



Agenda Report

18-637

Agenda Date: 7/16/2018

REPORT TO COUNCIL

SUBJECT

Actions Related to Revenue Opportunities for a November 2018 Ballot Measure - Cannabis Business Tax

EXECUTIVE SUMMARY

On July 5, 2018, following several months of public discussion regarding the City's fiscal outlook and the Council's interest in pursuing potential revenue options as one of several critical strategies to stabilize the City's 10-year fiscal outlook, the Council directed staff to bring back a measure related to a potential cannabis tax for further consideration and possible inclusion on the November 2018 ballot. This report outlines a recommendation for a ballot measure and ordinance which, with voter approval, could provide additional revenue to the City's General Fund.

BACKGROUND

During the January 2018 Council Goal Setting Session and the May 22, 2018 Fiscal Year 2018/19 Proposed Budget Study Session, the City Manager presented the City's 10-Year Fiscal Outlook which forecasts structural deficits over the next ten years. During the January session, the Council authorized staff to return with an analysis of revenue options and, by consensus, expressed support to commit to solve annual deficits with sustainable budget solutions such as on-going expenditure reductions, increases to current revenue sources, and/or identifying new revenue sources to stabilize the City's future fiscal condition.

On May 29, 2018, staff made a presentation to Council on potential revenue options aimed to stabilize the City's fiscal outlook to preserve service and staffing levels; generate more revenue to meet expenditure growth demand; and develop strategies for unfunded needs/projects. At the study session, Council considered several revenue options including:

1. Increase in the Transient Occupancy Tax (TOT) rate,
2. Increase in the Documentary Transfer Tax,
3. Establishment of a Utility User Tax (UUT),
4. Establishment of a Cannabis Tax, and/or
5. Establishment of an Infrastructure Parcel Tax.

Recognizing that both revenue and expenditure strategies are needed to balance future deficits, Council directed staff to proceed with analyzing two revenue options for the 2018 November Ballot and authorized the City Manager to enter into contracts to conduct the required community research and outreach:

1. Cannabis Tax
2. Infrastructure Bond Measure

Following the May 29, 2018 Council direction, staff began working with the Lew Edwards Group,

EMC Research and Public Dialogue Consortium to develop community outreach tools and to conduct research on the two potential revenue measures. A community research survey was developed and conducted in mid-June that included initial ballot measure language. Scientific focus groups were convened on June 28, 2018, to gather quantitative feedback.

The results of the research on the two Council-identified potential ballot measures were presented at the July 5, 2018 Council meeting. The research concluded that 65% of survey respondents agreed that the City had a need for additional funding and that 62% of the respondents expressed some level of support for a Cannabis Tax measure. Expressed priorities for use of new revenue included:

- Maintaining rapid 9-1-1 emergency response times (90% important)
- Prevent cuts to the number of firefighters and police officers (87% important)
- Repairing streets and fixing potholes (84% important)
- Maintaining essential city services (81% important)

Based upon the results, Council directed staff to pursue the Cannabis Tax measure for inclusion the November 2018 ballot with additional community meetings and the development of ballot language. Recognizing that this option could generate a level of revenue that would only partially address the projected FY 2019/20 shortfall, Council also indicated interest in preparing for possible additional tax measures as part of the November 2020 ballot.

Cannabis Business Tax

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.

As of January 2018, California State ("State") licensing of commercial activity, depending on license type, is overseen by the Bureau of Cannabis Control, the Department of Public Health, and the Department of Food and Agriculture. State regulations allow for six general license types for commercial cannabis enterprises: retail (including delivery); cultivation; manufacturing; transportation (microbusiness is included with transportation in license Type 12); 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.

In the interest of expanding revenue opportunities for the City, on September 26, 2017, Council directed staff to: 1) prepare cannabis regulations for future Council consideration; and 2) prepare a corresponding fee and tax strategy for commercial cannabis activity. On December 19, 2017, Council approved a contract with SCI Consulting Group ("SCI") to assist the City with the development of commercial cannabis regulations (Health & Safety and Land Use) together with a cost-recovery fee and tax strategy.

