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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2023  
OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission file number: 001-37949

**Innovative Industrial Properties, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

**Maryland**  
(State or other jurisdiction of incorporation or organization)

**81-2963381**  
(I.R.S. Employer Identification No.)

**1389 Center Drive, Suite 200**  
**Park City, UT 84098**  
(Address of principal executive offices)

**(858) 997-3332**  
(Registrant's telephone number)

**Not Applicable**

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbols (s)	Name of each exchange on which registered
<b>Common Stock, par value \$0.001 per share</b>	<b>IIPR</b>	<b>New York Stock Exchange</b>
<b>Series A Preferred Stock, par value \$0.001 per share</b>	<b>IIPR-PA</b>	<b>New York Stock Exchange</b>

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of August 3, 2023 there were 28,039,982 shares of common stock outstanding.

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INNOVATIVE INDUSTRIAL PROPERTIES, INC.

FORM 10-Q – QUARTERLY REPORT

JUNE 30, 2023

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**PART I**

**ITEM 1. FINANCIAL STATEMENTS**

**Innovative Industrial Properties, Inc.**

**Condensed Consolidated Balance Sheets  
(Unaudited)**

*(In thousands, except share and per share amounts)*

	June 30, 2023	December 31, 2022
<b>Assets</b>		
Real estate, at cost:		
Land	\$ 142,524	\$ 139,953
Buildings and improvements	2,081,731	2,010,628
Construction in progress	117,413	54,106
Total real estate, at cost	2,341,668	2,204,687
Less accumulated depreciation	(169,658)	(138,405)
Net real estate held for investment	2,172,010	2,066,282
Construction loan receivable	20,917	18,021
Cash and cash equivalents	92,602	87,122
Restricted cash	1,450	1,450
Investments	72,726	200,935
Right of use office lease asset	1,550	1,739
In-place lease intangible assets, net	8,675	9,105
Other assets, net	26,325	30,182
Total assets	<u>\$ 2,396,255</u>	<u>\$ 2,414,836</u>
<b>Liabilities and stockholders' equity</b>		
Exchangeable Senior Notes, net	\$ 4,414	\$ 6,380
Notes due 2026, net	295,772	295,115
Building improvements and construction funding payable	21,479	29,376
Accounts payable and accrued expenses	8,440	10,615
Dividends payable	51,080	50,840
Rent received in advance and tenant security deposits	58,482	58,716
Other liabilities	3,368	1,901
Total liabilities	443,035	452,943
Commitments and contingencies (Notes 6 and 11)		
Stockholders' equity:		
Preferred stock, par value \$0.001 per share, 50,000,000 shares authorized: 9.00% Series A cumulative redeemable preferred stock, \$15,000 liquidation preference (\$25.00 per share), 600,000 shares issued and outstanding at June 30, 2023 and December 31, 2022	14,009	14,009
Common stock, par value \$0.001 per share, 50,000,000 shares authorized: 28,040,054 and 27,972,830 shares issued and outstanding at June 30, 2023 and December 31, 2022, respectively	28	28
Additional paid-in capital	2,076,357	2,065,248
Dividends in excess of earnings	(137,174)	(117,392)
Total stockholders' equity	1,953,220	1,961,893
Total liabilities and stockholders' equity	<u>\$ 2,396,255</u>	<u>\$ 2,414,836</u>

*See the accompanying notes to the condensed consolidated financial statements.*

**Innovative Industrial Properties, Inc.**  
**Condensed Consolidated Statements of Income**  
**(Unaudited)**  
*(In thousands, except share and per share amounts)*

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2023	2022	2023	2022
<b>Revenues:</b>				
Rental (including tenant reimbursements)	\$ 75,919	\$ 69,995	\$ 151,448	\$ 134,109
Other	538	516	1,076	906
Total revenues	<u>76,457</u>	<u>70,511</u>	<u>152,524</u>	<u>135,015</u>
<b>Expenses:</b>				
Property expenses	5,759	2,427	11,382	4,409
General and administrative expense	10,570	8,707	20,943	17,484
Depreciation and amortization expense	16,704	15,233	33,418	29,101
Total expenses	<u>33,033</u>	<u>26,367</u>	<u>65,743</u>	<u>50,994</u>
Income from operations	43,424	44,144	86,781	84,021
Interest and other income	2,317	581	4,550	638
Interest expense	(4,472)	(4,504)	(8,992)	(9,270)
(Loss) gain on exchange of Exchangeable Senior Notes	—	(7)	22	(125)
Net income	<u>41,269</u>	<u>40,214</u>	<u>82,361</u>	<u>75,264</u>
Preferred stock dividends	(338)	(338)	(676)	(676)
Net income attributable to common stockholders	<u>\$ 40,931</u>	<u>\$ 39,876</u>	<u>\$ 81,685</u>	<u>\$ 74,588</u>
Net income attributable to common stockholders per share (Note 8):				
Basic	<u>\$ 1.45</u>	<u>\$ 1.42</u>	<u>\$ 2.89</u>	<u>\$ 2.77</u>
Diluted	<u>\$ 1.44</u>	<u>\$ 1.42</u>	<u>\$ 2.87</u>	<u>\$ 2.75</u>
Weighted-average shares outstanding:				
Basic	27,981,517	27,850,561	27,965,720	26,741,568
Diluted	28,257,239	28,036,690	28,239,841	27,159,774

*See accompanying notes to the condensed consolidated financial statements.*

**Innovative Industrial Properties, Inc.**  
**Condensed Consolidated Statements of Stockholders' Equity**  
**(Unaudited)**  
*(In thousands, except share amounts)*

	Three Months Ended June 30, 2023						Three Months Ended June 30, 2022					
	Series A Preferred Stock	Shares of Common Stock	Common Stock	Additional Paid-In Capital	Dividends in Excess of Earnings	Total Stockholders' Equity	Series A Preferred Stock	Shares of Common Stock	Common Stock	Additional Paid-In Capital	Dividends in Excess of Earnings	Total Stockholders' Equity
Balances at beginning of period	\$ 14,009	28,034,999	\$ 28	\$2,071,473	\$ (127,363)	\$ 1,958,147	\$ 14,009	26,107,769	\$ 26	\$1,718,234	\$ (85,608)	\$ 1,646,661
Net income	—	—	—	—	41,269	41,269	—	—	—	—	40,214	40,214
Issuance of unvested restricted stock, net of forfeitures	—	5,055	—	—	—	—	—	2,811	—	—	—	—
Exchange of Exchangeable Senior Notes	—	—	—	—	—	—	—	47,059	—	3,014	—	3,014
Net proceeds from sale of common stock	—	—	—	—	—	—	—	1,815,790	2	330,883	—	330,885
Preferred stock dividend	—	—	—	—	(338)	(338)	—	—	—	—	(338)	(338)
Common stock dividend	—	—	—	—	(50,742)	(50,742)	—	—	—	—	(49,101)	(49,101)
Stock-based compensation	—	—	—	4,884	—	4,884	—	—	—	4,437	—	4,437
Balances at end of period	\$ 14,009	28,040,054	\$ 28	\$2,076,357	\$ (137,174)	\$ 1,953,220	\$ 14,009	27,973,429	\$ 28	\$2,056,568	\$ (94,833)	\$ 1,975,772

	Six Months Ended June 30, 2023						Six Months Ended June 30, 2022					
	Series A Preferred Stock	Shares of Common Stock	Common Stock	Additional Paid-In Capital	Dividends in Excess of Earnings	Total Stockholders' Equity	Series A Preferred Stock	Shares of Common Stock	Common Stock	Additional Paid-In Capital	Dividends in Excess of Earnings	Total Stockholders' Equity
Balances at beginning of period	\$ 14,009	27,972,830	\$ 28	\$2,065,248	\$ (117,392)	\$ 1,961,893	\$ 14,009	25,612,541	\$ 26	\$1,672,882	\$ (75,218)	\$ 1,611,699
Adjustment to opening balance upon adoption of ASU 2020-06 (Note 2)	—	—	—	—	—	—	—	—	—	(1,340)	728	(612)
Net income	—	—	—	—	82,361	82,361	—	—	—	—	75,264	75,264
Issuance of unvested restricted stock, net of forfeitures	—	35,024	—	(568)	—	(568)	—	15,174	—	(2,441)	—	(2,441)
Exchange of Exchangeable Senior Notes	—	32,200	—	1,964	—	1,964	—	412,901	—	26,665	—	26,665
Net proceeds from sale of common stock	—	—	—	—	—	—	—	1,932,813	2	351,986	—	351,988
Preferred stock dividend	—	—	—	—	(676)	(676)	—	—	—	—	(676)	(676)
Common stock dividend	—	—	—	—	(101,467)	(101,467)	—	—	—	—	(94,931)	(94,931)
Stock-based compensation	—	—	—	9,713	—	9,713	—	—	—	8,816	—	8,816
Balances at end of period	\$ 14,009	28,040,054	\$ 28	\$2,076,357	\$ (137,174)	\$ 1,953,220	\$ 14,009	27,973,429	\$ 28	\$2,056,568	\$ (94,833)	\$ 1,975,772

See accompanying notes to the condensed consolidated financial statements.

**Innovative Industrial Properties, Inc.**  
**Condensed Consolidated Statements of Cash Flows**  
**(Unaudited)**  
*(In thousands)*

	For the Six Months Ended June 30,	
	2023	2022
<b>Cash flows from operating activities</b>		
Net income	\$ 82,361	\$ 75,264
<b>Adjustments to reconcile net income to net cash provided by operating activities</b>		
Depreciation and amortization	33,418	29,101
(Gain) loss on exchange of Exchangeable Senior Notes	(22)	125
Other non-cash adjustments	53	127
Stock-based compensation	9,713	8,816
Amortization of discounts on short-term investments	(2,621)	(513)
Amortization of debt discount and issuance costs	677	689
<b>Changes in assets and liabilities</b>		
Other assets, net	3,549	2,568
Accounts payable, accrued expenses and other liabilities	(514)	(1,290)
Rent received in advance and tenant security deposits	(234)	7,094
<b>Net cash provided by operating activities</b>	<b>126,380</b>	<b>121,981</b>
<b>Cash flows from investing activities</b>		
Purchases of investments in real estate	(34,906)	(129,562)
Funding of draws for improvements and construction	(111,457)	(291,408)
Funding of construction loan and other investments	(2,896)	(21,360)
Deposits in escrow for acquisitions	—	(600)
Purchases of short-term investments	(71,772)	(219,040)
Maturities of short-term investments	202,602	235,000
<b>Net cash used in investing activities</b>	<b>(18,429)</b>	<b>(426,970)</b>
<b>Cash flows from financing activities</b>		
Issuance of common stock, net of offering costs	—	351,988
Dividends paid to common stockholders	(101,227)	(84,339)
Dividends paid to preferred stockholders	(676)	(676)
Taxes paid related to net share settlement of equity awards	(568)	(2,441)
<b>Net cash (used in) provided by financing activities</b>	<b>(102,471)</b>	<b>264,532</b>
<b>Net increase (decrease) in cash, cash equivalents and restricted cash</b>	<b>5,480</b>	<b>(40,457)</b>
Cash, cash equivalents and restricted cash, beginning of period	88,572	86,419
<b>Cash, cash equivalents and restricted cash, end of period</b>	<b>\$ 94,052</b>	<b>\$ 45,962</b>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid during the period for interest, net of interest capitalized	\$ 8,337	\$ 8,876
<b>Supplemental disclosure of non-cash investing and financing activities:</b>		
Accrual for current-period additions to real estate	\$ 17,021	\$ 31,210
Deposits applied for acquisitions	250	25
Accrual for common and preferred stock dividends declared	51,080	49,439
Exchange of Exchangeable Senior Notes for common stock	1,964	26,665
Operating lease liability for obtaining right of use asset	—	1,017

*See accompanying notes to the condensed consolidated financial statements.*

**Innovative Industrial Properties, Inc.**

**Notes to the Condensed Consolidated Financial Statements**

**June 30, 2023**

**(Unaudited)**

**1. Organization**

As used herein, the terms “we”, “us”, “our” or the “Company” refer to Innovative Industrial Properties, Inc., a Maryland corporation, and any of our subsidiaries, including IIP Operating Partnership, LP, a Delaware limited partnership (our “Operating Partnership”).

We are an internally-managed real estate investment trust (“REIT”) focused on the acquisition, ownership and management of specialized industrial properties leased to experienced, state-licensed operators for their regulated cannabis facilities. We have acquired and intend to continue to acquire our properties through sale-leaseback transactions and third-party purchases. We have leased and expect to continue to lease our properties on a triple-net lease basis, where the tenant is responsible for all aspects of and costs related to the property and its operation during the lease term, including structural repairs, maintenance, real estate taxes and insurance.

We were incorporated in Maryland on June 15, 2016. We conduct our business through a traditional umbrella partnership real estate investment trust, or UPREIT structure, in which our properties are owned by our Operating Partnership, directly or through subsidiaries. We are the sole general partner of our Operating Partnership and own, directly or through subsidiaries, 100% of the limited partnership interests in our Operating Partnership.

**2. Summary of Significant Accounting Policies and Procedures and Recent Accounting Pronouncements**

**Basis of Presentation.** The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. They do not include all of the information and footnotes required by GAAP for complete financial statements.

This interim financial information should be read in conjunction with the audited consolidated financial statements in the Company’s Annual Report on Form 10-K for the year ended December 31, 2022. Any references to square footage or occupancy percentage, and any amounts derived from these values in these notes to the condensed consolidated financial statements, are outside the scope of our independent registered public accounting firm’s review.

Management believes that all adjustments of a normal, recurring nature considered necessary for a fair presentation have been included. This interim financial information does not necessarily represent or indicate what the operating results will be for the year ending December 31, 2023.

**Reclassification.** We have combined \$705.3 million of “Tenant improvements” as of December 31, 2022, which represent building improvements in which we are considered to be the accounting owner, with “Building and improvements” in our consolidated balance sheets to conform to the current period presentation as of June 30, 2023. There was no change to “Total real estate, at cost”.

**Federal Income Taxes.** We believe that we have operated our business so as to qualify to be taxed as a REIT for U.S. federal income tax purposes. Under the REIT operating structure, we are permitted to deduct dividends paid to our stockholders in determining our taxable income. Assuming our dividends equal or exceed our taxable net income, we generally will not be required to pay federal corporate income taxes on such income. The income taxes recorded on our condensed consolidated statements of income represent amounts paid for city and state income and franchise taxes and are included in general and administrative expenses in the accompanying condensed consolidated statements of income.

**Use of Estimates.** The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make a number of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the condensed consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Actual results may differ materially from these estimates and assumptions. The most significant estimates and assumptions made include determination of lease accounting, fair value of acquisition of real estate properties and valuation of stock-based compensation.

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**Reportable Segment.** We are engaged in the business of providing real estate for the regulated cannabis industry. Our properties are similar in that they are leased to the state-licensed operators on a long-term triple-net basis, consist of improvements that are reusable and have similar economic characteristics. Our chief operating decision maker reviews financial information for our entire consolidated operations when making decisions related to assessing our operating performance. We have aggregated the properties into one reportable segment as the properties share similar long-term economic characteristics and have other similarities, including the fact that they are operated using consistent business strategies. The financial information disclosed herein represents all of the financial information related to our one reportable segment.

