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REPORT TO COUNCIL

SUBJECT

Update and Direction on Commercial Cannabis-Related Items [Council Pillar: Promote and Enhance Economic and Housing Development]

BACKGROUND

The passage of Proposition 64, the Adult Use of Marijuana Act (AUMA), on November 8, 2016, legalized personal recreational use by persons 21 and over, and regulated commercial activities related to cannabis. Subsequently, the State legislature passed Senate Bill 94, the Medicinal and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA), unifying regulations on medical and non-medical commercial cannabis activities and the personal use of cannabis.

On November 21, 2017, the City Council adopted Ordinance No. 1973, which temporarily prohibited all commercial cannabis activity until January 1, 2019 and imposed reasonable restrictions on marijuana growth for personal use. This Ordinance was further amended on November 27, 2018 and May 21, 2019 to extend the temporary ban of all commercial cannabis activity until June 30, 2020.

As of January 2018, the State of California (“State”) began licensing of commercial activity, allowing for six general license types for commercial cannabis businesses: retail (including delivery); cultivation; manufacturing; transportation; distribution; and testing. Prior to the issuance of a State license, the State requires, among other items, a local license if local regulations have been enacted.

As a potential revenue enhancement vehicle, Council directed staff to prepare a ballot measure for November 2018 that would allow the City to collect a Cannabis Business Tax in the event commercial cannabis was permitted in the City. On July 16, 2018, Council adopted Resolutions No. 18-8569 and 18-8570 to call a Special Election to submit a Cannabis Business Tax ballot measure (“Measure M”) to the voters of Santa Clara. Measure M was passed with an approval of 76.7% of Santa Clara voters

on November 6, 2018. The voters authorized an initial tax rate on commercial cannabis businesses with a maximum rate of up to 10% of gross receipts and up to \$25 per square foot for cultivation and a starting tax rate of three to five percent of gross receipts in the event a commercial cannabis program was established in Santa Clara.

On February 19, 2019, staff presented Council with an update on work efforts related to developing a commercial cannabis regulatory framework and requested direction on key items such as the types of commercial cannabis licenses allowed, initial maximum number of retail storefronts allowed, frequency of collection of business tax, and allowable zoning designations to establish cannabis licenses. Council expressed some reservation in proceeding with the program and requested staff to bring back information on the impact of a potential commercial cannabis program on staffing resources, the history on Angel's Care, an unpermitted medical dispensary that was previously located in Santa Clara, the implementation and management of other cities' cannabis programs, cost analysis, and cash management.

DISCUSSION

Follow-Up Staff Response

Below is information in response to Council's February 19, 2019 request:

History on Angel's Care

Angel's Care was an unpermitted medical cannabis dispensary that operated from 2009 to 2013 at 891 Laurelwood Road. During that time, the Police Department received approximately 36 calls for service at the address. The calls were for a variety of reasons including, but not limited to, burglary alarms, area/security checks, drug related investigation, search warrant service, grand theft, and traffic stops in the parking lot. Most of the calls were resolved with warnings or minor citations for various traffic related issues. Santa Clara County Special Enforcement Team executed an illegal cannabis sales search warrant Angel's Care. The Santa Clara Police Department assisted with those efforts. In 2013, a police report was filed for grand theft from the safe of Angel's Care. The total loss from the grand theft was estimated to be in excess of \$40,000. No arrests were made in the case.

Impact on Public Safety Staffing Resources

Establishment of a commercial cannabis program will require staffing resources from multiple departments, including the City Attorney's Office, City Manager's Office, Community Development, Finance, Fire, and Police Departments. The Police Department will be the most impacted due to their involvement with monitoring licensed cannabis businesses, conducting inspections, enforcing regulations, and responding to any activities that might result from the presence of licensed cannabis businesses. The Police Department has prepared a Commercial Cannabis Monitoring and Enforcement Report (Attachment 1) that details the scope of their involvement if a commercial cannabis program is established. The report was prepared based on the assumption that Cannabis Business Permits will be issued for three retail storefronts (i.e. dispensaries) and includes a threat assessment, details about staffing needs, and recommendations for monitoring and enforcement requirements.

