

CANNABIS AND CRE: EXPLORING ENVIRONMENTAL COMPLIANCE AND DUE DILIGENCE

The Trials & Tribulations of an Emerging Industry

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The proliferation of the legal production and sale of cannabis throughout the U.S. has led to tremendous growth of the industry in a relatively short period of time. States where medical and recreational marijuana has been legal for several years show significant increases in the demand for commercial land and facilities.

For the environmental consultant, cannabis-related commercial development is of special interest both for the newness of the field and for the attention it can attract from regulators as well as community and business organizations. Regulatory requirements that apply to cannabis industry businesses range from the more obvious environmental regulations involving air, waste, and water, to unique ones such as local zoning laws relating to the proximity of these facilities to schools.

Legislators Fueling the Green Rush

Currently, [more than 35 states](#) have laws permitting the production and sale of medical marijuana, and [nearly 20 states](#) have laws permitting the production and sale of adult-use marijuana. In recent elections, more states have moved to [legalize cannabis use](#) and the continued acceleration of these trends is anticipated.

On the federal level, there are indications that bipartisan support for the legalization of cannabis is building. In December 2020, the Democrat-majority House passed the [Marijuana Opportunity Reinvestment and Expungement \(MORE\) Act](#), which would remove marijuana from the federal Controlled Substances Act, lifting the barriers state-licensed marijuana businesses across the country currently face. While Republicans generally don't support the bill's high tax rates and social equity programs, GOP lawmakers increasingly do support decriminalizing marijuana. In fact, in November 2021 Rep. Nancy Mace (R-S.C.) introduced the [States Reform Act](#), which also would remove marijuana from the federal controlled substances list.

These recent developments are clear signals that the cannabis industry will likely boom in the coming years.

Cannabis Facilities and CRE Demand

As cannabis facilities increase, so too will the number of commercial real estate transactions involving these facilities and properties. It is therefore critical for environmental consultants, lenders, and other parties involved in these deals to be aware of the unique legal and business considerations associated with this evolving industry and incorporate all relevant factors into environmental due diligence assessments and property transactions.

“ It is... critical for environmental consultants, lenders, and other parties... to be aware of the **UNIQUE LEGAL AND BUSINESS CONSIDERATIONS** associated with this evolving industry ”

Importantly, because cannabis is still illegal in the U.S. under federal law, additional real estate and business considerations come into play for transactions involving these properties, as discussed below.

Setting the Compliance Baseline

There are numerous environmental regulations that apply to businesses in the cannabis industry. [Compliance](#) generally includes developing chemical spill prevention programs and maintaining chemical inventories, registering storage tanks, and obtaining permits related to pesticide use and the generation of stormwater, industrial wastewater, hazardous waste, and air emissions.

[Federal environmental](#) statutes that may apply to cannabis production in states where it is legal include the:

- Clean Water Act (CWA)
- Clean Air Act (CAA)
- Emergency Planning and Community Right-to-Know Act (EPCRA)
- Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA)
- Resource Conservation and Recovery Act (RCRA)
- Toxic Substances Control Act (TSCA)
- Safe Drinking Water Act (SDWA)

If hazardous waste is an issue at a cannabis facility, other relevant federal statutes include the Hazardous Materials Transportation Act (HMTA), which regulates hazardous materials and hazardous waste packaging, labeling, and transportation and the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), which regulates some releases and long-term liability with waste disposal entities.

“Cannabis operators... must **NAVIGATE A PATCHWORK OF APPLICABLE LAWS AND REGULATIONS** that vary by state”

Cannabis operators also must navigate a patchwork of applicable laws and regulations that vary by state. Cities and municipalities also sometimes have additional legal requirements, adding a layer of complexity to the regulatory schemes that must be complied with.

Cannabis Industry Environmental Considerations

Common compliance considerations include the following:



Bacterial growth

Due to the perfect storm of carbon dioxide, heat, and humidity needed to cultivate cannabis plants, bacteria can be a problem. For the same reasons, mold also can be an issue and remediation can be expensive.



Common law

In addition to state and federal requirements, facility operators must be aware of local nuisance regulations as well as common law claims related to public nuisance and odor control. Neighbors can bring nuisance claims absent more formal environmental enforcement.



