

PLANTING THE SEED

The time to prepare for legal cannabis is now, real estate experts say

By Joshua Burd

Speaking to a room full of real estate brokers, Aaron Epstein offered some rather simple advice when it came to how they could prepare for the prospect of legalized recreational marijuana.

Do what you do best. And do it sooner rather than later.

“From a real estate standpoint, start identifying properties,” said Epstein, general manager of the Garden State Dispensary, a medical marijuana facility in Woodbridge. He added: “Once that law gets passed, you’re going to see people scrambling. ... So if you have clients who are interested in getting into this industry, they should be looking for property right now in New Jersey. They should be looking for property in New York, Pennsylvania and all of these states that aren’t even on the cusp of legalization.

“They should start identifying areas and properties that are ready to go, because it is very difficult to find those properties. And you’re going to make yourself very attractive if you have a couple of those in your holster to bring to clients as soon as things to start to heat up like they are in New Jersey.”

Epstein spoke to the group in mid-February during an event hosted by the Industrial and Office Real Estate Brokers Association and the Society of Industrial and Office Realtors, amid the growing prospect of legalized adult recreational marijuana use in New Jersey. It was a campaign promise of Gov. Phil Murphy, who says he remains committed to legalization, while state lawmakers in both houses have introduced legislation to achieve that goal.

Make no mistake: Legalization is far from imminent, with some reports suggesting that the Legislature may not take up the issue until late summer. And experts say getting involved in the cannabis industry is



The prospect of legalized recreational marijuana could have substantial benefits for New Jersey’s commercial real estate market, even with a long list of risks and complexities.

both complex and filled with risk, given that marijuana is still illegal under federal law.

But they also say the benefits to New Jersey's commercial real estate industry could be substantial, providing a boost to the state's already thriving industrial market. And it would be a natural fit for older, Class B and C warehouse buildings, but it could also provide a lifeline for obsolete office buildings in less desirable locations, which are less likely to be upgraded and salvaged by value-add investors.

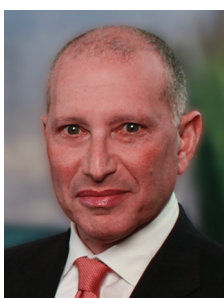
"I think that you'll see some of these less desirable locations, from a real estate perspective, have a newfound use," said Jack Fersko, an attorney and co-chair of the real estate department with Greenbaum Rowe Smith & Davis LLP. He also chairs the firm's newly formed cannabis industry practice group, which results in part from the fact that clients are now considering how to enter the business, whether through an expanded medicinal program or

legalized adult recreational use.

"They're starting to at least think about how they might get into it," Fersko said. "And I think there are areas that you can begin to examine and some activities that you can begin to undertake in order to prepare yourself for this."

Operators and would-be landlords both have a long list of things to consider, he said, from the additional power needed for a growing operation to the extensive security required. That's not to mention issues with title, insurance and easements, as well as other location-specific concerns.

"I think people, as they're looking at this, have to think about the location of these properties relative to schools, hospitals and daycare centers and the like," Fersko said.



Jack Fersko

"Because typically there's a distance requirement from such facilities, so people have to start to size that up when they're thinking about the potential future use of their property for cannabis growth or retail sale."

For those willing to take the risk, the upside is tough to ignore. In a report last summer focused on the Denver industrial market, CBRE found that the warehouse space being used for marijuana grow operations is commanding lease rates two to three times higher than average for comparable properties. The research examined the impact of recreational marijuana in Colorado three years after its legalization in 2014, finding that marijuana grow operations in Denver are located solely in Class B and C industrial space.

CBRE researchers also surveyed 25 leases signed between 2014 and 2016, finding that the average effective lease rate for marijuana grow houses was \$14.19 per square foot — two to three times higher than the average warehouse lease rates in the region's

top four cultivation submarkets.

At the time of the report, Denver's marijuana industrial footprint stood at 4.2 million square feet, or about 2.9 percent of Denver's total warehouse inventory, CBRE found. But the firm also noted that, for other states that have legalized recreational use, the outcomes may differ depending on their regulations and the size of their warehouse markets.

"The legalization of recreational marijuana definitely has an impact on a city or state's industrial-property market, as witnessed in Denver, but other states can't necessarily expect to duplicate those results exactly," said Spencer Levy, CBRE's head of research in the Americas. "The dearth of space zoned for grow houses as well as caps on the number of marijuana-production licenses allowed could cause the impact to vary widely market-by-market. There is also a high level of risk from factors such as a change in federal regulation and enforcement."

Still, Colorado in 2016 collected

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more than \$200 million tax revenue from marijuana sales, while Washington pulled in a reported \$256 million. By 2026, experts project that the overall legal cannabis industry would grow to \$50 billion.

In the meantime, New Jersey is among 29 states that allow medicinal marijuana in some form. Nine have legalized it for recreational use, following a series of Justice Department memos during the Obama administration that de-emphasized enforcement of crimes related to marijuana.

