



Wednesday, October 23, 2019
2:00 PM – 3:15 PM

Seminar 1

**Blowing Away the Smoke:
Financial Opportunities in Marijuana/Hemp Real Estate Deals**

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- **Setting the Stage – The Ever-Changing Legal Landscape of Medical and Recreational Marijuana Businesses**

“Commercial real estate developers say they have never seen a change so swift in so many places at once. From Monterey, California to Portland, Maine, the new industry is reshaping once blighted neighborhoods and sending property values soaring. In some Denver neighborhoods, the average asking lease price for warehouse space jumped by more than 50% from 2010 to 2015, according to an industry report. In the city overall, there are five times as many retail pot stores as stand-alone Starbucks shops.” *New York Times, Sunday, April 2, 2017*

The sharp rise in property prices follows the booming market for legal marijuana. Sales of legal cannabis reached \$6.7 billion in the United States last year and are expected to top \$20 billion by 2021, according to ACRVIEW Market Research.

The April 2 *New York Times* article describes the market in Denver, Colorado as follows:

“Denver has emerged as America’s *de facto* pot capital. Since Colorado legalized marijuana for recreational use in 2012, hundreds of stores selling pot have opened and enormous growing operations have set up shop. Legal cannabis sales topped \$1 billion in the state last year. From 2009-2014, 36% of new industrial tenants were marijuana businesses, according to the report on the city from CBRE Research, a commercial real estate company. Nearly four million square feet of industrial space was being used for cultivation in 2015 according to the report, about 3% of the city’s warehouse space. Retail spaces are just as hot. By 2015, there were upward of 200 marijuana stores in Denver, occupying high-end storefronts and former gas stations. The spike in demand has been good for landlords, who often charge 2-3 times market rates for spaces used for cultivation or sales.”



The April 2 *New York Times* article goes further to describe the nature of the current retail marijuana outlets.

“A short drive away in Brookline, the store in an old Beaux Arts bank was also doing a brisk business ... the [retailer] wanted some pizzazz for the customer experience, so it leased a bank. Inside, skylights and tall arched windows flood the former bank lobby with sunlight. Gilded Corinthian columns reach up to a domed turquoise ceiling. Where bank tellers once handed out cash, employees now hand over buds of Tangerine Haze and Master Kush. The decision to lease the former bank wasn’t cheap for the [retailer]. The group entered into a lease years ago and paid rent while it sat empty. ‘The holding costs there were significant,’ said Norton Arbelez, Director of Government Affairs for the [retailer]. But, Mr. Arbelez said, ‘we wanted to take this industry out of the shadows’ and a flashy retail space was one way to make that happen. So far, it seems to be working. On a busy day, the [retailer] can sell marijuana buds, pre-rolled joints and cannabis infused chocolates worth as much as \$100,000.”



A Brief Overview of Federal Legality and Illegality Issues

Under the 1970 Controlled Substances Act (21 U.S.C. § 800 *et seq.*), marijuana is listed as a Schedule 1 drug. Schedule 1 drugs are considered the most dangerous. Its current federal status puts marijuana in the same category as heroin, cocaine and opium, in sharp contrast to its legality in the early 1900s. Of particular interest to commercial property owners is 21 U.S.C. § 856 (the “crack house statute”) which provides that using or allowing real property to be used for unlawfully manufacturing, storing, distribution, or using a controlled substance is a federal crime, the penalty for which may include forfeiture. It is the fear of breaking federal law and, potentially, losing their property that quite logically has made landlords reluctant to lease to marijuana businesses even in states where it is legal.



Supremacy Clause

The supremacy clause of the U.S. Constitution (U.S. Constitution Article 6, Clause 2) provides that the federal law is the supreme law of the land and, as a result, the federal laws criminalizing marijuana use and sale preempt any state statute legalizing use.

The two seminal federal actions relaxing the impact of preemption are the Cole Memorandum and the Rohrabacher Farr Amendment.

The Cole Memorandum

The Cole Memorandum is a U.S. Department of Justice memorandum dated August 29, 2013, issued under the Obama administration by James M. Cole, Deputy Attorney General. In effect, the Cole Memorandum states that enforcement of marijuana laws is not the highest Department of Justice priority. The Cole Memorandum highlights the enforcement priorities which the Department of Justice has with respect to marijuana, and these priorities are as follows:

- Preventing the distribution of marijuana to minors;
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs and cartels;
- Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
- Preventing state authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
- Preventing drug driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Preventing marijuana possession or use on federal property.”

