



Memorandum

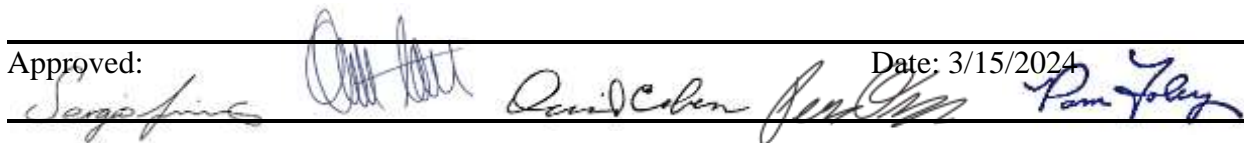
TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Councilmember Jimenez
Councilmember Torres
Councilmember Cohen
Councilmember Ortiz
Councilmember Foley

SUBJECT: SEE BELOW

DATE: March 15, 2024

Approved:

 Date: 3/15/2024

SUBJECT: Cannabis Business Regulations and Annual Operating Fee Comparisons

Recommendation:

1. Reduce the Cannabis Storefront Retail annual fee to \$30,000 per year and in future years allow a reasonable annual CPI adjustment, not to exceed 3%, to maintain cost recovery but not increase scope of regulation without an additional City Council vote.
2. In direct relation to the decrease of annual fee, align our city's regulations with state regulations, by identifying and eliminating duplicative and burdensome regulations within the San José Municipal Code. Staff is tasked to make the necessary cuts to the Division of Cannabis Regulation to make the program cost recovery within the lower fee structure and without shifting any cost to the General Fund.

Background:

Historical Context

Proposition 215, also known as the Compassionate Use Act of 1996, was a landmark California law enacted on November 5, 1996, through voter initiative, authorizing the use of medical cannabis. Medical marijuana was used by caregivers to assist AIDS patients in easing suffering and as palliative care. It passed with approximately 55.6% approval (5,382,915 votes for and 4,301,960 against). This act allowed patients with a valid doctor's recommendation, and their designated Primary Caregivers, to possess and cultivate marijuana for personal medical use, significantly impacting the legal framework around cannabis. Proposition 215 not only marked the beginning of legal medical marijuana in California but also set a precedent for state-level cannabis reforms across the United States, highlighting the tension between cities and states' rights and federal law.

During the Prop. 215 era, prior to the establishment of any local or state regulations, San José faced a situation where over 100 medical cannabis storefronts operated without any oversight. Under the stewardship of Mayor Reed and the City Council, it was recognized that there was an urgent need for structured regulation, therefore the City Council embarked on creating a legal framework to address this issue.

Registration and Compliance Timeline

In September 2013, the City acknowledged the necessity for regulation, leading to the development and approval of the Medical Marijuana Land Use Ordinance and the Medical Marijuana Regulatory Ordinance by June 2014. These ordinances aimed to establish control and set operational standards for medical cannabis establishments within the city. At the time, the State had not promulgated any regulations.

The city set a series of deadlines to streamline the registration and compliance process for cannabis collectives. Initially, all operating collectives were required to submit their registration applications by October 17, 2014, with 63 out of an estimated 90 cannabis collectives meeting this deadline. The next phase required these collectives to obtain a Zoning Code Verification Certificate by July 17, 2015, a milestone achieved by only 30 cannabis collectives. The compliance requirements were stringent, involving the submission of detailed building plans, payment of all Marijuana Business Taxes (past and present) and other fees, and the conducting of background checks. By November 20, 2015, the number of cannabis collectives still in the running had dwindled to 19, following additional screenings and compliance checks. On December 18, 2015, San Jose was left with only 16 cannabis collectives receiving the Notice of Complete Registration, allowing them to legally operate.

Financial Impact and Taxation

On November 2, 2010, Measure U was passed by San Jose voters, authorizing the city to impose a tax on all marijuana-related businesses. The Marijuana Business Tax (now Cannabis Business Tax or “CBT”) is levied at a rate of 10% of the gross receipts from all retail sales. In addition to retail sales, cannabis businesses pay a 3% tax on gross sales of all goods sold by their manufacturing operations and a 2% tax on gross sales of all goods transported by their distribution operations. The regulation of cannabis has had a notable financial impact on the city. Since its implementation, this tax has generated over \$50 million highlighting the economic benefit of the regulated cannabis industry to the municipal coffers. In 2023, the city received over \$15 million. This revenue supports various city services and underscores the importance of the cannabis sector as a contributing factor to the local economy.

Division of Cannabis Regulation (“DCR”)

In response to the evolving landscape of cannabis regulation, San José established the Division of Medical Marijuana Control within the Police Department in June 2016, which was later renamed the Division of Cannabis Regulation in January 2018. This Division, which started in the City Manager’s Office was moved to the Office of the Chief of Police, collaborates with various city departments to ensure that cannabis businesses comply with both local and state regulations. The Division's responsibilities include safeguarding community health and safety, accommodating the needs of medical patients, preventing the distribution of cannabis to minors, and implementing strong enforcement measures to prevent criminal enterprises from infiltrating

the cannabis market. This comprehensive regulatory approach underscores San José's commitment to a safe and well-regulated cannabis industry.

