

CANNABIS TAX REVENUES: HIGHS AND LOWS



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SUMMARY

On November 9, 2016, California Proposition 64 and Monterey County Measure Y were both approved by voters legalizing the commercial marijuana business. The Monterey County Board of Supervisors (BOS) approved a well-supported system to manage the new cannabis industry. The system was designed to provide discretionary revenue to fund new and enhanced community services. Since 2016, more than \$70M from the cannabis industry has been allocated by the BOS for community services. The BOS, in collaboration with several well-organized growers, had intended Monterey County to be a model for a well-administered cannabis industry in California. Since then, however, the industry has experienced numerous challenges with licensing, regulation, fines, and bankruptcies.

Market and environmental challenges now place the cannabis industry in a financial crisis. Overproduction, high initial tax rates, and growth in illicit production have significantly lowered market prices. Stricter regulations have resulted in multiple business closures and bankruptcies.

Since 2018, tax rates were reduced for growers by more than 75% with three separate ordinances instituted by the BOS. Despite these stabilizing efforts, cannabis businesses

continue to close and default on tax payments. Alarmingly, projected cannabis tax revenue for the current year may not fully fund the County's cannabis-related operational expenses for FY 2024-25.

Annual funding allocations from the Cannabis Tax Fund (CTF) for community services declined from a high of \$23M to \$100,000 for FY 2023-24.

The Cannabis Program was established in 2018 to oversee cannabis operations in collaboration with other County departments. The County commissioned a study conducted by Citygate Associates, LLC (Citygate) to review the organizational structure of the program and identify inefficiencies. Recommended actions undertaken by the BOS have not produced the desired organizational and structural results needed to stabilize the industry in Monterey County.

The Civil Grand Jury (CGJ) recommends the BOS take the necessary actions to help sustain and organize the cannabis industry in Monterey County, creating additional measures balancing revenues and expenses.



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BACKGROUND

In 2016, Measure Y imposed a tax on the commercial cannabis business in unincorporated areas of Monterey County. Tax revenues would be placed in the County's General Fund and used at the discretion of the BOS. Proposition 64, the California statewide measure, outlined the use of state tax funds to support primarily youth drug education programs, environmental protection, and law enforcement.

After what growers identified as an overly burdensome implementation of Measure Y, the BOS approved the creation of a Cannabis Program to oversee the industry and streamlines processes.

By 2021, cannabis tax revenues were the third leading contributor to the County's General Fund. Almost \$70M has been allocated by the BOS for community services from the CTF since the program began.

The cannabis industry now faces numerous challenges threatening its survival. More than 50 cannabis businesses have closed or filed for bankruptcy, defaulting on more than \$6M in unpaid taxes. Annual tax revenues have plummeted from \$20M just three years ago to approximately \$3M, excluding tax collections received from prior years' deferral plans.

Budgeted operational expenses for FY 2024-25 are projected to be more than \$3M, leaving little to no funding for community services. Several Citygate recommendations addressed improvements within the system. Documents presented by the Cannabis Program to the BOS Cannabis Subcommittee and the information made available on their website are difficult to interpret due to the inconsistently presented statistics from different departments.

To stabilize the cannabis industry and its tax revenues, more focused oversight from the BOS is needed to implement the following Citygate recommendations:

- initiating a comprehensive cannabis systems internal audit
- creating more operational expenditure efficiencies
- reallocating additional resources to mitigate the impact of the illicit market
- significantly reducing cannabis business tax deferral balances
- providing more funding for youth drug prevention and education

The Citygate recommendations deserve more attention and consideration.

METHODOLOGY

The CGJ launched an investigation into the current state of the Cannabis industry in Monterey County in 2023. The goal was to consider incoming revenues from growers and retailers with an emphasis on examining shifting tax rates, determining the benefits to the community, and ascertaining the viability of the Cannabis Program.

The CGJ interviewed key County of Monterey personnel, reviewed relevant documentation available both publicly and confidentially, read the 2021-22 CGJ report on this topic, researched past BOS meeting minutes, and kept abreast of current media reports.

Interviews were extensive and included County of Monterey representatives from the Auditor Controller's Office, Treasurer Tax Collector's office, the County Administrative Office, and the District Attorney's office. Additionally, the CGJ interviewed municipal leader and a private cannabis business partner.

