INNOVATIVE Industrial Properties

TRADITION INVESTMENT MANAGEMENT

High Yield Cannabis REIT Positioned for Recovery as Weak Tenants Flushed Out

Price $54.12 **Dividend Holding** **July 29, 2025**

- 13.9% Yield
- Triple net lease structure provides strong 52.3% operating margins even factoring in tenant defaults.
- Conservative capital structure, 1.2x debt to EBITDA with $2.2 billion in unencumbered property.
- 8.3 million active leasable square feet, with 1.2 million leasable square feet under development.
- Early results from tenant refresh started in the quarter ending March 2025 are positive, with management expecting market normalization within 18-36 months.
- Captive base, with cannabis operators having limited financing opportunities for large-scale properties leading to long 13.5-year average lease periods.

Investment Thesis

Innovative Industrial Properties (IIPR) is an industrial REIT focusing on cannabis operations. The property profile is 92% industrial, 2% retail, and 6% hybrid, with 8.3 million in leasable square feet active and 1.2 million in leasable square feet in development.

Year to date, IIPR's stock price declined 18.6% due to a string of tenant defaults putting approximately 20% of revenues at risk, which we believe originated from overleveraged operators succumbing to high regulatory costs associated with lack of Federal legalization. IIPR itself maintains a 1.2x debt to EBITDA ratio, and $2.2 billion in unencumbered real estate assets, and $159 million in annual free cash. Management has emphasized that they expect the market to 'normalize' within 18-36 months.

Currently IIPR pays out a yield of 13.9% or $7.60 annually per share. While the tenant defaults have pushed the FFO (funds from operations) coverage ratio to 103.9%, management may be able to continue to pay out the high yield given the early successes with re-leasing properties to new tenants. Overall, we believe that over the long-term, cannabis will continue its path toward federal legalization, in the meantime, investors can take advantage of a strong yield and highly specialized portfolio.

Estimated Fair Value

EFV (Estimated Fair Value) = EFY26 EPS (Earnings Per Share) times P/E (Price/EPS)

EFV = E26 EPS X P/E = $6.47 X 14.0 = $90.58

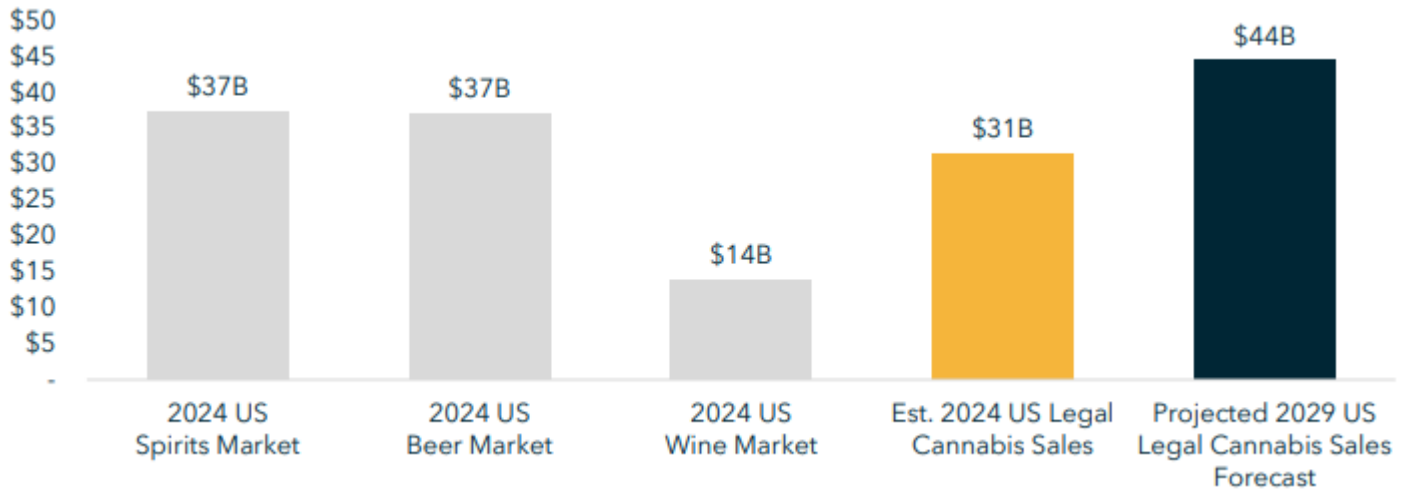
While we expect short term pressure from tenant defaults, as previously stated, we believe the long-term trend is one toward market liberalization and eventual legalization. Thus given the long average lease lengths and lack of traditional sources for operators we believe IIPR has a strong, largely captive, base to leverage for continued growth.

