



## Lowenstein Sandler's Real Estate Podcast: Terra Firma

### Episode 11: Reclassifying Cannabis, and Its Possible Impacts on Real Estate Transactions

By [Stacey Tyler](#), [Stephen Tanico](#)

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**Stephen Tanico:** Welcome to Terra Firma conversations on commercial real estate. I'm Stephen Tanico, a real estate attorney at Lowenstein Sandler. I'm joined today by my cohort, Stacey Tyler, a fellow attorney at Lowenstein Sandler, who's going to be wearing two hats today. One is my co-host and the second as the deputy chair of Lowenstein Sandler's Cannabis Practice. Today, we'll be talking about the cannabis rescheduling and how that potentially could change the deal landscape or real estate deals.

Both in financing and in leasing. Thanks for joining us today, Stacey.

**Stacey Tyler:** Happy to be here in both capacities today.

**Stephen Tanico:** To get started, can you give us a little background on what's happening?

**Stacey Tyler:** Sure. So I think a lot of us are probably already aware that there is kind of a big conflict of law that exists today about cannabis. So as we all know, especially those of us who live and work in the new Jersey, New York area, people are buying, recreational cannabis now on those markets because despite the fact that cannabis is still considered a controlled substance, a schedule one substance, as I'll get into in a little bit at the federal level, many states across the country have already legalized it in some way, shape or form already.

Lots of states already have medical use and a lot of states increasingly every year have recreational markets as well. The only reason that this exists is because there has been a lot of legal gymnastics at the state level to enable businesses to get into the cannabis, space, despite the fact that the federal government still considers it a schedule one substance.

And what does that mean? A schedule one substance is, defined under the Controlled Substances Act. That's the law that makes it illegal to do things like heroin. and it creates different schedules for controlled substances based on the severity of the abuse potential and whether there is any scientific or medical use. So right now, today, cannabis is a schedule one substance in the same bucket as meth, for instance, where the government has decided that there's a high potential for abuse and there's virtually no accepted medical or therapeutic or scientific use.

It's something that they just want to strictly prohibit because it's not good for anyone. I think a lot of us are already accepting the fact that that's really just not true of cannabis. There's lots of, potential uses. It's not something that is like meth at all or heroin. And there has been an increasing public pressure from a lot of different angles on the government to reassess the way they look at that.

It just doesn't make sense, for it to still be a schedule one substance, given how much the culture has changed in just general acceptance of cannabis use and also the investment that we see making that we see being made in, in different cannabis businesses across the country. So finally, we're seeing some regulatory movement on that. Just this past week, Attorney General Merrick Garland, after working with the DEA, submitted a proposal to change the classification of cannabis from schedule one to schedule three.

Schedule three substances are like lots of prescription drugs where there's a low or moderate potential for abuse, and there's lots of accepted medical uses. So that's a huge step. It's the most official, step in that direction that we've seen. So that's very significant. But I just want to temper everybody's expectations that this nothing has changed yet. This is just the first step and kind of a lot of red tape right now.

The white House Office of Management and Budget is reviewing that proposal. After that, there's going to be a public comment period. The DEA is going to have to do additional review. So we're still a ways away from an actual rescheduling. But this is really giving a lot of us in the cannabis industry hope that we are closer to a more rational federal approach to cannabis generally.

**Stephen Tanico:**

And because of this kind of discrepancy between the way the federal law views cannabis and certain state law abuse cannabis, how it has cannabis being a schedule one substance affected the market. In states where cannabis is legal in a state level up to now.

**Stacey Tyler:**

I just want to also just stay upfront. Obviously, our listeners know we are real estate attorneys, we're deal attorneys. We are not experts in criminal justice reform. So my commentary here is really going to be from that lens, focusing on the effects that the regulatory changes are going to have on the business world. Hopefully this rescheduling is also going to have significant impacts for criminal justice reform.

So I, I you know, we're all very excited about that too. But just I'm going to focus on the business side. So in general, the fact that the federal government sees cannabis as the same as meth, it means that the federal government doesn't think that any, business use is legitimate. Any kind of business activity is legitimate.

And that trickles down in federal law in a lot of significant ways. And it also means that a lot of national players, most significantly, national banks, are treating anybody who's in the cannabis industry as essentially like a drug dealer. So they just are not willing to do typical business activities with cannabis businesses, like making typical loans. So that has really handcuffed a lot of cannabis businesses.

They can't just go to Wells Fargo or Bank of America and get a typical loan for their business, because in their eyes, in the bank's eyes, everything that the cannabis business does is in violation of federal law, which is true, and it's just an inconsistency in the way that states and federal governments are looking at it.

**Stephen Tanico:**

You know, I think the fact that there are kind of this niche alternative lenders popping up for cannabis makes sense in terms of leasing. You know, I see living in Manhattan, kind of, cannabis shops all over the city. you know, you and I together

have worked on cannabis manufacturing leases. How does the leasing side work to harmonize the fact that cannabis is illegal technically, federally and legal in some states?

You know, I don't think they're kind of niche landlords popping up the way that you see in lending. You know, what? Can you talk a little bit about how those two things kind of operate now?

