



**City of Long Beach**  
Working Together to Serve

**Memorandum**

Date: July 2, 2019

To: Honorable Mayor Robert Garcia and Members of the City Council

From: Councilmember Rex Richardson, Chair, Economic Development and Finance Committee

Subject: **Economic Development & Finance Committee Request for a Feasibility Study on a Pilot Program to Expand the Tax Base of Non-Retail Cannabis Businesses**

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**RECOMMENDATION**

Receive a report from staff on the feasibility of the creation of a 24-month pilot program to expand the tax base of non-retail cannabis businesses by streamlining processes, adjusting tax rates, and providing incentives, and provide further input and direction to staff on development of a pilot program.

**DISCUSSION**

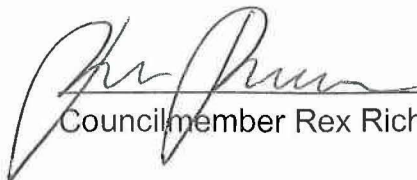
On April 9, 2019, the Economic Development and Finance (ED&F) Committee requested staff to submit a report to the City Council on the feasibility of the creation of a pilot program to expand the tax base of non-retail cannabis businesses by streamlining processes, adjusting tax rates, and providing incentives. On June 21, 2019, staff submitted its report to the Economic Development and Finance Committee outlining various options for a pilot program (ATTACHMENT A). The Chair of the ED&F Committee is referring the report to the City Council to provide further input and direction on development of a pilot program to expand the tax base for non-retail cannabis business types.

**FISCAL IMPACT**

No fiscal impact is associated with the recommendation at this time. Should the City Council choose to adopt a pilot program to expand the tax base of non-retail cannabis businesses, the fiscal impact will depend upon which options are selected by the City Council from staff's report.

Respectfully submitted,

ECONOMIC DEVELOPMENT AND FINANCE COMMITTEE




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Councilmember Rex Richardson, Chair



**City of Long Beach**  
*Working Together to Serve*

# ATTACHMENT A

## Memorandum

Date: June 21, 2019

To: Economic Development and Finance Committee

From: Patrick H. West, City Manager *T.H.W.*

For: Mayor and Members of the City Council

Subject: **Economic Development and Finance Committee Request for a Feasibility Study on a Pilot Program to Expand the Tax Base of Non-Retail Cannabis Businesses**

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On April 9, 2019, the Economic Development and Finance (ED&F) Committee requested staff to submit a report to the City Council on the feasibility of creating a pilot program to expand the tax base of non-retail cannabis businesses by streamlining processes, adjusting tax rates, and providing incentives. In response to this request, staff from the Office of Cannabis Oversight (OCO) in the City Manager's Office met with the departments responsible for regulating licensed cannabis activity in Long Beach to solicit ideas for a pilot program. In addition, the OCO met with industry representatives to receive feedback on the existing cannabis licensing process and challenges businesses have faced during the application phase.

Based on the information gathered through these meetings, staff from the OCO has prepared a report on commercial cannabis activity in Long Beach, which is presented herein. The purpose of the report is to provide the City Council with an update on the regulated cannabis market in Long Beach, and to identify options should the City Council wish to expand the tax base of non-retail cannabis businesses.

### Definition of Expanding the Tax Base

In tax policy, "expanding the tax base" means increasing the amount of economic activity subject to taxation. For the cannabis industry, this can be accomplished by either (1) increasing the number of licensed cannabis businesses operating in Long Beach, or (2) increasing the amount of taxable gross receipts generated by existing licensed businesses.

It is important to note the City Council has not yet directed staff to pursue expanding the tax base as a policy goal of the cannabis regulatory program. Pursuant to Section 5.90.010 of the Long Beach Municipal Code (LBMC), the goal of the cannabis regulatory program is to "regulate and restrict marijuana businesses, cultivation and other commercial cannabis activities to protect the neighborhoods, public health, safety, and welfare of the residents and patients of the City of Long Beach." A program to expand the tax base for non-retail cannabis businesses would represent a shift in policy. Thus, staff awaits further direction from the City Council before implementing a program to expand the tax base of non-retail cannabis businesses.

