



# Oregon

Kate Brown, Governor

Department of Revenue  
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February 1, 2016

The Honorable Senator Richard Devlin, Co-Chair  
The Honorable Representative Peter Buckley, Co-Chair  
Interim Joint Committee on Ways and Means  
900 Court Street NE  
H-178 State Capitol  
Salem, OR 97301-4048

Dear Co-Chairpersons:

## **Nature of the Request**

During the 2015 Legislative Session, the Department of Revenue indicated that it wasn't prepared to provide cost estimates associated for its preparation to handle large cash payments. You asked us to return with estimates during the 2016 Legislative Session for the permanent retail and temporary dispensary programs. We are providing our budget request for the implementation of more robust cashiering processes and procedures to enable us to handle large cash payments.

## **Agency Action**

During the fall, the department produced two documents for the Joint Committee on Ways and Means. In October, we produced a letter offering preliminary cost estimates for a temporary and a permanent solution to the department's needs for cash handling. In November, we provided an addendum that clarified some of our estimates and updated some of the figures with what we have learned from our research. As we noted then, this implementation is extremely fast-moving, and we're discovering new and relevant information—and identifying new challenges—every day.

The estimates provided in those documents were educated guesses at costs; the temporary solution was still in the process of being designed, and the permanent solution had not yet been approved by our internal review committee. Since then, we have continued to try to finalize costs while putting together our temporary solution. Based on our additional research and planning, our overall budget request is for \$2,500,829. Below, we will provide an update of our current status and the specifics behind our budget request.

## *Current Status*

The department is confident we are prepared to begin administering the temporary dispensary program, authorized by Senate Bill 460. The dispensary program authorizes

medical marijuana dispensaries to sell marijuana seeds, dried leaves, flowers, and non-flowering plants for recreational use from October 2015 to December 2016 as a stopgap measure while the full retail program is established. Dispensary sales will be subject to a 25-percent tax from January 4, 2016 through December 31, 2016.

During November and December, we began our official outreach to dispensaries and we've provided the documents necessary for dispensaries to file returns and remit tax payments efficiently. We have added a marijuana tax page to our website, which includes frequently asked questions to help taxpayers find information quickly.

With the help of the Oregon Health Authority, we sent registration forms for the marijuana tax program directly to all medical marijuana dispensaries in the state. We've been processing registrations as we receive them.

We also issued three emergency rules focused on payment schedules, cash handling, and registrations. These rules are now in effect and available on our website.

We completed construction on our temporary solution for processing payments in mid-December.

We also began hiring. The department is in the process of hiring eight Accounting Technician 2s to process cash and ensure dual-custody control at all times. A manager for the new cash transaction unit is on board. The requested Operations and Policy Analyst 2 position has not yet been posted. We expect to be fully staffed and ready for the first payments we receive in February. At this time, we believe that we will be setting pre-scheduled appointments with taxpayers.

### *The Challenge of Cash Handling*

Perhaps the most significant challenge in marijuana tax implementation is that the vast majority of participants in recreational marijuana sales will not have access to conventional banking services any time soon. Banks have been extremely reluctant to work with marijuana retailers because of marijuana's status as an illegal drug under federal law. This means that many businesses deal exclusively in cash. Although there is significant uncertainty about the share of tax payments that will be paid in cash, our internal estimates have ranged from 60 to 80 percent of payments being submitted in cash. Our planning has reflected this uncertainty, and we are working to make sure that unexpectedly large volumes of cash do not overwhelm us.

Because of the short timeline for implementation, the department decided that we needed to establish both a temporary solution for handling cash payments and a permanent solution. Based on availability, we decided to use unoccupied space in our main building for the purposes of taking cash payments. The timeline also compelled us

to begin construction and implementation prior to getting an Other Funds limitation increase directed at cash handling. Until tax revenues start to accumulate and the Legislature authorizes our spending, we're paying for marijuana program implementation expenses above the limitation increases authorized in HB 5047 with General Fund money.

Initial estimates had the temporary solution costing between \$60,000 and \$100,000, not including the cash counters, air filters, and operational supplies. Excluding those items (which were calculated separately before), our total cost on the temporary solution was \$103,313. Most of the extra expenditures were due to measures suggested in the security evaluation conducted by the Oregon State Police. Safety and security for both our taxpayers and our employees remains our highest priority in this implementation, and we are grateful to the State Police for providing a thorough review and useful suggestions on such a short timeline.