The Police Department's Community Response Team (CRT) will be primarily responsible for monitoring, inspecting, and enforcing any codes and regulations related to any commercial cannabis activity. Specifically, the CRT will need the following staff to enforce legal activities associated with a commercial cannabis program: 0.25 FTE Sergeant, 1.00 FTE Police Officer, and 0.75 FTE Community Service Officer II (2.00 FTE total). The total approximate annual cost for the 2.00 FTEs is

\$524,112 as approved in the Memorandum of Understanding for Bargaining Unit 2. While a Cannabis Business Permit regulatory fee will be full-cost recovery, that fee *will not cover* any additional work efforts associated with investigating and responding to illegal cannabis sales activities by unpermitted cannabis businesses, illegal narcotic organizations/groups, tax evasions, or other financial crimes. It also will not cover the cost of police response to associated or derivative criminal activity, such as theft. It is likely that those investigations will also require additional staffing resources from other departments, such as the City Attorney’s Office, City Manager’s Office and Finance Department.

Cost Analysis

The Commercial Cannabis Monitoring and Enforcement Report provides cost estimates for initial one-time program costs (\$36,472) and ongoing annual costs based on equipment, training, current salaries, benefits, and services (\$530,779) as detailed in the table below:

	One-Time Expense	Annual Cost
Personnel*	--	\$524,112
Training	\$3,800	\$3,800
Equipment, and corresponding Replacement Funds	\$32,672	\$2,700
Service Contracts	--	\$167
TOTAL	\$36,472	\$530,779

**Note: Assumes 0.25 FTE Police Sergeant, 1.0 FTE Police Officer, 0.75 FTE Community Service Officer II. Estimates subject to annual increases, as approved in the Memorandum of Understanding for Bargaining Unit 2*

Initial program costs include equipment and training. Ongoing annual costs include salaries, benefits, training, cell service, and vehicle maintenance. The annual cost for Police staff is projected to increase annually due to salary and benefits increases. These cost estimates do not include staffing and equipment costs for other impacted departments, such as the City Attorney’s Office, City Manager’s Office, Community Development, Finance, and Fire Departments. The implementation of a commercial cannabis program will also require staffing resources to review and approve applications and plans, conduct inspections, monitor and enforce the City’s regulations, and collect and review taxes.

In addition, the cost estimate above does not include costs associated with the staff resources required to address unpermitted (i.e., illegal) activity associated with the implementation of a cannabis program.

Cash Management

While the commercial cannabis industry was traditionally a cash-heavy industry due to many businesses’ hesitance to deposit profits into federally regulated banks, many businesses have since established relationships with banks or credit unions and, as a result, are able to accept payment from customers in the form of checks or credit cards. In turn, these businesses are now able to pay the taxes they owe to cities in the same manner. However, there may be some businesses that operate predominantly with cash and prefer to pay their regulatory fees and retail tax with cash. Most cities require cannabis businesses to make their payments on a set date of the month or quarter at their City Hall, sometimes with a security guard present. This additional expense can be paid for by the industry and incorporated into the calculation of the regulatory fee.

City of San José's Current Commercial Cannabis Program

The City of San José is currently the only city in Santa Clara County that allows all cannabis license types to operate in its jurisdiction. San José currently has 16 permitted cannabis businesses that include retail storefronts that can operate in different areas of the city, including its Light Industrial, Heavy Industrial, and Combined Industrial/Commercial zoning districts.

The San José Police Department's Division of Cannabis Regulations oversees the City's Cannabis Regulatory Program and is responsible for regulating, monitoring, and inspecting the permitted dispensaries in the City. The division consists of a civilian Division Manager (which is equivalent to a Lieutenant or Captain), a Sergeant, three Analysts, and an Office Specialist. The division had an annual budget of \$2.1 million in FY 2018/19 with the bulk of expenses being salaries and benefits, vehicles, training, office and equipment costs. Staff from other departments also provide support related to the program. For example, Code Enforcement is responsible for investigating illicit/criminal or non-registered dispensaries and grow operations while Finance is responsible for inspecting and regulating the dispensaries' financials. The Division of Cannabis Regulation has shared with our Police Department that criminal, non-registered dispensaries/delivery services and illegal grow operations that operate outside of the protection of the regulatory parameters are problematic because they do not have the police resources available for these types of criminal investigations.