**Acquisition of Real Estate Properties.** Our investment in real estate is recorded at historical cost, less accumulated depreciation. Upon acquisition of a property, the tangible and intangible assets acquired and liabilities assumed are initially measured based upon their relative fair values. We estimate the fair value of land by reviewing comparable sales within the same submarket and/or region. We estimate the fair value of buildings and improvements as if the property was vacant, taking into consideration current replacement costs and other relevant market rate information and may engage third-party valuation specialists. Acquisition costs are capitalized as incurred. All of our acquisitions to date were recorded as asset acquisitions.

The fair value of acquired in-place leases is derived based on our assessment of estimated lost revenue and costs incurred for the period required to lease the “assumed vacant” property to the occupancy level when purchased. The amounts recorded for acquired in-place leases are reflected as in-place lease intangible assets, net on our condensed consolidated balance sheets and are amortized on a straight-line basis as a component of depreciation and amortization expense over the remaining term of the applicable leases.

The fair value of the above-market component of an acquired in-place operating lease is based upon the present value (calculated using a market discount rate) of the difference between (i) the contractual rents to be paid pursuant to the lease over its remaining non-cancellable lease term and (ii) our estimate of the rents that would be paid using fair market rental rates and rent escalations at the date of acquisition measured over the remaining non-cancellable term of the lease. The amount recorded for one above-market operating lease is included in other assets, net on our condensed consolidated balance sheets and is amortized on a straight-line basis as a reduction of rental revenues over the remaining term of the applicable lease.

**Sale of Real Estate.** When a real estate asset is sold, we evaluate the provisions of ASC 610-20, *Gains and Losses from the Derecognition of Nonfinancial Assets* (“ASC 610-20”) to determine whether the asset is within the scope of ASC 610-20, including an evaluation of whether the asset being sold is a nonfinancial asset and whether the buyer has gained control of an asset within the scope of ASC 610-20. In assessing whether the buyer has gained control of the asset, we must determine whether the contract criteria in ASC 606, *Revenue from Contracts with Customers (Topic 606)* have been met, including 1) the parties to the contract have approved the contract and the contract has commercial substance, 2) we can identify each party’s rights regarding the asset to be transferred, 3) we can identify the payment terms for the asset to be transferred, and 4) it is probable that we will collect substantially all of the consideration to which we will be entitled in exchange for the asset to be transferred. If all of the contract criteria have been met, the carrying amount of the applicable asset is derecognized with a corresponding gain or loss from the sale recognized in our consolidated statements of income. If the contract criteria are not all met, the asset transferred is not derecognized and we continue to report the asset in our condensed consolidated balance sheet. See Note 6 “Investments in Real Estate - Property Disposition” for further information.

**Cost Capitalization and Depreciation.** We capitalize costs associated with development and redevelopment activities and improvements when we are considered to be the accounting owner of the resulting assets. The development and redevelopment activities may be funded by us pursuant to the lease. We are generally considered the accounting owner for such improvements that are attached to or built into the premises, which are required under the lease to be surrendered to us upon the expiration or earlier termination of the lease. Typically, such improvements include, but are not limited to, ground up development, and enhanced HVAC, plumbing, electrical and other building systems.

Amounts capitalized are depreciated over estimated useful lives determined by management. We depreciate buildings and improvements based on our evaluation of the estimated useful life of each specific asset, not to exceed 40 years. For the three months ended June 30, 2023 and 2022, we recognized depreciation expense of approximately \$16.5 million and \$15.0 million, respectively, and for the six months ended June 30, 2023 and 2022, we recognized depreciation expense of approximately \$33.0 million and \$28.7 million, respectively. Depreciation expense relating to our real estate held for investment is included in depreciation and amortization expense in our condensed consolidated statements of income. We depreciate office equipment and furniture and fixtures over estimated useful lives ranging from three to seven years. We depreciate the leasehold improvements at our corporate office over the shorter of the estimated useful lives or the remaining lease term. Depreciation expense relating to our corporate assets is included in general and administrative expense in our condensed consolidated statements of income.



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Determining whether expenditures meet the criteria for capitalization and the assignment of depreciable lives requires management to exercise significant judgment. Project costs that are clearly associated with the acquisition and development or redevelopment of a real estate project, for which we are the accounting owner, are capitalized as a cost of that project. Expenditures that meet one or more of the following criteria generally qualify for capitalization:

- the expenditure provides benefit in future periods; and
- the expenditure extends the useful life of the asset beyond our original estimates.

We define redevelopment properties as existing properties for which we expect to spend significant development and construction costs that are not reimbursements to tenants for improvements at the properties. When existing properties are determined to be redevelopment properties, the net carrying value of the buildings and improvements are transferred to construction in progress while the redevelopment activities are in process. During the six months ended June 30, 2023, we reclassified the net carrying value of the buildings and improvements totaling approximately \$51.2 million to construction in progress relating to an existing property that was placed into redevelopment. Costs capitalized to construction in progress related to redevelopment properties are transferred to buildings and improvements at historical cost of the properties as the redevelopment project or phases of projects are placed in service.

**Provision for Impairment.** On a quarterly basis, we review current activities and changes in the business conditions of all of our properties prior to and subsequent to the end of each quarter to determine the existence of any triggering events or impairment indicators requiring an impairment analysis. If triggering events or impairment indicators are identified, we review an estimate of the future undiscounted cash flows for the properties.

Long-lived assets are individually evaluated for impairment when conditions exist that may indicate that the carrying amount of a long-lived asset may not be recoverable. The carrying amount of a long-lived asset to be held and used is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. Impairment indicators or triggering events for long-lived assets to be held and used are assessed by project and include significant fluctuations in estimated net operating income, occupancy changes, significant near-term lease expirations, current and historical operating and/or cash flow losses, construction costs, estimated completion dates, rental rates, and other market factors. We assess the expected undiscounted cash flows based upon numerous factors, including, but not limited to, construction costs, available market information, current and historical operating results, known trends, current market/economic conditions that may affect the property, and our assumptions about the use of the asset, including, if necessary, a probability-weighted approach if multiple outcomes are under consideration. Upon determination that an impairment has occurred, a write-down is recognized to reduce the carrying amount to its estimated fair value. We may adjust depreciation of properties that are expected to be disposed of or redeveloped prior to the end of their useful lives. No impairment losses were recognized during the six months ended June 30, 2023 and 2022.

**Revenue Recognition.** Our leases are triple-net leases, an arrangement under which the tenant maintains the property while paying us rent. We account for our current leases as operating leases and record revenue for each of our properties on a cash basis due to the uncertain regulatory environment in the United States pertaining to the regulated cannabis industry, the limited operating history of certain tenants and the resulting uncertainty of collectability of lease payments from each tenant over the duration of the lease term. Contractually obligated reimbursements from tenants for recoverable real estate taxes, insurance and operating expenses are included in rental revenues in the period when such costs are reimbursed by the tenants. Contractually obligated real estate taxes that are paid directly by the tenant to the tax authorities are not reflected in our condensed consolidated financial statements.

For the three months ended June 30, 2023, rental revenue recognized included the application of approximately \$1.5 million of security deposits for rent with two tenants in connection with lease amendments. For the six months ended June 30, 2023, rental revenue recognized included the application of approximately \$3.1 million of security deposits applied for rent with two tenants who were in default under their respective lease agreements and approximately \$2.7 million of security deposits for rent with two tenants in connection with lease amendments.

**Construction Loan.** In June 2021, we executed a construction loan agreement with a developer, pursuant to which we agreed to lend up to \$18.5 million for the development of a regulated cannabis cultivation and processing facility in California. We have an option to purchase the property, and may execute a negotiated lease with an affiliate of the developer or with another third party, if we determine to exercise our purchase option. In February 2023, we amended the construction loan to provide for, among other things: (1) the additional capital commitment of the borrower into the project of \$1.0 million; (2) our agreement to fund an additional \$4.5 million into the project; (3) an increase in the interest rate effective April 1, 2023; (4) an extension of the loan term to December 31, 2023; and (5) the provision of additional collateral from the borrower for the loan. Interest on the loan continued to accrue through March 31, 2023, with monthly payment of interest having commenced April 1, 2023. As of June 30, 2023, we had funded approximately \$20.9 million of the \$23.0 million total commitment.

**Cash and Cash Equivalents.** We consider all highly-liquid investments with original maturities of three months or less to be cash equivalents. As of June 30, 2023 and December 31, 2022, approximately \$79.7 million and \$78.0 million, respectively, were invested in short-term money market funds, obligations of the U.S. government and certificates of deposit with an original maturity at the time of purchase of less than or equal to three months.

**Restricted Cash.** Restricted cash relates to cash held in escrow accounts for future draws for improvements for tenants in accordance with certain lease agreements.

**Investments.** Investments consist of obligations of the U.S. government and certificates of deposit with an original maturity at the time of purchase of greater than three months. Investments are classified as held-to-maturity and stated at amortized cost.

**Exchangeable Notes.** The liability and equity components of exchangeable debt instruments that may be settled in cash upon exchange, including partial cash settlement, were previously required to be separately accounted for in a manner that reflects the issuer's nonexchangeable debt borrowing rate. The initial proceeds from the sale of our Exchangeable Senior Notes (as defined below) were allocated between a liability component and an equity component in a manner that reflects interest expense at the rate of similar nonexchangeable debt that could have been issued at such time. The equity component represents the excess initial proceeds received over the fair value of the liability component of the Exchangeable Senior Notes as of the date of issuance. We measured the estimated fair value of the debt component of our Exchangeable Senior Notes as of the date of issuance based on our estimated nonexchangeable debt borrowing rate with the assistance of a third-party valuation specialist as we do not have a history of borrowing arrangements and there was limited empirical data available related to the Company's industry due to the regulatory uncertainty of the cannabis market in which the Company's tenants operate. The equity component of our Exchangeable Senior Notes was reflected within additional paid-in capital on our condensed consolidated balance sheets, and the resulting debt discount was amortized over the period during which the Exchangeable Senior Notes were expected to be outstanding (through the maturity date) as additional non-cash interest expense.

In August 2020, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2020-06, Debt — Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging — Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity. ASU 2020-06 simplifies the accounting for convertible debt by eliminating the beneficial conversion and cash conversion accounting models, and convertible debt proceeds, unless issued with a substantial premium or an embedded conversion feature, will no longer be allocated between debt and equity components. ASU 2020-06 also updates the earnings per share calculation and requires entities to assume share settlement when the convertible debt can be settled in cash or shares. We adopted ASU 2020-06 on January 1, 2022 and recognized a cumulative-effect adjustment of approximately \$728,000 to the opening balance of retained earnings and derecognized approximately \$1.3 million of the remaining equity component relating to the outstanding principal balance of our Exchangeable Senior Notes at the date of adoption.

**Deferred Financing Costs.** The deferred financing costs that are included as a reduction in the net book value of the related liability on our condensed consolidated balance sheets reflect issuance and other costs related to our debt obligations. These costs are amortized as non-cash interest expense using the effective interest method over the life of the related obligations.

**Stock-Based Compensation.** Stock-based compensation for equity awards is based on the grant date fair value of the equity awards and is recognized over the requisite service or performance period. If awards are forfeited prior to vesting, we reverse any previously recognized expense related to such awards in the period during which the forfeiture occurs and reclassify any non-forfeitable dividends and dividend equivalents previously paid on these awards from retained earnings to compensation expense. Forfeitures are recognized as incurred. Certain equity awards are subject to vesting based upon the satisfaction of various market conditions. Forfeiture of share awards with market-based restrictions does not result in a reversal of previously recognized share-based compensation expense.

**Lease Accounting.** We elected the practical expedient not to separate certain non-lease components from the lease component if the timing and pattern of transfer are the same for the non-lease component and associated lease component, and the lease component would be classified as an operating lease if accounted for separately. We also elected the short-term lease exception for lessees for leases that are less than 12 months. As lessee, we recognized a liability to account for our future obligations and a corresponding right-of-use asset related to our corporate office lease. The lease liability was initially measured based on the present value of the future lease payments discounted using the estimated incremental borrowing rate of 7.25%, which was the interest rate that we estimate we would have to pay to borrow on a collateralized basis over a similar term for an amount equal to the lease payments. In November 2021, we amended the lease to extend the term from April 2025 to January 2027 in connection with an expansion of the leased space which did not commence until February 2022. As a result of the lease amendment, we re-measured the lease liability relating to the

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existing lease space and measured the lease liability to the expansion space based on the present value of the respective future lease payments (excluding the extension option that we are not reasonably certain to exercise), discounted using the estimated incremental borrowing rate of 5.5%, which was the interest rate at that time that we estimate we would have had to pay to borrow on a collateralized basis over a similar term for an amount equal to the lease payments. Subsequently, the lease liability is accreted by applying a discount rate established at the lease commencement date to the lease liability balance as of the beginning of the period and is reduced by the payments made during the period.

The right-of-use asset is measured based on the corresponding lease liability. We did not incur any initial direct leasing costs or exchange any other consideration with the landlord prior to the commencement of the lease. Subsequently, the right-of-use asset is amortized on a straight-line basis during the lease term. For both the three months ended June 30, 2023 and 2022, we recognized office lease expense of approximately \$122,000, and for the six months ended June 30, 2023 and 2022, we recognized office lease expense of approximately \$243,000 and \$223,000, respectively, which are included in general and administrative expenses in our condensed consolidated statements of income. For the six months ended June 30, 2023 and 2022, amounts paid and classified as operating activities in our condensed consolidated statements of cash flows for the office lease were approximately \$248,000 and \$161,000, respectively.

As lessor, for each of our real estate transactions involving the leaseback of the related property to the seller or affiliates of the seller, we determine whether these transactions qualify as sale and leaseback transactions under the accounting guidance. For these transactions, we consider various inputs and assumptions including, but not necessarily limited to, lease terms, renewal options, discount rates, and other rights and provisions in the purchase and sale agreement, lease and other documentation to determine whether control has been transferred to the Company or remains with the lessee. A transaction involving a sale leaseback will be treated as a purchase of a real estate property if it is considered to transfer control of the underlying asset from the lessee. A lease will be classified as direct-financing if risks and rewards are conveyed without the transfer of control and will be classified as a sales-type lease if control of the underlying asset is transferred to the lessee. Otherwise, the lease is treated as an operating lease. These criteria also include estimates and assumptions regarding the fair value of the leased facilities, minimum lease payments, the economic useful life of the facilities, the existence of a purchase option, and certain other terms in the lease agreements. The lease accounting guidance requires accounting for a transaction as a financing in a sale leaseback when the seller-lessee is provided an option to purchase the property from the landlord at the tenant's option. Substantially all of our leases continue to be classified as operating leases and we continue to record revenue for each of our properties on a cash basis. Our tenant reimbursable revenue and property expenses continue to be presented on a gross basis as rental revenues and as property expenses, respectively, on our condensed consolidated statements of income. Property taxes paid directly by the lessee to a third party continue to be excluded from our condensed consolidated financial statements.

