

22. Accept and file the first biannual report for Fiscal Year 2024-25 on Cannabis Licensing Office operations, and take related actions ()



## **County of Santa Cruz Board of Supervisors**

### **Agenda Item Submittal**

**From:** County Administrative Office

**Subject:** First Biannual Report for Fiscal Year 2024-25 on Cannabis Licensing Office Operations

**Meeting Date:** January 28, 2025

**Formal Title:** Accept and file the first biannual report for Fiscal Year 2024-25 on Cannabis Licensing Office operations, and take related actions

### **Recommended Actions**

- 1) Accept and file the report for the first two quarters of Fiscal Year (FY) 2024-25 on Cannabis Licensing Office operations; and
- 2) Direct staff to return on or before August 19, 2025, with the annual report for FY 2024-25.

### **Executive Summary**

The Cannabis Licensing Office (CLO) has committed to reporting on activities and licensing operations twice a year. This report covers all activities for the first and second quarters of FY 2024-25. Our previous report was on August 27, 2024, and summarized activities for the previous fiscal year.

### **Background**

The Cannabis Licensing Office (CLO) is responsible for the annual licensing of retail and non-retail operations within the unincorporated County of Santa Cruz. Retail operators are governed by Santa Cruz County Code (SCCC) 7.130. Non-retail operators are governed by SCCC 7.128. The non-retail license process began in June 2018 with the enactment of Chapter 7.128. The non-retail licensing process involves obtaining approval from the licensing office and use permit(s) from the Planning Department with limited exceptions in the CA zone district, including a California Environmental Quality Act (CEQA) determination. Depending on the scope and scale of operations, the use permit may also require a public hearing.

In addition, the CLO has responsibilities for compliance and enforcement activities. CLO staff are assisted in the enforcement of the illicit market by Sheriff's staff.

### **Analysis**

#### **Market Changes**

The cannabis market within the county has continued to be more stable than the statewide market. During the first half of FY 2024-25, one newly licensed business began operations and four other businesses anticipate beginning operations this spring. One retail business closed during the first half of the fiscal year. Several businesses have expressed interest in consolidating this year based on the potential elimination of the co-location requirements. This consolidation will lead to a decrease in licensees though it is not anticipated to result in a decrease to production. Licensing fees will likely be amended to reflect ordinance changes approved by the Board.

Statewide the market has continued to consolidate, and some larger multi-state

operators have continued to leave California. The current State license data from January 6, 2025 shows 7,491 cultivation licenses are invalid (they have expired, been suspended, canceled, surrendered, or consolidated) which is equivalent to 61% of all cultivation licenses issued. Of those 47% of all cultivation licenses issued have become invalid in 2022 and 2023. In total, the State has issued 12,301 (annual and provisional) cultivation licenses.

Last calendar year, 2023, statewide year over year sales decreased 8% from 2022 according to a report published by MJ Biz Daily on January 10, 2023. The data represent the lowest cannabis sales since 2019. The data on yearly sales has not been published by the Department of Cannabis Control as of January 6, 2025. Current data for the calendar year 2024 only includes sales through November and it indicates a year over year decrease of 13%, but that number is reduced to only a 5% decrease in sales when adding a conservative projection for December.

### State Changes and Issues

The State continues to amend regulations in the cannabis field. AB 1775 was approved and the state is now allowing cannabis retailers the ability to have cannabis cafes. These allow for non-cannabis infused food and beverage preparation and sales.

In the previous quarterly reports, we identified a thriving illicit market as part of the problem for the statewide legal market. While illegal activity remains true on a statewide basis, it does not reflect the situation in our County. Locally, we have seen a significant decrease in illicit operations. The Cannabis Compliance Unit has continued its enforcement efforts. The 2023 illicit outdoor cultivation season was very small, and that trend continued this year. The 2024 outdoor cultivation season was the smallest we've seen since this program's inception, with only one complaint and no illicit operations found. Illicit indoor cultivation in the county appears to have decreased also. Many of the telltale signs such as electricity use, water use or odors were not present this past year.

Another driver of illicit sales appears to be a lack of concern for contamination from the general public and a lack of confidence that cannabis being sold at legal businesses is any better than cannabis in the traditional market. These issues are not new but four recent articles by the L.A. Times has highlighted the concern that consumers are not confident in the State testing program. The recent news coverage exposed the Department of Cannabis Control's lack of responsiveness to information on contamination. The Department of Pesticide Regulation has attempted to modify the testing requirements for cannabis since 2018 and have even appealed directly to the head of the Department of Cannabis Control but no updates have occurred or been proposed to date. L.A. Time reporting included data from 538 cannabis pesticide tests. 370 tests were on cannabis products in the legal industry and the remaining were from the illicit industry. The rate of contamination between the legal and illicit products was similar.

The take aways from the L.A. Time articles can be summed up in from this quote in their December 29th article titled Legal Weed, Broken Promises.

