

# California CENTERS

## IS THERE GREEN TO BE MADE IN CALIFORNIA'S CANNABIS INDUSTRY?

*Shopping center owners love an emerging retail category, particularly in this connected environment, but California's complex laws have many wondering whether cannabis is a viable offering.*

By Nellie Day

There's a new game in town that provides an experiential environment, consumable product, and newness and novelty due to its previously illegal nature. Excited yet? Or perhaps scared? These are two sentiments that seem to prevail over California's emerging retail cannabis industry. Proposition 64 legalized the recreational sale of marijuana in California in 2016, but that doesn't necessarily mean the state has rolled out the green carpet quite yet.

Medical marijuana has been legal in California since 1996. During this time, licensed cannabis clinics, or dispensaries, were overseen by local regulators and only serviced individuals on a doctor's recommendation. Most of these uses involved the treatment of symptoms stemming from cancer, AIDS, glaucoma, arthritis, migraines, chronic pain and anorexia. It has since grown to include the alleviation of other conditions, including anxiety, depression, insomnia, post-traumatic stress disorder (PTSD) and many others.

The cannabis landscape became murky and complex, however, once the state had authority to issue licenses on January 1, 2018. Suddenly, California found itself with a lot of recreation and little regulation. So the state did what it does best.

"You have to remember that California regulation is always more complex than any other state because it is California, and that's just the California way," says Amanda Ostrowitz, CEO and founder of CannaRegs, an online

resource service that simplifies cannabis laws and regulations. "For the past 20 years, there was no state-level regulation, just local regulation [regarding medical marijuana]. When the state finally decided it was going to regulate the cannabis industry, there was already a legal patchwork of local laws and taxes, which had never co-existed with state law. Naturally, this has led to a much more challenging landscape in California with overlapping, conflicting and duplicative laws at the state and local levels."

To begin with, potential cannabis retailers must obtain a state license before seeking out storefront space in a marijuana-friendly municipality. This poses two additional problems. State officials initially estimated about 6,000 cannabis shops would begin operation after the passage of Proposition 64. However, the state Bureau of Cannabis Control had only issued 547 temporary and annual licenses to marijuana retail stores



**Amanda Ostrowitz**  
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and dispensaries as of January 1, 2019, according to the *Los Angeles Times*. On top of that, CannaReg notes only 161 of California's 482 municipalities and 24 of the 58 counties have opted to allow commercial cannabis uses.

These can be frustrating numbers as companies like Canadian-based Choom Holdings, Inc., believe the demand is there. The cannabis company currently developing a network of North American retail stores says legal cannabis sales totaled nearly \$11 billion in North America in 2018. This market is expected to grow by almost 350 percent by 2027, or to \$47.3 billion, according to a study by Arcview Market Research and BDS Analytics.

These are loyal customers, too. Of the 3,000 U.S. cannabis users Choom recently surveyed, more than half not-



ECO Cannabis opened a retail space on Telegraph Avenue in Oakland this January. East Bay's first retail cannabis dispensary was geared toward lifestyle and wellness offerings that focused on a highly trained staff and specially curated products.

ed they used cannabis at least once a week. Cannabis retailers who are able to persevere in California can bring in lots of green for themselves and their landlords — and we're not talking about bud.

"Erba Collective sees between 500 and 700 customers per day and it only has nine parking spots," says Zack Johnson, founder and CEO of Greenbox Robotics, which operates cannabis product vending machines in dispensaries, including Erba Collective on Pico Boulevard in Los Angeles. "There tends to be lines throughout the day."

MedMen, a cannabis retailer with operations across the U.S., including flagship stores in Los Angeles, has experienced similar demand and success. The public company reported \$21.5 million in revenue in the first quarter of 2019, representing a 1,094 percent increase in growth over the first quarter of 2018. The company also achieved an annualized sales rate of \$6,188 per square foot across eight Southern California locations, with an 82 percent conversion rate.

Other than industry leaders like MedMen, which has 5.3 percent of the California cannabis marketshare, the average sales per square foot for legal cannabis retailers operating nationwide ranges between \$974 per square foot and \$1,773 per square foot. To put this in context, Lululemon does \$1,491 per square foot, TJ Maxx/Marshalls does \$448 and Dollar Tree does \$158.

## FIRST, THE BAD NEWS

Before landlords race to court the likes of MedMen, there are many factors to consider. The first is that the U.S. Department of Justice (DOJ) still classifies marijuana as a Schedule I narcotic.

"Landlords need to understand that these tenants remain in violation of federal law despite compliance with local law — there is simply no enforcement of the federal law prohibiting their operations," says Rick Thomas, a shareholder at Brownstein Hyatt Farber Schreck.

There are, unfortunately, risks associated with this federal classification as far as landlords are concerned.



MedMen owns 5.3 percent of the California cannabis marketshare. The company achieved an annualized sales rate of \$6,188 per square foot across eight Southern California locations, including Abbott Kinney (pictured) in Venice.

