

Lease Issues for Cannabis Businesses

I. Types of Businesses and Permitted Use

Many governmental agencies require a cannabis licensee to show lawful possession of and access to the property that will be licensed. This means a deed, signed lease, or a contract to purchase. In addition, regulatory agencies will require leases to explicitly list the intended cannabis use as a permitted use.

- A. Retail: Simple storefront retail sales to the consumer
 - 1. Most like other retail uses
 - 2. May be restricted by local zoning-NIMBY
 - 3. Similar to liquor stores? Proximity to sensitive uses.
 - 4. Public perception and acceptance
- B. Distribution or Wholesale:
 - 1. Warehouse type of use, which may include storage, warehousing, bulk sales to other licensees
 - 2. Security issues dealing with controlled substance
 - 3. Access and parking
 - 4. Regulatory issues ADA
- C. Growing:
 - 1. Agricultural versus Industrial
 - 2. Outdoors seems simple but not favored
 - 3. Indoors is industrial or manufacturing
 - 4. Special utility needs
 - a) water much more than simple warehouse use
 - b) power for grow lights may exceed standard electric service
 - 5. Fertilizer risks as chemicals

- 6. Pest control
- D. Processing, which may include extraction, mechanical processing, preparation of edibles, manufacturing of topicals:
 - 1. Manufacturing and industrial use
 - 2. Potentially dangerous process
 - 3. Heavy power requirements
 - 4. Hazardous Materials

II. Security issues:

- A. Cash business, banking is limited
- B. Controlled substance
- C. Limit landlord access
- D. Potential legal issues for landlord
- E. Potential financing issues

III. Federal issue:

- A. Illegal under Federal law
- B. Presently allowed state by state per memorandum
- C. Potential political shift could prohibit use
- D. Tenant right to terminate vs landlord security of investment

IV. Local permitting:

- A. Zoning
- B. Special ordinance NIMBY
- C. Required improvements to property. Qualified architects and contractors may have little or no experience with the specifics for a cannabis facility. Client needs to inquire.

- D. It can take several months to design a facility and prepare plans and specifications for submission.
- E. The industry is growing like a weed, and the city governments are overwhelmed. This can cause delays in getting applications processed.
- F. Building improvement to code by Landlord. The permanent improvements will benefit Landlord and enhance the property.
- G. Premises improvements specific for tenants use should be at tenants cost.
- H. Who bears risk if use prohibited after the lease commences?
- I. Improvements as condition to permit
- J. Special improvements versus general
- K. Rights to cancel
 - 1. Tenant or mutual if regulatory
 - 2. Landlord right if mortgage default

V. Rent Payments

- A. Retailers cannot deduct cost of rent under 280E, but producers can. Thus, a space that will be used for both retail and production should be separated into two individual leases. Rent for production space can be higher than rent for retail space.
- B. Landlords that accept cash rent payments over \$10,000 per year must file a Suspicious Activity Report (SAR) with FinCEN. Landlords should either include a disclosure that it will be filing a SAR in connection with any cash rent payments or consider not taking cash payments at all.
- C. Some mortgages will not allow the advance payment of rent. If a property is financed, check the loan document to determine if a tenant can make a large, advance payment of rent. (That said, mortgages usually disallow cannabis uses, since cannabis is illegal under federal law. If a lender finds out an owner is using a property for cannabis, the owner may have bigger problems than just the advanced payment of rent issue).

VI. Term of the Lease

- A. Landlords usually charge a huge premium to lease property to cannabis tenants, citing great “risk” to the landlord, so many cannabis tenants believe that rent will go down for them in the near future. Thus, cannabis tenants sometimes want a shorter lease term and either fewer renewal options or the option to renegotiate rent upon renewal (based on fair market value at the time of renewal).
- B. Special Termination Rights
 - 1. Cannabis leases must have special termination rights, allowing either the Landlord, the Tenant, or both to terminate the lease in the following circumstances, with no penalty:
 - 2. A change of enforcement policy at the federal level (e.g., change in Cole Memo, raids, public statements that federal government will begin enforcing the CSA, etc.);
 - 3. A change of state or local laws that makes the cannabis use illegal, impossible, impractical, or financially infeasible;
 - 4. The inability to obtain or failure in obtaining local or state licenses or approvals (often a date certain is set by which tenant must have licenses or can otherwise terminate);
 - 5. Termination, revocation, or administrative dissolution of a license (this provision is usually only seen when termination is not the fault of the licensee, and when it is tenant’s fault, it’s an event of default);
 - 6. The cannabis use presents a material threat to the landlord’s ownership interest in the property (must be evidenced by something tangible – like threats of arrest and / or prosecution of landlord or landlord’s receipt of a letter threatening seizure, confiscation, condemnation, or some similar impairment to the landlord’s ownership interest in the property)
 - 7. Upon the termination of the lease, cannabis tenants must be able to take all furniture, fixtures and equipment used directly in the production or processing of marijuana, inventory, and marijuana-related products and by-products.

