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New Jersey Cannabis Regulatory Commission Adopts Initial Rules to Govern Personal Use Cannabis Industry: Landlords, Tenants & Others Should Note Real Estate Implications

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On August 19, 2021, the New Jersey Cannabis Regulatory Commission adopted its initial rules to implement the Cannabis Regulatory, Enforcement Assistance, and Marketplace Modernization Act passed by the legislature on December 17, 2020 and signed into law by Governor Phil Murphy on February 22, 2021. The rules, which will be effective for a one-year period (expiring August 19, 2022) are lengthy and detailed in the oversight structure established for the regulated community (including owners and passive investors) and certain related businesses, including financial investors (including debt and equity) and management services contractors (including landlords).

Municipalities

The rules authorize municipalities to enact ordinances to set the number of cannabis businesses allowed within the municipality, including the maximum number within each class of license, and the location, manner and times of operation. Municipalities are authorized to impose their own local licensing requirements and establish civil penalties for a violation of their ordinances. A municipality may impose fees that are reasonably based on the administrative costs for the issuance of a municipal permit and may adopt an ordinance imposing a transfer tax or user tax on the sale of usable cannabis or cannabis products by a cannabis establishment located within the municipality. The Commission will inform a municipality of an application for a license that will be located within the municipality, and the municipality is authorized by the rules to express its preference to the Commission with respect to multiple applicants for the same license.

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Licensing Process and Priorities

The rules establish a clear prioritization for certain licenses, with preference given to:

- Social Equity Businesses, Diversely Owned Businesses, and Impact Zone Businesses over other license applicants;
- Conditional license applicants over annual license applicants;
- Microbusinesses license applicants over standard cannabis business license applicants; and
- License applicants given bonus points (including for an existing collective bargaining agreement or meeting certain residency requirements) over license applicants with no bonus points.

The rules set forth the details for an applicant to qualify as a Social Equity Business, Diversely Owned Business and Impact Zone Business. They also set forth in detail the rules governing the application process for a microbusiness, conditional and annual license, and the expansion of an Alternative Treatment Center (providing medical marijuana) into the personal use market. Annual licenses (including, an annual microbusiness license) are valid for one year, and the rules set forth the annual renewal process. They also establish the fees for applications, renewals, changes in ownership and location, and expansion of an Alternative Treatment Center into the personal use market.

The rules address the operations of a cannabis cultivator, manufacturer, retailer, home delivery service, and testing laboratory. Each have certain unique regulatory requirements that must be evaluated when applying for and operating such a business. Certain limitations are also established under the licensing rules promulgated by the Commission, including:

- Only 37 cannabis cultivator licenses will be issued until February 22, 2023 (microbusinesses do not count towards the 37).
- Prior to February 22, 2023:
 - A license-holder and its owners and principals may concurrently hold only one cannabis cultivator and one cannabis manufacturer license;
 - A license-holder and its owners and principals may concurrently hold only one cannabis retailer license and no other;
 - A license-holder and its owners and principals may concurrently hold only one cannabis distributor license and no other;
 - A license-holder and its owners and principals may concurrently hold only one cannabis delivery service license and no other; and
 - A license-holder and its owners and principals that have an expanded Alternative Treatment Center license may concurrently hold a cannabis cultivator, cannabis manufacturer, and cannabis retailer license, and an additional cannabis retailer license for each satellite dispensary.

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- After February 22, 2023:
 - A license-holder and its owners and principals may concurrently hold one cannabis cultivator, cannabis manufacturer, cannabis retailer, and cannabis delivery service license;
 - A license-holder and its owners and principals may concurrently hold only one cannabis distributor license and no other; and
 - A license-holder and its owners and principals that have an expanded Alternative Treatment Center license may concurrently hold a cannabis cultivator, cannabis manufacturer, and cannabis retailer license, and an additional cannabis retailer license for each satellite dispensary.
- A person or entity may be an owner of only one license applicant or license-holder, although a license-holder can hold more than one license, subject to the above-mentioned limitations.
- A person or entity may be a principal of only one license applicant or license-holder, although a license-holder can hold more than one license, subject to the above-mentioned limitations.
- A management services contractor may contract with and provide management services to up to 5 license applicants or license-holders.
- Neither a license applicant or license-holder, nor its owners or principals, may serve as a management services contractor.
- A financial source may only provide funding to up to 7 license-holders.
- Management Services Agreements and Financial Source Agreements are subject to prior Commission approval.
- The remuneration provided by a cannabis business license-holder to a management services contractor, a financial source, or vendor-contractor can be a flat fee or a percentage of revenue or profits.
- Notwithstanding an owner's capital contribution, their share of profits must be based on their ownership percentage.
- There may not be a change in the ownership percentage of a Diversely Owned Business, Social Equity Business, Impact Zone Business and microbusiness for a period of 2 years following the commencement of the business.
- Each owner of a conditional license applicant who has decision making authority, cannot have had an adjusted gross income for the immediately preceding tax year that exceeds \$200,000 or \$400,000 if filing jointly with another.

