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Staff Report for the City Manager's Recommendation to the City Council Regarding the Selection of a Medical Cannabis Dispensary Operator, Issuance of the Medical Cannabis Dispensary Permit and Establishment of the \$60,000 Annual Permit Fee

SUMMARY AND RECOMMENDATIONS

The City Manager recommends that the City Council award the medical cannabis dispensary permit to Harborside San Leandro, adopt the resolution and conditions of approval written into said permit, and that the City Council adopt the resolution establishing the annual medical cannabis dispensary permit fee, to be set at \$60,000.

BACKGROUND

Medical cannabis is a policy issue that has undergone substantial public debate in San Leandro, and for which the City Council has rendered various policy decisions going back to 2010. Below is a summary of some key milestones:

October 4, 2010: City Council passed an Interim Urgency Ordinance Prohibiting Consideration and Approval of Use Permits, Variances, Building Permits, Start of New Construction, or Other Entitlements for Any Establishment or Operation of Medical Marijuana Dispensaries, Marijuana Cultivation Facilities, or Other Land Uses that Could Be Proposed Should Proposition 19 Be Approved by Voters for a Forty-Five Day Period

November 15, 2010: City Council extended the Interim Urgency Ordinance to October 1, 2011.

May 16, 2011: City Council heard and did not pass an ordinance that would prohibit the establishment of medical marijuana dispensaries in the City. The moratorium continued in effect.

September 6, 2011: City Council extended the Interim Urgency Ordinance an additional 12 months, to September 30, 2012

June 15, 2012: City Council Approved at First Reading an ordinance prohibiting the establishment and operation of medical marijuana dispensaries with a sunset date.

July 2, 2012: City Council tabled discussion and action at Second Reading of an ordinance prohibiting the establishment and operation of medical marijuana dispensaries with a sunset date.

July 16, 2012: City Council directed the City Council Rules and Communications Committee to work with staff on an ordinance that would permit the establishment and operation of medical marijuana dispensaries within the City.

November 7, 2012: City Council Rules and Communications Committee approved the proposed ordinance, and forwarded it to City Council for review and comment.

December 3, 2012: City Council reviewed, discussed, and accepted public comments on a draft medical cannabis dispensary ordinance

February 12, 2013: City Council holds special Town Hall meeting to receive public input on the draft dispensary ordinance

December 16, 2013: City Council approves medical cannabis ordinance to facilitate the approval, regulation, and operation of one medical cannabis dispensary in San Leandro. To assist in developing a process to implement that ordinance, the City Manager formed an inter-departmental stakeholder group consisting of staff from the City Manager's Office, Community Development Department, Finance Department, City Attorney's Office, and Alameda County Public Health Department.

February 18, 2014: City Council appropriated \$50,000 towards the initial costs of implementing the ordinance. Following the May 2014 issuance of a Request for Proposals, staff entered into an agreement with ICF Resources, LLC to assist in the ordinance's implementation. A copy of that agreement is attached. ICF was selected based upon its extensive experience and expertise in project management support for governmental agencies, and specifically in evaluating the operations of medical cannabis dispensaries.

September 15, 2014: City Council adopted the evaluation criteria that ICF and staff proposed for screening applications to inform the City Manager's recommendation. The Council-adopted criteria are outlined below:

Phase I: Background Investigations

Phase II - Initial Ranking

- Business plan/ budgets
- Overview of management team, including demonstrated experience
- Security plan
- Proof of capitalization

Phase III - Final Scoring

- Labor and employment practices
- Environmental Plan (including efforts to minimize off-site impacts)
- Product safety & labeling
- Community benefits

Selection Phase

- Interviews / site visits / reference checks

November 3, 2014: City Council authorized the associated dispensary application fee schedule.

December 15, 2014: A request for applications from parties interested in serving as San Leandro's dispensary operator was released.

January 20, 2015: City Council amended the agreement with ICF because the scope of work needed adjustment to better reflect anticipated project deliverables that were identified as the process progressed.

