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Understanding the inconsistent legal landscape of cannabis in commercial and residential real estate - by Christopher Montalbano and Melanie Kido

March 01, 2019 - Owners Developers & Managers

Christopher Montalbano
Pilgrim Title Insurance Co.

Melanie Kido
CATIC

At a recent “Legislative Luncheon” hosted by the Greater Providence Chamber of Commerce, a significant portion of the time was spent addressing the question of whether Rhode Island should decriminalize adult recreational use of marijuana. “We will be surrounded soon. We have to do

something” replied Michael McCaffrey, the state’s senate majority leader. Currently, 20 states permit cannabis use for medicinal purposes and nine states and the District of Columbia have decriminalized both medical and recreational use for adults. In addition, 17 states have enacted laws permitting use of CBD oils. This trend has created new markets and influenced many traditional industries. The somewhat sudden open presence of lawful marijuana cultivation, production, storage and distribution operations has had an impact on commercial and residential real estate. Given the somewhat complex legal landscape these facilities operate in, closing cannabis related transactions present unique challenges.

Understanding the inconsistent legal landscape is key to recognizing the challenges unique to these transactions. While over half the states have authorized, subject to proper permitting and licensure among other requirements, operating facilities for the manufacture, storage and sale of cannabis, marijuana remains a Schedule I drug under the Controlled Substance Act, 21 USC sec 800 et seq.

Schedule I drugs are those the statute describes as having a high potential for abuse or no currently accepted medical use or lack of accepted safety for use under medical supervision. While there have been some indications at the federal level that certain marijuana related offenses are not a priority for the Department of Justice, use, possession or distribution of marijuana remains a federal crime.

Given the illegality of cannabis at the federal level, state-level cannabis real estate transactions face major hurdles. Because banks may not participate in or aid criminal activity, checks and credit cards are not viable payment methods, making the cannabis business virtually an all cash business. This leads to heightened security concerns at these locations, as well as vulnerability to illegal activity. Banks and the marijuana businesses themselves may be required to file Suspicious Activities Reports (SARs) or Currency Transaction Reports (CTRs) for cash transactions of more than \$10,000. Real estate title and escrow companies must also report transactions involving currency transactions greater than \$10,000 on FinCEN Form 8300 (Report of Cash Payments Over \$10,000 Received in a Trade or Business). If banks wish to open accounts with cannabis businesses, they must comply with regulations issued by the Financial Crimes Enforcement Network (FinCEN). These regulations are stringent and the demands upon the bank are so strict (and in some cases subjective), that few banks are willing to take the plunge.

Financing a real estate transaction involving a marijuana business can be equally as difficult. Federally chartered banks and credit unions are precluded from financing such deals, since to do so would facilitate a business which violates federal law. Other major investor channels are often constrained when attempting to invest in cannabis businesses. Funds governed by ERISA may be precluded as are certain endowments which by regulation, statute or internal by-law are precluded from investing in businesses which are illegal or are so-called “sin businesses.” However, some progress in this area is emerging, and the impediments to doing business with cannabis operations are being viewed as “temporary and resolvable.”⁽¹⁾ Further while Federal banks are currently barred, state-chartered institutions, including savings banks and credit unions have been helping to fill the void. Treasury secretary Steven Mnuchin has stated that treasury is looking at the FinCEN regulations and trying to bring them in-line with the current climate for cannabis businesses⁽²⁾.

Beyond the lending markets, much of the financing for cannabis deals have come from venture capital and private equity. These markets are attracted to what is perceived as ground floor entry into an industry with significant potential.

Once a real estate transaction is moving forward, there are other obstacles to overcome. Most investors in real estate transaction will not invest in a position if their investment is subject to loss due to title defects. As of the time of this writing, none of the four largest families of title insurance underwriters in the U.S. are willing to insure cannabis deals. These four families accounted for 85% of all title insurance written in 2017(3). Much like the state chartered banks have helped fill the void in the financing arena, regional title insurers have found methods to insure cannabis deals.

CATIC insures a full range of commercial facilities from those that legally grow and produce cannabis to those that sell and dispense medical marijuana. CATIC also insures recreational marijuana facilities if those facilities legally exist under state law and have received the requisite permits or licenses from both state and local authorities.

These creative alternatives to traditional markets and providers have begun to fuel the successful development and creation of a variety of cannabis businesses. As entries to barriers are broken down, clients will seek the expertise and knowledge of those who have the experience in the marketplace.

Christopher Montalbano, Esq. is principal at Pilgrim Title Insurance Company, and partner at Montalbano, Belliveau & St. Sauveur, LLP. Melanie Kido, Esq., is vice president and Massachusetts state counsel, CATIC.

1. Parker, Karen A. et als "Risk management within the cannabis industry: Building a framework for the cannabis industry" Financial Markets, Inst & Inst. 2019, 28:3-55 wileyonlinelibrary.com/journal/fmii, P32.

2. Id. at p. 33.

3. Industry Financial Data American Land Title Association www.ALTA.org.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540