To date, the authors are unaware of any such withdrawal or other memorandum addressing this issue from the current administration but there are rumors indicating that a new memorandum is forthcoming.



Rohrabacher Farr Amendment

In addition to the comfort afforded by the Cole Memorandum, marijuana users and retailers have also looked to a rider to the federal consolidated appropriations acts commencing in 2014 and continuing through September 2017, which provided in § 537 of the Consolidated Appropriations Act of 2017 that “none of the funds made available in this Act to the Department of Justice may be used with respect to any of the states [and the states legalizing medical and recreational marijuana are listed] to prevent any of them from implementing their own laws that authorize the use, distribution, possession or cultivation of medical marijuana.” The Department of Justice cannot use appropriated funds to enforce federal marijuana laws. Insiders do not expect the Rohrabacher Farr Amendment to be renewed at the end of September.



IRS/Taxes

With respect to business expenses and, more particularly, deduction of business expenses incurred by a marijuana retail operator, I.R.C. § 280(E) prohibits deduction of expenses from a trade or business on federal tax returns. The inability to deduct such expenses, including lease payments, obviously has a significant impact on profitability of retail marijuana outlets and effectively means marijuana stores pay higher taxes than other retailers.

Department of Treasury/Banking

There are significant issues under federal law with respect to banking and marijuana retail facilities. As noted above, the volume of money changing hands in retail sales was estimated to be \$6.7 billion in 2016. Both Department of the Treasury regulations and case law (*Fourth Corner CU v. Federal Reserve Bank of Kansas City*, District Court Colorado 15-CB-01633) (2016) hold that banks cannot facilitate criminal activity; therefore, because possession and sale of marijuana is illegal, under federal law, banks cannot accept deposits from marijuana wholesalers and retailers. As a result, retail marijuana businesses are cash-only businesses. Because of the volume of money involved, the safety and security issues surrounding a retail marijuana business are significant. Because of the cash-intensive nature of the business, marijuana business owners are also subject to suspicious activities reports (SARs) under the Financial Crimes Enforcement Network ("FinCEN") regulations, which provide that cash deposits in excess of \$10,000 must be disclosed to FinCEN.

FinCEN has issued regulations with respect to marijuana-related businesses. A Department of the Treasury FinCEN Guidance was issued on February 14, 2014 regarding treatment of marijuana-related businesses. The basis of the Department of Treasury FinCEN Guidance is the Cole Memorandum. If the current administration reverses the Cole Memorandum, the validity of the Department of Treasury FinCEN Guidance will come into question.



Trademark/Patents

Trademarks are only permitted with respect to lawful commerce. As a result, registration of trademarks relating to sale of marijuana are not permitted.



Bankruptcy

Relief under federal bankruptcy laws is not available to marijuana businesses which are insolvent (*in re Arenas* (Bankruptcy District Colorado (2014))). In addition, there is also a Department of Justice letter dated April 26, 2017 directed to bankruptcy trustees, stating “it is the policy of the U.S. that Trustees shall move to dismiss or object to all cases involving marijuana assets.”



Recent Case

Safe Streets Alliance v. Alternative Holistic Healing, LLC

Background: In two separate actions, landowners and Colorado, Kansas, and Nebraska law enforcement officials challenged Amendment 64 to Colorado Constitution, which repealed criminal and civil proscriptions on recreational marijuana, as preempted by federal Controlled Substances Act (CSA), and brought Racketeer Influence and Corrupt Organizations Act (RICO) action against marijuana growers on adjacent property.



LEASE ISSUES AND MODEL CLAUSES

The key to leasing to a marijuana-related business is incorporating specific marijuana leasing provisions that mitigate the criminal, financial, and operational risks. The following lease provisions should be considered by both landlords and tenants during the negotiation and drafting of a retail dispensary lease.

Permitted Use

Lease Example for Permitted Use

“The Premises shall be used by Tenant to carry out a lawful cannabis business in accordance with [insert relevant state marijuana law and regulations] for the following uses that Landlord has initialed next to the listed item and for no other purposes. [List agreed upon permissible uses, including whether recreational sales are permitted].”

“This is a nonsmoking premises. No smoking, including medical or recreational marijuana, inside or on the Premises is permitted. However, consuming medical marijuana with a vaporizer or in cannabis edibles, tonics, or concentrates is permitted.”

