DATE: August 24, 2020

SUBJECT

Study session on storefront retail cannabis sales

RECOMMENDATION

Receive information and provide staff with feedback on whether to develop zoning and cannabis ordinance amendments to allow for retail storefront cannabis sales, and provide input on the number, location and local regulatory requirements for retail storefront cannabis businesses.

STRATEGIC PLAN GUIDING PRINCIPLE

Economic Vitality

BACKGROUND

Medical cannabis use has been legal in California since 1996. On November 9, 2016, adult use of cannabis by persons age 21 or over became legal in California. In June 2017, California enacted the Medicinal and Adult Use Cannabis Regulation and Safety Act (MAUCRSA), which consolidated the state regulatory and licensing framework for medical and adult-use cannabis. The state agencies responsible for regulating commercial cannabis activity adopted regulations addressing commercial cannabis activity. These state regulations affect commercial cannabis activity and include a variety of licensing, operation, and business location requirements.

On January 1, 2018, the state began issuing state licenses allowing businesses to sell cannabis products for medical use to individuals who are at least 18 and have a valid physician’s recommendation, and adult use to adults 21 or over. In response to these statewide changes, the City Council of Redwood City approved a phased approach to implement local medical and adult use cannabis regulations. The phased approach includes:
• **Phase 1 (Completed):** In November 2017, the City Council adopted a Zoning Code amendment regulating personal cultivation of cannabis and banning commercial cannabis-related activities including commercial cultivation, manufacturing, testing, retail, and distribution, except for deliveries of medicinal and adult use cannabis by cannabis retailers located outside Redwood City. This step maintained local land use control and allowed City staff more time to analyze other potential allowed uses.

• **Phase 2 (Completed):** Delivery operators who may be delivering cannabis products in the City were notified that they needed to obtain a business license and pay the business license tax. Cannabis regulatory fees to offset staff costs involved with permitting and regulating cannabis activity and regulations associated with deliveries were developed in Phase 2 and adopted in Phase 3.

• **Phase 3 (Completed):** The City Council adopted regulations to allow cannabis delivery from non-storefront retail (i.e. delivery only) facilities located in the City and to allow cannabis nurseries. Non-storefront retail facilities are permitted by right in the Industrial Restricted (IR), Light Industrial Incubator (LII), Industrial Park (IP), and General Industrial (GI) and conditionally permitted in the Commercial Office (CO) zoning districts. Indoor nurseries are conditionally permitted in the CO, IR, LII, IP, and GI zoning districts. All commercial cannabis activity is subject to the minimum distance requirements of 600 feet from certain uses as well as requiring a Cannabis Business Permit pursuant to Municipal Code Chapter 32, Article V, Division 7. Furthermore, the City Council placed a cannabis tax measure on the November 6, 2018 Gubernatorial Election Ballot. The tax measure was approved by 78.69% of Redwood City voters.

• **Phase 4 (Current):** Consideration of policy and program recommendations to allow retail storefront (walk in) cannabis businesses to operate in designated zoning districts of the City.

Staff have developed five questions to guide the City Council’s discussion:

1) Should the City permit up to six cannabis retail storefront businesses?
2) Should cannabis retail storefront businesses be permitted to conduct delivery services as part of their cannabis business permit?
3) Should cannabis storefront retailers be permitted in all zoning districts allowing general retail?
4) Should retail storefront cannabis businesses be subject to the same City requirements established for non-storefront retail cannabis businesses?
5) Should retail storefront cannabis business applications be processed using a merit-based application process conducted by staff, or should the City Council be involved in the final decision or any appeal?
ANALYSIS

On August 15, 2019, the City Council Finance/Audit Sub-Committee (FAC) discussed options for increasing General Fund revenues as part of a strategy to address projected operating budget deficits over the next decade. On October 14, 2019, City staff presented the FAC with initial research on the potential new City revenue generation from permitting retail cannabis storefront businesses. The Sub-Committee recommended further analysis of this option and staff reconvened the City’s cannabis inter-departmental staff team to explore options for allowing cannabis retail storefront businesses.

