Cannabis Businesses and New Jersey Real Estate: The Landlord's Perspective - Part Two

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By: Carmen Andrade

With the Cannabis industry booming, commercial real estate owners and landlords are challenged with keeping up with best practices, laws, and regulations related to leasing space to cannabis businesses. The article below is the second article of our three-part series intended to help landlords navigate this evolving landscape. As with any business interest, the Porzio team strongly encourages seeking the advice of counsel prior to making any representations or entering into any agreements.

New Jersey Rental Rates for Cannabis Businesses

What makes sense in terms of rental rates and how much of a security deposit to require will be based on what the market can bear, the amount of the landlord's initial investment to prepare the space for the tenant's use, and the level of risk that the landlord is taking by leasing space for what could be construed as illegal use... Market indicators point to the fact that rent for facilities particularly suited for the cannabis industry has seen a dramatic increase in line with the number of states that have legalized cannabis production in one form or another. Because of the inherent risks in leasing to cannabis tenants, landlords should protect themselves by requiring a healthy upfront security deposit and the ability to draw down on the deposit if the lease is terminated due to compliance or legal issues.

Land-Use and Compliance

Compliance with laws in connection with the retrofit process can be tricky given the changing regulation at the local land-use level with respect to cannabis cultivation facilities. Landlords must understand the nature of the cannabis business they are leasing to in order to make sure the tenant is complying with local land-use regulations. For example, if the tenant is purely a grower with no retail operations on site, parking and site traffic control may or may not be an issue. For businesses planning to have a retail presence, local land-use regulations will likely have to enact parking and other traffic control regulations to address the expanding industry. Another factor to contend with are the myriad local municipalities enacting zoning changes to prohibit cannabis operation altogether. Prior to finalizing a lease this issue will need to be vetted or, in the alternative, tenants will want to see a contingency period following lease execution to allow sufficient time for the tenant to undergo any zoning approval process required and state licensing. Because adult use licensing process requires an applicant to demonstrate control over the leasehold when applying for a license, the tenant will want to sign the lease or a binding letter of intent prior to obtaining state approval for its operations and include a lease contingency which allows the tenant to terminate the lease or the letter of intent if approval is not obtained.

Environmental Laws

As with other manufacturing industries in New Jersey, landlords should anticipate increased regulation including laws enacted to protect the environment from noxious smells and fumes (odor mitigation). Laws relating to the impact of the

cannabis industry on energy conservation are also likely to be a factor. To mitigate risk to the landlord, the lease should generally impose the burden on the tenant to comply with any and all laws applicable to the build-out, use, and operation of the space by the tenant, including obtaining all of the necessary local and state approvals in connection with the retrofit and any environmental regulation. It will be essential to stay apprised of such laws, including any new environmental laws, as they evolve. To the extent specific registration or licensing requirements are implemented, the tenant should have an ongoing obligation to provide proof to the landlord of compliance.

Permitted Use

Typically, leases will specifically state what use is permitted in the space. Given the variety of activities and products that can be produced by cannabis growers and the different safety risks that may be associated with producing one product versus another, it is important to be very specific in the lease as to what type of products may be produced in the subject space and what type of methods may be used. For example, hash oil is a popular cannabis product that can create an explosion when being produced so special safety measures must be required of tenants to reduce the likelihood of a casualty. It is important for a landlord to research to make sure the language in the lease adequately protects their investment and mitigates risk. It is also important to note that the adult use bill requires a landlord to certify and acknowledge that the leasehold will be used for cannabis operations. The permitted use clause in the lease should be aligned with said certification.

Alternatively, landlords can choose to prohibit the manufacture of certain types of cannabis products. Given the tension between federal and state laws, a best practice is to include a disclaimer on whether the use is legal. This disclaimer should state that no representations are being made as to the tenant's ability to operate in the space for the tenant's intended purpose. Leases should also include affirmative language permitting the landlord to terminate the lease upon reasonable notice in the event the use results in liability to the landlord or is determined to be illegal.

When negotiating such a provision, it can be expected that the tenant will want to set the parameters stating when the landlord may terminate.

Click here to read part three of this series where we discuss lease terminations, noxious uses, insurance and more.