VII. Events of Default

- A. Landlords will want to include, as an event of default, the failure to comply with all state and local laws related to the cannabis use;
- B. Tenants will want lease to allow them to cure any violation of state or local laws and contest any administrative proceedings against them before an event of default occurs (as long as tenant can do so with impairing landlord's ownership interest or subjecting landlord or tenant to any liability of any kind, including criminal liability);
- C. Exclude cannabis inventory and marijuana-related products and by-products from default collection. Some states may even require that all equipment used directly in the production or processing of marijuana be excluded from collection upon default (as only licensees may possess).

VIII. Tenant Improvements

- A. Cannabis tenants must often make physical modifications to the space, either to accommodate the cannabis use or to comply with regulatory requirements;
- B. Landlord should be required to pay for improvements to bring the property to code, and tenants should pay for modifications needed for use. A typical list of improvements, which are not specific to the use but may be required by code that the Landlord should deliver might be:
 - 1. Finished ADA restrooms
 - 2. Water Heater
 - 3. Laundry sink and stub up for additional sink
 - 4. Lighting and emergency lighting
 - 5. Wall and Ceiling Insulation to current code
 - 6. Finished, painted gypsum board walls
 - 7. Overhead door and two man sized doors
 - 8. Electrical service adequate for use
 - 9. Lease should require that landlords cooperate with tenants to get local approvals, permits, and licenses;

10. Specifically call out improvements made by tenant that could arguably be considered fixtures to ensure that tenant can remove them at the end of the lease (with the condition that any damage caused by the removal must be repaired). The following equipment should be considered personal property of Tenant that does not become part of the leased premises: air conditioners and air handlers; irrigation equipment; supplemental electrical service; special fire systems; cameras and security system; safes; grow lights; modular walls for grow rooms; any and all equipment used in the production and processing of cannabis items;
11. Before the tenant or buyer spends money to improve the location the contingencies for permits and licenses must be resolved, even if a involves a delay in closing or lease commencement
12. The tenant is at risk of its own improvement costs in case the law has changed and they are shut down.

IX. Parking

- A. Many of the proposed facilities are older warehouses or repurposed properties. As part of the evaluation of the property, the available parking must be considered, based upon the proposed use:
- B. A site may have no provision for paved parking that meets City requirements for manufacturing.
- C. Cannabis growing is considered “agriculture” and does not require parking in some cities.
- D. Cannabis extraction is considered “Manufacturing” and does require parking.
- E. Cannabis Wholesale is “Wholesale” which has the same requirements as manufacturing.
- F. Cannabis dispensary is retail and likely will have the most requirements.
- G. Parking will have to include ADA compliant spaces, including at least one space which needs to be an ADA van space with loading aisle.

- H. Parking spaces need to be paved and have paved access from the street. Old warehouse site could be compacted gravel only.

X. Access to Premises

- A. Agencies will usually have rules regulating access to the licensed premises by anyone other than the licensee (except for dispensaries, of course). Each state is different, so state-specific rules on access should be incorporated.
- B. Standard lease clauses granting access to Landlord must be altered so that Landlord can only enter with a Tenant's employee and only after notice.

XI. Insurance

- A. Lease should exempt a cannabis tenant from insurance requirements when the tenant is unable to obtain the insurance due to the nature of the business (e.g., business interruption insurance, which may not be available for cannabis businesses);
- B. Insurance policies need to be reviewed carefully to ensure that the insurance will provide coverage for the cannabis tenant (some insurance policy contains prohibitions against extra hazardous uses or exclusions for illegal uses if the insurance policy is written by a national underwriter)
- C. Insurance policies should have considerations for the handling of large quantities of cash.

XII. Pesticides, Chemicals, Hazardous Conditions

- A. Ensure that any hazardous chemicals used in the normal course of business for cannabis processors are allowed by the lease, as long as used in compliance with all environmental laws;
- B. Some landlords want outdoor growers to use only organic inputs. Consider referencing, instead, the state-specific rules on pesticides. For example, Oregon has very strict pesticide requirements and has compiled a list of allowed pesticides for cannabis. Not all organic pesticides are on the list and some on the list are not organic. Alignment with state-specific rules can eliminate confusion.

- C. There are safety issues particularly with extraction. Landlords may want a provision requiring that the tenant will use safe extraction methods and not cause an explosion or fire. There may be hazardous chemicals which require an exception to the hazmat provisions.

XIII. Miscellaneous Cannabis Lease Considerations

- A. The general provisions of the lease should be modified to exclude compliance with federal laws. The typical provision requiring compliance with governmental regulations must be examined and changed. Ensure that parties waive the right to use federal illegality as a defense to the enforceability of the lease agreement.
- B. Any reference to “nuisances” in the lease should specifically exclude cannabis uses that are in compliance with local and state laws;
- C. Additional security issues need to be considered since the facility will be dealing in a controlled substance and large quantities of cash.