June 26, 2017

SUBJECT
Receive presentation on California Cannabis Legislation and Provide Direction on Proposed Actions for Redwood City

RECOMMENDATION
Review the information provided in this staff report regarding recent California cannabis legislation and its implications for local agencies, discuss the various options and staff recommendations presented, and provide direction to staff

BACKGROUND

Existing California State Cannabis Regulatory Framework – Medical and Recreational

In 2015, the California State Legislature passed the Medical Cannabis Regulation and Safety Act (MCRSA). MCRSA established a state licensing and regulatory framework for the cultivation, manufacture, transportation, storage, distribution and sale of medical cannabis. MCRSA requires applicants to have a local permit in order to obtain a state license to engage in medical cannabis business.

On November 8, 2016, voters passed Proposition 64, the Control, Regulate, and Tax Adult Use of Marijuana Act (AUMA). AUMA legalizes recreational cannabis use by adults age 21 and over, authorizes cultivation of up to six plants for personal consumption, and establishes a new state licensing and regulatory framework for the cultivation, manufacture, transportation, storage, distribution, sale and taxation of recreational cannabis. Proposition 64 was supported by 66.2 percent of Redwood City voters, and by 63 percent of voters in San Mateo County.

AUMA’s provisions legalizing consumption of cannabis and allowing personal cultivation took effect the day after the election. Under AUMA, smoking of cannabis is prohibited where the smoking of tobacco is prohibited. In Redwood City, smoking is prohibited in all enclosed public places within the City. AUMA provisions legalizing recreational cannabis businesses will not be operational until the State begins issuing licenses. The State is expected to begin issuing licenses by January 1, 2018.

While MCRSA requires applicants to have a local permit in order to obtain a state license to engage in medical cannabis business, AUMA does not require applicants to
have a local permit in order obtain a state license to engage in recreational cannabis business. Under AUMA, a state license can be issued unless prohibited by a local ordinance. Accordingly, local jurisdictions that wish to regulate or prohibit recreational cannabis businesses should do so before the State begins issuing licenses, either by enacting a recreational cannabis ordinance or by amending an existing medical cannabis ordinance (or other medical cannabis regulation) to include recreational cannabis within its scope.

Presently, Redwood City’s only regulation addressing cannabis-related activity is to prohibit medical cannabis distribution facilities in all zoning districts (see Zoning Ordinance Article 59). Delivery of medical cannabis is allowed, and is not subject to City business licenses obligations or any local taxes. City staff requested, from its sales tax consultant, a list of medical cannabis businesses that might deliver to Redwood City customers within a fifty-mile radius (Attachment 1); this produced a list of 48 potential medical cannabis delivery businesses in the region. The City currently has no way of tracking these businesses and their possible deliveries to Redwood City addresses.

Recent Change to California State Cannabis Regulatory Framework

On June 15, 2017, the California Legislature adopted its FY 2017-18 State Budget package. The package included a cannabis trailer bill. The bill incorporates numerous amendment requirements that the League of California Cities (LOCC) and the California Police Chiefs Association supported. The bill reconciles differences between AUMA and MCRSA and creates one regulatory system for all commercial cannabis activity, called the "Medicinal and Adult-Use of Cannabis Regulatory and Safety Act." The bill alters the structure of the cannabis industry and the responsibilities of various state and local agencies. For example, the bill requires local jurisdictions to provide State licensing agencies with a copy of any ordinance or regulation related to commercial cannabis activity and a contact to serve as a liaison between the state licensing entities and the local jurisdiction, and outlines a process by which locals and the state licensing authorities will communicate regarding an applicant for licensure. Notably, the bill clarifies that the state regulatory structure does not limit the authority of local agencies under any provision of law, including Section 7 of Article XI of the California Constitution.

