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**Alan D. Gold** *Innovative Industrial Properties, Inc. - Executive Chairman*

**Brian J. Wolfe** *Innovative Industrial Properties, Inc. - VP, General Counsel & Company Secretary*

**Catherine Hastings** *Innovative Industrial Properties, Inc. - CFO, CAO & Treasurer*

**Paul E. Smithers** *Innovative Industrial Properties, Inc. - President, CEO & Director*

## CONFERENCE CALL PARTICIPANTS

**John James Massocca** *Ladenburg Thalmann & Co. Inc., Research Division - Associate*

**Stephen Ross Manaker** *Compass Point Research & Trading, LLC, Research Division - Analyst*

## PRESENTATION

### Operator

Good day, and welcome to the Innovative Industrial Properties Incorporated Second Quarter 2018 Earnings Conference Call. (Operator Instructions) Please note, this event is being recorded. I would now like to turn the conference over to Brian Wolfe, General Counsel. Please go ahead.

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**Brian J. Wolfe** - *Innovative Industrial Properties, Inc. - VP, General Counsel & Company Secretary*

Thank you for joining the call. Presenting today are Alan Gold, Executive Chairman; Paul Smithers, President and Chief Executive Officer; and Catherine Hastings, Chief Financial Officer.

Before we begin, I'd like to remind everyone that statements made during today's conference call may be deemed forward-looking statements within the meaning of the Safe Harbor of the Private Securities Litigation Reform Act of 1995, and actual results may differ materially due to a variety of risks, uncertainties and other factors. For a detailed discussion of some of the ongoing risks and uncertainties of the company's business, I refer you to the news release issued Friday, and filed with the SEC on Form 8-K as well as the company's reports filed periodically with the SEC. The company disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise.

Before I hand the call over to Alan, I want to mention that we have a limited time for the call today, but we will answer as many questions as we can after our prepared remarks. Alan?

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**Alan D. Gold** - *Innovative Industrial Properties, Inc. - Executive Chairman*

Thank you, Brian, and welcome, everyone. Today, we get a chance to review and share our financial results for the second quarter, plus year-to-date 2018, and provide our updated perspective on the business and the industry from our last call in March. We are very pleased with our continued execution on our business plan in the second quarter, extending through today.

Since the beginning of the second quarter, we have closed on 4 additional properties in 3 new states totaling over 0.25 million square feet and representing an aggregate capital commitment by us of over \$50 million, including our committed funding to complete development and tenant improvements. Catherine will discuss our acquisitions in more detail. But we are excited to welcome 2 new tenants, Green Peak Innovations in Michigan and Holistic Industries in Massachusetts, to our tenant roster, in addition to expanding our relationships with PharmaCann in Massachusetts and Vireo in Pennsylvania, as each company continues to expand its national footprint.

As of today, we own 9 properties in 7 states, totaling approximately 875,000 square feet, which were 100% leased on a long-term basis to high-quality, licensed, medical-use cannabis operators. Our current blended yield on these properties is 15.7%, with each lease providing minimum annual



rental escalations ranging from 3.25% to 4% with a weighted average remaining lease term of nearly 15 years. In addition, we declared our fifth consecutive quarterly stock dividend of \$0.25 per share to stockholders of record as of June 29, 2018, having generated \$0.31 per diluted share in adjusted funds from operations in the second quarter, truly, a remarkable track record for such a young company.

Now Catherine will provide more detail regarding our financial results. A continuing theme of the medical-use cannabis industry is constant evolution and growth, with new programs being rolled out in certain states and existing programs gaining more and more traction. Paul will provide further perspective on these changes and other industry trends in the call today, in addition to discussing in further detail individual state markets.

We continue to be very optimistic about the future of this emerging industry and our ability to deliver results for our stakeholders and enduring value to our tenant partners by providing tailored, real estate solutions that meet key operational and capital needs.

And with that, I'd like to turn the call over to Paul. Paul?

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**Paul E. Smithers** - *Innovative Industrial Properties, Inc. - President, CEO & Director*

Thanks, Alan. As with prior calls, we'll try to provide as effective an overview as we can with the short time we have today, focusing in on 3 main topics. One, the current regulatory environment; two, the growth and evolution of the medical-use cannabis markets in the United States, generally; and three, an update on our state markets.

First, regarding the current regulatory environment. As you all know, cannabis remains a Schedule 1 controlled substance, which generally prohibits all cannabis use and cannabis-related commercial activity in the United States. That said, Congress has enacted spending bills since 2014 with a provision that has been interpreted by courts as preventing the Department of Justice from using funds to interfere with the implementation of state medical-use cannabis laws. That provision was again included in this year's congressional spending bill, which carries through to September 30.

