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## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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# Medical Marijuana Regulatory Structure Costs and Fees (Updated)

## OVERVIEW

On Monday March 28, 2011 the City Council is being asked to adopt two ordinances related to Medical Marijuana. The first would amend the City's Land Development Code and Local Coastal Program pertaining to medical marijuana cooperatives and the second would amend the Municipal Code relating to medical marijuana regulations for qualified patients, caregivers, and consumer cooperatives. The two ordinances result from the review and recommendations made by the City Council, Medical Marijuana Task Force, Land Use & Housing Committee (LU&H), Public Safety & Neighborhood Services Committee (PS&NS), Community Planners Committee, and the City Planning Commission.

At the April 28, 2010, PS&NS Committee meeting, the Medical Marijuana Task Force reported on its recommended guidelines for medical marijuana patients and police department enforcement. At that meeting, the Committee directed the City Attorney to provide legal recommendations, and the Office of the IBA to review the implementation, costs, fee structure, and proper departmental jurisdiction for the Task Force recommendations. In response to this request, the IBA released report [#10-45 Medical Marijuana Regulatory Structure Costs and Fees](#) which was presented to the PS&NS Committee on May 26, 2010. This report reviewed possible tax and fee structures as well as options for the implementation and oversight within the City with respect to collectives and cooperatives. To date the Mayor's Office has not provided an implementation plan that includes options for full cost recovery needed to minimize City expenses associated with the regulation of collectives and cooperatives.

In anticipation of the March 28, 2011 City Council meeting, Councilmember Marti Emerald released a Memorandum on March 16, 2011 asking that staff be prepared to respond to questions related to an implementation plan at the Council meeting. As noted in Councilmember Emerald's memorandum, an effective implementation plan is essential to ensuring a smooth transition for both the City and the citizens impacted by these ordinances. Ultimately, under the City's form of government, the staff that will be responsible for implementing and enforcing these ordinances report to the Mayor. In the absence of an implementation plan from staff, Council will need to direct the Mayor to come back at a later date with an implementation plan for review. The purpose of this IBA report is to update our Report #10-45 Medical Marijuana Regulatory Structure Costs and Fees to reflect additional information that has become available subsequent the release of our original report.

## FISCAL/POLICY DISCUSSION

The two ordinances include many regulatory requirements that require administrative and regulatory oversight by multiple City departments. Examples of these regulatory requirements include:

- The requirement that any cooperative, collective, or dispensary must have a permit (Municipal Code Section 42.1504);
- The City may recover its costs in the form of a permit fee for the costs of permitting and regulating medical marijuana consumer cooperatives (Municipal Code Section 42.1506);
- Responsible persons in medical marijuana consumer cooperatives shall undergo fingerprinting and the fingerprints shall be provided and kept on file with the City (Municipal Code Section 42.1507);
- The City may conduct a background check of all responsible persons. Any person who has been convicted of a violent felony or a crime of moral turpitude within the past seven years, cannot act as a responsible person in the medical marijuana consumer cooperative (Municipal Code Section 42.1507);
- Upon the City's request, responsible persons for the medical marijuana consumer cooperative shall provide to the City an audit of its operations for the previous calendar year (Municipal Code Section 42.1508);
- Responsible persons for the medical marijuana consumer cooperative shall ensure that medical marijuana edible products containing medical marijuana and concentrates comply with packaging and labeling requirements (Municipal Code Section 42.1512).

The following sections provide a general overview of existing regulatory structures within the Police Department, Development Services, and the Treasurer's Office that could be employed to address the recommended regulatory actions.

### Police Department Regulatory Process

For the permitting and regulation of medical marijuana cooperatives, the City could use the regulatory structure already existing within the Police Department's Permits & Licensing Unit for police-regulated businesses and occupations. This structure may be appropriate for implementing the regulatory administration and enforcement requirements outlined in the ordinance related to background checks; verification of documentation including audits; cooperatives age limitations; and packaging and labeling.

Per Section 33.0101 (b) of the City of San Diego Municipal Code:

*All police-regulated occupations and business, and all persons conducting or proposing to engage in a police-regulated occupation or business, are subject to any investigation and regulation required by this Article as a prerequisite to the granting of a police permit to conduct the occupation or business.*

Per Section 33.0103 (a):

*The Chief of Police shall make, or cause to be made, regular inspections of all police-regulated businesses. Any peace officer shall have free access to any police-regulated business during normal operating hours. It is unlawful for any permittee or employee to prevent or hinder any peace officer from conducting an inspection.*

As an example, the Police Department currently regulates tobacco retailers who are required to undergo an evaluation to qualify for a permit to conduct business in the City of San Diego. In the application process, the applicant must supply information for background verification, and the Police Department has the authority to grant or deny a police permit based on a review of the applicant's fitness to operate a tobacco retail business. The Application Fee for a Tobacco Retailer Permit is \$104, with a Regulatory Permit Fee of \$108, totaling \$212 for an initial application. Late and penalty fees apply with noncompliance.

