

March 15, 2024

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Re: Cannabis Cultivation Tax Rate Memo 2024

The County of Sonoma has a robust cannabis industry sector, including a large number of cannabis cultivation businesses. The County's current cannabis tax (Measure A) assesses a tax on cultivators based upon the square footage of canopy area but allows the County to adjust the rate and/or to change the tax basis to gross receipts so long as the equivalent rate of the tax does not exceed the maximum allowed by the measure.

In recent years the County has been exploring ways to provide relief for cannabis growers. To assist with this discussion, in 2022 the County engaged the services of HdL Companies to conduct a revenue review of a sample set of cultivators to determine how they would be affected by a potential change in the tax basis. HdL reviewed a sample set of the County's cultivation businesses and used that information to prepare a fiscal analysis exploring the issues and considerations for changing the County's cultivation tax from square footage to gross receipts, including the impact to the businesses, the impacts on County revenues and any necessary administrative changes. The report was provided to the County on January 20, 2023 (the 2023 analysis) and included recommended tax rates and revenue estimates.

On May 23, 2023 the Board of Supervisors adopted Ordinance 6433 amending the County's Cannabis Business Tax Ordinance to adjust the cultivation tax rates in accordance with the findings of HdL's analysis. Following upon this action, the County requested that HdL provide an annual update to its tax rate analysis, which would include a discussion of general market trends and wholesale prices to determine how they affect the County's square-footage tax as a percentage of gross receipts. The purpose of the analysis would be to inform annual adjustments to the County's square-footage tax rates that result in a fairly equitable impact on gross receipts for each cultivation type.

This report seeks to determine prevailing wholesale prices for cannabis cultivators as reported by licensed cultivators within the County and to provide an update to comparable tax rates from around the state, as well as any other pertinent information that may be of interest to the County in considering changes to its cannabis tax rates.

Current Cannabis Cultivation Tax Rates

Sonoma County's cannabis tax is described in Chapter 35 of the Sonoma County Code, entitled Cannabis Business Tax Ordinance (the tax ordinance). The tax ordinance allows maximum square footage rates of up to \$10 per square foot of cannabis cultivation area for outdoor cultivation, up to \$22 per square foot for mixed-light cultivation and up to \$38 per square foot for indoor cultivation. The tax was implemented with initial rates of up to \$2 per square foot for outdoor cultivation, up to \$6.50 per square foot for mixed light and up to \$11.25 per square foot for indoor

cultivation. The County previously instituted differential rates for each cultivation type based on the size of the licensed cannabis cultivation area, with smaller operations paying one-half to one-third the rate of larger operations.

HdL's 2023 tax rate analysis found that the County's previous square-footage rates resulted in an inequitable tax burden depending upon the cultivation type, with outdoor cultivators paying a rate that was effectively more than 10-times higher than the rate paid by indoor or mixed-light cultivators, due to having only a single harvest per year and receiving a far lower market price. Our report recommended the County's square-footage rates should be set to be equivalent to a gross receipts rate of no lower than 1.00% and no higher than 2.50%. Based on our analysis, the County implemented new rates of \$0.75 for outdoor cultivation, \$3.00 for mixed-light, and \$12.50 for indoor cultivation. The history of the County's cultivation tax rates is shown in Figure 1, below.

Figure 1: Sonoma County Cultivation Tax Rates

	Maximum Rate/SF	Initial Rate/SF	Previous Rate/SF	Current Rate/SF
Outdoor Cultivation				
1C - Specialty Cottage	\$10.00	\$1.00	\$0.62	\$0.75
1 - Specialty	\$10.00	\$1.50	\$0.93	\$0.75
2 - Small	\$10.00	\$2.00	\$1.24	\$0.75
3 - Medium	\$10.00	\$2.00	\$1.24	\$0.75
Mixed-Light Cultivation				
1C - Specialty Cottage	\$22.00	\$2.25	\$1.39	\$3.00
1 - Specialty	\$22.00	\$4.50	\$2.78	\$3.00
2 - Small	\$22.00	\$6.50	\$4.02	\$3.00
3 - Medium	\$22.00	\$6.50	\$4.02	\$3.00
Indoor Cultivation				
1C - Specialty Cottage	\$38.00	\$3.75	\$2.32	\$12.50
1 - Specialty	\$38.00	\$7.50	\$4.64	\$12.50
2 - Small	\$38.00	\$11.25	\$6.96	\$12.50
3 - Medium	\$38.00	\$11.25	\$6.96	\$12.50

Rate Comparison

In Figure 2, below, we have provided a sample of cannabis cultivation tax rates from a number of comparable counties and cities around California. We have selected only cities and counties that have a reasonable number of cultivation licenses issued by the state of California to demonstrate rates that have not been considered prohibitive by the industry. We have updated this table from our 2023 analysis to include both the maximum rates allowed under each city or county ordinance and any changes since our previous report.