In addition, there are numerous other initiatives taken by Congress including the establishment of the Bipartisan Congressional Cannabis Caucus in 2017, and the introduction of a number of bills in Congress in favor of varying forms of cannabis legalization on the federal level. We are monitoring all of these developments closely, including the recent bipartisan bill introduced by Senators Gardner and Warren in June, which prioritizes states' rights in state licensed and regulated cannabis activities.

And of course, it is hard not to notice the progress that other countries have made on a federal level with respect to legalization of cannabis, with Canada leading the way through its early legalization of medical cannabis on a federal level and the legalization of adult-use cannabis expected later this year. Joining Canada, numerous countries in Europe in addition to others such as Argentina and Israel have legalized medical cannabis on a national level, recognizing the needs of their citizens for this form of treatment for a wide variety of medical conditions.

Now on to a general update of the medical-use cannabis markets nationwide. The industry continues to move forward with tremendous velocity. States that have legalized medical-use cannabis by a popular vote or legislative process, now comprise a majority of the United States with over 200 million residents. Medical-use cannabis continues to poll with 90% plus popular support in the United States, and the cannabis industry is expected to continue to be a leading driver for U.S. jobs and tax revenues. In fact, recent estimates in June 2018 by ArcView, project a state-regulated cannabis market in the United States to grow from a projected \$11 billion in 2018 to over \$23 billion by 2022, and to support nearly 0.5 million full time jobs by 2022.

Drilling down a bit on current markets, New York, Massachusetts, Arizona, Maryland, Michigan, Pennsylvania, Minnesota, where our 9 properties are located, we see tremendous potential in each. New York. We have 2 properties in New York leased on a long-term basis to 2 strong multistate operators that we have purchased in sale-leaseback transactions in 2016 and 2017. As we have noted in past calls, New York's medical-use cannabis program has initially rolled out, had been described by many as one of the most restrictive and highly regulated.



In response, and in order to enable broader access to treatment, New York has taken several positive steps, over time, including expansion of the pool of potential recommending health professionals, expanding the types of products that can be manufactured and distributed, streamlining the registration process and expanding the list of qualifying medical conditions, most notably for chronic pain and PTSD, and in July, as an opioid alternative.

ArcView Market Research, in consideration of the changes made in the program and the market potential, sees significant ramping of the program from \$90 million in 2017 to an estimated \$219 million this year, growing to over \$500 million by 2022. Patient count growth is also accelerating with over 64,000 certified patients as of July 24.

There have also been interesting developments from state regulatory agencies, with the New York Department of Health publicly issuing its recommendation just last month, that recommends legalizing adult-use cannabis in the state after having compiled feedback from various state agencies relating to health, public safety, criminal justice, education and economics. We will continue to monitor this development as we do the developments in all of our states.

Massachusetts. We own 2 properties in Massachusetts, which we acquired this year, and which Catherine will discuss in more detail. We are very excited about entering into this new state with its tremendous market potential. As of June 30, there were 36 registered marijuana dispensaries and over 50,000 active patients in the medical cannabis program. According to ArcView, medical spending is expected to reach nearly \$165 million in 2018 and total regulated cannabis spending is expected to reach \$1.2 billion in 2022, representing a compound annual growth rate in excess of 50%. Massachusetts voters approved the legalization of adult-use cannabis in 2016, and first licenses for adult-use cannabis operators began to be issued just last month.

Now on to Arizona, where we own one property purchased in late 2017. As we've mentioned before, Arizona's medical-use cannabis program is further along in its maturity having commenced medical-use cannabis sales in 2010. According to the Arizona Department of Health Services, there are over 170,000 qualifying patients in Arizona's medical cannabis program as of June 2018, continuing a strong pace of growth. ArcView expects that growth to continue projecting over 200,000 patients by this year's end and nearly \$1.2 billion in regulated cannabis spending by 2022, up from a little under \$0.5 billion in 2017.

Maryland. We purchased our property in Capitol Heights, Maryland in mid-2017, with development completed in August of last year. Although it's still in its very early stages, with the first dispensaries opening in late 2017, we are optimistic regarding the development of the legal medical-use cannabis market in Maryland driven by Maryland's population size and anticipated demand, the inclusion of PTSD and chronic pain among the initial qualifying conditions, and the general view from regulators and policymakers that the industry represents an economic development opportunity. And while there have been some delays in terms of final approvals of dispensaries, which had been preapproved by the Maryland Medical Cannabis Commission, ArcView expects first full year sales to reach nearly \$80 million in 2018, growing to over \$400 million in total regulated cannabis sales by 2022.