The City received applications from 15 teams, each of whom submitted the required \$3,000 non-refundable application fee. City staff and ICF subsequently collaborated together to review and score the 15 applications using the above-referenced Phase I & II criteria (including a background investigation of each of the team members, which took nearly five months for processing by the State Department of Justice). The 8 top-scoring teams were subsequently invited to submit Phase III proposals, which also required the submittal of a \$7,000 application fee. A summary of the 8 teams that advanced to the third phase of the application process, and their corresponding scores, is provided below:

<u>Total Rank</u>	<u>Applicant Name</u>	<u>Phase II Score*</u>	<u>Phase III Score**</u>	<u>Total Score</u>
1	Harborside San Leandro	615	255	870
2	Magnolia Wellness Collective	591	245	836
3	Davis Street Wellness Center	556	242	798
4	VMK/Purple Lotus Patient Center	505	245	750
5	Blum/SL Community Collective	482	235	717
6	Morning Sun Cooperative	496	220	716
7	Purple Heart Patient Center	456	215	671
8	Box of Rain, Inc.	469	182	651

*Maximum possible score for Phase II = 650 points

**Maximum possible score for Phase III = 300 points

Following the ranking and scoring of the Phase III proposals by City staff and ICF using the Council-adopted criteria, the top six teams were invited for interviews with the City Manager's inter-departmental stakeholder group. Based upon the Phase II and Phase III scores and subsequent interviews, the consensus of the inter-departmental group was that the following three teams demonstrated the optimal combination of knowledge, expertise, experience, and alignment with the Council-adopted criteria (in alphabetical order):

- Blum / San Leandro Community Collective
- Davis Street Wellness Center
- Harborside San Leandro

In late August, the inter-departmental staff working group conducted site visits to dispensaries operated by the above three application teams. Staff also conducted due diligence on each of the three teams. These efforts included contacting references, having discussions and communications with staff persons from the City of Oakland, the City and County of San Francisco, Alameda County, the California State Department of Justice, and the Federal Bureau of Investigation, who are familiar with the aforementioned collectives' or cooperatives' operations in other jurisdictions.

Overview of Dispensary Operator Recommendation

Based upon staff's assessment of the submitted application materials, interviews with the dispensary teams and site visits, staff recommends that the dispensary permit should be awarded to Harborside San Leandro (hereafter referred to as HSL). HSL is recommended based upon the factors outlined below.

Demonstrated Experience

Harborside stood out among all of the applications because of its outstanding reputation and demonstrated experience. Harborside's Oakland facility was one of the four original dispensaries that were permitted to operate within the City of Oakland, having opened its doors nearly 9 years ago. Harborside Oakland quickly rose to prominence pioneering the development of methods and practices, further outlined below, that are generally considered among the best in the burgeoning medical cannabis industry.

Business Plan & Budgets

A review of HSL's business plan and bank statements demonstrates that it has more than sufficient capital to develop and build out a high-quality facility that will create a clean, welcoming atmosphere for San Leandro residents to acquire medicine. In congruence with HSL's business plan and the staff site visit to Harborside Oakland, the City Manager feels assured that HSL's facility was accurately described in its proposal, in that it will be a clean, professional, and well-operated establishment that provides a wide range of medicinal products, with high quality customer service, a welcoming atmosphere, and a holistic approach to serving its customers. Furthermore, since Harborside already operates a dispensary nearby in Oakland, HSL does not plan to purchase product from vendors, store bulk product, or separate product in San Leandro, which the City believes should keep the amount of traffic, on-site processing activity and on-site medicine inventory relatively low.

Security Measures

Harborside also maintains a substantial security system at its Oakland facility, which HSL states that it will essentially mirror at its San Leandro facility. The Oakland facility had multiple guards posted visibly outside and within the facility, including two who checked paperwork prior to dispensary entry. Staff also observed a communication system between the security guards and staff who were monitoring the cameras, a metal detector at the entrance, and biometric (fingerprint) security access systems throughout the facility keyed to employees who had varying levels of security clearance within the cooperative.

If HSL is awarded the permit, HSL commits that other features at the San Leandro facility will include high-definition cameras that monitor the facility 24 hours per day, along with licensed security guards who will be posted to provide round the clock monitoring. These efforts will be further augmented by a robust crime and nuisance prevention program utilizing a "broken windows" approach that addresses minor issues quickly and thoroughly, similar to its Oakland operations. As part of this approach, security personnel will provide perimeter monitoring to prevent littering, graffiti, excessive

noise, and other nuisance activity. According to a letter of support that was provided by former Oakland Mayor Jean Quan and included in HSL's application, crime rates actually decreased significantly in the neighborhood immediately surrounding the Oakland facility following commencement of operations and implementation of this strategy.

Product Safety & Labeling

HSL demonstrated a commitment to providing a safe product to its patients. Staff's impression during the site visit was that Harborside offered patients a diverse array of cannabis-infused products, and best practices concerning product handling measures to ensure the safety and cleanliness of medicine. If issued the permit, HSL's commitment is that all cannabis products will continue to be rigorously tested for the presence of molds, microbes, and other contaminants. Products will also incorporate a detailed labeling system, consistent with the requirements in the City's adopted dispensary ordinance. HSL also distinguished itself from one of the other top applicant teams by incorporating testing by an independent third-party laboratory.

