



**DATE:** March 21, 2017

**TO:** Mayor and Council

**FROM:** City Attorney and City Manager

**SUBJECT** Medical Cannabis and Adult Use of Marijuana Work Session: Where Do We Go From Here?

### **RECOMMENDATION**

That Council reviews this report and provides guidance and direction to staff on the following questions:

1. Should cannabis businesses be permitted or prohibited in Hayward?
2. If cannabis businesses are permitted, should those businesses include both medical and adult recreational products?
3. If cannabis businesses are permitted, how many should be permitted, where should those businesses be located and within what sort of regulatory framework?
4. If cannabis businesses are permitted, how should transactions be taxed under Hayward's voter-approved Measure EE?

### **BACKGROUND**

The purpose of this report is to provide background and relevant information regarding the state and local regulatory framework for the medical use of marijuana/cannabis and the adult recreational use of marijuana. "Marijuana" and "cannabis" are synonymous terms for the same plant material and are used interchangeably in this report. There are three key legislative developments referenced in this report. Their acronyms (to which this report will frequently refer), titles and dates of enactment are as follows:

- MCRSA (Medical Cannabis Regulation and Safety Act, AB 266, AB 243, SB 643), enacted January 1, 2016
- AUMA (Adult Use of Marijuana Act – Proposition 64), enacted November 9, 2016
- Measure EE (City of Hayward Cannabis Tax), enacted November 8, 2016

Presently, MCRSA permits small amounts of marijuana to be cultivated and consumed for personal use. The City cannot prohibit personal cultivation and use of small amounts. The

City currently prohibits large scale medical marijuana cultivation and sales through exclusionary zoning regulations. The City must decide prior to January 1, 2018 if and how to regulate marijuana in the community, otherwise the State of California could issue AUMA licenses to Hayward applicants.

Similarly, AUMA permits small amounts of marijuana to be cultivated and consumed for personal use. The City cannot prohibit personal cultivation and use of small amounts, with minor exceptions. AUMA allows large scale cultivation, manufacturing, distribution, and sale ('seed to sale') to adults aged 21 years or older – effective January 1, 2018. The City must decide prior to January 1, 2018 if and how to regulate marijuana in the community, otherwise the State of California could issue AUMA licenses to Hayward applicants.

If the City decides to permit sales under MCRSA and/or AUMA, the City must decide if local taxes will be applied to such businesses, pursuant to Measure EE which Hayward voters approved November 8, 2016.

## **DISCUSSION**

### **A. MCRSA - Medical Marijuana**

MCRSA has been around in some form since California voters adopted Proposition 215 in 1996 – the Compassionate Care Act. Proposition 215 was poorly written and inconsistently administered at every level of government. In addition to its poor administration at the state and local level, the federal government used marijuana's Schedule 1 controlled substances classification to criminalize cultivation, sales and use. The federal government in the Obama Administration indicated its unwillingness to intervene in the cultivation, sales and use of marijuana, if states enacted comprehensive regulatory schemes. MCRSA is California's attempt at creating a comprehensive regulatory scheme. Under the Trump Administration, it is unclear if that administration will continue a 'hands-off' policy as articulated by the previous administration. California has given every indication at this point that it fully intends to administer MCRSA and AUMA, with regulations and licensing planned to be in place by January 1, 2018.

The City's current exclusionary zoning regulations prohibit MCRSA businesses. Even so, if the City intends to prohibit AUMA (recreational marijuana) businesses, such prohibition should also extend to MCRSA businesses as explained later in this report. The state will not issue MCRSA licenses to a business that does not have a City license. It is staff's further understanding that MCRSA will require patients to obtain new medical care cards to be able to purchase products after January 1, 2018.

MCRSA products, as medicinal products, are theoretically available to patients of all ages, but AUMA products, as recreational products, will only be available for adults 21 or older, similar to alcohol. This slight distinction is important because the state intends to have the same testing requirements for both products. This means a MCRSA business can easily convert its business model to include AUMA products – with the only distinction being the age of the customer and whether taxes are imposed on the AUMA and MCRSA products.