“No recreational or medical marijuana may be consumed on the Premises by the Tenant(s) or Tenant’s guests and invitees without the prior written consent of the Landlord.”

“Unless otherwise consented to by Landlord, in writing, Tenant shall be prohibited from operating a recreational or adult use marijuana dispensary on the Premises, regardless of state law.”

“Tenant shall at all times during the term of the Lease or any extensions thereof, have a copy of Tenant’s state-issued marijuana license at the Premises and shall be available during working hours to present such license, which shall be in good standing with the applicable state governmental regulating authority. Upon each renewal of Tenant’s state-issued marijuana license, Tenant shall provide a copy of such license to Landlord within twenty-four (24) hours of receipt.”

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On-Site Cash

“Tenant shall use its best efforts to ensure that patients, customers, employees, agents, and owners of Tenant and Tenant’s dispensary neither loiter, nor use, smoke, vape, dab, consume, in any form or fashion, any THC and/or CBD marijuana product in the Premises or Building, on the Property or in any adjacent properties. Tenant shall remove cash from the Premises at the end of each day, so that at no time shall Tenant have in excess of \$[_____] on the Premises. Tenant shall provide Landlord with Tenant’s daily cash transfer schedule and procedures and shall update such information to Landlord within twenty-four (24) hours of any changes to Tenant’s cash transfer schedule and procedures.”



Payment of Rent

“Tenant shall pay all Rent, Additional Rent and any other amounts due to Landlord by check or wire transfer on the date set forth in this Lease. Unless otherwise agreed by Landlord, Tenant shall not be permitted to pay Rent, Additional Rent or any other amounts due Landlord in cash.”



Utilities

“Any excessive consumption of water or electricity shall be at Tenant’s sole cost and expense. No utilities user sharing the meter for electricity or water, as the case may be, shall be obligated to pay a disproportionate share of utilities. If Landlord determines that the only reasonable means for proper allocation of electricity/gas/water usage costs is the installation of a separate meter, Tenant shall pay the expense of the meter and its installation within five business days of the date upon which Landlord informs Tenant of its election to install a separate meter.”

Inspection of Premises

“If approval from the [insert relevant state and local regulators] or any other governmental authorities is necessary in order for Landlord or any mortgagee to inspect the Premises, Tenant shall use its best efforts to support obtaining such approvals for inspection, time being of the essence. If Landlord’s access to certain space in the Premises is conditioned on Landlord being accompanied by a member of Tenant’s management team, Tenant shall provide such access to the Premises as soon as reasonably possible, after Landlord request.”

“Landlord shall have the right, at any time any portion of the Premises is occupied by Tenant’s principals, agents, or contractors, including at times when the Premises is not open for business to the public, to enter the Premises for the purposes of ensuring compliance with the covenants, warranties, and representations of Tenant under this Lease. In accordance with state licensing rules, Landlord must be accompanied by authorized Tenant personnel while inspecting limited access areas. Landlord may photograph or video-record in any medium the activities of Tenant, subject to privacy restrictions under HIPAA and state laws and so long as such visual records are not provided to anyone with an interest in possessing Tenant’s trade secrets (other than government entities).”



Indemnification

“Except to the extent caused by or resulting from Landlord's gross negligence or willful misconduct, Tenant shall save Landlord harmless, and will exonerate and indemnify and defend Landlord from and against any and all civil, criminal, or other claims, liabilities, or penalties, including attorney's fees, asserted by or on behalf of any person, firm, or public or governmental authority on account of or based upon Tenant's use of the Premises or any injury to a person, or loss of or damage to property, sustained or occurring within the Premises.”



Signage/Marketing

“At all times during this Lease, Tenant shall comply with all applicable statutes and regulations involving [insert facility type] advertising, signage and marketing of the [insert facility type] business.”



Odors

"Tenant shall undertake reasonable and diligent steps to mitigate any odor emanating from marijuana located on the Premises."

Tenant Improvements/Build-Out

“The parties acknowledge that the Premises are not currently fit for the permitted use and that the alterations listed in Attachment A will have to be construed to render the Premises fit and that:

- a. Tenant shall, at its sole expense, but with the good faith and reasonable cooperation of Landlord, secure all licenses, permits, and other approvals required to make such alterations;*
- b. Tenant shall not be entitled to reimbursement from Landlord for making any alterations or improvements that are unique to the operation of a Cannabis business and provide no residual value to a subsequent tenant; and*
- c. Tenant shall remove, at its sole expense, any and all alterations that Landlord designates for removal at the end of the Lease term.”*

“Tenant’s covenant to comply with all applicable Mandates shall apply equally to dismantling Tenant’s operations at the end of the term and surrender of the Premises.”

