

R-25

December 3, 2019

HONORABLE MAYOR AND CITY COUNCIL
City of Long Beach
California

RECOMMENDATION:

Receive and file a report on the fiscal and jobs impact of reducing cannabis business license tax rates for Manufacturers, Distributors and Testing Laboratories to 1 percent, 2 percent, or 3 percent of gross receipts; and, provide further input and policy direction to staff on cannabis business license tax rates. (Citywide)

DISCUSSION

At its meeting on July 2, 2019, the City Council requested staff to prepare a fiscal and jobs impact analysis for reducing cannabis business license tax rates for Manufacturers, Distributors, and Testing Laboratories to 1 percent, 2 percent, or 3 percent of gross receipts. In response, staff has prepared the attached report (Attachment A). The report is organized in the following manner:

- I. Summary of the Existing Cannabis Market
- II. Fiscal Impact of Reducing Cannabis Tax Rates
- III. Jobs Impact of Reducing Cannabis Tax Rates
- IV. Additional City Council Requests for Information

A high-level summary of findings from the report is provided below. Staff is seeking further policy direction from the City Council on cannabis business license tax rates in the City of Long Beach (City).

Summary of Report Findings

Pursuant to Section 3.80.261 of the Long Beach Municipal Code (LBMC), the City Council has the authority to increase or decrease cannabis business license tax rates by Ordinance, subject to the maximum and minimum rates approved by Long Beach voters. Such a change would not require voter approval under Article XIII, Section C of the California Constitution. Table I provides a summary of the maximum and minimum rates allowable under the LBMC, including the rates that are currently charged to cannabis businesses in the City.

Business Type	Medical/Adult	Current Rate	Maximum	Minimum	Per
Dispensary	Medical	6%	8%	0%	Gross Receipts
	Adult-Use	8%	12%	0%	Gross Receipts
Cultivator	Both	\$12	\$15/sq ft	\$0/sq ft	Sq. Ft. of Canopy
Manufacturer	Both	6%	8%	0%	Gross Receipts
Distributor	Both	6%	8%	0%	Gross Receipts
Testing Laboratory	Both	6%	8%	0%	Gross Receipts

Fiscal Impact of Reducing Cannabis Tax Rates

The City Council requested staff to study the impact of adjusting tax rates specifically for Manufacturers, Distributors and Testing Laboratories. A description of these business types is provided below:

- *Manufacturers* – Facilities that compound, blend, extract, infuse, or otherwise prepare cannabis products (edibles, vaporizers, etc.).
- *Distributors* – Facilities where cannabis goods are stored, packaged, labeled, inspected for quality assurance, or transported between cannabis businesses.
- *Testing Laboratories* – Facilities that test cannabis goods for potency (THC, CBD, etc.) and various forms of contamination (mold, pesticides, heavy metals, etc.).

The short-term fiscal impact of reducing tax rates for Manufacturers, Distributors and Testing Laboratories is limited by the small amount of gross receipts currently being generated by these business types. Specifically, tax revenues for Manufacturers, Distributors and Testing Laboratories are projected to account for only 11 percent of total cannabis tax revenues in FY 20, as shown in Table II:

<u>Bus. Type</u>	<u>FY20</u>	
	<u>Estimated</u>	<u>%</u>
Dispensary	\$ 3,173,534	71%
Cultivation	\$ 823,577	18%
Subtotal (Disp, Cult)	\$ 3,997,111	89%
Lab Testing	\$ 314,345	7%
Manufacturing	\$ 132,804	3%
Distribution	\$ 47,250	1%
Subtotal (Lab, Manuf, Distr)	\$ 494,399	11%

Table III provides a summary of estimated FY 20 General Fund fiscal impacts from reducing tax rates for these business types to 1 percent, 2 percent, or 3 percent of gross receipts. Within these projections, the City Council asked staff to account for a potential

increase in the rate of business openings. In theory, reducing rates for Manufacturers, Distributors and Testing Laboratories will make Long Beach a more competitive destination for cannabis businesses, resulting in increased business locations within the City. However, local tax rates are only one of many variables that businesses consider when determining where to locate.

As a result, is unclear the extent to which businesses may respond to reduced rates by increasing investment locally. Given this uncertainty, staff identified a range of business “growth scenarios” for the City Council to consider. The growth scenarios are intended to capture the range of responses that the cannabis industry might have to a reduction of tax rates, and how those responses could impact fiscal projections.

TABLE III - Projected FY 20 General Fund Revenue Loss From Cannabis Gross Receipts Tax Reduction (Manufacturers, Distributors and Testing Laboratories Only)				
Business Growth Scenarios	Number of Licensees	FY 20 Revenue Loss For Specific Tax Rates:		
		3% Tax Rate	2% Tax Rate	1% Tax Rate
Current Projections	52	\$ (223,074)	\$ (293,118)	\$ (349,675)
"Low" Growth (+ 5 licensees)	57	\$ (210,061)	\$ (282,527)	\$ (339,675)
"Medium" Growth (+ 25 licensees)	77	\$ (108,791)	\$ (206,742)	\$ (283,267)
"High" Growth (+ 50 licensees)	102	\$ 4,487	\$ (120,562)	\$ (216,859)

**Co-located medical and adult-use license holders are counted as a single "licensee" for purposes of this table.
 **Projected revenues do not fall in linear fashion with rate reduction due to fact that a portion of Manufacturing, Distribution and Laboratory Testing facilities pay a minimum tax of \$1,000 annually.*

The “Current Projections” scenario assumes no additional growth in the total number of cannabis businesses, beyond what is already anticipated for FY 20 under the current tax rate structure. Under the “Low” growth scenario, staff assumes that an additional 5 businesses will receive a license to operate in FY 20 compared to “Current Projections.” In the “Medium” growth scenario, staff assumes that an additional 25 businesses will receive a license to operate. In the “High” growth scenario, staff assumes that an additional 50 businesses will receive a license to operate in FY 20. In nearly every scenario, the General Fund continues to project a net revenue loss from a reduction in cannabis tax rates. The only scenario that staff does not project a revenue loss is under the “High” growth scenario for a reduction in business license tax rates to 3 percent.

Given the slow pace of cannabis business openings, staff assumes the “Current Projections” growth scenario for estimating the fiscal impact of a cannabis tax rate reduction in FY 20. In this scenario, staff projects that reducing cannabis business license tax rates will result in an FY 20 General Fund revenue loss of between \$220,000 and \$350,000, depending upon the rate selected.

In the prior “Feasibility Study on a Pilot Program to Expand the Tax Base for Non-Retail Cannabis Businesses” presented to the City Council on June 19, 2019, staff estimated an impact to the General Fund of \$120,000 for every 1 percent tax rate reduction. This would translate to a General Fund revenue loss in FY 20 of between \$360,000 and \$600,000. However, this estimate did not account for the \$1,000 “minimum tax” on cannabis businesses, mandated by Chapter 3.80.261 of the LBMC. The minimum tax

has a mitigating effect on the potential revenue loss from a tax rate reduction on Manufacturing, Distribution and Laboratory Testing businesses in FY 20. In addition, the average quarterly business license tax payments for non-retail cannabis businesses is less than what had been expected as of June 19, 2019. This has served to further limit the estimated impact of a tax rate reduction for non-retail cannabis businesses in FY 20.

The long-term impact of a non-retail tax rate reduction on the General Fund beyond FY 20 is less clear. This uncertainty is based on the belief that non-retail cannabis businesses have much greater flexibility in the long-term to adjust supply in response to changes in local tax rates. This is known as the tax elasticity of supply and is difficult for staff to estimate without collecting greater amounts of tax revenue data from licensed businesses. For this reason, staff is unable to provide a long-term General Fund fiscal impact projection for a reduction to non-retail cannabis business license tax rates.

Jobs Impact of Reducing Cannabis Tax Rates

In addition to a fiscal impact analysis, the City Council asked staff to prepare a jobs study of the local cannabis industry. Within this study, the City Council requested the following information:

- Types of employment opportunities available in the cannabis industry;
- Range of salaries offered by cannabis businesses;
- Average number of jobs created by business type; and,
- Estimated number of jobs created through a reduction in local business license tax rates.

Staff worked with a consultant to collect information by conducting an online survey of local cannabis businesses. A discussion of survey results is included (Attachment A, Section III). Using the survey results, staff developed projections for the number of jobs that might be created through a reduction in local business license tax rates, as seen in Table IV. The job projections are based upon the same “Low,” “Medium” and “High” business growth scenarios identified in Table III. As with the fiscal impact analysis, jobs impact projections are presented as a range of possible outcomes due to the uncertainty inherent in predicting the response that businesses will have to a reduction in tax rates.

TABLE IV - Projected FY 20 Cannabis Jobs in Long Beach (Manufacturers, Distributors and Testing Laboratories Only)				
Business Type	Current Projections	Business Growth Scenarios		
		LOW	MEDIUM	HIGH
Full-Time Employees	350	379	511	672
Part-Time Employees	71	78	105	139
TOTAL	422	457	616	811

Under the current tax structure, staff projects that a total of 350 full-time and 71 part-time workers will be directly employed by cannabis Manufacturers, Distributors, and Testing Laboratories in Long Beach in FY 20. Should the City Council decide to reduce tax rates for these license types, staff estimates that total cannabis employment opportunities will

grow. On the "Low" end, staff projects that a total of 379 full-time and 78 part-time workers will be employed by Manufacturers, Distributors, and Testing Laboratories in FY 20. On the "High" end, staff projects that a total of 672 full-time and 139 part-time workers will be employed by these license types.

Additional City Council Requests for Information

As requested by the City Council during its meeting on July 2, 2019, the Fiscal and Jobs Impact Report also includes information in the following policy areas (Attachment A, Section IV):

- Current real estate vacancies in cannabis "Green Zones."
- Comparable tax revenue and jobs data for non-cannabis businesses.
- Additional Information on the plan review and construction phase of the application process.
- Reducing cannabis business license tax rates on a pilot vs. permanent basis.
- Background information on the cultivation square footage tax.
- Potential impact of a cannabis tax rate reduction on the illegal market.

