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The Potential Legalization of Cannabis in New Jersey: Real Estate Considerations

The likelihood of legalization of cannabis in New Jersey under state law necessitates the consideration of many legal issues. Aspects of legalization that are often overlooked, given New Jersey's unique real estate regulatory regimen, are the potential real estate considerations resulting from the cultivation, production and sale of cannabis if permitted under New Jersey (as opposed to federal) law.

Governor Phil Murphy has promised to legalize the production and sale of cannabis in New Jersey within his first 100 days as governor. On January 4, 2018, U.S. Attorney General Jeff Sessions rescinded the so-called "Cole Memorandum," which changed federal law enforcement priorities with respect to prosecution of cannabis-related crimes during the Obama administration. Therefore, cannabis remains a Schedule I controlled substance under federal law, and the possession, sale and distribution of cannabis are federal crimes under the Controlled Substances Act. If passed and signed by the governor, New Jersey's legalization bill, currently in committee, would allow cannabis to be taxed by both the state, initially at 7 percent, and by municipalities that allow lawful cannabis production and sales, initially at 1 percent but up to 3 percent after the first three years.[1]

Lawful cultivation and therefore production of cannabis can be undertaken in two ways. The first is warehouse or greenhouse production with hydroponics, where cannabis is grown as a perennial and the buds are harvested regularly, dried and sold for use. This method of production, which is used in Colorado, where cannabis is legal, has resulted in an uptick in the demand for warehousing facilities for use in cannabis production. The second cultivation method is growing it outside as a crop, either as a perennial or an annual, depending on the climate. While New Jersey's climate is likely too severe to make growth of cannabis as a perennial crop viable, there is ample agricultural land, particularly in the southern and northwest portions of the state, currently under farmland assessment for property tax purposes; this land is used mostly to grow hay, corn and soybeans. Cannabis could be cultivated in these areas in lieu of these and other crops. Typically, seedlings would be cultivated initially in greenhouses and transplanted in mid-April to mid-May, when the fear of frost has dissipated. Other reasons outdoor cannabis growth is problematic from a cultivation standpoint include the risk of pests, so plants will have to be treated with pesticides much like conventional crops, and outdoor cannabis plants are best grown trained, which means the utilization of trellises and cages, which makes farming more labor-intensive and expensive. The plants mature during the growing season, and buds are harvested, dried and sold, likely in September. Some growers in Colorado use this method, though it is not as productive as hydroponic cultivation.

In terms of production of cannabis, many municipalities, particularly urban or suburban ones, do not permit cultivation of crops or farming operations in most zoning districts. The current New Jersey bill would not permit homegrown cannabis, and experience in states with legalized cannabis has shown that permitting homegrown cannabis is problematic. It is difficult to regulate and therefore tax. In New Jersey's municipalities that permit annual crop farming, typically in so-called rural or agricultural zones in certain areas of the state (mainly in northwestern and southern counties), cannabis farming would be permitted unless expressly prohibited by the municipality. There are likely hundreds of thousands of tillable acres of farmland in New Jersey that could be converted to annual cannabis production. It remains to be seen whether the enacted enabling statute, or the regulations established pursuant thereto, will permit outdoor farming of cannabis. It probably will not, since security and regulatory concerns make exterior farming of cannabis problematic on a variety of levels, although farming in greenhouses, which is a traditional farming and agricultural operation, rather than warehouses, may be viable and permitted.

New Jersey's Right to Farm Act does not permit farming as of right, and it applies only to farming in zoning districts where farming is a permitted use as of December 31, 1997, or zoning districts that thereafter permit agricultural use. However, the Right to Farm Act can pre-empt municipal ordinances regulating commercial farming in certain circumstances, and these pre-emption issues are addressed on a case-by-case basis. For pre-emption, typically a commercial farm must provide a legitimate agricultural reason for not complying with local standards. Pre-emption most often comes into play when local regulations burden agriculture. The state's guidebook on the Right to Farm Act is available here. This is an issue to be considered if municipalities permit but intensely regulate cannabis cultivation and production.

There are various aspects of property taxation that lawful cannabis production will impact. As an initial matter, unless the enacting statute changes the farmland taxation structure in New Jersey, the state's Farmland Assessment Act will apply to effectively minimize property taxes on farmland placed under cultivation for cannabis production in the event exterior or greenhouse cultivation of cannabis is permitted. In this context, the Farmland Assessment Act applies to lands under cultivation at a minimum of five contiguous acres in size, and gross sales of products from the land must average at least $1,000 per year for the first five acres cultivated, plus an average of $5 per acre for each acre over five acres. The land must have been actively devoted to agricultural or horticultural uses for at least two years prior to the year in which farmland assessment is sought. For most existing farms, which would be converting from hay, corn or soybeans to cannabis, this would not be a problem. While the Farmland Assessment Act applies to land only as opposed to buildings, farming in greenhouses is considered actively devoted to agricultural or horticultural use under the act. The appropriate paperwork (Form FA-1) setting forth the crops cultivated and gross sales, among other information, must be filed with the assessor prior to August 1 of the immediately preceding tax year. It is reasonable to assume that cannabis crops would be rotated from year to year as are other crops. A good primer on the Farmland Assessment Act can be found here. In the current bill as proposed, there are no limits on the "canopy," or amount of space, that could be devoted to cannabis growth. However, that may change, and there may be limits placed on the amount of cannabis in cultivation.