Documents reviewed by the CGJ included:

- Cannabis Program Allocations for the past eight years
- The 2022 Citygate Report
- Budget Committee Bi-Annual Reports
- Cannabis revenues by type by fiscal year

- Industry and Governmental Organizational Charts
- Community Services Reports by fiscal year
- County of Monterey Strategic Plans and Goal Reports
- Information regarding growers and dispensaries
- County of Monterey Tax Payment Status Reports
- Tax policies of California State and County of Monterey
- Comparison of County of Monterey reports to other jurisdictions
- Community Needs Assessment Survey

DISCUSSION

Cannabis Tax Assignment Fund (CTF)

Cannabis tax revenues are recorded in the CTF, a sub-fund within the County's general fund. After accounting for annual cannabis program expenses, the CTF has been vital to supporting the County with allocations totaling approximately \$70M. Funded projects include:

Cannabis Tax Allocations Major Project Funding County of Monterey FY 2017-18 through FY 2022-23	
PROGRAM	ALLOCATION (in millions \$)
Covid-19 Services	9-12 M
Laguna Seca Projects/Bridge Construction	5-8 M
Children's Women's Emergency and Homeless Services	3.5 M
Pajaro River Projects	2-3 M
Sheriff Radios	2.5 M
Lakes Fund Deficit (San Antonio/Nacimiento)	2.6 M
Gonzales Community Center/Library	1.8 M
Domestic Water Protection	1.5 M
Jailhouse Addition	0.9 M

Source: Cannabis Program and County of Monterey Budget Office

County staff develop and propose many funding projects and submit them to the BOS for consideration. Of note, youth drug prevention and educational activities represented little more than one-tenth of one percent of the total CTF allocations.

The CTF fund balance in FY 2019-20 was \$26.9M. In FY 2023-24, the fund balance was reduced to approximately \$2.5M. Annual allocations from the CTF for community services are only projected to be about \$100,000 for the next few fiscal years.

Based on projected FY 2024-25 cannabis program tax revenue and expenses, the CTF fund balance will continue to decline as the cannabis industry looks to stabilize itself. The BOS continues to address these tax revenue reductions and a reduced CTF by cutting some operational expenses. However, the cuts are insufficient and not aligned with the reduction in revenues.

Cannabis Program Operational Support

Cannabis Program support is provided by several County departments. The Cannabis Program Manager functions as the centralized coordinator, including maintaining a website, producing reports, and supporting the bi-monthly BOS Cannabis subcommittee meeting. The Program Manager also participates in cannabis coalitions with other California counties and agencies.



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Licensing, permits, tax collections, inspections, accounting, and enforcement are paid for from cannabis tax revenues. Program support and expenses a few years ago included 28 full-time employees, plus support for six other County staff members. Annual budgeted expenses at that time were more than \$7M.

The BOS has faced difficult decisions regarding how to manage and service an important revenue resource effectively with fewer staff. Operational projections in FY 2024-25 include additional reductions from 18 to 14-15 full-time employees. Last year, the BOS reduced expenses and voted not to fund program expenses from the general fund.

Community Needs Assessment Survey

In 2018, the BOS approved funding from the CTF for a community needs assessment survey to identify priority funding from cannabis tax revenues. The top five priority areas were education, health, economic self-sufficiency, safety, and overall County services.

Specific programs included:

- substance abuse education/prevention
- water protection
- education
- streetlights

- affordable housing and shelter
- homeless services
- protections for legal growers
- regulation enforcement of illicit growers
- public transportation
- parks
- libraries
- safer environments for bikes/walking

Both the California Prop 64 ballot initiative and the survey identified priority funding to address youth education for drug prevention. As mentioned above, of the \$70M allocated by the BOS, only a little more than one-tenth of one percent (.014%) or \$93,000, could be identified for youth drug prevention and education.

Cannabis Revenue Community Needs Survey

COMMUNITY PRIORITY ADVOCACY RANKING	
EDUCATION	29.00%
HEALTH	28.00%
ECONOMIC SELF-SUFFICIENCY	22.00%
SAFETY	15.00%
Overall County Services	6.00%

Cannabis Tax Rates and Collections

The BOS establishes and updates tax rates for the commercial cannabis business within the unincorporated areas of Monterey County. Personal cultivation and personal use in compliance with code exceptions are exempt from this tax.