## B. AUMA – Recreational Marijuana

AUMA breaks new ground in California while presenting many new challenges, mainly whether the City prohibits or permits sales. The states of Oregon, Washington, Alaska, Colorado, and the District of Columbia, already have AUMA legislation in place. It is estimated that the “legal” marijuana business is now a multi-billion dollar enterprise, and growing. California will become the largest market when the state begins its licensing process in January 2018. The question for Hayward is whether to permit commercial operations associated with AUMA products. If the City chooses to prohibit commercial operations under AUMA, an ordinance must be affirmatively adopted and effective prior to January 1, 2018, otherwise the State of California could issue AUMA licenses to Hayward applicants.

Even if the City prohibits commercial marijuana operations, surrounding jurisdictions are likely to permit AUMA commercial operations, which may have impacts on the City. For example, in unincorporated Alameda County, there are two licensed medical marijuana distributors currently in place, with a third business under consideration. These ‘medical’ businesses could decide to expand their operations to include recreational sales under AUMA, and Hayward would not be able to prohibit the sales. Hayward would only be able to prohibit deliveries within the incorporated areas of the City. It is presumed that some Hayward residents are regular customers at these two county-licensed businesses in the unincorporated area. The cities of Berkeley, Oakland and San Leandro, along with the County, currently have fifteen licensed medical marijuana businesses, which could easily extend their business models to include AUMA products.

A perceived benefit of allowing AUMA sales is the contribution towards tax revenues to the City. Along with Hayward’s Measure EE, throughout the state, there were 36 other local marijuana/cannabis taxes voted upon in the November 2016 ballot. Measure EE allows the City to impose a tax of up to 15 percent, which could be in addition to any other state or regional taxes. This could mean that a \$1.00 transaction could be about \$1.45. The tax additions raise a legitimate question as to whether customers are willing to pay more for legal marijuana products than “black market” marijuana. This question does not have a definitive yes or no answer at this point. Legal marijuana will have been tracked and lab-tested, while black market marijuana will not have been tested or tracked and traced. Economic benefits and impacts are discussed later in this report.

In preparation for this report, City staff reached out to a local licensed medical marijuana distributor to better understand how different business models survive and thrive in a regulated market. The summary is attached as a case study (see Attachment II).

### C. Land Use Control Options

If the City chooses to permit MCRSA or AUMA businesses, or both, the best regulatory approach is to develop land use and zoning options to identify areas of the City most conducive to the various aspects of the businesses on the continuum from cultivation to consumption, while immunizing impacts to residential areas and youth. For example, indoor cultivation – that is, growing the crop – might fit best in industrial zones. Converting crop to smokable products, topicals or edibles could be located in industrial or manufacturing areas. Warehousing and distribution could similarly be situated in industrial or manufacturing zones. Retail sales mostly likely would fit in commercial zones. It is not envisioned that outdoor cultivation or any business activity would be permitted in residential zones.

In addition to zoning controls, conditional use permits (“CUP”) would provide for public hearing input and a level of discretionary review requiring certain findings to be made. CUPs might be preferred over Administrative Use Permits (“AUP”). AUPs are issued by staff, though AUPs may be referred to or appealed to the planning commission. Separation requirements between businesses and other sensitive users is not uncommon. AUMA already prohibits businesses from locating within 1000 feet of schools.

Land use regulations require staff time to develop and hearings before the Planning Commission hearings before the Council can consider them. Ideally, the Council should receive the final staff and Planning Commission recommendations before the summer recess. This timing would allow Council to enact new regulations prior to January 1, 2018.

### D. Regulatory Ordinances

Presently, there are eighteen licensed medical marijuana retailers in Alameda County – six in Berkeley, seven in Oakland, two in San Leandro (with a third pending) and two in unincorporated Alameda County (with ‘Hayward’ addresses).

