to either a manufacturer or distributor via invoice. at the time the product is first sold or transferred. The distributor is responsible for collecting the tax from the cultivator upon entry into the commercial market, and remitting it to the Board of Equalization.

The cultivation tax of \$9.25 per ounce of dried flower is equivalent to \$148 per pound. Just a year ago, HdL would have assumed an average wholesale market price for dried flower of around \$1,480 per pound, which would make that \$148 equal to 10% of value. Since then, however, prices have plummeted. Competitive market forces enabled by legalization have brought the average price for indoor cannabis down to around \$1,000 per pound, or even less (cannabis prices vary greatly based on quality of the product)^{xi}.

Conversations with cannabis industry trade groups suggest that the cumulative tax rate on the end product should remain at or around 30%. Higher rates create too much price disparity between legal and illegal cannabis, making it harder for the regulated industry to compete with the black market. Higher local tax rates can also make a county or city less attractive to the industry, especially for manufacturers and distributors, which have greater flexibility in choosing where to locate. We believe that setting rates that adhere to this 30% rule will help keep the local cannabis industry competitive with other cultivators across California, thus encouraging the transition to a legal industry.

Figure 4 shows how the cumulative tax rate on adult-use cannabis builds as the product moves towards market. The value of the product increases as it moves through the supply chain towards market, with manufacturers, distributors and retailers each adding their own markup. Testing laboratories do not add a direct markup to the product, but the cost of testing and the loss of a small test sample can add around \$55 per pound. Any or all of these activities may be taxed.

This model assumes a hypothetical case where cultivation, manufacturing, testing, distribution and retail sale all happen within the same jurisdiction and are thus all subject to that jurisdiction's tax rates. In actuality, this is unlikely to be the case. Manufacturers may work with product purchased from anywhere in California, and may sell their product to retailers elsewhere, as well. The cumulative tax burden for any product at retail sale will almost always include a variety of tax rates from numerous jurisdictions.

General Economic Impacts

Discussion of regulating and taxing the cannabis industry can too often overshadow the larger jobs and economic development issues that typically accompany efforts to attract new industry. Word that a new business or industry is looking to bring hundreds of new jobs to a community is more commonly met with open arms and offers of tax incentives. The cannabis industry is perhaps completely unique in that the inherent jobs and economic development benefits are welcomed more grudgingly and met with the disincentive of special taxes.

As with any other industry, the cannabis industry does not exist in a vacuum. Those businesses that actually grow, process, manufacture, distribute and sell cannabis products support a wide variety of other businesses that may never touch the actual product itself. Cultivators support garden supply stores, green house manufacturers, irrigation suppliers, soil manufacturers, and a wide variety of contractors including building and construction, lighting and electrical, HVAC, permitting, and engineering. Manufacturers support many of these same businesses, plus specialized tooling and equipment manufacturers, and product suppliers for hardware, packaging, and labeling. All of these businesses support, and are supported by, a host of ancillary businesses such as bookkeepers, accountants, tax preparers, parcel services, marketing and advertising agencies, personnel services, attorneys, facilities maintenance, security services, and others.

The economic benefits are not limited to those in the cannabis industry, itself. Cultivators and manufacturers bring new money into the community by selling their products into a statewide market. Their profits and the salaries they pay move into the general local economy, supporting stores, restaurants, car dealerships, contractors, home sales and other businesses. In Humboldt County, a study done in 2011 found that at least \$415 million dollars in personal income was entering the local economy annually from the cannabis industry, roughly equal to one quarter of the county's entire \$1.6 billion economy.

While Humboldt is likely an outlier, research done by HdL for other clients suggests that other counties and cities see similar, if smaller, economic inputs from this industry, with some in the range of \$100 million dollars or more annually. As this industry adapts to a legal paradigm, the challenge for some counties will be mitigating and minimizing the economic loss as the black market slowly fades away.

Because of the emerging nature of this industry, it is currently populated primarily (but not solely) by small, independently-owned businesses. Numerous studies have demonstrated that locally-owned, independent businesses recirculate a far higher percentage of every dollar back into the local community than large, corporately-owned businesses do. The same economic development arguments that are used to support other independent, locally-owned businesses apply to this industry, too. It is estimated that every \$1 spent at a medical or adult-use cannabis retailer generates an additional \$3 in economic benefits to the host city or county^{xii}. The City should expect to see comparable economic benefits from cannabis businesses as with any other new businesses, separate from any tax revenue that may be generated.