Fire code compliance

There may be secondary containment requirements for supplemental carbon dioxide needed for growing cannabis that trigger fire code compliance obligations.



Pesticides

In general, cannabis production does not involve a high volume of pesticides but it's still something to consider if pesticides are used.



Water quality

Water quality is not typically a problem if the facility is tied to a municipal wastewater treatment facility, but otherwise needs to be factored in.



Worker safety issues

Due to the nature of the production of plant-based oils and resulting marijuana residuals, VOCs and industrial hygiene are concerns and should be addressed. Carbon filtration is currently the best available control technology for reducing VOC emissions from indoor cannabis cultivation facilities.

Environmental Compliance: A Sleeper Issue?

Environmental compliance hasn't always been a priority for cannabis operators focused on day-to-day business and cannabis-specific laws and regulations. But local, state, and federal environmental [regulators are beginning to take notice](#). In addition, because some of these laws have citizen suit provisions, enforcement actions are not always agency-driven, but instead can be initiated by impacted individuals (think neighbors).

As such, cannabis facility operators – and anyone involved in related real estate transactions – must pay attention to waste management, air quality regulations, water laws, and other environmental requirements, especially since violation penalties can quickly detract from the bottom line.

Waste and Solvents Primary Concerns

A facility's waste footprint is a common compliance issue, and it's important for cannabis operators to have a waste plan in place for manufacturing and cultivation. Whether the waste is organic or hazardous can trigger disposal restrictions, which should factor into a due diligence analysis. For example, many solvents become hazardous waste when they can no longer be used for their intended purpose and are therefore subject to RCRA's waste management provisions. Common solvents in cannabis cultivation include propane, butane, ethanol, and isopropyl alcohol.

“Common solvents in cannabis cultivation include **PROPANE, BUTANE, ETHANOL, AND ISOPROPYL ALCOHOL.**”

When solvents evaporate, they also contribute to ozone formation, making them potentially subject to CAA regulations as well as state and local air quality requirements. Carbon filtration controls odor and volatile organic compound (VOC) emissions from cultivation and extraction. Because multiple regulations—local, state, and federal—can apply to the same chemical or process, it's up to the regulated entity to determine applicability and how to comply.

The cost of noncompliance can be high with penalties calculated on a per diem/per violation basis, as is the case for most environmental violations. In addition, it's possible for property values to be impacted by these operations—

potentially increasing or decreasing the value of the facility/property depending on the adherence to or violations of relevant regulatory requirements. Facility operators should focus on best management practices and making their operations more sustainable to avoid or mitigate potentially hefty penalties.

Unique Challenges for a Young Industry

The cannabis industry is young, Kaitlin Urso explained during a recent interview. Urso is an environmental consultant with the Colorado Department of Public Health and Environment who specializes in helping small businesses, specifically breweries and cannabis businesses, reduce their environmental impacts. Leaders of this burgeoning industry began their careers in agriculture, engineering, and other related fields, and most people now involved in cannabis cultivation have been so for less than 10 years, she said. While that makes managing the compliance aspects a challenge for everyone, it also presents various opportunities. “What other agricultural commodity are we growing entirely indoors at this kind of profit margin?”

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— Kaitlin Urso

Business Considerations

Marijuana is a highly regulated substance, especially when it comes to where cultivation and dispensary operations can take place. Many states limit the number of cannabis facilities that may operate in a particular municipality or zoning area, while local zoning ordinances may prohibit the facilities from operating within a specific distance of a school, public park, or church.

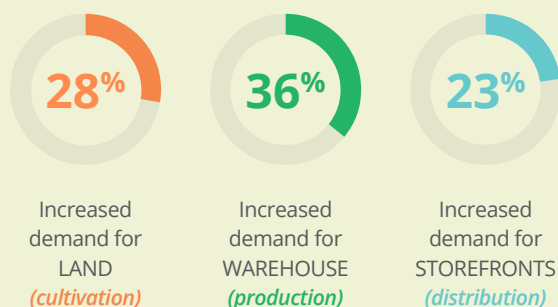
Additionally, not every operation has its own facility. Even if you aren't in the cannabis industry, you might own a business that is adjacent to cannabis storage or production in the same warehouse – this should factor into your due diligence analysis. Warehouse space is in demand like never before, which could drive up prices, increase the sharing of spaces, and raise concerns about energy and water costs when separate metering isn't possible.

“States where medical and recreational marijuana has been **LEGAL FOR MORE THAN FOUR YEARS** have seen increased demand for commercial properties”

States where medical and recreational marijuana has been legal for more than four years have seen increased demand for commercial properties, potentially driving up rent or incentivizing the repurposing of old industrial spaces for cannabis production.

Increased Demand

The [National Association of Realtors reported the following activity in 2020](#) for those states where medical and recreational marijuana has been legal for more than four years:



Given the illegality of cannabis on a federal level, cannabis companies typically pay [higher rents](#), but post-pandemic there may be [more opportunities](#) for better spaces at cheaper rates. Cannabis companies don't need the high ceilings that are seen in modern industrial buildings and, therefore, old industrial buildings with lower ceiling heights can be a good option for these companies.

“Given the illegality of cannabis on a federal level, cannabis companies **TYPICALLY PAY HIGHER RENTS**”

However, it's also important to consider the economic feasibility of repurposing old buildings and whether they can support the energy-intensive demands of cannabis production. Determining whether security will be an issue in urban warehouse locations should also factor into the real estate equation.

Other considerations regarding transactions:

- **Commercial leases:** There are likely to be nuances and special provisions in the lease that are specific to cannabis, including requirements to ensure adherence to local nuisance regulations (such as odor control).
- **Due diligence:** Although potentially less important if you are acquiring only one property, when acquiring an entity with a portfolio of properties, cannabis-related assessments should be included as a subheading of normal due diligence.
- **General liability and environmental insurance:** Will insurance coverage apply for businesses engaged in a federally illegal activity? This is an issue for landlords, too – are they covered if the property is leased for cannabis operations? Some niche insurance companies will cover these properties, but rates can be expensive.
- **Private lending:** Because cannabis production is still criminal at the federal level, it is difficult for the industry to access capital. Money is available, but loans can carry an 18 to 25 percent interest rate because federally-backed banks are not accessible.

“Because cannabis production is still illegal on the federal level, building owners are **NOT ELIGIBLE FOR ANY FEDERAL ENERGY EFFICIENCY TAX CREDITS** or other tax rebates”

Sustainability Practices

Furthermore, incorporating sustainable practices is critically important in the cannabis industry. Because cannabis production is still illegal on the federal level, building owners are not eligible for any federal energy efficiency tax credits or other tax rebates. As such, operation costs, especially energy costs, factor heavily into the overall bottom line. “Companies that focus on sustainable practices reduce their resource dependence and associated costs, positioning them to outperform competitors in the long-term,” according to a [National Cannabis Industry Association \(NCIA\) report](#). “Keeping pace with global sustainability goals may soon be necessary from an investment standpoint.”

In fact, the cannabis industry has an opportunity to raise environmental standards. "Legalization of cannabis is an unprecedented opportunity for environmentally sustainable practices to be adopted as the national industry standard from the outset, positioning the cannabis industry to emerge as a leader in environmental sustainability," the NCIA report said.

“Legalization of cannabis is an **UNPRECEDENTED OPPORTUNITY** for environmentally sustainable practices to be adopted as the national industry standard”

Conclusion

The cannabis industry is booming and will continue to grow as more states and (possibly) the federal government allow its legal production, sale, and use. For parties involved in real estate transactions or M&A deals that involve or are adjacent to cannabis production or storage facilities, it is important to ensure all potential compliance and liability risks and other business considerations are identified and factored into real estate transactions as part

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of environmental due diligence. It also will be increasingly important to become familiar with, evaluate, and understand any local and state regulations that apply to cannabis production processes that could give rise to potential liabilities or business interruptions.

To ensure potential cannabis CRE-related risks are properly identified and managed as transaction volume increases, environmental professionals might consider developing a cannabis-specific checklist, noting operations, processes, equipment, and materials used and stored at these properties. Proactively gathering and documenting this information will leave environmental professionals and their clients well-positioned in their cannabis-related CRE endeavors. 📦

This blog is the first in a series examining recent trends in the cannabis industry that are impacting CRE and environmental due diligence.

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