CRAIN'S DETROIT BUSINESS

Cannabis

Outrageous loans, plummeting prices spell trouble for Michigan's cannabis industry

By Dustin Walsh

The promise of riches brought thousands to the Michigan marijuana industry. But, for some, the promise of turning plants into profit has shriveled due to tough loan terms and plummeting prices.

A group of marijuana companies organized under the name Transcend, and its founders, bet their livelihoods on a ripe industry — entering into a loan agreement with exorbitant terms only to find them all but impossible to pay back.

Transcend and its affiliates secured a three-year loan of $3.6 million in March 2022 from Utah-based lender CBR Funding to acquire property and operations at the Harvest Park marijuana industrial park in Windsor Township. The terms were unfavorable — a $100,000 origination fee with a 25 percent interest rate. The loan, which was personally guaranteed by Transcend's founders Edward Merriman and Tarik Lester, translated to 35 monthly payments of nearly $80,000 with a final balloon payment of about $3.8 million.

The total cost of that loan is 80 percent higher than the loan itself at $6.475 million.

The group is now under a court-ordered receivership for failing to pay back the loan or taxes under a grinding marijuana business landscape.

"It's insane, but you're dealing with entrepreneurs here," said Chris Rosmarin, principal and head of cannabis practice at accounting firm Rehmann. "They see entering into these loans as the only way they can enter the business. A personal guarantee is just suicide."

That guarantee means creditors can seek repayment by repossessing the guarantors' personal assets, like their homes and cars and bank accounts.

Rosmarin said traditional loans like this one are less common in the industry — most seek funding from rich investors in exchange for equity — but they all carry a personal guarantee.

"The banks, they require a guarantee," Rosmarin said. "They understand the risk in the industry and they want the collateral in a volatile market."

Many real estate loans involve the borrower contributing 40 percent in equity and the 60 percent of the cost is returned to the borrower as a mortgage, which is then used for construction and other business purposes, according to a recent report in MJBizDaily. Other deals involve a sale-leaseback where the lender buys the property and leases it back at above market rates to the borrower.

The high-cost loans were gobbled up by borrowers in the industry because sky-high marijuana prices meant covering the cost of capital was a breeze. But now, with prices slumped, margins are negative or razor thin and the big payments are wreaking havoc on the industry.

Recreational marijuana retail prices have plummeted from $512.05 per ounce of flower in January 2020 to just $86 per ounce of flower in February — effectively eliminating margins for many businesses.

Winners and losers

When Transcend entered the business, prices were $190.65 per ounce but dropped nearly 60 percent in 11 months.

Harvest Park neighbor Skymint, which acquired capital through a real estate investment trust, entered into court-ordered receivership last month, owing lenders more than $127 million. At least five other Michigan marijuana businesses are also under receivership.

Alex Calderone, president of Birmingham-based Calderone Advisory Group, said most of the industry is underwater on loans.

"Our firm has observed a number of these situations in the cannabis business and the common denominator is that most folks underwrote to 'best case scenarios,'" Calderone told Crain's. "That was easy to do when credit was abundantly available and the good times never seemed like they'd end. Now that the tide has turned, most of these hard money loans are underwater."

Calderone said the lenders of these loans tend to be just as negligent as the borrowers that agree to the terms.

"Someone can attach the most onerously rich terms imaginable to a loan, but the reality is that they really don't matter when the underlying creditors can't generate break-even cash flow," he said.

Rosmarin said the great shakeout is occurring due to different capital structures, and the ultimate decider of winners and losers in the state's industry will be how capital was raised.

"Most cannabis companies raised money through friends and family, and your rich uncle isn't likely to take you to court. He'll accept the loss and move on," Rosmarin said. "Others found deep pockets in wealthy investors. Demand is still there. Sales keep going up. Who is going to survive the price slump are those who have investors willing to weather the storm and wealthy investors can weather the storm a lot easier than a bank."

The Michigan marijuana market saw new heights last month, recording new sales of nearly $250 million, up 15 percent from February.

By **Dustin Walsh**

Dustin Walsh is a senior reporter for Crain's Detroit Business, covering health care with a focus on industry change and operations, as well as the state's emerging cannabis industry. He is also a regular columnist on all things health, labor, economics and more.

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