



County of Santa Cruz Board of Supervisors

Agenda Item Submittal

From: County Administrative Office

Subject: Options for Consideration to Allow Cannabis Consumption at Retail Location and Cannabis Tax Code Revision

Meeting Date: January 28, 2025

Formal Title: Consider options to allow cannabis consumption at retail locations and potential cannabis business tax revisions related to consumption and non-cannabis goods

Recommended Actions

- 1) Provide staff direction on potential code amendments to allow cannabis consumption at existing retail sites;
- 2) Provide staff direction on potential code amendments regarding cannabis business tax application to cannabis lounges and ancillary product sales; and
- 3) Direct staff to return with a scheduled public hearing to consider amendments to Santa Cruz County Code (SCCC) Chapter 7.130 and Chapter 4.06.

Executive Summary

On December 10, 2024, the Cannabis Licensing Office (CLO) provided proposed amendments to SCCC Chapter 7.130 (cannabis dispensary licenses) to allow consumption at existing retail sites based on the Board motion on June 4, 2024. While considering the proposed amendments the Board directed the CLO to consider ancillary sales, cannabis business tax (CBT) sales in retail versus lounges, taxation on products consumed in lounges, and ways to extend the opportunity to have consumption lounges in more of the existing retailers. This letter is intended to provide the Board context and options related to their direction.

Discussion

On November 14, 2023, the Board considered cannabis cultivation issues related to sustainable growth, economic development, and responsible cannabis regulation, in alignment with the 2023 Sustainability Plan updates. The Board discussed the matter and directed the CLO to conduct public meetings across various districts to collect public opinion on several cannabis related ideas, including onsite consumption at existing retail business.

The Board instructed the CLO to facilitate community discussions on potential options to gain a deeper understanding of public concerns before considering any changes to the existing cannabis ordinance.

The CLO presented a report of the results of the listening sessions to the Board on June 4, 2024. The report prompted a discussion that resulted in the Board directing the CLO to draft ordinances related to the contents of the November 14, 2023, agenda item. This report is limited to consumption at existing retail businesses.

Retail Cannabis Business Licensing Code Background

The Board approved the first ordinance which allowed licensing of medicinal cannabis dispensaries in August 2016. This ordinance allowed for 13 existing medicinal dispensaries the opportunity to obtain a business license at their current locations. These 13 businesses were grandfathered into legality at their physical locations. This ordinance established the location requirements which would allow for a dispensary to relocate.

The location requirements were restricted to certain commercial zones and included setbacks to schools, alcohol and drug treatment facilities, other dispensaries, and residentially zoned parcels. The setbacks established mimicked recently adopted state laws known as the Medical Marijuana Regulation and Safety Act, which was composed of AB 266, AB 243 and SB 643 in 2015. These location requirements allowed dispensaries the opportunity to move into 41 parcels. 32 of the parcels are grouped near Dominican Hospital, near Sutter Maternity and Surgery Center, and northern 41st Avenue adjacent to Café Cruz in District 1, as shown on Attachment A. The nine remaining parcels are located south of the Aptos Village and adjacent to the hotel located off of State Park and Highway 1 in District 2, as shown on Attachment B.

The grouping of these parcels is important because our code does not allow dispensaries to be located within 600 feet of each other. Of the 41 parcels that are eligible for a dispensary there are only six locations which a dispensary could truly move to at the time the ordinance was adopted.

In April of 2017, the Board adopted a revised the dispensary ordinance to allow for one additional dispensary, with a well establish history of compassionate care work, to obtain a business license.

In October 2017, the Board adopted another revision to the dispensary ordinance meant to align County Code with State law changes enacted with the passage of Proposition 64 in 2016. These changes allowed for adult-use sales in addition to medicinal sales at cannabis dispensaries. Additional changes were made in the same vein in August 2018.

In March 2019, the Board adopted revisions which removed the original licensing language, various technical changes to better reflect state laws, and recommendations from the CLO and Sheriff's Office regarding security and license processing. Following these revisions dispensaries began being referred to as cannabis retailers. In May 2019, the Board adopted revisions to the setbacks for retailers if findings could be made that the general public benefit would outweigh concerns regarding intensity of use, land use compatibility, and public health and safety. This exception language and approval pathway was further revised to include a public notification and appeal process in August 2022.

In November 2022, the Board adopted minor changes which allowed for retailers located anywhere within the County to deliver to unincorporated areas and various non-substantive changes including the removal of dispensary and replacement with retailer to County Code.

These changes illustrate the iterative nature of the cannabis business licensing code. Since the inception of the cannabis code the Board acknowledged this process would continually evolve.

Options to Extend the Opportunity to Have Consumption Lounges

The Board directed staff to identify ways to extend the opportunity to have consumption lounges at more of the existing retailers. A concern was raised that some retailers do not have the space to accommodate a consumption lounge and the ability to obtain a lease on an adjacent property is out of their control. Below are three options for consideration and the potential effects of each.

Option 1: Allow retailers the option of pursuing on-site consumption either within their existing licensed space or at an adjoining commercial parcel to the existing site.

Potential Effects of Option 1:

- All of the existing retailers have the ability to allow for consumption at their existing licensed location with the exception of the two locations in the San Lorenzo Valley.
 - o Both of those retailers could pursue leasing an adjacent location and one of them already has secured a lease on an adjacent space.
- The size of the consumption lounges would vary based on the current licensed site.
- The spaces used for consumption will have to be retrofitted to comply with smokefree workplace considerations.

Option 2: Allow retailers the option of pursuing on-site consumption either within their existing licensed space, at an adjoining commercial parcel to the existing site, or at any parcel currently allowed within Code and not excluded by the 600-foot retailer to retailer location exception.