The costs of administering regulatory oversight of medical marijuana collectives and cooperatives by the Police Department would be based on the number of hours required by staff to meet the regulatory demands within the final ordinance. The Police Department will have to evaluate the level of staff time that would be required to meet the regulatory demands. Estimates would incorporate the time necessary for background checks, inspections, administrative duties, as well as initial and ongoing non-personnel costs such as office supplies, vehicle use, and office equipment. As an example, the fees charged to recover the cost of tobacco retailers' ordinance regulations to the Police Department are based on an assumed cost of \$285,901 per year, as of 2008. The Police Department has stated that this projection has not significantly changed since 2008. This

cost assumes Permits & Licensing staff hours from multiple sworn positions, in addition to non-personnel expenses.

It should be noted that on June 23, 2010 the San Diego County Board of Supervisors approved regulations related to medical marijuana dispensaries that limited them to 16 sites in unincorporated parts of the county. In their report to the Board of the Supervisors, staff estimated that, depending on the size of the collectives, a minimum of 60 additional staffing hours per week may be needed to handle the number of verifications and inspections. This would require the addition of one Deputy Sheriff and one Licensing Specialist. To recover the costs associated with verification and monitoring the collectives, the County will require an Operating Permit with an annual cost of \$11,017.

#### Development Services Department (DSD) Regulatory Process

As with the Police Department, the Development Services Department also has an existing regulatory structure pertaining to the regulation of a business that sells a regulated substance. Per Section 141.0502 of the Municipal Code, certain alcoholic beverage outlets are subject to administrative review as a part of the application process for a Beer and Wine or General Liquor License with the California Department of Alcoholic Beverage Control. Such a review involves verifying that the outlet meets location specifications relating to the crime rate, distance from other outlets, distance from sensitive uses, and residential property. The fees associated with this application process with DSD are: a \$591 Application and Review Fee, \$20 Records Fee, and \$10 Mapping Fee.

If a proposed alcoholic beverage outlet does not comply with the conditions outlined in the Municipal Code, the applicant can pursue approval through a Conditional Use Permit (CUP) Process 3 decision process. A Process 3 approval involves a staff level review of the application and plans submitted by the applicant, and a Hearing Officer Hearing. Appeals are filed to the Planning Commission or the Board of Zoning Appeals, with an appeal hearing with the Planning Commission or the Board of Zoning Appeals. It should be noted that the proposed land use ordinance for cooperatives would subject them to a Process 4 approval which requires Planning Commission approval with appeal to the City Council. In addition, cooperatives would not be permitted within 1,000 feet of schools, parks, churches, child care facilities, playgrounds, libraries owned and operated by the City of San Diego, youth-serving facilities, or other medical marijuana consumer cooperatives.

The administrative and regulatory costs borne by DSD for the review and regulation of collectives and cooperatives would differ for each application. The Development Services Department previously indicated that the cost to obtain a Conditional Use Permit, for medical marijuana collectives and cooperatives, could range from \$25,000 - \$35,000 of staff time for each application. This is a preliminary estimate as the cost

would vary depending on a number of factors including the regulations imposed, level of controversy involved, public contact, and the associated appeals. Less controversial permit processes would cost much less.

For the applicant to initiate a Conditional Use Permit process, an initial deposit of \$8,000 would be required. Staff time would be charged against the deposit. Additional deposits would be required with subsequent review and additional administrative charges. Per DSD, the typical rate for staff time can range between \$140-\$170 per hour depending on the level of review and level of staff involved. Payment of set fees in accordance with the DSD fee schedule would be required in addition to that related to the CUP process depending on whether the application involves other development activity requiring additional permits.

#### Treasurer's Office

For both of the regulatory processes described above, the Treasurer's Office has an integral role as a typical first point of contact with the Business Tax Certificate application process. As a component of the Business Tax Certificate application process, DSD reviews the appropriate Use Category for the proposed business location in accordance with the Land Development Code, and the use compliance with zoning regulations. Upon a determination that a business is in compliance with the Land Development Code and fits within an existing use category, DSD will issue a Zoning Use Certificate. The issuance of a Zoning Use Certificate is necessary for the final approval for a Business Tax Certificate to establish a business within the City. If DSD does not issue a Zoning Use Certificate, the Treasurer's Office cannot issue a Business Tax Certificate to permit the existence of the business within the City.

For applicants applying for a business tax certificate for a police regulated business, the Treasurer's Office informs the applicant that a separate police regulated business permitting process is required beyond the Business Tax Certificate application process, and they will refer them to the Police Department to initiate the application process. The Office will also inform the Police Department of the applicant's intent to file an application.

The current business tax rate that would apply to collectives and cooperatives within the City of San Diego is \$34 for establishments with 12 or fewer employees, and for larger establishments, \$125, plus \$5 per employee.