Tax rates have been consistent with rates identified elsewhere in California and neighboring counties. The BOS, however, did not fully account for the impact on the cannabis business by approving high tax rates as well as stringent capital mandates for

facility safety and security upgrades. Many businesses collapsed and defaulted on millions in deferred tax payments.

In response to growers' requests for tax relief, and in consideration of their high start-up costs and the significant drop in product price, the BOS has reduced the tax rates on multiple occasions. To help stabilize the industry, and to be consistent with other counties, tax rates have been reduced from \$15 per square foot of plant space (canopy) to \$2.13 in February 2023. Nursery rates are \$0.71 per square foot and dispensary sales taxes for the county are 4.15% of gross receipts. Plant cultivation this year is reported at \$3.1M per square foot compared to \$4.6M in FY 2020-21.

The cannabis business tax burden increased with the passage of Measure J. It was approved in 2022 to generate \$350,000 annually to benefit the Monterey County Fire District. Measure J was approved as an "evergreen" tax, a tax without a fixed end date. It can only be terminated upon repeal by the voters. This tax now represents more than 10% of all projected tax revenue from the cannabis industry in FY 2024-25 for unincorporated Monterey County.

Approximately 99% of cannabis tax revenue is generated from indoor/mixed light cultivation, nursery cultivation, and dispensaries. The remaining 1% tax revenue is received from manufacturing, distribution, and lab processing fees. Three different departments report on cannabis revenue: the Auditor Controller's Office, the Treasurer Tax Collector, and the County Administrative Office (Cannabis Program). They are inconsistent in how they report, making information tracking difficult.

Aggregate annual collection percentages are as follows:

- Indoor/Mixed Light Cultivation – 66%
- Nursery – 13-20%
- Dispensaries – 10-20%

Approximately 60 cannabis businesses are licensed in the unincorporated areas. The FY 2023-24 projected cannabis tax collections from current year taxes are approximately

\$3M. An additional \$2M is projected to be collected this year from prior years' deferral tax payment plans. County documents indicate annual tax collections peaked in FY 2020-21 between \$18.2M and \$20.1M. Lower tax rates and less cultivated canopy footage have resulted in more than an 89% reduction in tax collection.

Strategic Planning Overview

In June 2020, a cannabis program strategic plan was released after two years of discussions and work sessions. The BOS subcommittee and the County Administrative Officer (CAO) were tasked with the oversight and policy direction of the Cannabis Program, including supervision of the Program Manager and other supporting agencies. They approved goals to support cannabis economic development activity, public safety, equitable compliance, law enforcement, revenue growth, and system management. They prioritized the development of the Cannabis Program website and improved transparency of communications between stakeholders.

Each BOS subcommittee meeting provides updates, accountability reports, and key program data. Each goal of the Strategic Plan is scheduled to be updated every two years. The first notation of an updated Strategic Plan and goals was not identified until the January 2024 BOS subcommittee meeting.

Tax Deferrals

Commercial cannabis business taxes are paid quarterly to the County of Monterey's Treasurer-Tax Collector.

Initially these businesses had extensive start-up costs to meet strict regulatory safety codes and greenhouse modifications. These challenges, coupled with overproduction, falling product prices and financially challenging tax rates created the demand for tax deferrals. The BOS approved many tax deferral plans as did other counties in California. However, initial tax deferral plans were approved without documented qualifying criteria or consistency of terms. The Treasurer-Tax Collector's office had difficulties managing these tax deferral plans and various extensions and revisions.

In FY 2022-23 standardized deferral plan documents and agreements with set criteria were approved and implemented. A significant number of businesses closed or went bankrupt. Current county records reflect more than 50 business defaults resulting in over \$6M in unpaid taxes.

Approximately 25 cannabis businesses have an existing approved tax deferred payment plan with an unpaid deferral tax balance of over \$1M. Nine businesses are delinquent with a deferred tax balance of approximately \$333,900.

