

## Five tips for marijuana investing

It seems like many investors are enamored with the burgeoning marijuana industry and are jumping in headfirst before checking the facts. On the surface, the returns look amazing. Why wouldn't someone go buy an industrial building and lease it for four times what they could to a normal tenant? Should an investor take the plunge to invest in this new industry? Will the appreciation and rents continue? Will the political landscape change and have a major impact on the industry?

Before jumping on the marijuana bandwagon, here are five tips every investor needs to consider.

First, is the property general purpose? The industry is rapidly evolving and as prices increase, buyers are looking at unconventional properties for marijuana cultivation. For example, three years ago the primary properties for cultivation/manufacturing were plain vanilla industrial buildings. As demand for these properties increased, buyers have begun migrating to other lower-cost alternatives, for example, Class C and D office and even older motels. The question an investor has to ask himself is: As the industry evolves and/or if the growing methodology changes (i.e., outdoor, greenhouses, etc.), what could you repurpose the property for? I joke that they could reuse the motel with a "tropical theme" for future guests if the property were repurposed.

Second, can the high rents last? Unfortunately high rents that property owners are getting today are unsustainable. As more competition enters and pushes down the wholesale costs, tenants will be unable to sustain



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the above-market rents. Furthermore as rents rise, it is more economical to seek out lower-cost options outside the metro area (like Pueblo or Colorado Springs) where buildings are valued considerably less than in Denver. Marijuana is an easily transported product, so location is not as critical on the wholesale side. This trend will continue and rents ultimately will come down significantly.

Third, can the building prices continue their torrid pace? The answer is a resounding no. There are no market fundamentals to support the prices being paid for many industrial properties. I've seen some trading at over \$200 a foot for a marijuana building. For a normal tenant the cap rate would have to be less than 1 percent for the transaction to make sense. This means that investors are placing a higher value on an industrial building with a noncredit tenant as opposed to a major credit, retail-anchored center.

Fourth, will all the property improvements made by the tenant substantially increase the value of the property? Most marijuana tenants (or landlords) spend substantial dollars upgrading the building to accommodate the new tenant. This includes security, electrical, lighting, climate control, space reconfigura-

tion (grow rooms, drying rooms, for example), etc., to accommodate their specific use. Unfortunately the vast majority of these updates are not beneficial to future tenants and many are actually detrimental to a future repurposing of the property. For example, I recently inspected a 3,000-square-foot light-industrial building that originally had a small office area and then a warehouse, which was very functional for the area. The building was converted to all small rooms with no windows (for growing) with low ceilings (10 feet) so that a mezzanine could be built. Unfortunately in the building location (heavy industrial/warehouse area), this newly configured property would be nearly impossible to rent with the updated configuration. How many office users are looking for a building in an industrial area, with no other office users, with small offices and zero windows; sounds more like a jail than a functional office building. The tenant also considerably upgraded the power. The increase in power is 10 times more than a typical user could ever use in this size property. I saw a study in Nevada said that marijuana buildings use more electricity per foot than anything ever built in Southern Nevada. In a nutshell, the improvements made by the tenant did not increase the value of the property; they actually decreased the value to a general purpose user since the newly reconfigured space is dysfunctional and the average user would likely never need the improvements (think security, immense HVAC, power, grow light infrastructure, etc.).

Finally, the industry is changing

rapidly. What do these changes mean to property owners? First, market forces will reshape the industry. Larger players already are entering the market, driving down prices along with, in general, more market entrants and grows coming on line. Many of these new entrants are staking out claims in much lower-priced production areas (outside of metro, greenhouses, etc.), which will further their cost advantage. Along with general market forces there are also a number of unknowns in the political landscape. For example, presidential contender Chris Christie has vowed to "end Colorado's pot party" if elected. A new administration could substantially alter the current marijuana landscape through enforcement (or lack of enforcement) of various laws. In the marijuana industry change is not a matter of if, it is more a question of when and how suddenly.

With the items mentioned above, should you invest in marijuana? For the time being there could be money to be made as the industry is in a transition phase. The million-dollar question is not only when this large change will occur but also what it will look like (full outdoor growing, enforcement of federal laws, etc.). The marijuana industry is currently a game of musical chairs with a number of moving pieces. In marijuana real estate the objective of the game is to be close to the end of the game, but not be the last person with a chair (i.e., dysfunctional marijuana building) when the industry transitions and the music stops.▲