#### Cost Recovery Fee and Tax Exemptions Associated with Non-Profit Status

The draft Ordinance related to patients and caregivers includes a provision allowing the City to recover costs associated with the permitting and regulating cooperatives through a permit fee (Municipal Code Section 42.1506). It is important to note that a cost recovery fee may not exceed the reasonable costs to the City pursuant to Proposition 26. In their March 15, 2011 Report to the City Council, the City Attorney's office states that "a cost

recovery fee as proposed by the Medical Marijuana Task Force may be defensible as fitting within two of the seven exceptions contained in Proposition 26.” The following table provides a sample of other California Cities with Medical Marijuana ordinances and the permit fees they charge to cooperatives for operation and/or initial permitting. The table does not include additional fees such as Business Tax Certificate, fire inspection, and public assembly fees that cities may require. These types of fees vary by city. Any fee schedule proposed by the City should detail any miscellaneous fees that would be required in addition to the permit/operating fee.

City/County	Fee Description	Amount
City of Oakland	Dispensary Business Permit <sup>(2)</sup>	\$400
	Medical Dispensary Permit <sup>(2)</sup>	\$10,000 (4 to 500 Patients/Caregivers) \$20,000 (501 to 1,000 Patients/Caregivers) \$25,000 (1,001 to 1,500 Patients/Caregivers) \$30,000 (1,502 or greater Patients/Caregivers)
City/County of San Francisco	Dispensary Application Fee <sup>(1)</sup>	\$8,656
	Dispensary License Fee <sup>(2)</sup>	\$4,019
County of San Diego	Operating Certificate <sup>(2)</sup>	\$11,017

<sup>(1)</sup> Onetime Fee  
<sup>(2)</sup> Annual Fee

One item that the Council will need to consider when reviewing a Cost Recovery fee is the City’s policy to grant an exemption to some Non-Profit organizations. The draft Medical Marijuana ordinances require medical marijuana consumer cooperatives to operate as Non-Profit organizations. It is important to note that the San Diego Municipal Code includes language that exempts certain non-profit organizations from being required to pay business taxes; police permit fees, and processing fees or deposits for Conditional Use Permits. Those sections of the Municipal Code pertain to (1) business taxes, (2) police permits, and (3) development permits. The following outlines these Municipal Code sections:

***(1) §31.0201 Exceptions — Charities — Public Well-Being***

*No business tax shall be levied nor certificate of payment be issued under the provisions of this Article to any of the following:*

*(a) Any charitable institution, organization or association organized and conducted exclusively for charitable purposes, and not for private gain or profit. The issuance by the California Franchise Tax Board of a certificate of exemption from state income taxation shall conclusively establish the exempt status of any such entity.*

**(2) §33.0601 Exempt Institutions**

*The provisions of this Article shall not be construed to require the payment of any permit fee by any federal, state, county or municipal organization, or any non-profit organization, organized and qualified under the laws of the United States or California as a tax-exempt organization. The issuance of a tax-exempt certificate by the California State Franchise Tax Board shall be conclusive evidence of such exempt status.*

**(3) §112.0203 Waiver of Fees or Deposits**

*(b) Processing fees or deposits for Conditional Use Permits and Neighborhood Development Permits are waived for nonprofit institutions or organizations whose primary purpose is the promotion of public health and welfare and who have qualified for federal tax benefits. This waiver does not apply to institutions or organizations in circumstances in which the City is precluded by the California Constitution from making a gift of City funds.*

Each of these sections of the Municipal Code must be dealt with separately to make a determination of whether medical marijuana collectives and cooperatives qualify as exempt operations, therefore, precluding them from business taxes and permit fees. In addition, if these fees were waived, the City's General Fund could be significantly impacted.

Sales Tax Revenue

In general, the City of San Diego receives 1% of the 8.75% of sales tax that is generated for all taxable sales transactions within the City. In February 2007, the State Board of Equalization (SBOE) issued a special notice clarifying that medical marijuana sales are subject to sale and use taxes and that sellers of medical marijuana are required to apply for and hold a seller's permit. On February 24, 2011 Jerome E. Horton, Chairman of the California Board of Equalization (BOE), announced that the Board had reaffirmed that the sale of medical marijuana was not exempt from sales tax. In addition the BOE further affirmed that sellers of marijuana are required to hold a seller's permit and are required to file and pay sales tax. Persons who make sales without a seller's permit are also generally subject to an eight year look-back period for taxes, penalties, and interest.

Staff has estimated that 170 cooperatives are currently operating in the City. Due to the lack of clarity on the medical marijuana sales by cooperatives within the City, calculation of the potential annual sales tax receipts to the City is difficult. As an example, the BOE audited a Berkeley dispensary and found that for the period of July 1, 2004 through June 30, 2007 the organization owed more than \$6.4 million in taxes and interest.

## CONCLUSION

The IBA has evaluated the draft ordinances for Medical Marijuana and has provided an overview of departmental jurisdictions within the City that could undertake the administrative and regulatory oversight of the cooperatives. In addition, we have provided examples of the permit fees charged by other California cities for the regulation of cooperatives. However, under the City's form of government, the staff that will be responsible for implementing and enforcing these ordinances report to the Mayor and they will ultimately need to provide an implementation and enforcement plan as well as proposal for a cost recovery fee in order to minimize the impact to the General Fund.

**[SIGNED]**

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Jeffrey Sturak  
Deputy Director

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APPROVED: Andrea Tevlin  
Independent Budget Analyst