	E2025	E2026	E2027
Price-to-Sales	5.8	5.8	5.8
Price-to-Earnings	8.5	8.3	8.0

SeekingAlpha Analyst Consensus

Regulatory Stall

Approximately 54% of Americans now live in a state where recreational cannabis is legal, with an additional 19% living in a state with only medical cannabis being legal. Combined, IIPR has exposure to 68% of the US population. As of 2024, IIPR estimates that there were $31 billion in revenues in the US from legal cannabis sales, with that number projected to increase to $44 billion – rivaling the beer and spirits market.



Still, there are structural problems which we have discussed in previous articles, such as only 13% of FDIC insured banks offering services to cannabis operations, leaving them serviced primarily by the local credit unions. Tax treatment is still highly unfavorable,

including section 280E, which prohibits any tax deductions for 'plant-touching' operations, and is a significant weight on IIPR's tenants. Tax treatment under 280E often results in effective tax rates exceeding 50%.

Contrary to expectations, Legal cannabis did not pass in Florida, and rescheduling of cannabis was postponed. Those responsible for the ballot measure in Florida are attempting to get it back on the ballot for a revote for the 2026 midterms.

Previously RFK had been pro-cannabis legalization, but since his confirmation as HHS secretary he has been silent and sometimes critical of cannabis legalization. An uptick of immigration enforcement has also targeted legal cannabis operations in California, with the state's largest legal operation being the center of a protest and major raid. Finally, the new DEA chief administrator Terrance Cole, who was confirmed in mid-July, has been an outspoken opponent to legalization but in hearings appeared to be open to rescheduling.

Despite bipartisan support with several bills in committee, we do not expect any of them to reach the floor over the next few years. The next state to legalize recreational is likely to be Pennsylvania, with the current budget proposing legalization. The newest market is Minnesota, which began issuing license for recreational sales in June 2025.

While the momentum toward cannabis legalization has stalled, we believe that the overall long-term trend is toward federal legalization. Even the rescheduling of Cannabis to III from I would alleviate 280E tax treatment and provide a much-needed financial boost to operators.

Operations

Across 107 leasable properties, IIPR has 8.3 million rentable square feet with an average lease length of 13.5 years. The property profile is 92% industrial space typically used for growing or processing, 2% retail fronts, and 6% hybrid retail/industrial locations. As of the quarter ending March 2025, the properties had a 98.4% occupancy rate, although this does include some delinquent tenants. The client base is composed of 90% multi-state operators, and 62% publicly listed companies.

State	ABR ($000s)[1]	% of ABR[1]	# of Properties	Square Feet (000s)
Illinois	$44,276	14.5%	7	965
Pennsylvania	41,384	13.5%	10	1,361
Massachusetts	38,962	12.7%	10	989
New York	32,855	10.7%	2	623
Michigan	31,305	10.2%	14	946
Florida	29,404	9.6%	5	1,153
Ohio	17,753	5.8%	5	374
New Jersey	13,658	4.5%	4	291
Maryland	13,457	4.4%	5	316
California	12,433	4.1%	8	814
Total - Top 10 States	**$275,487**	**90.0%**	**70**	**7,832**

IIPR targets triple-net leases, meaning all property taxes, capital repairs and insurance are all paid by the tenant while occupied. We believe this operating structure is very favorable, even during market downturns. Overall, the cannabis real estate market is a captive one, with cannabis operators usually unable to raise the capital required to self-fund large industrial properties at favorable rates due to cannabis' status as a schedule I drug. This structure allows for higher margins than traditional REITs, or cannabis operators. As of the quarter ending March 2025, IIPR had an operating margin of 52.3%.

On top of the 8.3 million leasable square feet, IIPR has 1.2 million leasable square feet under development or redevelopment across 19 states. The major developments are a total of 491,000 rentable square feet, with 2 facilities in California and 1 in Texas. One of the California properties is pre-leased, with the other two still under construction.

Tenant Defaults

States where IIPR operates that have challenging operating environment are California, Michigan, and Massachusetts. A mixture of saturation, tariffs on packaging, proliferation of organized crime, and high regulatory costs have pushed previously safe operators into financial stress. We believe that this string of tenant defaults is caused by weak balance

sheets finally catching up to operators and exacerbated by lack of Federal legalization. IIPR's other tenants in the challenged states are experiencing no operational disruptions, even as they experience margin compression from external factors.

PharmaCann, the largest of IIPR's tenants representing 16.7% of lease revenues, defaulted on 6 of its 11 properties in December 2024. In January 2025, IIPR negotiated with PharmaCann to use its security deposits to cover the missed two months of rent and amended the leases for 9 of the 11 properties to reduce base rent by 7%. PharmaCann would provide its license to help re-lease 2 of the 11 properties, in exchange for IIPR not charging the $1.3 million in monthly rent. However, in March 2025 PharmaCann defaulted again on the 9 rent-paying properties, with IIPR entering eviction proceedings. Other operators, including Gold Flora, TILT, and Sozo also entered default during the 3 months ending March 2025, which IIPR applied $5.8 million in security deposit against the delinquency, on top of collecting approximately $4.5 million in partial rent. However, this was not enough to offset the decline in rental revenues associated with evicting tenants.

Due to the large numbers of delinquencies IIPR has begun a 'tenant refresh.' This is the end of favorable agreements like those signed with PharmaCann, and beginning a more aggressive process. A major logistical problem is avoiding being classed as a 'plant-touching' company, which would apply 280E tax treatment. In the cases where IIPR does not have a replacement tenant secure by the conclusion of the eviction, it places the property in an MSA with a third party.

As of April 2025 in Michigan, IIPR has already turned over a former PharmaCann lease to Berry Green, one of the largest operators in the state. A second Michigan property was sold for $9 million, with IIPR providing the new occupant $8.5 million in seller financing expiring in 2028. Management appeared optimistic about the medium term, expecting to have recycled properties into stronger tenants and continue its growth path within the 18–36-month timeframe. However, over the short term, just over 20.0% of their rental revenues are at risk.

Risk

While legislators had hoped that legalized cannabis would slowly outpace illegal operations, even in states like California where recreational usage has been legal for nearing a decade there has been backsliding. Organized crime is drawn to cannabis growing as it has a low law-enforcement pressure. The damage comes from illegal operators lying about their products being regulated, meaning they end up in legitimate dispensaries without the taxes or fees. California cannabis enforcement authorities estimate they seized more than $200 million in illegal Cannabis during 2024. NPR likens it to the end of prohibition, where many states continued to have liquor bans on the

books well into the 50s, allowing for a patchwork of regulations that are exploited by bad actors.

Given the previously mentioned limited access to traditional banking, often when IIPR sells a property, it must provide seller-financing. Even if IIPR begins to trim its portfolio, it may struggle to find buyers able to secure outside financing or those able to pay a fair price. In the same vein, limited access to outside financing can limit the growth prospects of even large multi-state operators during equity market downturns. These are highly specialized properties for cannabis operations, and outside uses are limited, leaving few options for offloading.

Financials

For the trailing twelve months ending March 2025, rental revenues declined 0.98% with total revenues declining 1.33%. This was due to the previously discussed defaults. However, it was partially offset by the application of security deposits against owed rent, and capital improvements which resulted in rent increases.

Quarter over quarter the picture is more challenged because of tenant delinquencies, with FFO (funds from operations) falling 13.0% between the quarter ending December 2024 and March 2025. This has increased the FFO payout ratio to 103.9%, which is not sustainable in the long term without tapping into its lines of credit.

We do believe it is possible that management preemptively cuts the dividend for the sake of preserving the low leverage ratio. The only debt is a $289.5 million in notes due in 2026, giving a net debt to EBITDA of 1.2x. IIPR remains unrated by majors, but has maintained a BBB+ from Egan Jones since 2021.

Though, it is also possible that given IIPR has already found tenants and buyers for some of the defaulting properties, FFO may inch down to a short-term sustainable level of the high 90s. As previously discussed, management expects a more normalized operation environment over the next 18-36 months.

Still, over the trailing twelve months ending March 2025 IIPR generated $159.0 million in free cash. While we expect this to fall during 2025 due to tenant delinquencies, we do not expect a major collapse in IIPR’s ability to generate positive free cash flow. Currently IIPR has $128 million in cash on hand, with $2.2 billion in unencumbered property.