In Michigan, we closed on our property earlier this month. Michigan, with its sizeable population of nearly 10 million people, is one of the largest medical cannabis markets in the United States with expected 2018 spending coming in at over \$850 million, according to ArcView. Although, the Michigan Marijuana Act was passed in 2008, the industry has operated as a highly permissive system, somewhat similar to how California's system had operated historically.

Recent laws have created a licensing framework for medical cannabis operators and the Bureau of Medical Marijuana Regulation began its pre-approvals just last month, with our tenant Green Peak Innovations, being one of the first recipients of pre-approval for several licenses, for which Catherine will go into more detail. Michigan residents will also be building, on a measure, an issues ballot to legalize adult-use cannabis. Taking into consideration all the dynamics of the Michigan market, ArcView expects Michigan's regulated cannabis market to continue to grow at a healthy pace reaching nearly \$1.4 billion by 2022.

In Pennsylvania, we closed on our property in April, representing an expansion of our relationship with Vireo. Pennsylvania is the fifth-largest state in the country with nearly 13 million residents, enacted medical-use cannabis legislation in May 2016 and dispensaries made their first sales in February of this year. 12 grower/processor licenses were issued in the first phase of this program, including the license to Vireo Health, with a total



of 25 grower/processor licenses potentially issuable pursuant to the legislation. In recognition of the large market potential, the strong support of the states' residents and the significant range of qualifying medical conditions under the program, ArcView Market Research projects Pennsylvania's total medical-use cannabis spending to grow rapidly, with \$363 million in sales by 2022.

Now on to Minnesota. We acquired our Minnesota property in November of 2017. Our tenant, Vireo, is 1 of 2 licensed medical cannabis operators in the entire state of Minnesota with each operator also operating 4 dispensaries. While a smaller market that began medical cannabis sales in mid-2015, registered medical cannabis patients in Minnesota have experienced significant and accelerating growth, increasing by over 100% year-over-year to over 8,000 actively enrolled patients as of year-end 2017, and increasing to nearly 11,000 in the first 6 months of 2018.

Similar to New York, Minnesota's medical cannabis program was initially rolled out as a highly regulated and restricted program, but has gradually expanded the program for treatment of additional medical conditions, including intractable pain and PTSD, and most recently autism spectrum disorders and sleep apnea, which are effective this month. ArcView expects Minnesota to grow at a compounded annual growth rate of 36% from 2017 to 2022 in recognition of the gradual loosening of restrictions in the program.

I'll now turn the call over to Catherine, who will walk you through our recent acquisitions and financial results for the second quarter and first 6 months of 2018. Catherine?

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**Catherine Hastings** - *Innovative Industrial Properties, Inc. - CFO, CAO & Treasurer*

Thanks, Paul. Having completed our IPO in December 2016, and having begun real estate operations shortly thereafter, with our initial property acquisition in New York, Q2 2018 represents just our sixth full quarter of operations. On the acquisition's front, as Alan mentioned, the last few months have been busy ones for our team. We acquired 4 properties in Massachusetts, Pennsylvania and Michigan, forging new tenant relationships as well as expanding existing relationships.

In April, we acquired an 89,000 square foot industrial facility from Vireo in a sale-leaseback transaction for a total consideration of \$8.6 million, which includes a \$2.8 million TI Allowance that's being utilized for improvements in expansion at the site to meet patient demand in Pennsylvania. It is the third transaction we have done with Vireo, with the first 2 completed last year in New York and Minnesota.

Our Pennsylvania lease with Vireo is similar to our 2 other leases with them, with a 15% initial yield on our total investments including the available TI Allowance, a 15-year initial term and a 3.5% annual escalation throughout the term. In May, we expanded our relationship with PharmaCann through the acquisition of a property in Massachusetts and execution of a long-term lease and development agreement for industrial and greenhouse facilities, comprising approximately 58,000 square feet upon completion.

PharmaCann was our first tenant when we commenced real estate operations after our IPO in December 2016. By acquiring PharmaCann's Hamptonburgh cultivation and processing facility, and we're excited to partner with PharmaCann on this new project. The lease term is 15 years and 3 months with an initial base rents of 14.5% on our expected total investment of \$18.5 million, which includes the \$3 million initial purchase price for the land and \$15.5 million of funding we will make available to PharmaCann to develop the property.

The base rent is subject to an initial 6-month abatement, so we will not begin to recognize rent on this property until the very end of November. Base rent is subject to annual increases of 3.25% through the term of the lease, with the first escalation occurring in June 2019. We are thrilled to support such a dynamic tenant as PharmaCann, who was recently awarded medical cannabis licenses in Ohio and Pennsylvania, in addition to the numerous other states where they operate and have licenses.

In July, we closed on the sale-leaseback of another Massachusetts property with Holistic Industries in Monson for \$12.75 million, a 55,000 square foot industrial building that serves as Holistic's medical-use cannabis cultivation and processing facility. The initial base rent is equal to 15% on our investment, subject to annual increases of 3.25% due to 20-year initial term of lease. Holistic is focused on the rollout of their dispensaries, already conducting active cultivation and processing, and we look forward to following their progress in the coming months.



Finally, in August, we closed on the acquisition of a property in Michigan currently under development and a long-term lease with Green Peak Innovations. Once completed, the property will comprise 56,000 square feet of industrial space, for which we have agreed to fund up to \$13 million for the acquisition of the land and development of the property. Our initial base rent is equal to 15% on our total expected investment of \$13 million subject to a 3-month rent deferral until November 2 that will be amortized over the balance of the initial term of the lease of 15 years and is subject to annual increases of 3.5%. Green Peak Innovations was one of the first companies to be prequalified by the Michigan Medical Marijuana Licensing Board for vertical integration, including 12 Class C cultivation licenses, 1 processor license and 19 provisioning center licenses.

And now on to our results for the second quarter and first 6 months of 2018. We had total revenues of \$3.3 million in the second quarter of 2018 and \$6.1 million for the first 6 months of 2018. As we noted, rent for our property under development with PharmaCann in Massachusetts that we acquired in May, is abated in full through November, and rent for our property under development with Green Peak in Michigan that we acquired in August, is deferred until the beginning of November. In addition, of course, our lease with Holistic in Massachusetts commenced subsequent to quarter end, so our results for the quarter do not include any rents from these 3 properties, as we recognize rental revenue for all of our leases on a cash basis.

For the 3 months ended June 30, 2018, we recorded net income of \$1.2 million, funds from operations which adds back property depreciation was \$1.7 million, and adjusted funds from operations which adds back noncash stock-based compensation expense was \$2.1 million. For the 6 months ended June 30, 2018, we recorded net income of \$1.8 million, funds from operations of \$2.8 million and adjusted funds from operations of \$3.5 million. As Alan mentioned, on July 16, we paid our fifth consecutive quarterly dividend of \$0.25 per share to common stockholders of record as of June 29.

Finally, I'd like to note that our financial results continue to be achieved utilizing a very conservative overall capital structure, funded entirely with preferred and common equity and no debt.

And with that, I'll turn it back to Alan. Alan?

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**Alan D. Gold** - *Innovative Industrial Properties, Inc. - Executive Chairman*

Thanks, Catherine. We had a very eventful second quarter for acquisitions and continued execution on our strategy, and we are excited about the opportunities to come. I want to thank the stockholders for your continued support and we look forward to continuing to execute on our exciting business model by servicing this very promising industry as a long-term real estate and capital provider and to creating sustainable, long-term value for our stockholders.

Now with that, I'd like to open it up for questions. Operator, could you please open the call up for questions?

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) The first question comes from John Massocca of Ladenburg Thalmann.

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**John James Massocca** - *Ladenburg Thalmann & Co. Inc., Research Division - Associate*

Can you give us maybe a quick update on the pipeline? I think, last quarter, you said you had transactions in various stages of review at around \$100 million. Have you been able to maintain that level of acquisition opportunities given the announced \$50 million of transactions that you announced subsequent and during 2Q '18?



**Alan D. Gold** - *Innovative Industrial Properties, Inc. - Executive Chairman*

Yes. Thanks, John. This is Alan speaking. Yes, I mean, I think we're very pleased with our pipeline. It's a very consistent and growing pipeline. And the quality of the pipeline is in the same genre of the transactions we have closed and it gives us great confidence that we're going to be able to achieve our goal of placing the capital that we raised within that 9-month time period.

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**John James Massocca** - *Ladenburg Thalmann & Co. Inc., Research Division - Associate*

Makes sense. I mean and how do you look at states where adult-use cannabis has been legalized when you're kind of underwriting investments in the states on a medical -- in terms of medical producers? Is it a positive or negative?

And then, also, kind of understanding that your current portfolio is 100% leased to medical cultivators, would you ever consider doing an investment with an adult-use producer?