All local jurisdictions that allow MCRSA businesses have adopted regulatory ordinances unique to these kinds of business models. These ordinances require ownership disclosures and backgrounds of the owners and employees, hours of operations, security requirements, signage and lighting controls on air emissions, inventory controls and financial practices, license review, inspections and revocation and so on. These requirements would be in addition to the state licensing requirements under MCRSA and AUMA.

Some jurisdictions have established by policy a limit on the number of MCRSA businesses allowed – San Leandro has a maximum of three MCRSA businesses (two are in operation), while unincorporated Alameda County also permits three (two are in operation). With this approach, jurisdictions often invite requests for qualifications to vet potential businesses before selecting an operator. Other jurisdictions use land use controls and separation requirements, which by their nature tend to limit the number of such businesses. The vetting approach would increase the likelihood a legitimately operated business would exist.

If the Council is inclined to permit marijuana businesses, a regulatory ordinance should be developed and submitted for Council consideration prior to the summer recess to ensure all ordinances are in place prior to the January 1, 2018 statewide rollout. In order to develop regulations for consideration, staff has developed the following questions for Council discussion:

1. Should cannabis businesses be permitted or prohibited in Hayward?
2. If cannabis businesses are permitted, should those businesses include both medical and adult recreational products?
3. If cannabis businesses are permitted, how many should be permitted, where should those businesses be located and within what sort of regulatory framework?
4. If cannabis businesses are permitted, how should transactions be taxed under Hayward's voter-approved Measure EE?

#### E. Benefits/Detriments of Cannabis/Marijuana

It is not the purpose of this report to exhaustively address the benefits of cannabis, either medical or recreational, given that both forms of cannabis have been legalized in California and many other states and the District of Columbia. It is fair to say, however, that limited empirical research exists because cannabis has been a federally-controlled substance with very little funding or authorization for mainstream research organizations. A recent compilation of available research was published by the National Academies of Sciences, Engineering and Medicine, probably the most unbiased such document produced to date by researchers working under the auspices of the federal government (a summary of this document is attached – see Attachment 4). This document reveals the pros and cons of regular cannabis use. As medical and recreational cannabis is introduced into the mainstream population, more research will clearly be undertaken to prove or disprove prevailing theories about the benefits and detriments of regular or long-term use.

#### F. Law Enforcement Concerns

Consumption of marijuana already presents challenges to law enforcement within the context of driving while impaired (DWI). There is no question but that marijuana consumption can negatively affect the ability to drive safely. However, there is no current legal standard as there is for alcohol – that is, blood alcohol content of .08 (8/100) is a fixed standard warranting arrest. Marijuana consumption, on the other hand, requires law enforcement to look for behaviors such as driving and weaving, falling asleep while stopped, slurred speech, unbalanced gait, and so on. An effort is underway legislatively and through research to reach a consensus on this point, but there is no conclusive agreement at this time. In other words, AUMA will add to the burden on law enforcement generally and of course in Hayward. AUMA will direct some funding to law enforcement for DWI, unless a jurisdiction has prohibited such businesses.

Legal cannabis will not eliminate the underground/black market. Consequently, law enforcement will continue to deal with drug trafficking at all levels of government.

As a matter of reference, in September 2016, the Rocky Mountain High Intensity Drug Trafficking Area (RMHIDTA) issued a comprehensive report, 'The Legalization of Marijuana in Colorado - The Impact, Volume 4,' which examines the effects of marijuana legalization in Colorado and makes a comparison over three time periods in the state. This report, which is available at [www.rmhidta.org](http://www.rmhidta.org), is deemed by many law enforcement agencies as the definitive source related to marijuana and its effects in Colorado. The report focuses on the following areas, summarized below: (1) impaired driving, (2) youth marijuana use, (3) adult marijuana use, (4) emergency room admissions, (5) marijuana-related exposure cases, and (5) diversion of Colorado marijuana.

