



Tuesday, September 20, 2022

Lompoc City Council
100 Civic Center Plaza
Lompoc, CA 93436

Re: Item 5 (Strategic Pause/Moratorium)

Good evening, Honorable Mayor, and members of City Council,

The retail market in Lompoc is under significant and increasing pressure as nearby jurisdictions actively pursue retail cannabis programs, including in the City of Guadalupe, as well as Orcutt, Los Alamos, and Santa Ynez. It would be prudent for Lompoc to limit the number of retail licenses.

According to our market research, the current population in Lompoc, relative to the number of legal retailers in the city, is less than optimal. Suppose the ratio of customers to retailers narrows further. In that case, your local operators will see a qualitative reduction in sales activity, followed by an inevitable diminution in taxable activity in the city.

There are numerous uncertainties in the cannabis industry in California. Those uncertainties are driven entirely by market forces.

The shrinking number of retail customers relative to the growing number of operators in our region, for example, is exacerbated by the continuing trend toward oversaturation. And this will continue as other jurisdictions begin their commercial retail cannabis approval processes, including Santa Maria, Buellton, Paso Robles, and eventually in other cities and unincorporated areas in San Luis Obispo County.

Today, there are over 1,400 dispensaries in California. And the state Legislature has a goal of two thousand dispensaries open by 2025. The state wants the tax revenues

from cannabis, and they seem to not care if they kill the golden goose to get it, even if it hurts cities and counties.

Lompoc should avoid the same mentality by nurturing its cannabis industry to thrive and continue generating healthy levels of local tax revenue. And this is made possible in the future by adopting a Strategic Pause today.

The local Industry's share of taxes since 2018 has been substantial. However, in the current ecosystem, the industry's ability to generate significant taxes depends on local operators' ability to generate significant sales, which is inextricably linked to operating in a limited licensed ecosystem.

By way of a slight digression, one of the most enduring challenges facing the industry is the illicit market. Meaning, consumers continue to have an available and cheaper option for purchasing cannabis products.

Lompoc's legal retail cannabis industry competes against illegal businesses that pay no local, state, or federal taxes. These illegal businesses also ignore local and state regulations, have no security protocols, offer zero community benefits, and pay nothing toward workers' compensation, health insurance, or retirement.

In numerous ways, these illicit actors are getting a free ride on the backs of the legal operators.

It should be no surprise that some consumers choose the black market to purchase cannabis when doing so means they avoid the costs associated with taxes, regulation, and compliance.

Unfortunately, what these consumers forget or ignore, is that they are buying an inferior and potentially unsafe product with the potential for ingesting dangerous chemicals that can cause harm to themselves. But the financial incentives are real.

The City Council should explore how much of the local tax contributions from the cannabis industry are being used to search out and shut down illegal operators in Lompoc. Has the city studied the black market and developed a strategy to shut it down? The return on investment would be substantial and more than pay for itself, not to mention the intrinsic value that would have on the city's existing legal market and the overall benefit to the public.

A BUYERS MARKET

A limited retail license market is of higher value to an operator, their customers, and the cities where the retail dispensary operates.

The value of a limited retail license market is exponential because, without it, there is no way to operate the business profitably due to the pressures that quickly form in an unlimited retail license market.

Every marketplace has a pie of intrinsic value. That pie is divided amongst the retail operators in the ecosystem. When the pie is divided into individual slices, some operators naturally figure out how to carve out a larger piece, while some end up with a smaller piece, while others end up with the smallest piece. This is the ruthless efficiency of the market in action. And we typically understand this to be a feature, not a bug.

However, when cannabis operators cannot achieve adequate sales to turn a profit, the operation loses money. If that occurs every day, they will, of course, sustain losses every day. So, this begs the question; how is this possible? Or perhaps more importantly for the city, why would a company do this?

The only businesses in this industry that can lose money every day to drive the limited sales they can achieve either have a ready amount of capital available to them or they are heavily leveraged and headed for financial disaster. But let's focus on the prior.

There is not a single local cannabis operator in this county that can afford to lose money on that scale. That means if an operator is willing to enter the Lompoc market knowing they will not achieve immediate profitability, it is because of certain factors they've already considered. One major factor is that they are interested in achieving a license to build a retail cannabis dispensary portfolio for future sales.