Federal Cannabis Regulatory Framework

There remains significant uncertainty surrounding California’s cannabis legislation in light of the fact that possession and use of cannabis remains illegal under federal law. Under the Obama administration, the U.S. Department of Justice chose not to prosecute most cannabis users and businesses that follow state and local cannabis laws, if those laws were consistent with federal priorities such as preventing cannabis from being taken across state lines into jurisdictions where it is illegal. However, this federal policy could change in the future. While President Donald Trump has voiced support for medical cannabis in the past, U.S. Attorney General Jeff Sessions recently directed the Justice Department to evaluate its cannabis enforcement policy. Congress,
however, continues to limit the Attorney General’s ability to interfere with state medical cannabis laws by including provisions in government funding and budget bills that prevent the Justice Department’s funding from being used to prevent a state from implementing its own laws that authorize the use, distribution, possession or cultivation of medical cannabis. Ultimately, how the current Justice Department will handle federal cannabis enforcement policy as pertains to recreational cannabis remains to be seen.

Potential Countywide Cannabis Regulatory Framework

The Board of Supervisors for the County of San Mateo has recognized the potential benefits of considering cannabis regulation and/or taxation on a regional (county-wide) basis. To that end, the Board placed a temporary ban on cannabis-related businesses and directed County staff to work with local cities to consider a regional, coordinated effort and response to AUMA. The County has convened four working groups on cannabis issues. Redwood City staff has attended each working group meeting, although the working groups haven’t been as proactive as Redwood City staff had originally anticipated.

ANALYSIS

The City has several options for regulating cannabis cultivation, cannabis-related business activity, and fees and taxes charged in connection with cannabis-related activity. The City may also modify local tobacco smoking ordinances, which would also apply to cannabis smoking. Depending on the approach taken, the City may:

- Incur new staff obligations for regulation, inspection and enforcement; once such approaches are in place, ongoing costs potentially could be recovered through fees but the effort required to develop regulations and inspection and enforcement protocols would require prioritizing this initiative over other City priorities for staff time.
- Be eligible (but not guaranteed) to receive State grants for law enforcement, fire protection, or other local programs addressing the public health and safety impacts of cannabis. This would only occur if the City did not prohibit cultivation and retail sale of cannabis within the City.
- Be able to generate revenue through application of the City business license to medical and/or recreational cannabis activity.
- Be able to generate revenue through a voter-approved sales tax on recreational cannabis activity.

These options are further described below. Staff also provides a recommended approach for the City Council’s consideration, including community outreach, as very little input has been received to date from the community or from cannabis-related businesses. This approach was developed based on staff’s understanding of issues that have arisen in other states and communities related to medical and recreational
cannabis, and with the understanding that communities within San Mateo County currently are taking local, rather than a region-wide, approach to these issues.

A. Local Regulatory Options

1) Personal Recreational Cannabis Cultivation: Regulate Indoor and/or Ban or Regulate Outdoor

AUMA permits adults 21 years or older to plant up to six plants within a single private residence (i.e. a home, apartment, mobile home or similar dwelling). Property owners, including landlords, can prohibit cultivation on their property. Further, the City can reasonably regulate, but cannot ban, personal indoor cultivation, and can ban or regulate personal outdoor cultivation. If the City bans personal outdoor cultivation, it is ineligible to receive state grant monies funded through the state excise tax.

Accordingly, staff requests that Council consider whether it wishes to (a) regulate personal indoor cultivation and/or (b) regulate or ban personal outdoor cultivation.

For personal indoor cultivation, whether the building that houses the cultivation meets certain health and safety requirements is of concern in light of the increased electricity needed for indoor cultivation due to the lighting and temperature controls required. Fire prevention issues must be carefully addressed with indoor cultivation.

For personal outdoor cultivation, security and aesthetics are of concern if the cultivation is visible from other properties, especially the public right of way. Security is a particular concern if the cultivation is visible from other properties or the right of way, as cannabis plants have financial value and can easily be stolen.

2) Ban or Regulate Recreational Cannabis Business

AUMA establishes 19 different businesses license types pertaining to cultivation, manufacturing, testing, retail and distribution. One of the business license types is for a "microbusiness," meaning the licensee is vertically integrated and has the State's permission to cultivate and to act as a manufacturer, distributor, and/or retailer. Local jurisdictions may ban any or all of these license types. Local jurisdictions may also adopt business and/or land use regulations pertaining to any or all of these license types. If a local jurisdiction bans commercial cultivation or retail sale of cannabis, it is ineligible to receive state grant monies funded through the state excise tax.

Accordingly, staff requests that Council consider whether it wishes to ban or adopt business or land use regulations pertaining to cultivation, manufacturing, testing, retail sales and distribution.

