

Cannabis Industry Letter to The City of Costa Mesa

Dear City Council and Staff Members,

The Cannabis Industry formally requests that the City of Costa Mesa reduce the gross receipts tax on cannabis manufacturing, distribution and testing businesses to 2% and allow for home delivery cannabis businesses at a gross receipts tax of 5%. The Cannabis Industry also requests that all taxation occur upon exit of product from the City, in order to avoid multi-layered taxation and to encourage/stimulate inter-city business between multiple cannabis operators.

As you may recall about a year ago, members of the local cannabis community started making rounds at City Hall and to multiple City Council members to offer an explanation as to why the 6% gross receipts tax was a heavy burden placed on operators and rendered Costa Mesa a non-competitive home for businesses within the cannabis space. In the letter below, we would like to take the opportunity to address some of the challenges we are facing in greater depth with you, as well as provide solutions that will help us overcome these challenging times:

TAX ON MANUFACTURING, DISTRIBUTION AND TESTING BUSINESSES:

One the first dual-licensed business to become operational in Costa Mesa openly shared the company's P&L on the Distribution side of the business with City Staff and multiple Council Members in an effort to further illustrate just how detrimental a 6% gross receipts tax really is. This business has now been forced to close their Distribution-to-Retail side because customers were going with Distributors located in other municipalities with much more favorable tax rates, where the cost of business is significantly less. The last tax payment from this operator to the City reflected a significant decrease in revenue and this trend will surely continue unless local cannabis operators are provided with significant tax relief.

As the legal cannabis industry continues to evolve, it is important to understand why revenues of new, legal cannabis businesses are generally declining. In short, there are many new challenges that have arisen for current cannabis business operators. Firstly, there are not enough legal retail outlets throughout the state, which is causing a bottle neck of product at the retail front and discouraging consumers from shopping at convenient, legal, safe outlets. This means that consumption of legal cannabis products has gone down, while consumption of illegal cannabis market products has increased.

Furthermore, since there is a bottle neck of too much legal product trying to make it onto too few legal retail shelves, the rest of the supply chain (distributors, manufacturers and cultivators) have seen wholesale margins drastically reduce as prices of raw material and final form goods have fallen dramatically over the last few months because of the shaky market conditions and the flourishing black market.

Therefore, the Cannabis Industry is finding that a 6% gross receipts tax on manufacturing, distribution and testing businesses is excessive and, in many cases, unsustainable. Cannabis operators in Costa Mesa are losing deals to Cities with lower taxes and with lower costs of doing business.

To date, the City has collected only \$259,000 in tax revenue- this amount is \$1.4 million below budget projections and will not help fix the City's structural budget deficit. We as the local cannabis community want to help you get these numbers up, but we also need your immediate help to make that happen.

There are several operators in Costa Mesa with multiple licenses across multiple cities, who are choosing to avoid moving cannabis business through Costa Mesa because of the harrowing gross receipts tax, despite Costa Mesa being an ideal logistical spot to manufacture and distribute cannabis products. This is a shame, as Costa Mesa was on the forefront of creating a cannabis community with Measure X and allowing cannabis businesses to operate within the City well before another other local municipalities.

Another key indicator that the gross receipts tax is far too excessive is the availability of properties currently located in the Green Zone. For the first few months after Costa Mesa announced the parameters of the Green Zone, there were many competing offers on properties and it was hard to

Cannabis Industry Letter to The City of Costa Mesa

secure a property- in many cases operators were forced into paying extremely excessive rent, sometimes even having to agree to give up an additional gross receipts percentage to landlords, simply to be able to secure a property to apply and open a cannabis business within the City.

Today, the landscape has dramatically changed as there is wide availability of properties with no current offers on them – this is because of the way the cannabis industry has evolved and additionally, the general impression of the cannabis industry outside of the local community is that it is extremely challenging to get a cannabis business up and running in a timely manner in Costa Mesa and even more challenging to sustain a profitable cannabis business within the City.

We are formally requesting an immediate reduction in the gross receipts tax to 2% on manufacturing, distribution and testing businesses, in order for these businesses to A) simply survive in many cases, and B) generate increasing, stable revenue over time to help support the budget deficit for the City of Costa Mesa.

