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Legal-Ease: What's in Your Warehouse? Leasing To The Marijuana Production Industry

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By Dina Bleckman and Sara Mccormick, Esq.

With medical marijuana use, recreational marijuana use or both now legal in nearly three dozen states in the United States, warehouse owners are seeing increasing demand from marijuana growers to lease space. These leasing arrangements can be incredibly lucrative—marijuana businesses are often willing to pay a premium for rents to operate—but, are the rewards worth the risk?

Whether or not the U.S. government will enforce federal drug laws remains unpredictable, but one thing is certain: Marijuana operations are not legal at the federal level. This creates an unusual set of concerns for industrial property owners looking to participate in a bustling new cannabis industry. Before deciding to lease to such a business, landlords should take several factors into account.

First, consider whether the property is a good fit. If the property is subject to a mortgage, review the loan documents—leasing to a tenant that will be using the property for a purpose deemed illegal is likely a breach. Obtaining a loan later also may prove difficult, as lenders may not want or be able to make a loan where the tenant conducts an illegal use.

Housing marijuana-growing tenants could increase a landlord's insurance rates and such tenants may not be able to obtain the types of insurance that a tenant would typically carry. Property owners considering leasing to a marijuana business should consult with their insurance advisor.

And, marijuana operations are cash businesses. Landlords should be prepared to receive rent in cash. Making large cash deposits at a bank will cause the bank to issue a "Suspicious Activity Report" with the Financial Crimes Enforcement Network (FinCEN) and could subject landlords to scrutiny.

The main risk that marijuana businesses face is that they could be subject to asset forfeiture by the federal government; landlords also are at risk. However, property owners can try to reduce risk via such lease provisions as:

- Include federal action, threat of forfeiture or a significant change in enforcement policy as an event of default, giving rise to landlord termination rights and other remedies. Absent such provisions, property owners could be at risk of seizure due to a tenant that can't be evicted.

- Consider a specific indemnification obligation and increased security deposits or guarantees to offset the landlord's damages in the event of federal intervention.

- Because a court could void the lease for illegality, agree to arbitrate lease disputes rather than submit them to the court system. Also, both parties should agree to waive the defense that the lease was an illegal contract.
- Refine lease language prohibiting tenants from using the premises for any illegal purpose. A marijuana tenant or marijuana licensing body may insist on language explicitly allowing marijuana production. Landlords should insist that such language also require tenants to maintain all necessary licenses, approvals and permits, and to notify the landlord of receipt of any notices from governmental authorities regarding their operations.

Beyond the big risk of asset forfeiture, other considerations must be taken into account. Marijuana licensing generally is linked to a business' location, so a license applicant may be required to have the lease in place prior to submitting their application. As such, marijuana businesses will want to know that their landlord will assist in the licensing process and that the tenant will have an "out" in the event that the license is not awarded. The lease should require a fee for early termination, funded out of the tenant's security deposit.

Licensing regulations may require installation of increased security systems, which could limit a landlord's ability to access the property for inspections or repairs. The details of what security systems will be implemented and how access will be granted should be clarified.

Landlords should demand higher security deposits and personal guarantees. While a landlord generally is able to take a security interest in a tenant's assets at the leased premises, a landlord will not have the ability to foreclose upon marijuana products.

Warehouse owners also should consider how marijuana-growing operations can affect the physical property itself. Marijuana cultivation generally requires high quantities of electricity and water. In the event such a business is not the only tenant in the building, consider the disproportionate effect on other tenants if utilities are charged based on percentage of building occupied, and adjust operating expense provisions accordingly.

Likewise, these businesses present environmental concerns. Given the water and humidity involved, marijuana-growing operations increase the risks of mold, and extraction techniques may use flammable and volatile solvents. The lease should address these potential hazards.

While there are many risks to weigh when considering whether to lease to a marijuana grower, the cannabis industry is thriving in many states and capitalizing on this growth can be quite profitable for warehouse owners.

ABOUT THE AUTHORS: **Dina Bleckman** and **Sara McCormick** are members of the Real Estate Practice Group at Ballard Spahr LLP in Philadelphia. For more information, visit www.ballardspahr.com.