



# Council Agenda Report

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**FROM:** Nat Rojanasathira, Assistant City Manager  
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**SUBJECT:** Direction to Staff to Develop a Regulatory Ordinance that Allows Three Retail Cannabis Permits in the City and receive an Update on Step 3 Elements of the Commercial Cannabis Roadmap (Not a Project under CEQA Article 20, Section 15378 and under General Rule Article 5, Section 15061)

**RECOMMENDATION:**

That the City Council direct staff to develop a regulatory ordinance that allows three retail cannabis permits in the City and receive an update on Step 3 Elements of the Commercial Cannabis Roadmap.

**FISCAL IMPLICATIONS:**

The analysis, discussion, implementation and management of cannabis businesses will require allocation of staff resources. Some of those costs can be recovered through regulatory fees (e.g., cost recovery for issuing licenses and permits) and taxes. Cannabis businesses are expected to bring in additional fees, sales tax, business license tax and cannabis excise tax revenues. A recent analysis by HdL Companies (Attachment 1) shows the city estimated tax or fee revenue for cannabis retailers to be between \$0.5M to \$1.5M per year. Variability in the city revenue depends upon factors such retailer location(s) and market saturation (i.e., other cannabis retailers in Monterey County).

Proposition 64 added a state excise tax of 15% on the privilege of purchasing cannabis at a retail store (Rev. & Taxation Code section 34011(a).) It also added an excise tax for the privilege of cultivating cannabis. Proposition 64 did not affect the City's authority to impose taxes on cannabis except for cannabis cultivated for personal use is exempt; medical cannabis is exempt from state and local sales tax, but not state or local excise taxes.

The City could consider a future ballot measure to implement a local cannabis excise tax. City sales tax cannot differ from Bradley-Burns Uniform Sales and Use tax law in either what is taxed or the rate of tax. Accordingly, local taxes on cannabis commerce are typically business license taxes, but often calculated as a percentage of retail sales and reflected on retail receipts, so they are commonly perceived as sales taxes when, technically, they are not.

**ENVIRONMENTAL DETERMINATION:**

The City of Monterey determined that the proposed action is not a project as defined by the California Environmental Quality Act (CEQA) (CCR, Title 14, Chapter 3 CEQA Guidelines Article 20, Section 15378). In addition, CEQA Guidelines Section 15061 includes the general rule that CEQA applies only to activities which have the potential for causing a significant effect on the environment. Where it can be seen with certainty that there is no possibility that the activity in

question may have a significant effect on the environment, the activity is not subject to CEQA. Because the proposed action and this matter have no potential to cause any effect on the environment, or because it falls within a category of activities excluded as projects pursuant to CEQA Guidelines section 15378, this matter is not a project. Because recovering the City's cost to regulate cannabis commerce and taxing that commerce to fund general city services does not cause a direct or any reasonably foreseeable indirect physical change on or in the environment, this matter is not a project. Any subsequent discretionary projects resulting from this action, such as appropriating the revenues realized, will be assessed for CEQA applicability.

#### **ALTERNATIVES CONSIDERED:**

The purpose of the agenda item is for Staff to provide an update regarding implementation of the Commercial Cannabis Roadmap. Council direction will allow staff to prepare for Step 3 of the roadmap, which includes drafting policy and selection process guidelines. Alternatives will be considered during the policy development process.

#### **DISCUSSION:**

##### ***Step 3 of the Cannabis Roadmap***

Since the launch of the Roadmap for Cannabis in December 2020, the City has engaged in a transparent process as it considers allowing commercial cannabis operations in Monterey. At its meeting on August 17, 2021 the City Council expressed its support for as few as one and as many as three cannabis retailers in the City, located in the downtown (except Alvarado Street), Lighthouse District, and Cannery Row Business District. Council also stated that it would consider cannabis retail operations on Cannery Row and the Monterey County Fairgrounds at some point in the future. Staff seeks direction from the City Council on its desired number and location of cannabis retail establishments.

At its meeting on December 21, 2021, Council will be provided more information about efforts as the City shifts to "Prepare for Launch," Step 3 of the *Cannabis Roadmap*. This third step involves three main components:

1. City Code/Planning Document Amendments and Environmental Review
2. Hire Consultant for support in defining the Cannabis Retailer Selection Process
3. Cannabis Revenue Strategy, such as an operating agreement or development agreement, and/or an excise tax ballot measure.

##### ***City Code/Planning Document Amendments and Environmental Review***

The City would need to amend:

1. City Municipal Code
2. Downtown and Lighthouse Specific Plans

At this time, staff seeks direction to draft a code amendment to allow no more than three (3) cannabis retail permits to businesses located in the downtown (except Alvarado Street), Lighthouse District, and/or Cannery Row Business District (except Cannery Row itself). This approach would allow a total of three establishments in the City. During the last meeting, the

Council discussed allowing all three in one district but staff is recommending that the direction be refined to one per area as described above.

If the Council chooses to allow three (3) in one district, the scope of the environmental review changes considerably and may result in additional studies.