Lease amendments are evaluated to determine if the modification grants the lessee an additional right-of-use not included in the original lease and if the lease payments increase commensurate with the standalone price of the additional right-of-use, adjusted for the circumstances of the particular contract. If both conditions are present, the lease amendment is accounted for as a new lease that is separate from the original lease.

Our leases generally contain options to extend the lease terms at the prevailing market rate or at the expiring rental rate at the time of expiration. Certain of our leases provide the lessee with a right of first refusal or right of first offer in the event we market the leased property for sale.

**Concentration of Credit Risk.** As of June 30, 2023, we owned 108 properties located in 19 states and leased to 30 tenants. The ability of any of our tenants to honor the terms of their leases is dependent upon the economic, regulatory, competition, natural and social factors affecting the community in which that tenant operates.

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The following table sets forth the five tenants in our portfolio that represented the largest percentage of our total rental revenues for the three and six months ended June 30, 2023 and 2022, including tenant reimbursements:

	For the Three Months Ended	
	June 30, 2023	
	Number of Leases	Percentage of Rental Revenue
PharmaCann Inc. ("PharmaCann")	11	15 %
Ascend Wellness Holdings, Inc. ("Ascend")	4	10 %
Green Thumb Industries, Inc. ("GTI")	3	8 %
Curaleaf Holdings, Inc. ("Curaleaf")	8	7 %
Trulieve Cannabis Corp. ("Trulieve")	6	7 %

	For the Six Months Ended	
	June 30, 2023	
	Number of Leases	Percentage of Rental Revenue
PharmaCann	11	15 %
Ascend	4	10 %
GTI	3	7 %
SH Parent, Inc. ("Parallel") <sup>(1)</sup>	4	7 %
Curaleaf	8	7 %

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2022		June 30, 2022	
	Number of Leases	Percentage of Rental Revenue	Number of Leases	Percentage of Rental Revenue
PharmaCann	11	13 %	11	14 %
Parallel	4	10 %	4	10 %
Ascend	4	10 %	4	9 %
Kings Garden Inc. ("Kings Garden") <sup>(2)</sup>	6	8 %	6	8 %
Trulieve	6	6 %	6	7 %

- (1) Commencing in November 2022, Parallel defaulted on its obligations to pay rent at one of our Pennsylvania properties. In February 2023, Parallel defaulted on its obligations to pay rent at one of our Texas properties, and we regained possession of that property in March 2023. See Note 11 "Commitments and Contingencies — Litigation" to our condensed consolidated financial statements for more information. Excluding security deposits applied for payment of rent for Parallel at one property in Pennsylvania and one property in Texas of approximately \$1.8 million and \$395,000, respectively, Parallel would have represented 6% of our total rental revenues for the six months ended June 30, 2023.
- (2) In July 2022, Kings Garden defaulted on its obligations to pay rent at all of the properties it leases with us, and pursuant to a confidential, conditional settlement agreement executed on September 11, 2022 between us and Kings Garden, we terminated the leases for two properties that were in development or redevelopment as of June 30, 2023 and regained possession of those properties. See Note 11 "Commitments and Contingencies — Litigation" to our condensed consolidated financial statements for more information.

In each of the tables above, these leases include leases with affiliates of each entity, for which the entity has provided a corporate guaranty.

As of June 30, 2023, our largest property was located in New York and accounted for approximately 5.4% of our net real estate held for investment. No other properties accounted for more than 5% of our net real estate held for investment as of June 30, 2023. As of December 31, 2022, none of our properties individually represented more than 5% of our net real estate held for investment.

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We have deposited cash with financial institutions that are insured by the Federal Deposit Insurance Corporation (“FDIC”) up to \$250,000. As of June 30, 2023, we had cash accounts in excess of FDIC insured limits. We have not experienced any losses in such accounts.

### 3. Common Stock

As of June 30, 2023, the Company was authorized to issue up to 50,000,000 shares of common stock, par value \$0.001 per share, and there were 28,040,054 shares of common stock issued and outstanding.

In January 2023, we terminated the previously existing “at-the-market” offering program and entered into new equity distribution agreements with four sales agents, pursuant to which we may offer and sell from time to time through an “at-the-market” offering program (the “ATM Program”) up to \$500.0 million in shares of our common stock. As of June 30, 2023, we had not sold any shares of common stock under the ATM Program.

During the six months ended June 30, 2023, we issued 32,200 shares of our common stock upon exchange by holders of \$2.0 million of outstanding principal amount of our Exchangeable Senior Notes.

### 4. Preferred Stock

As of June 30, 2023, the Company was authorized to issue up to 50,000,000 shares of preferred stock, par value \$0.001 per share, and there were 600,000 shares issued and outstanding of 9.00% Series A Cumulative Redeemable Preferred Stock, \$0.001 par value per share (the “Series A Preferred Stock”). The Company may, at its option, redeem the Series A Preferred Stock, in whole or in part, at any time or from time to time, for cash at a redemption price of \$25.00 per share, plus all accrued and unpaid dividends on such Series A Preferred Stock up to, but excluding the redemption date. Holders of the Series A Preferred Stock generally have no voting rights except for limited voting rights if the Company fails to pay dividends for six or more quarterly periods (whether or not consecutive) and in certain other circumstances.

### 5. Dividends

The following table describes the dividends declared by the Company during the six months ended June 30, 2023:

<u>Declaration Date</u>	<u>Security Class</u>	<u>Amount Per Share</u>	<u>Period Covered</u>	<u>Dividend Paid Date</u>	<u>Dividend Amount</u>
March 15, 2023	Common stock	\$ 1.80	January 1, 2023 to March 31, 2023	April 14, 2023	\$ 50,725
March 15, 2023	Series A preferred stock	\$ 0.5625	January 15, 2023 to April 14, 2023	April 14, 2023	\$ 338
June 15, 2023	Common stock	\$ 1.80	April 1, 2023 to June 30, 2023	July 14, 2023	\$ 50,742
June 15, 2023	Series A preferred stock	\$ 0.5625	April 15, 2023 to July 14, 2023	July 14, 2023	\$ 338

### 6. Investments in Real Estate

#### Acquisitions

The Company acquired the following properties during the six months ended June 30, 2023 (dollars in thousands):

<u>Property</u>	<u>Market</u>	<u>Closing Date</u>	<u>Rentable Square Feet<sup>(1)</sup></u>	<u>Purchase Price</u>	<u>Transaction Costs</u>	<u>Total</u>
Susquehanna Street	Pennsylvania	February 15, 2023	58,000	\$ 15,000	\$ 26	\$ 15,026
Boltonfield Street	Ohio	March 3, 2023	157,000	20,100	29	20,129 <sup>(2)</sup>
<b>Total</b>			<b>215,000</b>	<b>\$ 35,100</b>	<b>\$ 55</b>	<b>\$ 35,155<sup>(3)</sup></b>

(1) Includes expected rentable square feet at completion of construction of certain properties.

(2) The tenant is expected to complete improvements at the property, for which we agreed to provide funding of up to \$21.9 million.

(3) Approximately \$2.6 million was allocated to land and approximately \$32.6 million was allocated to building and improvements.

[Table of Contents](#)*Acquired In-Place Lease Intangible Assets*

In-place lease intangible assets and related accumulated amortization as of June 30, 2023 and December 31, 2022 is as follows (in thousands):

	June 30, 2023	December 31, 2022
In-place lease intangible assets	\$ 9,979	\$ 9,979
Accumulated amortization	(1,304)	(874)
In-place lease intangible assets, net	<u>\$ 8,675</u>	<u>\$ 9,105</u>

Amortization of in-place lease intangible assets classified in depreciation and amortization expense in our condensed consolidated statements of income was approximately \$215,000 and \$213,000 for the three months ended June 30, 2023 and 2022, respectively, and was approximately \$430,000 and \$411,000 for the six months ended June 30, 2023 and 2022, respectively. The weighted-average remaining amortization period of the acquired in-place leases was approximately 10.0 years, and the estimated annual amortization of the value of the acquired in-place leases as of June 30, 2023 is as follows (in thousands):

Year	Amount
2023 (six months ending December 31)	\$ 430
2024	860
2025	860
2026	860
2027	860
Thereafter	4,805
<b>Total</b>	<u>\$ 8,675</u>

*Above-Market Lease*

The above-market lease and related accumulated amortization included in other assets, net on our condensed consolidated balance sheets as of June 30, 2023 and December 31, 2022 is as follows (in thousands):

	June 30, 2023	December 31, 2022
Above-market lease	\$ 1,054	\$ 1,054
Accumulated amortization	(141)	(95)
Above-market lease, net	<u>\$ 913</u>	<u>\$ 959</u>

The above-market lease is amortized on a straight-line basis as a reduction to rental revenues over the remaining lease term of approximately 9.8 years. For the three months ended June 30, 2023 and 2022, the amortization of the above-market lease was approximately \$23,000 in each period. For the six months ended June 30, 2023 and 2022, the amortization of the above-market lease was approximately \$46,000 in each period.

*Additional Improvement Allowances*

In February 2023, we amended our lease with a subsidiary of Ascend at one of our New Jersey properties, increasing the improvement allowance under the lease by \$15.0 million to a total of approximately \$19.6 million, which also resulted in a corresponding adjustment to the base rent for the lease at the property. We also amended each of our leases with Ascend to include cross-default provisions applicable to each lease.

In February 2023, we amended our lease and development agreement with PharmaCann at one of our New York properties, increasing the construction fund by \$15.0 million to a total of approximately \$93.5 million, which also resulted in a corresponding adjustment to the base rent for the lease at the property. We also amended each of our leases with PharmaCann to include cross-default provisions applicable to each lease.

In February 2023, we amended our lease with a subsidiary of Goodness Growth Holdings Inc. at one of our New York properties, increasing the improvement allowance under the lease by \$4.0 million to a total of approximately \$53.4 million, which also resulted in a corresponding adjustment to the base rent for the lease at the property. We also amended each of our leases with Goodness Growth Holdings Inc. to include cross-default provisions applicable to each lease.

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### *Lease Amendments*

In January 2023, we entered into lease amendments with Holistic Industries Inc. (“Holistic”) at our properties located in California, Maryland, Massachusetts, Michigan and Pennsylvania, which (1) included cross-default provisions applicable to each lease; (2) extended the term of each lease; and (3) provided that 100% of the base rent shall be applied from the security deposits held by us for (a) the nine months ending September 30, 2023 with respect to the Michigan property and (b) the eight months ending September 30, 2023 with respect to the California property, with pro rata monthly payback of the security deposits over the twelve-month period starting January 2024.

In January 2023, we executed a lease amendment with Calyx Peak, Inc. at our Missouri property, which (1) extended the term of the lease; and (2) provided for 100% base rent deferral through March 31, 2023, with pro rata monthly payback of the deferred rent over the twelve-month period starting April 2023.

In March 2023, we executed a lease amendment with Temescal Wellness of Massachusetts, LLC (“Temescal”) at our Massachusetts property, which (1) provided for temporary reduced base rent from April 2023 through January 2024 to be partially paid through application of security deposits, with pro rata payback of those security deposits over twelve months starting in February 2024; (2) extended the lease term; and (3) increased base rent for the remainder of the term of the lease.

### *New Lease*

In June 2023, we executed a new long-term lease with a tenant at our property located at 68860 Perez Road in Cathedral City, California that was previously leased to Kings Garden, which is under construction as of June 30, 2023.

### *Capitalized Costs*

During the six months ended June 30, 2023, we capitalized costs of approximately \$101.8 million and funded approximately \$111.5 million relating to improvements and construction activities at our properties.

### *Property Disposition*

In March 2023, we sold the portfolio of four properties in California previously leased to affiliates of Medical Investor Holdings, LLC (“Vertical”) for \$16.2 million (excluding transaction costs) and provided a secured loan for \$16.1 million to the buyer of the properties. The loan matures on February 29, 2028 with two options to extend the maturity for twelve months, conditional in each instance on the payment of an extension fee and at least \$500,000 of the principal balance. The loan is interest only and payments are payable monthly in advance. The transaction did not qualify for recognition as a completed sale under GAAP since not all of the criteria were met. Accordingly, we have not derecognized the assets transferred on our condensed consolidated balance sheets. All consideration received, as well as any future payments, from the buyer will be recognized as a deposit liability and will be included in other liabilities on our condensed consolidated balance sheet until such time the criteria for recognition as a sale have been met. As of June 30, 2023, we received interest payments of approximately \$537,000. In addition, as we have not met all of the held-for-sale criteria, land and building and improvements with a gross carrying value of approximately \$3.4 million and approximately \$13.9 million, respectively, and accumulated depreciation of approximately \$1.5 million as of June 30, 2023, remain on the condensed consolidated balance sheet, and the buildings and improvements continue to be depreciated.

### *Future Contractual Minimum Rent*

Future contractual minimum rent (including base rent and property management fees) under the operating leases as of June 30, 2023 for future periods is summarized as follows (in thousands):

Year	Contractual Minimum Rent
2023 (six months ending December 31)	\$ 143,487
2024	296,831
2025	305,564
2026	314,623
2027	323,953
Thereafter	4,167,236
<b>Total</b>	<b>\$ 5,551,694</b>

**7. Debt**

***Exchangeable Senior Notes***

As of June 30, 2023, our Operating Partnership had outstanding approximately \$4.4 million principal amount of 3.75% Exchangeable Senior Notes due 2024 (the “Exchangeable Senior Notes”). The Exchangeable Senior Notes are senior unsecured obligations of our Operating Partnership, are fully and unconditionally guaranteed by us and our Operating Partnership’s subsidiaries and are exchangeable for cash, shares of our common stock, or a combination of cash and shares of our common stock, at our Operating Partnership’s option, at any time prior to the close of business on the second scheduled trading day immediately preceding the stated maturity date. The exchange rate for the Exchangeable Senior Notes at June 30, 2023 was 16.74033 shares of our common stock per \$1,000 principal amount of Notes and the exchange price at June 30, 2023 was approximately \$59.74 per share of our common stock. The exchange rate and exchange price are subject to adjustment in certain circumstances. The Exchangeable Senior Notes will pay interest semiannually at a rate of 3.75% per annum and will mature on February 21, 2024, unless earlier exchanged or repurchased in accordance with their terms. Our Operating Partnership will not have the right to redeem the Exchangeable Senior Notes prior to maturity, but may be required to repurchase the Exchangeable Senior Notes from holders under certain circumstances. At June 30, 2023, the if-exchanged value of the Exchangeable Senior Notes exceeded the principal amount by approximately \$986,000.

During the six months ended June 30, 2023, we issued 32,200 shares of our common stock upon exchanges by holders of \$2.0 million of outstanding principal amount of our Exchangeable Senior Notes. For the six months ended June 30, 2023, we recognized a gain on the exchange totaling approximately \$22,000, resulting from the difference between the fair value and carrying value of the debt as of the date of the exchange. The issuance of the shares pursuant to the exchanges resulted in a net non-cash increase to our additional paid-in capital account of approximately \$2.0 million for the six months ended June 30, 2023.