Cultivation
AUMA establishes 14 license types pertaining to cultivation. The license types are based on the size of the cultivation area (ranging from less than 5,000 square feet to greater than 22,000 square feet) and whether the cultivation is indoor or outdoor.

The potential impacts associated with commercial cultivation depend on whether the cultivation is indoor or outdoor.

For indoor commercial cultivation, as with indoor personal cultivation, the primary concern is whether the building that houses the cultivation meets certain fire prevention and health and safety requirements in light of the increased electricity needed for indoor cultivation due to the lighting and temperature controls required. In addition, proper ventilation is important to control for odor and to reduce the risk of mold infecting the plants.

For outdoor commercial cultivation, security is of great concern if the cultivation is visible from other properties, especially the public right of way.

Impacts associated with both indoor and outdoor commercial cultivation include odor, pesticide use, and security. Impact on water quality is also a concern because if potting soil and mulch, fertilizers or pesticides are stored or applied improperly they can be mobilized by runoff from watering or rain and discharge into surface waters. On a commercial cultivation scale, this could potentially result in contamination of those waters and the inspection of water runoff from cultivation sites is paramount to prevent contamination.

**Manufacturing and Testing**

AUMA establishes three license types pertaining to manufacturing. Manufacturing of cannabis products can involve either the extraction of cannabinoids from the raw flower or the production of consumable goods made with cannabis extracts. For extraction, there are two subcategories: one using volatile solvents and one using non-volatile solvents. The use of volatile solvents can result in an increased risk of lab explosions.

AUMA establishes one license type pertaining to testing. An entity with a testing license would perform tests of cannabis or cannabis products. The State will inspect manufacturing facilities and develop laboratory standards for testing the concentration of and contamination in the products. The State will also develop compliance requirements, labeling and packaging standards, and products standards for all consumables.

Impacts associated with extraction, preparation of consumables, and testing include security issues, odor and building safety issues, particularly in the context of fire prevention standards.
**Distribution and Retail**

AUMA establishes two business license types pertaining to distribution and two business license types pertaining to retail. Distributors are engaged in the procurement, sale, and transport of cannabis and cannabis products between entities licensed to engage in recreational cannabis business. Retailers are engaged in retail sale and delivery of cannabis and cannabis products to customers.

AUMA authorizes a local jurisdiction to ban or regulate distribution and retail locations and/or deliveries within their borders. However, a local jurisdiction cannot prevent a licensed entity from using public roads to simply pass through its jurisdiction to a delivery location outside of its boundaries.

Impacts from distribution facilities and retail stores may include security issues, loitering, nuisance, driving under the influence, and odor from smoking. In addition, retail stores may generate conventional retail impacts on traffic and parking.

3) Ban or Regulate Medical Cannabis Business

MCRSA authorizes a local jurisdiction to ban or regulate all medical cannabis business within their borders, except that lawful transportation of cannabis through its jurisdiction cannot be prevented. Further, MCSRA requires applicants to have a local permit in order obtain a state license to engage in medical cannabis business. Therefore, inaction by a local jurisdiction is an effective ban (except medicinal cannabis deliveries must be explicitly prohibited).

Presently, Redwood City has adopted an ordinance banning medical cannabis distribution facilities in all zoning districts. The City has no other ordinance expressly allowing or banning other types of medical cannabis business, so medical cannabis deliveries are allowed.

Staff requests that Council consider whether it wishes to expressly ban or allow and regulate, through business or land use regulations, medical cannabis business pertaining to cultivation, manufacturing, testing, retail sales and distribution. The impacts of these types of medical cannabis businesses are the same as the impacts of recreational cannabis businesses discussed above.

4) Enact Local Taxes and/or Fees on Cannabis Business

Effective January 1, 2018, AUMA imposes a State excise tax at the rate of 15% of gross retail sales receipts of cannabis. Also effective January 1, 2018, AUMA imposes a separate cultivation tax on all harvested cannabis as follows: $9.25 per dry-weight ounce on all cannabis flowers and $2.75 per dry-weight ounce on all cannabis leaves. After reimbursing State agencies for the costs of regulation and implementation, $25 million of the tax revenue generated from the State taxes are allocated to earmarked sources, and the remaining tax revenue is distributed to youth programs, substance
abuse education, prevention and treatment. If cultivation and retail sales are not banned by a local jurisdiction, it is eligible, but not guaranteed, to receive state grant monies for law enforcement, fire protection, or other local programs addressing the public health and safety impacts of cannabis, funded through the State excise tax.