In the interest of completing the Fiscal and Jobs Impact Report in a timely fashion, staff did not include a detailed discussion of unlicensed cannabis enforcement strategies in the Report. Instead, the Office of Cannabis Oversight initiated an interdepartmental review of the illegal commercial cannabis market. The purpose of the review is to identify enhanced enforcement options to shut down unlicensed businesses and the resources needed to implement those options. Staff will report back to the City Council with an update on these efforts at a later date.

This matter was reviewed by Deputy City Attorney Arturo D. Sanchez on October 22, 2019 and by Budget Manager Grace Yoon on October 17, 2019.

TIMING CONSIDERATIONS

City Council action on this item is not time critical.

FISCAL IMPACT

Should the City Council decide to reduce cannabis business license tax rates for Manufacturers, Distributors, and Testing Laboratories, staff estimates a FY 20 General Fund revenue loss of between \$220,000 to \$350,000 depending upon the rate selected. There is some indication that the actual FY 20 Measure MA revenues may come in higher than the \$4 million that is currently budgeted. This potential improved projection is due to recent growth in average quarterly gross receipts tax payments made by dispensaries, which contribute a disproportionate share of overall cannabis tax revenues to the City relative to other business types.

It is important to note, however, that given the emerging nature of the cannabis industry, Measure MA tax revenues are inherently volatile and revenue estimates for FY 20 can be expected to change materially throughout the fiscal year depending on the point in time in which tax payments are analyzed. Staff will continue to monitor Measure MA revenue trends as well as the overall General Fund status in FY 20 and report back to the City Council with updates through the Financial Performance Reports issued periodically throughout the year or through other reports as necessary.

At this time, it is unclear what the long-term impact of a non-retail tax rate reduction will be in FY 21 and beyond, and what effect tax rate reductions might have on the anticipated budgetary shortfalls in the General Fund beginning FY 21. Additionally, it is important to note that while the FY 20 Budget is balanced, the City is currently projecting a \$5-\$12 million structural deficit in FY 21, with an additional \$11-\$18 million structural deficit in FY 22. However, if the intent is to increase employment in this sector of the City's economy, it is a policy call for the City Council as to whether the increase in potential employment has a higher priority than the loss of revenue.

There is no fiscal impact associated with the suggested action, as it is a recommendation to receive and file a report from the City Manager's Office. Receiving and filing this report has no staffing impact beyond the normal budgeted scope of duties and is consistent with adopted City Council priorities.

SUGGESTED ACTION:

Approve recommendation.

Respectfully submitted,



THOMAS B. MODICA
ACTING CITY MANAGER

ATTACHMENTS: ATTACHMENT A – FISCAL AND JOBS IMPACT REPORT FOR REDUCING CANNABIS BUSINESS LICENSE TAX RATES FOR MANUFACTURERS, DISTRIBUTORS AND TESTING LABORATORIES TO 1%, 2% AND 3% OF GROSS RECEIPTS

ATTACHMENT A

FISCAL AND JOBS IMPACT REPORT – REDUCING CANNABIS BUSINESS LICENSE TAX RATES FOR MANUFACTURERS, DISTRIBUTORS AND TESTING LABORATORIES TO 1%, 2% AND 3% OF GROSS RECEIPTS

On July 2, 2019, the City Council requested staff to prepare a fiscal and jobs impact analysis for reducing cannabis business license tax rates for Manufacturers, Distributors, and Testing Laboratories to 1%, 2%, or 3% of gross receipts. In response to this request, staff has prepared the following report:

- I. Summary of the Existing Cannabis Market**
 - a. Cannabis business license types
 - b. City Council authority to reduce cannabis tax rates
 - c. Cannabis program revenues
 - d. Cannabis program expenditures
 - e. Update on the cannabis business licensing process
 - f. Comparison of Long Beach tax rates to other cities in California
- II. Fiscal Impact Analysis**
 - a. Revenue impact of cannabis tax rate reductions
 - b. Budgetary impact of cannabis tax rate reduction on General Fund expenditures
- III. Jobs Impact Analysis**
 - a. Survey of non-retail cannabis jobs, salaries and benefits
 - b. Potential jobs impact of a cannabis tax rate reduction
- IV. Additional City Council Requests for Information**
 - a. Current real estate vacancies in cannabis “Green Zones”
 - b. Comparable tax revenue and jobs data for non-cannabis businesses
 - c. Additional Information on the plan review and construction phase of the application process
 - d. Reducing cannabis business license tax rates on a pilot vs. permanent basis
 - e. Background information on the cultivation square footage tax
 - f. Potential impact of a cannabis tax rate reduction on the illegal market

Section I – “Summary of the Existing Cannabis Market” – was previously presented to the City Council through a report entitled “Feasibility Study on a Pilot Program to Expand the Tax Base for Non-Retail Cannabis Businesses” (Feasibility Study). Wherever possible, Section I has been updated to reflect current conditions of the cannabis industry in Long Beach. Readers who are already familiar with the information contained in Section I may skip to “Section II: Fiscal Impact Analysis,” starting on page 9 of the report.

In the interest of completing the fiscal and jobs impact report in a timely fashion, staff did not include a detailed discussion of unlicensed cannabis enforcement strategies in this report. Instead, the Office of Cannabis Oversight (OCO) has initiated an interdepartmental review of the illegal commercial cannabis market. The purpose of the review is to identify enhanced enforcement options to shut down unlicensed businesses, and the resources needed to implement those options. Staff will report back to the City Council with an update on these efforts at a later date.

I. Summary of the Existing Cannabis Market

Cannabis Business License Types

Pursuant to Chapters 5.90 and 5.92 of the LBMC, the City of Long Beach (City) is authorized to license the following types of cannabis businesses:

- *Dispensaries* – Facilities where cannabis goods are offered for retail sale to consumers
- *Cultivators* – Facilities where cannabis is planted, grown, harvested, dried, cured, or trimmed
- *Manufacturers* – Facilities that compound, blend, extract, infuse, or otherwise prepare cannabis products (edibles, vaporizers, etc.)
- *Distributors* – Facilities where cannabis goods are stored, packaged, labeled, inspected for quality assurance, or transported between cannabis businesses
- *Testing Laboratories* – Facilities that test cannabis goods for potency (THC, CBD, etc.) and various forms of contamination (mold, pesticides, heavy metals, etc.)

The City maintains a cap of 32 Dispensary licenses that can be issued citywide. There is no cap on the total number of licenses that may be issued for other cannabis business types (henceforth referred to as “non-retail” cannabis businesses).

City Council Authority to Reduce Cannabis Tax Rates

The City Council requested staff to explore options to improve the competitiveness of local non-retail cannabis market by reducing business license tax rates. Specifically, the City Council directed staff to study the impact of reducing cannabis business license tax rates for Manufacturers, Distributors, and Testing Laboratories to 1%, 2%, or 3% of gross receipts, from a current rate of 6%.

Pursuant to Section 3.80.261 of the LBMC, the City Council has the authority to increase or decrease cannabis tax rates by ordinance, subject to the maximum and minimum rates approved by voters. Such a change would not require voter approval under Article XIII C of the California Constitution. See the table below for a summary of the maximum and minimum rates allowable under the LBMC.

City of Long Beach Cannabis Business License Tax Rates			
Business Type	Medical/Adult- Use	Maximum	Minimum⁽¹⁾
Dispensary	Medical	8%	0%
	Adult-Use	12%	0%
Cultivator	Both	\$15/sq ft	\$0/sq ft
Manufacturer	Both	8%	0%
Distributor	Both	8%	0%
Testing Laboratory	Both	8%	0%

(1) Pursuant to Measure MA, Cannabis businesses are required to pay a minimum flat tax of \$1,000 per year.

Cannabis Program Revenues

Pursuant to Chapter 3.80 of the LBMC, medical and adult-use cannabis businesses in Long Beach are currently charged the following business license tax rates.

City of Long Beach - Cannabis Business License Tax Rates			
Business Type	Medical/Adult	Rate	Per
Dispensary	Medical	6%	Gross Receipts
	Adult-Use	8%	Gross Receipts
Cultivator	Both	\$12	Sq. Ft. of Canopy
Manufacturer	Both	6%	Gross Receipts
Distributor	Both	6%	Gross Receipts
Testing Laboratory	Both	6%	Gross Receipts

Gross receipt tax payments are due quarterly, based upon operating revenues generated over the prior three-month period. Cultivation tax payments are collected annually, based upon the maximum square footage of plant canopy under cultivation that year. The following table provides a summary of General Fund cannabis revenues collected in FY 18, and estimated revenues projected through FY 20. Estimated FY 19 revenues are based upon actual revenues collected as of August 1, 2019, projected through the end of the fiscal year. Estimated FY 20 revenues are calculated using average per-business tax collections as of August 1, 2019, multiplied by the anticipated number of licensed cannabis businesses operating in FY 20.

General Fund - Cannabis Program Revenues (as of August 1, 2019)				
Bus. Type	Tax	FY18	FY19	FY20
		Actual	Estimated	Estimated
Dispensary	<i>Gross Receipt Tax</i>	\$ 626,130	\$ 2,965,421	\$ 3,173,534
Cultivation	<i>Sq. Ft. Tax</i>	\$ 517,404	\$ 293,225	\$ 823,577
Lab Testing	<i>Gross Receipt Tax</i>	\$ 80,506	\$ 154,502	\$ 314,345
Manufacturing	<i>Gross Receipt Tax</i>	\$ 500	\$ 40,702	\$ 132,804
Distribution	<i>Gross Receipt Tax</i>	\$ -	\$ 10,500	\$ 47,250
SUBTOTAL TAX REVENUES		\$ 1,224,540	\$ 3,464,350	\$ 4,491,510
<i>Regulatory Fee Revenues</i>		<i>\$ 399,000</i>	<i>\$ 1,017,662</i>	<i>\$ 160,000</i>
TOTAL CANNABIS PROGRAM REVENUES		\$ 1,623,540	\$ 4,482,012	\$ 4,651,510

The City collected \$1.2 million in cannabis tax revenues in FY 18 and is estimated to collect \$3.4 million in FY 19 and \$4.4 million in FY 20. Including fee revenues, the cannabis regulatory program collected a total of \$1.6 million in General Fund revenues in FY 18, and is estimated to collect \$4.4 million in FY 19 and \$4.6 million in FY 20. Staff projects limited growth in total General Fund revenues between FY 19 and FY 20 due to a one-time spike in FY 19 fee collections that is not expected to continue in FY 20. This one-time spike was caused by an influx of applications immediately following passage of the adult-use ordinance in FY 19.