San José's cannabis businesses are required to pay regulatory fees and quarterly tax payments set at 10% of gross receipts. The city's adopted FY 2019/20 budget projects revenue of \$13.5 million from its marijuana business tax, the same amount that was projected for FY 2018/19. Conversations with San José indicate that while the staffing requirement for their cannabis program can be funded through fees collected, additional resources must be in place to address illegal activity.

Implementation and Management of Other Cities' Commercial Cannabis Programs

Only a few other cities in Santa Clara County have either adopted cannabis regulations or had active City Council discussions regarding adoption of a regulatory framework in recent years. The jurisdictions that have implemented commercial cannabis programs have experienced much lower tax revenue than originally projected. Below is a summary of the status of regulatory programs in neighboring communities:

City of Campbell - Campbell had three cannabis related measures on their April 2017 ballot. Campbell voters approved Measure A, which authorized the City to impose a business tax on cannabis businesses. Measure B, which failed, was a citizens' initiative that would have allowed up to three cannabis dispensaries to operate in Campbell, the delivery of medical cannabis, the cultivation of medical cannabis, and imposed regulations on dispensaries and cultivation. Measure C was a measure that was referred to the ballot by their City Council to compete with Measure B that would continue the City of Campbell's ban on cannabis dispensaries until April 2019, at the earliest, and to allow their City Council discretion over Campbell's cannabis policies after that date. Measure C was approved by Campbell voters. On March 19, 2019, the Campbell City Council accepted an informational report from staff providing an update on State and municipal regulations on cannabis, but there has been no subsequent action to create a regulatory framework for commercial cannabis activity.

City of Morgan Hill - Morgan Hill currently prohibits commercial cannabis activities. However, since 2017, the City Council has discussed the benefits and impacts of a regulated cannabis program. In November 2018, Morgan Hill voters approved a tax revenue measure on all cannabis businesses. The approved rates are up to 10% of gross receipts and commercial cultivation at a maximum rate of

\$15 per square foot.

City of Mountain View - In Fall 2018, the Mountain View City Council adopted regulations that would permit a total of four cannabis businesses, consisting of two storefront retail and two non-storefront retailer businesses. In Spring 2019, the City Council amended their cannabis regulations to permit a maximum number of three non-storefront retail cannabis businesses in the City. All other cannabis businesses are prohibited in Mountain View. No cannabis business currently has permits to operate within the City of Mountain View.

City of Redwood City - On November 6, 2018, Redwood City voters passed Measure DD, Cannabis Business Tax, which imposes a gross receipts tax on cannabis businesses that operate or provide services within the City of Redwood City. Redwood City does not allow for retail storefronts. The permit process has taken much longer than anticipated because of State and local permit requirements. Of the six applications in process, one business is ready to begin deliveries. As a result, Redwood City has not yet received any revenue from the six businesses. Because the permit process requires significant staff time for review, the city is considering hiring an outside consultant to expedite the permit process.

City of San Leandro - San Leandro City Council adopted an ordinance on April 1, 2019 that enabled the city's three previously permitted medical cannabis dispensaries to conduct retail sales of cannabis for adult use beginning in January 2020. San Leandro has issued three cannabis dispensary permits and there are no further plans to issue additional licenses. The city collected less than \$300,000 in taxes based on its local 6% gross receipts tax. San Leandro originally projected \$500,000 in tax revenue per year.

City of Union City - The City Council in Union City adopted a resolution in November 2017 that allows three permits to be issued for the following types of commercial cannabis businesses: cultivation, manufacturing, distribution, testing, and medical dispensaries. The resolution does not allow for permits to be authorized for adult-use dispensaries. Union City held two application processes between 2018 and 2019. To date, no facilities have been opened. Two businesses received approvals and they have been working on meeting the conditions of the approvals. One of the two businesses was awarded their permit in November 2018 and anticipates opening its retail phase in June 2020. They have not confirmed dates for the cultivation, manufacturing and distribution phases. The second business is anticipated to open in September 2020.

