Marijuana
from Policy Mandates to Upscale Dispensaries

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LETTERS FROM THE EDITORS
Marijuana: from Policy Mandates to Upscale Dispensaries
The original creators of the VIEW may never have dreamed that its current editors would choose cannabis as a topic for an issue, but then again, this is the Bay Area, home to many pioneering thoughts, innovations, and emerging markets, and these days it seems silly not to talk about it.

In this issue, we cover the topic from a variety of angles, starting with the legal background of what has become a new and highly controversial segment of one of the oldest and most conservative of investments: commercial real estate. Other articles offer insights into the challenges (and benefits) of leasing, rentals, contracts, and insurance as they pertain to real estate with cannabis operations. We discuss local government perspectives regarding how San Francisco and San José are dealing with the influx of cannabis operators. One article even explores water resource challenges, while two others touch on construction techniques and interior design for dispensaries.

Many thanks to the 15 (!) writers who contributed to this issue. It is their expertise, experience, and insights that keep the Bay Area at the forefront of new and evolving real estate trends.

Sincerely,
Elizabeth Swift, Editorial Board Representative – CREW East Bay

When we first settled on the topic of marijuana for this issue, some of us at the VIEW were admittedly a bit dubious that we would find enough content to fill all the pages of our modest publication. Little did we know the extent to which the legalization of cannabis (both medical and recreational) has affected—and continues to affect—commercial real estate professions. Ongoing discussions regarding the many issues that this burgeoning industry brings about in fact created a wealth of content for our readers to consider.

Needless to say, we were thrilled that our local CREW chapters stepped up to provide incredibly helpful insight into this important and evolving market sector. The issues relating to leasing, contracts, insurance, and permitting for cannabis businesses are multifaceted, and it seems that it will be some time before they are completely resolved.

In the meantime, cities, states, companies, and individuals are reacting to the evolving legal issues related to marijuana growth, consumption, and sale. Some companies and property owners steer clear of the market, while others weigh calculated risks against significant profits. Read on to see how CRE in the Bay Area is (or isn’t) "flying high."

Cheers,
Angie Sommer, Managing Editor

California Cities and Counties Grapple with Marijuana Legalization and the Implementation of Prop. 64:
 a San Francisco Case Study

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On November 9, 2016, by a 56-44% margin, California voters approved Proposition 64, the Adult Use of Marijuana Act (AUMA). With the passage of the AUMA, it became legal for any adult 21 years or older to do the following:

- Possess, transport, obtain, or give away to other adults 21 or older no more than one ounce of marijuana or eight grams of concentrated cannabis
- Cultivate up to six plants per residence and possess the marijuana produced by these plants. All plants and harvest in excess of one ounce must be kept in a locked space not in public view at one’s residence. Local governments may still forbid cultivation outdoors but must allow it inside a private residence or accessory structure that is “fully enclosed and secure.”

Retail sales for recreational use will not begin until licensed stores are in operation after January 1, 2018. Furthermore, medical marijuana patients will keep their existing rights under Prop. 215 to possess and cultivate as much as they need for personal medical use so long as they have a doctor’s recommendation, regardless of the Prop. 64 limits for adult users.

The passage of Prop. 64 presents an enormous challenge to local jurisdictions, which must adapt their rules and regulations to implement the provisions of Prop. 64. We will examine how implementation is proceeding in the City and County of San Francisco, and the particular challenges San Francisco is experiencing.
Mayor’s Directive

Immediately following the passage of Prop. 64, San Francisco Mayor Ed Lee issued an executive directive tasking the directors of planning and public health with drafting ordinances that address the following issues:

- Land use: Where will cultivation, manufacturing, and sales of cannabis be allowed and disallowed, and under what conditions?
- Local licensing: How should the City’s local licensing process be structured?
- Safety: Should the City change any laws regarding where or how cannabis may be consumed in public places?
- Youth access: How can the City prevent diversion and sales to under-age youth?

The Office of Cannabis and Permit Approvals

Unlike many jurisdictions in California, San Francisco had a significant head start in implementing Prop. 64, because it already had in place a Cannabis State Legalization Task Force, chaired by Terrance Alan, working on legalization issues for several months prior to November 2016.

With the help of the task force, the City took its first significant step in the implementation of Prop. 64 in early June. Supervisor Jeff Sheehy introduced legislation to the Board of Supervisors establishing an “Office of Cannabis.” The Office of Cannabis will be under the direction of the City Administrator, who is in the mayor’s office, and it is expected to commence operations with a staff of three, oversee the implementation of laws and regulations governing cannabis in San Francisco, and issue all cannabis-related permits in accordance with those laws and regulations.

The fact that San Francisco already has a robust regulatory scheme in place for medical cannabis both helps and hinders the City’s implementation of Prop. 64. The existing medical cannabis framework gives policy makers and the general public a significant amount of awareness of and experience in promulgating recreational-use regulations. On the other hand, one of the City’s major challenges is how to reconcile recreational regulations with existing medical regulations. (Note: In recognition of this, on September 12, the Board of Supervisors adopted an emergency ordinance imposing a 45-day moratorium on the Planning Commission’s consideration of pending medical cannabis dispensary (MCD) applications. The ordinance exempted MCDs that already have a scheduled hearing date at the Planning Commission.)

For example, the City currently has a detailed permitting and approval process for new MCDs, generally controlled by the Department of Public Health, which includes a public hearing at the Planning Commission. Moreover, the Board of Appeals deals with an extremely wide range of permit types, and it is challenging for the Board to develop expertise in MCD permits. This additional step in the permitting process leads to a great deal of instability and uncertainty for MCD operators.

One of the big frustrations with the approval process for MCDs is that after undergoing a long and often contentious process and obtaining an operating permit, the permit is then subject to appeal by the Board of Appeals. The Board of Appeals’ standard of review is de novo, meaning that the board has the authority to review and possibly deny the permit without any deference to the prior decisions by the Department of Public Health and Planning Commission. Moreover, the Board of Appeals deals with an extremely wide range of permit types, and it is challenging for the Board to develop expertise in MCD permits. This additional step in the permitting process leads to a great deal of instability and uncertainty for MCD operators.

The City is considering changes to this appeal process in implementing Prop. 64. Under consideration is an oversight board that would have expertise in cannabis and land use. The oversight board would have authority over cannabis rules and regulations, and could hear appeals of cannabis-related permits. Also under consideration is the establishment of an administrative hearing officer who would hear cannabis-related permit appeals. Either of these possibilities would provide the City with an entity dedicated solely to cannabis-related issues, unlike the Board of Appeals.

For example, the City currently has a detailed permitting and approval process for new MCDs, generally controlled by the Department of Public Health, which includes a public hearing at the Planning Commission. The question for recreational use is whether recreational-use retail facilities should follow the same approval procedures, or if there are there ways to improve the process.

Culinary Cannabis

On the lighter side, the wide reach of Prop. 64 has extended to San Francisco’s passion for food. The City’s Cannabis State Legalization Task Force has addressed this issue, noting that there is a desire within the culinary community to incorporate adult-use cannabis in dining options and opportunities, including the use of cannabis as a meal ingredient, and the establishment of food-and-cannabis pairing options. The Task Force has recommended that City policy makers collaborate with key stakeholders, such as culinary and hospitality organizations, to develop strategies for increasing these opportunities for restaurants and other food establishments.

