



City of Emeryville

CALIFORNIA

MEMORANDUM

DATE: June 1, 2021
TO: Christine Daniel, City Manager
FROM: Charles S. Bryant, Community Development Director
SUBJECT: Cannabis Industry Expansion Study Session

RECOMMENDATION

Staff recommends that the City Council conduct a study session regarding policy topics related to expansion of the number of cannabis businesses in the City.

BACKGROUND

On April 4, 2017, the City Council adopted two separate ordinances to create a local regulatory framework that would create opportunities in Emeryville for the cannabis industry. The first ordinance, Ordinance No. 17-002, amended the City's Planning Regulations to create two cannabis use types: Cannabis Sales (a Commercial Retail use type), and Cannabis Manufacturing (an Industrial Manufacturing use type). Cannabis Sales includes businesses selling cannabis or cannabis products for off-site or on-site consumption (i.e. "retail/dispensaries" or "storefront retail"). Cannabis Manufacturing includes manufacturing, testing, distribution, transport, delivery, and research and development. Pursuant to the Planning Regulations, a cannabis business must obtain a conditional use permit from the City's Planning Commission prior to commencing operations. The second ordinance, Ordinance No. 17-003, codified as Chapter 28 of Title 5 of the Emeryville Municipal Code ("Chapter 28"), requires cannabis businesses to obtain an annual permit from the Police Chief, often referred to as an "Operator's Permit".

Except for an Operator's Permit for storefront retail, cannabis businesses may apply for their Operator's Permit after obtaining the conditional use permit from the Police Department. For storefront retail businesses, the ordinance provides that Operator's Permits are issued pursuant to regulations which were adopted by the City Council in Resolution No. 17-135 on September 5, 2017. The regulations provide that after issuing a Request for Qualifications (RFQ), the City Council may deem a storefront retail cannabis business qualified to obtain an Operator's Permit from the Police Chief.

On November 6, 2018, the voters of Emeryville adopted Measure S, approving a Cannabis Business Tax, by a margin of 84% in favor and 16% opposed. Pursuant to Resolution No. 18-154, adopted by the City Council on October 30, 2018, the initial tax rates applicable to cannabis businesses were established as follows:

Business Type	Tax Rate
Testing	1% of gross receipts, tax from gross receipts from testing of products produced in, or distributed from, Emeryville subject to rebate to testing business
Distribution	1% of gross receipts
Manufacturing	2% of gross receipts
Delivery	3% of gross receipts
Storefront Retail	3% of gross receipts

Ordinance No. 19-004, adopted by the City Council on March 19, 2019, amended Chapter 28 by removing a provision that required all commercial cannabis activity to be shielded from the public right of way. On April 7, 2020, the City Council adopted Ordinance No. 20-004 which further modified Chapter 28 to align the City's regulations with state law and to reflect then-current City practice. On April 6, 2021, the City Council adopted Ordinance No. 21-002 requiring holders of Operator's Permits to conduct a commercially reasonable level of sales in order to retain their Operator's Permits.

At its February 2, 2021 meeting, the City Council requested staff to bring forward a study session item to discuss the potential expansion of the cannabis industry in the City, focusing on the revenue potential of additional cannabis businesses, the obstacles faced by cannabis businesses interested in operating in Emeryville, and what potential measures the City could take to alleviate those obstacles.

DISCUSSION

State of the Cannabis Industry

According to the 2021 Marijuana Business Factbook, cannabis product sales in the United States are growing and this growth is expected to continue. Nationwide sales of cannabis products were estimated at between \$16.9 billion and \$20 billion in 2020 and are expected to range from \$22 billion to \$26.4 billion in 2021. Sales are projected to nearly double, to \$45.9 billion, by 2025. The industry employs an estimated 400,000 people full time, nationwide¹. As a comparison, according to the Brewers Association, the craft beer market in 2020 was \$22.2 billion and employed over 138,000². This growth trend is also reflected in state level data. In California, \$4.4 billion of cannabis products were sold in 2020, compared with \$2.8 billion in 2019 and \$1.4 billion in 2018³.

¹ MJBiz Daily, dated April 8, 2021 at <https://mjbizdaily.com/new-marijuana-business-factbook-projects-nearly-45-billion-us-market-by-2025/> Last visited May 5, 2021

² Brewers Association, dated April 6, 2021 at https://www.brewersassociation.org/press-releases/2020-craft-brewing-industry-production-report/#:~:text=The%20overall%20beer%20market*%20dropped,a%2014%25%20decrease%20from%202019 Last visited May 5, 2021

³ Schroyer, John and Long, Andrew. "Cannabis sales records smashed or set in 2020, and insiders expect the gains to continue". MJBiz Daily, dated January 22, 2021 at <https://mjbizdaily.com/cannabis-sales-records-smashed-or-set-in-2020-and-insiders-expect-the-gains-to-continue/> Last visited May 5, 2021.