Along with Sonoma County, the counties of Humboldt, Monterey and Mendocino have all reduced their rates since our previous report. Humboldt County has temporarily suspended its cultivation tax in full, resulting in a 100% reduction of its tax rates for tax years 2023 and 2024. Monterey

County reduced its cultivation tax from the previous rates of \$2.50/sf, \$5.00/sf and \$8.00/sf (for outdoor, mixed-light and indoor cultivation, respectively) down to \$0.71/sf, \$1.46/sf and \$2.13/sf. Mendocino County reduced its rates from the previous 2.50% down to 1.25%. All other counties and cities listed below have maintained their rates as of yet, though we are aware that some cultivators in Ventura County have been lobbying for an unspecified rate reduction.

Figure 2: Selected Cannabis Cultivation Tax Rates

City or County	Maximum Rate			Previous Rates			Current Rates		
	Outdoor	Mixed-Light	Indoor	Outdoor	Mixed-Light	Indoor	Outdoor	Mixed-Light	Indoor
Humboldt County	\$1.00/sf	\$2.00/sf	\$3.00/sf	\$0.15/sf	\$0.30/sf	\$4.50/sf	\$0.00/sf	\$0.00/sf	\$0.00/sf
Monterey County	\$25.00/sf	\$25.00/sf	\$25.00/sf	\$2.50/sf	\$5.00/sf	\$8.00/sf	\$0.71/sf	\$1.46/sf	\$2.13/sf
Mendocino County	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	1.25%	1.25%	1.25%
Ventura County	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
City of Sacramento	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
City of Lompoc	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%
Santa Barbara County	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Yolo County	15.00%	15.00%	15.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Sonoma County	\$10.00/sf	\$22.00/sf	\$38.00/sf	\$1.24/sf	\$4.02/sf	\$6.96/sf	\$0.75/sf	\$3.00/sf	\$12.50/sf

sf = tax rate per square foot

% = tax rate as a percentage of gross receipts

Cultivator Questionnaire

For our analysis, HdL provided a questionnaire which was distributed to the County's cultivators. The questionnaire was a shorter version of the one provided for our 2023 analysis and sought information regarding each business's operations, including all of the following:

- The total square footage of their operations
- Cultivation type (indoor, outdoor, mixed-light)
- The highest, lowest and average prices received for flower (both large bud and small bud), leaf or trim, and fresh whole plant
- The volume of product sold for each of the above categories

A copy of the questionnaire is included within the appendix of this report.

Figure 3, below, compares the participants from our 2023 revenue analysis with those from our 2024 analysis. In both cases, the number of participants represented a very small sample set

compared with the total number of cannabis cultivation businesses in Sonoma County. Our 2023 analysis was based on just 7 participating cultivators, 3 of which cultivate indoors and 4 of which cultivate outdoors. No mixed-light cultivators participated in our 2023 analysis. For 2024, our sample set consists of 10 cultivators, including 5 indoor, 7 outdoor and 1 mixed light.

Figure 3: Participants by Cultivation Type and Size

Cultivation Type	2023			2024		
	#	%	Avg. SF	#	%	Avg. SF
Indoor	3	43%	12,673	5	38%	1,964
Outdoor	4	57%	23,620	7	54%	16,411
Mixed-Light	0	0%	-	1	8%	15,500

The average size of the participating cultivators for 2024 was significantly smaller than those who participated in our 2023 analysis. The average size for participating indoor cultivators in 2023 was 12,673 square feet, but this fell to a much smaller 1,964 square feet for 2024. The average size for outdoor cultivators was 23,620 square feet in 2023, but fell to 16,411 square feet for 2024. Our sample set for the 2023 analysis did not include any mixed-light cultivators, but our sample set for 2024 included just one, with 15,500 square feet of cultivation area.

The smaller average size of participating cultivators should not be presumed to indicate a decline in the average size of operations, overall. These figures are only indicative of those businesses which self-selected to participate in this analysis by filling out our questionnaire. The relatively smaller sizes could indicate that smaller growers were more inclined to participate, perhaps because they are more acutely impacted by current market conditions, including tax rates. We have attached the narrative comments provided by the participants in the Appendix, many of which speak to these issues.