Industry experts believe that California's current statewide production is five to eight times higher than the State's population consumes^{xiii}, a figure derived from the SRIA done for CDFA's cannabis cultivation program. That assessment found that California's cannabis industry produces some 13.5 million pounds of cannabis per year, which would be enough to provide over half a pound of cannabis per year for every Californian 21 and over. However, the assessment also found that California's 4.5 million cannabis users only consume about 2.5 million pounds of cannabis per year. A separate study performed for the California Cannabis Industry Association put statewide consumption even lower, at 1.6 million pounds^{xiv}.

The majority of the cannabis produced in California is presumably supplying other states that do not have legalized cannabis.

The Bureau of Cannabis Control projects that more than half of the adult use purchases currently in the black market will transition to the legal market to avoid the inconvenience, stigma and risks of buying unknown product through an unlicensed seller^{xv}. Essentially, the easier, cheaper and more reliable it is for consumers to access quality cannabis legally, the less reason they will have to purchase it through the black market. That same study projects that 60% of those currently in the legal, medical cannabis market will shift to the adult use market, for the reasons noted above. The availability of legal adult use cannabis is also anticipated to produce a small 9.4% increase in consumer demand.

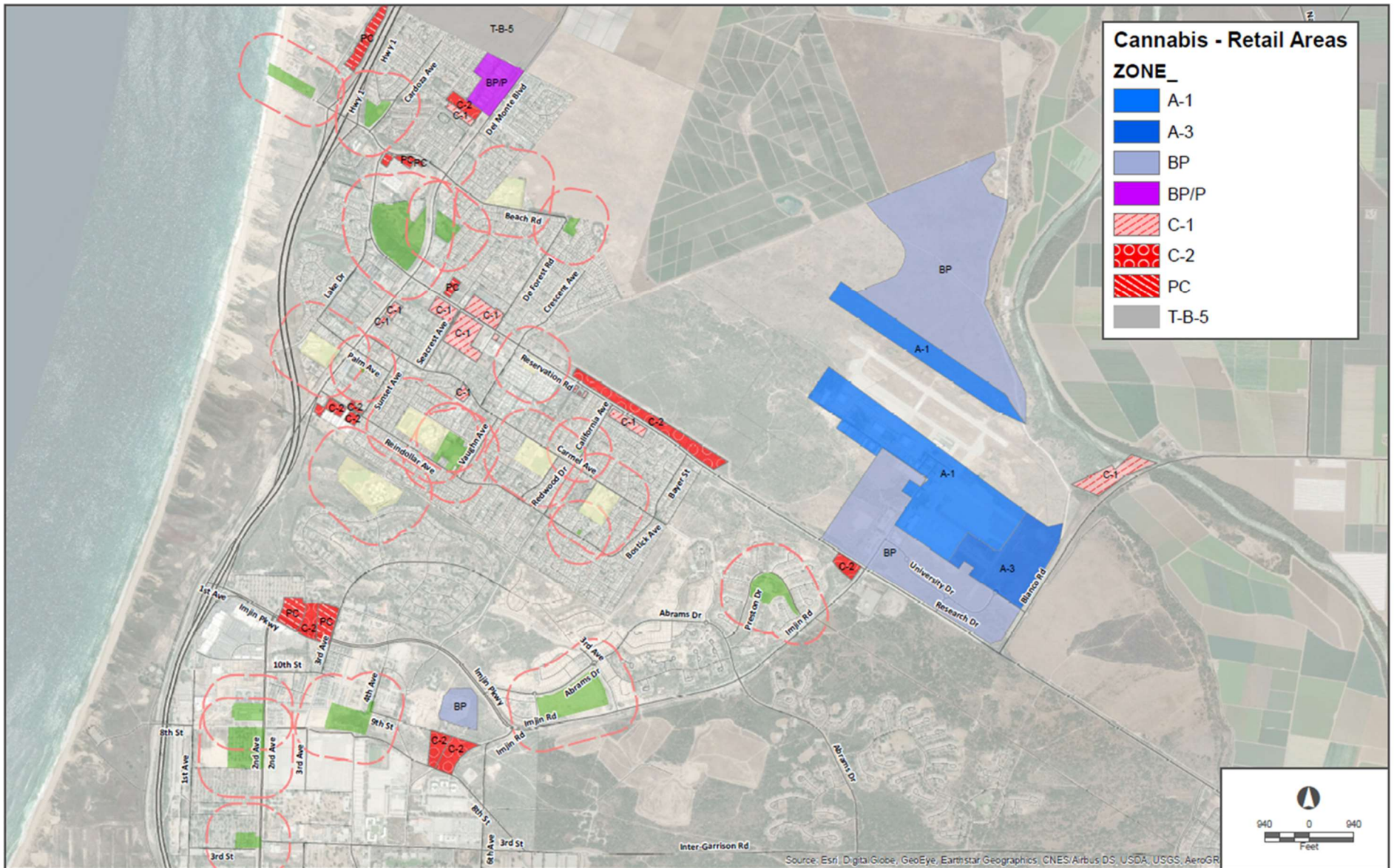
Given these figures, cities and counties should expect to see some increase in retail sales as these shifts occur in the market. More significantly, the existence of legally permitted cannabis retailers will allow a far greater portion of existing cannabis sales to be captured by legal (and tax-paying) retailers.

