

The Intersection of Cannabis Law and Commercial Real Estate

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VICENTE
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Vicente Sederberg LLP

- ▶ Full-service cannabis boutique
- ▶ Founded in 2010 by Brian Vicente and Christian Sederberg
- ▶ International Presence
- ▶ National footprint: offices in Denver, New York, Boston, Jacksonville and Los Angeles
- ▶ Services offered: merit licensing, local licensing, hemp, corporate and transactional, intellectual property, real estate, litigation

Overview

- ▶ Federal Law Update
- ▶ Colorado Law Update
- ▶ Landlord Considerations
 - ▶ Opportunities and Challenges
 - ▶ Navigating the Legal Landscape
- ▶ Marijuana-Specific Lease Terms
- ▶ Tenant Considerations
- ▶ Enterprise Structuring/280E Exposure
- ▶ Questions

Federal Law Update

- ▶ No change in law, remains illegal at federal level
- ▶ Cole Memorandum (rescinded)
- ▶ Joyce Amendment (formerly, Rohrabacher-Blumenauer Amendment)
- ▶ SAFE Banking Act
- ▶ Descheduling Efforts (e.g. STATES Act, MORE Act)

Colorado Law Update

- ▶ HB19-1090 – “PubCo Bill”
 - ▶ Limited ownership opportunities under initial law
 - ▶ No public companies
 - ▶ Limited out-of-state ownership
 - ▶ No foreign ownership
 - ▶ New law expands ownership opportunities
 - ▶ Public companies
 - ▶ Out-of-state and foreign ownership permitted (those with day-to-day management control must be Colorado residents)

Colorado Law Update

- ▶ HB19-1234 – “Delivery Bill”
 - ▶ Provides for delivery permits
 - ▶ Medical – 2020
 - ▶ Retail – 2021
- ▶ SB19-224 “Sunset Bill”
 - ▶ Relaxation of criminal history disqualifications
 - ▶ Felony convictions limited to three years from date of conviction
 - ▶ Marijuana-related conviction generally may not be sole basis of denial
 - ▶ Industrial hemp products may be sold in dispensaries (and used as ingredient in manufactured products)

Landlords

Opportunities and Challenges

▶ Opportunities

- ▶ Increased revenue from above-market rent
- ▶ Tenant improvements
- ▶ Bringing property up to code
- ▶ Security infrastructure

Landlords

Opportunities and Challenges

▶ Challenges

- ▶ Conventional lending largely unavailable (right now)
- ▶ Access to bankruptcy
- ▶ Risky tenants (loss of license means loss of revenue to pay rent)
- ▶ Cash-based businesses – target for theft
- ▶ 280E risks
- ▶ Federal illegality risks (e.g. civil asset forfeiture)
- ▶ State and local compliance

Landlords

Navigating the Legal Landscape

- ▶ Economic Interests – terminology
 - ▶ Regulated Marijuana Business (RMB)
 - ▶ Controlling Beneficial Owner (CBO)
 - ▶ Passive Beneficial Owner (PBO)
 - ▶ Indirect Financial Interest Holder (IFIH)

Landlords

Navigating the Legal Landscape

- ▶ Controlling Beneficial Owner (1 CCR 212-3 1-115)
 - ▶ Individual or entity (other than Qualified Institutional Investors) with 10% or more beneficial ownership of RMB
 - ▶ Qualified Institutional Investors (e.g. banks, investment companies) with 30% or more beneficial ownership of RMB
 - ▶ Individual or entity with Control over RMB
 - ▶ Individual or entity with Control over CBO (e.g. directors and officers)

Landlords

Navigating the Legal Landscape

- ▶ Control (1 CCR 212-3 1-115)
 - ▶ “[T]he possession, direct or indirect, of the power to direct or cause the direction of the management or policies of a Person, whether through the ownership of voting Owner’s interests, by contract, or otherwise” (emphasis added)

Landlords

Navigating the Legal Landscape

- ▶ Passive Beneficial Owner (1 CCR 212-3 1-115)
 - ▶ Individual or entity with less than 10% beneficial ownership of RMB
 - ▶ No Control over RMB

Landlords

Navigating the Legal Landscape

- ▶ Indirect Financial Interest Holder (1 CCR 212-3 1-115)
 - ▶ Holder of a Commercially Reasonable Royalty (IP-related)
 - ▶ Holder of convertible debt instrument
 - ▶ Contract counterparty (catch-all)
 - ▶ Expressly includes “lease of real property”
 - ▶ Excludes employment agreements

Landlords

Navigating the Legal Landscape

- ▶ Disclosures and Vetting – General
 - ▶ Marijuana Enforcement Division (MED) vets people and money
 - ▶ Right to receive portion of revenue generally considered beneficial ownership
 - ▶ Maintains wide discretion to interpret and enforce its own rules
 - ▶ All CBOs required to obtain finding of suitability (i.e. financial disclosures, fingerprints, background check)
 - ▶ Ownership – requires preapproval
 - ▶ Management – required to be submitted within 45 days
 - ▶ PBOs – not subject to disclosure or vetting
 - ▶ IFIHs – two or more requires disclosure and subject to discretionary vetting
 - ▶ Example – Property lease coupled with equipment lease/loan/management agreement
 - ▶ Note – IFIH with PBO also subject to disclosure

