

# Cannabis: Guidance for Real Property Owners

A Practical Guidance® Article by Garrett Graff and Bobby Dishell, Moye White LLP



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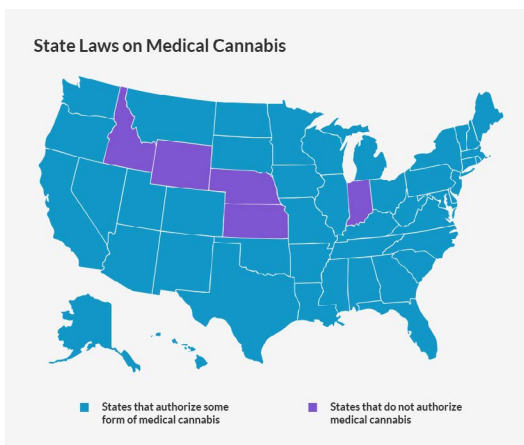
As cannabis continues to become legalized state by state across the country, many real property owners may contemplate leveraging their real estate assets and taking advantage of this growing sector of the economy. These real property owners may first ask themselves, “what do I need to do to protect myself?” This practice note discusses key considerations real property owners should evaluate when deciding whether to leverage the use of real property assets within the cannabis industry, with a focus on leasing transactions. Some states and local jurisdictions where

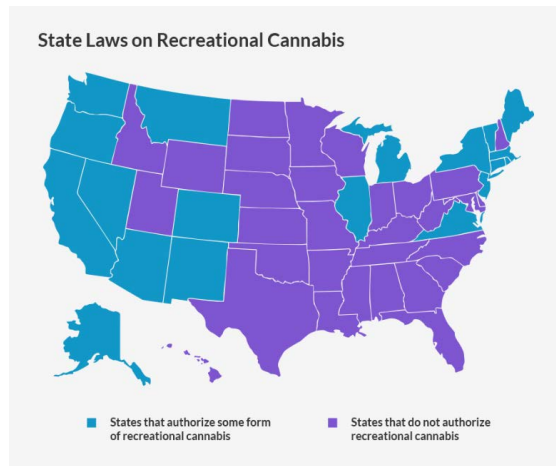
cannabis is legal require the inclusion of specific lease or ownership provisions in the documentation governing a sale or lease of real property for cannabis-related purposes. This practice note does not evaluate each jurisdiction and is instead intended as an overview of relevant considerations for real property owners.

For more on cannabis issues affecting real estate, see [State-Legalized Marijuana and Real Estate](#). For additional resources, see [Cannabis Resource Kit](#).

## Background and Context

Growing year over year during the past decade, the cannabis industry—direct, plant-touching operations—represents billions of dollars of business and state tax revenue. The following maps summarize states that permit some form of medical cannabis and states that permit some form of recreational cannabis. Note that in some states, especially among those that permit only medical use, the ability to access cannabis can still be quite limited. To review the law in a specific state, see [Medical and Recreational Marijuana State and Local Law Survey](#). These maps were created (and are maintained) by the Practical Guidance Team.





The cannabis industry includes both plant-touching operations and non-plant-touching business opportunities—for example, real property ownership or other “cannabis-adjacent businesses.” In some instances, a licensed cannabis business beneficially owns the real estate used for its business operations, while in others, a licensed cannabis business may merely use land owned by a third party through a (mostly) traditional landlord/tenant relationship. Despite not directly engaging in the cultivation, manufacture, or sale of cannabis or cannabis-derived products, those who are in cannabis-adjacent businesses—who neither directly sell or participate in the cannabis industry but may come across it by being part of the supply chain—continue to risk federal and state scrutiny and obligations that, in some cases, mirror the scrutiny, risks, and obligations of licensed cannabis businesses. In turn, these things can seriously impact real property owners who may lease to both cannabis businesses and cannabis-adjacent businesses. See [Risking a Contact High: The Tenth Circuit’s Failure to Defer to Colorado’s Marijuana Laws, 98 Denv. L. Rev. 265](#). While cannabis-adjacent businesses may be able to differentiate and separate themselves from the risks associated with cannabis plant-touching operations, it is important to be aware of the risks facing cannabis-adjacent businesses generally in case a conservative or liberal interpretation of how “adjacent” a business or tenant is, proves incorrect.