HdL compiled the high price, low price and average price data reported by the respondents to the questionnaire for each of the product categories (large bud, small bud, leaf/trim and fresh whole plant) and according to the type of cultivation (indoor, outdoor or mixed-light). This data was compared with the similar data from our 2023 analysis and is shown in Figure 4, below.

Figure 4: Change in Prices Received Among Survey Participants; 2023 to 2024

	Category	Indoor Average			Mixed-Light Average			Outdoor Average		
		2023	2024	% Change	2023	2024	% Change	2023	2024	% Change
1	Flower, Large, High Price	\$1,954.00	\$1,360.00	-30.39%		\$900.00	N/A	\$400.00	\$637.00	59.29%
2	Flower, Large, Low Price	\$745.00	\$470.00	-36.91%		\$350.00	N/A	\$143.00	\$369.00	158.65%
3	Flower, Large, Avg. Price	\$1,230.00	\$942.00	-23.40%		\$600.00	N/A	\$308.00	\$462.00	50.29%
4	Flower, Smalls, High Price		\$520.00	N/A		\$250.00	N/A		\$206.00	N/A
5	Flower, Smalls, Low Price		\$180.00	N/A		\$100.00	N/A		\$144.00	N/A
6	Flower, Smalls, Avg. Price		\$370.00	N/A		\$150.00	N/A		\$163.00	N/A
7	Leaf/Trim High Price	\$40.00	\$21.00	-47.50%		\$35.00	N/A	\$82.00	\$17.00	-78.95%
8	Leaf/Trim Low Price	\$10.00	\$5.00	-50.00%		\$5.00	N/A	\$29.00	\$9.00	-69.19%
9	Leaf/Trim Avg. Price	\$25.00	\$11.00	-54.40%		\$20.00	N/A	\$39.00	\$14.00	-65.13%
10	Fresh Whole Plant High Price	\$333.00		N/A			N/A	\$134.00		N/A
11	Fresh Whole Plant Low Price	\$288.00		N/A			N/A	\$49.00		N/A
12	Fresh Whole Plant Avg. Price	\$310.00		N/A			N/A	\$102.00		N/A

The 2023 questionnaire would have incorporated both the premium large bud and the lesser-value small bud within the single category of “flower”. For this reason, we would generally assume that the price shown for large bud as a separate category in the 2024 responses would be significantly higher than the price for non-specific flower in 2023. We would also expect to see the greatest price difference for the low price received, as the 2024 responses include only the price for large bud and are not dragged down by including the lowest price for small bud. The data supports this assumption for outdoor large bud, with the low price increasing by far more than the high price. However, the average price for indoor large bud has fallen by over 23%.

The decline in price for indoor flower could be reflective of aggressive pricing by some of the largest mixed-light cultivators in the state who are exploiting their ability to compete with indoor cultivation on quality and consistency while competing with outdoor cultivation on operational costs. Some of these largest cultivators have been very open about their goal of reducing their cost of goods sold (COGS) to as low as \$100 per pound as a way to force the market down and increase their market share. Wholesale buyers may not be willing to pay as much as they did previously for similar product, forcing other growers to accept a significantly lower price.

As noted previously, the sample set for our 2023 analysis did not include any mixed-light cultivators so we do not have any past year data for comparison. Our 2024 data reflects only one participating cultivator, so we are unable to say whether the reported price data is indicative of other mixed-light cultivators, too.

We note that only one respondent to our 2024 questionnaire provided pricing data for cannabis harvested and sold as fresh whole plant. As with the single mixed-light cultivator mentioned above, a single data point cannot be used to indicate averages or trends, so there would be no way to know if that pricing data is representative or indicative of any other cultivators. While mixed-

light is a category for the County's tax purposes, fresh whole plant is not. For this reason, we chose not to include this figure in our analysis.

Figure 4 shows the range of prices received (high, low and average) for various product subcategories (large bud, small bud and leaf or trim) for indoor, mixed-light and outdoor cultivation. This is an important level of detail as the overall average price for each cultivation type must reflect the full range of prices for all saleable product. Determining the tax rate based only on the highest price received would give a falsely-inflated value.

To appropriately account for the range of prices received for large bud, small bud and leaf/trim, we have adjusted each of these based upon the percentage of the overall product yield represented by each subcategory. The average price per-pound for each subcategory is multiplied by the volume produced, in pounds. The total value of all subcategories is added together and then divided by the total volume in pounds to produce the volume-weighted average price. Figure 5 shows the weighted average price for all saleable cannabis by cultivation type.