### Impaired Driving

The report indicates that in Colorado, marijuana-related traffic deaths increased 48 percent in the three-year average since Colorado legalized recreational marijuana compared to the three-year average prior to legalization. During that same time, all traffic deaths increased by 11 percent. Additionally, the report noted that marijuana related traffic deaths increased 62 percent from 71 to 115 persons after recreational marijuana was legalized in 2013.

### Youth Marijuana Use

Youth marijuana use increased 20 percent in the two-year average (2013/2014) since Colorado legalized recreational marijuana compared to the two-year average prior to legalization (2011/2012). Nationally, youth marijuana use declined 4 percent during the same time period. Additionally, college-age marijuana use increased 17 percent in the two-year average (2013/2014) since Colorado legalized recreational marijuana compared to the two-year average prior to legalization (2011/2012).

### Emergency Use Admissions

The report indicates that Colorado emergency department visits per year related to marijuana increased by over 4,000 between 2013 and 2014. Additionally, emergency department rates likely related to marijuana increased 49 percent in the two-year average since Colorado legalized recreational marijuana compared to the two-year average prior to legalization. The number of hospitalizations related to marijuana increased from 6,305 (in 2011) to 11,439 (in 2014). The study found that hospital rates likely related to marijuana increased 32 percent in the two-year average since Colorado legalized recreational marijuana compared to the two-year average prior to legalization.

### Marijuana Related Exposure Cases

Marijuana-related exposures increased 100 percent in the three-year average (2013-2015) since Colorado legalized recreational marijuana compared to the three-year average (2010-2012) prior to legalization. Additionally, marijuana-only exposures increased 155

percent in the three-year average (2013- 2015) since Colorado legalized recreational marijuana compared to the three-year average (2010-2012) prior to legalization. Marijuana exposure includes reported cases of second-hand smoke inhalation by children and toxic/poison ingestion by children and adults.

#### Diversioin of Colorado Marijuana

Highway patrol yearly interdiction seizures of Colorado marijuana increased 37 percent from 288 to 394 (2013-2015), since recreational marijuana was legalized.

### **SUSTAINABILITY IMPACTS**

Legal and illegal indoor cultivation of cannabis requires significant amounts of water and power. If the Council permits cannabis businesses, the conditional use permit or administrative use permit process would identify and address those impacts. Indoor cultivation is often discovered when power overloads cause fires, require a fire department response. Illegal cultivation is likely to continue, even if cannabis businesses are permitted in Hayward.

Cultivation for personal use, whether indoor or outdoor, is not believed to create any unusual impacts on the use of water or power.

### **FISCAL IMPACT**

If the Council were to permit cannabis and marijuana businesses, it is anticipated that a significant cost would be associated with the administration of land use and regulatory ordinances depending on the number and type of businesses Council chooses to allow. As an example, staff would be required to process applications, prepare reports to the Planning Commission and City Council, review business plans, obtain background results for proposed owners and employees, and interact with the state's cannabis regulators. Staff would also be involved in auditing financial records to determine if the City is accurately receiving funds resulting from the application of Measure EE. These staff functions would cover multiple departments and several full-time equivalent higher-level classifications, at the outset of operations in Hayward and subsequently to assure ongoing compliance. If the City were to allow five businesses to operate, staff costs could easily exceed \$500,000 annually. Some or possibly all of these administrative costs could be covered by City licensing fees approved as part of the Master Fee Schedule, but it would take at least two fiscal years of operations to identify true administrative costs. Oakland charges \$67,000 a year for each of its eight licensed retailers for administration, a total of \$500,000. Administrative fees are not the same as taxes, discussed below.

Additionally, law enforcement cost impacts would predictably increase, whether or not cannabis and marijuana businesses are allowed in Hayward, as discussed earlier in this report.