To analyze options and understand the experience of other communities, the City engaged the services of HdL, a recognized local government consulting firm with expertise in cannabis permitting policy. HdL has assessed the revenue potential, industry trends, best practices, and regional developments for the City’s exploration of establishing retail cannabis storefronts in Redwood City. The company represents over 175 cities and counties in California for cannabis related services. HdL’s Cannabis Management Team of professionals has over 46 years of direct experience establishing and implementing cannabis regulatory and taxation programs, including establishing land-use regulations, permit processes, staffing plans, cost recovery fees, regulatory compliance, financial audits and staff training. Furthermore, their staff has conducted over 16,000 cannabis compliance inspections and investigations in California, Colorado, and Nevada. In addition, HdL staff has reviewed, scored and processed over 2,200 cannabis business applications for California cities and counties in the last five years, which included reviewing pro-formas and other financial documents. Most recently, HdL assisted City staff with drafting the City’s 2018 cannabis tax measure.

On December 9, 2019, with the assistance of HdL, staff presented a fiscal analysis report to the Finance and Audit Committee (FAC). The FAC members recommended staff undertake further public outreach to determine public opinion about allowing cannabis retail storefronts in the City. The Committee also asked staff to present a report to the City Council that identified potential impacts, policy issues, and the merits of allowing cannabis storefront retail operations. This report provides that information and seeks City Council feedback on whether staff should develop zoning and Cannabis Ordinance amendments required to allow cannabis storefront retail sales.

Cannabis Retail Stores in San Mateo County

As of June 5, 2020, nine cannabis retail stores (non-storefront and storefront) have been licensed by the state to operate in San Mateo County.

<table>
<thead>
<tr>
<th>City</th>
<th>Number of Stores</th>
<th>City</th>
<th>Number of Stores</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brisbane</td>
<td>3</td>
<td>Pacifica</td>
<td>2</td>
</tr>
<tr>
<td>Redwood City</td>
<td>3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>South San Francisco</td>
<td>1</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The limited number of storefront retailers within a 20-minute radius of Redwood City suggests that a storefront retailer located in Redwood City would very likely capture a significant amount of sales from
customers in the surrounding area. This tax capture would continue for the foreseeable future but would likely decline at some point as other jurisdictions allow cannabis retailers over time.

Based on the feedback that staff has received by the community and a few of the current cannabis delivery operators, staff believes that allowing cannabis retail storefront businesses in the City would complement other retail activity and drive additional pedestrian traffic to those retailers. In addition, it would also complement the current cannabis delivery services that are licensed with the City.

**Question 1: Should the City permit up to six cannabis retail storefront businesses?**

The City Council will need to determine how many cannabis storefront retailers will be allowed to locate in the City. There are currently six non-storefront cannabis delivery operations permitted in Redwood City. In addition, out-of-town retailers operate in the City and are subject to Redwood City's cannabis tax.

Non-storefront cannabis delivery businesses that are located in the City are permitted to locate in the Industrial Restricted, Light Industrial Incubator, Industrial Park, General Industrial, and Commercial Office zoning districts and must be 600 feet from schools, day care centers and recreation centers. The owners of these non-storefront businesses may be interested in obtaining licenses for retail storefront operations. However, staff believes that none of the currently licensed non-storefront delivery services are in locations that would allow them to expand into storefront retail operations. This is because they are smaller in located outside of the retail areas of the city. Thus, storefront retailers would likely be in different locations than non-storefront retailers, even if in some cases they have the same owners.

Cannabis retail businesses typically serve the local community, rather than a statewide market. Consequently, the number of retailers is somewhat proportional to the local population. Consumer demand for cannabis is assumed to be constant, regardless of the legality of the business operation or the number of retailers. It is reasonable to conclude that more retailers would mean fewer customers for each business and lower gross receipts. The tax revenue generated by cannabis retailers is generally a function of the size of the market rather than the number of retailers.