Potential Effects of Option 2:

- 39 non-adjacent parcels (there were 41 parcels when the original ordinance passed but two retailers have relocated) would be eligible for use as a cannabis lounges.
- This could potentially double the number of retailers within the unincorporated county.
 - o A lounge is a retail point of sale and consumers (similar to a bar or restaurant with regard to wine sales) could purchase cannabis and take the left-overs home with them.
- This may disproportionately impact four retailers located near Dominican Hospital and northern 41st Avenue in District 1.
 - o They would likely face increased competition as 30 of the 39 potential parcels where a lounge could be located are within these areas.

Option 3: Allow retailers the option of pursuing on-site consumption either within their existing licensed space or at commercial locations similar to those allowed for restaurants and bars.

Potential Effects of Option 3:

- This could potentially double the number of retailers within the unincorporated county.
- This would provide the greatest flexibility for retailers to choose a desirable location to establish a cannabis lounge.
- Restaurants and bars can be located within the Neighborhood Commercial (C-1), Community Commercial (C-2), Workplace Flex (C-3), Commercial Services (C-4), Tourist Commercial (C-T), and the Professional and Administrative Offices (PA) zone districts.
 - o To allow consumption lounges would require amendments to chapter 13.10.332 of County Code to allow for these uses.

- o These businesses would be subject to the commercial use permit process.
- This would result in a more costly process to establish a cannabis lounge and likely limit the potential development of these businesses.

If the Board would like to continue pursuing allowing cannabis consumption the Board needs to provide staff direction on this topic. Options two and three presented above may lead to doubling the amount of retail outlets within the County. Limitation may be placed on cannabis lounges to mitigate the effect of these additional points of sale on existing businesses. The location of these additional businesses may disproportionately impact the existing retailers located within the Urban Services Line as most potential additional locations will be located there. In addition, there are several zoning and CEQA considerations to be analyzed if either of these options are pursued. Staff anticipates that pursuing either option two or three would be up to a year-long process.

Some of our existing retailers may not agree with the staff's analysis that all of the retailers located outside of the San Lorenzo Valley have the ability to pursue a cannabis lounge at their location. This conclusion was reached while staff discussed lounges with retail businesses during the annual inspection process in November and December 2024. The two retailers with the smallest square footage are planning on pursuing a lounge without expanding into an adjacent space. Based on those discussions and the size of the other retailers a cannabis lounge, within the existing site, is an option for every retailer outside of the San Lorenzo Valley. Some retailers do not think it's a viable business model, others are not going to pursue this because of liability concerns, and some retailers oppose this opportunity because they feel it could place them at a competitive disadvantage if they choose not to pursue a lounge.

Cannabis Business Tax Code Analysis

The Board directed staff to consider options that could impact taxes from ancillary sales, CBT sales in retail versus lounges, and different taxation rates on products consumed in lounges. Staff worked with County Counsel to analyze how the Board can amend our voter approved cannabis business tax code, SCCC Chapter 4.06. The options presented below identify how the Board can amend the code to address the concerns they previously raised.

Option 1: Define ancillary products

Pursuant to the authority granted under SCCC Chapter 4.06.330(B) the Board may interpret or clarify the methodology of the tax, or any definition applicable to the tax. Under this provision the Board may add a definition of ancillary products. By defining ancillary products as those products derived from cannabis or containing cannabis that would allow retailers the ability to sell non-cannabis goods (i.e. coffee, snacks, shirts, pipes) without those goods being subject to the cannabis business tax, in a similar fashion to non-cannabis retail stores.

Option 2: Define a tax rate for cannabis lounges

The Board has been granted the authority to set cannabis business tax rates anywhere between zero and ten percent of gross receipts. This authority is defined in SCCC Chapter 4.06.070(A). The Board can therefore set any rate within that range for cannabis lounge sales. The lounge rate does not have to align with the retail sales rates. Therefore, the Board could pursue different tax rates for products consumed on-site versus those sold via a retail.

These options could be pursued independently or jointly at any time. These options

provide the Board a method for removing non-cannabis goods from the cannabis business tax and allowing for different tax rates for cannabis goods consumed on-site versus sold via retail store. Option one also provides cannabis retailers a level playing field to pursue non-cannabis sales, which will increase if the Board allows for consumption lounges. Staff can prepare either or both of these options in conjunction with any direction the Board provides in regard to cannabis lounges.

Financial Impact

The addition of consumption lounges would create some additional staff work but that work level will vary greatly depending on which option the Board pursues. Option one would include minimal efforts to finalize the ordinance while options two and three could likely take upward of a year to finalize. Staff work associated with tax changes is negligible. If the Board pursues consumption lounges staff work will increase particularly at the outset when plans, ventilation systems, workplace safety and other items will have to be reviewed. New licenses or license amendments would need to be processed for any retailer adding a consumption lounge and would likely be billed on time spent, similar to how we currently approach issuing new licenses and processing license amendments.

As retailers are inspected annually with their license renewal, lounges would also require annual inspections and thus, annual licensing fees will need to be assessed if the Board pursues any of the options. If lounges were operated at separate distinct locations as mentioned in options two and three changes to the Unified Fee Schedule would also be required to address these new types of businesses. Potential changes could include a fee-based system that is based on the amount of inspections or based on square feet of lounge space.

Strategic Initiatives

Operational Plan - Dynamic Economy

Submitted By:

Carlos Palacios, County Administrative Officer

Recommended By:

Carlos J. Palacios, County Administrative Officer

Artificial Intelligence Acknowledgment:

Artificial Intelligence (AI) did not significantly contribute to the development of this agenda item.