We have broken out the costs into four sections: temporary solution costs that are not reusable; temporary solution costs that are reusable; recurring costs; and the estimates on the permanent solution. At the time of this letter, some of these costs are not quite finalized and might come in slightly below the listed cost.

*Temporary Space – One-time Costs*

We have worked to make as many of the expenditures as possible reusable in the permanent solution. If we believe that a portion of a large expense is reusable, we endeavored to account for that here. As an example, a portion of the security system we are adding will be reusable in the permanent solution, but a separate portion cannot be moved.

The full table of one-time costs is below. Any expenses that we did not anticipate in our earlier estimates are indicated as such below. (Please note that all expenses are rounded to the nearest dollar.)

Item	Description	Cost
Payment Windows	We added a secure glass window to the temporary location where department employees will accept cash payments.	\$13,450
Security-Related Expenses	This included an alarm system and security cameras. Additional details on security measures can be provided upon request of the subcommittee.	\$12,037
Cash Deposit Boxes	Secure deposit boxes were built into the wall to accept payments.	\$4,234

Badge Access System	We added some upgrades to the existing badge access system for the facility.	\$3,850
Electrical Upgrades	We had to rework some of the existing electrical setup in the space so it can handle the additional demand of the equipment.	\$3,750
Networking/Data	We needed to add additional data connections to ensure that employees would have access to the department's network.	\$2,000
HVAC Upgrades	Several upgrades were made to the area's heating, ventilation, and air-conditioning to increase airflow into the space.	\$1,000
Structural Analysis	The department authorized a structural analysis of the space to ensure that the building, as constructed, could handle the installation of a large safe. This was not included in our initial estimate.	\$550
Transport of Safe	The safe had to be moved from the department's basement to its temporary location.	\$312
Signage	We ordered several signs to provide information to prospective payers. Signs were not included in the initial estimate.	\$397
Office Furniture	We added some additional shelving to hold the computer systems. This was not included in the initial estimate.	\$189
<b>Total Costs</b>		<b>\$41,769</b>

#### *Temporary space – Reusable Purchases*

Most of our expenditures have been for items and expenses that we expect to be reusable in the long-term solution. Any expenses that we did not anticipate in our earlier estimates are indicated as such below.

<b>Item</b>	<b>Description</b>	<b>Cost</b>
Cash Counters	The department purchased three industrial-grade cash counting machines to process payments quickly and accurately.	\$60,000
Air Purifiers	In anticipation of large volumes of cash emitting unpleasant or unsanitary odors, the department purchased three high-density negative ionizers.	\$5,699

Security-Related Expenses (Reusable)	This included an alarm system and security cameras, much of which will be reusable in the permanent solution. Additional details on security measures can be provided upon request of the subcommittee.	\$43,754
Office Furniture	We added office furniture to the temporary solution; the furniture can be reused in the permanent solution.	\$9,000
Adjustable Height Tables	We purchased four adjustable height tables for our cash counters.	\$4,200
Safe	We purchased a heavy-duty safe to store cash between armored car pickups.	\$2,800
Operational supplies	The department purchased several coin trays, 10-key machines, calculator stands, and floor mats for employee use.	\$1,089
Extra Monitor	The State Police suggested that a visible monitor above the payment windows would be a significant deterrent for payers. This was not included in our initial estimates.	\$1,560
Signage	We added two signs directing people to make appointments in advance for their cash payments. These signs will be applicable for the permanent solution. Signs were not included in the initial estimate.	\$200
Small bill counters	We purchased a small bill counter for each payment station to handle low-dollar transactions more efficiently. (We will use the heavy-duty machines for most transactions, but smaller transactions can be processed more quickly in the smaller machines.) This was not included in our initial estimate.	\$30
<b>Total Costs</b>		<b>\$128,332</b>

Please note that while cash counters, air purifiers, and operational supplies were accounted for in our initial budget request, they are being considered as “reusable” equipment above, for the purposes of clarity.