At a 2% gross receipts tax on these businesses, Costa Mesa will become a competitive, financially sound location to run a cannabis business and fall in line with other cities such where cannabis businesses are *successfully thriving*. *Successfully thriving*.... these are important words because while many other cities have similar tax structures to Costa Mesa, they are experiencing the same significant gap in tax projections and operators in those cities are in a similar position to local operators here in Costa Mesa – they are trying to work with their cities to reduce taxes to a sustainable amount in order to kick start the local industry again.

It is imperative that a tax reduction to 2% for manufacturing, distribution and testing cannabis businesses is rendered quickly – an escalating tax bracket tier over time simply will not work. To start at a low tax percentage that is associated with limited revenue and then to see that tax percentage increase as revenue increases, still places Costa Mesa in a non-competitive state. Local businesses with licenses and operations in more favorable tax havens elsewhere would be forced to limit their production in Costa Mesa as to fall within the minimum tax bracket and continue increasing their production in the other municipalities where taxes are a sustainable, flat number across the board. Furthermore, an escalating tax bracket will not change the message to the greater cannabis industry that Costa Mesa is a cannabis business friendly city. The City will only see small operations that may or may not survive over time, as larger, multi-city operators will seek to maximize on the lower tax bracket revenue limits and move the balance to other cities with more favorable tax structures. Only a reduction to a 2% gross receipts tax on the above-mentioned business types would prevent this, as even a reduction to only 5%, 4% or 3% would still encourage operators to shift revenue to a city with 1% or 2% taxes because they will still see a significant profit benefit.

INTRODUCTION AND TAXATION OF HOME DELIVERY TO COSTA MESA:

There is an opportunity for the City to place a higher gross receipts tax on home delivery businesses of 5%, which is a percentage that is also sustainable for operators in Costa Mesa. As mentioned earlier, one of the challenges operators are facing right now is that there are too few, legal retail outlets for products throughout the state. Essentially this means that retail outlets, particularly dispensaries, hold all of the buying and negotiating power within the supply chain – there is way more legal product trying to come to market than the current store shelves can hold, which means wholesale margins have been decimated and many manufacturers and distributors are simply trying to find ways to stay alive at this point.

The introduction of home delivery in Costa Mesa solves a few other challenges. The first benefit of having home delivery in Costa Mesa is that manufacturers and distributors will no longer need to go through the “gatekeeper” dispensaries in order to get their products on the shelves for consumers to purchase – they will have the ability to directly sell to the consumer. This means that not only will manufacturer/distributors have the opportunity to be in full control of their own sales channels, it also means that margins will be significantly higher, as product will no longer be sold at wholesale pricing but rather it will be sold direct-to-consumer at retail prices.

Another major benefit of home delivery is it will provide direct access to patients who need cannabis to help cope with their medical issues, patients who otherwise in many cases have no way to obtain it.

Cannabis Industry Letter to The City of Costa Mesa

There are many residents of Costa Mesa (as well as the rest of Orange County) who would like to obtain legal cannabis to help with various ailments, however they are either A) unable to physically get to a dispensary because of health reasons, or B) may not be comfortable shopping in a dispensary but would still like to partake in the medical benefits of cannabis. Home delivery would provide safe, legal access to patients on a much greater scale than a single retail dispensary ever could.

Additionally, it is important to note that since Measure X was written and enacted upon, the State of California has determined that cannabis delivery is fully legal throughout the entire state, meaning that operators running home delivery businesses in Costa Mesa will have the opportunity to deliver to consumers throughout California and Costa Mesa would be able to collect 5% gross receipts tax on all of those sales. Furthermore, if there are any concerns that a reduction in gross receipts tax to 2% on manufacturing, distribution and testing businesses may hinder overall tax revenue for the City, the 5% gross receipts tax on home delivery would more than offset that difference as manufacturers and distributors would have access to the entire consumer base in California.

Another point that should be mentioned is that home delivery *is already taking place* in the City of Costa Mesa. Unfortunately, there are many illegal delivery services (and a couple legal ones) in Orange County that are still supplying residents of Costa Mesa with product and the City is not able to regulate this product or these deliveries, nor is the City able to currently benefit from any taxation on these deliveries. By allowing home delivery businesses in Costa Mesa, the City would be able to lean on cannabis businesses within the city limits to increase the flow of clean, safe regulated product being delivered to local consumers and they would also be able to take advantage of the 5% gross receipts tax on all deliveries made throughout the state.