Legalization of Non-Medical Cannabis

On November 8, 2016, voters approved the legalization of non-medical cannabis for use by adults aged 21, with the passage of Proposition 64, the Control, Regulate and Tax Adult Use of Marijuana Act (“AUMA”). In San José, Proposition 64 passed in every City Council District. Continuing to be at the forefront of legalization and social justice, the San José City Council adopted local regulations accordingly. By November 14, 2017, the Council had authorized registered medical cannabis collectives to extend their operations to include non-medical, adult-use cannabis activities, effective beginning January 1, 2018 (when the State regulations would go into effect).

State Law and Regulations

In June of 2017, SB94, the Medicinal and Adult-Use Cannabis Regulation and Safety Act (“MAUCRSA”) was passed by the legislature and signed into law by Governor Brown. MAUCRSA incorporated many of the provisions of AUMA. MAUCRSA and its implementing regulations went into effect on January 1, 2018. The regulations are now found within California Code of Regulations Title 4, Division 19.

Analysis:

Duplication with the State

San José has been a pioneer in cannabis-related land use and regulations, leading the way before the State and most local jurisdictions. While being at the forefront has its advantages, it has also led to certain policies becoming outdated. The industry is evolving, and it is imperative that San José evolves with it to remain competitive.

It is our sentiment that the cannabis industry should be treated like any other business entity within the city. Last year alone, the legal cannabis industry contributed upwards of \$15 million in taxes. Given the uncertain financial outlook for city finances, it is crucial that we streamline operations and support the success of this industry, ensuring the continuation and growth of this vital tax revenue stream that helps to fund crucial services.

In a memorandum written by Councilmember Jimenez, dated October 19, 2023, to Public Safety, Finance and Strategic Support Committee (PSFSS), he suggested that we needed to conduct a deeper analysis to ensure city regulations around cannabis align with state regulations. To that end we have made some changes aligning operation hours with state regulations which was a sensible step that was adopted by the Council.

As staff begins to re-align their scope of work in relation to the decreased annual fee, we have identified several areas where changes seem sensible. In a comparison between the City of San José's cannabis regulations and those set by the State, we have identified specific areas where local ordinances may be duplicative or more burdensome than necessary compared to state regulations. Below is a breakdown of the duplicative City and State Regulations:

1. Surveillance Cameras

Current Regulation: Both the State (4 CCR §15044) and San José (SJMC Section 6.88.420.A and CMO Regulation 4-1.A) have similar regulations regarding the use of surveillance cameras.

Solution: Eliminate the city's duplicative regulations.

2. Burglar and Fire Alarms

Current Regulation: State regulation (4 CCR §15047) and city regulations (SJMC Section 6.88.420.B and CMO Regulations 4-1.B, 4-1.C) overlap, with the city requiring UL certification, which the industry considers onerous.

Solution: Remove the city's additional UL certification requirement.

3. Door Locks

Current Regulation: Similar regulations exist at the state level (4 CCR §15046) and within San José (SJMC Section 6.88.420.G-H and CMO Regulation 4-3.B).

Solution: Eliminate the city's duplicate regulations.

4. Security Guards

Current Regulation: State (4 CCR §15045) and City (SJMC Section 6.88.420.K) regulations overlap.

Solution: Eliminate the city's duplicative regulation.

5. Identification Badges

Current Regulation: State regulations allow businesses to issue their own identification badges, conflicting with SJMC Section 6.88.425.E and city practices. Also, the City badges do not comply with State regulations.

Solution: End the city's practice of issuing badges and update the local regulation to match state law.

6. Deliveries

Current Regulation: State regulations (4 CCR §§15414-15421) cover the same aspects as CMO Regulation 4-5.

Solution: Eliminate the City's regulation on deliveries.

7. Disciplinary Action:

Current Regulation: State (4 CCR §17808) and City (SJMC Section 6.88.490) regulations are similar.

Solution: Remove the City's duplicate regulation.

8. Record Maintenance:

Current Regulation: Overlaps between state (4 CCR §145037) and City (SJMC Section 6.88.500) regulations.

Solution: Eliminate the City's duplicate record-keeping requirements.