*Recurring Costs*

There are several recurring costs associated with the cash handling process, one of which is personnel. We are requesting ten additional positions to staff the new cash processing unit: eight Accounting Technician 2s (AT2) to staff the payment windows, to receive cash payments, to reconcile payments, and to maintain a payment schedule; one Operations and Policy Analyst 2 (OPA2) to provide analytical support to the cash counting operation; and one Principal Executive Manager B (PEM B) to manage the unit. Those costs are listed below:

<b>Position</b>	<b># of positions</b>	<b>Monthly pay</b>	<b># of months in biennium</b>	<b>Total pay (including other payroll expenses)</b>
Accounting Technician 2 (AT2)	8	\$2,675	17.5	\$786,229
Operations and Policy Analyst 2 (OPA2)	1	\$4,223	17	\$132,402
Principle Executive Manager B (PEM B)	1	\$5,349	18	\$166,493
<b>Total Costs</b>				<b>\$1,085,124</b>

The next issue is rent. We began making rent payments for the space in November and anticipate needing to pay for the space through the end of the biennium. Based on the expected timeline of construction of the permanent solution, we expect to pay rent for the temporary space into the beginning of the 2017–19 biennium. We will also need to pay for rent on the permanent space while we are building out the new infrastructure, so for much of the remainder of the biennium, we will be paying double rent. Those costs are broken out in the table below.

<b>Location</b>	<b>Number of months</b>	<b>Monthly rent</b>	<b>Total rent</b>
Temporary Solution	20	\$3,136	\$62,727
Permanent Solution	14	\$3,000	\$42,000
<b>Total Costs</b>			<b>\$104,727</b>

The department continues to prioritize safety and security in its implementation. In consultation with the Oregon State Police, we believe that the best way to ensure security, while remaining conscious of cost, is to meet the security needs with two Oregon State Police retirees. Our current plan is to station the two retirees in different parts of the building, while being able to cover for one another while they are on scheduled breaks. Representatives from the Oregon State Police were concerned that

one trooper would not be enough to provide appropriate building coverage. Retirees cost substantially less than active troopers, but provide effective service in this sort of capacity. For example, retirees handle security on the Capitol Mall.

The cost of a single retiree is \$44.20 per hour. We are looking for 2 retirees for 17 months of the 2015–17 biennium. Allowing for potential overtime and some orientation time, we are requesting \$268,981 for security for the remainder of the biennium. This is higher than the \$170,000 figure that we suggested in our earlier letters, but we generated our earlier estimate prior to in-depth consultation with State Police and did not account for the need for a second trooper. In addition, we had not considered the option of retirees as a way to reduce costs.

We're budgeting for a processing fee for the bank to handle cash contaminated by strong odors. Although at least one other state has not yet had to pay for cash contamination, we are uncertain what will emerge in our contract with the bank. By Administrative Rule, we are prohibiting the payment of the tax with contaminated cash, but we are anticipating that there may be instances where the bank will characterize cash as contaminated that we did not. Our current estimate is \$35,000.

We also needed to budget for purchasing routine items used in daily work. This includes gloves, plastic bags, rubber bands, cash bands, aprons, sanitizer, masks, and sorting equipment. The rate at which we use some of these supplies, including cash bags, is difficult to project, but based on current estimates, we are assuming a need for \$9,310 worth of supplies for the remainder of the 2015–17 biennium.

We also reached an agreement with an armored car service. Our current armored car vendor is unwilling to transport cash from the marijuana tax program for legal reasons, so we have had to renegotiate and find a new armored car provider to handle all payments taken at our main building. The additional cost above our current armored car cost is \$195 per month. We also can request multiple pick-ups in a day, which we believe might be necessary towards the end of a month. Allowing for five additional pick-ups per month would add \$107 to the monthly cost, for a total increase in the armored car cost of \$302 per month. This calculates to \$5,134 in additional costs for the remainder of the biennium.

We signed up for annual maintenance contracts on the cash counting machines. Each machine has a charge of \$2,270 per year. We are requesting funding for two full years of maintenance, based on their schedule, even though such a contract would carry into the subsequent biennium. The total requested for maintenance is \$13,620.

We anticipate some consistent operating expenses for the cash processing section and include leases for copiers, alarm monitoring, and dedicated phone charges. These are being calculated at \$1,028 per month, beginning in January.

Lastly, we are requesting \$3,175 to fund travel and training for program staff. These expenses allow staff to attend conferences and training for the purposes of staying up-to-date on both emerging challenges and best practices in marijuana taxation.

The assorted recurring expenses are listed in the following table:

Expense	Cost
Cash Contamination Fee	\$35,000
Recurring Supply Costs	\$9,055
State Police Presence	\$268,981
Armored Car Service	\$5,134
Cash Counter Maintenance	\$13,620
Operating Expenses	\$18,504
Program Travel	\$3,175
<b>Total Costs</b>	<b>\$353,469</b>

Please note that the numbers provided on the recurring costs in this section have been prorated to account for the amount of time remaining in the biennium. The full request for the 2017–19 biennium will account for the full 24 months.