"These tests identified the presence of 45 pesticides California does not track in cannabis. All but one are illegal to use on the plant. The tests also found the presence of lab-created cannabis oils prohibited in the legal market, and potentially dangerous chemicals used to dilute products. The contamination is so widespread there is

evidence of insufficient clean-grown weed to supply the state's \$1-billion cannabis vape market. One brand said it was having difficulty sourcing pesticide-free cannabis concentrates. One of the state's largest oil manufacturers, Sisu Extracts, said it found 60% of the cannabis crops farms offered for sale contained pesticides not on California's screening list."

#### Federal Issues with Potential Impacts

At the Federal level, the Department of Health and Human Services has recommended to the Drug Enforcement Agency that cannabis be rescheduled from a schedule I substance to a schedule III substance. This would impact our local industry by allowing cannabis companies the ability to have the same federal tax write offs of any other company. The rescheduling hearing will begin on January 21, but this hearing has been delayed previously.

The push to allow cannabis companies access to the banking system failed the last two year but a change in scheduling could refresh the efforts to pass cannabis banking reform. This could significantly impact the safety of cannabis business by reducing the need for cannabis business to operate using cash only.

#### Retail Activities

The County currently has 11 licensed retail operators in the unincorporated area. One previous site has been eliminated for future use as a cannabis retail operation site due to the discontinuation of the license. Our ordinance requires continuous operations at a retail site to remain eligible for licensing.

#### Non-Retail Activities

The non-retail process begins with the submittal of a pre-application to the CLO. Application materials are reviewed, and an on-site inspection also takes place at this stage. The pre-application process is designed to better prepare the applicant for the use permit process by pointing out potential areas of challenge and possible restrictions to their proposed operational activities. The pre-application process provides a critical filter to the Planning Department.

A total of 96 non-retail cannabis business have been issued licenses since the program's inception. Currently, there are 46 operational non-retail businesses, 45 of which have received their local license. One operational business is still working under a letter of local authorization as they continue to fulfill the conditions of approval for their site. There are currently four licenses applications which are pending state approval.

The composition of the 46 non-retail operational businesses is summarized below:

- 25 cultivation sites
- 6 cultivation-distribution combination licenses
- 1 manufacturing licenses
- 4 distribution licenses
- 1 processor license
- 1 processor-distribution combination license
- 1 manufacturing and distribution combination license
- 2 cultivation, manufacturing, and distribution combination license (1 license)
- 5 cultivation, distribution, and processor combination license

We have issued 58 cultivation licenses plus an additional 13 cultivation-combination

licenses since 2018.

**Table 1: Licenses by Supervisorial District**

Licenses	District 1	District 2	District 3	District 4	District 5
Non-Retail	8	23	0	13	1
Retail	7	2	0	0	2

**Table 2: Cannabis Licensing Activity**

Pre-Applications Received	Pre-Applications Processed	Use Permit Application Submitted to Planning	Use Permit Application Approved	Licenses Issued
0	0	0	36	96
				51 Licensees have shut down operations

#### Compliance Activities

Compliance activity is divided into two spheres and is conducted jointly by one CLO Code Compliance Investigator and two Detectives in the Sheriffs Office, with assistance as required from the Cannabis Licensing Manager. Currently, the one code compliance investigator focuses primarily on compliance of operating cannabis businesses through quarterly inspections or those in the preapplication process and responds to complaints, while the Detectives primarily investigate illegal cannabis activities, taking a proactive approach in investigating leads generated from a variety of sources. The two detectives assigned to cannabis enforcement were reassigned last fiscal year and are now working on the Fentanyl Crisis response Team. They work on an as needed basis with the CLO. Below is a summary of the activities for the first two quarters of FY 2024-25.

**Table 3: Cannabis Compliance Activity**

FY 2023-24 Quarter	Operators Inspected	Corrective Actions Issued	Citations Issued	Violations Issued
1	53	5	0	0
2	45	5	1	0
Summary	98	10	1	0

The code compliance activities peaked during the harvest season in the first and second quarter. Follow up to corrective actions and working with operators to close those issues dominated code compliance staff workload in the second quarter. This paired with multiple outdoor farms harvesting earlier in the season led to a decrease in inspections in the second quarter. Code Compliance staff corrective actions are primarily issued for small discrepancies in premise diagrams and other paperwork. There was one non-compliance issue in the first and second quarters, which resulted in the issuance of an administrative citation. There were no major non-compliance issues observed, therefore no Notice of Violations (NOVs) were issued.

Outreach at inspections typically includes educating operators on best practices as well

as compliance needs. We have reinstated inspections protocols to pre-COVID standards. Most operators have little to no changes during this year, but we have seen better compliance from our larger operators maintaining timely reporting in the State track and trace system.

Enforcement activities have declined to their lowest levels since program inception. Code Compliance staff investigated a complaint on a non-licensed parcel. The Sheriffs Office team investigated a non-licensed parcel. Neither investigation resulted in a search warrant or any enforcement actions.

#### Commercial Cannabis Activities in the C and M Zones

Activity within the C and M zones is limited to a total of 100,000 square feet. There are currently five licensed properties in these districts. There is currently one additional property within the C and M zones building out to meet their license requirements. The total potential canopy within these buildings could be 11,000 square feet. Only two of the six sites within these zones are cultivating. The remaining four sites are or will be completing manufacturing and distribution activities.