Next Steps

It will take significant staffing resources to complete the development of a commercial cannabis program in Santa Clara. As presented at the February 19, 2019 Council meeting, there remains several ordinances and resolutions with key items that require further Council direction including:

- **Health and Safety Regulations:** These modifications to City Code would set the parameters for operating a commercial cannabis business in Santa Clara. They will determine the types of commercial cannabis licenses that would be allowed to operate, the number of licenses issued, and key business operations such as surveillance and security requirements, employee hiring and safety practices.
- **Business License Regulations:** These modifications to the City Code would set the parameters for which a business may apply and be selected to secure a Santa Clara license and the

requirements to maintain a license. A companion Resolution would detail the cannabis business license application and selection process, regulatory fees and cash management policy.

- Land Use Regulations: While Health and Safety Regulations define the manner in which commercial cannabis may operate, land use regulations set the parameters and conditions on where commercial cannabis activity is allowed. A companion CEQA analysis would also be required.

The State and local jurisdictions have not achieved the level of cannabis tax revenue as anticipated. As a result, these jurisdictions have been reducing their budget projections and have been examining the possibility of relaxing requirements to open and/or operate a commercial cannabis business.

As mentioned above, the current temporary ban on commercial cannabis activity will end on June 30, 2020. As such, a commercial cannabis program will need to be developed by that deadline unless Council provides other direction.

Given the staff effort necessary to prepare and outreach for potential regulations for Council consideration and the concurrent effort necessary to pursue alternative revenue enhancement opportunities for the November 2020 ballot, staff recommends instituting a permanent ban on cannabis activity.

ENVIRONMENTAL REVIEW

The action being considered does not constitute a “project” within the meaning of the California Environmental Quality Act (CEQA) pursuant to CEQA Guidelines section 15378(b)(5) in that it is a governmental organizational or administrative activity that will not result in direct or indirect changes in the environment.

FISCAL IMPACT

There is a no fiscal impact associated with the February 11, 2020 direction to staff other than administrative costs.

As a general estimate, in the past, municipalities expected to generate \$10-\$20 per capita on an annual basis. Applying this factor to Santa Clara, a local cannabis tax measure may generate \$1.2 to \$2.4 million annually. However, it should be noted that the amount of revenue generated for local jurisdictions with relatively new commercial cannabis programs has been less than their original projections.

COORDINATION

This report has been coordinated with the City Attorney’s Office and Police Department.

PUBLIC CONTACT

Public contact was made by posting the Council agenda on the City’s official-notice bulletin board outside City Hall Council Chambers. A complete agenda packet is available on the City’s website and in the City Clerk’s Office at least 72 hours prior to a Regular Meeting and 24 hours prior to a Special Meeting. A hard copy of any agenda report may be requested by contacting the City Clerk’s Office at (408) 615-2220, email clerk@santaclaraca.gov <<mailto:clerk@santaclaraca.gov>> or at the public information desk at any City of Santa Clara public library.

ALTERNATIVES

1. Direct staff to prepare an ordinance for Council consideration that will impose a permanent ban on all commercial cannabis activity;
2. Direct staff to develop the remaining ordinances and resolutions for Council consideration that together will form a policy framework to regulate commercial cannabis activity by June 30, 2020;
3. Direct staff to prepare an ordinance for Council consideration that will extend the temporary ban on all commercial cannabis activity until December 31, 2020;
4. Direct staff to develop the remaining ordinances and resolutions for Council consideration that together will form a policy framework to regulate commercial cannabis activity by December 31, 2020; or
5. Any other Council direction.

RECOMMENDATION

Alternative 1: Direct staff to prepare an ordinance for Council consideration that will impose a permanent ban on all commercial cannabis activity.

Reviewed by Ruth Mizobe Shikada, Assistant City Manager
Approved by Deanna J. Santana, City Manager

ATTACHMENTS

1. Commercial Cannabis Monitoring and Enforcement Report