**Cannabis 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.).
- Testing Laboratories – Facilities that test cannabis goods for potency (THC, CBD, etc.) and various forms of contamination (mold, pesticides, heavy metals, etc.)
- Distributors – Facilities where cannabis goods are stored, packaged, labeled, inspected for quality assurance, or transported between cannabis businesses.

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 (herein referred to as “non-retail” cannabis businesses).

**Cannabis Business License Tax Revenues**

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

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

Gross receipt tax payments are due quarterly, based on operating revenues generated over the prior three-month period. Cultivation tax payments are collected annually, based upon the estimated 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 on actual revenues collected as of May 1, 2019, projected through the end of the fiscal year. Estimated FY 20 revenues are calculated using average per-business tax collections as of May 1, 2019, multiplied by the anticipated number of licensed cannabis businesses operating in FY 20.

| <b>General Fund - Cannabis Revenues (as of May 1, 2019)</b> |                          |                     |                     |                     |
|---|--------------------------|---------------------|---------------------|---------------------|
| <b>Bus. Type</b>  | <b>Tax</b>               | <b>FY18</b>         | <b>FY19</b>         | <b>FY20</b>         |
|   |                          | <b>Actual</b>       | <b>Estimated</b>    | <b>Estimated</b>    |
| Dispensary  | <i>Gross Receipt Tax</i> | \$ 626,130          | \$ 2,375,246        | \$ 2,755,796        |
| Cultivation   | <i>Sq. Ft. Tax</i>       | \$ 517,404          | \$ 516,411          | \$ 701,270          |
| Lab Testing   | <i>Gross Receipt Tax</i> | \$ 80,506           | \$ 171,429          | \$ 336,914          |
| Manufacturing   | <i>Gross Receipt Tax</i> | \$ 500              | \$ 78,274           | \$ 256,482          |
| Distribution  | <i>Gross Receipt Tax</i> | \$ -                | \$ 7,250            | \$ 126,971          |
| <b>TAX SUBTOTAL</b>   |                          | <b>\$ 1,224,540</b> | <b>\$ 3,148,611</b> | <b>\$ 4,177,435</b> |
| Fees & Penalties  |                          | \$ 399,000          | \$ 1,065,617        | \$ 402,445          |
| <b>TOTAL REVENUES</b>                                       |                          | <b>\$ 1,623,540</b> | <b>\$ 4,214,228</b> | <b>\$ 4,579,880</b> |

In total, the City collected \$1.6 million in cannabis tax and fee revenues in FY 18 and is estimated to collect \$4.2 million in FY 19 and \$4.5 million in FY 20. Approximately two-thirds of all cannabis business license tax revenues collected to date have come from dispensaries, with remaining one-third coming from non-retail cannabis businesses.

Because the statewide cannabis industry is changing rapidly, staff cautions against drawing any long-term conclusions from FY 18, FY 19, and FY 20 tax revenue data. Significant year-over-year fluctuations in cannabis tax revenues can 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 useful to look at the number of businesses currently moving through the application process.

**Cannabis Business License Application 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 May 7, 2019, the City has a total of 614 active cannabis applications. Of these applications, 78 have been issued a business license, 93 are under construction, 139 are in building plan review, 199 are pending building plan submittal, and 105 are undergoing initial zoning and business license application review. The table below provides a summary of active cannabis applications submitted to the City.

