



## Agenda Report

19-1149

Agenda Date: 2/19/2019

### REPORT TO COUNCIL

#### SUBJECT

Commercial Cannabis Policy Implementation Update

#### 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.

As of January 2018, State of California (State) licensing of commercial activity 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; 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, in 2017, Council directed staff to prepare cannabis regulations for future Council consideration and a corresponding fee and tax strategy for commercial cannabis activity. In addition, the Council approved a moratorium on commercial cannabis activity in order to allow for the development of local regulations. The temporary ban on all commercial cannabis activities in Santa Clara is currently in effect until June 30, 2019.

On December 19, 2017, Council approved an agreement with SCI Consulting Group (SCI) to assist the City with the development of commercial cannabis regulations together with a cost-recovery fee and tax strategy.

In early 2018, SCI and staff held community meetings and stakeholder meetings. Presentations to the public included information about the history of cannabis; the cannabis industry; State of California cannabis licensing; and creating a policy framework for potential City of Santa Clara cannabis regulations.

In addition to these outreach meetings, staff from several City Departments visited two established cannabis businesses in San Jose to better understand operational issues associated with retail; indoor cultivation; manufacturing; distribution; testing and delivery; and protocols/procedures related to security; surveillance systems; tracking of product and delivery vehicles; hiring and staffing; cash management; and nuisance issues (i.e. noise, parking, odor. etc.). Three additional outreach meetings were held between May and July 2018 to gather feedback from the community on the topic

and proposed regulations.

On July 5, 2018, Council directed staff to pursue a Cannabis Business Tax and to move forward with the development of ballot language. On July 16, 2018, Council adopted resolutions calling for a Special Municipal Election and the submission of a ballot measure (Measure M) which would authorize a new tax on commercial cannabis businesses.

Measure M was passed by 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. Measure M also provides the Council the authority to adopt increases to the tax rates once a year, so long as the increased rates do not exceed the maximum rates approved by the voters. The initial tax rates for the potential license types are:

- 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

The revenue generated from the Cannabis Business Tax will go to the City's General Fund to fund City services.

On January 16, 2019, California's three State cannabis licensing authorities announced that the Office of Administrative Law (OAL) approved State regulations for cannabis businesses across the supply chain. The new cannabis regulations were effective immediately. Staff has been working with SCI to develop the remaining City regulations, while ensuring compliance with these new State regulations.

## **DISCUSSION**

Over the past several months, staff and SCI have been working to prepare the remaining cannabis regulations for Council discussion and consideration. The remaining regulations fall under three principal areas: health and safety regulations; business license regulations; and land use regulations. The requisite regulations would require amendments to several sections of the City's Municipal Code including Title 8 (Health and Safety); Title 5 (Business Licenses and Regulations) and Title 18 (Zoning), with some details defined in corresponding resolutions. Summaries of the potential regulations are detailed below.

Staff is requesting direction from Council on key items before finalizing the remaining ordinances and resolutions that together will regulate the operation of commercial cannabis activities in Santa Clara.

### **Health and Safety Regulations**

The Health and Safety Regulations will set the parameters for operating commercial cannabis businesses in Santa Clara. They will determine the types of commercial cannabis licenses that will be allowed to operate, number of licenses issued, and key business operations such as surveillance and

security requirements, employee hiring and safety practices, and records of customers. The new regulations issued by the State will also define some of the parameters for operations.

After reviewing the cannabis licensing structures in other cities and viewing the operation of the Santa Clara businesses, staff's initial recommendation on several key points include:

**Uses** - Staff recommends allowing all types of commercial cannabis licenses (retail; manufacturing; cultivation (including nursery); distribution; testing; and transportation) to operate in the City and allow multiple commercial cannabis activities to occur on the same premise, as long as the licenses are approved and in compliance with the State. Staff is also recommending a carve-out that would prohibit outdoor cultivation and volatile manufacturing.

**Operations** - In addition to proposed modifications to Title 8 (Health and Safety), based on Council direction on the types of allowable business, staff will develop a companion resolution to define certain operational requirements for commercial cannabis businesses for future Council consideration. The amended Ordinance and Resolution will incorporate recommendations from the Police, Fire, and Finance Departments and the City Attorney's Office, and will address security requirements, hours of operation, requirements of personnel employed, among other operational logistics, to the extent allowable by State law.

