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**THE
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**AN EXCLUSIVE
LOOK AT THE
COMMERCIAL REAL
ESTATE INDUSTRY**

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CANNABIS: SEEDING THE COMMERCIAL REAL ESTATE SECTOR

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Commercial cannabis operations in the U.S. are booming, with more states authorizing the use and sale of medical and/or recreational cannabis each year. Nine states and the District of Columbia currently have recreational cannabis laws and more than 30 states permit the use and/or sale of medical cannabis. This November, Michigan and North Dakota will vote on statewide recreational cannabis legalization and Utah and Missouri will consider medical marijuana legalization initiatives. In 2018, the U.S. cannabis trade was valued at more than \$8.5 billion with estimates showing the U.S. market will exceed \$40 billion by 2027.

The impact of commercial cannabis operations has been felt throughout the U.S. real estate market where cannabis has been legalized. Many areas have limited properties zoned for commercial cannabis operations, resulting in landlords and sellers demanding a premium from cannabis operators due to supply and perceived business risks with these types of businesses. In some markets the price per square foot for properties zoned for commercial cannabis use, where licenses are available, has doubled or tripled the market average. Retail storefronts have been repurposed into high-end cannabis dispensaries, with finishes comparable to those of other major, more traditional retail tenants. Industrial properties are being transformed into indoor cultivation and manufacturing facilities for cannabis goods and a variety of ancillary cannabis-related products.

These ancillary products and the businesses

that produce them are also driving real estate prices. Related businesses include cultivation equipment, packaging and labeling, security services, products and accessories, technology, medical research and testing, and consulting and professional services. In addition to the cannabis operations that "touch the leaf," these ancillary businesses also require real property in order to operate, and may further drive the demand for cannabis-related office, industrial, and retail space.

As of 2018, cannabis remains federally illegal under the Controlled Substances Act. Many traditional landlords are therefore reluctant to permit cannabis operations on their properties. With cannabis operations technically subject to seizure by the federal government, one of the most significant obstacles has been the availability of financing for both cannabis operations and property owners intending to house these operators. Additionally, financial institutions regulated by the federal government are subject to criminal and administrative sanctions if they offer financing to any cannabis-oriented operations. As a result, many traditional banks will not provide mortgages for real property used for cannabis operations. This limitation has led to the proliferation of cannabis hard money lenders and real estate investment trusts. A related consequence is that a number of large U.S. cannabis companies have elected to go public in Canada, as our neighbors to the North have legalized cannabis nationwide.

If the federal government decides to prioritize cannabis enforcement actions, commercial

real estate markets will undoubtedly be impacted as the uncertainty of federal prosecution currently restricts the supply of real estate available for cannabis-oriented businesses. While federal legalization of cannabis in 2019 is improbable, more than 40 pro-cannabis bills have been introduced to Congress. Federal legalization of cannabis would mitigate many of the aforementioned risks associated with cannabis operations and would most certainly free up capital and financing for cannabis operations and properties devoted to cannabis use. The reduced risk and increase in available financing and investor acceptance would likely result in market adjustments to lower and stabilized rents for the cannabis industry. Positive federal legalization also could lead to a geometric increase in use, production, and demand for cannabis and cannabis-related products which could offset rent stabilization with further increased demand.

While the future of the U.S. cannabis market is uncertain at this time, the potential risks and various obstacles associated with leasing or selling property for cannabis operations, along with restrictive licensing by local government agencies, will continue to influence real estate markets in cannabis-friendly states. As the interest in commercial cannabis continues to grow, more cities and counties may embrace cannabis legalization favorably as a source of significant revenue through licensing fees and taxes. Positive public opinion of legalized cannabis and the positions and actions taken by our federal government will remain principal drivers for the industry, and in turn, the real estate market that supports it.