“Tenant hereby covenants to dispose, according to Mandates, all unused inventory, refuse, and scrap materials and thereafter to clean to commercially acceptable standards (including sterilization of impermeable surfaces, wall to wall and ceiling to floor) all floors, walls, immovable fixtures, and air ducts serving the Premises.”



Events of Default

“...Tenant’s failure to maintain the [insert facility type] license in good standing with the applicable governmental authorities,”

“...the initiation of any Federal enforcement investigation or action involving Tenant, Tenant’s affiliates or Tenant’s use of the Premises as a result of operating as a marijuana [insert facility type],”



End of the Lease Term

“Tenant shall remove, coordinate, and/or destroy, as permitted and directed by the applicable governmental authorities, all medical marijuana products remaining in the Premises upon expiration or earlier termination of this Lease.”



Duty to Report

“Tenant shall be required to report to Landlord within twenty-four (24) hours, including providing copies of any written notices, of any complaints received by Tenant, including but not limited to, patients, employees, agents, or owners, loitering, or using, smoking, vaping, dabbing, or consuming, in any form or fashion, any THC and/or CBD marijuana product in the Premises or Building, on the Property or on any adjacent properties. If Tenant receives any notices from the [insert relevant state and local regulators] or any other governmental authorities, regarding Tenant’s [insert facility type] license or use of the Premises as a [insert facility type], Tenant shall submit such notices to Landlord within twenty-four (24) hours.”



Definition of 'Laws'

Tenant's obligation hereunder shall include (i) all state and local laws and regulations from any governmental authority with jurisdiction over Tenant's use, including but not limited to [relevant state law and regulations] and local zoning ordinances; and (ii) all federal laws to the extent those laws are not inconsistent with state and local laws allowing Tenant to use the Premises for the specified permitted uses. The covenant to comply encompasses all applicable laws that become effective before and during the Lease term, as may be extended (collectively, the "Mandates"), regardless of the cost of such compliance. Tenant's inability to comply with the Mandates shall be grounds for termination of this Lease.

OTHER AREAS OF CONCERN

Insurance

Insurance policies for marijuana tenants can be very expensive and typically contain many carve-outs regarding what is actually covered. Landlords will want to require tenants to obtain a robust insurance policy. However, landlords should be sensitive to what types of policies and coverages tenants can actually obtain.

Security

Landlords should be aware of the additional security concerns that come with leasing to marijuana tenants. Landlords should consider either requiring tenants to pay for additional security systems for the premises (which may include the hiring of a security guard) or building-in such costs to the lease. With regard to security guards, landlords should ensure a tenant hires an insured and reputable security company, or possibly require the hiring of off-duty policemen. Landlords also may want to specify whether security guards are permitted to be armed. (Note: This may be subject to state law specifics).

Limitation of Liability

Landlords will not want to limit their recovery for any breach of the lease or damages from the tenant's activities to exclude recovery from any partner, shareholder, member, trustee, or beneficiary of the tenant. Landlords should consider lease guaranties.

OTHER AREAS OF CONCERN

Landlord Reservations

Landlords should reserve the right to terminate the lease upon changes in laws related to the tenant's activities, including changes to applicable local, state, and federal laws, or upon revised official guidance concerning enforcement priorities from the Department of Justice (rescission of the Cole Memorandum).

Governing Law

Both landlords and tenants need to confirm applicability of laws governing the location of the marijuana activity and that counsel knowledgeable about the specific local requirements (such as zoning regulations) has reviewed the lease.

Waiver of Defense

Both landlords and tenants should waive any defense based on violation of federal laws and should stipulate that federal illegality based on the presence of marijuana is not a valid defense to a claim arising under the lease. Many states that allow marijuana cultivation require this term to be included in the lease, thus negating any federal "innocent owner defense" for a landlord.

OTHER AREAS OF CONCERN

Warranty of Suitability

Landlords may want to remove warranties that the premises are suitable for a tenant's proposed use, since this may require significant alterations to the premises, such as building code and zoning alterations and inspections. Tenants should be responsible for all necessary permits, licenses, and approvals.

Environmental Concerns

Both landlords and tenants should agree upon proper procedures for the disposal and storage of herbicides, pesticides, and fertilizers in addition to light and water use.



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