

The Tailwinds in the Cannabis Market: A Comprehensive Overview

Overview:

The cannabis market in the United States has experienced rapid growth and transformation over the past decade. Despite facing numerous challenges, including regulatory hurdles and a complex legal landscape, the market has been bolstered by several tailwinds that have the potential to reshape the industry. This paper examines key developments that are likely to drive growth in the cannabis market, including the potential rescheduling of cannabis by the Drug Enforcement Administration (DEA), the movement toward adult-use legalization in states like Florida and Pennsylvania, the possibility of a memo from Attorney General Merrick Garland, and the potential for cannabis companies to uplist on U.S. stock exchanges. Additionally, the impact of these developments on cannabis real estate will be explored.



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DEA Rescheduling and Its Implications

One of the most significant potential tailwinds for the cannabis market is the possibility of the DEA rescheduling cannabis from its current status as a Schedule I controlled substance. Under the Controlled Substances Act, Schedule I drugs are classified as having a high potential for abuse, no accepted medical use, and a lack of safety under medical supervision. Cannabis's current classification places it alongside drugs like heroin, making it difficult for researchers to study its effects and for businesses to operate without significant legal risk.

The DEA recently concluded the comment period for reclassifying cannabis from a Schedule I to a Schedule III controlled substance. Rescheduling could lead to increased research opportunities, broader access to banking services, and reduced legal risks for cannabis businesses. Furthermore, it could pave the way for federal legalization or decriminalization, which would create a more consistent regulatory environment across the country.

Rescheduling would be tremendous for cannabis operators, who are currently subject to Internal Revenue Code 280E. As it stands, cannabis businesses are being taxed on top-line revenue due to 280E and are permitted from taking standard business deductions. If cannabis is rescheduled, 280E would no longer apply, and cannabis operators would be allowed to take normal business deductions on their taxes.

For cannabis real estate, rescheduling could lead to increased demand for properties suitable for cultivation, processing, and retail operations. As legal risks decrease and the industry becomes

more legitimized, investors may be more willing to finance cannabis-related real estate projects, leading to a surge in property values in areas zoned for cannabis use.

The Potential for Adult-Use Legalization in Florida and Pennsylvania

Another critical tailwind for the cannabis market is the potential for adult-use legalization in key states such as Florida and Pennsylvania. Both states have significant populations and existing medical cannabis programs, making them prime candidates for expanding to adult-use markets. Florida, with its large and diverse population, has the potential to become one of the largest cannabis markets in the United States. The state's medical cannabis program is already one of the most robust in the country, and a move to adult-use could exponentially increase the market size. Similarly, Pennsylvania's medical cannabis market has grown rapidly since its inception, and adult-use legalization would further boost the state's cannabis industry.

The legalization of adult-use cannabis in these states would likely drive substantial growth in the market, attracting new businesses and consumers. For cannabis real estate, this could translate into increased demand for retail spaces, cultivation facilities, and distribution centers. Areas with favorable zoning laws could see a surge in property values as cannabis companies seek to establish a foothold in these emerging markets.

The Impact of a Possible Garland Memo

Attorney General Merrick Garland has the potential to issue a memo similar to the Cole Memorandum, which was issued during the Obama administration and provided guidance on the federal government's enforcement priorities regarding state-legal cannabis activities. The Cole Memo essentially deprioritized federal prosecution of cannabis-related activities in states where it was legal, provided that certain conditions were met, such as preventing the distribution of cannabis to minors and ensuring that cannabis revenue did not fund criminal enterprises.

A similar memo from Garland could provide much-needed clarity and reassurance to cannabis businesses, reducing the fear of federal intervention and encouraging further investment in the industry. This would be particularly impactful in states that have legalized cannabis but still operate under the shadow of federal prohibition.

For cannabis real estate, a Garland memo could lead to increased investor confidence and a surge in real estate development tailored to the cannabis industry. This could include the construction of new cultivation facilities, retail outlets, and processing centers, as well as the repurposing of existing properties for cannabis-related uses.

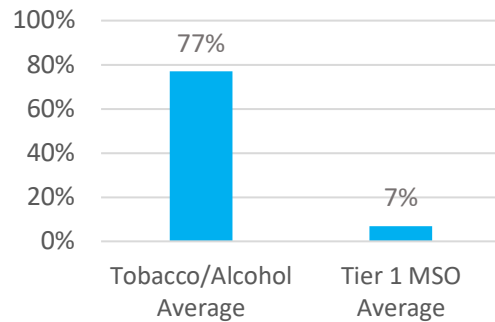
Uplisting on U.S. Stock Exchanges

Currently, most U.S.-based cannabis companies are unable to list on major U.S. stock exchanges like the NYSE or NASDAQ due to federal prohibition. However, if federal laws were to change, or if cannabis were to be rescheduled, it could open the door for these companies to uplist on U.S. exchanges. Uplisting would provide cannabis companies with access to a broader pool of investors, increased liquidity, and greater visibility.

The ability to uplist on U.S. exchanges would likely result in higher valuations for cannabis companies, making it easier for them to raise capital and expand their operations. This, in turn, would drive demand for cannabis real estate, as companies seek to scale their production, distribution, and retail capabilities to meet growing market demand.

Furthermore, according to a recent report by Water Tower Research (see chart 1), top tier Multi-State Operators (MSOs) have significantly less institutional ownership when compared to tobacco/alcohol companies. If U.S. cannabis companies were permitted to list on national exchanges, institutional ownership may increase significantly.

Chart 1 - Institutional Ownership



Positive Impacts on Cannabis Real Estate

The tailwinds discussed above—DEA rescheduling, potential adult-use legalization in Florida and Pennsylvania, a Garland memo, and the possibility of uplisting on U.S. stock exchanges—could collectively have a significant positive impact on cannabis real estate. As the legal and regulatory landscape becomes more favorable, the cannabis industry is likely to experience rapid growth, leading to increased demand for properties suitable for cultivation, processing, and retail.

Investors and developers who recognize the potential of cannabis real estate may see substantial returns as property values rise in response to growing demand. Additionally, the legitimization of the cannabis industry could lead to the development of specialized real estate investment trusts (REITs) focused on cannabis properties, providing a new avenue for investment in this emerging market.

Conclusion

The cannabis market in the United States is on the brink of significant transformation, driven by a combination of regulatory changes, state-level legalization efforts, and the potential for greater access to capital markets. These tailwinds have the potential to unlock substantial growth in the cannabis industry, with positive ripple effects on cannabis real estate. As the legal and regulatory environment becomes more favorable, investors and businesses that position themselves to capitalize on these developments may stand to benefit from the continued evolution of the cannabis market.

References:

1. Redmond, J., Water Tower Research, *Cannabis Catalyst Update*. Retrieved August 22, 2024
2. Rosendal, R., guest columnist. *Rescheduling alone wouldn't solve the marijuana industry's banking problem*. Retrieved August 16, 2024