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## Weeding through the restrictions: Real property transactions in the cannabis industry

By Ian O'Banion

Although there are currently more than thirty states with legalized recreational and/or medicinal cannabis, the fact that cannabis remains illegal at the federal level still presents some significant hurdles for owners and operators of cannabis businesses to navigate when dealing with real property.

For instance, despite the widespread use of title insurance and escrow agents in typical commercial real estate transactions, these “customary” aspects of commercial real estate deals remain substantial challenges within the cannabis industry. This is primarily due to the conflict that exists between federal and state laws and the numerous concerns they present to title insurance companies.

As a Schedule I drug under the Controlled Substances Act, it is a federal crime to possess, use, sell, or distribute marijuana. Therefore, handling funds or settling financial transactions for cannabis-related businesses could be considered assisting in unlawful activity. This also presents numerous risks of insuring and transferring real property that is associated with unlawful activity, including, for example, the potential to implicate anti-money laundering rules as well as forfeiture laws.

In a typical commercial real estate transaction, it is customary for the purchaser of real property to obtain an owner's policy of title insurance at closing. By issuing the owner's policy, the title company insures the purchaser against loss incurred by reason of fee title not being vested in the purchaser. So, at a basic level the purchaser of the commercial property knows that the seller has not previously sold the property to another party. Purchasers of property with cannabis use are generally not able to obtain title insurance and thus must rely more heavily on their own due diligence and on the representations and warranties of the seller in the purchase and sale agreement. Therefore, cannabis business owners should make sure they have an excellent team of consultants, including legal advisors, to help fully diligence the real property and carefully negotiate the terms of the purchase and sale agreement.

Additionally, in a typical commercial real estate transaction if the purchaser is obtaining financing to purchase the real property, the lender will obtain a loan policy of title insurance for the lender's benefit. Since many title insurance companies are not willing to issue a loan policy of title insurance

when the property involves cannabis use, this makes it difficult for purchasers of property with cannabis use to obtain financing from traditional lenders.

A leasehold policy of title insurance is frequently obtained by a tenant when there is a ground lease or other long-term lease arrangement, particularly when the tenant has a purchase option that is being recorded. Given that leasehold policies are generally not available for properties with cannabis use, cannabis business owners that enter into long-term leases should engage legal counsel to make sure their leasehold interest is properly documented and recorded in the real property records. This is especially important if the tenant has any purchase rights under the lease, such as a right of first offer or other purchase option.

In addition to issuing title insurance, title companies frequently act as escrow agents to facilitate real property transactions and handle the transfer of funds, whether it is a purchase and sale transaction or financing secured by real property. This is the standard approach for most commercial real estate transactions; however, many title companies will not provide escrow services for real property transactions involving cannabis.

Nevertheless, some progress is being made to address these concerns at the state level. For example, in 2020 California enacted legislation (2019 California Assembly Bill No. 1525), which provides that banks, accountants, and other entities providing financial services may provide services to licensed cannabis businesses without committing a crime under California law.

However, given the many concerns that still exist at the federal level, most national title insurance companies, as well as many smaller regional companies, will not issue title insurance or provide escrow services for real property transactions that involve the cultivation, distribution, manufacture, or sale of marijuana. It will likely take comprehensive cannabis reform legislation at the federal level before title and escrow can become more normalized for real property transactions in the cannabis industry.

In the meantime, owners, operators, and investors in the cannabis industry must critically evaluate each real property transaction. Given the difficulty of obtaining title insurance in real property transactions involving cannabis use, it is important that owners, operators, and investors work closely with their legal counsel to review the title, zoning, and the environmental condition of the real property, as well as to negotiate the terms of the purchase and sale agreement, including seller's representations, warranties, and obligations. Performing real property due diligence is important for every real estate transaction, but is especially critical when navigating the federal, state, and local rules that apply to cannabis businesses.

For more information on the content of this alert, please contact any member of our [Cannabis](#) and [Real Estate](#) teams, your Nixon Peabody attorney or:

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