Providing greater access to retailers could initially result in a shift in cannabis purchases occurring through legal, regulated channels rather than through the illicit market. Eventually though, the local cannabis market will reach saturation, at which point new cannabis retailers will simply cannibalize sales from existing retailers. Essentially, both licensed and unlicensed cannabis retailers all share the same market. In places where no legal access is provided, it can be assumed that the unlicensed market will essentially dominate the market. Where licensed retailers are available, convenient, and competitive, it is likely that sales will steadily shift from the illicit market over time. However, the taxable amount of gross sales will likely plateau at some point regardless of the number of retailers.

According to data collected by *Marijuana Business Daily*, during the early stages of COVID-19, delivery services saw an unprecedented increase in customers, in some cases as high as 220%, but recently data shows that customers are returning to storefront retail stores. The reason for this shift is the benefit a cannabis retail establishment provides the consumer, which is the interaction with a salesperson who is knowledgeable about the products.
The City’s cannabis consultant believes that the current cannabis market demand in San Mateo County would allow four to six Redwood City retailers to develop into a sustainable business operation without having an impact on the ability of other essential businesses to find retail space or lead to clustering of cannabis retail businesses. This is equivalent to one cannabis retailer per 20,000 residents. Taking into consideration the greater population of 250,000 people in the surrounding service area, the number of retailers (including non-storefront) that potentially could be supported could be as high as 12 or 13. This analysis takes into consideration that other cities in the region might potentially allow cannabis storefronts. With a population of 727,209, the County as a whole could ultimately support up to thirty-four storefront and non-storefront retail businesses.

**Staff recommends allowing up to six storefront cannabis retailers, equal to the current six non-storefront retailers in Redwood City. This should allow for sustainable business operations even as other communities eventually allow storefront sales, while avoiding undue impacts on other retail businesses in the community and avoiding clustering of cannabis retail businesses.**

**Question 2: Should cannabis retail storefront businesses be permitted to conduct delivery services as part of their cannabis business permit?**

The most recent data from Marijuana Business Fact Book estimates that as much as 30% of cannabis consumers may use delivery services as part of their purchasing experience due to convenience, lack of transportation, or limitations from medical condition. In addition, delivery may be an essential part of a storefront retail businesses’ business model. State law does not restrict storefront retailers from providing delivery services to consumers, which may increase future deliveries in the City, should more cannabis retailers open in San Mateo County. Finally, another pandemic like COVID-19 that limits the ability of customers to patronize retail storefronts may have an impact on in-store sales and City tax revenue.

Additionally, City staff has received inquiries from existing City permitted cannabis delivery businesses who wish to establish separate retail storefronts in commercial areas in Redwood City to complement their cannabis delivery businesses. If the City allows this, the permit process would need to address delivery-related impacts including loading zones, parking, and traffic.

**Staff recommends that the City allow cannabis retail storefront businesses to conduct deliveries.**

**Question 3: Should cannabis storefront retailers be permitted in all zoning districts allowing general retail?**

The City Council may also choose to implement a number of restrictions and requirements as to how, where, and when a cannabis business may operate. The City Council may consider the following issues in making these determinations.

Should the City Council decide to allow cannabis storefront retailers, the City would need to amend Article 59 of the Zoning Ordinance to allow cannabis storefront retailers in certain zoning districts. A cannabis storefront retail business is a licensed premise with a physical location from which the sale of cannabis would be conducted. This use would operate similarly to other retail uses. In general, cannabis storefront retailers prefer to be located with other retail stores in typical storefront locations, and in areas zoned for retail land uses, as opposed to locating in industrial zoned areas that can accommodate cannabis
storefront retail businesses. By allowing cannabis retailers to locate in commercial areas, the City would be a more desirable location for retailers.

Staff recommends classifying storefront retail cannabis as “general retail” and allowing retail cannabis stores to be located in all of Redwood City’s zoning districts by right that already permit general retail (Table 1).

