

Real Estate LAW

Commercial leasing in the marijuana age

With New York on the verge of legalizing recreational marijuana, landlords across the state will face various questions once the smoke clears. Specifically, landlords will need to decide whether to accept the risks of renting to marijuana businesses, and if so, determine the best way to protect their interests.

Even if recreational marijuana is legalized, until federal law is changed marijuana remains a Schedule 1 narcotic and a landlord is violating federal law by knowingly leasing property for manufacturing, storing, distributing or using marijuana. Such a violation can result in property seizure regardless of whether the landlord is involved in the tenant's business. In the past, the U.S. government has used forfeiture laws to seize billions of dollars of property for controlled substance (including marijuana) offenses.

Since 10 states have already legalized recreational marijuana, and many more have legalized medical marijuana, landlords might presume that Congress will soon modify federal law to "de-criminalize" marijuana. Any such presumption is premature. Over the past 10 years, the U.S. Department of Justice has provided conflicting and uncertain guidance as to whether and how it will enforce federal law in states where marijuana is legal. This uncertainty, when combined with the charged political climate in Washington and the fact that



By **JOHN A. ANDERSON**
Daily Record
Columnist

most states have yet to legalize recreational marijuana, may indicate that congressional action could take some time. Landlords considering leasing to marijuana businesses must recognize the risk of property seizure if the federal government seeks to enforce federal law.

While the risk of an enforcement action might be small, the ramifications (e.g., complete loss of property) are severe.

If a landlord decides that the economic benefits of such a lease outweigh the legal risk, it should first review its existing (and anticipated) financing arrangements since many federally chartered banks and financial institutions refuse to do business with marijuana businesses. Any lease may require approval from existing lenders and may limit a landlord's ability to obtain future financing. Additionally, if the premises is part of a larger retail or office complex, a landlord should review its other leases since an existing tenant may have the right to "veto" a lease to a marijuana business.

If a landlord gets to the point of negotiating a lease with a marijuana business, it should consider the following issues:

1. **Rent.** Base rent should be set at a level commensurate with the risk.

2. **Percentage Rent.** Retail leases typically charge, in addition to base rent, rent equal to a percentage of tenant's sales. Landlords should not charge percentage rent in order to avoid additional governmental scrutiny and any argument that it has an interest in the tenant's business.

3. **Security.** Landlords should consider personal guarantees and/or security deposits.

4. **Use.** The tenant's permitted use should be limited to only those specific uses authorized by its state license.

5. **Laws.** The tenant should be required to strictly comply with its license and all federal, state and local laws and regulations, excepting only federal law expressly contrary to the specific use permitted by its state license.

6. **Termination.** Landlords should have the right to terminate the lease upon any government enforcement action, raid, loss of license or change in law.

7. **Insurance.** Since some large insurance carriers refuse to insure marijuana businesses, landlords should confirm that the lease will not affect its existing coverage and should carefully review the tenant's policy and possibly require higher levels of coverage.

8. **Indemnification.** The tenant should indemnify the landlord from all

claims and damages related to tenant's business, customers, security issues, violations of law and enforcement actions.

9. **Utilities/Taxes.** Marijuana businesses may have significant utility and security requirements and may be subject to new types of taxes. The tenant should be required to pay for all such additional costs.

10. **Build-out.** Landlords should avoid financing the tenant's build-out to prevent loss from a tenant failure due to loss of license, governmental regulation, etc. Landlords may also require the

tenant to fund specified security measures at the premises.

11. **Hazardous Substances.** The lease should identify any hazardous substances to be utilized by the tenant and require it to comply with all laws relating thereto and to indemnify the landlord from all liability.

12. **Disputes.** New York state courts (or mandatory arbitration) should be the exclusive forum for disputes since the lease may not be enforceable in federal courts.

13. **Nuisance.** The tenant should agree

not to release offensive odors or otherwise create a public or private nuisance.

If New York legalizes recreational marijuana, landlords should carefully consider the legal and business risks before deciding to rent to marijuana businesses. If they do, they should insist upon leases that adequately address the unique issues implicated by such tenancies.

John A. Anderson is a partner and leader of the Real Estate practice at Harter Secrest & Emery LLP. He can be reached at janderson@hselaw.com.