"Landlords face the prospect of federal forfeiture, which can be administrative, civil or criminal, of the real property that houses the tenant," says Hilary Bricken, an attorney at Harris Bricken that hosts Southern California investment forums to educate those interested in cannabis and ancillary industries. "They also face secondary criminal liability [in terms of] aiding, abetting and conspiring to violate the Controlled Substances Act, or CSA."

As scary as this sounds, Robert W. Selna, attorney at Wendel Rosen Black & Dean, offers some perspective.

"The feds have all but eliminated law enforcement in states with commercial cannabis regulations," Selna notes. "Congress has also removed Department of Justice funding for enforcing federal marijuana laws in states that have medical cannabis regulations. As a result of changes in federal law enforcement, the threat of asset forfeiture for licensed operators following the rules of their jurisdictions has been minimal for several years."

Just because the risk is minimal doesn't mean it doesn't exist, however.

"Nonetheless, there are lease provisions which can help property owners and landlords if they are confronted with a cease and desist letter threatening property seizure," Selna continues. "In sum, the lease provisions allow the

landlord to terminate the lease if the threat of law enforcement, including asset forfeiture, emerges by way of a cease and desist letter or another law enforcement communication."

There are cases of the federal government attempting to seize California-based assets and close cannabis businesses prior to the passage of Proposition 64.

"A very good cautionary tale is the Harborside case where the federal government tried to take the two properties at which Harborside, then a medical cannabis dispensary, was operating," says Bricken of the 2012 case involving dispensaries in San Jose and Oakland.

"When drafting the lease, the landlord completely neglected to take into account of asset forfeiture. When the DOJ moved to take the properties, Harborside would not vacate the locations."

Though the DOJ eventually dismissed the forfeiture action, it wasn't before a real mess ensued. This involved an unlawful detainer (eviction) lawsuit in state court, landlord appeals and motions denied by the federal court and eventually the U.S. Court of Appeals for the Ninth Circuit, which decided the DOJ could not spend funds to interfere with the state's medical cannabis programs.

"The landlord could have avoided the entire situation, and the likely massive expenditure of attorney's fees, if their lease would have been tighter and more comprehensive regarding federal forfeiture," Bricken cautions.

Martin Olive, president of the Vapor Room in San Francisco, experienced the fed's wrath for himself in 2012. Though the medical dispensary had operated legally in the Lower Haight community since 2004, it ran afoul of the government when the then-U.S. attorney noted the Vapor Room's proximity to a playground at Duboce Park, another no-no. Regulations dictate a dispensary cannot be situated near a school, public playground or park,



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child care or day care facility, youth center or church. The proximity varies depending on local laws, but it dictates a 600- to 2,500-foot radius away from these establishments.

“We operated without incident and improved the relative safety of our surrounding Lower Haight neighborhood until 2012 when we lost our permitted, compliant and model medical cannabis dispensary during the 2011 to 2012 federal crackdown,” Olive says. “We tried our hardest to stay open but we, along with others, succumbed to the federal threats rather than risk action against our landlord’s property by the feds.”

To reiterate Selna’s sentiment, these instances occurred prior to the new recreational cannabis laws. Still, they highlight the very real pull the federal government has over this industry and the spaces where they operate.

## NOW, FOR SOME GOOD NEWS

Even the federal government couldn’t keep cannabis enthusiasts like Olive down. He and his Vapor Room are back, with a new San Francisco outpost on 9th between Market and Mission streets that opened in January.

“The response to our reopening has been fantastic,” Olive says. “Old customers from our original location that was shut down in 2012 and new customers are all really excited to check out our beautiful, little shop. We have a great staff and a unique shopping experience. I’m a shop keep at heart. I really love working the floor, greeting customers and helping them find the products that will best suit their needs. It’s been really fun getting back into the retail environment with a new shop that is set up very differently than traditional dispensaries.”

Making his environment experiential and welcoming was part of Olive’s design goals from the start. He believes this is one of the easiest ways to combat stereotypes about cannabis and its clientele.

“By creating a knowledge, responsible and informative atmosphere, we begin to remove those ill-conceived notions of cannabis being ‘bad,’” he says. “By building a welcoming, well-designed and professional-look-



Zack Johnson knows shopping in a dispensary for the first time can be very overwhelming. That’s why the entrepreneur created GreenBox, a cannabis product vending machine that provides products and information directly from the manufacturers.

ing dispensary, we show our community that these are places to be proud of, to highlight in our neighborhoods as a point of pride and that we take our work seriously.”

These endeavors also, naturally, involve an open-minded landlord. Thomas notes that, in many instances, these landlords need to be even more open-minded as federally insured lenders cannot participate in a project occupied by a cannabis tenant. This can build an interesting dynamic between landlord and tenant, as the landlord may be literally invested in the cannabis company’s success.

“My advice to a cannabis tenant would be to take advantage of tenant improvement allowances and other forms of landlord financing as the landlord has a vested interest in the tenant’s success and is able to provide financing where an institutional lender would be prohibited from doing so,” he suggests.



**Rick Thomas**  
Shareholder  
Brownstein Hyatt  
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Another important point to note is that banks and credit unions that rely on federal support cannot participate in these establishments. Solutions regarding accounting, banking and payments do exist for cannabis retailers, though, as most well-informed lawyers can tell you.