During the three and six months ended June 30, 2022, we issued 47,059 and 412,901 shares, respectively, of our common stock upon exchanges by holders of approximately \$3.1 million and \$26.9 million, respectively, of outstanding principal amount of our Exchangeable Senior Notes. We recognized a loss on the exchanges totaling approximately \$7,000 and \$125,000 for the three and six months ended June 30, 2022, respectively, resulting from the difference between the fair value and carrying value of the debt as of the date of the exchange. The issuance of the shares pursuant to the exchanges resulted in a non-cash increase to our additional paid-in capital account of approximately \$3.0 million and \$26.7 million for the three and six months ended June 30, 2022, respectively.

The following table details our interest expense related to the Exchangeable Senior Notes (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2023	2022	2023	2022
Cash coupon	\$ 42	\$ 55	\$ 99	\$ 331
Amortization of issuance cost	8	13	20	71
Total interest expense	\$ 50	\$ 68	\$ 119	\$ 402

The following table details the carrying value of our Exchangeable Senior Notes (in thousands):

	June 30, 2023	December 31, 2022
Principal amount	\$ 4,436	\$ 6,436
Unamortized issuance cost	(22)	(56)
Carrying value	\$ 4,414	\$ 6,380

Accrued interest payable for the Exchangeable Senior Notes as of June 30, 2023 and December 31, 2022 was approximately \$49,000 and \$70,000, respectively, and is included in accounts payable and accrued expenses on our condensed consolidated balance sheets.



**Notes due 2026**

On May 25, 2021, our Operating Partnership issued \$300.0 million aggregate principal amount of its 5.50% Senior Notes due 2026 (the “Notes due 2026”). The Notes due 2026 are senior unsecured obligations of our Operating Partnership, are fully and unconditionally guaranteed by us and our Operating Partnership’s subsidiaries and rank equally in right of payment with all of the Operating Partnership’s existing and future senior unsecured indebtedness, including the Exchangeable Senior Notes. However, the Notes due 2026 are effectively subordinated to any of the Company’s, the Operating Partnership’s and the Operating Partnership’s subsidiaries’ future secured indebtedness to the extent of the value of the assets securing such indebtedness. The Notes due 2026 will pay interest semiannually at a rate of 5.50% per year and will mature on May 25, 2026. The terms of the Notes due 2026 are governed by an indenture, dated May 25, 2021, among the Operating Partnership, as issuer, the Company and the Operating Partnership’s subsidiaries, as guarantors, TMI Trust Company, as trustee (as successor-in-interest to GLAS Trust Company LLC), and Securities Transfer Corporation, as registrar (as successor-in-interest to GLAS Trust Company LLC). The terms of the indenture provide that if the debt rating on the Notes due 2026 is downgraded or withdrawn entirely, interest on the Notes due 2026 will increase to a range of 6.0% to 6.5% based on such debt rating.

In connection with the issuance of the Notes due 2026, we recorded approximately \$6.8 million of issuance costs, which are being amortized using the effective interest method and recognized as non-cash interest expense over the term of the Notes due 2026.

The following table details our interest expense related to the Notes due 2026 (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2023	2022	2023	2022
Cash coupon	\$ 4,125	\$ 4,125	\$ 8,250	\$ 8,250
Amortization of issuance cost	331	311	657	618
Capitalized interest	(34)	—	(34)	—
Total interest expense	<u>\$ 4,422</u>	<u>\$ 4,436</u>	<u>\$ 8,873</u>	<u>\$ 8,868</u>

The following table details the carrying value of our Notes due 2026 (in thousands):

	June 30, 2023	December 31, 2022
Principal amount	\$ 300,000	\$ 300,000
Unamortized issuance cost	(4,228)	(4,885)
Carrying value	<u>\$ 295,772</u>	<u>\$ 295,115</u>

The Operating Partnership may redeem some or all of the Notes due 2026 at its option at any time at the applicable redemption price. If the Notes due 2026 are redeemed prior to February 25, 2026, the redemption price will be equal to 100% of the principal amount of the Notes due 2026 being redeemed, plus a make-whole premium and accrued and unpaid interest thereon to, but excluding, the applicable redemption date. If the Notes due 2026 are redeemed on or after February 25, 2026, the redemption price will be equal to 100% of the principal amount of the Notes due 2026 being redeemed, plus accrued and unpaid interest thereon to, but excluding, the applicable redemption date.

The terms of the indenture for the Notes due 2026 require compliance with various financial covenants, including minimum level of debt service coverage and limits on the amount of total leverage and secured debt maintained by the Operating Partnership. Management believes that it was in compliance with those covenants as of June 30, 2023.

Accrued interest payable for the Notes due 2026 as of June 30, 2023 and December 31, 2022 was approximately \$2.1 million and \$2.1 million, respectively, and is included in accounts payable and accrued expenses on our condensed consolidated balance sheets.

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The following table summarizes the principal payments on our outstanding indebtedness as of June 30, 2023 (in thousands):

<b>Payments Due by Year</b>	<b>Amount</b>
2023 (six months ending December 31)	\$ —
2024	4,436
2025	—
2026	300,000
2027	—
Thereafter	—
<b>Total</b>	<b>\$ 304,436</b>

## 8. Net Income Per Share

Grants of restricted stock and restricted stock units (“RSUs”) of the Company in share-based payment transactions are considered participating securities prior to vesting and, therefore, are considered in computing basic earnings per share under the two-class method. The two-class method is an earnings allocation method for calculating earnings per share when a company’s capital structure includes either two or more classes of common stock or common stock and participating securities. Earnings per basic share under the two-class method is calculated based on dividends declared on common shares and other participating securities (“distributed earnings”) and the rights of participating securities in any undistributed earnings, which represents net income remaining after deduction of dividends accruing during the period. The undistributed earnings are allocated to all outstanding common shares and participating securities based on the relative percentage of each security to the total number of outstanding participating securities. Earnings per basic share represents the summation of the distributed and undistributed earnings per share class divided by the total number of shares.

Through June 30, 2023, all of the Company’s participating securities received dividends or dividend equivalents at an equal dividend rate per share or unit. As a result, distributions to participating securities for the three and six months ended June 30, 2023 and 2022 have been included in net income attributable to common stockholders to calculate net income per basic and diluted share.

The 74,260 and 87,437 shares necessary to settle the Exchangeable Senior Notes on the if-exchanged method basis were dilutive for the three and six months ended June 30, 2023, respectively, and were included in the computation of diluted earnings per share. The 103,742 and 304,348 shares necessary to settle the Exchangeable Senior Notes on the if-exchanged method basis were dilutive for the three and six months ended June 30, 2022, respectively, and were included in the computation of diluted earnings per share.

For the three and six months ended June 30, 2023 and 2022, the performance share units (“PSUs”) granted to certain employees were not included in dilutive securities as the performance thresholds for vesting of the PSUs were not met as measured as of the respective dates (see Note 10 for further discussion of PSUs).

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Computations of net income per basic and diluted share (in thousands, except share and per share data) were as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2023	2022	2023	2022
Net income	\$ 41,269	\$ 40,214	\$ 82,361	\$ 75,264
Preferred stock dividends	(338)	(338)	(676)	(676)
Distribution to participating securities	(373)	(207)	(734)	(409)
Net income attributable to common stockholders used to compute net income per share – basic	40,558	39,669	80,951	74,179
Dilutive effect of Exchangeable Senior Notes	50	68	119	402
Net income attributable to common stockholders used to compute net income per share – diluted	\$ 40,608	\$ 39,737	\$ 81,070	\$ 74,581
Weighted-average common shares outstanding:				
Basic	27,981,517	27,850,561	27,965,720	26,741,568
Restricted stock and RSUs	201,462	82,387	186,684	113,858
Dilutive effect of Exchangeable Senior Notes	74,260	103,742	87,437	304,348
Diluted	28,257,239	28,036,690	28,239,841	27,159,774
Net income attributable to common stockholders per share:				
Basic	\$ 1.45	\$ 1.42	\$ 2.89	\$ 2.77
Diluted	\$ 1.44	\$ 1.42	\$ 2.87	\$ 2.75

### 9. Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. Accounting guidance also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1—Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2—Includes other inputs that are directly or indirectly observable in the marketplace.

Level 3—Unobservable inputs that are supported by little or no market activities, therefore requiring an entity to develop its own assumptions.

The following table presents the carrying value and approximate fair value of financial instruments at June 30, 2023 and December 31, 2022 (in thousands):

	At June 30, 2023		At December 31, 2022	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Investments <sup>(1)</sup>	\$ 72,726	\$ 72,550	\$ 200,935	\$ 200,715
Exchangeable Senior Notes <sup>(2)</sup>	\$ 4,414	\$ 5,476	\$ 6,380	\$ 10,282
Notes due 2026 <sup>(2)</sup>	\$ 295,772	\$ 253,395	\$ 295,115	\$ 264,234
Construction Loan <sup>(3)</sup>	\$ 20,917	\$ 25,350	\$ 18,021	\$ 20,167

- (1) Short-term investments consisting of obligations of the U.S. government with an original maturity at the time of purchase of greater than three months are classified as held-to-maturity and valued using Level 1 inputs.
- (2) The fair value is determined based upon Level 2 inputs as the Exchangeable Senior Notes and Notes due 2026 were trading in the private market.
- (3) The construction loan receivable is categorized as Level 3 and was valued using a yield analysis, which is typically performed for non-credit impaired loans. To determine fair value using a yield analysis, a current price is imputed for the loan based upon an assessment of the expected market yield for a similarly structured loan with a similar level of risk. In the yield analysis, the Company considers the current contractual interest rate, the maturity and other terms of the loan relative to risk of the company and the specific loan. At June 30, 2023 and December 31, 2022, the expected market yield used to determine fair value was 25%. Changes in market yields may change the fair value of the construction loan. Generally, an increase in market yields may result in a decrease in the fair value of the construction loan. Due to the inherent uncertainty of determining the fair value of a loan that does not have a readily available market value, the fair value of the construction loan may fluctuate from period to period. Additionally, the fair value of the construction loan may differ significantly from the

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value that would have been used had a readily available market existed for such loan and may differ materially from the value that the Company may ultimately realize.

As of June 30, 2023 and December 31, 2022, cash equivalent instruments consisted of approximately \$79.7 million and \$78.0 million, respectively, in short-term money market funds that were measured using the net asset value per share that have not been classified using the fair value hierarchy. The fund invests primarily in short-term U.S. Treasury and government securities. Short-term investments consisting of certificate of deposits and obligations of the U.S. government are stated at amortized cost, which approximates their relative fair values due to the short-term maturities and market rates of interest of these instruments.

The carrying amounts of financial instruments such as cash equivalents invested in certificates of deposit, obligations of the U.S. government with an original maturity at the time of purchase of less than or equal to three months, accounts payable, accrued expenses and other liabilities approximate their fair values due to the short-term maturities and market rates of interest of these instruments.

### 10. Common Stock Incentive Plan

Our board of directors adopted our 2016 Omnibus Incentive Plan (the “2016 Plan”) to enable us to motivate, attract and retain the services of directors, employees and consultants considered essential to our long-term success. The 2016 Plan offers our directors, employees and consultants an opportunity to own our stock or rights that will reflect our growth, development and financial success. Under the terms of the 2016 Plan, the aggregate number of shares of our common stock subject to options, restricted stock, stock appreciation rights, restricted stock units and other awards, will be no more than 1,000,000 shares. Any equity awards that lapse, expire, terminate, are canceled or are forfeited (including forfeitures in connection with satisfaction of tax withholdings obligations of the recipient) are re-credited to the 2016 Plan’s reserve for future issuance. The 2016 Plan automatically terminates on the date which is ten years following the effective date of the 2016 Plan.

A summary of the restricted stock activity under the 2016 Plan and related information for the six months ended June 30, 2023 is included in the table below:

	Unvested Restricted Stock	Weighted- Average Grant Date Fair Value
Balance at December 31, 2022	34,026	\$ 181.08
Granted	35,565	\$ 110.88
Vested	(9,154)	\$ 187.00
Forfeited <sup>(1)</sup>	(5,596)	\$ 115.01
Balance at March 31, 2023	54,841	\$ 141.31
Granted	5,055	\$ 71.23
Vested	(2,811)	\$ 128.11
Balance at June 30, 2023	<u>57,085</u>	\$ 135.75

(1) Shares that were forfeited to cover the employees’ tax withholding obligation upon vesting.

The remaining unrecognized compensation cost of approximately \$6.1 million for restricted stock awards is expected to be recognized over a weighted-average amortization period of approximately 2.0 years as of June 30, 2023. The fair value of restricted stock that vested during the six months ended June 30, 2023 was approximately \$1.7 million.

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The following table summarizes our RSU activity for the six months ended June 30, 2023. RSUs are issued as part of the Innovative Industrial Properties, Inc. Nonqualified Deferred Compensation Plan (the “Deferred Compensation Plan”), which allows a select group of management and our non-employee directors to defer receiving certain of their cash and equity-based compensation. RSUs are subject to vesting conditions of the Deferred Compensation Plan and have the same economic rights as shares of restricted stock under the 2016 Plan:

	Restricted Stock Units	Weighted-Average Grant Date Fair Value
Balance at December 31, 2022	83,677	\$ 144.30
Granted	61,785	\$ 103.60
Balance at March 31, 2023	145,462	\$ 127.01
Granted	4,494	\$ 71.23
Balance at June 30, 2023	149,956	\$ 125.34

The remaining unrecognized compensation cost of approximately \$8.6 million for RSU awards is expected to be recognized over an amortization period of approximately 2.1 years as of June 30, 2023.

In January 2021 and 2022, we issued 70,795 and 102,641 “target” PSUs, respectively, to a select group of officers, which vest and are settled in shares of common stock based on the Company’s total stockholder return over a performance period of approximately three years from the grant date.

Stock-based compensation for market-based PSU awards is based on the grant date fair value of the equity awards and is recognized over the applicable Performance Period. For both the three and six months ended June 30, 2023 and 2022, we recognized stock-based compensation expense of approximately \$2.7 million and \$5.3 million, respectively, relating to PSU awards. As of June 30, 2023, the remaining unrecognized compensation cost of approximately \$12.0 million relating to PSU awards is expected to be recognized over the remaining Performance Period of approximately 1.4 years.

As measured as of June 30, 2023, the performance thresholds for the vesting of the PSUs were not met for any of the applicable awards.

## 11. Commitments and Contingencies

**Office Lease.** The future contractual lease payments for our office lease and the reconciliation to the office lease liability reflected in other liabilities in our condensed consolidated balance sheet as of June 30, 2023 is presented in the table below (in thousands):

Year	Amount
2023 (six months ending December 31)	\$ 249
2024	511
2025	526
2026	543
2027	45
Total future contractual lease payments	1,874
Effect of discounting	(192)
Office lease liability	\$ 1,682

**Improvement Allowances.** As of June 30, 2023, we had approximately \$29.6 million of commitments related to improvement allowances, which generally may be requested by the tenants at any time up until a date that is near the expiration of the initial term of the applicable lease.