Security requirements for all commercial cannabis businesses will be recommended to include a surveillance system that can be assessed by City personnel; fixed camera coverage at all portions of the premises and all points of sale areas; a retention period of no less than 90 calendar days for all camera video recordings; and copies of the recordings shall be provided within seven (7) business days to the City of Santa Clara, the Santa Clara Police Department, or any other law enforcement agency upon request. In addition, staff will be recommending specific requirements for each type of commercial cannabis business. Examples of recommended additional regulations for dispensary and retail businesses include requiring at least one registered security guard present during all hours of operation; requiring onsite personnel to monitor the premises to ensure that there is no onsite consumption of cannabis products; requiring a minimum of 40 hours of operation per week; and limiting the hours of operation to no earlier than 9 a.m. and no later than 9 p.m.

### **Business License Regulations**

The Business License Regulations will 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. These regulations include modifications to Title 5 (Business License and Regulations) and a companion resolution detailing the cannabis business license application and selection process, regulatory fees, and cash management policy.

While Measure M, which was passed by Santa Clara voters on November 6, 2018, allows a tax to be applied on commercial cannabis businesses, regulatory fees that are imposed on businesses seeking a license to operate in the City allows the City to recover costs related to implementing a Commercial Cannabis Program. It is important to note that the City cannot recover its costs for enforcing the City's regulations against non-licensed activity, given that no fees are collected.

Based upon the Council feedback on the types and number of business licenses to be allowed, SCI will finalize its work to calculate a regulatory fee for a Cannabis Business Permit. The fee is intended to be set at 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.

A cash management policy goes hand in hand with regulatory fees. Cannabis is still categorized as a Schedule I drug in federal courts yet many cannabis businesses have started establishing relationships with banks or credit unions and as result are able to accept payment from customers in the form of checks or credit cards. In turn, they are able to pay the taxes they owe the City in the same manner. The Cannabis Business Tax ordinance adopted by the City allows taxes to be collected either monthly or quarterly. This depends on the amount of revenue being generated from the businesses as well as staffing resources. Payments by businesses to the City in cash form may be made to a specified location or the City can explore the option of hiring an armed courier service to collect its taxes. This administrative expense can be paid for by the industry and incorporated into the calculation of the regulatory fee.

Based upon review of licensing policies of other cities and current staffing capacity, staff's initial recommendations include:

**Number of licenses** - New State regulations allow for deliveries from a licensed cannabis business to any other city or county. Only the jurisdiction issuing the business license for the delivery business (i.e. point of origin) will collect the generated business tax. Staff recommends allowing for an initial maximum of three (3) commercial storefront retail (and delivery) cannabis locations in the City until a commercial cannabis program is established and the City has data/metrics on revenue and operational issues such as City staffing and resource requirements associated with the implementation of a cannabis licensing program.

Storefront retail is anticipated to require a higher level of service demand for City resources in order to properly monitor and regulate activity (i.e. police, fire, and building inspections). Once the program has been established and data collected, staff can return to Council with additional recommendations, including possibly increasing the number of retail licenses.

Staff recommendation does not include a cap on the number of licenses issued for other allowable business categories that meet all State and other City requirements.

**Frequency of tax collection** - Allow taxes to be collected on a quarterly basis. Some jurisdictions collect taxes on a monthly basis. However, similar to Transient Occupancy Tax, staff is recommending collection on a quarterly basis. Once the program has been established and data collected, staff can return to Council with additional recommendations, including possibly increasing the frequency of tax reporting and collection.

### **Land Use Regulations**

While Health and Safety Regulations define the manner in which commercial cannabis may operate, land use regulations through Title 18 (Zoning) set the parameters and conditions on where commercial cannabis activity is allowed.

During stakeholder and outreach meetings, varying opinions were expressed as to where retail cannabis businesses should be allowed. Citing issues such as lack of visibility and accessibility by transit, cannabis industry stakeholders requested that the City consider allowing cannabis retail

beyond traditional industrial areas and within commercial areas, like that along El Camino Real. Several attendees at community meetings expressed concern about allowing commercial cannabis activities in proximity to residential areas.