#### State Level Updates

The Department of Cannabis Control (DCC) has been working to get all provisional (temporary) state licenses transitioned to annual (permanent) licenses. This transition has affected many of our operators over the last 18 months. The Unified Cannabis Enforcement Taskforce and the DCC enforcement branches have been busy with enforcement activities in the Bay Area. They've been involved in multiple search warrants resulting in approximately 1,700 pounds of cannabis flower and 581 pounds of concentrate seized in November and December.

#### Regional Activities

The CLO continues to meet with the Central Coast Regional Cannabis Forum to share best practices, coordinate responses to the State agencies and gain insights from one another on cannabis activities and issues. This group includes representatives from Mendocino, Monterey, San Francisco, San Luis Obispo, San Mateo, Santa Barbara, Santa Cruz, Sonoma, and Yolo counties. The meetings have transitioned to bi-annual meetings with the larger group and quarterly meetings with new sub-committees. We are currently part of the legislative and regulatory subcommittee. This subcommittee includes outside legislative consultants as well as regulators. Our focus has been on upcoming legislation and assessing ways of working with legislatures on the draft bills they are submitting.

#### Financial Activities

The CLO continues to monitor its budget closely. Licensing revenues for FY 2024-25 were budgeted with the anticipation of an 80% renewal rate. Because the licensing process and use-permit process is not predictable, either in terms of timing or costs billed for services, the receipt of licensing revenues is irregular for any new non-retail licensing activities.

As of January 8, 2025, CLO expenses were \$250,244 to a budget of \$852,001. We are 50% through the year and have received 37% of budgeted revenues and expended 27% of budgeted costs. Total revenues received were \$131,490 against a budget of \$353,000. The budgeted revenues decrease is primarily due to the vast decrease in illegal activity resulting in fewer civil penalties being issued. The following chart shows the CLO budget status as of December 31, 2024.

**Table 4: Budget Data for Fiscal Year 2024-25**

CLO Budget	2023-24 Actual	2024-25 Budgeted	2024-25 YTD Actual	2024-25 Est. Act	2024-25 1/4ly Est. Act*	% of Act. To Bud Spent / Rcvd.
Licenses and other fees	292,840	200,000	131,290	200,000	100,000	65.65%
Civil Penalties / Code Enforcement	185,181	153,000	200	30,000	76,500	0.13%
Other Revenues	0	0	0		0	
<b>Total Financing</b>	<b>478,021</b>	<b>353,000</b>	<b>131,490</b>	<b>230,000</b>	<b>176,500</b>	<b>37.25%</b>
Salaries and Benefits	369,413	506,325	186,592	381,341	253,163	36.85%
Services and Supplies	103,042	345,676	58,678	327,462	172,838	16.97%
Fixed Assets						
Intrafund Transfers / Other charges	439,481		4,974			
<b>Total Expenses</b>	<b>911,936</b>	<b>852,001</b>	<b>250,244</b>	<b>708,803</b>	<b>426,001</b>	<b>29.37%</b>
<b>Financing - Expenses = Net County Cost</b>	<b>433,915</b>	<b>499,001</b>	<b>118,754</b>	<b>478,803</b>	<b>249,501</b>	<b>23.80%</b>

Note: Est. Actual is what we predict we will actually spend and receive this year, 1/4ly Est. Actual is total budgeted per quarter x number of quarters elapsed.

In addition, the CLO keeps track of the Cannabis Business Tax (CBT) revenues. We are 50% through the year and have received 47% of our budgeted revenues. Actual revenues of \$1,226,408 are 18% lower than last year at the same time or \$276,842 less. Revenues from retail sales are likely to decrease below estimates due to a change in state tax law which prohibits the inclusion of excise tax in the definition of gross receipts. This will reduce taxable retail sales by 15% beginning this calendar year. The following table shows the CBT revenues as of December 31, 2024.

**Table 5: Cannabis Business Tax Data for Fiscal Year 2024-25**

Taxes	2023-24 Actual	2024-25 Budgeted	2024-25 YTD Actual	2024-25 Est. Act	2024-25 1/4ly Est. Act*	% of Budget Rcvd. to Date	Last FY Rcvd. at Same Time	Variance LYTD to YTD
CBT Retail	2,124,650	2,158,282	1,035,708	1,985,708	1,079,141	47.99%	1,104,269	-6.21%
CBT Non-Retail	639,363	468,404	190,700	400,700	234,202	40.71%	398,981	-52.20%
<b>TOTAL</b>	<b>2,764,013</b>	<b>2,626,686</b>	<b>1,226,408</b>	<b>2,386,408</b>	<b>1,313,343</b>	<b>46.69%</b>	<b>1,503,250</b>	<b>-18.42%</b>

Note: Est. Actual is what we predict we will actually receive this year, 1/4ly Est. Actual is total budgeted per quarter x number of quarters elapsed.

## Financial Impact

The recommended actions to accept and file this report have no financial impact.

## Strategic Initiatives

Operational Plan - Comprehensive Health & Safety

## Submitted By:

Carlos Palacios

## 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.