| <b>Summary of Cannabis Business License Applications (as of May 7, 2019)</b> |                    |                        |                      |                    |                 |             |
|--|--------------------|------------------------|----------------------|--------------------|-----------------|-------------|
| Business Type  | Initial App Review | Pending Plan Submittal | Building Plan Review | Under Construction | Licenses Issued | Grand Total |
| <b>MEDICAL</b>   |                    |                        |                      |                    |                 |             |
| Dispensary   | 0                  | 4                      | 5                    | 7                  | 16              | 32          |
| Cultivator   | 4                  | 43                     | 21                   | 18                 | 5               | 91          |
| Manufacturer   | 8                  | 52                     | 30                   | 14                 | 11              | 115         |
| Distributor  | 6                  | 36                     | 35                   | 13                 | 10              | 100         |
| Lab Testing  | 1                  | 1                      | 0                    | 5                  | 2               | 9           |
| <b>Subtotal (Medical)</b>  | <b>19</b>          | <b>136</b>             | <b>91</b>            | <b>57</b>          | <b>44</b>       | <b>347</b>  |
| <b>ADULT-USE</b>   |                    |                        |                      |                    |                 |             |
| Dispensary   | 1                  | 1                      | 4                    | 4                  | 16              | 26          |
| Cultivator   | 22                 | 11                     | 10                   | 11                 | 2               | 56          |
| Manufacturer   | 29                 | 27                     | 18                   | 11                 | 10              | 95          |
| Distributor  | 31                 | 22                     | 16                   | 9                  | 6               | 84          |
| Lab Testing  | 3                  | 2                      | 0                    | 1                  | 0               | 6           |
| <b>Subtotal (Adult-Use)</b>  | <b>86</b>          | <b>63</b>              | <b>48</b>            | <b>36</b>          | <b>34</b>       | <b>267</b>  |
| <b>TOTAL</b>   | <b>105</b>         | <b>199</b>             | <b>139</b>           | <b>93</b>          | <b>78</b>       | <b>614</b>  |

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 248 cannabis facilities are either licensed or moving through the application process. Of these proposed facilities, 37 have been issued a business license, 53 are under construction, 77 are in building plan review, 68 are pending building plan submittal, and 13 are pending application review. The table below provides a summary of proposed cannabis facilities in Long Beach:

| <b>Summary of Proposed Cannabis Facilities (as of May 7, 2019)</b>   |                   |
|--|-------------------|
| Facility Status  | No. of Facilities |
| Issued License   | 37                |
| Under Construction   | 53                |
| Building Plan Review   | 77                |
| Pending Plan Submittal   | 68                |
| Application Review   | 13                |
| <b>TOTAL</b>   | <b>248</b>        |
| <i>Note: Facilities with multiple applications are categorized under status for application that is furthest along in the process.</i> |                   |

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 phases. Some cannabis applicants appear to have stalled completely. To better understand the slow progression of cannabis applicants through the licensing process, staff reached out to external stakeholders and internal City departments for more information.

### **Outreach Efforts**

In preparing this study, the OCO contacted non-retail cannabis applicants and operators to receive feedback regarding the application process. In addition, the OCO met with internal city staff to discuss reasons why more non-retail business licenses have not been issued. A summary of external stakeholder and internal department responses is provided below:

- **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, such as the City of Los Angeles.
- **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.
- **Facility Plan Check** – Non-retail cannabis businesses have found it difficult to navigate the building plan review phase. Businesses requested that the City take steps to streamline the plan check process for cannabis applicants. Conversely, staff from the Fire and Development Services Departments reported 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.
- **Access to Statewide Retail Markets** – Approximately 80 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 in th Long Beach.
- **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.

- 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 *Attachment 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, Adelanto, and Desert Hot Springs.

### **Options to Expand the Tax Base for Non-Retail Cannabis Businesses**

The ED&F Committee request is summarized as follows:

*Request staff to refer to the City Council a report on the feasibility of the creation of a 24-month pilot program to expand the tax base of non-retail cannabis businesses by streamlining processes, adjusting tax rates, and providing incentives.*

Should the City Council decide to pursue this as a policy goal, staff has prepared the set of options for the City Council provided below. In theory, any of the options identified below could be implemented as a 24-month pilot. However, the overall effectiveness of a program to expand the tax base may be limited if adopted on a trial basis only. Businesses tend to avoid uncertainty when making investment decisions. The shorter the pilot, the less likely a business will respond to a policy by increasing investment. Therefore, a pilot program may not fully capture the effect that a permanent program would have on commercial cannabis activity in Long Beach.

In addition, the results of a 24-month pilot program may be difficult for staff to accurately measure. To perform a pilot, staff must first establish a baseline for non-retail cannabis tax revenues to compare against the results of the pilot. As explained earlier in this report, significant year-over-year fluctuations in cannabis tax revenues should be expected, even without any change in current 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 a 24-month period.