Updated revenue projections for FY 20 are approximately \$490,000 higher than what was budgeted in the FY 20 Adopted General Fund Budget. This increase is due to the recent growth in average quarterly gross receipts taxes paid by dispensaries, as measured by the most recent

quarter of tax payments. To date, approximately three-quarters of all cannabis business license tax revenues have come from dispensaries, with remaining one-quarter coming from non-retail businesses. Thus, any increase in dispensary gross receipts will have a disproportionate impact on total amount of cannabis tax revenues collected by the City.

Cannabis Program Expenditures

The following table provides a summary of total Measure MA program expenditures for fiscal years FY 18 – FY 20. This includes actual expenditures in FY 18, and estimated expenditures in FY 19 and FY 20, calculated as of August 1, 2019. For comparison, the table also includes cannabis program revenues for the same fiscal years, summarized from the previous section.

General Fund - Cannabis Program Expenditures/Revenues (as of August 1, 2019)			
	<u>FY 18 Actual</u>	<u>FY 19 Estimated</u>	<u>FY 20 Estimated</u>
EXPENDITURES			
Cannabis Oversight	\$ 2,404,612	\$ 2,839,593	\$ 2,864,227
Homeless Related Expenses	\$ 1,383,726	\$ 1,487,586	\$ 1,095,773
Measure B - Rainy Day Fund	\$ 16,452	\$ 34,643	\$ 40,000
Total Measure MA Expenditures	\$ 3,804,790	\$ 4,361,822	\$ 4,000,000
REVENUES			
Measure MA Bus. Lic. Tax Revenues	\$ 1,224,540	\$ 3,464,350	\$ 4,491,510
Total Measure MA Revenues	\$ 1,224,540	\$ 3,464,350	\$ 4,491,510
Measure MA Surplus/(Deficit)	\$ (2,580,249)	\$ (897,472)	\$ 491,510
<i>Cannabis Regulatory Fee Revenues</i>	\$ 399,093	\$ 1,017,662	\$ 160,000
Cannabis Program Surplus/(Deficit)	\$ (2,181,156)	\$ 120,189	\$ 651,510

Cannabis program expenditures include departmental costs related to permitting, regulating and enforcing the cannabis industry. In addition, Measure MA expenditures include costs for homeless services and Measure B one percent (1%) set aside for the budget stabilization fund. Although these costs are not directly related to cannabis oversight, Measure MA specifies that funds may be used for “public safety, 9-1-1 emergency response, police officers, homelessness, and general City services.” Thus, homeless services and Measure B expenditures are appropriate uses of Measure MA funds.

As seen in the table above, FY 19 represents the first year that Measure MA tax revenues, when combined with cannabis regulatory fees, are projected to exceed total Measure MA expenditures. Staff expects this surplus to grow modestly in FY 20, primarily due to growth in dispensary gross receipts.

Staff cautions against drawing any long-term conclusions from FY 18, FY 19, and FY 20 Measure MA data. Significant year-over-year fluctuations in cannabis tax revenues should be expected as the industry matures over time. For a better understanding of where the Long Beach cannabis market may be headed in the long run, it is more useful to look at the number of businesses currently moving through the application process.

Update on Cannabis Business Licensing Process

To receive a license to operate in the City, a cannabis business must complete the following steps in the application process:

1. Initial zoning/business license application review
2. Building plan submittal
3. Building plan review
4. Facility construction and inspection
5. License issuance

As of August 1, 2019, the City has a total of 618 active cannabis applications. Of these applications, 106 have been issued a business license, 109 are under construction, 160 are in building plan review, 171 are pending building plan submittal, and 72 are undergoing initial zoning and business license application review. The table below provides a summary of active cannabis applications submitted to the City.

Summary of Cannabis Business License Applications (as of August 1, 2019)						
Business Type	Initial Zoning/ App Review	Pending Plan Submittal	Building Plan Review	Under Construction	Licenses Issued	Grand Total
MEDICAL						
Dispensary	0	3	3	8	18	32
Cultivator	3	41	23	15	8	90
Manufacturer	3	45	36	19	13	116
Distributor	3	38	30	14	16	101
Lab Testing	1	1	1	4	2	9
Subtotal (Medical)	10	128	93	60	57	348
ADULT-USE						
Dispensary	2	1	3	4	18	28
Cultivator	17	8	14	11	5	55
Manufacturer	15	20	29	19	13	96
Distributor	27	13	20	12	13	85
Lab Testing	1	1	1	3	0	6
Subtotal (Adult-Use)	62	43	67	49	49	270
TOTAL	72	171	160	109	106	618

Most cannabis applications are for co-located or vertically-integrated businesses. Co-location means a cannabis business is applying for both a medical and an adult-use business license from a single premise. Vertical integration means that a business is applying for multiple license types (e.g., Cultivation, Manufacturing, and Distribution) out of the same facility. As a result, the total number of proposed cannabis facilities in Long Beach is less than the total number of applications that have been submitted. Accounting for co-location and vertical integration, a total of 246 cannabis facilities are either licensed or moving through the application process. Of these proposed facilities, 50 have been issued a business license, 53 are under construction, 60 are in building plan review, 79 are pending building plan submittal,

and 4 are pending application review. The table below provides a summary of proposed cannabis facilities in Long Beach:

Summary of Proposed Cannabis Facilities (as of August 1, 2019)	
Facility Status	No. of Facilities
Issued License	50
Under Construction	53
Building Plan Review	60
Pending Plan Submittal	79
Application Review	4
TOTAL	246

Given the current pace of business openings, it is difficult to predict how many cannabis facilities will ultimately receive a license to operate in Long Beach. Non-retail businesses, in particular, have moved very slowly through the zoning, plan review, and construction phase of the licensing process. Many non-retail cannabis applicants appear to have stalled completely. To better understand why most non-retail businesses have been unable to obtain a license, staff from the OCO contacted cannabis businesses and City departments involved in the application process. A summary of the most common explanations cited by businesses and departments are provided below:

1. Competitiveness of Local Tax Rates – Non-retail cannabis businesses expressed concern over the tax rates charged by the City of Long Beach for non-retail cannabis activity. Some non-retail applicants indicated they were considering abandoning their application and relocating to a neighboring city with lower non-retail cannabis business license tax rates.
2. Access to Capital – Non-retail cannabis businesses require a significant amount of up-front capital to build a facility that meets minimum state and local building code requirements. Sufficient startup capital is also necessary to cover application fees and taxes prior to issuance of the business license. Some cannabis businesses underestimate the amount of capital necessary to open a non-retail business, and must secure additional investments midway through the application process.
3. Facility Plan Check – Non-retail cannabis businesses have found it difficult to navigate the building plan review phase. Staff from the Fire and Development Services Departments report that the architectural drawings submitted by non-retail businesses often do not comply with California Building Code, California Fire Code, or other facility design standards. City staff will not approve facility plans until they are compliant with all California Code requirements.
4. Access to Statewide Retail Markets – Approximately 75 percent of cities in California continue to ban licensed cannabis retailers in their jurisdictions. This has severely limited the market for licensed cannabis products statewide, and perpetuated sales on the illicit market. Unlike dispensaries, which compete primarily at the local level, non-retail businesses deliver products at wholesale to licensed businesses throughout the state. The lack of licensed retailers across most jurisdictions in California has directly impacted demand for products and services from licensed non-retail businesses, including those located in Long Beach.

5. State Licensing Process – Cannabis applicants must receive a separate business license from the State of California and the City of Long Beach prior to handling any cannabis goods. Some non-retail applicants have received a business license from the City, but are still awaiting approval from the state before operating.

6. Cost of Industrial Real Estate in Long Beach – Following passage of the medical cannabis voter initiative in November 2016 (Measure MM), the asking rent for industrial real estate grew significantly in areas of Long Beach where non-retail cannabis businesses may locate (Green-Zones). This trend can be seen in *Exhibit A* to this report. In the two largest Green-Zones in Long Beach, the asking price per square foot more than doubled between 2016 and 2019. By some reports, property owners are demanding significantly higher rent from cannabis businesses than they are from other business types for the same property. The inflated cost of industrial property in Long Beach has forced some cannabis applicants to consider relocating to other jurisdictions with lower real estate prices in eligible Green-Zones, such as Sacramento, Santa Rosa, Adelanto, and Desert Hot Springs. Additional information on Long Beach industrial real estate trends is provided in Section IV of this report.

Comparison of Long Beach Tax Rates to Other Cities in California

While there are many other factors businesses consider when determining where to locate, the competitiveness of local rates do have an impact on business investment decisions. The following tables compares Long Beach tax rates to other local jurisdictions in California. The first table compares Long Beach tax rates to cities in Southern California that allow for commercial cannabis activity. The second table compares Long Beach rates to cities in other regions of the state, with populations greater than 100,000.