Employee Benefits

HSL anticipates hiring an initial staff of 17 employees, which was the largest projected workforce identified by any of the top applicant teams. Staffing would consist of a three-member executive team, one HR & Compliance Coordinator, one manager and eight patient services associates, as well as one manager and three associates for its security team. HSL will pay all employees a wage of no less than \$15/hour, which exceeds San Leandro's living wage ordinance. HSL's compensation package was the most generous of all applicants, providing all employees healthcare benefits, paid time off, and retirement.

HSL also committed to conduct outreach to hire local San Leandro residents who reflect the community's diversity. This commitment to diversity is reflected in its current Oakland staffing, 38% of whom are female, and 64% of whom are of African American, Asian American, Native American, Hispanic and/or Pacific Islander heritage. In order to improve access for non-native English speaking patients, HSL will seek multilingual staff for all public-facing positions, prioritizing Spanish and Mandarin/Cantonese speakers.

HSL will also provide educational opportunities for all eligible employees through its Education Achievement Program, which is modeled after the Starbucks College Achievement Plan. This program will provide all full-time employees with the opportunity to enroll in two classes per quarter toward an accredited degree from Cal State East Bay, with tuition fully paid by HSL.

One of the executive directors of the applicant team is a San Leandro resident with strong ties to the community. Dan Grace is co-owner and operator of Zocalo Coffee House on Bancroft Avenue in San Leandro. As a collective association, HSL has also committed to fully supporting the right of its workers to associate, organize, and bargain collectively if they so choose. HSL will not prescribe how employees should do so or with what union, and will support them in a free and open process for making those decisions and will recognize any union that they may choose.

Community Benefits & Financial Contributions to the City's General Fund

HSL commits to providing a robust community benefits program. This program would consist of a voluntary donation of 4% of the dispensary's annual gross sales receipts towards a community benefits fund, approximately 80% of which will be donated to local San Leandro non-profit organizations through a community grants program. The program would be overseen by an oversight board (yet to be created) chosen by HSL, where over half of the members would be

comprised of San Leandro residents. The task of the HSL community benefit oversight board would be to review and recommend to HSL applications for funding from local San Leandro-based community-serving non-profit organizations. Award allocations would be made on a semi-annual basis.

According to conservative revenue projections, total contributions to a San Leandro Community Benefits Fund could reach approximately \$191,200 in 2016, and approximately \$287,200 in 2017. The remaining 20% of this fund would be used to provide a multitude of HSL in-house programs for the collective's members and patients, such as: free to members and patients holistic health services like acupuncture, massage, yoga, chiropractic, and ayurvedic healing; a care package program offering free or low-cost medicine to patients who have demonstrated financial need; and an outreach program targeted toward special needs patient groups, including peer counseling sessions, harm reduction drug abuse counseling, and peer support groups for new patients, senior citizens, parents of juvenile medical cannabis patients, and patients with various specific medical conditions.

HSL will also voluntarily commit to donate 1% of its gross receipts to the City of San Leandro each year. Preliminary estimates indicate that this contribution would be approximately \$47,800 in 2016 and \$71,800 in 2017. Additionally, HSL has committed to voluntarily contributing 10% of its net income to the City of San Leandro, which preliminary estimates indicate would be approximately \$14,000 in 2016 and \$45,000 in 2017. These voluntary commitments have been incorporated as conditions of approval in the attached resolution.

Future Tax Discussion

The above financial commitments were negotiated with HSL in light of the fact that the City of San Leandro does not presently have in place a gross receipts tax on sales of medical cannabis within San Leandro, which is commonplace in other California jurisdictions that have allowed dispensaries to operate. Because HSL developed its business model and financial projections based on this assumption, the conditions of approval mandating the aforementioned commitments would be nullified if San Leandro voters approved a measure to impose such a tax. Nevertheless, the City Manager recommends that the City Council continue to explore such a gross receipts tax further.

Some examples of jurisdictions with such taxes in place, and their specified rates, are outlined below:

<u>City</u>	<u>Tax Rate</u>
Berkeley	2.5% gross receipts
Oakland	5% gross receipts
Los Angeles	6% gross receipts
San Jose	authorized to go up to 10% of gross receipts (currently 7%)

In addition to these financial contributions, HSL will also collect a 10% sales tax on all products sold, approximately 1.5% of which will be remitted to the City of San Leandro by the State Board of Equalization, which includes the 0.5% Measure HH local sales tax measure. Conservative projections indicate San Leandro's share of those sales tax receipts would be in the order of approximately \$71,800 in 2016 and approximately \$107,000 in 2017.

