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Title: Recommendation to 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)

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Attachments: 1. 120319-R-25sr&att.pdf, 2. 120319-R-25 PowerPoint.pdf

Date	Ver.	Action By	Action	Result
12/3/2019	1	City Council	approve recommendation	Pass

Recommendation to 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)

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.

TABLE I - Long Beach Cannabis Business License Tax Rates					
Business Type	Medical/Adult-Use	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:

TABLE II - General Fund Cannabis Tax Revenue	
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%

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, it 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 (Manufacturers, Distributors and Testing Laboratories)				
Business Growth Scenario	Number Licensee	FY 20 Revenue Loss For Specific Tax		
		3% Tax Rate	2% Tax Rate	1% Tax Rate
Current Projections	52	\$ (223,074)	(293,198)	(349,672)
"Low" Growth (with 5 licensees)	57	\$ (210,061)	(282,527)	(339,672)
"Medium" Growth (with 25 licensees)	77	\$ (108,791)	(206,742)	(283,261)
"High" Growth (with 50 licensees)	102	\$ 4,487	(120,562)	(216,851)

**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 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.

Business Type	Current Projection	Business Growth Scenario		
		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.

City Council action on this item is not time critical.

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.

Approve recommendation.

[Enter Body Here]

THOMAS B. MODICA
ACTING CITY MANAGER

APPROVED:

THOMAS B. MODICA
ACTING CITY MANAGER