For these reasons, staff has not assumed a 24-month expiration when discussing various policy options. Instead, staff awaits further direction from the City Council on whether to adopt any of the options on a pilot or permanent basis.

#### **Option #1: Revisit Cannabis Building Design and Zoning Requirements**

*Direct staff from the Department of Development Services to conduct a study of cannabis building design and zoning requirements. Request the Planning Commission to review the study, recommend any necessary changes to the Long Beach Municipal Code relating to building and zoning requirements, and refer those recommendations to the City Council for final approval.*

Pursuant to Section 5.92.765 of the LBMC, adult-use cannabis businesses are required to meet industry specific building design requirements. The building design requirements establish minimum standards for signage, window installation, exterior lighting, visibility, and other important architectural elements. The requirements were recommended by the Planning Bureau to discourage the design and construction of cannabis facilities that detract from the overall aesthetics of the surrounding area. Prior to the adoption of these requirements, multiple medical cannabis businesses had submitted architectural plans to the City that removed windows, walled off doors, and proposed other building façade alterations that negatively impacted the character of adjacent neighborhoods. The adoption of new building design standards in Chapter 5.92 of the LBMC allowed staff to balance cannabis industry concerns for security with community concerns for attractive facility design.

Since passage of the adult-use ordinance, staff has gained a deeper understanding of the cannabis industry, and its specific needs relating to safety, security, lighting, product visibility, and other aspects of business operation. Consequently, staff is able to conduct a one-year review, and to recommend improvements to the facility design standards. As part of this review, staff from the Planning Bureau will explore other policies to streamline the plan check process, such as amending the requirements for businesses to obtain an Administrative Use Permit (AUP) or Conditional Use Permit (CUP) in industrial areas of the city.

If directed by the City Council, staff will be able to complete the study and present findings to the Planning Commission by August 2019, which is approximately one year after passage of the adult-use ordinance. By referring the item to the Planning Commission, the City Council will ensure the process allows for public comment from residents, businesses, and other members of the Long Beach Community.

**Option #2: Adjust Cannabis Business License Tax Rates**

*Request the City Attorney to prepare a draft Ordinance to adjust cannabis business license tax rates for Manufacturers, Testing Laboratories, and Distributors to a level determined by the City Council.*

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.

| <b>City of Long Beach Cannabis Business License Tax Rates</b> |                           |                |                |                              |
|---|---------------------------|----------------|----------------|------------------------------|
| <b>Business Type</b>  | <b>Medical/Adult- Use</b> | <b>Current</b> | <b>Maximum</b> | <b>Minimum<sup>(1)</sup></b> |
| Dispensary  | Medical                   | 6%             | 8%             | 0%                           |
|   | Adult-Use                 | 8%             | 12%            | 0%                           |
| Cultivator  | Both                      | \$12/sq ft     | \$15/sq ft     | \$0/sq ft                    |
| Manufacturer  | Both                      | 6%             | 8%             | 0%                           |
| Testing Laboratory  | Both                      | 6%             | 8%             | 0%                           |
| Distributor   | Both                      | 6%             | 8%             | 0%                           |

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



Feasibility Study on Program to Expand the Tax Base of Non-Retail Businesses

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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 table compares Long Beach tax rates to other large cities in California:

| 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 <sup>(1)</sup>    | 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 <sup>(1)</sup>       | 178,488   | 0%     | 3%       | 2%          |     | 1%            |     | 0%           |     | 0%          |     |
| Salinas                         | 161,784   | 5%     |          | \$15/sq ft  |     | 5%            |     | 5%           |     | 5%          |     |
| Santa Clara <sup>(1)</sup>      | 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 the table above, Long Beach cannabis tax rates remain competitive with most other large cities in the State. Recently, however, some cities have taken steps to reduce their cannabis tax rates to attract more cannabis businesses. This includes the cities of Oakland, Berkeley, Palm Springs, and Vallejo. It is not yet clear what impact these tax reductions will have on the number of cannabis businesses locating in those cities. It is also unclear how a reduction of cannabis tax rates in Northern California cities, such as Oakland, Berkeley, and Vallejo will influence business location decisions in the Southern California area.

