



CITY OF ATASCADERO

CITY COUNCIL STAFF REPORT

Item H1

Department: Community
Development
Date: 10 /14/2025
Placement: Management
Report

TO: JAMES R. LEWIS, CITY MANAGER

FROM: PHIL DUNSMORE, COMMUNITY DEVELOPMENT DIRECTOR

PREPARED BY: PHIL DUNSMORE, COMMUNITY DEVELOPMENT DIRECTOR

SUBJECT: Cannabis Land Use Update Discussion

RECOMMENDATION:

Council receive an overview of the Cannabis Zoning Code, an update on the retail industry, and provide staff direction on consideration of adding a retail land use to the list of conditionally allowed uses in Atascadero.

DISCUSSION:

BACKGROUND

During the City Council Goal Setting meeting on Saturday, February 22, 2025, City Council asked staff to bring forward a discussion regarding the potential for retail cannabis sales within appropriate commercial zones in the City. The City of Atascadero completed a comprehensive update to the Cannabis chapter of the Zoning Code (Title 9, Chapter 17) in 2017. This was done in response to Proposition 64 which created significant change to state law, thereby allowing Cities to adopt policies for cannabis retail sales, manufacturing, and cultivation. In May of 2021, the City completed a second round of zoning edits creating a comprehensive set of standards that apply to commercial cannabis land uses, including design, operations, and security standards (Attachment 1), however, storefront retail sales were not adopted into the allowed uses list at that time. The updates included the adoption of a local cannabis tax. The current tax rate for cannabis retail sales in Atascadero is 4% of gross receipts, and the maximum tax rate approved by the voters is 6% of gross receipts. (Title 3, Chapter 18). Because the tax was approved as a voter initiative, the tax rate cannot be increased beyond 6% without a subsequent ballot measure. It can be changed, however, by action of the Council without a vote of the people, provided the tax rate does not exceed 6%.

EXISTING CITY CANNABIS REGULATIONS

The existing Cannabis regulations in the City's zoning code already provide a comprehensive framework that addresses many of the topics associated with Cannabis land uses (retail, manufacturing, testing, delivery, etc.). Each commercial land use is subject to a comprehensive set of development and performance standards that are already within the City code and are

augmented by state law. The City currently allows for two commercial land uses: testing facilities and non-storefront delivery services. Since code adoption, neither of these land uses have operated in Atascadero. However, there are cannabis delivery services that originate outside of the City and make deliveries to Atascadero residents. The City collects tax from these delivery services averaging approximately \$32,000 per year.

ANALYSIS

Status of the Industry in California and the Central Coast

In California the retail cannabis industry is in a state of flux, marked by financial struggles for legal businesses, intense competition from a thriving illicit market, and shifting tax policies. While the legal market continues to grow in terms of production and units sold, sales revenue is declining, leading to consolidation and business failures.

Declining sales and falling prices

- Lowest quarterly sales: The first quarter of 2025 saw California's lowest quarterly legal cannabis sales in five years, down 30% from the market's peak in early 2021 (*Attachment 2*).
- Lower prices, not volume: Despite an increase in the number of units sold, total sales revenue has decreased, indicating that consumers are purchasing cheaper products.
- Michigan surpasses California: California's once-dominant position as the largest legal market is being challenged. In 2024, Michigan sold more cannabis products per month than California.
- San Luis Obispo County sales are mixed: San Luis Obispo City and Grover Beach have seen a decline in overall tax revenue year over year, while Morro Bay had its largest year so far.
 - San Luis Obispo has two storefronts and averages \$1 Million per year in tax revenue.
 - Grover Beach has four storefronts and averages between \$1 and \$1.2 Million per year in tax revenue.
 - Morro Bay has two storefronts and averages around \$500,000 per year but states that 2025 is likely to be highest year at \$536,185.

The dominant illicit market

- Outselling legal products: The black market for cannabis continues to outsell the legal market by a significant margin. The March 2025 report (*Attachment 3*) estimated that unlicensed cannabis sales accounted for 60% of consumption in California in 2024.
- High prices for legal goods: High taxes, fees, limited availability, and compliance costs in the legal market drive up consumer prices, making illicit products more attractive. For example, in Los Angeles, which has a 10% tax rate, illegal shops are thriving while legal businesses struggle to compete.
- Enforcement has limited effect: While the state's Unified Cannabis Enforcement Task Force has seized hundreds of millions in unlicensed cannabis, it only represents a small fraction of the total illegal production.

High taxes and fees

- Excise tax hike: The state excise tax increased from 15% to 19% on July 1, 2025. This was opposed by the industry and is expected to further harm legal businesses by driving up consumer costs. Governor Newsom expressed support for halting the tax increase and a

recent proposal reached his desk that would repeal the tax increase, effective October 1, 2025 setting state taxes back to 15%.

- High local taxes: Some of the largest retail markets in the state, such as Los Angeles and San Jose, have local tax rates as high as 10%. San Luis Obispo has a 6% tax rate, Morro Bay and Grover Beach are 5%.