## Areas of Caution

There are several areas where real property owners should pay close attention when working with cannabis businesses, particularly when the owner has a tenant that is a licensed, plant-touching operation. These areas include the following:

- Compliance with all laws

- Mortgage cross-defaults
- Banking considerations
- Availability of insurance coverage
- Environmental conditions
- Zoning requirements –and–
- Security issues

### Compliance with All Laws

Most commercial contracts have a clause along the lines of, “[The parties] shall comply with all local, state, and federal laws.” Real property owners should evaluate all existing commercial agreements relating to their property, and their interest therein, because once a real property owner leases property to a cannabis business, the property’s use no longer complies with all federal laws, which may inure a breach of such contractual provision, along with other implications of such noncompliance, as more fully discussed below. Owners should be comfortable with agreeing to comply with all applicable state and local laws and some federal laws, and the relevant documents should carve out any obligation to comply with all federal laws “related to marijuana’s present designation as a controlled substance under the federal Controlled Substances Act.” This amended obligation may impact real mortgage obligations, insurance coverage, and banking, which are explored in greater detail below.

### Mortgage Cross-Defaults

Most real property owners have a mortgagee—a lender or other capital provider who has a security interest in their property. Mortgagees often obligate the property owner to abide by certain covenants related to the use of the property to ensure the value of the real property security is preserved. By leasing space to a cannabis business, a real

property owner can easily violate its various loan covenants or obligations under other agreements. As mentioned above, this could be as simple as a violation of a covenant to ensure the property is exclusively used in compliance with all federal laws. Leasing or selling real property to a cannabis business can, therefore, provide the lender with the right to accelerate the loan, leaving the real property owner in a precarious position; absent an alternative remedy, the owner may be compelled to refinance the mortgage (which can be expensive and at exorbitant interest rates), pay off the debt and self-finance the property, or consider selling the property to the prospective cannabis tenant.

Accordingly, real property owners interested in working with cannabis businesses should carefully review loan covenants and representations and warranties to ensure that the lender does not have an approval right and that doing business with a cannabis business will be permitted. Separately, the lender may not be willing to sign an SNDA or may have a document it requires the tenant to sign. Prior to finalizing an agreement with a cannabis business, make sure the owner and lender are on the same page to help mitigate risk and avoid acceleration of the underlying mortgage and consideration of alternative financing. This can be especially critical in a real property sale if the lender will not accept funds originating from a cannabis company for a loan payoff.

## **Banking**

If a real property owner elects to lease or sell their real property to a cannabis business, the owner should follow all corporate formalities to protect other assets unrelated to the cannabis tenant. Best practices may include forming a special-purpose entity for ownership of the real property being leased to a cannabis business to segregate the real property—along with any rent revenue and tax implications—from the owner's other assets and accounts. If the majority of the real property owner's business is unrelated to cannabis or leasing to cannabis companies, the owner should not allow its other assets to be commingled with its assets related to the property leased for a cannabis-related use, as various banking and/or tax implications can arise out of the cannabis-related use.

Under the Bank Secrecy Act and further guidance issued by the Financial Crimes Enforcement Network (FinCEN), financial institutions that choose to provide banking services to cannabis businesses are required to file a Suspicious Activity Report (SAR) when a bank knows, suspects, or has reason to believe the transaction is related

to illegal activities under federal law. See [Department of the Treasury well-advised by FinCEN Guidance Issued February 14, 2014 FIN-2014-G001](#).

Under current guidance, a bank may flag your rent from a cannabis business with a SAR. Some types of SARs are often used to flag transactions when a financial institution reasonably believes, based on its due diligence, the company does not implicate one of the priorities detailed under [the memorandum](#) issued by James M. Cole on August 29, 2013 (the Cole Memo). (See also [2014 FinCEN Guidance](#).)

Such SARs may designate a report as a Marijuana Limited filing, a Marijuana Priority filing, or a Marijuana Termination filing. A Marijuana Limited filing is where red flags are not raised with respect to the tenets of the Cole Memo; a Marijuana Priority filing means one or more “red flags” are raised with respect to the Cole Memo's tenets, and that further investigation is warranted; and a Marijuana Termination filing is where the banking institution's due diligence indicates that termination of the account is justified by the concerns raised with respect to Cole Memo compliance. See [Risking a Contact High: The Tenth Circuit's Failure to Defer to Colorado's Marijuana Laws, 98 Denv. L. Rev. 265](#).

Where a business is indirectly related to cannabis, like a commercial landlord leasing to a cannabis business, the bank does not have to distinguish between a Marijuana Limited and Marijuana Priority filing. However, the decision to provide such banking services should be risk-based and include an analysis of the Cole Memo priorities. See [Risking a Contact High: The Tenth Circuit's Failure to Defer to Colorado's Marijuana Laws, 98 Denv. L. Rev. 265](#). For example, banking institutions such as Partner Colorado Credit Union established a separate subsidiary, Safe Harbor Private Banking, functioning as the credit union's cannabis banking arm, which is subject to heightened and extensive diligence and compliance reviews but which is still examined by federal examiners.

