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Advice for landlords and owners to consider when leasing to tenants in the cannabis industry - by Randall Beach

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Recreational cannabis use is now legal in nine states, as well as the District of Columbia. Thirty-one states have legalized cannabis use for medical purposes. New York State legalized medical cannabis use in 2016, and a recent report from the New York State Department of Health, together with public comments from the governor's office, make the legalization of cannabis for recreational use in New York State appear likely in the not too distant future. Despite these changes in state laws, and numerous polls that indicate most Americans believe cannabis use should be legalized across the U.S., Cannabis remains a Schedule 1 regulated substance under the Controlled Substances Act and, thus, illegal under federal law.

What does the state of cannabis regulation have to do with real estate? Quite a bit actually. Whether we consider sales or leasing, the intersection of real property and the cannabis industry presents many challenges for real estate professionals, property owners and managers, as well as the cannabis businesses themselves. Many of these issues stem from the fact that the manufacturing, possession and sale of cannabis remains a federal crime.

At present, it appears that most cannabis businesses are looking to lease rather than own the real property on which they will conduct operations. This means that landlords in New York, and the professionals that represent them, must sharpen their pencils and jump head first into a new learning curve.

Landlords considering leasing to a cannabis industry member must first understand the unique risks at play. The greatest risk is, arguably, civil property forfeiture under the Controlled Substances Act. This allows for the seizure of property, including real property, that is used to facilitate a crime—in this case the manufacture, possession or sale of cannabis. For civil forfeiture to be successful, a substantial connection between the property and the crime must be shown—it is not necessary for the owner of the subject property to have directly participated in the crime. Thus, landlords must address and become comfortable with the risk that their ownership interest in real property could be lost simply due to the fact that they lease that real property to a participant in the cannabis industry. Until cannabis is made legal on the federal level, this risk will remain. There are, however, steps landlords can take to mitigate their exposure to civil forfeiture.

Another fact that a landlord which is considering embracing the cannabis industry must recognize is that its standard commercial lease will not work with a cannabis tenant. Leasing space to a cannabis-related tenant will require a specialized lease in order to address the various unique issues

that this emerging industry presents. Issues such as defining legal requirements, access, licensing, dispute resolution, indemnity and the environment, all require special consideration here. Further, the nature of the tenant's business must be addressed in the body of the lease with a great deal of specificity in order to avoid regulatory pitfalls. Off the shelf, boilerplate leases are non-starters. They won't work for the cannabis tenant and will not provide adequate protections for the landlord.

It is not often that a new industry emerges and immediately challenges traditional real estate practices. The cannabis industry, though, is doing just that. Until federal law is amended to allow cannabis use, these special challenges will continue to exist. This is an exciting, new industry and many landlords are naturally eager to seize upon lucrative opportunities to participate. It is critical, though, that these landlords be willing to be flexible to meet the needs of the cannabis businesses, and work with knowledgeable real estate professionals to mitigate inherent risks.

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