Regulatory and market challenges

- Business failures and consolidation: The challenging market conditions have led to widespread business failures and consolidation, with thousands of licensed companies going out of business.
- Limited retail access: Many cities and counties still prohibit cannabis businesses, creating a patchwork of access for consumers and potentially encouraging the black market.
- Regulatory maze: Complex and continuously evolving regulations, along with federal prohibition, create hurdles for business owners seeking capital, locations, and stable operations.

The market is still resilient

- Recent policy changes: The state eliminated the cultivation tax in 2022 and shifted the excise tax collection point to retailers, an effort to simplify administration.
- Support for social equity: State initiatives are aimed at lowering barriers to entry for new business, including fee waivers and deferrals.
- Some businesses succeed: Despite the overall trend, some businesses are adapting and surviving by focusing on consolidation and competitive pricing. Some craft cannabis dispensaries have even expanded.
- Licensed market still growing: In 2024, licensed cannabis production and units sold increased despite the decrease in overall revenue, suggesting the legal market is still expanding in terms of volume.

Crime and Security plans

Staff interviewed planning and police department staff from Morro Bay, San Luis Obispo, and Grover Beach. None of the Cities reported any issues with significant changes in criminal activity due to the presence of retail storefronts. All of the Cities noted that the high level of security required for each storefront is a good deterrent to criminal issues and is an important design requirement. All the cities interviewed require that retailers provide and maintain a comprehensive security plan that includes cameras, on-site security, ID checks, and secure areas where product deliveries occur. These secure areas typically include a fenced carport or vehicle garage that is attached to each retailer where deliveries are handled.

The City of Atascadero has already adopted a set of requirements for crime prevention in the existing cannabis ordinance. If a retail land use is added, the Police Chief and City Attorney should evaluate the existing code to see if additional security provisions are needed. During the conditional use permit process, security provisions may also be added or enhanced, and each store would need to submit a security plan to the satisfaction of the City.

Signs and Advertising

Each of the Cities regulate commercial signage in a similar fashion with size limitations, illumination restrictions, and restrictions on temporary signs. Atascadero already has a sign regulation specific to cannabis (AMC 9-17.006):

Signage. On-site signage for a commercial cannabis activity that is viewable from the exterior of the premises shall comply with all local signage laws applicable to the permitted and licensed premises, including Chapter 9-15 of this code. Signage may not be designed to appeal to children, or contain any false or misleading statements, or make any misrepresentations.

Since it is assumed that any cannabis retailer would also be subject to a conditional use permit, additional sign criteria can be added based on each potential location. As an option, the sign criteria noted above can also be amended to provide additional restrictions to prohibit illumination, restrict imagery, restrict freeway facing signs, or limit the size and number.

Where could a retail land use exist in Atascadero and how many retail stores?

Consistent with State law, the Atascadero Municipal Code already limits the locations of commercial cannabis activities as follows:

*AMC 9-17.006 Distance. Commercial Cannabis activities shall be **prohibited within 600 feet of schools, parks, youth centers, or day care centers.** All distances specified in this section shall be measured in a straight line, without regard to intervening structures or topography, from the nearest point of the building or structure in which the commercial cannabis activity is, or will be located, to the nearest property line of the parcel where such use is located. If the commercial cannabis activity is, or will be located, in a multi-unit building, the distances shall be measured from the nearest point of the suite in which the cannabis business is or will be located.*

Based on the distance criteria, commercial cannabis land uses would be restricted to several locations along the commercial corridor along El Camino Real. Staff has created a set of maps that indicate where there are commercial zoned properties that are outside of the restricted areas already established by the code (Attachment 3). Unrestricted areas include the retail district on El Camino Real south of the Vons Shopping Center and north of Curbaril Avenue as well as other locations on north El Camino Real. The City Council would need to determine what zoning districts are appropriate and if any additional location limitations should apply.

What other provisions should be considered in a code update?

Community Benefit Program

Most communities require that cannabis businesses provide a community benefit program that mitigates the potential use of cannabis in the community. These programs are typically negotiated with each City through the Conditional Use Permit process. In the City of Atascadero, our code already has a provision that suggests such mitigation:

9-17.008 Conditions of approval may require that a commercial cannabis activity be subject to conditions that mitigate potential impacts of the sale of cannabis products in the community.

This provision can be used to ensure that a cannabis retailer funds a specific program in the City that furthers specific activities such as youth programs, parks, or related health programs that may have a nexus to the impact of cannabis products.

Staffing Impacts

The Police Chief is currently evaluating potential impacts to staffing based on the potential addition of a retail land use. Retail land use is not assumed to result in substantial increases in crime but instead results in the need for additional law enforcement collaboration and monitoring. Additionally, the business review and processing of Use Permits along with monitoring and annual review will also result in staffing impacts to the Planning Division. For example, the review and monitoring of security programs, background checks for new businesses and employees will need to be mitigated through the required community benefit program or through the introduction of a new fee for a Cannabis business License. Other Cities use such a nexus to charge fees in excess of \$80,000 for such a permit. The City of San Luis Obispo has a full time liaison that is responsible for the handling of cannabis businesses. The overall impact and cost of additional staff has not been determined at this time, but a full analysis can be completed, should the City Council vote to ask staff to pursue the code update.