Of greater significance for the Southern California commercial cannabis market is the ongoing development of the cannabis industry in the City of Los Angeles. This is based in part on the size of the Los Angeles market, 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 region due to a delay in implementation of the Los Angeles application process. This delay has prevented most new businesses from being able to apply for a cannabis license in Los Angeles. Recently, however, the City of Los Angeles announced it would soon begin Phase 3 of its application process. Phase 3 will open the application process to all new cannabis business license applicants. Once Phase 3 begins, 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 region.

In the interest of maintaining the competitiveness of the Long Beach non-retail cannabis market, the City Council has the authority to reduce non-retail cannabis business license tax rates to a level more in line with the City of Los Angeles. However, there are other factors to consider beyond regional competitiveness when deciding whether to adjust cannabis tax rates. This includes the impact that a tax rate reduction would have on General Fund revenues. In the *short-run*, the impact to the General Fund would be limited by the relatively small number of non-retail businesses currently operating in the city. Specifically, non-retail tax revenues are projected to account for only 24 percent of total cannabis tax revenues in FY 19, and 34 percent in FY 20. Based upon current cannabis revenue projections, staff estimates the following General Fund Impact for every 1 percent reduction in non-retail gross receipts tax rates, and/or \$1 reduction in the cultivation square footage tax:

| <b>General Fund Revenue Impact – Non-Retail Cannabis Tax Rates Reductions</b> |                         |                       |                                      |                                      |
|---|-------------------------|-----------------------|--------------------------------------|--------------------------------------|
| <b>Bus. Type</b>  | <b>Current Tax Rate</b> | <b>Reduction Rate</b> | <b>FY19 Estimated<br/>Loss to GF</b> | <b>FY20 Estimated<br/>Loss to GF</b> |
| Lab Testing   | 6% Gross Receipt Tax    | 1% Reduction          | \$ (18,662)                          | \$ (56,152)                          |
| Manufacturing   | 6% Gross Receipt Tax    | 1% Reduction          | \$ (11,690)                          | \$ (42,747)                          |
| Distribution  | 6% Gross Receipt Tax    | 1% Reduction          | \$ (1,125)                           | \$ (21,162)                          |
| <b>Subtotal (Manufacturing, Distribution, Lab Testing)</b>                    |                         |                       | <b>\$ (31,477)</b>                   | <b>\$ (120,061)</b>                  |
| Cultivation   | \$12 Per Sq. Ft. Tax    | \$1 Reduction         | \$ (28,630)                          | \$ (58,439)                          |
| <b>Total (Non-Retail)</b>   |                         |                       | <b>\$ (60,108)</b>                   | <b>\$ (178,501)</b>                  |

*\*Assumes reduced tax rates for FY19 would be applied as of June 1, 2019.*

For Manufacturers, Distributors and Testing Laboratories, staff estimates that for every 1 percent reduction in the gross receipts business license tax, General Fund revenues will decrease by \$31,000 in FY 19 and \$120,000 in FY 20. For Cultivators, staff estimates that for every \$1 reduction in the square footage business license tax rate, General Fund revenues will decrease by \$28,000 in FY 19 and \$58,000 in FY 20.

In calculating these projections, staff assumes that over the short-run, businesses will not increase supply in response to lower tax rates. Additionally, staff assumes that the pace of non-retail business openings in FY 19 and FY 20 will not change in response to a reduction in tax rates. Should these assumptions prove incorrect, the anticipated revenue loss to the General Fund could be partially or fully offset by an increase in taxable non-retail cannabis activity in Long Beach.

It is less clear what the *long-run* impact of a non-retail tax rate reduction would 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. For this reason, staff is not able to provide a *long-run* General Fund fiscal impact projection for a reduction to non-retail cannabis business license tax rates.

