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Is Colorado 'high' on marijuana?

With the legalization of recreational marijuana and continuing growth in marijuana, a new gold rush is on in Colorado. Many newcomers are entering the industry hoping to strike it rich. Investment dollars from outside the state are beginning to finance these new ventures. The demand for legal marijuana products is growing exponentially. So what does this mean for Colorado?

In this article, I am going to focus on the impacts of marijuana (both medical and now recreational) on the real estate environment. To get into the marijuana business, there are a number of hurdles (both business and regulatory). One of the most prominent regulatory items is the location of a grow operation. Grow operations are prohibited from being near any public or parochial school or the principal campus of any college, university or seminary, as well as child care center or drug treatment center. As a result of this regulation, along with various requirements by the respective cities regarding marijuana facilities, the vast majority of marijuana facilities have located in industrial areas. Not only do industrial areas meet many of the location requirements, but also many have heavy power and ample water, which is also required by marijuana growers. Industrial facilities have become the preferred location for this new industry.

As a result of industrial facilities being ideally suited for the medical marijuana business, demand for this property type has increased exponentially both for purchase and leasing. Build-



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ing owners have demanded premium lease rates and sales prices. In many cases, due to the limited supply, building owners have been getting leases and sales substantially above market. This is most easily illustrated through an example on a transaction that I recently analyzed for a borrower (see accompanying chart).

As a result of the market lease rates noted in the chart, building owners perceive that their buildings have increased substantially in value. In the example I am using, a borrower was under contract to purchase the property for \$1.8 million; this is substantially above market (both on the income and sales approaches). After analyzing the market rents, I came to a much different assessment of the market value of the property.

Why would a lender look at market rents when the current owner has a long-term lease with a marijuana tenant? First and foremost, the tenant is not a credit tenant and may or may not be there a year from now. Second, the competitive landscape is rapidly evolving and there is no doubt margins will be compressed. As larger players enter the business and consolidation continues, the price points will continue to decline (a number of players in the industry have

stated there was a 40 percent decline last year in wholesale pricing). Along with the change in the competitive landscape, the marijuana business ultimately will be run like any other business (alcohol, tobacco, etc.). A business in a competitive market environment will not be able to sustain above-market rents. For example, a local distillery does not pay a premium to rent space.

Along with the micro aspects listed above, there are many macro factors also impacting the industry. As more states continue to legalize marijuana in one way, shape or form, the growing methods will continue to evolve. Eventually a state with a more temperate climate will allow growing in greenhouses and, ultimately, outdoor growing. This is one of many regulatory changes that could occur that would drastically alter the marijuana landscape. If outdoor or greenhouse growing is legal, the premium paid for industrial space would be eliminated since there would be a surplus of space as growers transitioned to less expensive manufacturing methods.

In Colorado, industrial properties are definitely getting "high" on marijuana. The current above-market rents and subsequent sale prices are unsustainable. It is inevitable that both lease rates and purchase prices will come into alignment with market rates. With the macro and micro forces mentioned above, the million-dollar question is when this will occur, not if this will occur.▲