Figure 5: Weighted Averages

Outdoor	\$277/lb
Mixed-Light	\$335/lb
Indoor	\$606/lb

The weighted averages shown above may seem at odds with the pricing information in Figure 4, especially for outdoor cultivation. Figure 4 shows the average price for outdoor flower as increasing by more than 50% year-over-year, from \$308/lb to \$462/lb, while Figure 5 shows a weighted average of just \$277/lb, reflecting a slight decline. This is largely due to the fact that the 2024 price shown in Figure 4 reflects only the premium large-bud flower, with the lower-priced small-bud flower being separated into its own category. In addition, the average price for outdoor leaf/trim has dropped significantly, by over 65%. When each subcategory is properly weighted by volume, the result shows a slight decline to \$277 per pound.

As noted, the methodology used for our 2024 analysis incorporates a number of changes from our 2023 analysis. These include distinguishing between large bud and small bud as separate product categories, and using weighted averages based upon the volume of product sold in each category. These changes were implemented partly in response to input from respondents to our 2023 questionnaire, as well as to information gathered from cultivators elsewhere in California.

We believe these changes provide a more discerning analysis, though we recognize that it makes for a less precise year-over-year comparison. However, the goal of our analysis is to provide the County with a range of tax rates that best reflect current prices for cultivators in the County, which we believe our revised methodology does.

Recommended Tax Rates

Using these weighted averages based on the actual reported pricing and volume from participating cultivators within the County, we can construct the applicable square footage tax rates to approximate a range of equivalent gross receipts rates. Our 2023 analysis recommended

that the County's rates should be set to be no lower than 1.00% and no higher than 2.50%, or their square footage equivalents. Using the same square-footage-to-gross-receipts conversion methodology from our previous analysis, we have provided the following range of square footage rates for the County's consideration.

Figures 6, 7 and 8, below, provide 3 sets of square footage rates to approximate equivalent gross receipts rates of 1.00%, 1.25% and 2.50%. Of these, the rates shown in Figure 8 would best approximate the County's current rates and would likely best approximate the same level of cannabis tax revenues.

The County's current rates for outdoor and mixed-light cultivation are \$0.75/sf and \$3.00/sf, respectively. The rates shown in Figure 8 would reduce these to \$0.69/sf and \$2.51/sf. More significantly, the rate for indoor cultivation would drop from \$12.50/sf to \$7.58.

Figure 6: Square Footage Equivalents for 1.00% Gross Receipts Rate

	A	B	C	D	E	F	G	H
Cultivation Type	Harvest Cycles/Year	Sample Area (sq ft)	Yield @ 1 lb/10 sf/cycle	Price per pound	Gross Receipts	Tax Rate % Gross Receipts	Total Annual Tax Paid	Tax Rate per SF
Indoor	5	10,000	5,000	\$606.00	\$3,030,000.00	1.00%	\$30,300.00	\$3.03
Mixed-Light	3	10,000	3,000	\$334.00	\$1,002,000.00	1.00%	\$10,020.00	\$1.00
Outdoor	1	10,000	1,000	\$277.00	\$277,000.00	1.00%	\$2,770.00	\$0.28

Figure 7: Square Footage Equivalents for 1.25% Gross Receipts Rate

	A	B	C	D	E	F	G	H
Cultivation Type	Harvest Cycles/Year	Sample Area (sq ft)	Yield @ 1 lb/10 sf/cycle	Price per pound	Gross Receipts	Tax Rate % Gross Receipts	Total Annual Tax Paid	Tax Rate per SF
Indoor	5	10,000	5,000	\$606.00	\$3,030,000	1.25%	\$37,875.00	\$3.79
Mixed-Light	3	10,000	3,000	\$334.00	\$1,002,000	1.25%	\$12,525.00	\$1.25
Outdoor	1	10,000	1,000	\$277.00	\$277,000	1.25%	\$3,463.00	\$0.35

Figure 8: Square Footage Equivalents for 2.50 % Gross Receipts Rate

	A	B	C	D	E	F	G	H
Cultivation Type	Harvest Cycles/Year	Sample Area (sq ft)	Yield @ 1 lb/10 sf/cycle	Price per pound	Gross Receipts	Tax Rate % Gross Receipts	Total Annual Tax Paid	Tax Rate per SF
Indoor	5	10,000	5,000	\$606.00	\$3,030,000.00	2.50%	\$75,750.00	\$7.58
Mixed-Light	3	10,000	3,000	\$334.00	\$1,002,000.00	2.50%	\$25,050.00	\$2.51
Outdoor	1	10,000	1,000	\$277.00	\$277,000.00	2.50%	\$6,925.00	\$0.69

Appendix:

Cultivator Questionnaire

Sonoma County Cannabis Cultivation Questionnaire

The County of Sonoma is requesting your participation in this questionnaire to help inform possible revisions to the County's cannabis cultivation tax to ensure the rates are reasonable, equitable and competitive with common rates within the Northern California region and around the state. Your participation is voluntary but is greatly appreciated. All information will be aggregated and anonymized to ensure confidentiality for your business.