Operators understand that the smartest way to build a portfolio of retail licenses they can later sell is to acquire them at the lowest possible cost. These are typically fly-by-night operators who pursue shambolic buildouts with flaky business plans. They promise cities the moon to secure the license, but once they are in the door, what they deliver isn't what they promised.

Moreover, these types of operators often support their operations through illicit means. They attract criminal elements because the need to utilize whatever means necessary to sustain the business as it goes upside down 100k+ a month requires them to do so. This is not advantageous for the employees, the city, or the local community.

One fascinating aspect of the discussion over limiting retail licenses is the opinion that allowing an unlimited number of retail operators isn't all bad. It's great for consumers; after all. Competition drives down prices. And as consumers use their purchasing power to negotiate better prices, retail operators will inevitably agree to retain their customer base and to protect their market share. This drives down prices but also profits. And that subsequently reduces the amount of local taxes generated for the city.

So, while consumers win in this scenario, the operators lose, and eventually so will the city. And by the way, price wars can also change consumer habits regarding the regularity of their purchasing.

Instead of customers buying from a store weekly, they might decide to buy from a store bi-weekly or monthly. This change has ramifications on other local businesses. This is the multiplier effect in reverse. It will also impact a customer's overall loyalty to the retailer and the jurisdiction where they typically purchase their cannabis products. Instead of finding the best deal in Lompoc, now they're all about finding the best deal. So maybe it is in Santa Barbara, Orcutt, or soon, Guadalupe.

It cannot be overstated that a limited retail license market is superior to one that loses its calibrated market equilibrium. It's a delicate balance. We believe Lompoc should strive to achieve a calibrated market balance.

To that end, we urge the city to partner with the industry in working towards a carefully planned customer-to-operator market calibration. The Industry respectfully asks the city to implement a Strategic Pause to allow the city and the Industry to assess the condition of the current eco-system.

We believe a Strategic Pause will offer the city's cannabis industry a framework to establish a sensible, fair, and consistent standard by which the industry can thrive. And we believe providing the industry and the community-at-large the opportunity to have a framework to pursue this necessary exercise in restraint will accrue to the financial benefit of the industry, the city, and ultimately the economic and social welfare of the Lompoc community.

MORE WITH LESS

From the city's point of view, the optimal model is to receive more revenue with the least amount of regulatory and enforcement necessary. This is best achieved in a limited retail license environment. It is simply more advantageous for a city to receive more revenues while spending less resources on regulation and enforcement.

The cannabis industry has had a positive and productive relationship with the city of Lompoc. And so, I want to make the following point abundantly clear. Your local cannabis industry appreciates the respect Lompoc has shown it.

The city's program has provided the industry with the freedom and flexibility to open, operate, and grow. One of the concerns, however, is a scenario where because of an increase in the number of retail licenses in the city and the impacts and enforcement pressures associated with that, the city's resources for proper oversight will become more stretched and even more strained, which would inevitably impact the industry's ability to continue having the successful strategic partnership it currently has with the city. And that would be very unfortunate.

The industry believes regulatory oversight from the city accrues to the benefit of the existing retail operators, and for the city and its general fund departments. Most importantly, the industry believes it works well for the Lompoc community.

Lastly, another unintended consequence of a market with too many licensed retail operators is its effect on how those operators view and treat their competitors.

When the size of the economic pie is constantly shrinking, meaning sales are constantly declining, and profits are falling, tempers and frustrations rise. And dirty deeds can occur.

Many operators in the industry have witnessed and experienced dirty deeds, especially when prices are falling. Operators will slander other operators. They will even use social media to post bad reviews. In more extreme cases operators will recruit and pay people to sit outside their competitors stores and harass customers. It creates a negative vibe throughout the industry. It is regrettable but thankfully it is also easily avoidable. The solution is a limited retail license market.

Therefore, the industry respectfully asks the City Council to adopt a Strategic Pause tonight with the intent to study the costs and benefits and the pros and cons of limiting the number of retail licenses in the city. The industry believes this will offer the Lompoc cannabis industry a legal, regulatory, and market framework that is sensible, fair, and consistent with how the program was initially envisioned by the city council in 2017-18.

And we also believe this framework will accrue to the financial benefit of the industry, the city, and ultimately the economic and social welfare of the Lompoc community.

Thank you and we will be available tonight to answer any question should you have any.

Sincerely,

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Submitted on behalf of the following local operators:

