

CANNABIS REAL ESTATE INVESTMENT TRUSTS: A MULTIBILLION DOLLAR INDUSTRY AND GROWING

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INVESTMENT IN A CANNABIS REIT

Billions of dollars have been invested in cannabis Real Estate Investment Trusts (REIT) over the past few years and since late last summer, stocks have been climbing as more and more states legalize adult use medical and recreational cannabis. The first publicly traded cannabis REIT in the United States, Innovative Industrial Properties (NYSE: IIPR), had a stock value of \$183.93 per share and a market capitalization of \$4.16 billion as of the date of this article¹. This pivotal moment for the cannabis industry has given rise to a significant new investment opportunity for institutional and individual investors.

WHAT IS A CANNABIS REIT?

A cannabis REIT is a Real Estate Investment Trust that invests in real estate used in the cannabis industry. This includes farms, greenhouses, processing plants, dispensaries and other facilities. Like all REITs, cannabis REITs can be publicly or privately held, with the latter being the far more common of the two. A REIT is a passive investment vehicle, much like a limited partnership or limited liability company, that raises capital from outside sources and then uses that capital (depending on the type of REIT) to:

- Purchase and lease income-producing real estate (equity REITs).
- Make mortgage loans (mortgage REITs).
- Do a combination of the foregoing (hybrid REITs).

Unlike limited partnerships and many limited liability companies, REITs are taxed as corporations.

REIT Rules

All REITs are subject to a unique set of rules:

- 75% of a REIT's assets must be real estate-related.
- 75% of a REIT's income must be derived from income producing real estate.
- 90% of a REIT's profits must be distributed to its shareholders annually.
- A REIT must have at least 100 shareholders after its first year of existence.
- No more than 50% of a REIT's shares may be held by five or fewer people.
- A REIT must be managed independently and have a board of trustees or directors.

¹ <https://finance.yahoo.com/quote/IIPR/key-statistics> (As of April 1, 2021)

WHAT DO CANNABIS REITS DO FOR CANNABIS COMPANIES?

A number of things, but principally:

- They provide needed capital for property acquisition and development.
- Through sale-leaseback transactions, they free cannabis companies from the burdens of managing their real estate portfolios allowing them to instead focus on their core competencies.

WHAT ARE THE BENEFITS TO INVESTORS IN CANNABIS REITS?

REIT stocks, especially cannabis REIT stocks, tend to offer a number of advantages to investors:

- They pay annual dividends.
- They typically earn a high rate of return as yields tend to range from 4% to 8%.
- They qualify for a 20% tax deduction.
- They allow investors to diversify their portfolios by investing in real estate without the burden of property management.
- They are reasonably liquid and transferrable.

WHAT ARE THE LIABILITIES OF CANNABIS REITS?

Because cannabis is still illegal under federal law, cannabis REITs face several challenges unique to the industry:

- Banks and other financial institutions often refuse to do business with them.
- They face reputational harm due to the stigma still associated with the cannabis industry.
- Their assets are subject to seizure by federal authorities and forfeiture.
- Participants run the risk of being criminally prosecuted under federal law.
- Insurance, if obtainable, is costly.
- They cannot avail themselves of bankruptcy protection.
- They face significant zoning and entitlement challenges.
- Loan collateralization is complicated and not always assured.
- Leases require enhanced scrutiny and negotiation.

WHAT IS THE FUTURE OF CANNABIS REITS?

As the adult use medical and recreational cannabis trend continues, more cannabis REITs will be formed to meet the industry's capital demands. Cannabis REITs will remain a viable capital source for adult use medical and recreational cannabis companies and an attractive investment for investors, but only as long as commercial banks stay on the sidelines. Recently, a bipartisan group of 30 Senators introduced The Secure and Fair Enforcement Banking Act of 2019 (the SAFE Banking Act) in the Senate. The SAFE Banking Act, which the House of Representatives passed in 2019, is designed to protect financial institutions serving the adult use medical and recreational cannabis industry. In particular, the SAFE Banking Act would prevent federal banking regulators from:

- Taking any actions to prevent financial institutions from making loans to legitimate state-

sanctioned cannabis businesses and associated businesses.

- Penalizing financial institutions for providing financial services to legitimate state-sanctioned cannabis businesses and associated businesses.
- Eliminating a financial institution's federal deposit insurance for doing business with legitimate state-sanctioned cannabis businesses and associated businesses.
- Providing incentives to financial institutions for refusing to do business with legitimate state-sanctioned cannabis businesses and associated businesses.

If and when both chambers of Congress pass the SAFE Banking Act or legislation like it, commercial banks will likely get into the game. When this happens, their size, operational efficiencies, marketing budgets, and existing infrastructure will allow them to dominate the market and send cannabis REITs to the sidelines. Until then, at least, cannabis REITs will continue to spur the growth of the adult use medical and recreational cannabis industry by providing much needed capital.

PROFESSIONALS

Jonathan Grosser

CAPABILITIES

Cannabis

Real Estate