COMPARABLE CITIES BY REGION											
City	Pop.	Retail		Cultivation		Manufacturing		Distribution		Lab Testing	
		M	A	M	A	M	A	M	A	M	A
Long Beach	478,561	6%	8%	\$12/sq ft		6%		6%		6%	
Los Angeles	4,054,400	5%	10%	2%		2%		1%		1%	
Santa Ana ⁽¹⁾	338,247	6%	8%	6%		6%		6%		5%	
Pomona	155,687	up to 6%		up to 10/sq ft		up to 6%		up to 6%		up to 6%	
Pasadena	144,388	4%		\$7/sq ft		2.5%		2%		1%	
Costa Mesa	115,296	6%		6%		6%		6%		6%	
Carson	93,799	18%		\$25/sq ft		18%		18%		18%	
Bellflower	77,682	5%		\$15/sq ft		5%		5%		5%	
La Puente	40,686	10%	N/A	10%	N/A	10%	N/A	10%	N/A	10%	N/A
Culver City	39,860	5%	6%	\$12/sq ft		4%		2%		1%	
West Hollywood	36,723	0%	7.5%	0%	7.5%	0%	7.5%	0%	7.5%	0%	7.5%
Maywood	28,044	up to 10%		up to 10%		up to 10%		up to 10%		up to 10%	
Malibu	12,957	0%	2.5%	0%	2.5%	0%	2.5%	0%	2.5%	0%	2.5%

(1) Square footage tax may apply if gross receipts fall below a minimum amount.

COMPARABLE CITIES BY POPULATION											
City	Pop.	Retail		Cultivation		Manufacturing		Distribution		Lab Testing	
		M	A	M	A	M	A	M	A	M	A
Long Beach	478,561	6%	8%	\$12/sq ft		6%		6%		6%	
San Diego	1,419,845	0%	5%	0%	5%	0%	5%	0%	5%	0%	5%
San Jose	1,051,316	10%		10%		10%		10%		10%	
San Francisco	883,963	0%	2.5 - 5%	1 - 1.5%		1 - 1.5%		1 - 1.5%		1 - 1.5%	
Fresno	538,330	10%		\$12/sq ft		10%		10%		10%	
Sacramento	501,344	4%		4%		4%		4%		4%	
Oakland	428,827	5%	10%	5%	10%	5%	10%	5%	10%	5%	10%
San Bernardino	221,130	6%		\$10/sq ft		4%		3%		3%	
Stockton	315,103	5%	10%	5%		5%		5%		5%	
Santa Rosa ⁽¹⁾	178,488	0%	3%	2%		1%		0%		0%	
Salinas	161,784	5%		\$15/sq ft		5%		5%		5%	
Santa Clara ⁽¹⁾	129,604	5%		5%		5%		3%		3%	
Berkeley	121,874	2.5%	5%	2.5%	5%	2.5%	5%	2.5%	5%	2.5%	5%
Richmond	110,967	5%		5%		5%		5%		5%	

(1) Square footage tax may apply if gross receipts fall below a minimum amount.

As seen in these tables, Long Beach tax rates remain competitive with many of the cities in California that license commercial cannabis activity. Recently, however, some cities have taken steps to reduce their cannabis tax rates to attract more cannabis businesses. These cities include Oakland, Berkeley, Palm Springs, and Vallejo. The City of Oakland, for example, amended its cannabis tax ordinance to allow businesses to deduct the cost of raw materials from its gross receipts tax, and lowered its tax for businesses that make less than \$500,000 to 0.12% of gross receipts. In addition, a handful of cities in Southern California have begun to offer development agreements for Manufacturing and Distribution businesses, with operating fees that typically range between 1% – 2.5% of gross receipts. This includes the cities of El Monte, Lynwood, Montebello and Commerce. However, because development agreements are only offered on a limited basis by these jurisdictions, it is unlikely that the rates being charged will have a significant impact on business location decisions in the Southern California region.

Of far greater significance for the Southern California market is the ongoing development of the cannabis industry in the City of Los Angeles. This is based in part on the size of Los Angeles, its proximity to Long Beach, and the fact the City of Los Angeles charges significantly lower cannabis business license tax rates than Long Beach for most non-retail business types. Thus far, the Los Angeles market has had a limited impact on cannabis business location decisions in the Southern California area due to a delay in implementation of the Los Angeles application process. This delay has prevented most new non-retail businesses from being able to apply for a cannabis business license in Los Angeles. Recently however, the City of Los Angeles Department of Cannabis Regulation (DCR) announced the opening of Phase 3 of its application process. Phase 3 will allow for new retail and non-retail cannabis businesses to apply for a license in Los Angeles. In its announcement, the DCR clarified that Phase 3 would first begin with the acceptance of new retail applications only. Phase 3 will not open for non-retail businesses until mid-2020 at the earliest. Once Phase 3 begins for non-retail businesses however, the discrepancy in tax rates between Los Angeles and other cities in the region could have a greater impact on commercial cannabis location decisions in the Southern California area. Until that time, the impact of the Los Angeles market will be limited by the restrictions that the city has placed on the acceptance of new applications.

II. Fiscal Impact Analysis

Revenue Impact of Cannabis Tax Rate Reductions

When determining the fiscal impact of a reduction in business license tax rates for Manufacturers, Distributors and Testing Laboratories, it is necessary to first differentiate short-run (i.e. FY 20) from long-run (i.e. FY 21+) effects. In the short run, the fiscal impact will be limited due to the small amount of gross receipts currently being generated by these business types. Specifically, tax revenues for Manufacturers, Distributors, and Testing Laboratories are projected to account for only 11 percent of total cannabis tax revenues in FY 20, as shown in the table below:

General Fund Cannabis Tax Revenues - % of Total (as of August 1, 2019)		
Bus. Type	FY20	
	Estimated	%
Dispensary	\$ 3,173,534	71%
Cultivation	\$ 823,577	18%
Subtotal (Disp, Cult)	\$ 3,997,111	89%
Lab Testing	\$ 314,345	7%
Manufacturing	\$ 132,804	3%
Distribution	\$ 47,250	1%
Subtotal (Lab, Manuf., Distr)	\$ 494,399	11%

The underperformance of these sectors is caused in part by the fact that many Manufacturers and Distributors have not yet begun generating revenues, despite having received a license to operate from the City. In the instance where a cannabis business fails to generate gross receipts, the business is required to pay a minimum tax of \$1,000 per year. As a result, any short-run revenue loss from reducing cannabis business license tax rates will be mitigated by the fact that a significant portion of revenues collected from Manufacturers and Distributors have so far been levied as a flat \$1,000 tax, independent of the 6% gross receipts rate.

The following table summarizes the short-run General Fund fiscal impact from reducing tax rates for Manufacturers, Distributors and Testing Laboratories to 1%, 2% or 3% of gross receipts. As part of this analysis, the City Council asked staff to account for potential growth in the local supply of non-retail cannabis due to lower tax rates. In theory, reducing rates for Manufacturers, Distributors and Testing Laboratories will make Long Beach a more competitive destination for cannabis businesses, resulting in increased cannabis investment and production locally. However, as stated earlier, local tax rates are only one of many variables that businesses consider when determining where to locate. Thus, it is unclear the extent to which businesses may respond to reduced rates, relative to changes in other economic variables. Given this uncertainty, staff identified a range of business "growth scenarios" for the City Council to consider. The growth scenarios are intended to capture the range of responses that the cannabis industry might have to a reduction of tax rates, and how those responses could impact fiscal projections.

Projected FY 20 General Fund Revenue Loss From Cannabis Gross Receipts Tax Reduction (Manufacturers, Distributors and Testing Laboratories Only)				
Business Growth Scenarios	Number of Licensees	FY 20 Revenue Loss For Specific Tax Rates:		
		3% Tax Rate	2% Tax Rate	1% Tax Rate
Current Projections	52	\$ (223,074)	\$ (293,118)	\$ (349,675)
"Low" Growth (+ 5 licensees)	57	\$ (210,061)	\$ (282,527)	\$ (339,675)
"Medium" Growth (+ 25 licensees)	77	\$ (108,791)	\$ (206,742)	\$ (283,267)
"High" Growth (+ 50 licensees)	102	\$ 4,487	\$ (120,562)	\$ (216,859)

**Co-located medical and adult-use license holders are counted as a single "licensee" for purposes of this table.
**Projected revenues do not fall in linear fashion with rate reduction due to fact that a portion of Manufacturing, Distribution and Laboratory Testing facilities pay a minimum tax of \$1,000 annually.*

The "Current" scenario assumes no additional growth in the total number of cannabis businesses, beyond what is already anticipated for FY 20 under the existing tax rate structure. This includes businesses already licensed, as well as a portion of businesses in the plan check and construction phase that staff expects to receive a license in FY 20. Under the "Low" growth scenario, staff assumes that an additional five businesses will receive a license to operate in FY 20 as a direct result of lowering non-retail tax rates. In the "Medium" growth scenario, staff assumes that an additional twenty-five businesses will receive a license to operate. In the "High" growth scenario, staff assumes that an additional fifty businesses will receive a license to operate in FY 20. In nearly every scenario, the General Fund continues to project a net revenue loss due to a reduction in cannabis tax rates. The only scenario that staff does not project a revenue loss is under the "high" growth scenario for a reduction in business license tax rates to 3%.

Given the slow pace of cannabis business openings, staff recommends assuming the "Current" growth scenario when measuring the budgetary impact of a cannabis tax rate reduction. Based on this assumption, staff projects that reducing cannabis business license tax rates will result in an FY 20 General Fund revenue loss of between **\$220,000 and \$350,000**, depending on the rate selected by the City Council.

In the prior "Feasibility Study on a Pilot Program to Expand the Tax Base for Non-Retail Cannabis Businesses" presented to the City Council on June 19, 2019, staff estimated an impact to the General Fund of \$120,000 for every 1% tax rate reduction. This would translate to an FY 20 General Fund revenue loss of between \$360,000 and \$600,000. However, this estimate did not account for the \$1,000 "minimum tax" on cannabis businesses, mandated by Chapter 3.80.261 of the LBMC. The minimum tax has a mitigating effect on the potential revenue loss from a tax rate reduction on Manufacturing, Distribution and Laboratory Testing businesses in FY 20. In addition, the average quarterly business license tax payments for non-retail cannabis businesses are coming in lower than what had been expected as of June 19, 2019. This has served to further limit the estimated impact of a tax rate reduction for non-retail cannabis businesses in FY 20.