Local jurisdictions may impose their own taxes or fees on the privilege of cultivating, manufacturing, selling or distributing cannabis, except that AUMA prohibits imposition of local sales taxes on medical cannabis and AUMA exempts cannabis cultivated for personal use from taxation. Collection of such taxes is more complicated in situations where cannabis-related businesses conduct transactions in cash.

Accordingly, to the extent the Council directs staff to enact regulations allowing certain types of medical or recreational cannabis business in the jurisdiction, staff requests that the Council consider whether it wishes to impose local taxes or fees for each type of business. Any new cannabis tax must be approved by the voters (50% for general taxes and two-thirds for special taxes).

B. Staff Time Implications of Approaches

Depending on the approach taken, significant staff time could be required to develop land use policies and approaches to regulate, inspect, and enforce locally-established regulations. To some extent, policy development activity and issues that arise could be addressed through existing code enforcement, fire prevention, and law enforcement resources, however, these functions are already fully tasked and at times demand for services, such as code enforcement, exceeds staff capacity. As a result, adding to the workload to these functions is an important consideration.

Once policies and regulation mechanisms are in place, ongoing costs associated with these activities potentially could be recovered through fees but the effort required to develop regulations and inspection and enforcement protocols would require prioritizing this initiative over other City priorities for staff time.

C. Implications of General Smoking Ordinance on Cannabis Consumption

Under AUMA, smoking of cannabis is prohibited where the smoking of tobacco is prohibited. In Redwood City, smoking is prohibited in all enclosed public places within the City. Staff anticipates presenting an ordinance prohibiting smoking in multi-family housing for Council’s consideration in the upcoming months. Accordingly, the City’s adoption of any smoking ordinance will prohibit smoking of both tobacco and cannabis in the specified locations unless the City specifically exempts recreational and/or medical cannabis from that ordinance.

D. What Other Cities Around San Mateo County Are Doing
Cities in San Mateo County have had a broad spectrum of reactions to cannabis business. Several cities, including Belmont, Colma, and San Mateo, have opted not to allow cannabis businesses. Other cities, including Burlingame, East Palo Alto, Foster City, and Woodside have adopted interim bans with the intention to further research the issue. The rest of the cities are in the study phase or are considering allowing some commercial businesses within their jurisdiction. San Carlos and Half Moon Bay are considering regulations allowing cannabis businesses, including cultivation, manufacturing, and testing.

E. Staff Recommendations

In general, staff recommend that the City take limited steps to enable personal cultivation and receipt of cannabis-related products, and that the City apply the local business license tax to both medical and recreational cannabis activity. Staff believe the application of this tax is appropriate in recognition of the profits generated by this activity, and other communities have observed that taxing only recreational cannabis products can have the unintended consequence of encouraging recreational users to obtain cannabis-related products under medical cannabis provisions in order to avoid the tax.

Developing land use policies and inspection and enforcement mechanisms to regulate commercial cultivation, manufacturing, and sale of cannabis products would take a significant amount of staff time. At this time, staff does not believe this is a high priority for the business or residential community or the City Council, though the City Council has not yet discussed this topic and the community outreach process may provide a new understanding. To date, staff has not received inquiries regarding establishment of cannabis-related businesses in Redwood City. Unlike other communities in San Mateo County or other parts of the state, Redwood City currently does not have a significant agricultural base, so Redwood City may not be a likely location for commercial cultivation. Similarly, manufacturing and testing of cannabis-related products may be more likely activities in communities which have other scientific and manufacturing industries. In the future, should business interest arise, the City could consider development of land use policies and the associated inspection and enforcement activities.

Additionally, though allowing commercial cultivation is required for an agency to receive state grant monies funded through the state excise tax, the mechanism for distributing those funds has not been determined and is not guaranteed. As a result, it is conceivable that significant staff and City Council effort could be expended to establish regulations for activity that may not be desired by the residential or business community, and for which the City might not receive any state grant funds.