While cannabis farmers could reap the benefits of reduced farmland assessments, those who produce cannabis hydroponically in warehouse space could see increased property taxes. It is arguable that such warehouse production would result in the warehouses being classified as income-producing property, and therefore local assessors could arguably take into account the amount of net income from cannabis production for purposes of real property taxation. Assessors can seek income and expense information from income-producing properties pursuant to N.J.S.A. 54:4-34 and can establish assessments based on comparable income production, including the net income of the subject facility. Landlords who lease to cannabis-production operations might see higher property taxes based upon higher rents paid for production facilities compared with conventional warehouse storage space. Warehouse space used for cannabis production will require more complex electrical, plumbing and discharge components than average warehouse space and therefore may command higher rents.

Likewise, there will likely be a proliferation of cannabis dispensaries statewide. Municipalities will be given the option to permit them. Due to the fact that the dispensaries may be permitted in relatively few areas of perhaps a small cross-section of the municipalities in New Jersey, rents for dispensary space may be substantially inflated resulting in higher property tax assessments for dispensary outlets.

Municipalities have the authority to regulate land use by virtue of the Municipal Land Use Law of 1975. A municipality may not exercise its authority, however, in conflict with the authority exercised by the state, county or federal government. Although the federal Controlled Substances Act prohibits the possession, cultivation and distribution of marijuana and the Constitution of the United States pre-empts any state law that conflicts with federal law, most states that have legalized marijuana have determined that doing so, and enacting zoning laws regulating marijuana-related businesses, does not trigger a pre-emption issue. Nonetheless, it is worth noting that those able to secure real estate for the purpose of engaging in the marijuana business have faced non-real-estate–related difficulties — for example, finding banks and financial institutions willing to engage or invest, and risk running afoul of federal law.

Following legalization of cannabis, municipalities may choose to regulate dispensary outlets as they do other businesses deemed potentially dangerous to sensitive populations, such as adult stores, gentlemen's clubs, or smoke shops. Many municipalities that allow adult-oriented or "obscene" businesses prohibit such facilities within a certain distance from daycare centers, libraries, schools, substance abuse treatment centers, religious institutions or other similar adult-oriented businesses

in an attempt to shield sensitive populations such as children and individuals with a history of substance abuse from the perceived negative impacts and to prevent clusters of such businesses in a small geographical area. Many municipalities have also limited the signage and related advertising permitted for adult-oriented businesses in order to similarly shield the public from any harm caused by the nature of the business. Using similar justifications, many municipalities have barred adult-oriented businesses entirely. Cannabis dispensaries will likely be subject to similar location restrictions, or municipalities may prohibit the use entirely, thus vastly limiting viable options for those interested in entering the marijuana and marijuana product dispensary business. And in those cases where a cannabis dispensary is a permitted use, a fee simple owner may not be willing to lease to a tenant interested in engaging in such business.

If, as expected, many municipalities prohibit marijuana dispensaries entirely and those that do permit such businesses enact narrowly written zoning ordinances strictly regulating the location and signage of such businesses, given that New Jersey is a densely populated state, the number of feasible dispensary locations is likely to be low even after the legalization of marijuana. Depending on the demand for such space, would-be dispensary owners and/or operators will likely encounter competition to purchase or lease property where a cannabis dispensary would be permitted under local zoning laws. Purchasers, landlords and tenants of cannabis-related businesses should be wary, because given the state of federal law, contracts for sale and lease of property for cannabis businesses may be *ultra vires* under federal law. Parties who ultimately attempt to enforce breaches or defaults under such contracts or leases may be faced with the defense of the illegality of such contracts.

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[1] Notwithstanding the legalization of cultivation, production, sale and possession of cannabis under New Jersey law, unless federal law changes, the cultivation, production, sale and possession of cannabis in New Jersey would remain federal offenses, and therefore, engaging in such activity would expose the actor to prosecution by federal authorities for the aforementioned acts as well as other related offenses, including, for example and *inter alia,* transportation of a Schedule I controlled substance across state boundaries or using the financial system to store or transfer funds from the sale and production of same, including aiding and abetting and conspiracy. In addition to criminal penalties, there can be a civil forfeiture of property in connection with cannabis-related crimes under federal law. Counsel should be consulted before any activity in connection with cannabis is commenced, even if it is technically legal under New Jersey law.

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