The shift from medical to adult use sales is not expected to change the overall volume of sales, only the category into which they fall. Once the legal, adult use market is properly functioning, it is anticipated to capture about 61.5% of the overall cannabis market in California. The legal medical cannabis market is projected to decline to just 9% of the overall market. The other 29.5% is expected to remain in the black market^{xvi}.

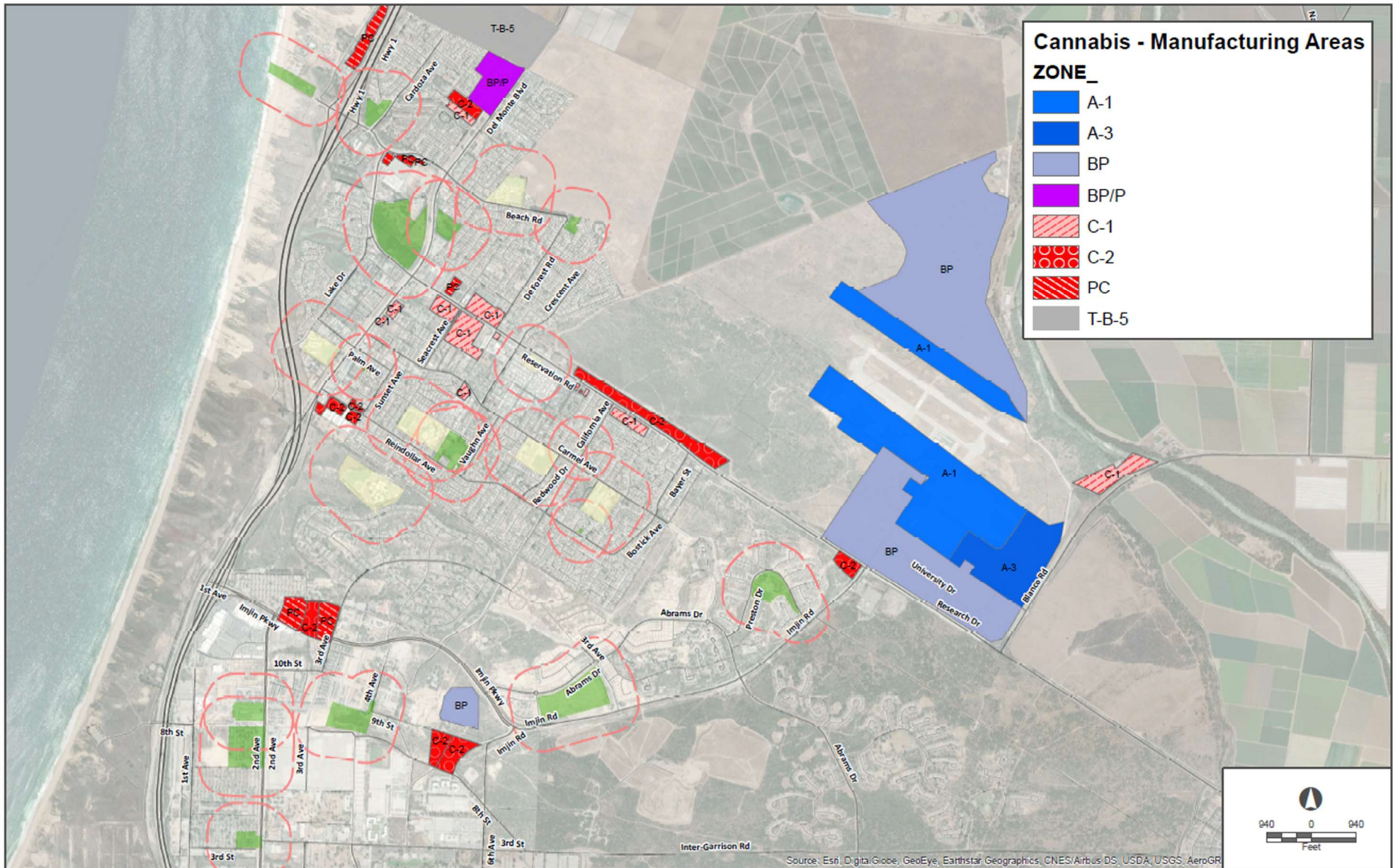
These numbers only apply to the 1.6 million to 2.5 million pounds of cannabis that is consumed in California, representing the potential size of the legal cannabis market. If 29.5% of the cannabis consumed in California continues to come from the black market, then the size of the market for legal cannabis must be adjusted downward accordingly. This would reduce the size of the legal market in California to between 1.13 million and 1.76 million pounds.