It is unclear what the *long-run* (e.g. FY 21 +) impact of a non-retail tax rate reduction will be on the General Fund. The main reason for this uncertainty is the fact that in the long-run, non-retail cannabis businesses have much greater flexibility to adjust supply in response to changes in local tax rates. This is known as the tax elasticity of supply, and is difficult for staff to estimate

without collecting greater amounts of tax revenue data from licensed businesses. For this reason, staff is currently not able to provide a long-run General Fund fiscal impact projection for a reduction to non-retail cannabis business license tax rates.

Budgetary Impact of Cannabis Tax Rate Reduction on General Fund Expenditures

As discussed earlier in this report, current Measure MA revenue projections are approximately \$490,000 higher than what was adopted in the FY 20 General Fund Budget. This increase is due to recent growth in average quarterly gross receipts tax payments made by dispensaries. Given this result, staff from the OCO did not ask departments to identify specific reductions in Measure MA expenditures to account for a loss of \$210,000 to \$340,000.

It is important to note, however, that given the emerging nature of the cannabis industry, Measure MA tax revenues are inherently volatile. FY 20 revenue estimates can be expected to change materially throughout the fiscal year depending on the point in time in which tax payments are analyzed. Therefore, regardless of what actions are taken by the City Council, staff will continue to monitor Measure MA revenue trends and report back to the City Council with new information as it becomes available.

III. Jobs Impact Analysis

In addition to a fiscal impact analysis, the City Council asked staff to prepare a jobs study of the local cannabis industry. Within this study, the City Council requested the following information:

- Types of employment opportunities available in the cannabis industry;
- Range of salaries offered by cannabis businesses;
- Average number of jobs created by business type;
- Estimated number of jobs created through a reduction in local business license tax rates.

To collect this information, staff hired a consultant to conduct an online survey of local cannabis businesses. Using the results of the survey, staff then developed projections for the number of jobs that might be created through a reduction in local business license tax rates. A summary of these results is provided below.

Survey of Non-Retail Cannabis Jobs, Salaries and Benefits

The cannabis jobs survey was released to cannabis businesses during the month of September 2019. Survey responses were requested from licensed cannabis businesses, as well as businesses that had reached the Building Plan Review or Construction phase of the application process. Businesses that have reached this phase of the application process are generally considered more likely to receive a business license from the City than those in earlier stages of review.

In total, the City received complete responses from 34 licensed cannabis businesses and 26 businesses in the Building Plan Review and Construction phase. To account for the fact that businesses in the application process are not yet operating, survey data was requested from

those 26 businesses on a pro-forma basis, based upon anticipated employment levels within the first year of opening. A summary of survey responses is provided below.

Cannabis Jobs Survey Results			
Average Number of Employees by License Type			
Business Type	Avg. No. of Employees	Full Time* (%)	Part Time* (%)
Dispensary	16	80%	20%
Cultivation	14	89%	11%
Manufacturing	7	82%	18%
Distribution	8	80%	20%
Laboratory Testing	21	95%	5%

**Full Time defined as working 30 hours or more per week. Part time defined as working less than 30 hours per week.*

Given the total number of licenses that have been issued by the City to-date, staff estimates that there are currently 557 full-time and 117 part-time employees working in the Long Beach cannabis industry today. Across each of the cannabis business types, employee salaries can vary significantly. The table below provides a summary of salary data collected through the survey, and grouped by license types.

Cannabis Jobs Survey Results						
Average Senior, Mid-Level and Entry-Level Salaries by License Type						
Business Type	Senior/Executive		Mid-Level		Entry-Level	
	Average Annual Salary	% of Staff	Average Annual Salary	% of Staff	Average Annual Salary	% of Staff
Dispensary	\$ 57,750	11%	\$ 47,300	16%	\$ 30,396	74%
Cultivation	\$ 96,875	8%	\$ 61,333	20%	\$ 34,764	73%
Manufacturing	\$ 78,441	35%	\$ 61,063	30%	\$ 37,324	35%
Distribution	\$ 77,962	22%	\$ 56,944	26%	\$ 35,246	52%
Laboratory Testing	\$ 162,500	16%	\$ 87,500	24%	\$ 47,500	60%

Within each license category, salary data is categorized into three broad employee classifications – Senior/Executive Staff, Mid-Level Management, and Entry-Level Employees. Senior/Executive staff are responsible for the overall performance of the cannabis business. Staff in these positions set organizational goals and make major corporate decisions. Equivalent job titles in this category include President, Vice President, Executive Officer and Chief Officer. Mid-Level Managers are involved in day-to-day operations of the cannabis business. Staff in these positions supervise small or large groups of employees in departments, divisions or business locations. Equivalent job titles include Director, Manager and Master Grower. Entry-Level Employees work under supervisions on routine tasks. Staff in these positions often require on-the-job training. Equivalent job titles include budtender, trimmer, packager and delivery driver. For more information on cannabis job titles and job descriptions, refer to *Exhibit B* to this report.

In addition to providing estimates for number of employees and annual salaries, businesses were asked to identify the types of benefits offered to employees. A summary of survey responses is provided below. The data is presented as percentages of businesses that offer different types of employee benefits. Unfortunately, due to survey limitations, staff cannot provide information on the specific terms and conditions offered by cannabis businesses within each benefit category.

Cannabis Jobs Survey Results					
Percent of Businesses Offering Employment Benefits by License Type					
Business Type	Health Insurance	Dental Insurance	Life Insurance	Paid Vacation	Retirement Benefits
Dispensary	78%	78%	11%	100%	67%
Cultivation	70%	50%	10%	60%	40%
Manufacturing	44%	28%	11%	56%	11%
Distribution	36%	36%	14%	36%	29%
Laboratory Testing	100%	50%	0%	100%	50%

Potential Jobs Impact of Cannabis Tax Rate Reduction

Using employment survey data collected from cannabis businesses, staff has prepared projections for the number of jobs that may be created due to a reduction in cannabis business license tax rates for Manufacturers, Distributors and Testing Laboratories. Projections are based upon the “Low,” “Medium” and “High” growth scenarios, previously summarized in the fiscal impact section of this report. As with the fiscal impact analysis, jobs impact projections are presented as a range of possible outcomes, due to the uncertainty inherent in predicting the response that businesses will have to a reduction in tax rates.

Projected FY 20 Cannabis Jobs in Long Beach				
(Manufacturers, Distributors and Testing Laboratories Only)				
Business Type	Current Projections	Business Growth Scenarios		
		LOW	MEDIUM	HIGH
Full-Time Employees	350	379	511	672
Part-Time Employees	71	78	105	139
TOTAL	422	457	616	811

As stated in the fiscal impact section – the “Current” scenario assumes no additional growth in the total number of cannabis businesses, beyond what is already anticipated in FY 20 under the existing tax rate structure. Under the “Low” growth scenario, staff assumes that an additional five businesses will receive a license to operate in FY 20 as a direct result of lowering non-retail tax rates. In the “Medium” growth scenario, staff assumes that an additional twenty-five businesses will receive a license to operate. In the “High” growth scenario, staff assumes that an additional fifty businesses will receive a license to operate in FY 20.

Under the current tax structure, staff projects that a total of 350 full-time and 71 part-time workers will be employed by cannabis Manufacturers, Distributors and Testing Laboratories in Long Beach in FY 20. Should the City Council decide to reduce tax rates for these license types, staff estimates that total employment opportunities will grow even further. On the “Low”

end, staff projects that a total of 379 full-time and 78 part-time workers will be employed by Manufacturers, Distributors and Testing Laboratories in FY 20. On the “High” end, staff projects that a total of 672 full-time and 139 part-time workers will be employed by these license types.

IV. Additional City Council Requests for Information

Current Real Estate Vacancies in Cannabis “Green Zones”

To apply for a cannabis business license in Long Beach, applicants must first secure property in an area of the city where cannabis businesses are eligible to locate. These areas are commonly referred as cannabis “Green Zones.” As part of the fiscal impact report, the City Council requested additional information on current Green Zone vacancies in Long Beach. The purpose of this request was to help identify the ceiling on how many new cannabis businesses could possibly locate in Long Beach, beyond the approximately 240 facilities that are already moving through the application process or are currently licensed.

Following passage of the medical cannabis voter initiative in November 2016 (Measure MM), the vacancy rate for Green Zone properties in Long Beach fell to historic lows. This trend can be seen in *Attachment B* to the fiscal impact report. Specifically, in the two largest Green-Zone areas in Long Beach, vacancy rates temporarily dipped below one percent in early 2017. While vacancy rates have since increased, cannabis applicants continue to cite the difficulty of securing a Green Zone eligible property as one of the biggest impediments to opening a cannabis business in Long Beach.