On January 23, 2018, the Council held a study session on commercial cannabis which in turn launched a work plan to create a policy framework to allow certain cannabis activity in Santa Clara and to create a new tax.

In February 2018, SCI engaged in education and community outreach efforts holding two community meetings and two stakeholder meetings. Presentations to the public included information about the history of cannabis; the cannabis industry; State of California cannabis licensing; work effort to create policy framework for potential City of Santa Clara cannabis regulations. In addition to these outreach meetings, staff visited two established cannabis businesses in San Jose. Cannabis activities in these businesses included: retail, indoor cultivation, distribution and delivery. In May and June 2018, two more community outreach meetings were held. Most recently, at a community meeting held on July 12, 2018, residents were asked for their feedback on several topics including a Cannabis Business Tax Measure.

Local commercial cannabis policy regularly has three separate bodies of regulations that together form the overall policy framework for the operation of commercial cannabis businesses in local jurisdictions. First, Health & Safety regulations set local time, place and manner parameters, and licensing regulations, on the businesses. Second, land use regulations set local parameters and conditions on the appropriate locations where various classes of cannabis businesses may operate. Staff anticipates that the health & safety and land use regulations will be brought forward in a Council study session in August with final Council consideration of regulations in September.

The third body of policy and regulations are fiscal in nature: the imposition of regulatory fees and the establishment of new taxing regulations. Regulatory fees may be charged to businesses seeking a license to operate in the City. The calculation of such a regulatory fee would include full cost recovery of all City staffing costs associated with the licensing activity including, but not limited to, processing, background checks, review, monitoring, inspection, etc. The calculation of the fee cannot include costs associated with general deterrence or enforcement activity for activities not directly associated with the license. The regulatory fees require analysis of projected costs, and a staff recommendation to set the fees will be brought forward for Council consideration in September/October.

Many municipalities in California have been or are in the process of pursuing an overall cannabis policy and taxing structure in order to generate taxes to enhance revenue. Redwood City, Mountain View, San Jose, Pasadena, Long Beach, and Oakland all have already or are in the process of formulating cannabis policies to allow for taxation.

California Constitution Article XIII C, Section 2, provides that no local government may increase any general tax unless submitted to the electorate and approved. In November 2016, there were more than 35 local measures on the ballot throughout the State of California relating to a cannabis tax. Taxation methodology on cannabis may be approached in several ways including: gross receipts, square footage, and/or inventory weight. (Most tax measures use gross receipts as the principal method to levy taxes.) Almost all of the more than 35 measures were passed by the voters. Unlike sales taxes, the local cannabis business tax would apply to all businesses - whether wholesaler, distributor, or retailer - regardless of whether or not they have a resale tax exemption.

A general tax measure, such as one Santa Clara is interested in pursuing, must be considered at a general election and requires a 50%+1 majority vote to pass. Funds generated by a general tax on commercial cannabis activity would be unrestricted and flow directly to the City's General Fund.

Potential tax measures must be forwarded to the Registrar of Voters 88 days prior to the November

election for placement on the ballot. As such, in order to place a measure entitled City of Santa Clara Commercial Cannabis Activity Measure which would authorize a Cannabis Business Tax onto November 6, 2018 ballot, the measure must be forwarded to the Registrar of Voters by August 10, 2018.

DISCUSSION

Prior to the effectiveness of regulations to legalize commercial cannabis in Santa Clara (health & safety and land use), a taxation system should be in place to ensure the City can generate funding for the General Fund. The proposed tax structure provides a responsible taxation system to generate new revenue for the City, while not taxing so highly that a black market on sales is encouraged.

Determining appropriate tax rates is important to the entire economic cycle of cannabis cultivation, manufacturing, and sale because a cumulative tax rate that is too high will drive the legal market underground. The City recognizes that cannabis businesses (and by extension, users of cannabis products) will be bearing initial costs to start up the local cannabis program as they adjust to the new legal environment and adhere to State and local regulations. As such, imposed tax rates are intended to secure funding for the needs of the community, while not overburdening the market.