Allowing for retail cannabis in areas traditionally associated with retail and commercial uses have more visibility and pedestrian activity and would have physical spaces that may be more suitable for retail. By right means that stores could locate in the zoning districts without a discretionary review process and permit, unless certain circumstances arise, specifically if the use did not meet the required parking pursuant to Article 30.5, proposed exterior changes, proposed an addition to the structure, or proposed signage. Interior changes would require a building permit. In all scenarios, retail commercial cannabis activity would be subject to the minimum distance requirements of 600 feet from certain “sensitive” uses and would require a Cannabis Business Permit.

The following table details where general retail is allowed by zoning district in Redwood City. Bold highlighted districts indicate where, as proposed, retail cannabis would be permitted by right; italics indicate where it would be conditionally permitted with limitations for square feet. The map in Attachment A shows the areas of the City where cannabis retail uses would be allowed by right or with a use permit. The designated areas took into consideration the required 600 foot buffer for sensitive receptors or uses.

<table>
<thead>
<tr>
<th>ZONING DISTRICT</th>
<th>GENERAL RETAIL</th>
<th>SQ. FT. LIMITATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Redwood City Downtown (DTTP)</td>
<td>Permitted</td>
<td>N/A</td>
</tr>
<tr>
<td>Neighborhood Commercial (CN)</td>
<td>Permitted</td>
<td>N/A</td>
</tr>
<tr>
<td>General Commercial (GC)</td>
<td>Permitted</td>
<td>N/A</td>
</tr>
<tr>
<td>Industrial Restricted (IR)</td>
<td>Conditionally Permitted</td>
<td>Greater than 30,000 sq. ft.</td>
</tr>
<tr>
<td>Light Industrial Incubator (LII)</td>
<td>Permitted</td>
<td>2,500 sq. ft. or less</td>
</tr>
<tr>
<td></td>
<td>Conditionally Permitted</td>
<td>Greater than 2,500 sq. ft.</td>
</tr>
<tr>
<td>Industrial Park (IP)</td>
<td>Conditionally Permitted</td>
<td>Greater than 30,000 sq. ft.</td>
</tr>
<tr>
<td>Mixed Use Corridor (MUC)</td>
<td>Permitted</td>
<td>N/A</td>
</tr>
<tr>
<td>Mixed Use Neighborhood (MUN)</td>
<td>Permitted</td>
<td>N/A</td>
</tr>
<tr>
<td>Mixed Use Transitional (MUT)</td>
<td>Permitted</td>
<td>5,000 sq. ft. or less</td>
</tr>
<tr>
<td></td>
<td>Conditionally permitted</td>
<td>Greater than 5,000 sq. ft.</td>
</tr>
<tr>
<td>Mixed Use Waterfront (MUW)</td>
<td>Permitted</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Question 4: Should retail storefront cannabis businesses be subject to the same City requirements established for non-storefront retail cannabis businesses?

In all allowed location scenarios, all retail storefront and non-storefront commercial cannabis activity will be subject to the State’s minimum distance requirements of 600 feet from certain sensitive receptors such as K-12 schools both public and private, commercial daycare centers, and youth facilities as well as requiring a Cannabis Business Permit as currently described in in Municipal Code Chapter 32, Article V, Division 7.
The City’s Cannabis Business Permit is reviewed by the City Manager’s Office in conjunction with the Redwood City Police Department and has a long list of requirements for cannabis delivery businesses operating in the City including background checks, security, monitoring, surveillance, and reporting.

Staff recommends that retail storefront cannabis businesses be subject to the same City requirements established for non-storefront retail cannabis businesses including 600 foot buffers from certain sensitive receptors such as K-12 schools both public and private, commercial daycare centers, and youth facilities.

Question 5: Should retail storefront cannabis business applications be processed using a merit-based application process conducted by staff, or should the City Council be involved in the final decision or any appeal?

