Latest cannabis law could reshape California's food and beverage scene

Landlords have an opportunity to fill a sea of vacant second-generation restaurant space

By Brannon Boswell

A new law could help California's legal cannabis industry expand beyond the struggling dispensary model with retail and entertainment space that can tap demand for more unique dining and shopping experiences.

Known as the Control, Regulate and Tax Adult Use of Marijuana Act, the law allows cities to let cannabis retailers serve non-cannabis food cooked on site and host live entertainment events, such as concerts.

“California is once again leading the way in supporting legal, safe cannabis businesses and culture,” said Matt Haney, the San Francisco assemblymember who authored the law.

The law is already taking hold in Los Angeles at The Woods, a dispensary and lounge in West Hollywood co-owned by actor Woody Harrelson and talk show host Bill Maher, where customers can now order refreshments like coffee and desserts while consuming cannabis products. The Woods, one of the first licensed operators to take advantage of the new law, is creating a larger menu and applying for permits to add stages for concerts and other live entertainment.

California joins at least seven other states in allowing food service and live entertainment at cannabis venues. In Michigan, a state that allows on-site food and beverage consumption at dispensaries, cannabis consumers are spending triple the amount of their counterparts in California, according to industry publication MJBizDaily.

Still, there's no guarantee that added food and experiential features will revive California's legal cannabis industry that has remained stubbornly stagnant in recent years, largely as a result of high taxes and an unfriendly regulatory environment, experts say.

However, the new law gives commercial real estate landlords an opportunity to fill a sea of vacant second-generation restaurant space as cannabis companies move to larger spaces with kitchens, seating and stages.

Sector in decline

California voters legalized recreational marijuana use in 2016; ever since, several cannabis "lounges" have cropped up throughout the state where customers can smoke indoors.

Prior to the recently enacted law, such dispensaries could only sell prepackaged snacks and drinks.

California's legal cannabis business has been challenged by taxes and competition from the illegal

market. Legal cannabis sales in the state reached $4 billion in 2020, while illegal sales are believed to have surpassed $8 billion that same year, according to Haney.

The number of cannabis growers and brands has decreased by more than 70% since legalization first took effect, according to the Mercury News. MedMen, a cannabis retail chain that Wall Street valued at more than a billion dollars when California's legal market launched, filed for bankruptcy in April and closed all of its dispensaries in the state.

Adding food and beverage features while allowing for more operational flexibility could help dispensaries expand during a time of overall tenant retrenchment in California's retail scene, with vacancy rates climbing in Sacramento, San Diego and San Francisco.

In Los Angeles alone, retail tenants have given back 2.3 million more square feet than they have leased in the past year, according to CoStar data. Recent demand levels, compared to market size, were among the lowest recorded across major U.S. markets, according to Ryan Patap, CoStar's senior director of market analytics.

The experience solution

Dispensaries are diversifying as other more traditional brands add experiential concepts to boost sales.

Retailers ranging from Lexus to Dick's Sporting Goods are building brand awareness and increasing their foot traffic with experiential attractions, according to Placer.ai analyst Bracha Arnold.

At the same time, retailers like Crate & Barrel, Louis Vuitton and Lululemon are adding restaurants to keep shoppers on site longer and spending more.

An "Amsterdam-style" approach to food is needed to help reverse the pharmacy-like experience at most cannabis dispensaries, Haney said. The Netherlands is home to more than 700 coffee shops that sell cannabis and do $1 billion in sales each year, he added.

Dispensary operators are making expansion plans and applying for new licenses across the Golden State in the wake of the law, including the Crystal Nugs dispensary in Sacramento, where the owner is adding a stage and two VIP rooms to the existing dispensary in midtown.

Like The Woods, many existing cannabis retail locations are retailers with limited parking that are not built out for restaurant use, so current sites will have some challenges to convert their existing stores to cafes, said Chris Maling, principal with Avison Young, who brokers commercial properties throughout Southern California.

However, "second generation restaurant sites that are currently vacant may get a second look as potential cannabis cafes," Maling told CoStar News.

Long road ahead

The cannabis cafe expansion could take up to nine months to start showing sprouts as operators apply for the necessary licenses, according to experts.

Local governments must convert their regulations to conform to the new state law, an often slow process. Some cities have already expressed an interest in growing their cannabis businesses; Sacramento, for one, launched a cannabis lounge pilot program in November that's currently helping to establish permitting guidelines.

Projects could face additional hurdles as some cities will require owners to win separate approvals for the cannabis component and for food and beverage sales, which may limit immediate expansion and growth, Maling said.

Staffing also might be an issue for these new cannabis cafes, Maling said. Workers will have to sign waivers or releases for “environmental work conditions” due to exposure to secondhand cannabis smoke, he said.

Opponents argued the law would undermine the state's no-smoking laws in restaurants. But Haney said such cafes allow smokers a place to indulge with other smokers away from nonsmokers.