After the code amendments are crafted by a consultant, reviewed by Staff, and conceptually reviewed by the Planning Commission, the City will initiate environmental review of the project. The review will start with publication of an Initial Study reviewing the project impacts. Staff anticipates that the environmental review will either conclude with a Negative Declaration or Mitigated Negative Declaration unless more complex environmental issues are identified during the project review resulting in an Environmental Impact Report. Ultimately, the Downtown and Lighthouse Specific Plan amendments will be reviewed by the Planning Commission. The Commission is required to adopt a resolution making a recommendation on the amendments and environmental impacts.

Staff Recommendation: Staff recommends that the Council direct staff to develop a regulator ordinance allowing no more than three (3) cannabis retail permits, with no more than one (1) permit issued in each of the following three (3) business areas: downtown (except Alvarado Street), Lighthouse District, and Cannery Row Business District (except Cannery Row itself).

### ***Cannabis Retailer Selection***

Based on best practices among municipalities in California, staff recommends a selection process that begins with a clear application process. Staff would work with a consultant to develop a review, score, rank, interview, and final selection process of cannabis business permittees. Litigation over these decisions is common, so legal review of the criteria and their implementation will be essential. These costs can be recovered from application fees, regulatory fees on successful permittees, and cannabis taxes, as discussed below.

This transparent process would result in the City awarding no more than three (3) cannabis retail permits to businesses located in the downtown (except Alvarado Street), Lighthouse District, and/or Cannery Row Business District (except Cannery Row itself).

The process would include evaluation criteria consistent with state law and the City's ordinance, to ensure that applicants have addressed all requirements before being allowed to move forward to the permitting process. City staff, in concert with a consultant, would conduct an initial screening of all applications for completeness based upon an objective checklist of deliverables and requirements. The draft Request for Proposals (RFP) would be developed by the consultant and approved by the City Council before it is released.

A final report would be prepared by the consultant, which shall inform the final determination of which applicants shall be allowed to apply for operating permits.

Staff Recommendation: Engage with a consulting firm to begin planning for a cannabis retail selection process, as outlined above.

## ***Cannabis Revenue Strategy***

As stated previously, an analysis by HdL Companies (Attachment 1) shows the City of Monterey's estimated tax or fee revenue for cannabis retailers to be between \$0.5M to \$1.5M per year. Variability in the City's revenue depends upon factors such retailer location(s) and market saturation.

The City has two main revenue strategies: develop a standard operating or development agreement and implement a cannabis retail tax.

### ***Standard Operating or Development Agreement***

This agreement would be required for any cannabis permittee as a means for requiring cannabis businesses to provide agreed-upon community benefits (e.g., support the City's recreation programs, Sports Center, parks, and libraries) in exchange for land use rights to operate a cannabis business in the City. The City could set a specific rate for which the business must provide a benefit (e.g., a certain percentage of revenue).

The agreement could provide that these payments will be credited against any tax voters may subsequently approve, allowing the development agreement fee to sunset when a tax is in place.

Staff will explore whether to develop and implement a Standard Operating or a Development Agreement for any cannabis retail permittee that operates prior to the establishment of a cannabis retail tax.

### ***Cannabis Retail Tax***

A cannabis retail tax would be a stable means of generating revenue for the City, for a fixed percentage of revenue. The tax would replace any Standard Operating or Development Agreement fee in place. Cannabis retail tax rates in the region range from 4.5% in unincorporated Monterey County to 7% in Santa Cruz County and Pacific Grove. Some cities, such as Seaside, have voter-approved ordinances authorizing a cannabis retail tax of up to 10%, with a lower rate adopted by City ordinance.

In addition to revenues between \$0.5M to \$1.5M, HdL anticipates that a voter-approved cannabis retail tax of 4.00% could capture between roughly \$85,000 and \$187,000 in revenue from deliveries made by retailers from outside of the City to addresses inside the City.

These are revenues that the City would not be able to capture through operational or development agreements alone, as the businesses are located outside of the City's jurisdiction and do not enjoy City land use approvals.

Implementation of a cannabis retail tax would require voter approval. The most cost-effective means of this voter-approved tax would be to place a ballot measure on the Statewide November 2022 General Election. The cost for this election could range from \$100,000 to \$150,000.

Staff Recommendation: Direct staff to prepare documents and efforts to regulate three cannabis retail businesses and to place a cannabis retail tax on the ballot for Monterey voters to consider in November 2022.

### ***Cannabis Events at the Monterey County Fairgrounds***

The Monterey County Fairgrounds has recently asked the City to reconsider permitting cannabis-related events as soon as summer 2020 (Attachment 2). These events feature the sale of cannabis and cannabis-themed products, which are not currently permitted in the City.

While the City Council and City staff have both expressed an interest to explore cannabis events at the Fairgrounds in the future, the City does not have the resources and time to consider cannabis-related events at this time. Existing City Work Program and City Priorities are currently taking precedence, and extensive planning and legal research, and community outreach is necessary before such events could be permitted.

Staff Recommendation: Consider cannabis events at the Monterey County Fairgrounds after cannabis retailers are in operation.

Attachments:           1. HdL Analysis – Taxes on Cannabis Deliveries into the City of Monterey  
                                  2. Cannabis Events Support Letter, Monterey County Fairgrounds

Writings distributed for discussion or consideration on this matter within 72 hours prior to the meeting, pursuant to Government Code § 54957.5, will be made available at the following link:  
<https://monterey.org/Submitted-Comments>