Cities are granted great discretion in the cannabis business application process. In cities where the numbers of businesses are limited, as is proposed here, it is very common for the cities to use a merit-based application process. Under this process, a series of scoring criteria are set by ordinance or by City Council resolution. If the City Council elects to implement a merit-based application process, staff would evaluate applications according to the scoring criteria and conduct interviews. Staff recommends Option #1 in Table 2 for consideration of cannabis business applications. Table 2 provides other alternatives for the City Council to consider if the City Council would like to have a role in determining application approval or hearing appeals of decisions related to applications.

<table>
<thead>
<tr>
<th>TABLE 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Phase 1</strong> - Application Submittal Determination of Eligibility (same for all options)</td>
</tr>
<tr>
<td><strong>Phase 2</strong> - Application Review Criteria Scoring (HdL) (same for all options)</td>
</tr>
<tr>
<td><strong>Phase 3</strong> - Interview and Second Ranking (Staff) (same for all options)</td>
</tr>
<tr>
<td><strong>Phase 4</strong> - Final Determination (City Manager)</td>
</tr>
<tr>
<td><strong>Appeals (Hearing Officer or Law Judge)</strong></td>
</tr>
</tbody>
</table>

It is important to note that merit-based applications are a time intensive process that would require significant staff time and/or resources to set criteria and evaluate applications. Staff recommends using HdL to evaluate applications, with the cost of this service and the cost of staff time being recovered through the business application fee. A merit-based process would increase the cost of the program but also allow for a more timely and efficient.

Staff recommends a merit-based application process with the application process managed by HdL, with final determination by the City Manager, and any appeals being decided by a hearing officer or law judge (Option 1).
FISCAL ANALYSIS

HdL has provided a range of preliminary projections based upon certain assumptions and confidential data collected from cannabis storefront and non-storefront retailers in the Bay Area as well as other market trends.

Based on this data, staff recommends that four to six retailers be permitted to locate in Redwood City. The table below estimates the potential revenue that could be generated for the City Excise Tax, the 1% City Sales Tax and Measure RR 0.5% transaction tax for the storefront retailers. It should be noted that staff does not recommend, at this time, establishing a cannabis tax above the prevailing rate of 4%-6%. A revenue estimate for a 10% excise tax rate is provided for illustrative purposes since the tax ordinance does authorize the City Council to increase the rate up to 10%. The City’s current cannabis excise tax rate for non-storefront and retail cannabis sales is 4%.

<table>
<thead>
<tr>
<th>Excise Tax Rate</th>
<th>Storefront Retailers Projected Revenue</th>
<th>Bradley Burns Local Sales Tax (1%)</th>
<th>Measure RR Transaction Tax (0.5%)</th>
<th>Total Annual Projected Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>4 Stores</td>
<td>6 Stores</td>
<td>4 Stores</td>
<td>6 Stores</td>
</tr>
<tr>
<td>4%</td>
<td>$720,000</td>
<td>$960,000</td>
<td>$180,000</td>
<td>$240,000</td>
</tr>
<tr>
<td>5%</td>
<td>$900,000</td>
<td>$1,200,000</td>
<td>$180,000</td>
<td>$240,000</td>
</tr>
<tr>
<td>6%</td>
<td>$1,080,000</td>
<td>$1,440,000</td>
<td>$180,000</td>
<td>$240,000</td>
</tr>
<tr>
<td>10%</td>
<td>$1,800,000</td>
<td>$2,400,000</td>
<td>$180,000</td>
<td>$240,000</td>
</tr>
</tbody>
</table>

Recommended range – 4-6%

For illustration purposes - not recommended

In addition to the revenue that will be generated from the cannabis storefront retailers, the consultant estimates that the City will also receive approximately $472,500-$652,500 in revenues from the non-storefront retailers in excise, sales and transaction taxes. Non-storefront retailers also contribute $10,000 each as part of the annual renewal fee that is designated for cannabis drug education for children and youth. This fee will be collected for the first time in 2021 when non-storefront retailers renew their license. City staff propose to include the same cannabis drug children and youth education prevention fee for storefront retailers.
**FISCAL IMPACT ON CITY RESOURCES**