## **ECONOMIC IMPACTS**

Economic impacts of potential cannabis and marijuana businesses in Hayward can best be understood in the context of what is happening in other markets. By the end of 2016, seven states and the District of Columbia had legalized recreational marijuana, and 28 states had legalized medical cannabis. The state of Colorado, where voters approved medical and recreational marijuana in 2012, tallied \$1 billion in legal cannabis sales in the first ten months of 2016. In October alone, there were \$82.8 million in recreational sales and \$35 million in medical sales. Cannabis businesses have paid \$150 million in various taxes to Colorado as of October. The cannabis industry is estimated to generate over \$22 billion nationally by 2020.

As California recreational marijuana permits roll out in 2018, both gross sales of various products and the taxes on those products will increase dramatically. Local tax data in California is harder to pin down because: a) cities and counties charge different rates on top of the state tax rate of 7.5 percent; and b) data is only available for medical cannabis products. That said some data is available from which reasonable extrapolations can be drawn. For example, Harborside in Oakland, possible the nation's largest retailer, generates about \$30 million in annual gross sales, and about \$1.5 million in local taxes. Berkeley's four authorized retailers generate about \$600,000 in local taxes. A fair assumption about Hayward is approximately \$200,000-500,000 in Measure EE sales taxes could be generated, based on three to five retail operations. The City would also receive 1 percent of the AUMA taxes collected by the state, similar to the allocation of sales taxes.

There is very little reliable data available for gross sales and resulting state or local taxes related to non-retail cannabis and marijuana manufacturing or commercial businesses. Non-retail sales are typically business-to-business transactions which have been historically strong in Hayward because of the large industrially-zoned areas west of Hesperian Boulevard. Non-retail businesses could be approved for indoor cultivation, processing, manufacturing or distribution of edibles, topicals, smokables and paraphernalia, and so on. Gross receipts generated by non-retail cannabis and marijuana businesses would be subject to Measure EE, but reasonable projections are extremely difficult to make, despite efforts by staff in consulting with the City's sales tax consultants.

Given the probability that retail sales might not be acceptable in prime commercial zones, despite the likelihood of Measure EE revenues, consideration should be given to non-retail business activity in industrial and manufacturing areas of the City. As cannabis-based products move into mainstream markets, there will be predictable investment and growth in markets that supports retail sales. While Measure EE revenues are difficult to predict, business-to-business transactional activity is likely to be significant between 2018-2020, as California develops into the largest market in the country.

As the Council considers the economic viability of the legal cannabis and marijuana market, here is an anecdotal analysis by one commentator on the factors consumers consider in choosing where to spend their money on cannabis:

1. Your taxes, combined with state taxes, are too high compared to the black market
2. Law enforcement is ignoring the black market.
3. Loyalty – the black market dealer is the buyer’s friend, and they want to keep doing business with him.
4. They grow their own, or get it from someone who does.
5. No special trip – they work in a jurisdiction with lower taxes and go there every day.
6. Sensible special trip – they live so close to a jurisdiction with lower taxes that it makes economic sense to drive there.
7. Spiteful special trip – they go out of their way to buy in a jurisdiction with lower taxes – spending more on gasoline than they save on taxes. They cut off their nose to spite their face – because they say your taxes are too high and they want to show you.

## **PUBLIC CONTACT**

This is a work session that has been publicly noticed on the City’s website. The City Attorney’s Office, which handles many of the public’s inquiries about marijuana/cannabis regulations, has conveyed information about this work session in recent contacts. In the event the Council directs staff to begin working on land use and regulatory controls, the meetings at which those topics would be discussed would be publicly noticed as legally required and web pages related to this topic would be added to the City’s website.

## **NEXT STEPS**

If the Council decides to prohibit cannabis and marijuana businesses in Hayward, staff would draft legislation that specifically bans such businesses, to be in place prior to January 1, 2018. If the Council decides to permit cannabis and marijuana businesses, staff would draft land use legislation and regulatory controls, for consideration by the Planning Commission and Council, to be effective prior to January 1, 2018.

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Approved by:



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Kelly McAdoo, City Manager