The extraordinary growth of the cannabis industry is attributable to changing attitudes about the product, and this trend has been reflected in legislative actions over the past several years, which have opened additional markets and created regulatory structures allowing for adult use of cannabis. State and local governments have been the leaders in this policy arena, with California's adult use market launching in 2018.

State legislative activity around cannabis currently includes several bills that would fine tune the state's regulatory landscape. Examples include: Assembly Bill 273, which would limit how cannabis companies can advertise, principally focusing on billboards; Senate Bill ("SB") 59, which would extend provisional licenses that have been issued; SB 398, which would establish a state-operated cannabis licensing program for cities that do not operate their own; and potential language in an upcoming budget trailer bill that would allow cannabis companies to provide trade samples, similar to the current practice of alcohol producers.

Cannabis industry participants generally acknowledge that legislation at the Federal level is needed to support full maturation of the cannabis industry. United States Senate leadership is known to be working on legislation that would address cannabis' status as a "Schedule 1" substance under the Controlled Substances Act and issues related to banking. Depending on the outcome of these discussions, these policy changes could remove many of the barriers faced by cannabis businesses related to securing operating locations discussed further below. However, the prospects of this legislation are uncertain at this point.

The Local Cannabis Industry

The local regulatory and taxation framework resulting from the City Council's adoption of the ordinances and resolutions described in this report has resulted in an environment that is favorable to cannabis businesses located in Emeryville. Based on staff's communications with industry stakeholders, Emeryville is highly regarded in the cannabis industry for its approach to regulating cannabis businesses. Many cannabis businesses inquiring about space in Emeryville are seeking to relocate from adjacent jurisdictions that are viewed as less favorable to the industry due to regulations and permitting timelines. According to both existing and prospective businesses, on the dimensions of regulation and taxation, Emeryville is out-competing most of the cities in the region.

To date, the City has issued Conditional Use Permits for cannabis businesses at seven locations and issued seven Operator's Permits. Of the seven sites that received Conditional Use Permits, six remain in current use by cannabis businesses; and of the seven Operator's Permits issued, six remain in operation. The six businesses currently operating include three manufacturing businesses, two storefront retailers, one distributor, and one delivery service. The six businesses currently operating have generated a total of over \$841,000 in local revenues collected under Measure S as of April 30, 2021, which calculates to an average revenue generation rate of \$119,000 per quarter.

Staff continues to see strong interest and frequently receives inquiries from cannabis businesses interested in locating in Emeryville, however, for the reasons outlined below, most of these businesses have been unable to establish operations in the City.

Barriers to Expansion

Staff inquired with existing and prospective Emeryville cannabis businesses, landlords and commercial real estate brokers to gather information on real and perceived barriers to cannabis businesses looking to establish operations in Emeryville.

Unsurprisingly, the most frequently cited barrier expressed from businesses was limited availability of space. Reasons for limited availability include the City's relatively small inventory of suitable commercial spaces (as compared to neighboring cities) combined with high demand.

Compounding this issue, owners of available commercial properties are less likely to consider leasing to cannabis businesses than other types of businesses. Principally this is due to limitations on obtaining financing for commercial properties. Major financial institutions are unwilling to consider refinancing when the tenant is a cannabis business, which reduces the pool of financing providers to smaller community banks. According to owners and brokers, financing costs obtained through these banks are higher and therefore less attractive to property owners. Additionally, most commercial property owners have established relationships with their banks; establishing a new relationship with a community bank, at potentially higher costs, is a disincentive to transacting with cannabis businesses.

Additionally, even in some cases where financing relationships exist or the owner does not require financing, some owners remain opposed to cannabis. Staff is also aware of one prospective business that had commenced negotiations with a willing property owner but concerns of other tenants in and around the building caused the property owner to reconsider leasing to a cannabis business. This opposition appears to be due principally to the stigma associated with cannabis, and secondarily about concerns specific to cannabis operations including security risks, odors and traffic.

Finally, and in consideration of the above factors, strong demand for space from non-cannabis businesses further limits the number of available properties. When landlords are considering offers from multiple prospective tenants, there is a strong incentive to lease to the most established, creditworthy and simple to understand business, which is usually not a cannabis business. In many cases, owners are able to lease to prospective tenants that do not require conditional use permits for their businesses, which is more attractive to the property owner due to the time and documentation required to secure a conditional use permit.