There will be some additional impact to City resources (primarily staff time) to expand the cannabis program but with the assistance of the consultant this impact can be minimized and costs can be recouped through the application fee. The initial consultant contract with HdL Companies to assist in developing a cannabis regulatory program that includes all costs to develop, evaluate the applications and provide staff assistance will cost $58,750. Should the City contract with HdL to assist staff with oversight of all the cannabis businesses annually, the estimated cost of this service is $11,000 per business. This approach would significantly reduce the impact to staff in overseeing these operations. In addition, the benefit of utilizing HdL is that the consultant’s costs will be recovered from the application and permit fees from the prospective applicants and current licensed operators. Permit fees, which have yet to be determined, can also cover staff time involved in processing permits and ongoing monitoring of business operations.

**COMMUNITY OUTREACH**

The City Council requested community input to help guide the retail cannabis discussion. Staff publicized two workshops and solicited the assistance of the consultant to facilitate and conduct a presentation. Workshops were held on February 18, 2020 at the Veterans Memorial Senior Center and March 5, 2020 at the Fair Oaks Community Center (in Spanish). The goal of the workshops was to gauge the community’s interest and concerns associated with allowing cannabis retail storefront businesses to operate in the City.

During the meeting, an overview was provided and key areas of concerns such as public safety, land use, environmental, public health, access to youth and oversight regulations were discussed. Community members were broken up into small groups to discuss the following questions:

1. Should cannabis storefront retail businesses be permitted in the City?
2. How many businesses should be allowed in the City?
3. What type of restrictions should be placed on each of the operations?
4. What type of application process should be established for the issuance of the permits?
5. What are your concerns in allowing cannabis storefront retail businesses to be permitted in the City?

In general, the feedback received was very positive. The twenty-two attendees supported allowing storefront retail cannabis in traditional retail locations. The attendees indicated that retail locations in the industrial zoned areas are not conducive for retail shopping, as they are not located in convenient retail areas of the city, may be poorly lit and may feel unsafe in the evening hours.

The March 5, 2019 outreach meeting was intended for the Latinx community and materials and the presentation were provided in Spanish. This date coincided with rising concerns regarding the COVID 19 pandemic and only two members of the community attended.

In addition to the above community outreach, a survey was available online from February 5 to March 12, 2020 and then again from June 19 to July 5, 2020. The second survey was translated into Spanish with specific outreach to the Latinx community. The survey consisted of the following questions:
1. In general, do you support or oppose allowing storefront cannabis retailers in Redwood City?

2. Storefront cannabis retailers should be allowed in:
   - All commercial districts
   - Commercial districts where large retailers are
   - Neighborhood districts
   - Downtown central business district
   - Mixed-use districts
   - Light industrial districts

The City received a total of 1,238 responses. Sixty-one percent of survey respondents strongly or somewhat support storefront cannabis retailers in Redwood City, and 38% of survey respondents strongly or somewhat oppose storefront cannabis retailers in Redwood City. Responses to survey questions about the potential location of cannabis retailers are included in Attachment B.

**CHART 2**

**In general, do you support or oppose allowing storefront cannabis retailers in Redwood City?**

Once City staff receives City Council feedback, should the City Council wish to move forward, City staff will develop zoning amendments for the Planning Commission’s consideration, will begin the development of an application process, and draft amendments to the City’s Cannabis Ordinance for City Council consideration in fall 2020.

**ENVIRONMENTAL REVIEW**

This study session is not a project and is exempt from the California Environmental Quality Act (CEQA).
PUBLIC NOTICE

Public notification was achieved through the City’s communications channels and by posting the agenda, with the agenda items being listed, at least 72 hours prior to the meeting.

ALTERNATIVES

None.

ATTACHMENTS

Attachment A – Map of potential locations for storefront retail cannabis business
Attachment B – Community survey results

REPORT PREPARED BY:

Alex Khojikian, Assistant City Manager
akhojikian@redwoodcity.org
(650) 780-7302

APPROVED BY:

Melissa Stevenson Diaz, City Manager