**Construction Loan.** As of June 30, 2023, we had approximately \$2.1 million of commitments related to our construction loan for the development of a regulated cannabis cultivation and processing facility in California. The developer is required to complete construction by December 31, 2023, subject to extension in certain circumstances.

**Environmental Matters.** We follow the policy of monitoring our properties, both targeted acquisition and existing properties, for the presence of hazardous or toxic substances. While there can be no assurance that a material environmental liability does not exist, we are not currently aware of any environmental liabilities that would have a material adverse effect on our financial condition, results of operations and cash flow, or that we believe would require disclosure or the recording of a loss contingency.

## **Litigation.**

### *Class Action Lawsuit*

On April 25, 2022, a federal securities class action lawsuit was filed against the Company and certain of its officers. The case was named *Michael V. Malozzi, individually and on behalf of others similarly situated v. Innovative Industrial Properties, Inc., Paul Smithers, Catherine Hastings and Andy Bui*, Case No. 2-22-cv-02359, and was filed in the U.S. District Court for the District of New Jersey. The lawsuit was purportedly brought on behalf of purchasers of our common stock and alleges that we and certain of our officers made false or misleading statements regarding our business in violation of Section 10(b) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), SEC Rule 10b-5, and Section 20(a) of the Exchange Act. According to the filed complaint, the plaintiff is seeking an undetermined amount of damages, interest, attorneys’ fees and costs and other relief on behalf of the putative classes of all persons who acquired shares of the Company’s common stock between May 7, 2020 and April 13, 2022.

On September 29, 2022, an Amended Class Action complaint was filed under the same Case Number, adding as defendants Alan D. Gold and Benjamin C. Regin, and asserting causes of action under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. According to the Amended Class Action Complaint, the plaintiff is seeking an undetermined amount of damages, interest, attorneys’ fees and costs and other relief on behalf of the putative classes of all persons who acquired shares of the Company’s common stock between August 7, 2020 and August 4, 2022. On December 1, 2022, defendants moved to dismiss the Amended Class Action Complaint; on January 25, 2023, plaintiff responded to defendants’ motion to dismiss the Amended Class Action Complaint; and on March 6, 2023 defendants replied to plaintiff’s response. The court has not issued a ruling. It is possible that similar lawsuits may yet be filed in the same or other courts that name the same or additional defendants. We intend to defend the lawsuit vigorously. However, at this time, we cannot predict the probable outcome of this action, and, accordingly, no amounts have been accrued in the Company’s condensed consolidated financial statements.

### *Derivative Action Lawsuit*

On July 26, 2022, a derivative action lawsuit was filed against the Company and certain of its officers and directors. The case was named *John Rice, derivatively on behalf of Innovative Industrial Properties, Inc. v. Paul Smithers, Catherine Hastings, Andy Bui, Alan Gold, Gary Kreitzer, Mary Curran, Scott Shoemaker, David Stecher, and Innovative Industrial Properties, Inc.*, and was filed in the Circuit Court for Baltimore City, Maryland. The lawsuit asserts putative derivative claims for breach of fiduciary duty, unjust enrichment, abuse of control, gross mismanagement, and waste of corporate assets against the directors and certain officers of the Company. The plaintiffs are seeking declaratory relief, direction to reform and improve corporate governance and internal procedures, and an undetermined amount of damages, restitution, interest, and attorneys’ fees and costs. On September 6, 2022, the defendants in this action filed a Consent Motion to Stay the Proceedings, which was granted on October 11, 2022. On September 28, 2022, a second derivative action lawsuit was filed against the Company and certain of its officers and directors. The case was named *Karen Drover, derivatively on behalf of Innovative Industrial Properties, Inc. v. Paul Smithers, Catherine Hastings, Andy Bui, Alan Gold, Gary Kreitzer, Mary Curran, Scott Shoemaker, David Stecher, Defendants, and Innovative Industrial Properties Inc., Nominal Defendant*, Case Number 24-C-22-004243, and filed in the Circuit Court for Baltimore City, Maryland. The lawsuit asserts putative derivative claims for breach of fiduciary duty, and seeks actions to reform and improve the Company, and an undetermined amount of damages, restitution, interest, and attorneys’ fees and costs. On October 19, 2022, the parties to both cases filed a Joint Motion to Consolidate Related Shareholder Derivative Actions and to Appoint Lead and Liaison Counsel for plaintiffs, which was granted on December 16, 2022, along with a stay in the lawsuit pending a ruling on the defendants’ motion to dismiss the federal class action lawsuit described above. On April 17, 2023, a third derivative action lawsuit was filed against the Company and certain of its officers and directors. The case was named *Ross Weintraub, derivatively on behalf of Innovative Industrial Properties, Inc. v. Alan Gold, Paul Smithers, Catherine Hastings, Ben Regin, Andy Bui, Tracie Hager, Gary Kreitzer, David Stecher, Scott Shoemaker, Mary Curran, and Innovative Industrial Properties, Inc.*, Case Number 1:23-cv-00737-GLR, and filed in the United States District Court for the District of Maryland. The lawsuit asserts putative derivative claims for breach of fiduciary duty and violations of Section 14(a) of the Exchange Act, and seeks an undetermined amount of damages, equitable relief, and attorneys’ fees and costs. Defendants in this action filed a Consent Motion to Stay the Proceeding, which was granted on April 17, 2023. On June 5, 2023, a fourth derivative action lawsuit was filed against the Company and certain of its officers and directors. The case was named *Franco DeBlasio, on behalf of Gerich Melenth Nin (GMN) LP, derivatively on behalf of Innovative Industrial Properties, Inc. v. Paul Smithers, Catherine Hastings, Alan D. Gold, Tracie J. Hager, Benjamin C. Regin, Andy Bui, Gary A. Kreitzer, David Stecher, Scott Shoemaker, Mary Curran, and Innovative Industrial Properties, Inc.*, Case Number 1:23-cv-01513-GLR, and filed in the United States District Court for the District of Maryland. The Company intends to vigorously defend each of these lawsuits. However, at this time, the Company cannot predict the probable outcome of these actions, and, accordingly, no amounts have been accrued in the Company’s condensed consolidated financial statements. On July 19, 2023, the United States Court for the District of Maryland consolidated Case Nos. 1:23-cv-00737-GLR and 1:23-cv-01513-GLR with case number 1:23-cv-00737-GLR as the lead case, and kept the stay in place.

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### *Kings Garden Lawsuit*

In July 2022, one of our tenants, Kings Garden Inc., defaulted on its obligations to pay base rent and property management fees under each of its six leases with our indirect, wholly owned subsidiary, IIP-CA 2 LP, and defaulted on its obligations to reimburse us for certain insurance premiums at the properties incurred by us that are payable by Kings Garden as operating expenses under such leases.

On July 25, 2022, IIP-CA 2 LP filed a lawsuit against Kings Garden. The case was named *IIP-CA 2 LP, a Delaware limited partnership v. Kings Garden Inc., a Nevada corporation, CK Endeavors, Inc., a California corporation, and JM Endeavors, Inc., a California corporation*, and was filed in the Superior Court of the State of California. The lawsuit asserts claims for breach of contract, declaratory relief, and injunctive relief. On August 2, 2022, the case was amended to be named *IIP-CA 2 LP, a Delaware limited partnership v. Kings Garden Inc., a Nevada corporation, CK Endeavors, Inc., a California corporation, JM Endeavors, Inc., a California corporation, Michael King, an individual, Gary LaSalle, an individual, Charles Kieley, an individual, and Laurie Kibby, an individual*, and to include claims relating to construction at the expansion project and the property that was under redevelopment as of June 30, 2022 for breach of implied covenant of good faith and fair dealing, fraud, negligent misrepresentation, conversion, theft by false pretenses, money had and received, and violations of the Racketeer Influenced and Corrupt Organization Act (18 U.S.C. Section 1962(c)). The amount related to these project costs reported in construction in progress as of June 30, 2023 and December 31, 2022 was approximately \$33.1 million and \$33.2 million, respectively.

On September 11, 2022, the parties to the lawsuit entered into a confidential, conditional settlement agreement pertaining to matters related to the lawsuit. Pursuant to the conditional settlement agreement, as of June 30, 2023, the Company received a total of \$15.6 million in partial settlement payments from Kings Garden, which was accounted for as a reduction to net real estate held for investment on our condensed consolidated balance sheets. Of the six properties previously leased to Kings Garden, four were operational, with an expansion project at one of those properties, and the other two properties were in development or redevelopment as of December 31, 2022 and June 30, 2023. In connection with the conditional settlement agreement, the Company terminated leases and regained possession of the two properties that were in development or redevelopment as of December 31, 2022.

Out of the amounts included in construction in progress at June 30, 2023, we are in the process of investigating additional costs paid of approximately \$9.6 million to determine whether these are potential overpayments. Although there is at least a reasonable possibility that a loss may have been incurred in connection with the default by Kings Garden and the related construction projects, as of June 30, 2023, we are unable to make such an estimate.

On February 14, 2023, Kings Garden filed an Arbitration Demand related to the interpretation of the confidential, conditional settlement agreement between the parties that concerns certain terms governing (along with the relevant lease) the assignment of one of the Kings Garden leases. The Company filed a Response to Kings Garden's Arbitration Demand, Affirmative Defenses and Counter-Claim on March 1, 2023 (the "Counter-Claim"). Kings Garden filed an answer to the Counter-Claim on March 15, 2023. An emergency hearing was conducted on April 13, 2023, pursuant to which the arbitrator denied Kings Garden's Motion for Interim Relief, and established timeframes and procedures for the arbitration. In July 2023, the Company filed a motion for leave to amend its Counter-Claims. A hearing before the arbitrator is scheduled for August 17, 2023.

### *Parallel Pennsylvania Litigation*

On February 6, 2023, IIP-PA 8 LLC, as landlord and an indirect subsidiary of the Company, filed a lawsuit against Goodblend Pennsylvania LLC, as tenant, and Parallel, as guarantor, in the Court of Common Pleas of Allegheny County, Pennsylvania, regarding the lease and related guaranty for one of the Company's properties located in Pennsylvania. The lawsuit asserts claims for breach of contract by the tenant and guarantor and ejectment. Goodblend Pennsylvania LLC and Parallel filed preliminary objections to the lawsuit on March 3, 2023. IIP-PA 8 LLC filed its response to Goodblend Pennsylvania LLC's and Parallel's preliminary objections on March 23, 2023. The Court issued an Order on June 13, 2023 denying Goodblend Pennsylvania LLC's and Parallel's preliminary objections and directing Goodblend Pennsylvania LLC and Parallel to file an answer to the complaint. On June 9, 2023, IIP-PA 8 LLC filed a Motion for a Trial Date, which is scheduled to be heard on September 6, 2023. Goodblend Pennsylvania LLC and Parallel have filed a joint answer to the complaint requesting that the complaint be dismissed.

*Parallel Texas Litigation*

On February 11, 2023, a subsidiary of Parallel defaulted on its obligations to pay rent under the lease at one of our properties in Texas that is under development. On February 23, 2023, IIP-TX 1 LLC, as landlord and an indirect subsidiary of the Company, filed a lawsuit against Surterra San Marcos, LLC, as tenant, in the Justice Court of Hays County, Texas, regarding the lease, asserting claim for possession. On March 9, 2023 a judgment for possession was entered in favor of IIP-TX 1 LLC, as well as monthly rental amounts due. On March 13, 2023, IIP-TX 1 LLC filed a subsequent lawsuit against Surterra San Marcos, LLC, Parallel and Sunstream Opportunities LP (“SAF Entity 1”) in the District Court of Hays County, Texas, regarding the same lease, asserting claims against Surterra San Marcos, LLC, Parallel and SAF Entity 1 for breach of contract, tortious interference with contract, unjust enrichment, fraud and fraudulent inducement, intentional failure to disclose and misrepresentations and conversion, and also requested the granting of a temporary injunction and the appointment of a receiver over the license(s) pertaining to the property’s operations as a regulated cannabis facility.

*Green Peak Michigan Litigation*

On February 2, 2023, IIP-MI 1 LLC, as landlord and an indirect subsidiary of the Company, filed a lawsuit against Green Peak Industries, Inc. (“Green Peak”), as tenant, in 56-A District Court of the State of Michigan, regarding the lease for one of the Company’s properties located in Michigan, asserting claim for possession. On February 22, 2023, IIP-MI 1 LLC filed a subsequent lawsuit against Green Peak and Tropics LP (“SAF Entity 2”) in the 56<sup>th</sup> Circuit Court of the State of Michigan, regarding the same lease, asserting claims against Green Peak for breach of contract, unjust enrichment, and innocent misrepresentation, against SAF Entity 2 for tortious interference with contract, and against both Green Peak and SAF Entity 2 for civil conspiracy. On March 3, 2023, a stipulated order appointing a receiver over substantially all of Green Peak’s assets was entered in the Circuit Court of Ingham County, Michigan.

We may, from time to time, be a party to other legal proceedings, which arise in the ordinary course of our business. Although the results of these proceedings, claims, inquiries, and investigations cannot be predicted with certainty, we do not believe that the final outcome of these matters is reasonably likely to have a material adverse effect on our business, financial condition, or results of operations. Regardless of final outcomes, however, any such proceedings, claims, inquiries, and investigations may nonetheless impose a significant burden on management and employees and may come with significant defense costs or unfavorable preliminary and interim rulings.

**12. Subsequent Events**

In July 2023, we amended our lease with a subsidiary of 4Front Ventures Corp. at one of our Illinois properties, pursuant to which, among other things, we agreed to apply a portion of the security deposit that we hold under the lease to pay one-half of the monthly installments of base rent due from the tenant, commencing on August 1, 2023 and continuing through November 30, 2023, which the tenant is then required to repay over a 12-month period commencing on January 1, 2024.



## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion should be read in conjunction with the condensed consolidated financial statements and notes thereto appearing elsewhere in this report. We make statements in this report that are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. In particular, statements pertaining to our capital resources, portfolio performance and results of operations contain forward-looking statements. Likewise, our statements regarding anticipated growth in our funds from operations and anticipated market and regulatory conditions, our strategic direction, demographics, results of operations, plans and objectives are forward-looking statements. Forward-looking statements involve numerous risks and uncertainties, and you should not rely on them as predictions of future events. Forward-looking statements depend on assumptions, data or methods which may be incorrect or imprecise, and we may not be able to realize them. We do not guarantee that the transactions and events described will happen as described (or that they will happen at all). You can identify forward-looking statements by the use of forward-looking terminology such as "believes," "expects," "may," "will," "should," "seeks," "approximately," "intends," "plans," "estimates" or "anticipates" or the negative of these words and phrases or similar words or phrases. You can also identify forward-looking statements by discussions of strategy, plans or intentions. The following factors, among others, could cause actual results and future events to differ materially from those set forth or contemplated in the forward-looking statements: rates of default on leases for our assets; concentration of our portfolio of assets and limited number of tenants; the estimated growth in and evolving market dynamics of the regulated cannabis market; the demand for regulated cannabis facilities; inflation dynamics; our ability to improve our internal control over financial reporting, including our inability to remediate the identified material weakness, and the costs and the time associated with such efforts; the impact of pandemics on us, our business, our tenants, or the economy generally; war and other hostilities, including the conflict in Ukraine; our business and investment strategy; our projected operating results; actions and initiatives of the U.S. or state governments and changes to government policies and the execution and impact of these actions, initiatives and policies, including the fact that cannabis remains illegal under federal law; availability of suitable investment opportunities in the regulated cannabis industry; our understanding of our competition and our potential tenants' alternative financing sources; the demand for regulated cannabis facilities; the expected medical-use or adult-use cannabis legalization in certain states; shifts in public opinion regarding regulated cannabis; the potential impact on us from litigation matters, including rising liability and insurance costs; the additional risks that may be associated with certain of our tenants cultivating, processing and/or dispensing adult-use cannabis in our facilities; the state of the U.S. economy generally or in specific geographic areas; economic trends and economic recoveries; our ability to access equity or debt capital; financing rates for our target assets; our level of indebtedness, which could reduce funds available for other business purposes and reduce our operational flexibility; covenants in our debt instruments, which may limit our flexibility and adversely affect our financial condition; our ability to maintain our investment grade credit rating; changes in the values of our assets; our expected portfolio of assets; our expected investments; interest rate mismatches between our assets and our borrowings used to fund such investments; changes in interest rates and the market value of our assets; the degree to which any interest rate or other hedging strategies may or may not protect us from interest rate volatility; the impact of and changes in governmental regulations, tax law and rates, accounting guidance and similar matters; our ability to maintain our qualification as a REIT; our ability to maintain our exemption from registration under the Investment Company Act of 1940; availability of qualified personnel; and market trends in our industry, interest rates, real estate values, the securities markets or the general economy.*

*The risks included here are not exhaustive, and additional factors could adversely affect our business and financial performance, including factors and risks included in other sections of this report. In addition, we discussed a number of material risks in our Annual Report on Form 10-K for the year ended December 31, 2022, in Part II, Item 1A of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2023, and in Part II, Item 1A below. Those risks continue to be relevant to our performance and financial condition. Moreover, we operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time and it is not possible for management to predict all such risk factors, nor can it assess the impact of all such risk factors on our Company's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Any forward-looking statement made by us speaks only of the date on which we make it. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by law. Stockholders and investors are cautioned not to unduly rely on such forward-looking statements when evaluating the information presented in the Company's filings and reports.*

*The purpose of this Management's Discussion and Analysis ("MD&A") is to provide an understanding of the Company's consolidated financial condition, results of operations and cash flows. MD&A is provided as a supplement to, and should be read in conjunction with, the Company's condensed consolidated financial statements and accompanying notes.*

## Overview

As used herein, the terms “we”, “us”, “our” or the “Company” refer to Innovative Industrial Properties, Inc., a Maryland corporation, and any of our subsidiaries, including IIP Operating Partnership, LP, a Delaware limited partnership (the “Operating Partnership”).

We are an internally-managed REIT focused on the acquisition, ownership and management of specialized properties leased to experienced, state-licensed operators for their regulated cannabis facilities. We have leased and expect to continue to lease our properties on a triple-net lease basis, where the tenant is responsible for all aspects of and costs related to the property and its operation during the lease term, including structural repairs, maintenance, real estate taxes and insurance.

We were incorporated in Maryland on June 15, 2016. We conduct our business through a traditional umbrella partnership real estate investment trust, or UPREIT structure, in which our properties are owned by our Operating Partnership, directly or through subsidiaries. We are the sole general partner of our Operating Partnership and own, directly or through subsidiaries, 100% of the limited partnership interests in our Operating Partnership. As of June 30, 2023, we had 22 full-time employees.

As of June 30, 2023, we owned 108 properties comprising approximately 8.9 million square feet (including approximately 1.6 million rentable square feet under development/redevelopment) in 19 states. As of June 30, 2023, we had invested approximately \$2.3 billion in the aggregate (consisting of purchase price and funding of draws for construction funding and improvements submitted by tenants, if any, but excluding transaction costs) and had committed an additional approximately \$50.2 million to fund draws to certain tenants and sellers for construction and improvements at our properties. Of the approximately \$50.2 million committed to fund draws to certain tenants and sellers for construction and improvements at our properties, approximately \$20.6 million was incurred but not funded as of June 30, 2023. These statistics do not include a \$23.0 million loan commitment from us to a developer for construction of a regulated cannabis cultivation and processing facility in California, of which we have funded approximately \$20.9 million as of June 30, 2023.

Of these properties, we include 103 properties in our operating portfolio, which were 99.9% leased to state-licensed cannabis operators as of June 30, 2023, with a weighted-average remaining lease term of approximately 14.9 years. Rent collection for our operating portfolio (calculated as base rent and property management fees collected as a percentage of contractually due base rent and property management fees, including an aggregate of approximately \$1.5 million of security deposits applied for payment of rent for our leases with Holistic and Temescal) was approximately 97% for the three months ended June 30, 2023. Rent collection for our operating portfolio (calculated as base rent and property management fees collected as a percentage of contractually due base rent and property management fees, including an aggregate of approximately \$5.8 million of security deposits applied for payment of rent for our leases with Green Peak, Parallel, Holistic and Temescal) was approximately 98% for the six months ended June 30, 2023, respectively. As of June 30, 2023, we had fully applied approximately \$909,000 of security deposit for payment of rent for one of our former leases with Green Peak and fully applied approximately \$2.2 million of security deposits for payment of rent for a former lease with Parallel in Texas and a lease with Parallel in Pennsylvania.

We do not include in our operating portfolio the following properties (all of which were under development/redevelopment as of June 30, 2023, and together are expected to comprise approximately 715,000 rentable square feet upon completion of development/redevelopment):

- Inland Center Drive in San Bernardino, California;
- Perez Road in Cathedral City, California (pre-leased);
- 63795 19th Avenue in Palm Springs, California;
- Leah Avenue in San Marcos, Texas; and
- Davis Highway in Windsor, Michigan.

## Factors Impacting Our Operating Results

Our results of operations are affected by a number of factors and depend on the rental revenues we receive from the properties that we acquire, the timing of lease expirations, general market conditions, the regulatory environment in the regulated cannabis industry, and the competitive environment for real estate assets that support the regulated cannabis industry.

### **Rental Revenues**

We receive income primarily from rental revenues generated by the properties that we acquire. The amount of rental revenues depends upon a number of factors, including:

- our ability to enter into leases with increasing or market value rents for the properties that we acquire; and
- rent collection, which primarily relates to each of our tenant's financial condition and ability to make rent payments to us on time.

The properties that we acquire consist of real estate assets that support the regulated cannabis industry. Changes in federal law and current favorable state or local laws in the cannabis industry may impair our ability to renew or re-lease properties and the ability of our tenants to fulfill their lease obligations and could materially and adversely affect our ability to maintain or increase rental rates for our properties.

### **Conditions in Our Markets**

Positive or negative changes in regulatory, economic or other conditions, drought, and natural disasters in the markets where we acquire properties may affect our overall financial performance.

The success of our tenants in operating their businesses and their ability to pay rent continues to be significantly influenced by many challenges including the impact of inflation, labor shortages, supply chain constraints on their cost of doing business, and the U.S. consumer financial health. Additionally, market dynamics and the regulatory regime in the states where they operate create challenges that may impact our tenants' businesses and/or decrease future demand for regulated cannabis cultivation and production facilities. The potential impact of current economic challenges on the Company's financial condition, results of operations, and cash flows is subject to change and continues to depend on the extent and duration of these risks and uncertainties.

#### *Market Dynamics in Regulated Cannabis State Programs*

States vary significantly in their market dynamics, driven by many factors, including, but not limited to, regulatory frameworks, enforcement policies with respect to illicit, unlicensed cannabis operations, taxation and licensing structures. For example, in California, according to Global Go Analytics, the illicit market for cannabis remains a much larger portion of overall sales in the state, and state and local authorities have assessed significant taxes on regulated cannabis products, both of which have had the impact of significantly limiting the growth and profitability for operators in the state's regulated cannabis market.

Many states continue to experience significant declines in unit pricing for regulated cannabis products, with that decline more pronounced in certain states than in others, which compresses operating margins for operators. As a result, certain regulated cannabis operators have announced that they are consolidating operations or shuttering certain operations to reduce costs, which if prolonged, could have a material negative impact on operators' demand for regulated cannabis facilities, including our existing tenants.

#### *Inflation and Supply Chain Constraints*

The U.S. economy is experiencing a sustained increase in inflation rates, which we believe is negatively impacting our tenants. This inflation has increased costs for labor and production inputs for regulated cannabis operators, in addition to increasing costs of construction for development and redevelopment projects. Ongoing labor shortages and global supply chain issues also continue to adversely impact costs and timing for completion of these development and redevelopment projects, which are resulting in cost overruns and delays in commencing operations on certain of our tenants' projects.

#### *Reduced Capital Availability for Tenants and the Company*

For the past several months, financial markets have been volatile, reflecting heightened geopolitical risks and material tightening of financial conditions since the U.S. Federal Reserve began increasing interest rates in the spring of 2022 and continued uncertainty regarding monetary policy. Driven in part by overall macroeconomic conditions, both capital availability and mergers and acquisitions activity have significantly declined for regulated cannabis operators.

Capital raising activities by U.S. REITs have also experienced steep declines, including significantly reduced capital availability for our company.

### ***Significant Tenants and Concentrations of Risk***

As of June 30, 2023, we owned 108 properties located in 19 states leased to 30 tenants. Many of our tenants are tenants at multiple properties. We seek to manage our portfolio-level risk through geographic diversification and by minimizing dependence on any single property or tenant. At June 30, 2023, our largest property was located in New York and accounted for approximately 5.4% of our net real estate held for investment. No other properties accounted for more than 5% of our net real estate held for investment at June 30, 2023. See Note 2 in the notes to the condensed consolidated financial statements for further information regarding the tenants in our portfolio that represented the largest percentage of our total rental revenues for the three and six months ended June 30, 2023.

In July 2022, Kings Garden, a tenant of ours at six properties that we own in southern California, defaulted on its obligations to pay rent. In November 2022, Parallel defaulted on its obligations to pay rent at one of our properties in Pennsylvania, and Green Peak defaulted on its obligations to pay rent at one of our properties in Michigan. In February 2023, Parallel also defaulted on its obligations to pay rent at one of our properties in Texas. In March 2023, Green Peak was placed into receivership.

See Note 11 “Commitments and Contingencies — Litigation” to our condensed consolidated financial statements included in this report for more information regarding Kings Garden, Parallel and Green Peak.

### ***Competitive Environment***

We face competition from a diverse mix of market participants, including but not limited to, other companies with similar business models, independent investors, hedge funds, lenders and other real estate investors, as well as potential tenants (cannabis operators themselves), all of whom may compete with us in our efforts to acquire real estate zoned for regulated cannabis operations. Competition from others may diminish our opportunities to acquire a desired property on favorable terms or at all. In addition, this competition may put pressure on us to reduce the rental rates below those that we expect to charge for the properties that we acquire, which would adversely affect our financial results.

### ***Operating Expenses***

Our operating expenses include general and administrative expenses, including personnel costs, stock-based compensation, and legal, accounting and other expenses related to corporate governance, public reporting and compliance with the various provisions of U.S. securities laws. We generally structure our leases so that the tenant is responsible for taxes, maintenance, insurance and structural repairs with respect to the premises throughout the lease term. Increases or decreases in such operating expenses will impact our overall financial performance.

### ***Our Qualification as a REIT***

We have been organized and operate our business so as to qualify to be taxed as a REIT for U.S. federal income tax purposes. Shares of our common stock and Series A Preferred Stock are subject to restrictions on ownership and transfer that are intended, among other purposes, to assist us in qualifying and maintaining our qualification as a REIT. In order for us to qualify as a REIT under the Code, the relevant sections of our charter provide that, subject to certain exceptions, no person or entity may own, or be deemed to own, by virtue of the applicable constructive ownership provisions of the Code, more than 9.8% (in value or number of shares, whichever is more restrictive) of the aggregate of our outstanding shares of stock or Series A Preferred Stock or more than 9.8% (in value or number of shares, whichever is more restrictive) of our outstanding common stock or any class or series of our outstanding preferred stock.

### ***Results of Operations***

#### ***Investments in Real Estate***

See Note 6 in the notes to the condensed consolidated financial statements for information regarding our investments in real estate activity and property portfolio activity during the six months ended June 30, 2023. In March 2023, we sold the portfolio of four properties in California previously leased to affiliates of Vertical for \$16.2 million (excluding transaction costs) with a secured loan for \$16.1 million with the buyer of the properties. The transaction did not qualify for recognition as a completed sale since not all of the criteria were met. Accordingly, we have not derecognized the assets transferred. All consideration received, as well as any future payments, from the buyer is recognized as a deposit liability and is included in other liabilities on our condensed consolidated balance sheet until such time the criteria for recognition as a sale have been met. In addition, as we have not met all of the held-for-sale criteria, land and building and improvements with a gross carrying value of approximately \$3.4 million and approximately \$13.9 million, respectively, and accumulated depreciation of approximately \$1.5 million as of June 30, 2023, remain on the condensed consolidated balance sheet, and the buildings and improvements continue to be depreciated. During the three and six months ended

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June 30, 2023, we received cash interest payments of approximately \$403,000 and \$537,000, respectively, which has been recorded as a liability as of June 30, 2023.

**Comparison of the Three and Six Months Ended June 30, 2023 and 2022**

The following table sets forth the results of our operations (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2023	2022	2023	2022
<b>Revenues:</b>				
Rental (including tenant reimbursements)	\$ 75,919	\$ 69,995	\$ 151,448	\$ 134,109
Other	538	516	1,076	906
Total revenues	76,457	70,511	152,524	135,015
<b>Expenses:</b>				
Property expenses	5,759	2,427	11,382	4,409
General and administrative expense	10,570	8,707	20,943	17,484
Depreciation and amortization expense	16,704	15,233	33,418	29,101
Total expenses	33,033	26,367	65,743	50,994
Income from operations	43,424	44,144	86,781	84,021
Interest and other income	2,317	581	4,550	638
Interest expense	(4,472)	(4,504)	(8,992)	(9,270)
(Loss) gain on exchange of Exchangeable Senior Notes	—	(7)	22	(125)
Net income	41,269	40,214	82,361	75,264
Preferred stock dividends	(338)	(338)	(676)	(676)
Net income attributable to common stockholders	\$ 40,931	\$ 39,876	\$ 81,685	\$ 74,588

**Revenues.**

*Rental Revenues.* Rental revenues for the three months ended June 30, 2023 increased by approximately \$5.9 million, or 8%, to approximately \$75.9 million, compared to approximately \$70.0 million for the three months ended June 30, 2022. The increase in rental revenues was generated by properties we acquired in prior periods, including contractual rent escalations. Rental revenues for the three months ended June 30, 2023 included the partial application of approximately \$1.2 million of security deposits for payment of rent for two of our leases with Holistic in accordance with lease amendments executed with Holistic in January 2023 and the partial application of \$300,000 of security deposits for payment of rent for one lease with Temescal in accordance with a lease amendment we executed with Temescal in March 2023 (see Note 6 in the notes to the condensed consolidated financial statements for information). Rental revenues for the three months ended June 30, 2023 and 2022 included approximately \$5.4 million and \$2.5 million, respectively, of tenant reimbursements for property insurance premiums and property taxes.