#### *Long-term cash handling solution*

Our long-term cash handling solution planning is still in the preliminary stages. At this time, we're planning on retrofitting the building's atrium with several payment windows. This will allow more taxpayers to pay at the same time and will streamline the cash-payment process. At this stage of our planning, we are at the point of being able to provide a conceptual construction estimate. We are not yet at the point of being able to provide a design estimate or a full-construction estimate.

We've determined that it will be most cost-effective to build the permanent solution into existing employee space. This means that the construction will have two separate components: the cash handling space as well as new space for the displaced employees. This estimate accounts for both elements of that construction.

Our October letter set a broad range for the long-term cash handling solution between \$480,000 and \$1.07 million. Our conceptual construction estimate places the cost within that range, at \$787,408. It is worth noting that this number is in addition to the \$124,202



in expenses that have been paid already that will be reusable. Adding those in would drive the total cost of the permanent solution to \$911,610.

Several months of planning and design will be needed to complete the temporary solution. As of writing, the conceptual estimate is with the Department of Administrative Services. If DAS approves, they would green-light the department moving into the design phase; at that point, the department would contract out for architects and engineers for specific plans. We cannot move forward into the design phase without significant expenditures for the necessary outside help. We're including these initial costs as soft construction, which includes the work needed from architects and engineers, structural reviews to ensure that the selected space can handle two heavy safes, permitting, and oversight from DAS, which we expect will assign a Project Manager to the construction. The overall estimate for these costs is \$123,400.

Once the designs are completed, the plans will need to be approved, with an estimate produced based on those plans. Finally, before construction can begin, we will need to find a construction firm through a bidding process. They will provide a final construction estimate. Considering the various hurdles between now and then, providing that estimate is probably not feasible until the middle of 2016. With that said, we can provide a starting estimate for our anticipated hard construction costs, which we are basing on costs in previous construction work, extrapolated to an estimated area of 1,500 square feet. These include demolition work, walls, ceiling, doors, windows, lighting, flooring, fire suppression, electrical work, HVAC, and data. Our overall estimate for these costs is currently at \$250,750. We will not have a final number on these costs until we select a contractor.)

Once the construction is completed, we will need to account for equipment costs in addition to what is being used in the temporary solution (that equipment will be repurposed in the permanent solution). This includes systems furniture, additional computers, two additional cash-counting machines (to account for the additional cash processing from non-marijuana programs), seating, badge access, motorized cash drawers, panic alarms, additional cameras, an additional vault, and a drop safe. The overall estimated cost of these items is \$200,600.

Conceptual estimates are by their very nature uncertain, so it is standard practice to include some estimates for overhead. Currently, we are including a standard 25-percent contingency cost and a 12-percent addition for general contractor fees. Together, these account for \$212,658. As we progress through the project, we will gradually get more cost certainty, and during that time, we will be looking for ways to increase efficiency and reduce cost.

These costs are summarized in the below table:

Item	Elements	Estimated Cost
Soft Construction	Architecture/engineering, structural reviews, permitting, oversight	\$123,400
Hard Construction	Demolition work, walls, ceiling, HVAC, etc.	\$250,750
Equipment	Additional furniture, additional cash counting machines, camera work	\$200,600
Overhead / Contingency	25 percent contingency, 12 percent for general contractor fees	\$212,658
<b>Total Costs</b>		<b>\$787,408</b>

One lesson we have learned during the design of the temporary solution is that security considerations often increase costs. We have begun our planning of the permanent solution with some useful input from the Oregon State Police, but until we have a full plan in place, we will not be able to estimate any potential cost increases that arise from State Police recommendations.

### Action Requested

The department requests that the legislature approve the funding necessary to support the temporary and permanent cash handling solutions and additional staff to support the work related to the marijuana taxation program implementation by increasing our Other Fund limitation for the Marijuana Tax Program by \$2,500,829.

### Legislation Affected

Increase Other Fund expenditure limitation established by section 2 (4), chapter 596, Oregon Laws 2015 (enrolled House bill 035), for the biennium beginning July 1, 2015 through HB 5047, section 5 by \$1,292,157.

Increase Other Fund expenditure limitation established by section 2 (1), chapter 596, Oregon Laws 2015 (enrolled House bill 035), for the biennium beginning July 1, 2015 through HB 5047, section 4 by \$1,208,672.

Respectfully submitted,



Kristine Kautz, Interim Director  
Oregon Department of Revenue