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**Alan D. Gold** - *Innovative Industrial Properties, Inc. - Executive Chairman*

Well, I think that's an interesting question. You never say never to anything, but we as a company have taken a position of being highly focused and maintaining our focus on medical-use cannabis growers and providers. We think that it's a positive. It's a net positive for our growers that are in states that have both or will have both adult-use and medical cannabis opportunities or licenses. We think that any -- certainly, any grower that is growing medical cannabis in a controlled environment will have a leg up with any as opposed to any new grower that's trying to grow outside of a controlled environment, in an open field-type environment. So we believe our growers are well positioned to continue to provide high-quality medical product in a consistent basis based on the structures that they're growing the product in. And so I think that gives them an advantage to continuing to provide the product as the states expand into adult use. All that being said, I think adult-use users are also going to want high-quality and consistent product, and the growers that are able to brand their product and brand it well and really focus on that type of marketing are going to be able to be very successful.

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**John James Massocca** - *Ladenburg Thalmann & Co. Inc., Research Division - Associate*

Understood. And then you guys talked in the past about keeping a close eye on the California market. What's your kind of current view on the regulatory environment there? What needs to get set up from a regulatory perspective before you would feel comfortable investing there? And could we potentially see that as a place where you'll have some investment opportunities maybe even as soon as 2019?

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**Alan D. Gold** - *Innovative Industrial Properties, Inc. - Executive Chairman*

So -- I mean, California is an interesting market. It's a highly competitive market. I'm going to turn it over to Paul to talk about the regulatory environment. But I think that we are looking at transactions in California and consistently look at transactions in California, but in 2019 might be the year that we actually are able to see that there is a good investment environment for us to do that. But Paul, why don't you talk about the environment?

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**Paul E. Smithers** - *Innovative Industrial Properties, Inc. - President, CEO & Director*

Sure. Thanks, Alan. John, so Alan is correct at -- we've got to understand first, while the size of the California market is gigantic, and so we will probably be there at some point. But right now, I think we're happy to take a position of seeing how the structure is going to roll out. Right now, it's a little disappointing from July 1 the rollout is not what people wanted it to be mostly because of problems getting product to the shelves. The product needs to be -- go through laboratories, the labs aren't up, so it's a little growing pains right now in California. So we're going to watch probably for the end of this year and maybe, like Alan mentioned, 2019 when things settle down and there is a balance where the growers can get product on the shelves and approve product, I think we'll take a look at that point.



**John James Massocca** - *Ladenburg Thalmann & Co. Inc., Research Division - Associate*

Makes sense. And then kind of one last one, I know it's really days in the industry, but have you seen any kind of consolidation among operators? And could that potentially provide additional acquisition opportunities for you guys?

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**Alan D. Gold** - *Innovative Industrial Properties, Inc. - Executive Chairman*

I think, honestly, I haven't seen any consolidation as of yet. And we think we've seen some operators, early-stage operators come in and not be able to meet the regulatory environment and or have the financial strength to sustain themselves. And we've seen those kind of guys have fallen by the wayside, where all the larger, more established groups that we've been working with have been able to increase market share, so that's all we've seen. We do believe that, in the future, as the industry continues to grow, the consolidation will occur. And that's why we are highly focused on the quality growers that we're working with, their ability to raise capital, their ability to execute their business plan are keys to our underwriting. And why it takes so much time for us to underwrite and move forward with transactions, it's -- we spend a great deal of time understanding that prior to moving forward.

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**Operator**

The next question comes from Steve Manaker of Compass Point.

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**Stephen Ross Manaker** - *Compass Point Research & Trading, LLC, Research Division - Analyst*

Quick question, it seems like you guys are getting more development loans -- or providing more development loans. I wanted to get your sense of what you're seeing in the market that's leading you towards this? And also, just -- can you discuss your underwriting on the development loans relative to the loans for buildings up and running?

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**Alan D. Gold** - *Innovative Industrial Properties, Inc. - Executive Chairman*

I think what you're referring to is the transactions where we're helping organizations fund their new grow operations in new states from -- as they move to a new state. And yes, we are seeing those things, and that occurs as these new states have come online issued these new licenses and the growers have obtained the licenses that are now putting in high-quality, first-generation spaces in those specific states. And we're addressing that through our kind of our development-type program. In addition to that, we do have a sizable portion of our pipeline in existing facilities. And I think all that comes back from the fact that this is an emerging growing industry and where we have states recently approving medical cannabis and implementing their programs, and so that's why you're seeing that type of opportunities in our portfolio.

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**Operator**

This concludes our question-and-answer session. I would like to turn the conference back over to Alan Gold, Executive Chairman for any closing remarks.

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**Alan D. Gold** - *Innovative Industrial Properties, Inc. - Executive Chairman*

Well, I would like to thank our stockholders again, and certainly I want to thank the team for all their hard work and effort to get us through here. And with that, we conclude our conference and thank you all. Bye now.

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**Operator**

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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