Real Estate Implications for Property Owners, Landlords, Tenants, Lenders

There are a number of real estate related implications presented by the rules, including:

- The rules make clear that it is not unlawful under New Jersey law for a property owner that is at least 21 years of age to lease or otherwise allow the use of property to a licensed cannabis business.

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- A property owner that leases its property may prohibit or regulate the consumption, use, display, transfer, distribution, sale or transportation of cannabis items on or in the property or any portion thereof.
- The regulations make clear that an ownership interest in a cannabis business does not arise from a security interest in, or lien or encumbrance on, property.
- A landlord is deemed a vendor-contractor under the rules.
- A vendor-contractor may receive remuneration in the form of a flat fee or a percent of revenue or profits, thus permitting a landlord to charge percentage rent.
- A creditor holding a note, mortgage or other form of indebtedness from a license-holder or cannabis business is a financial source subject to the rules applicable to a financial source.
- A license applicant that will lease the premises in which it will operate must obtain a certification from the landlord that it is aware that the tenant's use of the premises will involve activities associated with operations as a cannabis cultivator, manufacturer or retailer. This raises a number of issues from the perspective of both landlords and tenants, including that each should evaluate the landlord's loan documents to ensure the use is not a prohibited use, and from the tenant's perspective that the current and any future mortgage lender acknowledge the use and enter into a non-disturbance agreement since the lease is likely by its terms subordinate to any current and future mortgage. A tenant-cannabis business does not want to find itself facing a situation in which the landlord is in default of its mortgage due to the cannabis business's use of the property, resulting in a foreclosure and loss of the lease.
- A cannabis retailer must certify that the location is not in any premises in which a grocery store, delicatessen, indoor food market or other store engaging in retail sales of food, or any premises in which it operates includes a store that engages in licensed retail sales of alcoholic beverages. This presents a number of interesting issues for a tenant. Thought should be given to including such restrictions in the lease and entering into a memorandum of lease that is recorded and sets out the restrictions so that they are of record.
- A license applicant must include in its application a copy of any proposed or executed contract, term sheet, agreement or side letter between an owner, principal, financial source and another party that pertains to real property.
- A landlord may be required to submit to a financial probity review based on its status as a vendor-contractor.
- While most landlords require broad access and inspection rights, the rules make clear that the landlord, as a vendor-contractor, will be considered a visitor and access is restricted, and only if accompanied by a person that possesses a Cannabis Business Identification Card.
- Due to the extensive security requirements set forth in the rules, it is important that a tenant secure all related rights within its lease to ensure compliance.

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- If a party is seeking to become a license-holder for an outdoor cultivation facility, it is important to check the municipal zoning requirements, since the rules require that a minimum 8-foot-tall fence surround the facility. Many municipalities limit fence height to 6 feet.
- A landlord should consider as a lease default any “violation” as defined in the rules, subject only to a cure period, if any, allowed under the rules, and not any other cure period that may be allowed with respect to non-monetary defaults under the lease.
- A landlord should also provide that a failure to secure a renewal of a license is a default that is not subject to cure. A tenant, however, may want a right to challenge such non-renewal per the terms of the rules.
- A cultivator cannot operate or be located on land that is valued, assessed or taxed as an agricultural or horticultural use per the Farmland Assessment Act of 1964.

This Client Alert provides a general overview of some significant issues covered by the New Jersey Cannabis Regulatory Commission’s initial rules. The rules do not, however, address a wholesale or distribution license.

Next Steps

Interested parties should stay alert for the Commission’s publication of a request for applications, and planning for that event should begin immediately.

Please contact the author of this Alert, **Jack Fersko** jfersko@greenbaumlaw.com | 732.476.3354 with questions related to the regulation of New Jersey’s cannabis industry or to discuss your specific business circumstances. Mr. Fersko is Chair of the firm’s **Cannabis Industry Practice Group** and Co-Chair of the **Real Estate Department**.