While it is important that all tenants comply with state law, it is increasingly important for tenants involved in cannabis-related businesses as real property owners want to avoid any filing beyond a Marijuana Limited filing when it comes to their bank transactions. As mentioned above, real property owners should consider using a separate bank account and entity for each real property asset to help mitigate liability related to other unrelated ventures or real estate assets the company may be engaged in.

## Insurance

Real property owners should communicate with their insurance provider that they plan to lease to a cannabis business and should build proper protections into a lease agreement with the cannabis tenant. Insurance companies do not have an obligation to insure a cannabis business; many insurers may maintain internal controls that prohibit the provision of insurance policies for cannabis-related uses, and note cannabis-related uses as exceptions to policies. Thus, it is critical to be transparent with insurance companies to ensure that a policy will remain in full force and effect, despite the cannabis-related use.

Assuming a valid policy is issued, there is no settled law on whether an insurance company is obligated to pay a claim on a policy that insured a cannabis business—case precedent provides mixed results in favor of both the insurer and the insured. Some courts have held that insurance companies are required to pay out on a policy where the insurer knew of the cannabis operations, or fashion some other remedy that reflects that the insurer was knowingly availed of the nature of the insured's operations. In *Green Earth Wellness Ctr., LLC v. Atain Specialty Ins. Co.*, a medical cannabis company made an insurance claim for cannabis plants and equipment destroyed in a fire. 163 F. Supp. 3d 821 (D. Colo. 2016). The court held that the insurance provider was required to honor its contractual promises and did not invalidate the contract. The court reasoned that “[the insurance company], having entered into the policy of its own will, knowingly and intelligently, is obligated to comply with its terms or pay damages for having breached it.” 163 F. Supp. 3d at 835.

In any event, insurance proceeds are not necessarily guaranteed for a cannabis business. Property owners are well-advised to discuss their plans with their insurance provider and structure contract agreements to avoid issues should they arise. These insurance issues are not just limited to property insurance but also apply to title insurance. Similar to property insurers, not all title insurance companies are willing to insure a property that leases to a cannabis business, and doing so may invalidate the title insurance policy. As with property insurance, communication is key and the owner should discuss planned activities with the title insurance provider to ensure the policy remains valid.

## Environmental Conditions

Given the nature of cannabis as an agricultural commodity, cannabis businesses—particularly indoor cannabis cultivation facilities—can be prone to mold, and a cannabis-related facility may also be more prone to odor issues than most

businesses. Specifically, facilities that engage in cannabis-related activities may increase the humidity or expose the property to odor, which, if not properly addressed, can lead to environmental conditions that can damage the premises. (For more on this, see [State-Legalized Marijuana and Real Estate](#).) Additionally, with the advent of cannabis hospitality businesses—which afford the on-site consumption of cannabis—potential tensions or conflicts with a state's clean indoor air laws or regulations can arise. Real property owners should consider whether certain infrastructure will be required to comply with these environmental laws and how to pass infrastructure costs on to the tenant.

## Zoning and Land Use

As a threshold matter for both landlords and tenants alike, not all properties are fit for cannabis businesses and may be expressly prohibited by zoning or land use laws or regulations. Zoning approvals are often a prerequisite of state and local authorities in evaluating a tenant's license application. While this would likely be flagged in an initial review by a licensing agency, if a property owner (or prospective tenant) has not done their homework ahead of time, the property may already be tied up in a lease or option, taking the property off the market while it goes through a regulatory review. In addition, zoning and land use regulations are not necessarily guaranteed to remain constant without amendment. In *Giuliani v. Jefferson Cty. Bd. Of Cty. Comm'rs*, a cannabis dispensary was effectively zoned out of existence. In this case, the tenant leased property in a shopping center for a medical cannabis dispensary, which, as zoned, was allowed at the time. 303 P.3d, 131 (Colo. App. 2012). Two months after opening their business, the zoning administrator charged them with a zoning violation. The Colorado Court of Appeals did not rule on the merits (as there would likely be hotly contested issues of vested property rights versus privileged license rights and more), instead finding the dispute moot based on a later-enacted Board of County Commissioners decision banning all cannabis businesses. See [Risking a Contact High: The Tenth Circuit's Failure to Defer to Colorado's Marijuana Laws](#), 98 *Denv. L. Rev.* 265. Additionally, some state and/or local authorities will enact limits on the number of licenses available (thus narrowing the potential volume of prospective tenants) or distance restrictions between cannabis-related businesses, to ensure there is not too much density (in the eyes of the regulators) of cannabis-related businesses. Real property owners who desire to secure cannabis-related tenants should be prepared to pivot as needed in the face of zoning changes or other local regulations.

