

Stuart Kane LLP

What You Should Know Before Leasing Property for Cannabis and Hemp Use

When the City of Huntington Beach imposed a fine on a landlord in excess of \$150,000 for allowing a cannabis dispensary to operate out of his property, the landlord was surprised to learn that while cannabis has been legalized by California, each city has the right to regulate, restrict and prohibit commercial cannabis operations within its boundaries. In this case, Huntington Beach prohibited the operation of any such business, and that prohibition remains today.

Some Orange County cities do permit the operation of cannabis businesses. However, landlords that are considering leasing to a tenant for a cannabis-related purpose, as well as those tenants themselves, should all have a general understanding of federal, state and local cannabis laws before entering into such a lease.

Cannabis Operations

Many landlords know that, despite California's cannabis legalization, leasing to a cannabis business remains illegal under federal law, given that cannabis is still a Schedule I substance under the Controlled Substance Act. As such, if property is to be leased to a cannabis business, the lease provisions should be modified to account for the conflict between federal, state and local law.

A proper cannabis lease, for example, should accurately define and limit the business use; require that the tenant follow all laws except federal law, to the extent federal law is inconsistent with state and local cannabis laws; and provide remedies for each party should federal or state enforcement or other changes in the law occur during the term of the lease.

To the extent a landlord intends to lease to a cannabis business, the landlord should know what types of cannabis operations are permitted at their property. Regulations are specific to the jurisdiction where the subject property is located. Currently, only four Orange County cities permit some form of cannabis use or operations, as follows:

Orange County City	Permitted Cannabis Use(s)
Costa Mesa	Manufacturing; Distribution; Testing
Irvine	Testing
La Habra	Distribution; Testing
Santa Ana	Cultivation; Manufacturing; Distribution; Testing; Retail

Orange County cities not listed in the table above do not permit any type of commercial cannabis activity.

In order to operate a cannabis business, the operator must obtain state and local authority, usually in the form of a permit from the city, and a license from the state. The tenant will usually want the lease to be contingent on obtaining its permit and license, and many landlords will agree to that contingency in exchange for a non-refundable payment.

Hemp Operations

Although hemp is legal under federal law, under state and local law, hemp businesses have yet to be given as much legislative attention as cannabis has received. As a result, landlords and tenants need to be aware of the varying legal status of hemp, and the risks associated with hemp businesses before committing to lease property for hemp operations. Preliminarily, knowing the specifics of the type of hemp business that a tenant intends to operate can help landlords and tenants narrow the risks in leasing property for such use.

Pursuant to the 2018 Farm Bill, hemp is no longer a Schedule I substance under the Controlled Substance Act. Unlike cannabis, hemp can now be possessed without violating federal law. However, hemp is defined in the Farm Bill as any part of the Cannabis Sativa L. plant with a delta-9 tetrahydrocannabinol ("THC") concentration of not more than 0.3% percent on a dry weight basis. Therefore, if the hemp plant contains more than 0.3% THC, it is considered cannabis and a controlled substance.

But even though hemp has been removed from the Controlled Substance Act, it does not mean that hemp products can be sold without regulation. There are

barriers to entry and potential risks to business success imposed by the U.S. Food & Drug Administration ("FDA"), as well as state and local authorities.

The FDA and the California Department of Public Health ("CDPH"), for example, have stated that cannabidiol ("CBD"), a widely-used derivative of cannabis and hemp, cannot be used in food or beverages, with the exception (on a state level) that cannabis edibles may be produced under a valid state cannabis manufacturing license and local permit. Accordingly, if a tenant intends to produce food and beverages containing CBD, but they do not obtain a cannabis manufacturing license, there is a risk to the landlord leasing to such a tenant, given that the products being produced will be deemed illegal.

Similarly, dietary supplements and medical products containing CBD are illegal unless approved by the FDA, which has only approved a few products containing CBD to date.

The quandary for some landlords and tenants, however, is that hemp products that are not food or beverages, nor claim to have medicinal benefits, are operating in a grey area. Other than hemp's declassification from a Schedule I substance, there is little guidance provided by federal, state and local authorities as to where and how hemp products may be processed and sold.

To that end, cities vary greatly in their treatment of hemp businesses. Most cities do not have any ordinance specifically regulating hemp. Some cities permit hemp manufacturing, viewing it as a legal component of an end product. Other cities state that hemp is to be treated as cannabis, given that the city does not currently have a process by which to distinguish between cannabis and hemp or to determine if CBD is derived from hemp or cannabis. This issue is further complicated by the fact that hemp is expressly excluded from the definition of cannabis at the state level and by many local ordinances, meaning that hemp cannot by law be treated the same as cannabis.

Given the ongoing evolution of the regulatory scheme for cannabis and hemp, landlords should do extra diligence regarding the intended operations of a prospective cannabis or hemp tenant, and landlords and tenants should both plan on working closely with the city and legal counsel to ensure the intended use of the property is in compliance with state and local law.

Author Bios

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