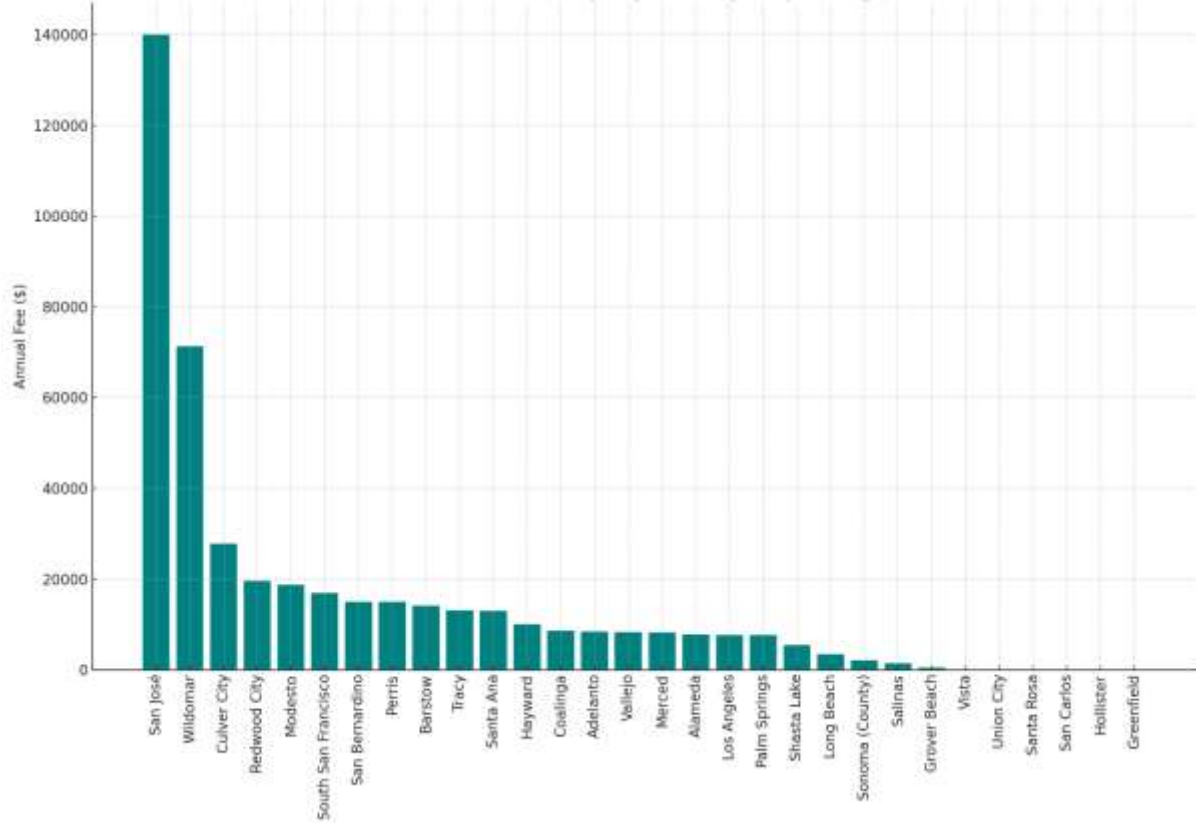
By removing these duplicative regulations, the DCR could refocus its efforts primarily on registering new cannabis businesses and renewing registrations along with ensuring compliance with age restrictions, particularly preventing sales to individuals under 21. This approach aims to streamline the regulatory process, reduce administrative burdens, and avoid any costs that might be shifted to the General Fund with the reduction of the annual fee.

Highest Fees in the State

San José has the highest annual fee structure and requirements compared to other jurisdictions. Since its inception no cannabis retailer has had its registration suspended (except recently for the failure to pay the CBT). On a comparative basis it appears that the current annual fees imposed on cannabis businesses by the DCR may be burdensome and excessive.

Below is a visual representation of San José's fees compared against local municipalities that allow and have operational cannabis **retail storefronts.**

Annual Cannabis Business Fees by City Including San José (Highest to Lowest)



Annual Cannabis Business Fees by City

City	Annual Fee
San José	\$139,000
Wildomar	\$71,307.80
Culver City	\$27,771.00
Redwood City	\$19,599.00
Modesto	\$18,732.00
South San Francisco	\$16,931.00
San Bernardino	\$15,015.55
Perris	\$15,008.45
Barstow	\$14,107.85
Tracy	\$13,100.00
Santa Ana	\$12,968.00
Hayward	\$10,000.00
Coalinga	\$8,576.00
Adelanto	\$8,460.00
Vallejo	\$8,288.00
Merced	\$8,209.00
Alameda	\$7,770.00
Los Angeles	\$7,691.00
Palm Springs	\$7,656.00
Shasta Lake	\$5,445.02

Long Beach	\$3,435.00
Sonoma (County)	\$2,163.00
Salinas	\$1,443.25
Grover Beach	\$500.00
Greenfield	Admin. Fee \$200.00 plus Actual Costs (\$5,000 initial deposit)
San Carlos	Actual cost with \$3,000 deposit
Hollister	\$0.00
Santa Rosa	\$0.00
Union City	\$0.00
Vista	\$0.00

We want to extend our gratitude to the staff for their diligent work on this issue and appreciate the active participation from the industry.

As we move forward, it is essential that we maintain a balanced approach that supports the growth and regulation of the cannabis industry while ensuring the safety and well-being of our community. A failure of the San José Cannabis Industry in succumbing to the illegal market is the worst possible outcome for the City of San José. We look forward to engaging in fruitful discussions and making informed decisions that reflect the evolving landscape of cannabis regulation.

The signers of this memorandum have not had, and will not have, any private conversation with any other member of the City Council, or that member's staff, concerning any action discussed in the memorandum, and that each signer's staff members have not had, and have been instructed not to have, any such conversation with any other member of the City Council or that member's staff.