These strategies could include:

- developing, proposing, and pursuing a state legislative approach that would create an exemption for these types of culinary experiences;
- developing a patron notification process for any food establishment offering these opportunities; and
- developing mechanisms to determine the appropriate distribution of cannabis-friendly dining venues throughout the city.

Again, however, while these are promising ideas, the City has a significant amount of work ahead before these ideas become policy realities.

The challenges posed by implementation of Prop. 64 are daunting for local jurisdictions. This is evidenced in San Francisco, which has significant experience with medical cannabis, a designated task force that had been working on these issues for months before the passage of Prop. 64, and a wealth of policy and regulatory experts. Even with all of these resources, many challenges still lie ahead for the City in meeting Prop. 64’s retail-licensing deadline. The proof will be, as they say, in the pudding. Cannabis-infused, no doubt, beginning January 1, 2018.

About the Author

Thomas Tunny’s practice focuses on transactions and litigation in all aspects of land use and planning law, including the California Environmental Quality Act; the Planning and Zoning Law; local land use, planning, and zoning codes; and exactions (fees/dedications). Thomas has assisted in obtaining development approvals for numerous commercial and residential projects, including cannabis-related permits.
Since the passage of California Proposition 64 in November 2016, communities in the greater San Francisco Bay Area are having discussions—some internal and quiet, others very public—revisiting their positions on medical and recreational marijuana.

What is a cannabis property?
A cannabis property is a property—industrial, warehouse, retail, or otherwise—where a local municipality allows a cannabis business to legally operate. In their attempt to integrate cannabis into communities, cities can designate “green zones” where cannabis properties and communities can coexist with the least amount of adverse impact on “sensitive receptors” (see below).

Now, it must be noted that zoning differs from city to city. What works in a dense city like San Francisco, which mostly has retail and residential uses integrated throughout, won’t work for a smaller suburb. So, look to local regulations to give you guidance whether your client’s property qualifies.

As real estate professionals we all understand the concept of high-end and best use; here is where, through restrictive zoning ordinance, communities in the greater San Francisco Bay Area are having discussions—some internal and quiet, others very public—revisiting their positions on medical and recreational marijuana.

One local example is in San José, where the zoning ordinance allows dispensaries to locate in the following zoning districts: light industrial, heavy industrial, combined industrial/commercial, industrial park, and downtown primary commercial (second story only). They are not allowed in other commercial zones, in planned development districts, or in residential zones. They also are not allowed in three development policy areas (North San José, Eden- vale, and the International Business Park).

Patti Zanin, an independent real estate agent in Denver, says that buildings zoned as “light industrial” that have been vacant for years are now the most valuable properties in the area, thanks to the marijuana industry. “Properties go so quickly that a secondary use to one of the “good actors” can typically expect a tenant to spend millions in improvements to the property.

Potential windfalls and pitfalls
Because of the scarcity of available properties, the reward to the landlord is the opportunity to receive higher-than-market rents. There are many examples of this: one registered medical marijuana dispensary in San José negotiated a lease in 2015 for $1.25 per square foot; the going rate for commercial light industrial sites in the area at the time was $0.85 per square foot, a 47% increase to the landowner. Another dispensary in San José is paying almost $3.00 net for a property (well over the rent for a comparable industrial building and closer to a retail rental rate). In Oakland, some warehouse/industrial buildings are fetching as much as $200 per square foot! Another positive is that a property owner who leases space to one of the “good actors” can typically expect a tenant to spend millions in improvements to the property.

On the other hand, a property owner might face a risk if their mortgage is held by a federally chartered bank. The loan could be recalled, as the tenant would be considered to be engaging in illegal activity and in violation of the loan agreement, without exception.

Stay away from sensitive receptors
When evaluating a property for a client, a landlord or a potential tenant should be made aware of sensitive receptors, as they can make or break a deal. Sensitive receptors include, but are not limited to, all residential housing, schools, daycare, parks, hospitals, rehab centers, convalescent facilities, and places of worship. These are areas where the occupants are more susceptible to cannabis’s adverse effects.

In San José, a property must conform to the following sensitive-receptor setbacks in order to qualify as a cannabis property:

- 1,000 feet from public or private preschools, elementary schools, or secondary schools; child daycare centers; community and recreation centers; parks; or libraries
- 500 feet from substance abuse rehabilitation centers or emergency residential shelters
- 150 feet from places of religious assembly; adult daycare centers; or residential uses (including legal nonconforming residential uses)
- 50 feet from another collective
How many of you commercial landlords out there have insurance coverage requirements built into your standard leases? How many of you have looked at them since they first went into that standard lease agreement? If you want to join many of your fellow commercial property owners in taking advantage of the premium rents available through leasing to cannabis businesses, it is time to dust off those insurance requirements and make a few tweaks.

Insurance requirements are included in commercial lease agreements in order to protect property owners from property damage or liability resulting from their tenants’ operations. There are exceptions, but the risks presented by a business occupying your property are typically fairly straightforward. For most commercial tenants, requiring that the business carry property insurance and commercial general liability coverage with appropriate limits is typically sufficient, so long as the property owner is named as an additional insured.

Cannabis tenants are different. The reason relates to the continued status of cannabis as a Schedule 1 narcotic under federal law — but not in the way you might think. While the risks of forfeiture or criminal liability are generally known to owners engaging in this industry, they are accepted largely because, even with the new presidential administration, the likelihood of their coming to pass remains quite low, from a practical perspective.

What does pose practical problems is the impact that federal illegality plays when attempting to enforce insurance policies in the federal courts, where most insurance coverage disputes end up. In recent years and months, it has become more and more clear that federal courts will interpret standard insurance policies as not covering cannabis-related losses, due to marijuana’s Schedule 1 classification. As a commercial landlord, that means that if your cannabis tenant only carries standard insurance, that additional insured certificate that you are holding is not worth the paper it is written on. For example, property policies often exclude loss to “growing plants.” This type of exclusion will be enforced, and it is one you do not want to find after your indoor marijuana cultivation tenant suffers a major crop loss for which you may be held liable. Instead, it is far better to require up front that your tenant also purchase crop coverage. A dispensary tenant, however, would understand that crop coverage is typically sufficient, so long as the property owner is named as an additional insured.

About the Author

Nira F. Doherty, a partner in Burke, Williams & Sorensen’s Oakland office, regularly advises property owners, real estate professionals, and others in litigation matters and counsels them regarding the placement of insurance coverage and other risk management strategies. Jason represents property owners, real estate professionals, and others in litigation matters and counsels them regarding the placement of insurance coverage and other risk management strategies. Jason has written and spoken extensively regarding the intersection of insurance coverage and the cannabis industry, having been most recently featured as part of the Business program at the California Land Title Association’s annual conference. Super Lawyers magazine recognized Jason as a Rising Star in 2015 and 2016.

Jason M. Horst is a litigation and insurance risk management attorney and principal at Horst Legal Counsel. Jason represents property owners, real estate professionals, and others in litigation matters and counsels them regarding the placement of insurance coverage and other risk management strategies. Jason has written and spoken extensively regarding the intersection of insurance coverage and the cannabis industry, having been most recently featured as part of the Business program at the California Land Title Association’s annual conference. Super Lawyers magazine recognized Jason as a Rising Star in 2015 and 2016.
Although cultivation and use of cannabis for medicinal purposes has been legal in California for two decades, the recent legalization of recreational cannabis use creates untold opportunity for expansion of the state’s cannabis market (notwithstanding that the cultivation, sale, and use of cannabis remains illegal under fed-
eral law). The prospect of cashing in on this burgeoning market seems to have sparked the interest of land speculators and would-
be cannabis farmers and entrepreneurs, spurring increased agri-
cultural land values on California’s North Coast from Sonoma to Humboldt County.

This heightened demand is expected to translate into increased levels of marijuana cultivation, both in well-established agricultural areas (through conversion of existing crops to marijuana) and poten-
tially in areas not currently developed for agricultural use. This may, in turn, heighten competition for surface water and ground-
water resources, especially in areas where wine grape vineyards are converted to cannabis. Certain state regulatory requirements may further constrain the availability of water and intensify con-
licts over water.

Increased Land Values

The trend of increasing North Coast land values—apparently driv-
en by the prospect of cannabis cultivation—is reflected both in land sale data for Sonoma, Mendocino, and Humboldt Counties and in anecdotal evidence from landowners and brokers operat-
ing in the so-called “Emerald Triangle”—Humboldt County, Men-
docino County, and further inland Trinity County.

The California Chapter of the American Society of Farm Managers and Rural Appraisers, in its “2017 Trends Report” (http://www.calsfirma.com/trends.php), observed that the “legal-
ization of recreational cannabis in California has created an emerg-
ing market in the coastal areas of California.” The report explains that legalization has brought cannabis growers out of the hills and into competition with growers of other crops for established ag-
cultural cropland. While the report notes that insufficient time has passed since legalization to address valuation issues or clearly track any trends, it nonetheless acknowledges that legalization is having an impact on land values in the Emerald Triangle.

Data obtained from AcresValue (https://www.acresvalue.com), a da-
tabase of agricultural land and water right sales, reveals that during the first half of 2017 the average price for land planted in grapes in Sonoma and Mendocino Counties—both attractive locations for outdoor marijuana cultivation—increased markedly: 32% in the former (where some local zoning changes may also have affected land values), but by 200% in the latter. A general survey of land sales in Humboldt County between June 2016 and July 2017 also revealed a dramatic increase in land values beginning in late 2016. Though one can only speculate about the influence of cannabis le-
galization on these land values, the timing of the increases (shortly before the Adult Use of Marijuana Act (AUMA) was approved) cer-
tainly suggests a strong correlation.

Landowners and real estate brokers in Mendocino and Humboldt Counties have likewise reported significant increases in land prices and noted the proliferation of land sale advertisements openly marketing land to would-be cannabis farmers. In a March 2017 article, Santa Rosa’s The Press Democrat reported that a real estate agent specializing in the sale of ranches in Mendocino and Humboldt Counties estimated that land prices had increased by about 30-40% over the past year or two. Other brokers esti-
mate the increases to be even higher, with properties with the right conditions for cannabis cultivation or with existing grow operations fetching the highest prices. Websites specializing in property listings for existing cannabis farms or land suitable for cannabis cultivation are also adding new dimensions to the cannabis land sale market.

Increased Competition for Water

The conversion of established agricultural cropland to cannabis cultivation and the potential for cannabis crop expansion to un-
developed land is likely to spur greater competition among water users for surface water; and to some extent groundwater. This is especially likely to be true in the wine-growing regions of Sonoma-

ria County and in parts of Mendocino County, where both surface water and groundwater supply can be scarce, especially during drought conditions like those experienced between 2012 and 2016. Conversion of vineyards is likely to increase the demand for water, because cannabis is estimated to be up to two times “thirst-
ier” than wine grapes, meaning that outdoor cannabis cultivation generally requires more water than wine grapes on a per-acre basis.

This competition for water resources may be further intensified by implementation of two regulatory schemes that mandate wa-
ter supply identification and management: the licensing require-
ments of the Medical and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA), and the Sustainable Groundwater Man-
agement Act (SGMA).

The MAUCRSA requires applicants for a cannabis cultivation li-
cense to identify the water source for their operation as one of the following: (1) water provided by a retail water supplier, (2) surface water diverted pursuant to an existing water right or a pending application for an appropriative right issued by the State Water Resources Control Board, or (3) groundwater extractions.

In the past, many cannabis farmers in the Emerald Triangle have re-
lied upon unauthorized surface water diversions for irrigation. For these farmers, the water supply identification requirement poses a threat to the viability of their operations, which unfortunately may deter these growers from seeking a license. Non-filers may actu-
ally further increase competition for water because unauthorized diversions reduce the overall availability of water, so parties with lower priority water rights are at a greater risk of receiving little to none of their water requirements in a given year.

For cannabis cultivation in the limited number of areas on the North Coast where groundwater is the primary source of irrigation water supply, increased competition for water resources may be further exacerbated by implementation of the SGMA. Beginning no later than 2022, certain groundwater basins will be subject to regulation under a groundwater sustainability plan (GSP), which will identify specific actions required to ensure that groundwater withdrawals are balanced with groundwater recharge and that long-term groundwater basin sustainability will be achieved. De-
pending upon the terms of the GSP, the groundwater sustainabil-
ity agency responsible for implementing the plan may have the power to, among other things, require measuring and reporting of groundwater extractions and limit or prohibit some extractions. This regulation may further reduce the available supply of water, which will in turn intensify competition among users for that limit-
ed supply.

Conclusion

Legalization of recreational cannabis is adding another high-value crop to bolster North Coast agricultural land values, but with both increasing competition and regulation, water supply may become a crucial component of land deals and cannabis farming in the coming years.  

About the Author

Courtney Davis is an attorney at Allen Mat-
kins, where she is a member of the Land Use and Environmental and Natural Resources practice groups. Her practice focuses on land use, water rights, and renewable en-
ergy development. She counsels clients on project entitlements, planning and zoning, Coastal Act permitting, and CEQA compliance. Her water practice covers water rights permitting, regulatory compliance, and basin management planning. In her free time, Courtney enjoys explor-
ing the natural beauty of the North Coast.
Before the legalization of medical marijuana, there was for many years an underground, not-so-hidden marijuana industry thriving in many parts of California. Growers found ways to inhabit all types of property: industrial areas, apartment buildings, and single-family homes. Property owners often were taken by surprise to find out that their property was being used as an illegal marijuana farm, with all the resulting problems. Some owners turned a blind eye, taking unusually high rents in return for allowing these operations to exist. As a commercial real estate broker in the East Bay, I have run into these situations more than once. Below are three examples of personal encounters I have had that illustrate the spectrum of risks involved.

Example #1
This property owner managed a series of small industrial buildings (1,000–5,000 square feet). He had always rented to growers who he considered to be good, high-paying tenants. His tenants tended to run professional organizations that complied with fire codes, had proper ventilation systems so that the smell would not alert the neighborhood when a crop was coming in, and ran very sophisticated security systems. He believed he was the small owner of property for federal authorities to go after him, so the risk was outweighed by the profitability of a relatively trouble-free tenant.

Will things change much with the legalization of marijuana? Legalization comes with government regulations and taxes. I suspect it will be a matter of economics. Word on the street is that cannabis prices have dropped dramatically, which will probably drive some small growers out of business. Larger, more sophisticated businesses may find it more profitable to remain illegal rather than pay the taxes and comply with government regulations. Landlords will need to be vigilant to protect their property.

Example #2
This client purchased an apartment building out of foreclosure. The building was an excellent value but came with a grow house in the basement, screaming at us, demanding to know who we were. My fearless client stood her ground and insisted that I tour the property. By the heavy marijuana smell, it was obvious what was being grown in the garage. As soon as we left, the owner called the police. By the time the police arrived several hours later, the plants, the equipment, and the very large man were gone.

Example #3
This investor client wanted to sell a rental house so that she could buy an apartment building. Giving the tenant the standard 24 hours’ notice, she arranged for me, as the broker, to tour the house. The tenant asked her to wait a couple of days, but the owner insisted on her rights to enforcing the 24-hour notice regulation. Upon our arrival, no one answered the doorbell, so we entered the house and were greeted by a very large man (weighing more than my client and me together!). He was charging out of the bedroom, screaming at us, demanding to know who we were. My fearless client stood her ground and insisted that I tour the property. By the heavy marijuana smell, it was obvious what was being grown in the garage. As soon as we left, the owner called the police. By the time the police arrived several hours later, the plants, the equipment, and the very large man were gone.

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When medical marijuana was first legalized in California in 1996, patients were often forced to get their fix in dark, dreary dispensaries policed by scowling guards stationed behind thick glass screens. But as pot has gained both social and legal acceptance here and across the country, those days are long gone.

Today many medical marijuana dispensaries resemble upscale boutiques more than seedy opium dens. Nowhere is this trend more evident than in the Bay Area, which is home to some of the most stylish and sophisticated pot clubs on the planet.

One of the most striking examples is the Apothecarium in San Francisco’s Castro District, an elegant emporium of weed that features crystal chandeliers, white marble countertops, tufted leather chairs, original artwork, and fresh-cut flowers. Visiting the Apothecarium is not unlike checking into a trendy European-style hotel. Customers are greeted by a smiling receptionist behind a sleek, semi-circular desk illuminated by domed pendant lamps. After a check of their paperwork (basically all that’s needed to gain admission is a valid doctor’s recommendation), visitors are assigned to a “patient consultant” to guide them through the menu of available products, which range from flowers and edibles to concentrated and topical applications.

The 5,000-square-foot space, which was formerly occupied by an upscale restaurant and cocktail lounge, is divided into several sections, including a boutique offering pot paraphernalia, clothing, and a variety of other items; a gallery area displaying a rotating selection of work by local artists; a space for seminars and support groups; and the sales floor, with its sleek white counters and dark wood cabinetry.

The Apothecarium was designed by Urban Chalet, a woman-owned interior design firm based in Marin County, in association with San Francisco architect Vincent Gonzaga. The designers aimed to create a space that was clean and modern but also had traditional touches that would appeal to a wide range of clients.

“It was important to create an aesthetic that allowed patients of all types to feel comfortable,” said Michelle Granelli, a principal at Urban Chalet. “We wanted a space that was very fresh and contemporary but also blended traditional elements.” To that end, the cool minimalist aesthetic is accented with traditional notes such as wingback chairs, houndstooth fabric, and traditional moldings.

The Market Street dispensary has been so successful that the Urban Chalet team designed a second Apothecarium on Lombard Street in the Marina District, which opened in the summer of 2017.

Medithrive, a small dispensary in the Mission District, offers customers a more intimate but equally stylish experience. The small storefront dispensary got customers into the proper frame of mind with large monitors displaying vivid photographs of marijuana plants and other pot-related subjects, trippy artwork by local artists, and the soothing strains of Bob Marley on the sound system.

A mouthwatering assortment of brownies, donuts, chocolates, and other edibles are brightly displayed in a curved, three-tiered glass case. The buds themselves are cleverly exhibited on slender black glass domes. The effect is like looking at a sculpture in a museum. Customers can examine the buds on cantilevered glass countertops. For a closer inspection—to ensure the cannabis is free of disease, rot, or other defects—microscopes are available that project images of the buds onto large, wall-mounted monitors.

Medithrive manager Sheryl Clark said the dispensary was designed to give customers a feeling of openness and ease. “We’re all about transparency,” she said. “We wanted to make sure our customers can get close to the product and close to our staff.”

Word has apparently gotten out. Medithrive has been featured on the front page of the San Francisco Chronicle and in the style section of the Los Angeles Times, and one of its staff members was recently voted best “budtender” by readers of SF Weekly.

Across the Bay in Oakland, Harborside Health Center, founded by renowned marijuana evangelist Steve DeAngelo, is one of the oldest and largest medical cannabis dispensaries in the country. Harborside doesn’t have the sleek, polished vibe of its San Francisco rivals, but it does offer a warm, inviting ambiance, which is exactly what designer Yolanda Felix intended.

“When we opened Harborside 10 years ago, going to a dispensary felt like visiting a jail,” Felix said. “There were angry, mean-looking guards behind bulletproof glass. You went down into this dark place. It made you feel like you were doing something wrong. We wanted to bring it into the light.”

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Will Legalizing Marijuana Have a Significant Impact on California’s Real Estate Sector?

Short-Term Impacts

The legalizing of recreational cannabis in California in 2016 is anticipated to affect all aspects of the economy, including the real estate sector. Specifically, the state can anticipate the need for more agricultural acreage, as well as warehousing space, to grow different cannabis products, since they will no longer need to be imported illegally from outside California. Legalizing cannabis will also encourage more office space use, as there will be a need for professional help (lawyers, consultants, and accountants) to obtain entitlements. There will be increasing demand for retail stores, including bakeries specializing in marijuana edibles.

There will also be a demand for government workers to test and inspect the product, as well as police, fire department, and medical personnel, who will be involved when a participant becomes ill from overindulging.

Other employment sectors for which there will be an increased demand include testing labs, cash management firms, security, and marijuana tourism, the last of which has been a significant factor in the Colorado market, the Marijuana Policy Group’s October 2016 report, “The Economic Impact of Marijuana Legalization in Colorado,” predicts that the visitor market will account for annual sales of 55 metric tons by 2020.

Other short-term impacts can also be predicted by drawing parallels with the legalization that occurred in Colorado in 2012. The same Colorado economic impact report showed that in 2014 and 2015, legal marijuana was the second largest excise revenue source, with $121 million in combined sales and excise tax revenue. Marijuana tax revenue was three times larger than that of alcohol, and by 2020, according to the report, it is anticipated to be greater than cigarette sales tax revenue, which has been declining in Colorado. Based on this, California is expected to follow a similar tax revenue trajectory in the coming years.

Chefs trained in producing multicourse meals will also be in demand. The April 24, 2017, New Yorker article “The Martha Stewart of Marijuana Edibles” noted, “In Los Angeles, thrill-seekers are paying as much as five hundred dollars a head to have a cannabis chef cater multicourse meals, pairing different cannabis strains with their culinary complements (heirloom-tomato bisque infused with a lemony Sour Diesel, for example).”

However, there will be an ongoing shift from both the illegal and medical marijuana trade. From both a growth and retail store perspective, this means some medical marijuana dispensaries will convert to adult marijuana stores and clubs. Others will go out of business. The good news from an economic standpoint is the majority of related jobs will be local, not from outside the state or country.

Long-Term Impacts

In the longer term, marijuana is likely to go the way of alcohol at the end of Prohibition. Currently, about 20% of US citizens have or will have (in states that have legalized cannabis but not finalized the process) ready access to marijuana products, most of them located in high-density West and East Coast states. But it’s quite likely that within the next two decades, marijuana will be legal throughout the country.

When it is legal, demand can be expected to decrease significantly in those states that were the first to offer legalized marijuana. Marijuana tourism will no longer be relevant per se but will be more like today’s alcohol purchases that are made by tourists—typically not a primary motivation for a visit, except for wine tours in places like Napa Valley. On the other hand, physicians and medical clinics will feel freer to use cannabis products to alleviate pain and depression, particularly for their cancer patients.

As legalization spreads, the shift in demand will cause a retrenchment, at which time there will be a consolidation of marijuana retail facilities along with a reduction in office and warehouse space. As a result, many small producers and retail providers will be put out of business by well-financed conglomerates.

But in the shorter run, marijuana facilities will occupy some of the current empty retail space that has occurred as a result of changes in shopping patterns by the giant internet behemoths like Amazon. In the longer term, however, the internet will once again take business away from in-store providers. The big unknown is the timing of these marijuana-related real estate cycles.

About the Author

Nina J. Gruen has been the principal sociologist in charge of market research and analysis at Gruen Gruen + Associates (GG+A) since cofounding the firm with her husband Claude in 1970. Nina applies the analytical techniques of the social sciences to estimating the demand for real estate and to understanding the culture of the groups who determine the success of development, planning, and public policy decisions. She is past president (1995–1996) of the International Women’s Forum—Northern California. In 1984, she was the first woman to be elected president of the Western Regional Science Association. She is a member of CREW and Lambda Alpha, an honorary land economics society. In 1982, Nina became the first woman elected to the Urban Land Institute’s board of trustees, where she served until 1997, when she was designated an honorary member. Since January 2014, she has been the industry’s “Dear Ms. Real Estate” for ALM Real Estate Media Group and publishes a monthly column for GlobeSt.com. Nina has lectured at major universities and published over 80 articles. In December 2015, she published her memoir, Believe It or Not: The Challenges Facing One Professional Woman a Half Century Ago.
MEDICAL MARIJUANA
IN RENTAL HOUSING

Rental property owners in California constantly have new laws to consider, both annually by the state and intermittently by local councils. Many of these laws become “gray,” as they may conflict with another law, such as state smoking laws and house rules prescribed by the rental property owner.

Recall that voters in California passed the Compassionate Users Act in 1996, which allows doctors to prescribe marijuana for medical purposes. Medical marijuana cardholders have the right, under state law, to have six full-size plants or 12 seedlings (and local jurisdictions may allow for more than that). Holding such a card also allows for smoking the product.

But California law also states that an owner has a duty to protect tenants from behavior that affects how they live on the property. One way to do this is by having a sound, updated lease that protects residents and the landlord’s assets and makes clear what the house rules are.

For example, a landlord can try to prohibit renters from growing marijuana or smoking it by including the rule as a clause in the lease. Many rental property owners do have such no-smoking policies in their buildings, as most residents these days are sensitive to smoke in their living space and owners are keen to avoid the damage smoke can cause.

But such a policy—for resident holding a medical marijuana card—can be adversely affected by the right to grow and smoke. Depending on local just-cause provisions, and a city’s overall stance on marijuana eviction of such a tenant may require consultation with a lawyer. (Suggesting that the medical card holder ingest marijuana or smoking it may provide a workable solution for all sides.) If the issue comes up after the lease has been signed without such a clause, the landlord would likely need to rely on an antidrug or anticrime policy, if such wording were included in the lease.

If an owner tries to evict a tenant based on growing in the unit, most judges and juries will recognize the risk of mold and threat of electrical fires that could jeopardize an entire structure full of residents, and would not be apt to allow for such reckless behavior.

However, should an owner in Alameda County try to evict a tenant for smoking marijuana, chances are the owner will lose. Though much is dependent on the judges and jury who fill the courtroom, the tolerance for this type of smoking can elicit great empathy, depending on the circumstance.

Marijuana is a larger issue for cities that have well-established business practices for those seeking to legally sell marijuana. With the product and materials coming to a California community near you, this can make for a scenario that owners will need to actively manage with residents, as there is always the threat of possible illegal and violent activity when selling is involved, for example, strangers coming in and out of housing complexes to purchase marijuana illegally from a tenant instead of at a registered grow house that has a city license.

About the Author
As executive director of the East Bay Rental Housing Association (EBRHA), Jill Brodhurst is responsible for the strategic goals of the organization, including its financial health, membership growth, educational programs, and service options. Founded in 1939, the EBRHA is a full-service nonprofit organization dedicated to promoting fair, safe, and well-maintained residential housing that is compliant with local ordinances and state and federal laws. Jill graduated from Saint Mary’s College in Moraga with a BS in business administration and economics and spent ten years in marketing, advertising, and project management for the food, brokerage, and online music industries.

Call it the “Wild West” days of medical marijuana in San José.

Back in 2014, up to 125 medical marijuana dispensaries were located willy-nilly throughout the city, in retail strip centers and industrial parks—the result of zero regulations on where these businesses could go. Complaints from residents soared, as there appeared to be no end to the industry’s expansion.

Fast forward to today, and San José has 16 legal medical marijuana businesses that operate under close city scrutiny.

Now, California voters have approved Proposition 64, which allows for the sale of marijuana for recreational use. A new state licensing system will be in effect next January.

But that doesn’t mean marijuana entrepreneurs, real estate brokers, and related service providers should expect the boom times to return. At present, the city has no plans to open up San José to more marijuana businesses, medical or otherwise. Yet officials will soon study the growing industrial component to the sector, such as manufacturing and distribution.

Just how’d we get here? And what’s ahead in light of shifting state law?

A Focus on Regulation
“San José has a strict regulatory program, and staff’s focus is to monitor medical marijuana collectives to ensure they comply with state and local laws,” said Wendy Sollazzi, division manager in the San José Police Department, who works on marijuana policy.

In the Bay Area, most neighboring cities have simply said “no” to marijuana businesses altogether (Oakland is the one exception). San José city leaders, however, opted for a system that allowed the industry to exist here—if it met certain strict conditions.

Here’s how it came about: In 2014, San José’s City Council approved a regulatory framework for the cultivation, manufacturing, and dispensing of marijuana. Among other requirements, businesses could only be located in certain industrial zoning districts and had to maintain their distance from schools, community centers, parks, rehab centers, places of religious assembly, and other marijuana businesses. All marijuana being sold inside the facility had to be grown and manufactured in the same space.

Then the city opened a 90-day window for businesses to apply. By the December 18, 2015, full-compliance deadline, 16 so-called “collectives” had fulfilled their obligations. And that was it. The city is not accepting more applications.

The system has so far worked well, regulators say. The facilities are monitored inside and out 24 hours a day, security is high (windows must be smash-proof), and complaints are few.

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San José Keeps Focus on Regulation of Pot Shops, But Don’t Expect More to Pop Up Soon

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Should You “Just Say No”? Risks Associated with Leasing to Cannabis Industry Tenants

Most of us remember the 1980s television commercial where an egg is dropped into a hot frying pan followed by the chilling statement “This is your brain on drugs.”

Since the passage of Proposition 64 in November 2016 legalized cannabis for recreational use in California, property owners, managers, and brokers—flooded with inquiries and proposals to lease property for the operation of a legal cannabis business—have been asking: “What will my property look like on drugs?” This article provides an overview of some of the risks and considerations involved in whether to enter into what will no doubt appear to be a lucrative lease.

Background

Despite the fact that California has legalized cannabis for recreational and medical use beginning in January 2018, it remains strictly illegal under federal law. The federal Controlled Substances Act (CSA) specifies that cannabis is a Schedule I drug, meaning that it has no currently accepted medical use and a high potential for abuse. This is the highest classification, which also includes heroin, MDMA (Ecstasy), and LSD.

At the present time, however, there are protections for those acting in compliance with state laws that permit the sale of cannabis for medical use: (1) the “Cole Memorandum,” establishing the current policy of the Department of Justice and (2) the Rohrabacher-Farr Amendment, a rider to a bill funding the federal government’s short-term spending. It is important to note that both apply only to medical cannabis and not to recreational cannabis.

The Cole Memorandum is a statement of policy issued to federal prosecutors in 2013, during the Obama administration, guiding them to focus prosecutions of cannabis operators in states where it has been legalized only on specific grounds, such as cases involving gang or cartel, the transportation of cannabis across state lines, and sales to minors, among a few others. The Cole Memorandum is simply a policy, not a law, and can be changed at any time.

The Rohrabacher-Farr Amendment, on the other hand, prohibits the Department of Justice (DOJ) from spending federal funds for the purpose of prosecuting individuals engaged in conduct permitted by state medical marijuana laws. It is important to note that this amendment has a short term and must be regularly extended by Congress.

Both the current DOJ policy and the Rohrabacher-Farr Amendment are subject to change at any time in accordance with the wishes of Congress and the current federal administration, in particular Attorney General Jeff Sessions. Mr. Sessions has publicly expressed his disapproval of both medical and recreational cannabis legalization, use, and users. He has already called for the formation of a federal task force to investigate methods for enforcing the CSA, including utilizing asset forfeiture penalties. On May 1, 2017, Mr. Sessions wrote a letter to congressional leaders, requesting them to not extend the Rohrabacher-Farr Amendment. To date, statements and actions of Mr. Sessions demonstrate his clear opposition to states’ legalization of cannabis for medical purposes and his staunch opposition to the legalization of cannabis for recreational purposes. The extent to which the current administration will change policies is unknown at this time.

Implications for Commercial Real Estate

What does this have to do with commercial real estate? Simply put: cannabis is illegal under federal law. No matter what laws California passes regarding cannabis, federal laws take precedence. The real question is whether the federal government will enforce the CSA in California.

In the event that current policies are changed, federal law enforcement and prosecutors could enforce the CSA against any one involved in California’s “legal” cannabis industry. Owners of commercial property used by cannabis tenants, are their potential targets. In leasing property to cannabis tenants, commercial landlords can be considered for being in aiding and abetting their tenants violation of the CSA, which itself is a crime under federal law. The federal government could seize the real estate assets of commercial landlords through a process known as forfeiture. This type of attack was previously used against commercial property owners leasing property to medical cannabis businesses in 2011 and 2012, when property owners were threatened with the forfeiture of their real estate in the event that they did not terminate their tenants’ operation of medical cannabis businesses on leased property.

In addition to the possibility of criminal and civil forfeiture proceedings by the federal government, there are various business risks associated with the cannabis industry that should be evaluat ed by commercial landlords prior to deciding whether to lease to cannabis tenants.

The regulatory process and local zoning requirements pertaining to cannabis businesses and the real estate they occupy must be strictly followed in order for the business to legally operate. Commercial landlords must diligently investigate whether all state and local regulations pertaining to the type of business, including zoning, are identified and ensure that cannabis tenants strictly comply with them.

Because cannabis is illegal on the federal level, federally insured banks and credit unions are prohibited from opening accounts for and accepting deposits from known cannabis businesses. Credit card companies cannot facilitate cannabis transactions. Rent paid by cannabis tenants is often delivered in cash, which could cause a landlord’s bank to issue a suspicious activity report upon deposit, triggering an investigation by the FBI.

Insurance policies that properly insure the use of commercial real estate for cannabis-related activity may be difficult for the landlord or tenant to secure because cannabis is illegal on the federal level. This is particularly important, as some cannabis uses of real estate can subject a property to heightened physical risk of fire or other casualty, and there is significant risk associated with the industry. Special care should be taken to determine whether insurance coverage is available and that the policy does not exclude coverage for a federally illegal activity.

In addition, many loans secured by commercial real estate properties deem leasing to a tenant who conducts illegal activities a material default, stemming from the fact that federally insured banks cannot loan money for an illegal use. Depending on the terms of the particular loan, many of which require the borrower to comply with all laws in the operation of the property, it is possible that a lease to a cannabis industry tenant could trigger a loan default and potential acceleration of the debt.

Commercial property owners should also carefully scrutinize other issues, such as whether tenant improvements will properly protect the property from damage resulting from the intended use, particularly risks from indoor cultivation and processing. The cost of utilities should be reviewed prior to leasing as lease terms can be drafted to adequately protect property owners from unexpected increased utility costs. Security needs should also be analyzed and considered prior to entering into a lease with a cannabis tenant in light of the value of the product and the cash-only nature of the business.

There are a myriad of other issues and potential risks that should be considered and addressed prior to leasing to a cannabis tenant. Commercial landlords will benefit from seeking advice from legal counsel with specific expertise regarding both the legal and business implications of leasing to cannabis industry tenants and in drafting and enforcing commercial leases.

About the Author

Alison Geddes is an attorney practicing commercial property management law at Trainor Fairbrook, a boutique real estate law firm in Sacramento. Her law practice includes assisting property owners and managers of retail, industrial, office, and mixed-use properties with all aspects of property management, lease enforcement, and disputes, including unlawful-deterrence and breach-of-lease litigation. Her practice also includes negotiating and drafting a wide range of commercial lease documents, including lease assignments, amendments, and termination agreements.