Staff will continue to monitor the economic impact of the industry and its effect on overall business climate in the City to evaluate and report to Council. In the coming years, tracking and tracing industry trends will provide crucial data on gross revenues generated at various points within the supply chain, thereby enabling Council to be better informed as to the most appropriate taxation rates.

Recognizing the volatility of the newly-legalized cannabis market, staff recommends adoption of limited initial tax rates to balance the financial needs of the City with its desire to support this industry and the viability of the industry itself. With the uncertainty of the evolving industry both at the local and state level, retaining flexibility for Council to adopt policies that ensure a sustainable and responsible approach to management of cannabis businesses in our community is important.

To give the Council the ability to make future adjustments to the implementation and enforcement provisions of this business tax, and to respond to changes in state law governing the cannabis businesses operating in Santa Clara, but without putting additional measures on the ballot, the proposed ordinance gives the Council the authority to adopt by resolution, increases to the tax rates, once a year, so long as the increased rates do not exceed the maximum tax rates approved by the voters. The proposed ballot measure and ordinance would authorize the City Council to implement a business tax on commercial cannabis businesses of up to 10% of gross receipts and up to \$25 per square foot for cultivation. The measure provides the Council with the authority to determine implementation and operational oversight of the Cannabis Business Tax with community engagement.

The language of the proposed ballot question would read as follows:

MEASURE 1 City of Santa Clara Commercial Cannabis Activity Measure To	YES
maintain fiscal stability/essential city services, including rapid 911 emergency response times; preventing cuts to police officers/firefighters; repairing streets/potholes; maintaining library/youth/senior services, shall an ordinance be adopted establishing a tax on commercial cannabis up to 10% of gross receipts and up to \$25 per square foot for cultivation, generating approximately \$2,200,000 annually until ended by voters, with annual independent audits, and all funds used locally?	
	NO

The Ordinance to be submitted to the voters for approval is attached as Exhibit A to the Resolution. Key provisions of the proposed Ordinance are as follows:

The initial tax rates that will go into effect if the ballot measure passes on November 6, 2018 include:

- Retail: 5% of gross receipts
- Manufacturing: 5% of gross receipts
- Cultivation: \$6 per square foot of cultivation area or 5% of gross receipts, whichever is greater
- Distribution: 3% of gross receipts
- Nurseries: 3% of gross receipts
- Testing: 3% of gross receipts
- Transportation: 3% of gross receipts

Collection of the cannabis business tax would be done through the City's existing business tax process in the Department of Finance. Business tax is generally submitted annually; however, staff proposes the cannabis business tax be payable quarterly. Upon cessation of a business, any tax due would become due immediately. Failure to timely remit payment to the City, would result in a penalty of 10 percent plus 1 percent interest for the first month. If the period of delinquency exceeds one month, an additional penalty of 25 percent of the tax due, plus 1 percent interest per month after the first month, shall be assessed.

Cannabis Business Tax Ballot Measure

In order to place a Cannabis Business Tax measure on the November 2018 ballot, The Council must adopt resolution(s) submitting the question and setting applicable deadlines for Arguments, Rebuttals and the City Attorney's Impartial Analysis. Staff is recommending the adoption of three separate Resolutions. The Resolution submitting the proposed ballot measure includes a number of recitals stating the City's intent/purpose of the measure and the rationale for the imposition of a Cannabis Business Tax.

Ballot Measure and Introduction of Ordinance

Adoption of the recommended Resolution approves the ballot question and the proposed text of a Cannabis Business Tax Ordinance.

Once the measure is placed on the ballot, as a general tax, the measure requires approval from a

simple majority of voters. Per California Elections Code 9217, the Ordinance would be considered as adopted upon the date that the vote is declared by the legislative body and goes into effect 10 days after that date. However, since the land use ordinance will not be in place at that time, the effective date of the tax measure would be delayed until the effective date of the land use ordinance.

As previously mentioned, the deadline to submit a ballot measure to the Registrar of Voters for a Special Election is 5:00 pm on Friday, August 10, 2018.

Written Argument - Support or Against

If the City Council adopts the Resolution placing the measure on the ballot, it must determine whether it wishes to exercise its right to author and sign ballot arguments regarding the tax.