It is also worth noting that Harborside's Oakland facility currently serves as the second largest sales tax contributor in the City of Oakland (including the above-referenced 5% gross receipts tax). City of Oakland staff also confirmed that Harborside proactively and consciously pays in full its tax obligations, including on the underlying cultivation sites over which it has control. According to City of

Oakland staff, the collection of this tax from cultivators is an ongoing challenge, and Harborside distinguishes itself favorably in this regard.

Analysis of Harborside Oakland's Legal Issues, and Any Potential Effects on Harborside San Leandro

Staff independently analyzed the legal issues related to the Federal government's civil forfeiture action against Harborside Oakland. Subsequent discussions with HSL's principals corroborate the analysis. In short, a civil forfeiture is a lawsuit brought in Federal or State court (depending on the crime being charged) by law enforcement against property, real or personal, suspected of being involved in crime. U.S. Attorney for the Northern District of California, Melinda Haag, filed a civil forfeiture lawsuit to seize Harborside's assets about three years ago (2012), as part of a campaign to crack down on large-scale commercial cannabis operations. A seizure of Harborside's assets, including termination of its lease, would effectively close Harborside Oakland. Currently, medical cannabis dispensary operations are legal under state and local law but remain prohibited under federal law.

The City of Oakland filed its own lawsuit against the Department of Justice to attempt to block the civil forfeiture action. Oakland argued primarily that if Harborside suffers a civil forfeiture, public safety and health crises would occur because Oakland would lose hundreds of thousands of dollars, including monies currently used for city regulation and enforcement of medical cannabis dispensary and cultivation operations, and medical cannabis patients would not have access to medicine, thereby causing them to resort to the black market, with all of its attendant personal dangers and health risks (including lack of testing and quality assurance). Oakland's lawsuit was appealed to the Ninth Circuit, which issued its opinion on August 20, 2015. Although the Court found that closure of Harborside would cause actual economic damages to Oakland, the Court held that the city does not have legal standing in the civil forfeiture action, which is between the Department of Justice and Harborside's assets. Currently, Harborside Oakland is still vigorously defending the civil forfeiture action. Even though Ms. Haag is to be replaced as U.S. Attorney for the Northern District of California, it is unclear what her successor will do related to the civil forfeiture action. Since 2013, and as explained further below, civil forfeiture actions against medical cannabis dispensaries and patients has declined nationwide.

Staff analyzed specifically what effect, if any, a successful civil forfeiture action against Harborside Oakland would have on Harborside San Leandro, and the likelihood that a civil forfeiture action would be brought against Harborside San Leandro. To the first question, the answer is that there likely would be no effect on HSL. It has been represented by the principals of HSL to the City Manager and staff that HSL is separate, in organization and management, from Harborside Oakland, in that it will be its own collective. As such, the Department of Justice would have to file its own civil forfeiture action against HSL, and its assets.

The prospect of that occurring today, versus three years ago when the Department of Justice brought the initial action against Harborside Oakland, is arguably low because of several subsequent pronouncements and events related to Federal civil enforcement, investigations, and prosecution of medical cannabis dispensaries and patients, and the funding for those activities. August 29, 2013, Deputy Attorney General James M. Cole issued a Memorandum to all United States Attorneys, a copy of which is attached to this staff report, which shifted federal enforcement away from strict enforcement of federal cannabis laws towards a more hands-off approach in "jurisdictions that have enacted laws legalizing marijuana in some form and that have also implemented strong and effective regulatory and enforcement systems to control the cultivation, distribution, sale and possession of

marijuana.” San Leandro’s strong regulatory and enforcement systems that follow the prevailing State laws and closely track the California Attorney General’s Guidelines are the minimum standard; the City Manager and staff also met with and took advice from staff of other jurisdictions more advanced in their experience with medical cannabis dispensaries, most notably the City of Oakland, Alameda County, and the City and County of San Francisco, for best practices and lessons learned, which have been incorporated into the analysis of the applications, and proposed conditions of approval.

Additionally, in December 2014, as part of the federal spending bill, an amendment was passed that basically blocks the Department of Justice from spending federal funds to prosecute medical marijuana dispensaries or patients that abide by state laws. Finally, the City and its State lobbyist are actively commenting and monitoring AB 266, which is the Legislature’s latest, and it appears most successful attempt so far, at establishing comprehensive medical cannabis regulations meant in significant measure to put California in compliance with the Cole memo. In weighing these matters, the City Manager is reasonably assured that legal issues related to Harborside Oakland, coupled with the Federal shift in enforcement priorities away from medical cannabis dispensaries and patients, will not have a detrimental effect on HSL, and that HSL is not significantly exposed to a future civil forfeiture action.