General Business Information

Business Name	<input type="text"/>		
Contact Name	<input type="text"/>		
Contact Phone Number	<input type="text"/>		
Total Licensed Square Footage	<input type="text"/>		
Cultivation Type	Outdoor	Mixed-Light	Outdoor
Total square footage of flowering canopy per type	<input type="text"/>	<input type="text"/>	<input type="text"/>

Pricing Information

Please provide the highest, lowest and average wholesale price per pound received during calendar year 2023 for each of the categories listed below.

	High	Low	Average
Flower (large bud)	<input type="text"/>	<input type="text"/>	<input type="text"/>
Flower (smalls or popcorn)	<input type="text"/>	<input type="text"/>	<input type="text"/>
Leaf or trim	<input type="text"/>	<input type="text"/>	<input type="text"/>
Fresh whole plant	<input type="text"/>	<input type="text"/>	<input type="text"/>

Volume Information

Please provide the volume of product sold (in pounds) during calendar year 2023 for each of the categories below.

Flower (large bud)	<input type="text"/>
Flower (smalls or popcorn)	<input type="text"/>
Leaf or trim	<input type="text"/>
Fresh whole plant	<input type="text"/>

Additional Comments

We greatly appreciate any additional comments you can provide to help us understand your business, current industry trends, market conditions or any other information you believe may be relevant for our analysis.

Narrative Comments from Questionnaire Participants

Taxes need to be adjusted to a more sustainable formula for cultivators. We pay tax on SF whether we cultivate or not. High and unfair tax effect along with adverse market conditions are putting cultivators out of business. Please act to readjust the tax structure so we can continue to stay in business.

For small producer like us it makes no sense to work with anything but the top buds. Everything else goes to compost. There not much here at the current prices and the expenses we incur.

Getting payment is extremely difficult. We need to supply terms and those terms has already passed. We have collected only 75,000 with 300,000 outstanding. We have had issues getting investors on rumors how difficult Sonoma County has been.

Plus we were robbed and the County Ag only gave us a percentage off of what was stolen off of our taxes. This happened last year too. So we pay taxes on stolen products.

We are trying to survive! I'm willing to sit down with anyone to look how we can turn this around. I strongly believe that we should be taxed on what we sell not square feet. The way we grow is not full canopy so we are taxed even higher. There is no way to do our square feet and when I asked Maggie simply replied "I just pick up the wheel in open spots".

Our indoor and mixed light are not live yet, so all of the data is relative to the outdoor grow.

The market is extremely tough and what we are showcasing above is the tippy top of what the market will provide.

We have our own Consumer Product Goods (Eighths and Half Ounces), which averages us about \$900/lb. All bulk sales will range in the \$400-\$600 for outdoor flower. On very rare occasions, prices will be higher.

The prices on flower are what we have been offered, but not necessarily what we received on our sale

The questionnaire was complicated given our situation. Due to low market value of cannabis we arranged a deal with a manufacturer to create concentrate with our flower. 400 of the 650 pounds sold in 2023 we manufactured into concentrate and used in vape pens that we sold from our dispensary license.

When the indoor tax rates for cultivation were almost tripled from what they were, it came out to be just under a 9% effective annual tax rate of gross revenue from the prior year. As a small craft farmer these rates are extremely inequitable and unsustainable with all the other fees, taxes, etc. It only looks like the market is getting worse as well. All of my rooms were small and have been running on old equipment, so I'm trying to remodel to be more efficient as well as be able to compete, but it's pretty hard to pay for when I have no money to even pay myself a living wage. I have a business degree in accounting and I am on food stamps. That is wrong on so many levels.

Please consider: 1) A reasonable gross receipts tax or 2) A progressive tax such as how Federal income tax is calculated so that lower revenue businesses are not paying a higher effective tax rate than a higher revenue business would.

I really want to pay my fair share but these taxes are arbitrarily high. It also makes absolutely zero sense that outdoor cannabis seems to be at about \$400-\$600 per pound, roughly half of what indoor is per pound, yet indoor cannabis is taxed at 16.67 times (\$12.50/\$0.75) what outdoor is. Why is this?