Another factor to consider when deciding whether to adjust local non-retail cannabis tax rates is the impact it may have on demand for industrial real estate in Long Beach. As discussed earlier, demand for industrial property in eligible Green Zones of the city increased significantly following passage of Measure MM in November 2016. Recently, local demand for industrial real estate has stabilized, as industrial vacancy rates have returned to more normal levels. However, staff anticipates demand for industrial real estate in Long Beach may once again increase in response to a reduction in non-retail cannabis business license tax rates. The increase in demand would benefit existing industrial property owners through an increase in property value. Conversely, non-cannabis businesses in the area may be negatively impacted if faced with higher asking rents due to increased competition for industrial real estate from the cannabis industry.

Should the City Council choose to adopt a program to reduce non-retail cannabis business license tax rates, staff recommends excluding Cultivators from this program. Staff estimates a tax of \$12 per square foot of plant canopy translates to a tax of approximately 2 percent on 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.

Based upon the information provided in this report, staff requests further direction from the City Council regarding recommended changes to non-retail cannabis business license tax rates.

*Option #3: Allow for Shared-Use Manufacturing Facilities*

*Direct staff from the Office of Cannabis Oversight (OCO) in the City Manager's Office work with departments to research the feasibility of licensing and regulating shared-use cannabis manufacturing facilities in Long Beach, and refer findings to the City Council for input and policy direction.*

Cannabis manufacturers are businesses that compound, blend, extract, infuse, or otherwise prepare cannabis products for consumers. These products include edibles, beverages, vaporizers, lotions, and other types of consumable goods. Cannabis manufacturers are considered "non-retail" businesses because they are not authorized to sell cannabis goods direct to consumers. Instead, manufacturers must first transfer their products to a licensed distributor. The distributor may then sell the cannabis goods to a licensed dispensary located anywhere in the state.

In 2018, the State of California Department of Public Health created a new manufacturing license, "Type S – Shared Use Manufacturing." Type S Manufacturers operate from shared-use facilities, in which multiple businesses can manufacture products from a single premise.

Type S manufacturers are required to post and adhere to an occupancy schedule that defines the dates and times that the premise will be used by each business. Only one business may utilize the manufacturing premise at a given time.

Currently, the City of Long Beach does not issue Type S Manufacturing business licenses. Each cannabis manufacturer in Long Beach is required to build and maintain its own separate and distinct premise. For some businesses, the amount of time and capital necessary to design and construct a cannabis facility can be cost prohibitive. Shared-use manufacturing has the potential to reduce this barrier to entry by allowing multiple businesses to share in the cost of building and maintaining a manufacturing facility.

Allowing for shared-use manufacturing in Long Beach could expand the tax base for non-retail cannabis businesses by creating new opportunities for less capitalized businesses to obtain a business license. However, a study would need to be conducted on the feasibility of regulating this new license type. Staff would need to research the cost and time it would take to process and regulate Type S businesses. Should the City Council wish to pursue this option, staff from the OCO will work with departments to prepare the feasibility study. As part of this analysis, the OCO will contact other jurisdictions in California that currently allow shared-use manufacturing facilities to learn from their experience. The findings on shared-use manufacturing will be referred to the City Council for input and policy direction.

### **Administrative Changes to the Cannabis Business License Application Process**

In preparing this report, staff identified several other opportunities to streamline the cannabis permitting process. Unlike the policies described above, these improvements can be made administratively, without further action by the City Council. Staff has already begun implementing these process improvements during preparation of this report.

1. **Timing of the Annual Cultivation Business License Tax Payment** – Pursuant to Section 3.80.261 of the LBMC, the City Council and the City Manager have the authority to set the timing and frequency of cannabis business license tax payments. Currently, cannabis cultivators are required to submit an initial tax payment for their first year of operation upon issuance of a building permit, which occurs prior to facility construction. This is consistent with the timing of the initial tax payment for most other non-cannabis businesses in the Long Beach.

For cultivators, the initial tax payment presents unique challenges that do not exist for other cannabis business types. Specifically, cultivators are charged an annual tax per square foot of plant canopy under cultivation, as opposed to a quarterly percentage of gross receipts. As a result, the size of the initial tax payment for cultivators is much larger than that of other non-retail businesses types. Depending on the estimated square footage of area under cultivation, the initial tax payment may significantly reduce the amount of startup capital available for cultivators to complete facility construction and receive a business license.