California has been issuing temporary licenses for commercial cannabis businesses since the beginning of the year. As of May 30th, CDFA's CalCannabis division has issued 3,664 cultivation licenses, capable of producing over 7.3 million pounds of cannabis per year. That amount is over three times more cannabis than the State's legal buyers are anticipated to consume. Were the State to issue no more licenses, we would expect a failure rate of at least 60% in the first two years.

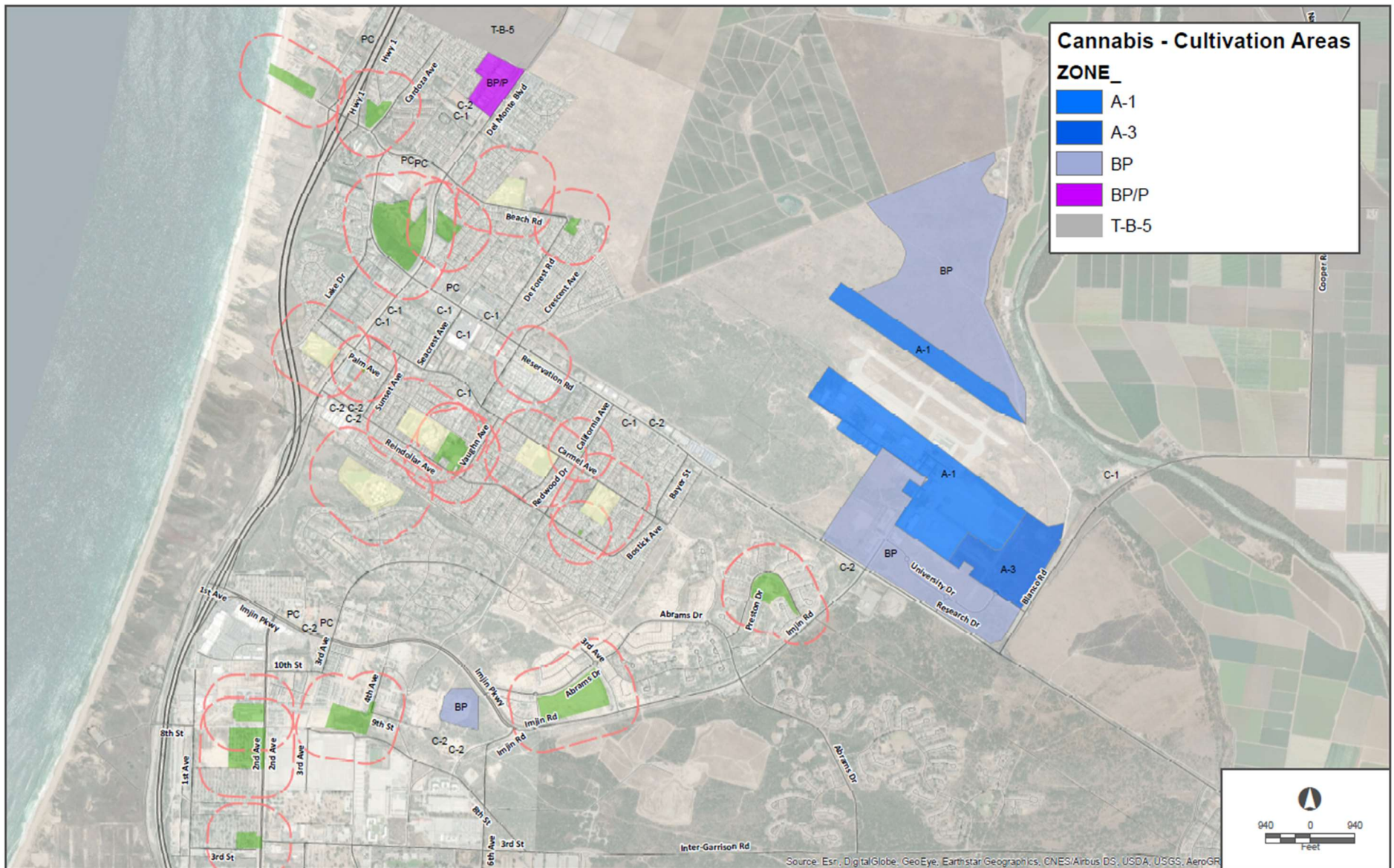
Cannabis Retail Zoning and Buffer Areas



Cannabis Manufacturing Zoning and Buffer Areas



Cannabis Cultivation Zoning and Buffer Areas



EC 9212 Report

Sections g, h, I and j

g. Analysis of the impact of exclusion, if there is an impact, such as exclusion from the ability to secure federal grants.

Any analysis of this issue turns on the illegality of cannabis at the federal level and the resulting conflict between California and federal laws and the impact of that conflict on securing and complying with federal grants.

California Law.

In 2015, the California created a comprehensive regulatory system governing the cultivation, testing, and distribution of medical cannabis commencing at California Business and Professions Code Section 19300. MMRSA governs the medical cannabis industry from “seed to sale” including cultivation, distribution, testing, delivery to qualified patients and primary care givers for medicinal purposes. All medical cannabis businesses or commercial cannabis activities must have both a state and local license/permit. Once licensed, MMRSA provides that a business is immune from criminal prosecution, arrest, civil action, or seizure or forfeiture of assets.

In 2016, the Adult Use of Marijuana Act (AUMA) was passed by the voter’s to (1) allow adults over 21 to possess up to one ounce of marijuana and cultivate up to six plants for personal use, (2) regulate and tax production of and sale to those adults, and (3) reduce criminal penalties for common marijuana felonies to the misdemeanor level and allow prior offenders to petition for reduction in charges. AUMA added to existing medicinal use regulations a regulatory structure for recreational use. Licensing/permitting and immunity⁵ provisions appear in AUMA as well.