Lastly, it should be noted that the state already has detailed regulations in place to ensure that home delivery businesses are run in a safe, compliant and responsible manner, however Costa Mesa would have the opportunity to work with current operators to impose additional regulations if the City were to deem it necessary. Essentially the home delivery model is VERY similar to the Distribution model, the difference being that product would be delivered direct to consumers rather than retail dispensaries. Deliveries are required by law to be done on a pre-designated route in unmarked, yet secured vehicles, a there are limitations on how much product any driver can carry at any given time. Furthermore, product cannot simply be left at a consumer's door – the individual ordering the product needs to be present, show full identification and then take direct possession of the product. The Cannabis Community is happy to share with additional regulations with you and how this business model would work safely, discreetly and effectively in Costa Mesa.

In summary, we have been asking the City for a year to take action, and now we absolutely need your help as the legal cannabis market has presented operators with many new, unexpected and unforeseen challenges that are threatening the sustainability of our businesses. We want to succeed here in Costa Mesa, and we want the City to benefit from our success, but the only way this can happen is that we have to work together, and we need you to please act and to help us.

We ask that you support our requests and swiftly take action. Many local cannabis businesses that are either currently operational or are in mid-process with the City for licensure are currently consulting with their investors, who seek to sell off operations in Costa Mesa or abandon the licensure process and continue licensure/operations in Cities with significantly more favorable taxes. This could result in a mass exodus of cannabis businesses from Costa Mesa which would be detrimental Costa Mesa and to budget projections.

Any and all members of the Costa Mesa Cannabis Community are available for discussion and are happy to expound on our requests in greater detail.

Thank you for your consideration, we await to hear what actions will be taken.

Sincerely,

The following Costa Mesa Cannabis Industry Executives/Owners:

Michael Moussalli
Se7enLeaf

Jim Fitzpatrick
Solutioneers

Krystal Kitahara
Yummi Karma

Chris Boudreau
Cannabis Chamber of Commerce

Eric Spitz
C4 Distro

Steve Hellings
SW Ventures

Blake Terreri
JoshD

Jeff Droege
Sol Distro

Chris Sheppard
Oil Haus

Matt Longo
Mellow Extracts

William Waldrop
EVIO Labs

Nick Rohan
Expando Products

Paul Jacobsen
Aureus

Perry Srey
Leaf Concepts

Daniel Abrahami
TEVE

Peter Ishak
Distillate Co

Mehran Moghaddam
Nature's Market

Clay Tanner
California Leaf Company

Kandice Hawes
OC NORML

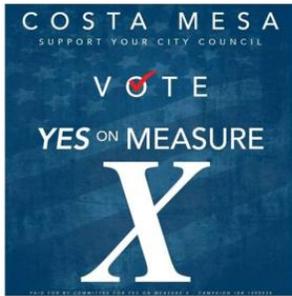
Nic Deangelo
Property Owner 18k sf

Wes Eder
Shelflife Distributing

This initiative and the above requests are also supported by the Cannabis Chamber of Commerce:



Measure X: November 2016 – People voted 54%



X-City of Costa Mesa, The City of Costa Mesa Medical Marijuana Measure
Completed Precincts: 66 of 66

	Vote Count	Percentage
Yes	19,870	54.2%
No	16,786	45.8%

• More votes than any one Council Candidate

“You cannot Manage what you do not Measure” – Peter Drucker

**City of Costa Mesa
Marijuana Gross Receipts Tax Revenue Collections**

REPORTING MONTH	FY 18/19 TOTAL
July 2018 - December 2018	\$ 57,887.57
January 2019	13,146.48
February 2019	14,645.33
March 2019	19,713.66
April 2019	14,798.37
May 2019	19,130.15
June 2019	24,481.72
Grand Total	\$ 163,803.28

City of Costa Mesa Marijuana Gross Receipts Tax Revenue Collections	
REPORTING MONTH	TOTAL
July 2019	\$ 46,229.04
August 2019	49,014.06
September 2019	-
October 2019	-
November 2019	-
December 2019	-
January 2019	-
February 2019	-
March 2019	-
April 2019	-
May 2019	-
June 2019	-
Grand Total	\$ 95,243.10

TOTAL : \$259,046.38

Source: Multiple Public Records Requests