To provide the City Council with a more detailed picture of the total number of Green Zone vacancies in Long Beach, staff worked with a commercial real estate services firm to identify the total number of available properties on the market for sale or lease to a cannabis business. Available properties were identified through the CoStar Commercial Industrial Real Estate Database (CoStar Database). The results of the analysis are summarized below:

Industrial Buildings Available for Sale/Lease in Long Beach (as of 7/19/19)			
Description	Sale	Lease	Total
Industrial Buildings Available in Long Beach	45	65	110
Industrial Buildings Available in "Green Zones"	34	38	72
Industrial Buildings Available in "Green Zones" <i>and</i> Property Owner Will Allow Cannabis Use	34	18	52
<i>Source: CoStar Commercial Real Estate Database</i>			

As of July 19, 2019, there were a total of 110 industrial buildings listed for sale or lease in Long Beach. Of these buildings, 72 were located in eligible Green Zone areas of the City. Of the 72 eligible Green Zone buildings, a total of 52 property owners indicated that they would be willing to sell or lease to a cannabis business when contacted. The remaining property owners commonly cited the following reasons for not leasing to cannabis businesses:

- Concerns over federal legality
- Prior negative experience with a cannabis tenant
- Parking restrictions

- Port Industrial Zoning restrictions
- Loan covenants that prohibit leasing to a cannabis business
- Building design not appropriate for cannabis use
- Real Estate Investment Trust (REIT) or other ownership entity unable to lease to a cannabis business
- Moral conviction against cannabis

Despite current limitations on available property in Long Beach, more buildings will become available over time for cannabis businesses to lease or purchase in Green Zone eligible areas. According to the CoStar Database, there are a total of 1,040 industrial buildings in Long Beach. The average lease period for an industrial property is approximately 3-5 years in length. Assuming 50% of industrial buildings are owner occupied, and 50% are under lease, staff projects that, on average, 10 new industrial buildings will become available each month for lease. Thus, over the long-run, the availability of Green Zone real estate will depend on the ability of cannabis businesses to pay at or above market rates for industrial property in the city.

Comparable Tax Revenue and Jobs Data for Non-Cannabis Businesses

The City Council asked staff to provide comparable data for non-cannabis businesses in Long Beach, specifically those businesses located in Green Zone areas of the city. The purpose of the request is to provide the City Council with information on businesses that may be displaced by the expansion of non-retail commercial cannabis businesses into Long Beach, and the potential fiscal and jobs impact that displacement could have on the City.

To gather this information, staff from the OCO analyzed actual business license and sales tax data in Long Beach, as of the most recently completed fiscal year (FY 18). Average employee estimates were calculated using self-reported data submitted to the City by licensed businesses as part of the application process. The data was then filtered for only those businesses that fall within Green Zone areas of the city. This allowed staff to isolate the data for only those businesses that compete directly with the cannabis industry for available real estate. Next, the data was sorted into broad categories for business type. Each category was then associated with a North American Industry Classification System (NAICS) code. NAICS is the standard used by Federal and State agencies to classify business establishments for purposes of collecting and publishing statistical data related to the U.S. business economy. Using NAICS codes, staff was able to estimate the average salary for each industry through data provided by the State of California Employment Development Department (EDD). A summary of the findings is presented below.

Fiscal and Jobs Impact Report for Reducing Cannabis Business License Tax Rates

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Non-Cannabis Business License Data - Long Beach Green Zones - As of 8/1/19					
Business Class	Industry NAICS Code	Average Annual Business License Tax	Average Annual Local Sales Tax*	Average No. of Employees	Average Salary Per Employee
Contractors	23	\$661	\$4,431	14	\$67,298
Manufacturing	31-33	\$604		23	\$79,150
Wholesale	42	\$504		10	\$74,310
Retailing	44-45	\$521		12	\$37,268
Warehousing	48-49	\$1,032		4	\$64,991
All Other Categories	N/A	\$1,582		11	\$65,167
Weighted Avg. of All Business Types		\$1,174	\$4,431	12	\$64,713

**Note: Due to privacy laws, sales tax data can only be presented as an average across all businesses in eligible Green Zones.*

Using this methodology, staff estimates that non-cannabis businesses located in Green Zone areas pay an average of \$1,174 in annual business license tax, and \$4,431 in annual sales tax to the City. In addition, non-cannabis businesses in Green Zone areas of the City employ an average of 12 workers per business. These workers receive an average salary of \$64,713 per year.

Additional Information on the Plan Review and Construction Phase of the Application Process

The City Council requested additional information on the average length of time needed to obtain a cannabis business license. Specifically, staff was asked to provide a breakdown of the total amount of time required by businesses to complete the Building Plan Review and Construction phase of the application process, and the portion of that time spent awaiting approval from City departments. The table below summarizes this information for licensed cannabis businesses in Long Beach, as of August 1, 2019:

Business Type	Average Length of Time to Complete Each Phase (Months)			
	Plan Check	Construction	Other Phases ⁽¹⁾	Total
Dispensary	5.1	4.3	5.6	15.0
Cultivation	6.3	4.1	3.2	13.6
Manufacturing	5.9	5.2	2.5	13.6
Distribution	6.1	3.9	3.8	13.8
Laboratory Testing	4.6	3.8	1.8	10.2
Average (All Licensed Businesses)	5.8	4.3	3.1	13.2

(1) Note: Includes Zoning Review, Application Review, and Final Inspections

On average, licensed cannabis businesses have taken 13.2 months to complete the business license process. During this time, they have required an average of 5.8 months to complete Facility Plan Check, and 4.3 months to complete Construction Phase.

Staff from the OCO contacted departments involved in the plan check process to determine how long it takes the City to review and approve cannabis building plans, or return those plans to applicants with required corrections. Departments were also asked to provide estimates for the length of time required to complete facility inspections during the Construction Phase. A summary of department responses is provided below:

Department	Type of Review	Average No. of Reviews	Average Length of Time Per Review	
			Initial	Inspections
Development Services	Commercial Building	2	4-5 weeks	1-2 days
Development Services	Planning	1	2-5 weeks	N/A
Fire	Fire Building	3	1-2 weeks	1-2 days
Health & Human Services	Food Facilities	1	1-3 weeks	2 days

Department responses ranged anywhere from one to five weeks per plan review, depending on the facility type and whether the applicant paid for standard or expedited plan check. Plan resubmittals after the first round of corrections are typically reviewed more quickly, with some departments offering over-the-counter service to process the resubmittals. Inspections during the construction process typically require anywhere from 1-2 days to schedule and complete. Based upon these results, staff from the OCO estimate that less than 25% of the time that cannabis applicants require to complete Building Plan Review and Construction is spent awaiting approval from City Departments.

Reducing Cannabis Business License Tax Rates on a Pilot vs. Permanent Basis

The City Council requested staff to further explore the option of reducing cannabis business license tax rates on a 24-month trial basis. The purpose of a 24-month pilot would be to measure the temporary effect of a tax rate reduction on the local economy. The City Council could then review the results of the pilot to determine whether the tax rates should be extended permanently, or revert back to prior levels.

While in theory a pilot program allows the City to experiment with tax rates to arrive at the best policy, there are some limitations to taking a pilot approach. First, businesses tend to avoid uncertainty when making investment decisions. Generally, businesses make plans over a 5 to 10-year horizon, and invest in capital assets that have an estimated life span of 10 to 20 years. Thus, the shorter the pilot program, the less likely businesses will respond by increasing investment in the City.

Second, the results of a 24-month pilot program may be difficult for staff to accurately measure. To implement a pilot program, staff must first establish a baseline for non-retail cannabis tax revenues to compare against the results of the pilot. However, as explained earlier in this report, significant year-over-year fluctuations in cannabis tax revenues can be expected, even without any change in cannabis policy. Therefore, it may not be possible to separate the impact of the pilot program from the more general volatility of the cannabis industry over the next 24 months.

Given these concerns, staff awaits further direction from the City Council on whether to proceed with a pilot or permanent program to reduce cannabis business license tax rates for Manufacturers, Distributors and Testing Laboratories.

Background Information on the Cultivation Square Footage Tax

Local cannabis business license tax rates were approved by Long Beach voters on November 8, 2016 through the "Marijuana Taxation Measure" (Measure MA). Measure MA established a tax on cannabis cultivation of \$12 per square foot of total plant canopy. For all other cannabis

business types, Measure MA set a tax rate of 6-8% of gross receipts. City Council asked staff to provide an explanation for why cultivation is taxed at a rate of \$12 per square foot, rather than as a percentage of gross receipts.

Taxing cultivation as a flat amount per square foot offers a number of benefits to the City compared to charging the tax as a percentage of gross receipts. First, a square footage tax provides more certainty in developing tax projections, given that tax revenues will not change with temporary fluctuations in the cannabis market. For instance, the cultivation tax is not impacted by ongoing variations in the wholesale price of cannabis. Second, a square footage tax is relatively straightforward for City staff to calculate and enforce, and does not require an in-depth audit of financial records to ensure that businesses are reporting the correct amount. Finally, a square footage tax is a reasonable indicator of the amount of revenues being generated at the cultivation facility, thus ensuring equitable distribution of the tax across all cultivation businesses.

Despite these benefits, there are some disadvantages to charging a square footage tax on cultivation. First, unlike a tax on gross receipts, a square footage tax does not allow businesses to reduce tax payments to account for a temporary reduction in revenues due to crop failure, natural disaster, or other unanticipated events. This increases the risk exposure for cultivation operators and investors. Second, a square footage tax does not account for the cyclical nature of cannabis cultivation, which typically requires 3-4 months per harvest. This can create cash flow challenges for local cultivators, particularly during the first year of operation when the timing of the square footage tax may not align with the collection of revenues.

Under Article XIII C of the California Constitution, changing the cultivation tax from a price per square foot to a percentage of gross receipts would require voter approval through the voter initiative process. However, pursuant to Measure MA, the City Council does have the authority to change the square footage tax *rate* without seeking voter approval. Currently, the cultivation business license tax rate is set at twelve dollars (\$12) per square foot. This rate can be increased up to a rate of fifteen dollars (\$15) per square foot, or lowered to a rate of \$0 per square foot by the City Council.

Despite City Council authority to amend the square footage tax rate, staff does not recommend adjusting cultivation business license tax rate at this time. The current cultivation tax of \$12 per square foot of plant canopy translates to a tax of approximately two percent (2%) of gross receipts, based upon the current wholesale price of indoor cannabis and the anticipated yield per square foot of canopy. Thus, a tax rate of \$12 per square foot is already competitive with most other large cities in California, including the City of Los Angeles.