Rental revenues during the three months ended June 30, 2023 were negatively impacted by non-collection of rent during the quarter from properties in our operating portfolio totaling approximately \$2.2 million primarily related to contractual base rents and property management fees from two tenants, Parallel and Green Peak.

Rental revenues for the six months ended June 30, 2023 increased by approximately \$17.3 million, or 13%, to approximately \$151.4 million, compared to approximately \$134.1 million for the six months ended June 30, 2022. Approximately \$15.4 million increase in rental revenues was generated primarily by properties we acquired in prior periods, including contractual rent escalations and amendments to leases for additional improvement allowances and construction funding at existing properties that resulted in adjustments to rent. The remaining \$1.9 million of the increase in rental revenues was generated by properties acquired during the six months ended June 30, 2023. Rental revenues for the six months ended June 30, 2023 included the full application of approximately \$909,000 of security deposit for payment of rent for one of our former leases with Green Peak, the full application of approximately \$2.2 million of security deposits for payment of rent for a former lease with Parallel in Texas and an existing lease with Parallel in Pennsylvania, partial application of approximately \$2.4 million of security deposits for payment of rent for two of our leases with Holistic in accordance with lease amendments executed with Holistic in January 2023 and the partial application of \$300,000 of security deposit for payment of rent for one lease with Temescal in accordance with a lease amendment executed with Temescal in March 2023 (see Note 6 in the notes to the condensed consolidated financial statements for information). Rental revenues for the six months ended June 30, 2023 and 2022 included approximately \$10.6 million and \$4.4 million, respectively, of tenant reimbursements for property insurance premiums and property taxes.

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Rental revenues during the six months ended June 30, 2023 were negatively impacted by non-collection of rent during the period from properties in our operating portfolio totaling approximately \$3.6 million (including approximately \$3.5 million of contractual base rents and property management fees and approximately \$143,000 of tenant reimbursements for property insurance premiums and property taxes) from three tenants, Green Peak, affiliates of Vertical and Parallel.

*Other Revenues.* Other revenues for the three and six months ended June 30, 2023 and 2022 consisted of interest revenue related to leases for property acquisitions that did not satisfy the requirements for sale-leaseback accounting.

### **Expenses.**

*Property Expenses.* Property expenses for the three and six months ended June 30, 2023 increased by approximately \$3.4 million and approximately \$7.0 million compared to the three and six months ended June 30, 2022. The increase was primarily due to new property acquisitions and additional investment in existing properties which resulted in higher property insurance premiums and property taxes that we paid for our properties. Property expenses are generally reimbursable to us by the tenants under the terms of the leases.

*General and Administrative Expense.* General and administrative expense for the three months ended June 30, 2023 increased by approximately \$1.9 million to approximately \$10.6 million, compared to approximately \$8.7 million for the three months ended June 30, 2022. General and administrative expense for the six months ended June 30, 2023 increased by approximately \$3.4 million to approximately \$20.9 million, compared to approximately \$17.5 million for the six months ended June 30, 2022. The increase in general and administrative expense was primarily due to approximately \$749,000 and approximately \$1.4 million in litigation-related expense incurred during the three and six months ended June 30, 2023 related to matters described in Note 11 “Commitments and Contingencies — Litigation” to our condensed consolidated financial statements included in this report, higher compensation to employees, the hiring of additional employees, higher public company costs and occupancy costs. Compensation expense for the three and six months ended June 30, 2023 included approximately \$4.9 million and \$9.7 million, respectively, of non-cash stock-based compensation. Compensation expense for the three and six months ended June 30, 2022 included approximately \$4.4 million and \$8.8 million, respectively, of non-cash stock-based compensation.

*Depreciation and Amortization Expense.* The increase in depreciation and amortization expense was related to depreciation on properties that we acquired and the placement into service of construction and improvements at certain of our properties.

*Interest and Other Income.* Interest and other income for the three months ended June 30, 2023 increased by approximately \$1.7 million compared to the three months ended June 30, 2022. Interest and other income for the six months ended June 30, 2023 increased by approximately \$3.9 million compared to the six months ended June 30, 2022. The increase in both periods was due to higher interest rates on our interest-bearing investments and approximately \$545,000 of interest received on our construction loan during the three months ended June 30, 2023.

*Interest Expense.* Interest expense consists of interest on our Exchangeable Senior Notes and our Notes due 2026. Interest expense for the three months ended June 30, 2023 and 2022 included approximately \$339,000 and \$324,000, respectively, of non-cash interest expense. Interest expense for the six months ended June 30, 2023 and 2022 included approximately \$677,000 and \$689,000, respectively, of non-cash interest expense. Interest expense for the six months ended June 30, 2023 decreased by approximately \$278,000 compared to the six months ended June 30, 2022 due to exchanges of approximately \$26.9 million outstanding principal amount of our Exchangeable Senior Notes during the year ended December 31, 2022, and also due to the exchanges of \$2.0 million outstanding principal amount of our Exchangeable Senior Notes and capitalization of approximately \$34,000 of interest during the six months ended June 30, 2023.

### **Cash Flows**

#### **Comparison of the Six Months Ended June 30, 2023 and 2022 (in thousands)**

	Six Months Ended June 30,		Change
	2023	2022	
Net cash provided by operating activities	\$ 126,380	\$ 121,981	\$ 4,399
Net cash used in investing activities	(18,429)	(426,970)	408,541
Net cash (used in) provided by financing activities	(102,471)	264,532	(367,003)
Ending cash, cash equivalents and restricted cash	94,052	45,962	48,090

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### *Operating Activities*

Cash flows provided by operating activities for the six months ended June 30, 2023 and 2022 were approximately \$126.4 million and \$122.0 million, respectively. Cash flows provided by operating activities were generally from contractual rent from our properties, partially offset by our general and administrative expense, interest expense, property expenses in excess of tenant reimbursements and property expenses at properties that were not leased.

### *Investing Activities*

Cash flows used in investing activities for the six months ended June 30, 2023 were approximately \$18.4 million, of which approximately \$149.3 million related to investments in real estate and funding of draws for a portion of the improvement allowances, construction funding at our properties and other investments, partially offset by approximately \$130.9 million related to net purchases and maturities of short-term investments. Cash flows used in investing activities for the six months ended June 30, 2022 were approximately \$427.0 million, of which approximately \$442.9 million related to investments in real estate and funding of draws for a portion of the improvement allowances, construction funding at our properties and other investments, partially offset by approximately \$15.9 million related to net maturities of short-term investments.

### *Financing Activities*

Net cash used in financing activities of approximately \$102.5 million during the six months ended June 30, 2023 was the result of dividend payments of approximately \$101.9 million to common and preferred stockholders and approximately \$568,000 related to net share settlement of equity awards to pay the required withholding taxes upon vesting of restricted stock for certain employees.

Net cash provided by financing activities of approximately \$264.5 million during the six months ended June 30, 2022 was the result of approximately \$352.0 million in net proceeds from the issuance of our common stock, partially offset by dividend payments of approximately \$85.1 million to common and preferred stockholders and approximately \$2.4 million related to net share settlement of equity awards to pay the required withholding taxes upon vesting of restricted stock for certain employees.

## **Liquidity and Capital Resources**

Liquidity is a measure of our ability to meet potential cash requirements. We expect to use significant cash to acquire additional properties, develop and redevelop existing properties, pay dividends to our stockholders, fund our operations, service our Exchangeable Senior Notes and Notes due 2026, and meet other general business needs.

### *Sources and Uses of Cash*

We derive substantially all of our revenues from the leasing of our properties and collecting rental income, which includes operating expense reimbursements, based on contractual arrangements with our tenants. This source of revenue represents our primary source of liquidity to fund our dividends, interest payments on Exchangeable Senior Notes and Notes due 2026, general and administrative expenses, property development and redevelopment activities, property operating expenses and other expenses incurred related to managing our existing portfolio and investing in additional properties. Because substantially all our leases are triple net, our tenants are generally responsible for the maintenance, insurance and property taxes associated with the properties they lease from us. If a tenant defaults on one of our leases or the lease term expires with no tenant renewal, we would incur property costs not paid by the tenant during the time it takes to re-lease or sell the property.

As of June 30, 2023, we owned 108 properties. Of these properties, the 103 properties in our operating portfolio were 99.9% leased to state-licensed cannabis operators, with a weighted-average remaining lease term of approximately 14.9 years. Rent collection for our operating portfolio (calculated as base rent and property management fees collected as a percentage of contractually due base rent and property management fees, including an aggregate of approximately \$1.5 million of security deposits applied for payment of rent for our leases with Holistic and Temescal) was approximately 97% for the three months ended June 30, 2023. Rent collection for our operating portfolio (calculated as base rent and property management fees collected as a percentage of contractually due base rent and property management fees, including an aggregate of approximately \$5.8 million of security deposits applied for payment of rent for our leases with Green Peak, Parallel, Holistic and Temescal) was approximately 98% for the six months ended June 30, 2023. As of June 30, 2023, we had fully applied approximately \$909,000 of security deposit for payment of rent for one of our former leases with Green Peak and fully applied approximately \$2.2 million of security deposits for payment of rent for a former lease with Parallel in Texas and a lease with Parallel in Pennsylvania.

In July 2022, Kings Garden defaulted on its obligations to pay rent at all of the properties that Kings Garden leases from us. Two of our properties, which were previously leased to Kings Garden, and an expansion project at a property where Kings Garden

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continues to occupy the property pursuant to a confidential, contingent settlement agreement, were under development as of June 30, 2023. In November 2022, Parallel defaulted on its obligations to pay rent at one of our properties in Pennsylvania, and Green Peak defaulted on its obligations to pay rent at one of our properties in Michigan. In February 2023, Parallel also defaulted on its obligations to pay rent at one of our properties in Texas. In March 2023, a receiver was appointed over substantially all of Green Peak's assets.

See Note 11 "Commitments and Contingencies — Litigation" to our condensed consolidated financial statements included in this report for more information regarding Kings Garden, Parallel and Green Peak.

We expect to incur some property-level operating costs from time to time in periods during which properties that become vacant are being remarketed. In addition, we may recognize an expense for certain property costs, such as insurance premiums and real estate taxes billed in arrears, if we believe the tenant is likely to vacate the property before making payment on those obligations or may be unable to pay such costs in a timely manner. Property costs are generally not significant to our operations, but the amount of property costs can vary quarter to quarter based on the number of property vacancies and whether we have any underperforming properties. We may advance certain property costs on behalf of our tenants but expect that the majority of these costs will be reimbursed by the tenant and do not anticipate that they will be significant to our operations. In addition, for properties that are not leased and are under development or redevelopment, we may make significant additional investments in these properties in order to get them ready for their intended use and to re-lease them.

To the extent additional resources are needed, we expect to fund our investment activity generally through equity or debt issuances either in the public or private markets. Where possible, we also may issue limited partnership interests in our Operating Partnership to acquire properties from existing owners seeking a tax-deferred transaction.

In May 2021, we received an investment grade rating from a ratings agency. We sought to obtain an investment grade rating to facilitate access to the investment grade unsecured debt market as part of our overall strategy to maximize our financial flexibility and manage our overall cost of capital. On May 25, 2021, our Operating Partnership issued \$300.0 million aggregate principal amount of Notes due 2026. The Notes due 2026 are the Operating Partnership's general unsecured and unsubordinated obligations, are fully and unconditionally guaranteed by us and all of the direct and indirect subsidiaries of the Operating Partnership, and rank equally in right of payment with all of the Operating Partnership's existing and future senior unsecured indebtedness, including the Exchangeable Senior Notes. The terms of the Notes due 2026 are governed by an indenture, which requires compliance with various financial covenants including limits on the amount of total leverage and secured debt maintained by the Operating Partnership and which require the Operating Partnership to maintain minimum levels of debt service coverage. Management believes that it was in compliance with those covenants as of June 30, 2023. Subject to the terms of the indenture, any new subsidiary of the Operating Partnership will also guarantee the Notes due 2026. In addition, the terms of the indenture provide that if the debt rating on the Notes due 2026 is downgraded or withdrawn entirely, interest on the Notes due 2026 will increase to a range of 6.0% to 6.5% based on such debt rating.

During the six months ended June 30, 2023, we issued 32,200 shares, respectively, of our common stock upon exchange by holders of \$2.0 million of outstanding principal amount of our Exchangeable Senior Notes.

In January 2023, we terminated the previously existing "at-the-market" offering program and entered into new equity distribution agreements with four sales agents, pursuant to which we may offer and sell from time to time through an "at-the-market" offering program (the "ATM Program") up to \$500.0 million in shares of our common stock. As of June 30, 2023, we had not sold any shares of common stock under the ATM Program.

We have filed an automatic shelf registration statement, which may permit us, from time to time, to offer and sell common stock, preferred stock, warrants and other securities to the extent necessary or advisable to meet our liquidity needs.

We expect to meet our liquidity needs through cash and short-term investments on hand, cash flows from operations and cash flow from sources discussed above. We believe that our liquidity and sources of capital are adequate to satisfy our cash requirements. We cannot, however, be certain that these sources of funds will be available at a time and upon terms acceptable to the Company in sufficient amounts to meet our liquidity needs. Our investment guidelines also provide that our aggregate borrowings (secured and unsecured) will not exceed 50% of the cost of our tangible assets at the time of any new borrowing, subject to our board of directors' discretion.

In recent months, financial markets have been volatile in general, which has also significantly reduced our access to capital. If this environment continues for a prolonged period of time or worsens, this would have a material adverse effect on our business, financial condition and results of operations, including our ability to continue to make acquisitions of new properties and fund investments for improvements at existing properties.



[Table of Contents](#)*Dividends*

The Company is required to pay dividends to its stockholders at least equal to 90% of its taxable income in order to qualify and maintain its qualification as a REIT. As a result of this distribution requirement, our Operating Partnership cannot rely on retained earnings to fund its ongoing operations to the same extent that other companies whose parent companies are not REITs can. Our ability to continue to pay dividends is dependent upon our ability to continue to generate cash flows, service any debt obligations we have, including our Exchangeable Senior Notes and Notes due 2026, and make accretive new investments.