Alison is a member of CREW Sacramento, where she currently serves on the board of directors as president-elect.
The commercial real estate market in the East Bay has been opened up to new industry: cannabis cultivation, harvest- ing, and distribution. This addition has created significant interest, and the marketplace has responded with cannabis conventions, expos, seminars, and educational forums.

Let’s examine a few construction techniques related to buildings for the cannabis industry. As with many commercial real estate projects, these can be categorized as ground-up construction or tenant improvements.

Concrete Tilt-Up

A common construction technique for cannabis is what is called in the industry “concrete tilt-up,” which has been around for many years. Its most common use has typically been in erecting industrial buildings, warehouses, business parks, and exercise facilities.

This construction essentially consists of building a concrete slab on the ground by first making a framework of 2×6-inch wooden boards and filling it in with concrete; then walls are raised using a crane, and a roof component is added. The interior design criteria for future use determine the construction flow.

The initial design criteria for a concrete tilt-up cannabis building include interior and intended use considerations: lighting, (LED or other), PG&E load, ventilation, HVAC, cross-contamination, wall and floor sealing, heat build-up, humidity, grow pattern, and room size (floor area and height).

In some cases, prior to the pouring of the concrete tilt-up walls, design-build contractors and engineers design in “stub-outs” (piping, clips, and hardware for future windows and doors). Some cannabis growers are hedging their investments in this type of construction by having additional provisions, like special steel plates, installed initially so the structure can be converted into a two-story office building in the future should market conditions dictate a change of use.

Greenhouses

Another type of cannabis construction project is “greenhouses.” Most are commonly built with a concrete pad and a metal framework (usually aluminum or steel) as the main structure. Determining the power requirements for the water, air filtration, HVAC, lighting, irrigation, humidity, and temperature systems—and sophisticated controls to operate them—is very important. The final facility should also have provisions for packaging, labeling, and shipping (including a loading dock) once a harvest is completed. A maintenance program, backup power, and the use of natural sun vs. artificial lighting are also important considerations when building such a facility.

Security

Another design element that cannabis facilities of either kind need is a vault for cash and product security. These vaults are integral and should be equipped with rides and a tightly fashioned door closed with a complex lock. The most important reason is to have a security method that is immobile and all but impenetrable. A vault provides an indispensable level of security and may be the last line of defense against attacks or unforeseen catastrophes, such as floods, fires, and earthquakes.

Tenant Improvements

Growers are also converting existing industrial and warehouse buildings into grow facilities, much like a “change of use” situation in a typical commercial real estate project. These conversions may be deemed change of use, adaptive reuse, or remodels. In the cannabis industry, we see designer contractors adding specialized tenant improvements and converting them into a grower’s facility especially in a concrete-tilt-type building.

It is important to recognize that the design criteria and construction techniques used to grow cannabis are not new to the construction industry, only the tenant or user is. In California, especially in the Central Valley, producers of more conventional crops have been growing indoor produce for many years, as in the case of hydroponic latticeworks and other vegetables.

To view a 10-minute time-lapse video of the construction of a concrete tilt-up building, visit www.tilt-up.org/basics.

About the Author

Daniel Sanders is the Director of Business Development for Proforma Construction, a general contractor with over 30 years’ experience providing preconstruction, design-assist, design-build, and bid-build construction services for commercial, retail, industrial, and other specialized projects, ranging from adaptive reuse to the construction of new facilities. During his 30-year career in commercial real estate, Dan has held positions in brokerage and mergers and as a loan officer for two commercial banks. During his off hours, you can find Dan at the golf links, trying to improve his handicap.

Kali-rai, continued from page 7

Although banks don’t typically go looking for federally illegal tenants, they are on occasion notified by federal law enforcement. Property owners should beware that if they are financing, they understand the peril of a note being recalled.

An additional risk to landowners is the current climate in Washington DC and US Attorney General Jeff Sessions’ stance on marijuana. Although steps were taken by Resp. Barbara Lee to defund the “war on drugs,” leaving the department rather unable to enforce such laws at present time, there is the potential of the Trump administration reviving enforcement activity.

One such notable case was that of Harborside Health Center, an Oakland medical marijuana dispensary in operation since 2006, with tens of millions in annual sales, which the Feds targeted in an attempt to shut down its operations, seize all its assets (including the property held by the landlord); and incarcerate the business owner. In this unique case, Oakland’s then-mayor Jean Quan stepped in and stated the city would not follow federal demands to shut down this tax-paying business owner. After five long years in litigation and millions of dollars in legal fees for Harborside and the property owner, the Justice Department dropped the case as of May 2016.

This prompted current Oakland mayor Libby Schaaf to say, “It’s a great day for Oakland and for all of California: the federal government isn’t going to waste tax dollars trying to frustrate the desires of Californians to have safe access to medical cannabis.”

The near future

Every day, conversations are taking place in California cities about cannabis. Cities and counties such as San Mateo, Menlo Park, San Carlos, Union City, Fremont, Mountain View, Milpitas, San Juan, San José, and San Benito are having open discussions about cannabis business licenses (dispensary, cultivation, manufacturing, testing, and distribution) within their borders. Keep your eyes open and your clients abreast of the potential of cannabis properties and the game-changing opportunities they can bring.

About the Author

Sean Kali-rai, founder of Jackson and Main, LLC, in Los Gatos, is a California-based business advisory and lobbyist specializing in land use entitlement, the cannabis industry, and state-level legislative actions. Sean is also a California real estate licensee/broker. He represents the top five (largest medical cannabis dispensaries in San José. In 2015 Sean helped seven of San José’s 16 legally operating medical marijuana facilities secure their local licenses. His expertise is in government affairs, land use, lobbying, business development, and business consulting in the San Francisco Bay Area and Silicon Valley. Sean works with city, county, and state regulators on behalf of his clients. He graduated from Santa Clara University with a BS in economics. He was a former budget and policy aide under San José Mayor Gonzales and also a California real estate licensee/broker.

A deputy campaign director and finance director for Measure A (“BART to San José”).
Will California’s Cannabis Real Estate Markets Copy Colorado?

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Colorado adopted legal marijuana use for debilitating medical conditions in 2000. Over the next decade, the law expanded, eventually allowing legal dispensaries in 2009. Colorado’s Amendment 64, passed by voters in 2012, approved the use and sale of recreational marijuana in the state. Colorado left it up to counties and municipalities to determine if, where, and how to license the growth, manufacture, warehousing, and sales of weed. (As of mid-2016, 228 of 321 jurisdictions, or 71%, still banned all marijuana sales.)

Capital inflows to Colorado real estate investment supporting cannabis-related businesses revved up when the US Department of Justice announced in 2013 that it would not prosecute the cannabis-related segment of federal law in states that had legalized pot, granting protection to the industry. Out-of-market investors, their capital, and their employees flocked to Colorado to cash in. Some counties and cities have determined not to limit the number of licenses for retail or medical sales; others have predetermined a maximum number of licenses that will be issued. Other jurisdictions have decided to be grow and warehouse friendly. Those jurisdictions that tolerate cannabis have experienced massive changes to their industrial real estate markets, which affect the state as a whole.