Potential Impact of a Cannabis Tax Rate Reduction on the Illegal Market

Unlicensed cannabis businesses undermine the legal market by competing directly with licensed operators. Specifically, unlicensed operators evade taxes and circumvent State and local regulatory requirements, enabling them to offer lower prices to cannabis consumers relative to licensed businesses. This leads to reduced sales at licensed businesses, and reduced tax revenues to support general city services. Customers who purchase cannabis from unlicensed businesses often do so to avoid the higher cost of purchasing goods from legal dispensaries, despite the significant health and safety risks associated with consuming

untested and unregulated products. In theory, reducing tax rates for licensed cannabis businesses should allow the legal industry to more effectively compete with the illegal market.

However, local taxes account for only a small portion of the overall cost of operating on the legal market. Cities have little control over the majority of the price difference between legal and illegal cannabis products. Other taxes that licensed cannabis business must pay include a 15% state cannabis excise tax, \$9.25/ounce state cultivation tax, and 10.25% state and local sales tax. In addition, cannabis businesses are subject to the federal income tax under Section 280e, which prohibits most deductions and credits for businesses engaged in trafficking controlled substances. Factoring in federal and state taxes, licensed cannabis businesses pay an effective tax rate of greater than 50%.

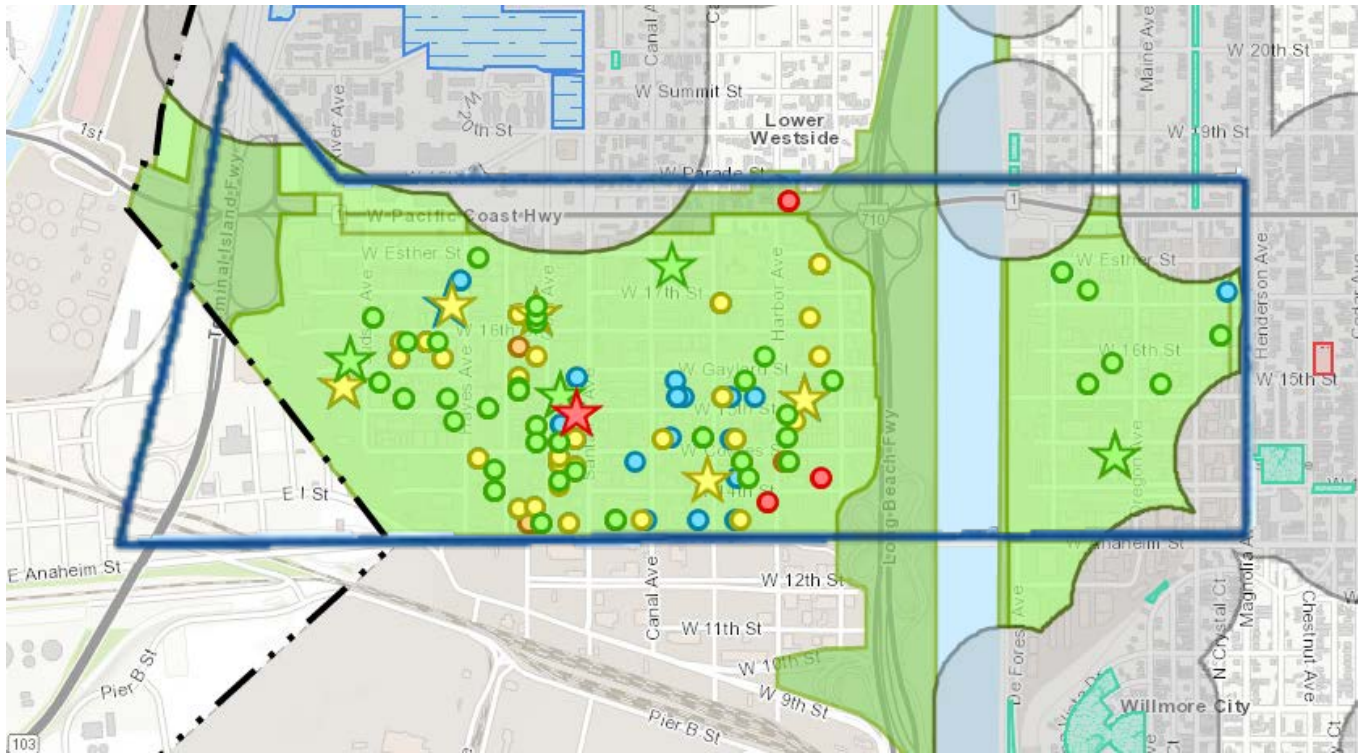
In addition, licensed cannabis businesses are expected to meet the minimum regulatory requirements set forth by State agencies such as the Bureau of Cannabis Control, Department of Public Health, and Department of Food and Agriculture. State regulations further add to the cost of goods sold. These regulations include laboratory testing requirements, child-resistant packaging, accurate product labeling, and state application and permitting fees. Given significant State and Federal tax and regulatory costs, it is unlikely that a reduction in local business license taxes from a current rate of 6% of gross receipts to a reduced rate of 1-3% will fundamentally alter business or consumer behavior on the illicit market. The price incentive for selling or purchasing goods on the illegal market will remain despite proposed adjustments to local tax rates.

Instead, the primary effect of a reduction in business license tax rates will be to help local cannabis businesses compete with *licensed* cannabis businesses in other jurisdictions. A local tax reduction may also serve to attract more legal operators to the City of Long Beach, from other jurisdictions with higher tax rates. However, unless a reduction in local cannabis tax rates is paired with a lowering of tax rates and loosening of regulatory requirements at the State and Federal level, it is unlikely that a reduction in local business license tax rates will have a significant impact on the illegal market.

EXHIBIT A

City of Long Beach Industrial Zones 1 and 4

Industrial Zone 1 (West Side)



Industrial Zone 4 (North Side)