Recognizing this challenge, staff proposes to delay the timing of the initial cultivation tax payment until construction of the facility is finished and the Certificate of Occupancy has

been issued. When implemented, this administrative change will allow businesses to obtain a business license and begin generating revenues soon after the tax is paid.

2. *Cannabis application flow chart* – The cannabis business license application review process involves staff from multiple departments, including Financial Management, Development Services, Fire, Police, Health and Human Services, and City Manager's Office. Each department must review and approve different portions of the cannabis operation before a business license can be issued. Given the complexity of this process, businesses are sometimes uncertain of the next steps to receive a license from the City. When this occurs, applicants will typically call or email the Financial Management Department to determine which department reviews remain outstanding. In many instances, Financial Management is not the appropriate point of contact to field these questions. To address this problem, Financial Management staff will create a detailed cannabis business license application flowchart. The purpose of the flowchart is to help applicants better understand each step of the application process, and to provide businesses with the appropriate contact information for each stage of application review.
3. *Cannabis inspection checklists* – When performing on-site inspections of cannabis facilities, staff rely upon inspection checklists to ensure that businesses are following state and local regulatory requirements. Businesses that do not satisfy these requirements are expected to fix any areas of non-compliance prior to issuance of the license. This may require the applicant to reschedule the inspection to confirm the appropriate corrections have been made. To help businesses avoid re-inspection, staff will post inspection checklists online for applicants to review in advance of the inspection.

Until recently, staff had not been able to post the inspection checklists because the California Code of Regulations for cannabis businesses were undergoing constant revision by state agencies. With the final adoption of permanent regulations by state agencies in 2019, staff can finalize inspection checklists and post the materials online for applicant review.

4. *Coordination with Southern California Edison (SCE)* – Non-retail cannabis businesses often consume significantly more energy than most industrial facilities in Long Beach were designed to accommodate. For example, cultivation facilities require a continuous supply of electricity to support high-intensity lighting, cooling, ventilation, dehumidification, CO2 generation, and other equipment needs. As a result, non-retail applicants typically must work with SCE to upgrade their electrical infrastructure prior to receiving a license. City staff recently met with representatives of SCE to discuss opportunities to streamline this process for cannabis applicants. SCE identified three areas where the City could assist in the utility upgrade process, to which City staff agreed:
  - Provide SCE with a monthly list of pending cannabis business license applications and facility locations. The updated list of applicants will allow SCE to determine which cannabis businesses are operating in compliance with local laws, and thus should be permitted to proceed through the SCE plan review process.

- Notify applicants during the Cannabis Facilities Consultation Program meeting to contact SCE immediately to initiate the utility upgrade process. City staff should also refer non-retail cannabis applicants to the SCE planning website and hotline for more information.
- Schedule semiannual meetings with SCE to discuss ways to improve the cannabis plan check process, and determine if more steps should be taken to provide adequate energy supply for non-retail cannabis businesses in Long Beach.

### **Summary**

Staff requests further direction from the City Council on the following policy options:

1. Revisit Cannabis Building Design and Zoning Requirements.
2. Adjust Cannabis Business License Tax Rates.
3. Allow for Shared-Use Manufacturing Facilities.

In addition, staff will implement the process improvements listed below to the cannabis licensing program. These changes will be made administratively, and, thus, do not require further action from the City Council.

1. Delay the Timing of the Annual Cultivation Business License Tax Payment.
2. Development of a business license application flowchart for cannabis businesses.
3. Online publishing of cannabis facility inspection checklists.
4. Coordination with Southern California Edison to streamline the utility upgrade process.