A firm understanding of zoning and land use law as it applies to cannabis businesses is also critical because it

can impact what is or is not allowed under a lease. When negotiating the lease, being clear on what is permissible versus what is impermissible can mitigate the potential for costly landlord-tenant disputes down the road. Keep in mind that land use and zoning may impact the tenant's business when it comes to items such as:

- The exterior of the premises
- What can (or cannot) be viewed from the street
- The sale of non-cannabis-related products or foods
- Smells or odors
- The ability to have a line outside –and–
- Other issues that may not solely relate to cannabis

COVID-19-related impacts, like the advent of modified dispensing allowances—including curbside delivery or drive-throughs—must also be accounted for by real property owners.

## Security

Due to the lack of clear access to banking, many cannabis companies conduct all their business in cash. Real property owners should be aware that many cannabis dispensaries or other businesses may require installation of a safe. A commercial safe can be quite heavy, and a proper engineering study should be conducted to determine if a safe can be located on the property without material damage to the structure.

Separately, given the cash nature of the business, many cannabis companies will hire private security companies to transport their cash revenue and provide extra security for their products and funds. Real property owners should be aware that large trucks and armed guards may regularly be on premises. Even with extra security, there is an increased risk to the real property of break-ins and attempted break-ins. Owners should adequately prepare for these concerns.

## Civil Forfeiture

As discussed in [State-Legalized Marijuana and Real Estate](#), “even in states where [cannabis] is legal, landlords risk having the premises seized or facing criminal charges for aiding and abetting in a federal crime, as the [Controlled Substances Act] makes it unlawful for landlords to lease any real property for purposes of unlawfully manufacturing or distributing a controlled substance.” See 21 U.S.C. § 856(a)(2).

A civil forfeiture case is easier to prosecute than a criminal charge because the property owner subject to the forfeiture does not need to be convicted or charged with a criminal offense; instead, the real property owner is treated as a third-party claimant. A civil forfeiture claim can be raised if

the government can show a substantial connection between the premises and the alleged crime. 21 U.S.C. § 856(a)(2). Notwithstanding the foregoing, the authors are not aware of any recent civil forfeiture cases involving state-legalized cannabis or cannabis-adjacent businesses that are compliant with state and local laws and regulations and otherwise generally align with the tenets of the Cole Memo.

## Common or Beneficial Ownership

Certain lease structures, such as taking a percentage of the tenant's revenue (which is not atypical in conventional landlord-tenant relationships), can implicate the real property owner as a beneficial owner with a cannabis business. Moreover, some plant-touching businesses form special-purpose entities that separately own real estate used in furtherance of the cannabis business, but where such special-purpose entities remain under common ownership with the plant-touching cannabis business. Becoming a common and/or beneficial owner of a cannabis business can pose additional risks, compliance protocols, and liabilities that the real property owner did not intend. This includes, without limitation, implications under I.R.C. Section 280E, which affects tax-related deductions or credits a business may otherwise be eligible for under federal law. The IRS and many regulatory agencies look at both substance and form, so it is important that the corporate structure, the lease, and/or other real property agreement with a cannabis or cannabis-adjacent business are structured to minimize connections (including common or beneficial ownership) between the cannabis business and its direct revenue from sales from the real property business.

## Specific Lease Terms

### Lease Term

Many regulatory agencies will require that a cannabis business applicant demonstrate site control or present possession of real estate when they submit their application. This obligation can directly impact lease negotiations and contingencies surrounding the lease term. Real property owners should be prepared for a delayed start to the tenant occupying the space and ability to pay rent upon commencement and occupation and should confirm this does not violate any covenants they may have with neighboring landowners. Moreover, termination rights may also require modification to conform with regulator expectations and consideration of whether an applicant does, in fact, receive a license award.

Real property owners should also consider items like a license renewal and possibly automatically renew the term of the lease upon receipt of a renewed license. Keep in

mind that the cannabis operation cannot operate without its license, so the lease term should be drafted to account for items such as application review period, license expiration, and application renewals.

### **Permitted Use**

The permitted use section of a lease should be narrowly tailored to the cannabis business's operations. It is not advisable to provide the "all uses otherwise permitted under applicable law" or similar language here, given the nuanced risks associated with the contemplated cannabis-related use. Instead, real property owners should narrow this typical language to mirror the language of the relevant regulatory agency to avoid a tenant possibly going beyond the scope of the applicable law's limitations.