Federal Law.

The Controlled Substances Act (CSA) was enacted by Congress in 1970 as Title II of the Comprehensive Drug Abuse Prevention and Control Act, at 21 U.S.C. 801 et seq. It imposes a “comprehensive regime to conquer drug abuse and to control the illegitimate traffic in controlled substances.” The CSA regulatory scheme lists marijuana as a Schedule I drug, meaning that marijuana along with other Schedule I drugs are deemed per CSA to be the most serious of those regulated, having a “high potential for abuse, lack of any accepted medical use, and absence of any accepted safety for use in medically supervised treatment.” It is illegal to import, manufacture, distribute, possess, or use a Schedule I drug in the United States.

On January 4, 2018, U.S. Attorney General Sessions issued a one page memorandum “For All United States Attorneys,” entitled “Marijuana Enforcement.” In it he issued a new marijuana enforcement guidance standard, i.e. “to weigh all relevant considerations, including federal law enforcement priorities set by the Attorney General, the seriousness of the crime, the deterrent effect of criminal prosecution, and the cumulative impact of particular crimes on the community.”⁶ The Attorney General noted that the new guidance is to be treated “solely as a guide

⁵ This immunity is as to state and local law. The Supremacy Clause of the U.S. Constitution (Article VI, Clause 2) supports the preemptive force of federal law where Congress is empowered to regulate. Congress, as courts have determined, is a legitimate regulator of controlled substances, including marijuana, and may enforce despite conflicting state and local law. Given established principles of federalism, however, the United States may not require state and local government to assist in federal criminal investigation and enforcement, though some do cooperate voluntarily.

⁶ This standard is “reflected” in chapter 9-27.000 of the U.S. Attorneys’ Manual.

to the exercise of investigative and prosecutorial discretion.” With this memo the Attorney General rescinded all such previous guidance.