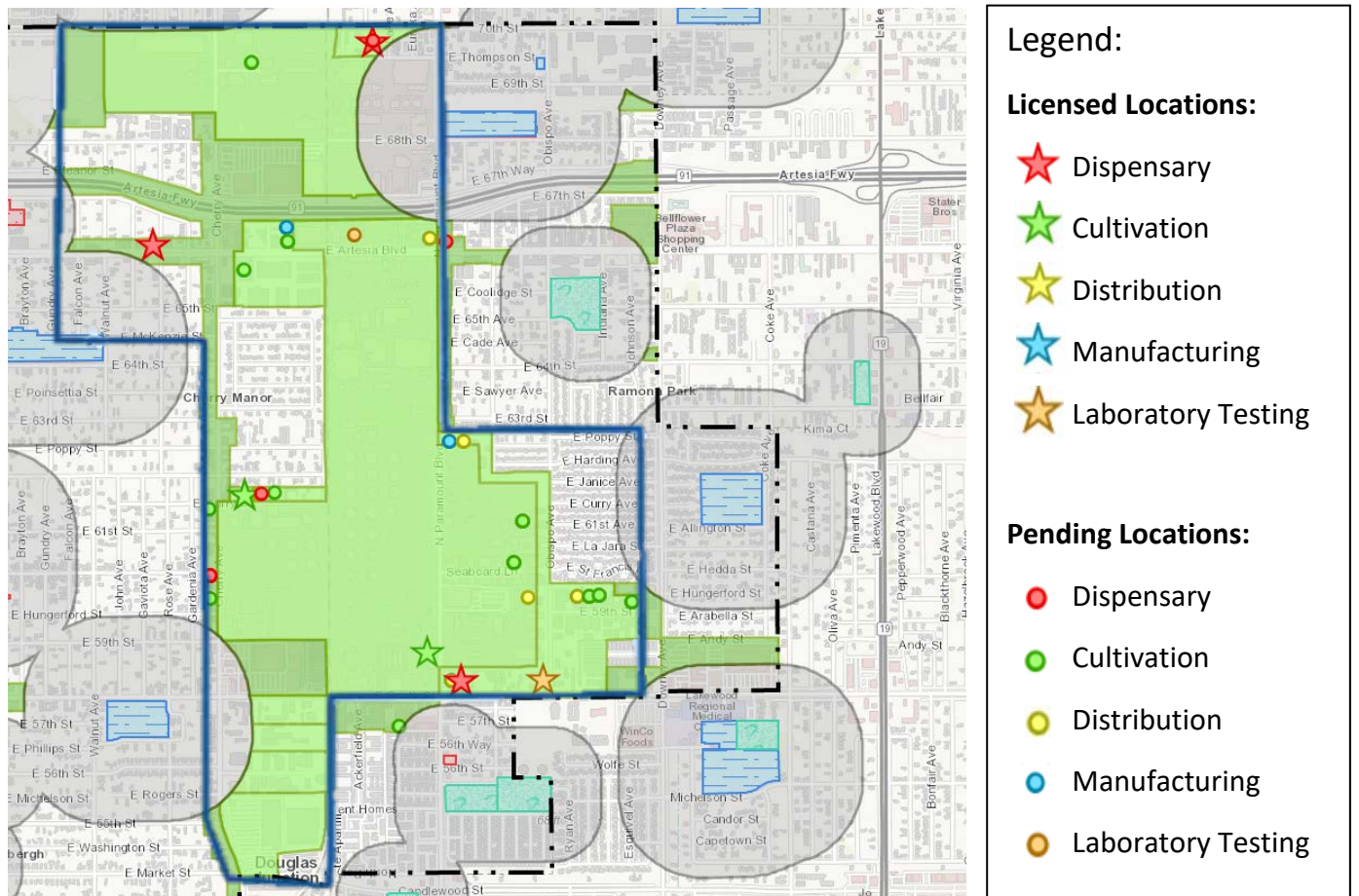


EXHIBIT A

Industrial Zones 1 and 4 Asking Rents and Vacancy Rates

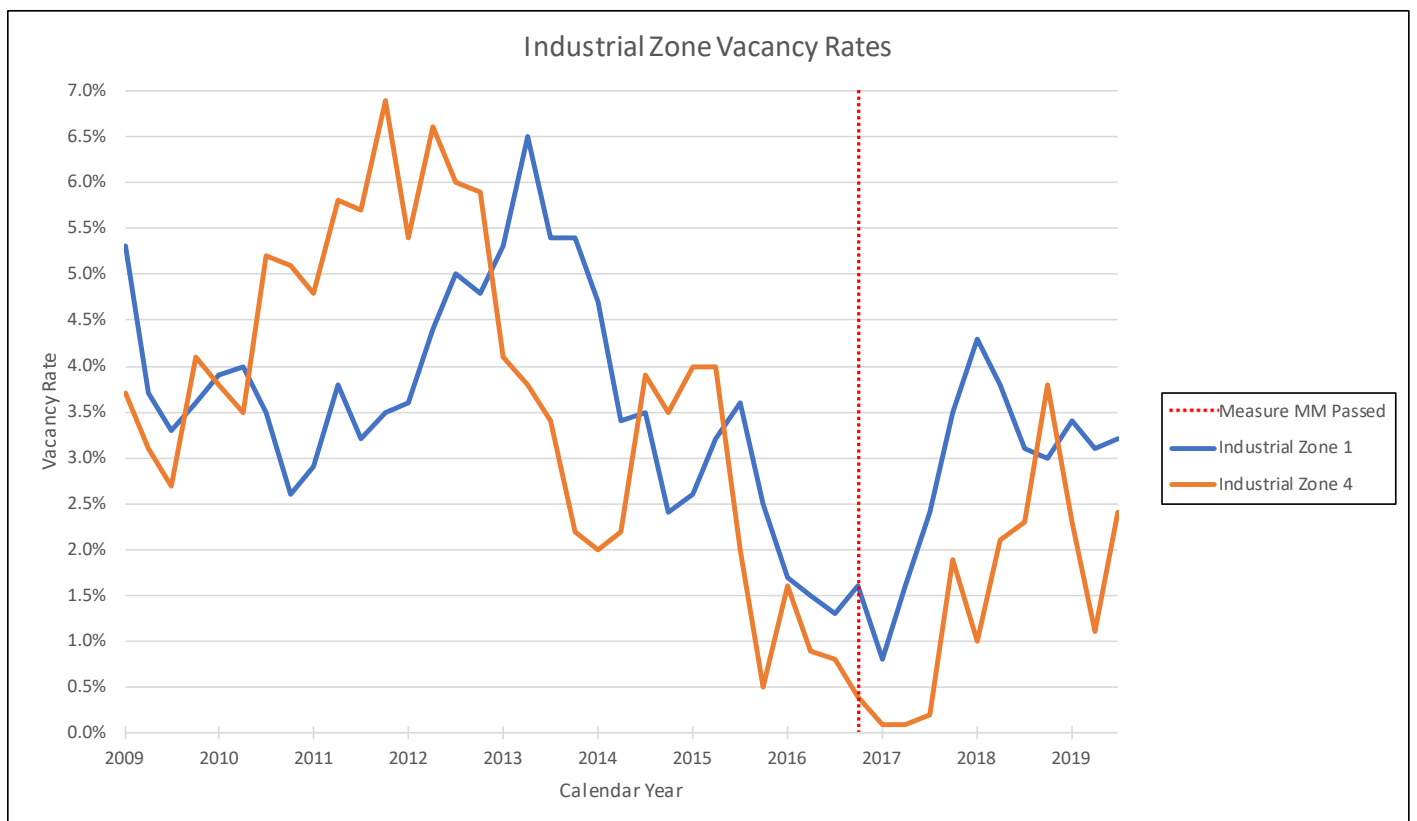
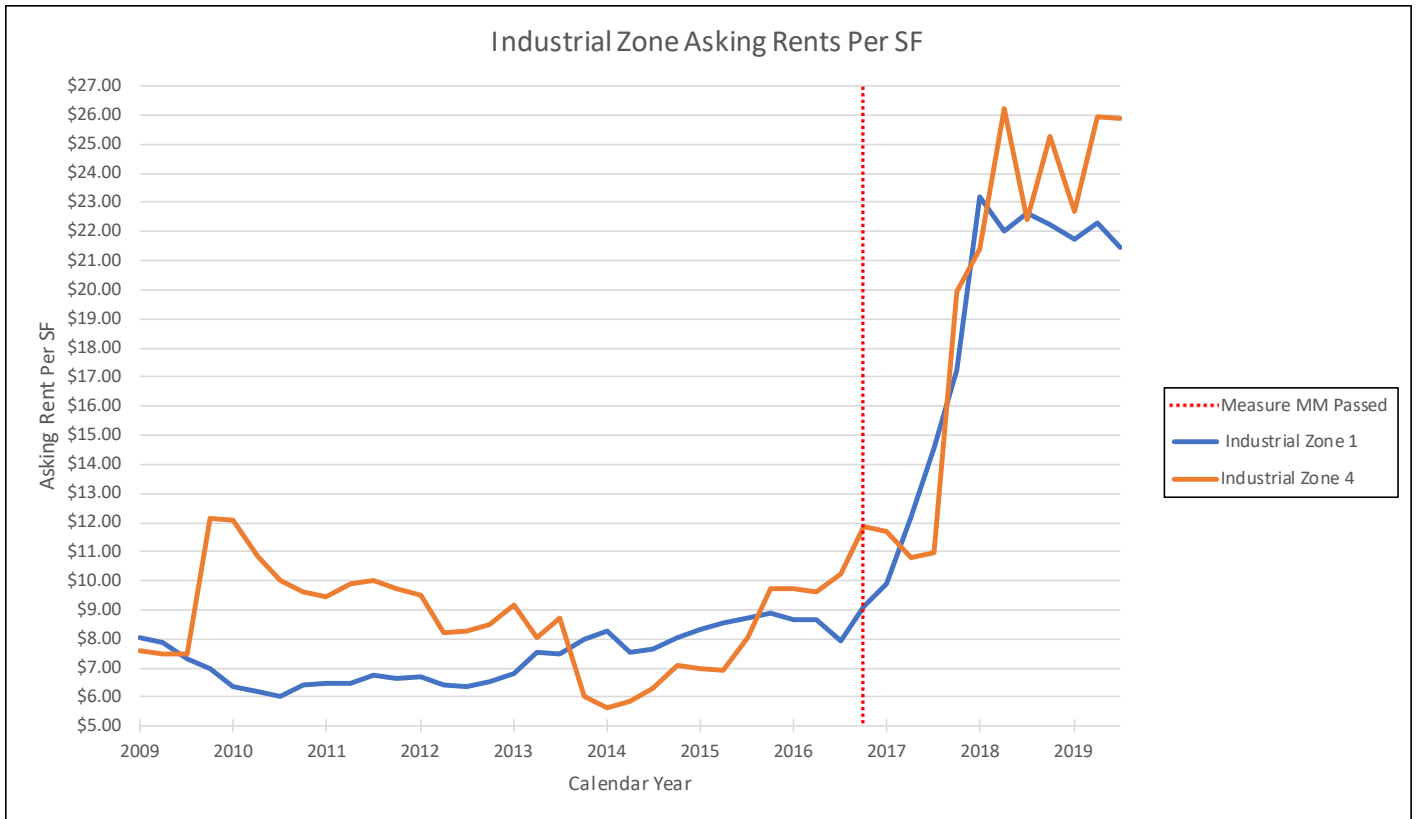


EXHIBIT B

COMMON CANNABIS JOB TITLES AND JOB DESCRIPTIONS		
JOB TITLE	SIMILAR OR RELATED JOB TITLES	GENERAL JOB DESCRIPTION
Accountant	<i>Bookkeeper, Controller, Financial Analyst, Account Administrator</i>	Performs general accounting functions, manages bookkeeping software, responsible for verifications, allocations, reconciliations and/or discrepancy resolutions, manages vendor payments and cash receipts, processes payroll entries, taxes and accruals, prepares necessary financial reports for audits
Attorney	<i>General Counsel, Compliance Officer, Regulatory Specialist</i>	Manages legal and regulatory matters related to business operations, prepares local or state permit applications, monitors operations to identify and correct instances of non-compliance, reviews and evaluates compliance issues or concerns
Budtender	<i>Receptionist, Sales Associate</i>	Provides guests with customer service and salesmanship, accurately verifies customer's age, checks customers into POS system, answers phones, manages sales and transactions, and stays informed on current products and trends
Driver	<i>Delivery Driver, Delivery Lead</i>	Delivers products to customers or other cannabis businesses in a timely manner, loads inventory and check manifests, collects payments from consumers, maintains product value limits in vehicle, verifies functionality of monitoring systems
Executive	<i>President, Vice President, Chief Officer</i>	Manages overall performance of business, sets organizational goals, makes major corporate decisions, develops and maintains investor relations and creates profitability
General Manager	<i>Operations Manager, Master Grower, Plant Manager, Production Manager</i>	Resolves day-to-day issues, monitors performance plans related to staffing, scheduling and quality of products, ensures compliance with policies and procedures
Inventory Specialist	<i>Packager, Trimmer, Inventory Lead</i>	Inspects product deliveries for accuracy and compliance with regulatory requirements, trims, fills, packages, and labels cannabis products, conducts inventory audits
Maintenance Worker	<i>Janitor, Custodian, Dishwasher</i>	Maintains cleanliness and sanitation of facility, including common areas and areas where cannabis goods are sold, cultivated, manufactured, distributed, stored or tested
Cannabis Technician	<i>Extraction Technician, Chemist, Lab Technician, Cultivation Technician, Grow Technician</i>	Prepares and maintains highly sophisticated equipment, manages chemicals and products, cultivates, manufactures or tests products in compliance with regulatory requirements
Marketing Associate	<i>Brand Associate, Field Representative, Social Media Manager</i>	Engages consumers by offering promotions and education on products, represents the business during promotional events, on-site and on social media, develop sales strategy and design campaigns to maximize sales.
Security Personnel	<i>Security Guard, Security Officer</i>	Provides premises security, controls access to business site, monitors entrances and exits to prevent unapproved or unlawful entry, monitors remote entrances using closed circuit television, screen visitors and employees to expedite entrance to business site