As with past practice, Council may wish to appoint three of its members to write and file the argument (not exceeding 300 words - Elections Code Section 9282).

If the Council chooses not to authorize any member(s) to write arguments, then any individual voter who is eligible to vote on the measure, or bona fide association of citizens, or any combination of voters and associations, may file a written argument for or against the Ordinance pursuant to Elections Code Section 9282. In this situation, the City Clerk will select an argument in favor of and against the measure for the ballot pamphlet in accordance with the priority order set forth in Elections Code Section 9287.

The deadline to submit ballot arguments to the City Clerk is noon on August 14, 2018.

Written Rebuttal Argument - Support or Against

The author or a majority of the authors of an argument relating to a City measure may prepare and submit a rebuttal argument (not exceeding 250 words) or may authorize in writing any other person or persons to prepare, submit, or sign the rebuttal arguments.

The deadline to submit a rebuttal argument in favor or against local ballot measures must be submitted to the City Clerk by noon on August 21, 2018.

Impartial Analysis

Under Elections Code Section 9280, at the direction of the City Council, the City Attorney "shall prepare an impartial analysis of the measure showing the effect of the measure on the existing law and the operation of the measure." The Impartial Analysis appears preceding the arguments for and against the measure in the voter's handbook and is limited to 500 words.

The deadline to submit the Impartial Analysis to the City Clerk is noon on August 21, 2018.

In order to reduce sample ballot costs, the full text of the proposed tax measure shall be available on the City's website and the City Attorney's Impartial Analysis will contain the following statement, "The full text of the measure is available at www.santaclaraca.gov or by calling the City Clerk's Office at 408-615-2220 and a copy will be sent to you at no cost."

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)(4) in that it is a

fiscal activity that does not involve any commitment to any specific project which may result in a potential significant impact on the environment.

FISCAL IMPACT

Because Santa Clara will hold a General Municipal Election November 6, 2018, there is an economy of scale with calling the Special Election for the same date.

The Registrar of Voters (ROV) has estimated costs for cities consolidating the General Municipal Election to be approximately \$366,605, and assumes one ballot measure. ROV has provided cities with an estimated cost for each additional ballot measure at \$90,800. There are other costs for conducting an election, including printing, translation services, publishing notices and other related costs.

Based upon these estimates, the City Clerk's Office has included costs associated with a General Municipal Election and two ballot measures in the Fiscal Year 2018/19 Operating Budget.

Following the election, the ROV will determine the actual costs and will bill the city for its pro-rata share. Should costs exceed the approved budget amount, staff will return to the council to request additional funds.

COORDINATION

This item has been coordinated with the City Clerk's Office and the City Attorney's Office.

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. Approve Recommended Actions 1-5
2. Modify Recommendation 4: designate an alternate committee to prepare Arguments and authorize the submittal of Arguments to the City Clerk

RECOMMENDATION

1. Adopt Resolution calling for a Special Municipal Election on November 6, 2018 for a vote on a ballot measure entitled City of Santa Clara Commercial Cannabis Activity Measure which would amend Title 3 "Revenue and Finance" of the Code of the City of Santa Clara adding a new Chapter 3.60 entitled "Cannabis Business Tax";
2. Adopt Resolution requesting the consolidation of a Special Municipal Election with the Statewide General Election to be held on November 6, 2018 for the purpose of submitting a ballot measure entitled City of Santa Clara Commercial Cannabis Activity Measure related Cannabis Business Tax;
3. Adopt Resolution ordering the submission of a ballot measure entitled City of Santa Clara Commercial Cannabis Activity Measure to qualified electors of the City related to Cannabis

Business Tax;

4. Authorize three members of the Council to author and submit an Argument in Favor of the ballot measure, and if necessary, a Rebuttal to an Argument Against the ballot measure; and,
5. Direct the City Attorney to prepare an Impartial Analysis for submission to the City Clerk.

Reviewed by: Ruth Shikada, Assistant City Manager

Approved by: Deanna J. Santana, City Manager

ATTACHMENTS

1. Resolution Calling for Special Election
2. Resolution Consolidating Election
3. Resolution Submitting Ballot Measure
4. Cannabis Business Tax Ordinance