For these reasons, staff recommend the following approach for the City Council’s consideration. The proposed approach could be in place for a fixed period of time, such as through December 31, 2018, in order to assess market forces and community interest over time, and the City Council would retain the ability to extend or reverse the ban at any point. Staff recommends that public outreach be conducted to obtain
feedback on the proposed approach, if endorsed by the Council, and would return with recommended policies and regulations in October 2017 so that any necessary ordinances would be effective prior to January 1, 2018.

1) Personal Cultivation
   a) Limit indoor cultivation to six plants (cultivation of up to six plants is allowed under State law) and, if needed, consider amendments to City regulations if the resulting electrical requirements would likely exceed typical residential electrical capacity and potentially incur fire risk.
   b) Limit outdoor cultivation to six plants and require that plants not be visible from outside the property, including from the public right-of-way and neighboring properties.

2) Recreational Cannabis Business
   a) Ban commercial cultivation, manufacturing, testing, retail and distribution facilities.
      i. Should the City Council wish to consider allowing retail locations, staff would recommend limits on the number, size, location and operations of such businesses.
   b) Allow retail delivery of cannabis, but develop regulations to limit or eliminate cash transactions, require tracking and limits on the product delivered, and require businesses to obtain a City business license.

3) Medical Cannabis Business
   a) Continue to allow delivery of medical cannabis, but develop regulations to limit or eliminate cash transactions, require tracking and limits on the product delivered, and require businesses to obtain a City business license.

4) Local Taxes and/or Fees on Cannabis Business
   a) As noted above, apply business license fees to both medical and recreational cannabis sales in Redwood City or when delivered to Redwood City inhabitants.
   b) Consider proposing a local sales tax on recreational cannabis sales in the future; this could be actively considered for the 2018 election or addressed at another time. It would require voter approval (50% for general tax and 2/3 for special tax). The City cannot impose a sales tax on medical cannabis per state law; it may impose an excise tax on medical cannabis.
   c) If a physical retail sales location were allowed, establish a business license fee for the operator of the business. Licensing fees must be tied to anticipated regulatory costs (administrative costs of processing and issuing licenses/permits, investigations/inspections, and audits). Additionally, consider whether to establish a gross receipts business license tax, which would require voter approval.
   d) Should the City Council wish to consider allowing commercial cultivation, manufacturing and testing, staff recommends consideration of an excise tax on these activities, which would require voter approval.
5) Public Outreach
Prior to returning with proposed City cannabis regulations, staff recommends community outreach to provide for public input. The following steps are similar to those used with the outreach conducted recently on fee increases for development services.

a) Conducting all legally-required public notices and hearings
b) Establishing a City webpage that provides access to an online survey, proposed cannabis regulations, including information on the public process and a timeline for proposed adoption
c) Creating a cannabis City email address, which will allow the public to comment on proposed regulations, with comments shared with the Council
d) Conducting an online survey seeking community input on proposed cannabis regulation approaches
e) Drafting a post for the City’s weekly electronic newsletter with a hyperlink to the City’s cannabis webpage (eNews currently has 6,000 subscribers)
f) Drafting a post for the City’s social media platforms
g) Emailing information to medical marijuana delivery businesses with active business licenses on file, and include a hyperlink in the email to the City’s cannabis webpage
h) Presenting at the Chamber of Commerce, Redwood City Improvement Association, and Downtown Business Group (depending on Council direction regarding retail sales)
i) Providing information to Neighborhood Associations

Fiscal Impacts
The fiscal implications will vary depending upon the direction given to staff.

There are four potential revenue resources. First, if cultivation and retail sales are not banned by the City, it will eligible, but not guaranteed, to receive state grant monies for law enforcement, fire protection, or other local programs addressing public health and safety funded through the State excise tax. Second, the County or City may impose sales and use tax on recreational cannabis business or an excise tax on both medical and recreational cannabis. Third, the City may impose a business license fee on any individual or entity for the privilege of doing business in this jurisdiction. Lastly, the City may impose a gross receipts business tax.

There is no possibility of revenue if the City bans all cannabis activities.
ATTACHMENT

1. List of Medical Cannabis Dispensaries within a 50-Mile Radius of Redwood City