Colorado initially limited grow operation licenses to those who were linked to a retailer. Retailers who wished to sell recreational pot when full legalization commenced had to have been medical purveyors licensed prior to October 1, 2013. This requisite vertical-shaft limitation from grower to retailer restrained the expansion of retailers and curbed an explosion of unlicensed grows.

Even with these limitations, a land grab, particularly for warehouse space, occurred in weed-friendly Colorado districts. The timing of recreational pot legalization in Colorado happened in tandem with a rise in overall economic activity after the Great Recession, which resulted in radical absorption rates and a rise in the rental rates of Colorado warehouses.

In any state that has legalized marijuana, roughly 80% of available industrial real estate is not available for cannabis industry use due to loan constraints and other ramifications of the federal classification of pot as an illegal substance. The remaining 20% of real estate inventory is subject to jurisdictional restraints and the willingness of owners to risk seizure by federal statute, which affects its availability to the industry. The inventory left in Colorado, primarily in heavy industrial areas with 40- to 60-year-old buildings, is what became home to 3.7 million square feet of “cannabiz,” or businesses growing, manufacturing, storing, and distributing marijuana.

In Colorado, between 2009 and 2014, 35% of all industrial leasing in Denver was related to the expanded legality of marijuana. Class C industrial warehouse vacancies plummeted from 8% to 2% in this period. Class C industrial rents jumped 56% from their 2009 recession lows to their 2014 levels, following recreational legalization.

What had been functionally obsolete factory and warehouse properties underwent rehabilitation at as much as $200 per square foot, for installation of upgraded electrical capacity and delivery—mostly to control the climate for grow operations—and for manufacturing.

This capital investment has not only recapitalized individual properties but revitalized and cleaned up warehouse districts, which are now thriving and supporting multiple levels of employment. As the supply meets the demand, retail pricing is declining. Weaker players are being consolidated into dominant operators, and the demand for space is leveling off, even while the overall economy is vibrant and demand for all warehouse space is strong. The absorption rate of industrial space by cannabis businesses is now slowing.

The big profits happen early in the cycle, when expansion is greatest, so investors are setting their sights on—and deploying their capital in—markets that are now earlier in the cycle of legalization and rapidly expanding the chain of supply and distribution, like California.

California cities with functionally obsolete warehouse space are poised, if their citizens vote to allow it, to take advantage of Prop 64’s wealth-generating potential. In zoned areas, employment will get a nice boost and land values and rents will rise dramatically. Warehouses will get expensive renovations.

Early in the legalization cycle, landlords will be able to charge inflated rents in exchange for their risk of federal forfeiture, absence of debt constraint, and location in jurisdictions that allow marijuana. Expensive upgrades to old warehouses and huge electricity costs will be justified by the high retail price of pot. For now, the opportunity is too big to ignore: grow as much as you can, to be ready for the day legal weed can be sold.

The race to build and deliver a legal marijuana business supply chain will create huge winners—and some losers who are late to the game. Some players will be absorbed, as dominant operators push out the second-tier competition. Marijuana will cost less in the future, as the supply meets the demand. If federal law is loosened and interstate transportation is legalized, growing facilities will be located where land is very cheap and will not be required in each state, which will lessen the demand for warehouse space.

There is already speculation about the marijuana real estate boom and bust. If a marijuana real estate investment requires the price of pot to stay the same forever (it probably won’t)—don’t make the deal. Warehousing inventories of typewriters made sense at one time—and then it didn’t. A new industry will come along, and the real estate will be retrofitted again. With change comes opportunity.

About the Author

Carol Ann Flint is an investment sales broker at First California Realty in Marin. She relocated to the Bay Area from New York City in 2015.
muddled by recent legal changes. Clarity, rather than terms such as “illegal drugs,” which have been their current policies prohibit the use of marijuana, and whether the policy and its potential repercussions before it becomes a disciplinary issue. This can help prevent future incidents, while also legally protecting employers from allegations that may stem from misinterpretation of the policy. Though Proposition 64 made significant changes in the criminal classification of marijuana, it is still up to each employer to decide how to adapt these changes to the workplace and, perhaps most importantly, to convey these policies to their employees.

Additionally, employers should decide if medicinal marijuana will be treated differently from recreational usage. Since marijuana is still illegal at the federal level, some employers with federal contracts or those bound by Department of Transportation or other federally mandated regulations may not have much choice in the matter. These employers should still consult their current policies to determine if the verbiage is consistent with industry regulations and clearly defined to prevent miscommunication. (In fact, all employers should consult with qualified legal counsel to verify that their policies are compliant with applicable laws and regulations.)

Employers should also decide what measure(s) will be used for enforcement of this policy. Should employers choose to use drug testing, they will need to clearly state when and under what circumstances such testing will take place. Numerous employee privacy laws surround drug testing, and so employers should make certain to consult with legal counsel to ensure that their policies are compliant. In the final step of policy development, employers should decide what, if any, measure(s) will be used to discipline employees who violate company policy. Whenever drafting any form of guidelines regarding employee discipline, the most important consideration is consistency. To avoid claims of discrimination or disparate treatment, employers need to apply the same policies to their best employees as to their worst, and so employers should take extra care and consideration to draft an effective policy that is consistent with company values and the overall message of their human resource policies.

Finally, after a policy has been drafted and approved by qualified legal counsel, employers need to disseminate and clearly explain the policy, even if nothing has changed. Many employees are mistakenly under the impression that Proposition 64 allows them to use marijuana without any adverse impact on employment. Clarifying company policy preemptively allows employees to understand the policy and its potential repercussions before it becomes a disciplinary issue. This can help prevent future incidents, while also legally protecting employers from allegations that may stem from misinterpretation of the policy.

Proposition 64 specifically allows employers to draft their own company policies that may or may not permit employees to use marijuana, even off the clock. As such, employers are still explicitly granted the right to enact drug-free workplace policies, which may include administering drug tests and even terminating employees who test positive for marijuana. Additionally, this provision even extends to medical marijuana, as upheld by California courts in 2008 and 2016. All of this seems to directly contradict the legality of marijuana and can lead to confusion, misinformation, and disintegrated employee-employer relationships if not handled carefully and effectively.

The first point of consideration is for employers to determine if their current policies prohibit the use of marijuana, and whether they would like to continue this prohibition. If employers choose to prohibit marijuana usage, specifically listing it by name will aid in clarity, rather than terms such as “illegal drugs,” which have been muddied by recent legal changes.

In November of 2016, California voters passed Proposition 64, essentially legalizing the use and possession of recreational marijuana statewide. Despite the publicity and attention gained by the proposition, there is still a lot of misinformation surrounding the full implications of its passage. This is especially true in the arena of human resources and employment law. Commercial real estate industry employers will need to evaluate how this legislative change affects their current policies and if these policies are consistent with the regulations imposed by their clients or applicable regulatory agencies.

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