Most jurisdictions with commercial cannabis activity (but not all) limit retail businesses to operate within industrial zones. By State law, commercial cannabis businesses are required to be located at least 600 feet away from schools, recreational centers, youth centers, and childcare facilities. Additionally, the State prohibits smoking, ingesting, or consuming cannabis on the premises of a commercial cannabis business or within 1,000 feet of the premises.

The attached maps (Attachment 1) reflect five different zoning maps as described below and reflect a State-mandated 600-foot buffer zone around schools, recreational centers, youth centers, and childcare facilities.

- Map #1 - Depicts allowable areas under Heavy Industrial Zoning Districts (MH) zone
- Map #2 - Depicts allowable areas under Heavy Industrial Zoning Districts (MH) and Light Industrial Zoning Districts (ML) zones
- Map #3 - Depicts allowable areas under Heavy Industrial Zoning Districts (MH); Light Industrial Zoning Districts (ML); and Planned Industrial (MP) zones
- Map #4 - Depicts allowable areas under Heavy Industrial Zoning Districts (MH); Light Industrial Zoning Districts (ML); Planned Industrial (MP); and Thoroughfare Commercial Zoning Districts (CT) zones
- Map #5 - Depicts allowable areas under Heavy Industrial Zoning Districts (MH); Light Industrial Zoning Districts (ML); Planned Industrial (MP); Thoroughfare Commercial Zoning Districts (CT); and Community Commercial Zoning Districts (CC) zones

**Zoning** - Staff's recommendation is to allow commercial cannabis activities in Heavy Industrial Zoning Districts (MH); Light Industrial Zoning Districts (ML); and Planned Industrial (MP) zones (Map #3) which limits activities to industrial areas of the City.

In order for Council to consider any zoning change, an environmental analysis under CEQA is required. Recognizing that CEQA analysis can study a project proposal that is larger than the ultimately approved project, SCI's subcontractor, Placeworks, prepared an Initial Study/Negative Declaration, which analyzes permitting commercial cannabis activity in all five zoning districts (Map #5).

After receiving City Council input on the recommended zones, staff will draft an Ordinance amending Title 18 for consideration by both the Planning Commission and City Council reflecting that direction.

#### Next Steps

Staff will distribute the Initial Study/Negative Declaration to commence the CEQA process and bring to Council draft Ordinances amending Title 5 (Business Licenses and Regulations), Title 8 (Health and Safety), Title 18 (Zoning), and Resolutions to establish the procedures for reviewing and selecting cannabis business license applications; establish a Cash Management Policy; and establish regulatory fees for a Cannabis Business License.

#### **FISCAL IMPACT**

While there is no fiscal impact associated with the February 19<sup>th</sup> direction to staff other than administrative time and expense, it should be noted that the amount of revenue generated for the State has been much less than projected. This situation has been highlighted in several recent news articles (Attachment 2), including the attached San Francisco Chronicle article in which the State Treasurer states that the State has received less than half of the \$185 million it was projected to generate in tax revenue from recreational cannabis in FY 18.

In an attempt to drive down black market sales, California lawmakers have introduced AB 286, which, if adopted, would reduce the State's 15% cannabis excise tax to 11% and eliminate a cultivation tax that growers pay for three years.

As a general rule of thumb, municipalities may expect to generate \$10 to \$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.

### **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. Prior to adoption of an ordinance, the Council will be asked to consider an Initial Study / Negative Declaration, which staff is currently preparing and which will be distributed for public review in the near future.

### **COORDINATION**

This report was coordinated with the City Attorney's Office and the Finance 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) <<mailto:clerk@santaclaraca.gov>> or at the public information desk at any City of Santa Clara public library.

### **RECOMMENDATION**

Provide direction to staff regarding cannabis regulations.

Reviewed by: Ruth Shikada, Assistant City Manager

Approved by: Deanna J. Santana, City Manager

### **ATTACHMENTS**

1. Zoning Maps
2. Cannabis Tax Revenue Articles