Conclusion

As outlined above, this recommendation represents the culmination of a methodical and objective screening process with an extensive public process that was guided using the Council-adopted criteria, based on industry best practices. All eight of the Phase III applications were submitted by teams who currently operate permitted dispensaries throughout various other jurisdictions in Northern California, and several of the top teams demonstrated local ties with San Leandro residents serving in some capacity in their executive management or oversight boards. Therefore, in staff’s estimation, all eight of these teams demonstrated the capacity to operate a viable dispensary in San Leandro. However, given that San Leandro’s adopted dispensary ordinance allows for only one dispensary, the City Manager and staff focused on identifying the applicant that demonstrated the superior combination of knowledge, experience and expertise based on the totality of quantitative and qualitative factors measured against the Council-adopted criteria. Pursuant to that totality, the City Manager recommends that the City Council select Harborside San Leandro for the award of San Leandro’s dispensary permit.

Future Analysis

Presuming the dispensary that is selected by the City Council demonstrates a positive track record by fully integrating itself into the surrounding neighborhood and contributing in a positive manner to the broader San Leandro community, staff recommends that the City Council consider revisiting the provision of the ordinance allowing only one dispensary. As in any industry, competition serves to incentivize best practices and responsiveness to consumer demands. San Leandro community residents could see similar benefits from healthy competition by a second dispensary operator.

Overview of Dispensary Permit Annual Fee Recommendation

The adopted dispensary ordinance states that the City Council must approve an annual medical cannabis dispensary permit fee. The purpose of this annual permit is to fully recover the costs borne by the City in order to regulate and inspect the dispensary’s operations. Because the City has never previously authorized a medical cannabis dispensary, staff crafted an assessment of the various steps and staff resources that are anticipated over the course of the year ahead, including ensuring that all permit requirements are complied with, and to allow for regular inspections and oversight. As

part of this analysis, staff also examined the fees charged by neighboring jurisdictions for similar operating permits.

It is expected that regulation of the dispensary will require the work of staff from a range of City departments, including but not limited to: the City Manager's Office, Finance Department, City Attorney's Office, Community Development Department, Police Department, Alameda County Fire Department, as well as administrative support to each Department.

Anticipated work will include the need to monitor, audit, and inspect the dispensary. Since current agency staffing has never before regulated such a facility, it is expected that some of this work may need to be completed by third-party consultants (such as forensic audit and investigation services, industry and product handling experts, etc.). Staff estimates that an extensive amount of staff time will be required to ensure that there is no diversion, that the facility operates as permitted, abides by building, construction, and electrical requirements, and adequately reports and pays its fees and taxes. Since this is an emerging industry, coupled with ongoing efforts at the state level to develop new statewide regulations, it is anticipated that staff will need to work extensively with the City's state-level advocate, representatives from the industry, and state officials as new regulations are developed and implemented.

Based upon that analysis, staff recommends that the annual fee be set at \$60,000, which is the same fee that is presently charged by the City of Oakland for a similar permit. If the operator so chooses, the annual fee may be paid in quarterly installments throughout the year. The first installment would be due 30 days after the facility commences operations. Over the year ahead, staff intends to closely monitor staff time and other costs associated with regulating the dispensary and may recommend to the City Council an adjustment to that fee based upon actual costs.

Fiscal Impacts

The proposed \$60,000 annual dispensary permit fee has been designed to fully off-set the City's costs in regulating the dispensary's operations. In addition, it is estimated that the facility will generate approximately \$71,800 in annual sales tax in 2016 and approximately \$107,000 in 2017. The voluntary commitment to donate 1% of gross receipts is estimated to generate approximately \$47,800 in 2016 and \$71,800 in 2017, and HSL's voluntary contribution of 10% of net income could equate to approximately \$14,000 in 2016 and \$45,000 in 2017. The facility will also be required to pay an annual business license tax that is set by a formula based on the number of employees, which will likely be in the order of less than one thousand dollars annually. If the City were to adopt a gross receipts tax on local sales of medical cannabis, such a tax could potentially generate in the order of several hundred thousand dollars per year, depending upon the tax rate.

ATTACHMENTS

- Harborside San Leandro Phase II & Phase III Application Materials and Overview of Proposal
- Consulting Services Agreement with ICF Resources
- Copy of Deputy Attorney General James M. Cole's Memo to US Attorneys

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