Illicit Market



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Funding was approved by the BOS for staff in the Monterey County Sheriff's Office (MCSO) and the District Attorneys' office to address the illicit market. All are dedicated to inspections and prosecution of illicit market cannabis production, cultivation, and sales. The staff utilized a state Track and Trace system to assist in identifying illicit cannabis. Initial inspections were primarily focused on facility code and regulatory compliance, generating supplemental income from fines.

In 2019, the MCSO confiscated or destroyed approximately \$36M in illicit cannabis, peaking at \$68M in 2022. Primarily based on security hazards for staff, inspections in 2023 have been inconsistent. The illicit market became less profitable as prices for cannabis fell. Law enforcement officials have witnessed a reduction in the number of illicit cannabis fields.

Some cannabis varieties can produce flower from seed in fewer than 2.5 months. The time interval associated with fewer inspections creates the potential for untaxed cannabis production with licensed growers.

CONCLUSION

Since voter approval of legalized sales, the cannabis industry in Monterey County and across the state has experienced start-up regulatory and operational hurdles. Local officials have approved numerous changes to create sustainability within the cannabis industry, including an additional tax rate reduction over one year ago. Maintenance of a lower tax rate, as well as reductions in Cannabis Program staff, are expected to provide a stabilizing effect on the CTF and cannabis operators. In the event the BOS approves the regulated licensing of cannabis lounges in Monterey County, revenues could potentially increase.

FINDINGS

- F1. Current revenues do not provide sufficient margins over expenses to fund community services at prior years' levels. Without operational changes, the Cannabis Program's sustainability is in jeopardy, and future funding for community services from this source will be minimal and/or unavailable.
- F2. The 2020 Cannabis Program Strategic Plan, intended to be updated every two years, was not revised until January 2024, causing delays in assessing key metrics and whether program goals are being met.
- F3. Current tax rates have stabilized. Revenues for FY 2024-25 are projected to be consistent with prior years, contributing to the Program's sustainability if Program expenses are aligned with revenues.
- F4. An internal audit of the Cannabis Program, recommended by the Citygate Report, was not completed, thus risking inefficient operating practices and the potential for inaccurate record keeping.

- F5. More than 50 cannabis businesses have closed or filed bankruptcy leaving the County with \$6M in unpaid taxes, resulting in reduced revenues for community services.
- F6. A community survey indicated that a high priority for cannabis tax revenues should be allocated toward drug education and prevention. However, only a small fraction of the cannabis tax revenues has been allocated toward such programs. The lack of funding for these programs is inconsistent with community priorities and increases the potential for drug abuse and death.
- F7. Illicit activities are one of several major factors contributing to the reduction in funds available for community needs.
- F8. Criminal/Civil penalties for most illicit business activities may be adjudicated as a misdemeanor by the District Attorney's office with less than a year probation and/or a fine of \$1,000 or less, resulting in an ineffective deterrent system.

RECOMMENDATIONS

- R1. The BOS direct Cannabis Program staff to analyze ways to reduce expenses within the Cannabis operational system, supplementing best practices identified in the Citygate report recommendations to stabilize and grow the Cannabis Tax Assignment Fund by September 30, 2024.
- R2. Cannabis Program Manager complete a Strategic Plan every year and provide the BOS with status updates at each subcommittee meeting by January 31, 2025.
- R3. The BOS support the growth and sustainability of the Cannabis industry by maintaining the current Program tax rates for the next two budget years by September 30, 2024.
- R4. The Office of the Auditor-Controller's Internal Audit Division (IAD) conduct an internal audit on the Cannabis Program in FY 2023-24 by January 31, 2025.
- R5. The Office of the Auditor-Controller's Internal Audit Division (IAD) conduct an internal audit of cannabis businesses with tax deferral payment plan agreements, including those in tax delinquency by January 31, 2025.
- R6. The Treasurer-Tax Collector Office develop a timely action plan for those growers in arrears and recommend to the BOS to consider phasing out further tax payment extensions by November 30, 2024.
- R7. The Director of Public Health identify projects to assist with youth drug awareness/education/prevention and request funding from BOS as a priority allocation from the CTF by September 30, 2024.
- R8. MCSO increase enforcement of the regulations regarding illicit activity by licensed and unlicensed growers by September 30, 2024.