Exclusion from Federal Grants

Our research has not found any instance where a local jurisdiction in a state which legally permits medical or recreational use of cannabis has on that basis been categorically excluded from applying for a federal grant. However, the conditions under which the grant is made may create compliance problems.

Most federal grants stipulate that the recipient organization must not violate any federal laws and doing so will cause a forfeiture of the federal funds. On March 31, 2017, in a memorandum for “Heads of Department Components and United States Attorneys,” entitled “Supporting Federal, State, Local and Tribal Law Enforcement” Attorney General Sessions stated “jurisdictions whose law enforcement agencies accept funding from the Department are expected to adhere to the Department’s grant conditions as well as to all federal laws.” The memo further directed immediate review of grant making, technical assistance and training and compliance reviews among other Department activities.

It is therefore possible that the Justice Department intends in this memo to send a message to state and local government that failure to comply with federal law could have significant consequences for police departments of local public agencies where medical or recreational use of cannabis is permitted and whose police departments are the recipients of grants from the Department of Justice.

Recipients of federal grants of any size are required to maintain a drug-free workplace in accordance with 41 U.S. Code §8103. Grant recipients are required to make certain certifications and to take specific actions to provide a drug-free workplace which are a material representation upon which reliance is placed by the federal government in awarding a grant. In context of an airport, the Federal Aviation Administration’s “Assurances” require an airport sponsor requesting federal funds for aviation programs to comply with all applicable federal laws and regulations including the Drug-Free Workplace Act of 1988.

h. The risks of forfeiture or adverse impacts resulting from conflict with California Law with Federal Law.

Assuming the concern involves the forfeiture of financial assets, a local agency permitting medical and recreational cannabis enterprises should build in as many protections as possible in a regulatory ordinance. Indemnity, insurance coverage, provisions crafted to remove the jurisdiction and its officials from any possibility of exposure, are important parts.⁷ As well, at every turn, in every document, the local agency must repeatedly advise those applying for permitted cannabis activities that while California law allows such activities, federal law has the immediate power to punish them, and that state/local approval does not immunize from federal criminal, civil, and seizure actions. Should the federal government seek to confiscate money collected as taxes or fees charged by the city for permitting cannabis activities, and intended for use in regulating and enforcing terms of

⁷ For example, in its medical marijuana ordinance, the City of Adelanto requires insurance as required by city; an indemnification agreement fully indemnifying the city for all liabilities associated with issued permits; agreement to defend city, its officials and employees, at permittee expense; agreement to reimburse (attorney fees, costs, etc.) city related to any action against city, agents, officers, employees associated with permits.

the permit, the primary precaution, in our view, would be adequate insurance/bonding coverage required of a permittee, to cover that potential loss.^{8,9}

i. Whether the risks described in g and h would have different impacts based on medicinal cannabis and/or recreational cannabis activities.

The analyses in response to the concerns posed in both g and h above turn on the conflict created with federal law by California permitting both medicinal and recreational use of cannabis. Under federal law, both activities remain illegal and therefore the impact of the risks described above would not, in our opinion, vary based upon the nature of the permitted use of cannabis, whether for medicinal or recreational purposes.

j. Whether the impact of the risks described in g and h would have difference impacts based on authorization of cultivation, distribution, manufacturing, or retail activities.

Again, the analyses in response to the issues posed in both g and h above turn on the conflict created with federal law by California permitting cultivation, distribution, manufacturing and retail activities involving cannabis. Under federal law, the cultivation, manufacture and distribution of cannabis remains illegal and therefore the impact of the risks described above would not, in our opinion, vary based upon the nature of the activity involving cannabis.

Changes in federal attitude toward compliance with federal law by local grant recipients permitting the use of cannabis for medicinal or recreational purposes will inevitably vary from state to state, based on social, cultural, and political influence. We can guess, but cannot possibly know, whether the federal government may decide to target local jurisdictions receiving federal grant funds which permit the medicinal or recreational use of cannabis. There may be practical reasons that federal enforcement may not escalate significantly, including the probable need to hire more personnel.

⁸Some are advising cities to put the funds in a segregated account, but query what this accomplishes ultimately.

⁹ Also a consideration here is whether insurance would be available for what an insurance provider might consider insurance covering a criminal act. And, recently we have heard and read reports regarding the reluctance of bankers and realtors to become involved in serving marijuana business. Some banks will not handle proceeds for fear, we assume, of seizure. Some real estate organizations are questioning their membership becoming involved in rentals and sales associated with use of property for marijuana activities.

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