**Stacey Tyler:**

Sure. So I would say that obviously these deals are happening. We see dispensaries popping up all over the place in New York, New Jersey and other states where we have recreational legalization. To some extent, the deals are happening, and the terms of those deals are really just going to depend on the counterparty. So I've negotiated a lot of different leases for cannabis businesses, and I've had a lot of different experiences that the landlords are individuals or businesses, and they're all a little bit different.

The way they handle it. I've seen a lot of landlords who are totally comfortable with this industry. They see the value and they're comfortable that it's highly unlikely that the federal government is going to, you know, swarm in and, you know, ruin the business or throw up the deal, because of the cannabis use, just based on the fact that we've had legalization for in some way, shape or form for decades.

In some places in California, for instance, we have some very mature markets, and it just hasn't happened. We've also seen landlords who are and I would say this is especially landlords that are maybe like smaller, you know, smaller shops, mom and pop kind of thing. And they just can't really wrap their heads around that. In their mind, this is a drug, this is illegal.

And because of that, they want to take a more conservative approach. So it really kind of runs the gamut. I would say it definitely has changed the bargaining position of tenants, because the tenants are going to want the least to acknowledge the fact that there is this conflict of law. They want the landlord to acknowledge that and to make the lease make sense for their use.

So, for instance, if there's a long licensing process, which there typically is in most states, certainly what we see here in New York and New Jersey, they want things like a licensing contingency. They want the ability for the lease to be amended in the event that laws change, that's highly likely things are going to change. This is an ever-evolving market like we're seeing now with this most recent proposal.

So, you know, there's a lot of different ways that a cannabis deal has been different historically from any other type of business. But I think really it's just comes down to the parties at play.

**Stephen Tanico:**

Now, I, I will caveat that the answer I'm going to ask for you here will be speculative. But in terms of when cannabis now being a schedule one substance, the effect of that on getting capital on insurance products and leasing. Where do you see a rescheduling to a schedule three substance potentially impact? those areas.

**Stacey Tyler:**

So you're right, this is pretty speculative. But I think we in the cannabis industry have been seeing, you know, the really big impediments to deals are going to significantly change. So I already touched on the lending aspect, just having federal banks, nationally regulated banks, get more comfortable with this type of asset class and really just use the same type of underwriting criteria for a cannabis business that they would use for any other type of business.

**Stacey Tyler:**

That's really going to just make things so much easier for cannabis business. It's going to give them a lot more choice when it comes to seeking sources of funds. Insurance is another closely related industry where it's highly regulated and having them see cannabis less as a mess and more as like a prescription drug is going to really change the way that they see their own underwriting.

Another super significant point is from a taxation perspective. So I think anybody involved in cannabis businesses is familiar with the tax consequences of your main product being a schedule one substance. And what I'm talking about is under the Internal Revenue Code section 280 E, that typically allows any normal business to deduct ordinary business expenses on their taxes because cannabis is scheduled one substance like a heroin.

The federal government says that no, that's not an ordinary business expense. You cannot make any deduction for anything related to a schedule one substance. So that essentially means that cannabis businesses can't deduct any business expenses because they're all tied to the schedule one substance. And some way they're all essentially drug dealing related, if you will. So I think that is going to be immediate dollars in in cannabis businesses pockets.

So I think really the other things that are somewhat more tangential to the real estate world, there's a lot of changes that are going to be made. I mentioned part of the point of the scheduling system is based on the potential for medical or other therapeutic use. So just moving it to schedule three is going to enable so much more research and development.

It's going to be a ton more opportunity in, the life sciences space. We have a lot of people at Lowenstein who work in that space in states where there's been more progress towards legalization, and as soon as there's more federal freedom to invest in those types of potential therapeutic uses, we're just going to see a ton more opportunity there.

Hopefully more revenue streams, technological advancements, and hopefully we're also going to see some harmonization. So I think in new Jersey we've seen just a very, very long and bumpy rollout. And we're really seeing that across the country because there has been this very segmented state by state approach. Every state has kind of a different procedure for getting businesses licensed, for overseeing them going forward, for how you deal with the criminal justice reform aspect, for how you, you know, kind of try to do some form of restitution, invest in the communities that have been most adversely impacted.

Every state is completely different that the for the way that they're doing this and that has a lot of consequences. It just means that it's really hard for people to do anything outside of their state. Whereas a lot of other businesses, it's quite easy for you to expand cross-border into other states here. It's a completely different regulatory framework.

So it just makes compliance very complicated. So hopefully we're going to see some harmonization here. Once we have rescheduled at the federal level. Hopefully there is more of an effort made to make the federal scheme kind of even these border differences US. And hopefully that makes it a lot easier for companies to do more across all of the United States.

**Stephen Tanico:**

Amazing. Stacey, that about wraps it up for us today. Thank you so much for joining us as both my co-host and as a guest of the deputy chair of the cannabis practice at Lowenstein Sandler. I think we're all a lot smarter about the potential rescheduling of cannabis and hopeful to see kind of how this unfolds over the upcoming months.

And thank you, listeners for tuning in today. Be sure to like, subscribe, and follow Terra Firma wherever you're listening to this podcast station. I would love to hear from you, so feel free to reach out to us at [terrafirma@lowenstein.com](mailto:terrafirma@lowenstein.com). Until next time.

**Stacey Tyler:**

Ciao.

**Kevin Iredell:**

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