Still, in cannabis-friendly areas like San Francisco, the industry grows (no pun intended). The Vapor Room is joined by fellow retailers like Moe Green’s, the Apothecarium, the Green Croos and the Bloom Room within the city.

The founders of ECO Cannabis took a similar design and experiential approach to Olive when they opened their retail space on Telegraph Avenue in Oakland this January. East Bay’s first retail cannabis dispensary was geared toward lifestyle and wellness offerings, creating a singular experience that emphasizes a highly trained staff and specially curated products.

“We are excited for what this new space means for those local to Oakland and the Bay Area, adding to the fabric of this vibrant city,” says Bronwyn Kopacek, ECO’s CMO. “Our mission at ECO is to become the social equity standard for the cannabis industry.”

ECO Cannabis' new space also highlights a larger customer service trend within the retail industry. Though personalized in-store consultations are available with "Experience Guides," consumers have the option to expedite the purchasing process through express-style online orders and in-store, self-service check-out options. Like Johnson, ECO Cannabis has taken note of long dispensary lines since the lack of licenses and oftentimes business-unfriendly climates have caused demand to far outweigh supply. Johnson believes the self-service approach can also bridge the gap for consumers who are new to cannabis. Before Proposition 64, most individuals would have little interaction with the substance, save for a doctor's recommendation or a college party or two.

"We have always believed that the express checkout model should be available in every retailer," Johnson says of his GreenBox vending machines. "Shopping inside of a dispensary for the first time can be very overwhelming. The GreenBox provides a private shopping experience. What sets our machines apart is the aesthetics, robotics, compliance, education around products and overall ease of use. Customers have the ability to learn about all of the products with information directly from the manufacturers. Our niche is bringing automation and education to the wild, wild West of cannabis."

## HIGHER EDUCATION

Education is exactly what is needed on this new frontier. Licensing, permitting and uses aside, the cannabis industry is still fighting a glut of pushback from cities, neighborhoods, landlords and co-tenants (legal experts advise landlords should always review lease covenants regarding use restrictions and other contractual prohibitions prior to introducing the idea of a cannabis retailer at their center). Regardless of where this product falls on one's moral compass, there are certain facts that should be considered. These include marijuana's pros and cons, demand, potential revenue, and how to properly regulate its recreational sale and use, just as the alcohol industry



ECO Cannabis' new space offers personalized in-store consultations, as well as express-style online orders and in-store, self-service check-out options, highlighting the latest trends in the broader retail environment.

did decades ago.

Rick Daniels, city and utility manager for Needles, California, a city in the Mohave Valley near the Arizona border that has issued 82 permits to cannabis-related businesses, thinks the largest misconceptions surround just who, exactly, partakes in cannabis.

"There was a lot of concern initially about nefarious characters hanging around the dispensaries," he says. "That has not materialized due to the strict no loitering enforcement, on-site consumption regulations and the retailers' efforts to make sure their places can draw all customers. Many customers are senior citizens. A bad environment scares those customers away. The biggest concern for a safe and attractive retail outlet are expressed by the retailers themselves."

Olive believes many landlord and city officials resistant to these retailers would be surprised to see the diverse masses cannabis can attract.

"Cannabis is one of the greatest cultural equalizers in the world," he states. "In the 15 years we've been operating, our lounge has seen the widest cross section of demographics sharing in their enjoyment of cannabis. There are senior citizens diagnosed with cancer coming in, and they are sharing



**Martin Olive**  
President  
Vapor Room

with young guys and people who, demographically speaking, would have absolutely nothing in common with them. That to me, speaks volumes about how cannabis can be beneficial to people from all walks of life; young and old, poor and rich, and everyone in between."

Choom Holdings research cites that 66 percent of weekly cannabis users are Millennials, with 64 percent being male. Attracting Millennials plays a large role in the viability of today's shopping centers as we enter tomorrow's market. The early adopters of many emerging categories — including gyms, schools, churches and showrooms — all had to deal with the doubts and naysayers when they initially attempted to enter shopping centers. What is different with cannabis retailers is the gaggle of agencies attempting to oversee this substance in California and at the federal level. It remains to be seen how the retail industry will view the cannabis industry's consumer cannabis locations. For now, some in the industry are trying to follow a trend. After all, you don't have to wear Nike to appreciate that sneakers are a hot consumer trend.

"I believe time and education are the only ways to answer the question of how to change the stereotypes around cannabis," Johnson says. "The more time that goes by, the more people will embrace the use of cannabis because of the wellness benefits. It will not happen overnight, but if you look at the past five years, we have made some incredible strides in overcoming this negative stigma. I believe the brands that can educate consumers on the when, why and how to consume or apply their products will be the Nike's, Levi's and H&M's of the cannabis market. I am excited about the progression of this market, and optimistic about the next five years." **CC**

*[Editor's Note] This article is not intended as advice, opinion or counsel on the subject of cannabis real estate. As with any real estate deal, we suggest you seek counsel from experienced and specialized real estate and legal professionals to make your own informed judgments.*