- R9. The District Attorney's office in cooperation with the Cannabis Program and Sheriff/Coroner's office increase prosecutorial efforts of unlicensed and underreporting cannabis growers to the maximum extent of the law; by using existing resources, potential grant funding, and assistance from the Cannabis Administrative Prosecutor Program (CAPP) by December 31, 2024.

REQUEST FOR RESPONSES

The following responses are required pursuant to Penal Code sections 933 and 933.05:

From the following governing bodies within 90 days of the publication of this report:

- Monterey County Board of Supervisors
 - Findings: F1-F8
 - Recommendations: R1-R9

From the following individuals within 60 days of the publication of this report:

- Monterey County District Attorney
 - Finding: F8
 - Recommendation: R9
- Monterey County Auditor-Controller
 - Findings: F4, F5
 - Recommendations: R4, R5
- Monterey County Treasurer/Tax Collector
 - Finding: F3, F5
 - Recommendations: R5, R6
- Monterey County Sheriff/Coroner
 - Finding: F7
 - Recommendation: R8, R9

INVITED RESPONSES

From the following individuals:

- Monterey County Health Department Director
 - Finding: F6
 - Recommendation: R7
- Monterey County Cannabis Program Manager
 - Findings: F1-F4
 - Recommendations: R1, R2

Reports issued by the Grand Jury do not identify individuals interviewed. Penal Code section 929 requires that reports of the Grand Jury not contain the name of any person or facts leading to the identity of any person who provides information to the Grand Jury.

GLOSSARY AND ACRONYMS

BOS	Board of Supervisors
CA Proposition 64	The Adult Use of Marijuana Act effective November 9, 2016. It legalized specific personal use and cultivation of marijuana for adults 21 years of age or older, reduced criminal penalties for specific marijuana-related offenses for adults and juveniles, and authorized resentencing and dismissal and sealing of prior, eligible marijuana-related convictions. The proposition includes provisions on regulation, licensing, and taxation of legalized use. (courts.ca.gov)
CAO	County Administrative Office
CAPP	Cannabis Administrative Prosecutor Program. Established in 2023 and provides California cities and counties who partner with DOJ with legal support to address illicit cannabis activity through administrative enforcement and nuisance abatement
Citygate	Consultancy who was contracted to provide reports for various departments within Monterey County
CTF	Cannabis Tax Assignment Fund
DA	District Attorney
FY	Fiscal Year
IAD	Internal Audit Division
MCSO	Monterey County Sheriff Office

BIBLIOGRAPHY

Cannabis Program County of Monterey
<https://www.co.monterey.ca.us/government/departments-a-h/administrative-office/intergovernmental-and-legislative-affairs/cannabis-program#mcp>

Cannabis Program Indicators County of Monterey

<https://www.co.monterey.ca.us/government/departments-a-h/administrative-office/intergovernmental-and-legislative-affairs/cannabis-program/performance-indicators#mcp>

Citygate Associates LLC Organization Review of Current Cannabis Program
February 2022

<https://monterey.legistar.com/View.ashx?M=F&ID=10554107&GUID=B80F13A9-0D1F-4904-A35C-68DADB327D5>

Department of Cannabis Control 2024 Announcements (Unified Enforcement Cannabis Taskforce)

<https://cannabis.ca.gov/2024/01/california-seizes-over-312m-in-unlicensed-cannabis-during-task-forces-first-calendar-year-of-operation/>

County of Monterey Treasurer/Tax Collector Tax Rates

<https://www.co.monterey.ca.us/government/departments-i-z/treasurer-tax-collector/commercial-cannabis-business-tax>

Local News Matters: Monterey County looking to eliminate prior cultivation requirement for outdoor growers

<https://localnewsmatters.org/2024/01/10/monterey-county-looking-to-eliminate-prior-cultivation-requirement-for-outdoor-growers/>

Monterey County Board of Supervisors 3.6.2024 Agenda Items Related to Cannabis

<https://monterey.legistar.com/LegislationDetail.aspx?ID=6559569&GUID=074BB660-F225-48FB-8158-3B64E4144D03&Options=ID|Text|&Search=Cannabis>