Landlords

Navigating the Legal Landscape

- ▶ Disclosures and Vetting – Leases
 - ▶ Landlords generally considered IFIH
 - ▶ PBO – performance-based rent under 10%
 - ▶ CBO – performance-based rent of 10% or more
 - ▶ Performance-based rent increases okay
 - ▶ Lease required to be disclosed at every application (e.g. initial application, renewal, change of ownership)
 - ▶ Lease must provide tenant's control of property (Denver requires 90 days)
 - ▶ Property liens (esp. tax liens) occasionally vetted
 - ▶ Commercially reasonable rent (not usually heavily vetted)
 - ▶ NOTE: Two or more IFIHs requires disclosure and subject to discretionary vetting

Marijuana-Specific Lease Terms

▶ Rent and Security Deposit

▶ Rent

- ▶ Set rent rate (i.e. not performance-based)
- ▶ Rent increases can be based on performance (e.g. rent increases to “x” if annual sales in previous year were at least “y”)
- ▶ Consider possible licensing lag in tenant’s ability to pay rent (and consider an out for failure to obtain licensure)

▶ Security Deposit

- ▶ Consider increased security deposit to account for risk

Marijuana-Specific Lease Terms

- ▶ Compliance with laws
 - ▶ Need to carve-out Controlled Substances Act (and other similar federal laws – e.g. RICO, Anti-Money Laundering)
 - ▶ Ensure compliance with all state and local regulatory laws (including maintaining licensure)
 - ▶ Ensure cannabis-related activity is a permitted use under the lease

Marijuana-Specific Lease Terms

- ▶ Landlord's access to premises
 - ▶ All access must be in compliance with applicable laws
 - ▶ Only those with proper authorization (i.e. badge) and those accompanied by those with proper authorization (including landlords)
- ▶ Areas of note: entry onto premises in general; environmental testing; auditing books and records

Marijuana-Specific Lease Terms

- ▶ Governing law, dispute resolution, venue
 - ▶ Colorado law expressly provides that marijuana-related contracts are enforceable in Colorado courts (C.R.S. § 13-22-601)
 - ▶ Ensure venue is in state court
 - ▶ Consider arbitration (for privacy purposes)

Marijuana-Specific Lease Terms

▶ Insurance and Indemnification

▶ Insurance

- ▶ Determine who is responsible for what coverages
- ▶ Beware that insurance is difficult to obtain for both tenants and landlords (could cause issues with pre-existing policies)

▶ Indemnification

- ▶ Environmental – especially important for cultivation leases
- ▶ Federal enforcement (tenant should indemnify landlord for any damages sustained as a result of federal enforcement)

Marijuana-Specific Lease Terms

▶ Reformation Provision

- ▶ Lease will be disclosed to MED
- ▶ MED likes to see provision regarding possible reformation
- ▶ EXAMPLE: This Agreement may be subject to review by one (1) or more governmental agencies, including but not limited to the Colorado Department of Revenue, Marijuana Enforcement Division (the “MED,” and collectively with any other applicable government agencies the “Governmental Authority”). If the Governmental Authority determines this Agreement must be reformed, the Parties shall negotiate in good faith to so reform this Agreement according to the Governmental Authority’s requirements while effectuating the original intent of this Agreement as nearly as possible.

Tenant Considerations

- ▶ Ask for right to assign lease to affiliates without prior approval (relevant to enterprise structuring flexibility)
- ▶ Anticipate personal guaranty requirement
 - ▶ Also a practice tip for landlords!
- ▶ Ensure lease provides legal level of control over premises

Enterprise Structuring

▶ What?

- ▶ Structuring enterprise with complex corporate organization to maximize value and protection
- ▶ Separate entities for (i) holding real estate assets (e.g. land, lease), (ii) holding IP assets, (iii) operations, etc.

▶ Why?

- ▶ In real estate context, driving motivation is avoiding 280E exposure

280E Exposure

- ▶ I.R.C. § 280E: “No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of Schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted”
- ▶ The Supreme Court has determined that all taxpayers, even drug traffickers, pay tax only on gross income, which is gross receipts minus the costs of goods sold (the exact determination of COGS is a more complex issue and there is not a good case that clarifies what is or is not COGS)

280E Exposure

- ▶ Recent case law
 - ▶ Patients Mutual Assistance Collective Corporation d/b/a Harborside Health Center (November 29, 2018)
 - ▶ Harborside tried to argue, in part, that it was not subject to 280E since a portion of its business involved the branding and sale of non-marijuana products and 280E only applies to businesses that are entirely based on trafficking. The court rejected Harborside's arguments
 - ▶ Alternative Health Care Advocates (December 20, 2018)
 - ▶ Management company was found to be subject to 280E despite not obtaining title to marijuana and being a legally separate entity from the dispensary. Court did not read the term "trafficking" to require having title to the marijuana. Beware tax liabilities hidden in management companies.
- ▶ Landlord exposure
 - ▶ IRS has expressed intention to apply 280E to other aspects of the marijuana industry, including owners of real property that lease to marijuana tenants
 - ▶ Do not expect such challenges to be successful, but we shall see...
- ▶ Practice tip – corporate tax status provides equity-holder level protection from eventual audit

Enterprise Structuring

- ▶ How?

- ▶ High rent rate

- ▶ Shift maintenance expenses and tenant improvement costs to non-280E company

Questions?



Thank You!



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