A memo by the Trump administration

and Attorney General Jeff Sessions threatened to slow that momentum in January, rescinding the Obama-era guidance documents, while still leaving it up to individual U.S. Attorneys as to whether to prosecute marijuana businesses. But several states and companies have continued to move forward in spite of the changing policy.

Vermont did so by legislative enactment less than three weeks after the memo, while other states such as Michigan and Oklahoma have since floated the idea of placing the issue on their November ballots.



BREAKING THE MOLD

When it comes to cannabis, the usual boilerplate lease provisions simply won't do.

For instance, Jack Fersko said there would be a need to modify the typical "compliance with law" provision, given that recreational marijuana remains illegal in the eyes of the federal government.

"You cannot comply with federal laws as it relates to a controlled substance, so you have to have carve-outs there," Fersko said. "On the other hand, if you're a landlord, you would want a tenant to comply with the federal Americans with Disabilities Act, so that any access issues are addressed. So you have to address and refine your lease in that respect."

As another example, he said a permitted use clause would likely have to be tailored to a specific segment of the cannabis business, such as growing or retail, based on

the nature of the operator's license. Similarly, landlords and tenants would have to agree on who would be responsible for upgrading the power at the facility, along with questions of insurance, signage and other areas.

There's also the question of the right to get out of a lease, on either side, given the uncertain nature of the business.

"If you have a situation where suddenly the federal government has come in and is going to start to enforce the law — and it may result in a civil forfeiture — you want the right to terminate a lease if you're a landlord," he said. "Or if your license gets revoked as a tenant, you want the right to perhaps be able to get out of your lease under that circumstance."

"So there are a host of other issues that a landlord has to think about or a tenant has to think about that you don't find in a traditional lease setting."

"I think you're seeing quite an upswell of popular sentiment in favor of it," Fersko said. "It's probably a little bit reminiscent of the movement out of Prohibition, with alcohol: Rather than keep it underground, put it in plain sight where it can be regulated and the economic benefits inure to the public, rather than to, essentially, organized crime."

It's still unclear if New Jersey residents would overwhelmingly support the concept. Polls from Quinnipiac, Rutgers and Fairleigh Dickinson universities have found support ranging from 42 to 53 percent going back to last fall. The low number in that range came most recently, as a result of the FDU poll in February.

Murphy has been clear about his intention to legalize adult recreational use, as have Democratic lawmakers who have crafted bills to that effect. State Sen. Nicholas Scutari of Union County has introduced a measure that would allow adults to possess and use small amounts of marijuana, while also allowing for commercial businesses and a new regulatory agency for the industry.

Assemblyman Reed Gusciora, a Mercer County Democrat, has also introduced a bill that would accomplish many of the same objectives, but differ on details such as the number of dispensaries that the state would allow and the tax rate for cannabis sales.

A more recent bill by Gusciora would also dramatically expand the number of licensed medical marijuana dispensaries allowed in the state, from six to 18. Such an expansion has also become a priority for Murphy and could gain momentum on its own, even if it may be several months before there is action on a bill for recreational use.

If legalization happens, Fersko said it's likely that individual municipalities will get to decide whether to allow the cannabis industry in their town or city. That could create significant real estate opportunities for those that do, from growing and storage facilities to and retail outlets.

Maplewood, Jersey City and Asbury Park are among those that have embraced it, while towns such as

Old Bridge, Point Pleasant Beach and Linden have vowed to ban recreational sales or moved forward with ordinances to do so. With many towns and cities already stating their position, it's an opportunity for potential cannabis operators and landlords to identify locations.

"You can start to look at where you might want to locate and try to take the temperature of the local community for such an activity," Fersko said. He added that would-be landlords should also consider title issues, such as whether an easement that is needed for accessing the property is tied to any "compliance with laws" provisions.

Prospective operators should also be examining New Jersey's medicinal licensing requirements as well as recreational requirements in other states, Fersko said. That's in addition to investigating funding and lending sources, since many traditional banks have shied away thus far.

Epstein, meantime, noted that different parts of the cannabis supply chain will have distinct real estate needs. When it comes to cultivation, because New Jersey allows the sale of dry, unprocessed marijuana leaf and flower, Epstein said growers would likely require high-ceilinged indoor space rather than greenhouse facilities. Warehouses are "where you're going to grow the highest level of pharmaceutical grade cannabis" when selling the plant in its natural form.

When it comes to retail operations, his company most commonly targets former bank buildings when scouting locations for a dispensary, he said, citing the need for a vault and other security measures.

"You don't want to reinvent the wheel, so if you're trying to predict what sites are going to be best for cannabis retail dispensaries, bank locations are No. 1," Epstein said. "Plus, you're looking at this from the mind of an applicant. Essentially, this is a competitive process where people are going to try to differentiate themselves."

"One guy is walking in with an old Starbucks and the person next to him has a former bank location. So these are the things that people who are trying to secure real estate start to focus on." **RENU**