In addition to space constraints, prospective storefront retail cannabis businesses face an additional barrier due to the requirement to be selected as qualified to obtain an

Operator's Permit pursuant to an RFQ process. This effectively limits the number of retail storefront businesses in the City.

For these reasons, cannabis businesses continue to have difficulty establishing operations in Emeryville despite the City's desirability as a business location.

Potential Interventions

In staff's view, most of the barriers outlined above are not Emeryville-specific, but rather are macro-level issues that the cannabis industry faces in every real estate market. Movement towards banking reforms, federal rescheduling, and general acceptance may address these barriers in the long run, and the City's ability to address these barriers is limited. Possible interventions that could prompt incremental change include:

Permit Streamlining

As noted above, the requirement for cannabis businesses to obtain a conditional use permit can be a minor disincentive for a landlord to lease to a cannabis business, particularly if other prospective tenants do not require conditional use permits. The City Council could consider further modification of the Planning Regulations to streamline the process for cannabis businesses under certain circumstances. An example could be to require cannabis businesses to obtain a "minor" conditional use permit, which does not require a public hearing before the Planning Commission, when the business is proposed to be located in a zone that does not include residential uses. This would reduce the time and costs associated with establishing a cannabis business in certain areas, which may help the cannabis businesses better compete with other uses for space.

Focused Outreach

While staff already works to communicate the City's support of the cannabis industry generally, these efforts could be formalized and enhanced by developing a focused campaign to normalize the commercial real estate community's attitudes towards the cannabis industry. Staff would work with industry participants to develop communication tools that highlight the City's support of the cannabis industry and address common misconceptions about the industry. Staff would use these tools to conduct systematic outreach with property owners, developers and commercial real estate professionals. This campaign could help convince property owners who are wary of (but not completely opposed to) leasing to cannabis businesses to consider these prospective tenants.

Incentives

Traditionally, incentives are provided to desired businesses in order to attract those businesses to a community as they compete against other locations. In contrast, the desired cannabis businesses are already incentivized to locate in Emeryville due to its location, regulations, and favorable tax rates; but property owners are reluctant to accommodate these businesses due to real and perceived risks, costs of financing, and stigma. To address this, the City could provide an incentive to property owners. One possible route could entail the use of economic development funds to target the reuse of underutilized commercial spaces specifically for cannabis business tenants. Some

commercial properties require high levels of investment to be put into productive use. Examples include properties that have obsolete tenant improvements and require significant building code upgrades or seismic retrofits, or buildings that are new and require basic infrastructure. The City could develop a program to provide grants and/or loans for space improvements if a landlord commits to leasing to an identified cannabis business for a minimum term and the cannabis business achieves certain revenue milestones. This type of program could motivate property owners to lease to cannabis businesses and put their buildings into more productive use. Any such program would require substantial additional analysis by staff.

Storefront Retail RFQ

As noted above, storefront retail businesses may only obtain Operator's Permits subsequent to a competitive RFQ process and evaluation by the City Council. It is possible that some retail-oriented commercial spaces may be controlled by owners that are open to leasing to cannabis businesses, but this is unknown due to the limited number of storefront retail operators actively searching for this type of space in Emeryville. Issuing an RFQ for one or more additional qualified operators would prompt these businesses to search for potential locations, and the process may result in additional retail storefront businesses.

FISCAL IMPACT

While this study session has no direct fiscal impact, the cannabis industry represents an important and growing contributor to the City's revenue base. To the extent the policy interventions discussed in this report are implemented in the future and are successful in reducing the obstacles to expansion of the cannabis industry in Emeryville, positive fiscal impacts would result.

STAFF COMMUNICATION WITH THE PUBLIC

The Economic Development Advisory Committee is scheduled to discuss the topics described in this report at its meeting on May 19, 2021; staff will include the EDAC's input in the presentation to the City Council on June 1, 2021. Additionally, staff intends to inform existing and prospective Emeryville cannabis businesses of the study session via email prior to the meeting.

CONCLUSION

Emeryville is an attractive place for cannabis businesses to locate, which has led to strong, sustained demand for locations that allow cannabis operations. Demand for cannabis business real estate far outstrips supply. Cannabis businesses are an important source of revenue for the City; consequently it is in the City's interest to facilitate the expansion of the industry in Emeryville. There are limited actions the City can take to address the underlying causes of the supply/demand imbalance discussed in this report; however staff has identified potential actions that could create incremental improvements for the City Council's consideration and further study.

PREPARED BY: Chadrick Smalley, Economic Development and Housing Manager

**APPROVED AND FORWARDED TO THE
CITY COUNCIL OF THE CITY OF EMERYVILLE:**



Christine Daniel, City Manager