Selection and Location Determination Process

Some cities, such as San Luis Obispo and Morro Bay, have limitations on the number of Cannabis retailers that may be allowed in their City. In order to vet a qualified retailer, these Cities have ranking criteria that evaluates the retailer (Attachment 4). These rankings allow City staff to fairly select a retailer based on specific items that are important to the City, such as community benefit, experience, and other factors. Such a ranking is not mandated by state law and is not a critical component of a code update, but is one option to consider should the City restrict the number of retailers. One of the factors to consider with a ranking process, however is that it has the potential to result in legal challenges with the City being accused of unfairly ranking one business over the other. Such was the case in San Luis Obispo, where legal challenges to the ranking process resulted in lawsuits.

Another way to refine the number of retail establishment would be to adopt one or more specific overlay zones where cannabis retailers may establish. Within such a zone, the City could adopt distance criteria between each store that may help to automatically limit the overall number of retail outlets without having a merit or selection process. This overlay zone could be applied to certain locations along El Camino Real within the retail zone south of the Morro Road Intersection, or the area in the CPK zone north of downtown. This method can also more precisely control the location of retail stores.

What tax revenue could be anticipated in Atascadero?

Staff interviewed local cities to determine current sales tax revenues (Attachment 5). San Luis Obispo and Grover Beach are averaging roughly \$1 million per year each while Morro Bay is averaging roughly half a million dollars per year. Assuming Atascadero may be the only retailer in the North County, revenues could be on par with Grover Beach or Morro Bay. However, Atascadero currently has the lowest tax rate in the County at 4%, while Grover and Morro Bay are at 5% and SLO is at 6%. Megan from Megan's Market in SLO reports that 40% of her sales are from the North County, with 15% of sales specifically from Atascadero. It is also likely that some Atascadero residents are currently using delivery services, and some are shopping in Morro Bay

or Grover Beach. Atascadero's low tax rate may help increase sales, but may also result in overall reduced tax revenue based on gross sales. In any case, the market is not likely to increase in our region by the addition of retail in the North County, it will only be further diluted amongst the participating communities.

What would be the process if Atascadero wants to allow a retail land use?

In order to amend the code to allow for retail sales, the City would need to amend title 9, Chapter 17 of the Zoning Code. The amendments would add a retail storefront land use to the list of conditionally allowed uses, decide which districts are appropriate, and decide whether there needs to be additional location, design, and security characteristics that are not already within the code. Lastly, the City will need to decide (or not) on a maximum number of retail stores and the criteria by which to select authorized retailers. Several other communities in the County, including Morro Bay, Grover Beach, and San Luis Obispo, have similar provisions.

Specifically, the City would need (or may desire) to amend the following:

1. 9-17.003: Add a definition of retail sales
2. Table 17-1: add a retail land use
3. Delete section 9-17.006 (1) which prohibits on-site retail sales
4. 9-17.006 (3): Provide additional sign/advertising standards *as desired by Council*.
5. 9-17.009 add operational standards, *as desired by Council*.

Next Steps

If the City Council votes to direct staff to begin the preparation of a code update, City staff would want to prepare additional public outreach similar to what was done with the Cannabis Code update in 2021. This outreach would include social media, a potential community survey, or even an in-person workshop. Staff would then bring draft code options back to City Council for a preliminary review, prior to bringing a code update through the regular adoption process (Planning Commission, City Council, second reading). This process could take place after the adoption of the General Plan update early next year.

CONCLUSION

The Cannabis retail market continues to adapt and refine. In general, cannabis retail sales appear to be waning due to the market factors noted in the report. There is still space for a retail market in Atascadero. However, other Cities such as Paso Robles are beginning to evaluate options to accommodate retail cannabis, therefore the market may be reduced as retail options expand. The assumed "problems" with the retail industry such as crime and other factors do not appear to be present in the local communities that surround us. There are health factors with cannabis use that are not explored with this report, however these factors are similar with other products such as alcohol and tobacco. The City Police Chief and Fire Chief did not have available data on medical calls associated with cannabis use. Since cannabis is already available by delivery and available in surrounding communities, this factor may not be expanded by the placement of a retail store.

FISCAL IMPACT:

It is expected that the sales tax revenue from the addition of one or more retail cannabis stores in Atascadero could potentially reach \$500,000 in annual tax revenue. However, some additional

costs would be incurred due to increased staff time, monitoring of security provisions and other details that have not yet been fully explored.

REVIEWED BY OTHERS:

This item has been reviewed by the Police Chief and Administrative Services Director.

REVIEWED AND APPROVED FOR COUNCIL AGENDA:



James R. Lewis, City Manager

ATTACHMENT(S):

1. Title 9, Chapter 17, Atascadero Cannabis regulations
2. Condition and Health of the Cannabis Industry
3. 600' buffer maps for Atascadero retail zones
4. City of SLO Merit Criteria
5. Evaluation of SLO County Cannabis Retailers