In the quarter ending March 2025, IIPR was reauthorized for $100 million in repurchases, which $99.7 million remains or 6.5% of shares. As previously discussed, given the high FFO coverage ratio it will likely have to trade off share repurchases for the dividend (or the other way around) if it wants to keep its low-leverage ratio intact.

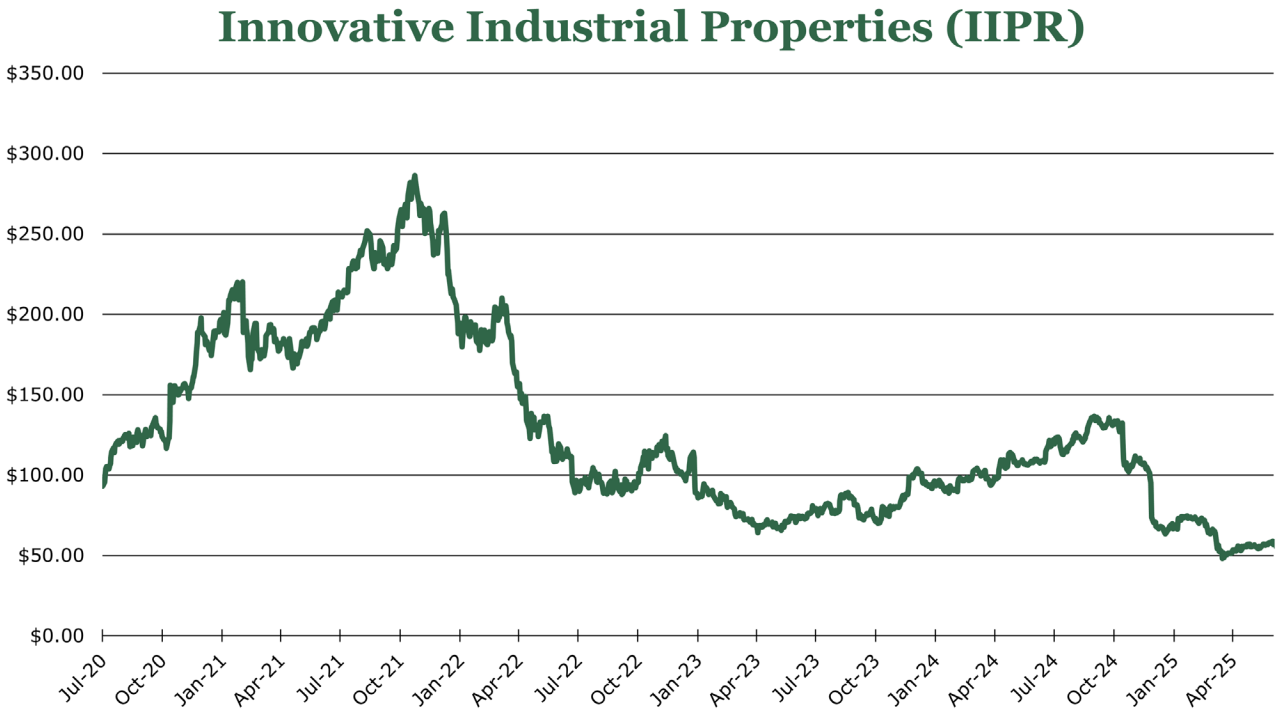
Conclusion

The current tenant distress, while likely to stall growth in the near-term, appears to be localized to weaker operators rather than a fundamental failure of the market. IIPR has a strong balance sheet and strong free cash flow which we believe are more than sufficient to continue both current operations and expansion projects.

While the current FFO coverage is unsustainable over the long term, management has had early success in finding new tenants, giving us confidence that the dividend cut may be smaller than the market is pricing in. Overall IIPR offers investors exposure to the cannabis market without the lower margins or risk associated with 'plant-touching' businesses.

Peer Comparisons

	Innovative Industrial Properties (IIPR)	Advanced Flower Capital (AFCG)	NewLake Capital Partners (NLCP)	Chicago Atlantic Real Estate Finance (REFI)
Price-to-Earnings	14.55	5.26	12.19	-
Price-to-Sales (TTM)	4.93	2.42	5.64	4.69
EV-to-EBITDA (FWD)	7.02	-	7.00	-
EBITDA Margin	78.77%	-	82.51%	-
Dividend Yield	14.29%	12.82%	12.37%	15.40%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