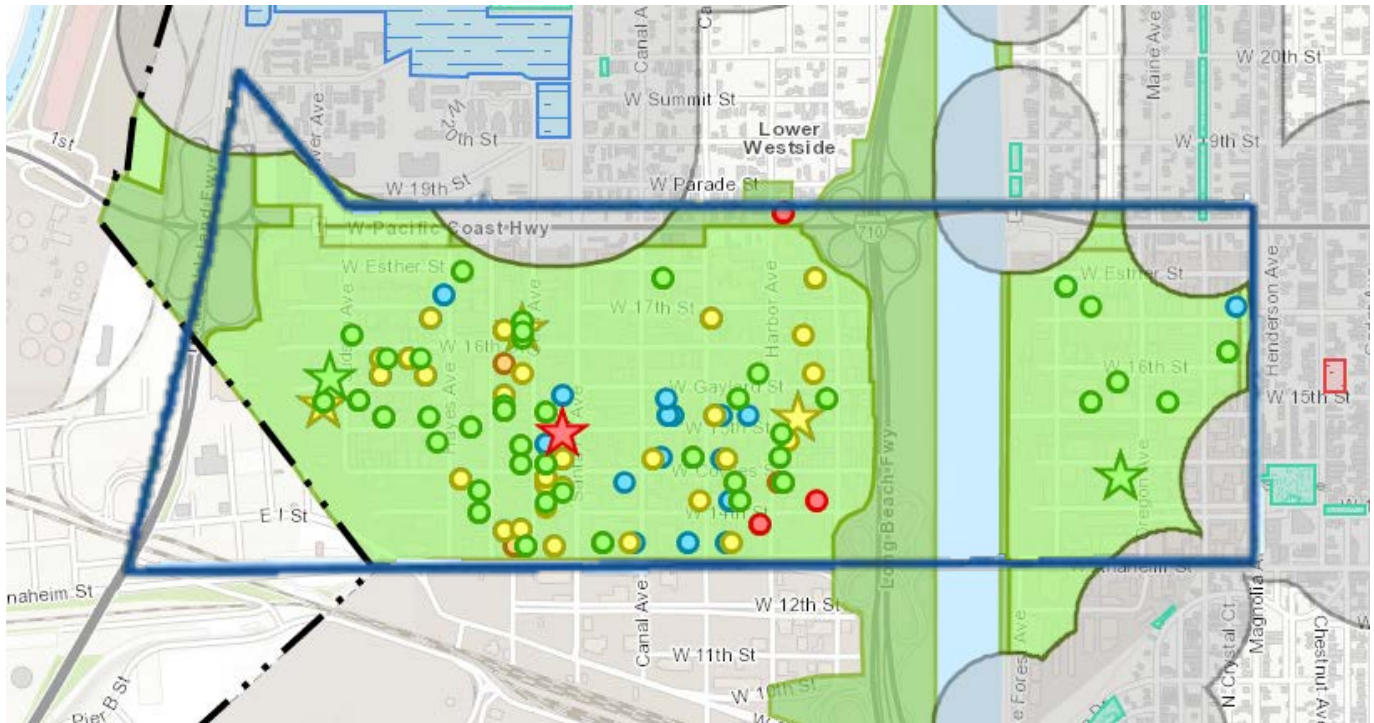
If you have questions, please contact Ajay Kolluri at (562) 570-6406 or via email at [Ajay.Kolluri@longbeach.gov](mailto:Ajay.Kolluri@longbeach.gov).

ATTACHMENT A – INDUSTRIAL ZONES

CC: CHARLES PARKIN, CITY ATTORNEY  
LAURA L. DOUD, CITY AUDITOR  
DOUGLAS HAUBERT, CITY PROSECUTOR  
TOM MODICA, ASSISTANT CITY ATTORNEY  
KEVIN JACKSON, DEPUTY CITY MANAGER  
JOHN GROSS, DIRECTOR OF FINANCIAL MANAGEMENT  
REBECCA GARNER, ADMINISTRATIVE DEPUTY TO THE CITY MANAGER

# City of Long Beach Industrial Zones 1 and 4

## Industrial Zone 1 (West Side)



## Industrial Zone 4 (North Side)



**Legend:**

**Licensed Locations:**

- ★ Dispensary
- ★ Cultivation
- ★ Distribution
- ★ Manufacturing
- ★ Laboratory Testing

**Pending Locations:**

- Dispensary
- Cultivation
- Distribution
- Manufacturing
- Laboratory Testing

# Industrial Zones 1 and 4 Asking Rents and Vacancy Rates