### **Building Rules**

If a real property owner maintains a multi-tenant space, keep the building rules in mind. While jurisdictions generally do not allow for public consumption of cannabis, real property owners may want to specifically express this prohibition. It is not uncommon for dispensaries to have customers who may use cannabis in their car or loiter outside the premises to consume cannabis. This could upset other tenants or place the real property at risk of enforcement action. Real property owners will want to understand the cannabis rules and appropriately tailor their building rules to avoid conflicts with other tenants or unwanted activities from a tenant's customers.

## **Cannabis Opportunities**

While it is easy to focus on the risks of cannabis businesses, there are also many opportunities. To offset the risks, many real property owners are able to get a higher price per square foot in rent. For real property owners who are not risk averse, this rental premium could present a great opportunity for additional revenue. Separately, real property owners should pay close attention to how licenses work in their jurisdictions. For example, in Colorado, the license is tied to the land. While licenses can be transferred, such transfers are not always easy. Having a valid license and lease in place can substantially increase the value of a property. Moreover, some jurisdictions will only issue a certain number of licenses, meaning if the license is tied to your land and there are no more licenses to be awarded, the value proposition for having a cannabis tenant has substantially increased. Accordingly, some cannabis entrepreneurs and established companies are willing to pay well over market on a square foot basis in order to have the right to the property with a cannabis license. If you are in a multi-tenant space, a cannabis retail business can also substantially increase foot traffic.

While leasing to a cannabis company is not without its risks, there can be many rewards. To help mitigate the risks, we recommend assembling a team that is well-versed in issues related to tax, real property, and cannabis to best protect your property and have a successful relationship with your future cannabis tenant.



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### **Garrett Graff, Partner, Moye White LLP**

Garrett counsels clients throughout their corporate life cycle on corporate formation and structuring; ongoing operational agreements, including leases, supply/distribution agreements, licensing agreements, and services agreements; as well as debt/equity financing and mergers and acquisitions. Garrett's practice often involves serving as outside general counsel and is inclusive of both corporate/M&A and regulatory compliance matters, along with issues relating to real estate, intellectual property protection, tax, litigation, policy, and international issues.

Garrett specializes in representing clients in a variety of regulated sectors, including cannabis (inclusive of both marijuana and hemp), food/beverage, and alcohol. Specific to the cannabis industry, Garrett represents clients on successfully obtaining licenses in numerous states in both competitive and non-competitive licensure processes. He also assists clients in general corporate matters, protecting intellectual property, establishing partnerships and joint ventures, and expanding clients' footprints across multiple states and/or countries, along with regulatory compliance matters.

Garrett represents hemp companies across the country and world on matters including import/export, cultivation, processing and manufacturing, distribution, and navigating legislative and regulatory frameworks. He frequently works with federal, state, and local authorities on policy and enforcement matters. Notably, Garrett represented hemp industry stakeholders against the DEA in confirming the Farm Bill's hemp provisions pre-empt DEA authority and the CSA. He also regularly works with stakeholders in drafting model legislative and regulatory policy.

Relatedly, from a regulatory perspective, Garrett counsels clients in navigating the many layers of international, federal, state, and local laws and regulations, ranging from marijuana- or hemp-specific laws and regulations to issues relating to conventional FDA and FTC compliance, Proposition 65 compliance, and import/export issues, along with other regulatory considerations.

Garrett has testified in judicial proceedings related to regulatory matters and frequently speaks in many forums - conferences, symposiums, and other events - regarding various issues, including cannabis and natural products.

### **Bobby Dishell, Associate, Moye White LLP**

As a member of the firm's real estate team, Bobby focuses on transactional matters including industrial acquisition, disposition, and development, and work related to multifamily assets. He is passionate about advanced energy matters and regularly advises clients on solar leasing and development.

Bobby works with cannabis clients on leasing matters and assists in obtaining third-party certifications. He also researches and advises marijuana and hemp clients on the complex and interconnected federal, state, and local regulatory frameworks.

Prior to joining Moye White, Bobby worked for Baltimore City Public Schools as a middle school English and Humanities Teacher as a Teach for America Corps Member. Additionally, Bobby was an extern in the Office of Legal Counsel for Governor Hickenlooper. In law school, he taught with the Marshall Brennan Constitutional Literacy Project and worked as a Student Attorney at the Sustainable Community Development Clinic on matters involving non-profit 501(c)(3) formation, commercial co-venture agreements, multi-party land leases, and agreements for agricultural and educational programs.

Bobby serves as a publicly elected leader on the Board of Directors for the Regional Transportation District in Denver, working to promote transportation equity and transitioning to a zero-emission transit system.

In his spare time, Bobby enjoys trying new restaurants and breweries, being in the mountains, and spending time with his family and friends.

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