The following table describes the dividends declared by the Company during the six months ended June 30, 2023:

<u>Declaration Date</u>	<u>Security Class</u>	<u>Amount Per Share</u>	<u>Period Covered</u>	<u>Dividend Paid Date</u>	<u>Dividend Amount</u> <i>(In thousands)</i>
March 15, 2023	Common stock	\$ 1.80	January 1, 2023 to March 31, 2023	April 14, 2023	\$ 50,725
March 15, 2023	Series A preferred stock	\$ 0.5625	January 15, 2023 to April 14, 2023	April 14, 2023	\$ 338
June 15, 2023	Common stock	\$ 1.80	April 1, 2023 to June 30, 2023	July 14, 2023	\$ 50,742
June 15, 2023	Series A preferred stock	\$ 0.5625	April 15, 2023 to July 14, 2023	July 14, 2023	\$ 338

*Contractual Obligations*

The following table summarizes our contractual obligations as of June 30, 2023 (in thousands):

<u>Payments Due by Year</u>	<u>Notes due 2026</u>	<u>Exchangeable Senior Notes</u>	<u>Interest</u>	<u>Office Rent</u>	<u>Total</u>
2023 (six months ending December 31)	\$ —	\$ —	\$ 8,333	\$ 249	\$ 8,582
2024	—	4,436	16,523	511	21,470
2025	—	—	16,500	526	17,026
2026	300,000	—	6,646	543	307,189
2027	—	—	—	45	45
<b>Total</b>	<u>\$ 300,000</u>	<u>\$ 4,436</u>	<u>\$ 48,002</u>	<u>\$ 1,874</u>	<u>\$ 354,312</u>

Additionally, as of June 30, 2023, we had approximately \$29.6 million outstanding in commitments related to improvement allowances, which generally may be requested by the tenants at any time up until a date that is near the expiration of the initial term of the applicable lease. As of June 30, 2023, we also had approximately \$2.1 million outstanding in commitments to fund a construction loan, which the developer is required to complete by December 31, 2023, subject to extension in certain circumstances. The commitments discussed in this paragraph are excluded from the table of contractual obligations above, as improvement allowances generally may be requested by the tenants at any time up until a date that is near the expiration of the initial term of the applicable lease and construction loan funding generally may be requested by the borrower from time to time, subject to satisfaction of certain conditions.

**Supplemental Guarantor Information**

In March 2020, the SEC adopted amendments to Rule 3-10 of Regulation S-X and created Rule 13-01 to simplify disclosure requirements related to certain registered securities. The amendments became effective on January 4, 2021. Our Notes due 2026 and our Exchangeable Senior Notes are the unsecured senior obligations of our Operating Partnership and are fully and unconditionally guaranteed on an unsecured basis, jointly and severally, by us and all of our direct and indirect wholly-owned subsidiaries. Only the Notes due 2026 and the related guarantees are registered securities under the Securities Act. See Note 7 “Debt” to our condensed consolidated financial statements included in this report for a description of certain terms of our Notes due 2026.

The offer and sale of the Exchangeable Senior Notes and the related guarantees were not and will not be registered under the Securities Act or the securities laws of any other jurisdiction and instead were issued in reliance upon an exemption from such registration. Unless they are subsequently registered under the Securities Act, the Exchangeable Senior Notes and the related guarantees may be offered and sold only in transactions that are exempt from the registration requirements under the Securities Act and the applicable securities laws of any other jurisdiction.

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As a result of the amendments to Rule 3-10 of Regulation S-X, subsidiary issuers of obligations guaranteed by the parent are not required to provide separate financial statements, provided that the subsidiary obligor is consolidated into the parent company's consolidated financial statements, the parent guarantee is "full and unconditional" and, subject to certain exceptions as set forth below, the alternative disclosure required by Rule 13-01 of Regulation S-X is provided, which includes narrative disclosure and summarized financial information. Accordingly, separate consolidated financial statements of our Operating Partnership and the Subsidiary Guarantors have not been presented.

Furthermore, as permitted under Rule 13-01(a)(4)(vi) of Regulation S-X, we have excluded the summarized financial information for the Operating Partnership and the Subsidiary Guarantors because the combined assets, liabilities, and results of operations of the Operating Partnership and the Subsidiary Guarantors are not materially different than the corresponding amounts in our condensed consolidated financial statements, and management believes such summarized financial information would be repetitive and would not provide incremental value to investors.

### **Non-GAAP Financial Information**

In addition to the required GAAP presentations, we use certain non-GAAP performance measures as we believe these measures improve the understanding of our operational results. We continually evaluate the usefulness, relevance, limitations, and calculation of our reported non-GAAP performance measures to determine how best to provide relevant information to the public and thus such reported measures could change.

#### ***Funds from Operations, Normalized Funds from Operations and Adjusted Funds from Operations***

Funds from operations ("FFO") and FFO per share are operating performance measures adopted by the National Association of Real Estate Investment Trusts, Inc. ("NAREIT"). NAREIT defines FFO as the most commonly accepted and reported measure of a REIT's operating performance equal to net income (computed in accordance with GAAP), excluding gains (or losses) from sales of property, depreciation, amortization and impairment related to real estate properties, and after adjustments for unconsolidated partnerships and joint ventures.

Management believes that net income, as defined by GAAP, is the most appropriate earnings measurement. However, management believes FFO and FFO per share to be supplemental measures of a REIT's performance because they provide an understanding of the operating performance of our properties without giving effect to certain significant non-cash items, primarily depreciation expense. Historical cost accounting for real estate assets in accordance with GAAP assumes that the value of real estate assets diminishes predictably over time. However, real estate values instead have historically risen or fallen with market conditions. We believe that by excluding the effect of depreciation, FFO and FFO per share can facilitate comparisons of operating performance between periods. We report FFO and FFO per share because these measures are observed by management to also be the predominant measures used by the REIT industry and by industry analysts to evaluate REITs and because FFO per share is consistently reported, discussed, and compared by research analysts in their notes and publications about REITs. For these reasons, management has deemed it appropriate to disclose and discuss FFO and FFO per share.

We compute normalized funds from operations ("Normalized FFO") by adjusting FFO, as defined by NAREIT, to exclude certain GAAP income and expense amounts that we believe are infrequent and unusual in nature and/or not related to our core real estate operations. Exclusion of these items from similar FFO-type metrics is common within the equity REIT industry, and management believes that presentation of Normalized FFO and Normalized FFO per share provides investors with a metric to assist in their evaluation of our operating performance across multiple periods and in comparison to the operating performance of other companies, because it removes the effect of unusual items that are not expected to impact our operating performance on an ongoing basis. Normalized FFO is used by management in evaluating the performance of our core business operations. Items included in calculating FFO that may be excluded in calculating Normalized FFO include certain transaction-related gains, losses, income or expense or other non-core amounts as they occur.

Management believes that adjusted funds from operations ("AFFO") and AFFO per share are also appropriate supplemental measures of a REIT's operating performance. We calculate AFFO by adjusting Normalized FFO for certain cash and non-cash items.

For the three and six months ended June 30, 2023, FFO (diluted), Normalized FFO and AFFO, and FFO, Normalized FFO and AFFO per diluted share include the dilutive impact of the assumed full exchange of the Exchangeable Senior Notes for shares of common stock. As a result, for purposes of calculating FFO (diluted), cash and non-cash interest expense of the Exchangeable Senior Notes was added back to FFO, and the total diluted weighted-average common shares outstanding increased by 74,260 and 87,437 shares for the three and six months ended June 30, 2023, respectively, which were the potentially issuable shares as if the Exchangeable Senior Notes were exchanged at the beginning of the period.

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For the three and six months ended June 30, 2022, FFO (diluted), Normalized FFO and AFFO, and FFO, Normalized FFO and AFFO per diluted share include the dilutive impact of the assumed full exchange of the Exchangeable Senior Notes for shares of common stock. As a result, for purposes of calculating FFO (diluted), cash and non-cash interest expense of the Exchangeable Senior Notes was added back to FFO, and the total diluted weighted-average common shares outstanding increased by 103,742 shares and 304,348 shares for the three and six months ended June 30, 2022, respectively, which were the potentially issuable shares as if the Exchangeable Senior Notes were exchanged at the beginning of the period.

For the three and six months ended June 30, 2023 and 2022, the performance share units (“PSUs”) granted to certain employees were not included in dilutive securities as the performance thresholds for vesting of the PSUs were not met as measured as of the respective periods.

Our computation of FFO, Normalized FFO, and AFFO may differ from the methodology for calculating FFO, Normalized FFO and AFFO utilized by other equity REITs and, accordingly, may not be comparable to such REITs. Further, FFO and AFFO do not represent cash flow available for management’s discretionary use. FFO, Normalized FFO and AFFO should not be considered as an alternative to net income (computed in accordance with GAAP) as an indicator of our financial performance or to cash flow from operating activities (computed in accordance with GAAP) as an indicator of our liquidity, nor is it indicative of funds available to fund our cash needs, including our ability to pay dividends or make distributions. FFO, Normalized FFO and AFFO should be considered only as supplements to net income computed in accordance with GAAP as measures of operations.

The table below is a reconciliation of net income attributable to common stockholders to FFO, Normalized FFO and AFFO for the three and six months ended June 30, 2023 and 2022 (in thousands, except share and per share amounts):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2023	2022	2023	2022
Net income attributable to common stockholders	\$ 40,931	\$ 39,876	\$ 81,685	\$ 74,588
Real estate depreciation and amortization	16,704	15,233	33,418	29,101
FFO attributable to common stockholders (basic)	57,635	55,109	115,103	103,689
Cash and non-cash interest expense on Exchangeable Senior Notes	50	68	119	402
FFO attributable to common stockholders (diluted)	57,685	55,177	115,222	104,091
Financing expense	—	104	—	104
Litigation-related expense	670	119	1,216	119
Loss (gain) on exchange of Exchangeable Senior Notes	—	7	(22)	125
Normalized FFO attributable to common stockholders (diluted)	58,355	55,407	116,416	104,439
Interest income on seller-financed note <sup>(1)</sup>	403	—	537	—
Stock-based compensation	4,884	4,437	9,713	8,816
Non-cash interest expense	331	311	657	618
Above-market lease amortization	23	23	46	46
AFFO attributable to common stockholders (diluted)	\$ 63,996	\$ 60,178	\$ 127,369	\$ 113,919
FFO per common share – diluted	\$ 2.04	\$ 1.97	\$ 4.08	\$ 3.83
Normalized FFO per common share – diluted	\$ 2.07	\$ 1.98	\$ 4.12	\$ 3.85
AFFO per common share – diluted	\$ 2.26	\$ 2.15	\$ 4.51	\$ 4.19
Weighted average common shares outstanding – basic	27,981,517	27,850,561	27,965,720	26,741,568
Restricted stock and RSUs	201,462	82,387	186,684	113,858
Dilutive effect of Exchangeable Senior Notes	74,260	103,742	87,437	304,348
Weighted average common shares outstanding – diluted	28,257,239	28,036,690	28,239,841	27,159,774

(1) Amount reflects the non-refundable interest paid on the seller-financed note issued to us by the buyer in connection with our disposition of a portfolio of four properties in southern California previously leased to affiliates of Vertical, which is recognized as a deposit liability and is included in other liabilities in our condensed consolidated balance sheet as of June 30, 2023, as the transaction did not qualify for recognition as a completed sale.

## **Critical Accounting Estimates**

Our condensed consolidated financial statements have been prepared in accordance with GAAP, which requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ materially from those estimates and assumptions.

We continually evaluate the estimates and assumptions we use to prepare our consolidated financial statements. Our critical accounting estimates are defined as accounting estimates or assumptions made in accordance with GAAP, which involve a significant level of estimation uncertainty or subjectivity and have had or are reasonably likely to have a material impact on our financial condition or results of operations. The following critical accounting estimates discussion reflects what we believe are the most significant estimates and assumptions used in the preparation of our consolidated financial statements. This discussion of our critical accounting estimates is intended to supplement and should be read in conjunction with the more complete discussion of our accounting policies and procedures included in Note 2 “Summary of Significant Accounting Policies and Procedures and Recent Accounting Pronouncements” to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2022.

### ***Lease Accounting***

We account for our leases under ASC 842 “Leases”, which requires significant estimates and judgments by management in its application. Upon lease inception or lease modification, we assess the lease classification of both the land and building components of the property. The determination of lease classification requires the calculation of the rate implicit in the lease, which is driven by significant estimates relating to the unguaranteed residual value of the assets at the end of the non-cancelable lease term.

### ***Acquisition of Rental Property, Depreciation and Impairment***

All of our acquisitions of rental properties to date were accounted for as asset acquisitions and not business combinations because substantially all of the fair value is concentrated in a single identifiable asset or group of similar identifiable assets (i.e., land, buildings, and related intangible assets). The accounting model for asset acquisitions requires that the acquisition consideration (including acquisition costs) be allocated to the individual assets acquired and liabilities assumed on a relative fair value basis.

We exercise judgement to determine key assumptions used in each valuation technique. For example, we are required to use judgment and make a number of assumptions, including those related to projected growth in rental rates and operating expenses, anticipated trends and market/economic conditions. The use of different assumptions can affect the amount of consideration allocated to the acquired depreciable/amortizable asset, which in turn can impact our net income due to the recognition of the related depreciation/amortization expense in our condensed consolidated statements of income.

We depreciate buildings and improvements where we are considered the owner for accounting purposes based on our evaluation of the estimated useful life of each specific asset, not to exceed 40 years. Determining whether expenditures meet the criteria for capitalization and the assignment of depreciable lives requires management to exercise significant judgment.

The determination of whether we are or the tenant is the owner of improvements for accounting purposes is subject to significant judgment. In making that determination, we consider numerous factors and perform a detailed evaluation of each individual lease. No one factor is determinative in reaching a conclusion. The factors we evaluate include but are not limited to the following:

- whether the lease agreement requires landlord approval of how the improvement allowance is spent prior to installation of the improvements;
- whether the lease agreement requires the tenant to provide evidence to the landlord supporting the cost and what the improvement allowance was spent on prior to payment by the landlord for such improvements;
- whether the improvements are unique to the tenant or reusable by other tenants;
- whether the tenant is permitted to alter or remove the improvements without the consent of the landlord or without compensating the landlord for any lost utility or diminution in fair value; and
- whether the ownership of the improvements remains with the landlord or remains with the tenant at the end of the lease term.

When we conclude that we are the owner of improvements for accounting purposes using the factors discussed above, we record the cost to construct the improvements as our capital asset.

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We evaluate our real estate assets for potential impairment whenever events or changes in circumstances indicate that the carrying amount of a given asset may not be recoverable. We evaluate our real estate assets for impairment on a property-by-property basis. Indicators we use to determine whether an impairment evaluation is necessary include:

- deterioration in rental rates for a specific property;
- deterioration of a given rental submarket;
- significant change in strategy or use of a specific property or any other event that could result in a decreased holding period, including classifying a property as held for sale, or significant development delay;
- evidence of material physical damage to the property; and
- default by a significant tenant when any of the other indicators above are present.

When we evaluate for potential impairment our real estate assets to be held and used, we first evaluate whether there are any indicators of impairment. If any impairment indicators are present for a specific real estate asset, we then perform an undiscounted cash flow analysis and compare the net carrying amount of the real estate asset to the real estate asset's estimated undiscounted future cash flow over the anticipated holding period. If the estimated undiscounted future cash flow is less than the net carrying amount of the real estate asset, we perform an impairment loss calculation to determine if the fair value of the real estate asset is less than the net carrying value of the real estate asset. Our impairment loss calculation compares the net carrying amount of the real estate asset to the real estate asset's estimated fair value, which may be based on estimated discounted future cash flow calculations or third-party valuations or appraisals. We recognize an impairment loss if the amount of the asset's net carrying amount exceeds the asset's estimated fair value. If we recognize an impairment loss, the estimated fair value of the asset becomes its new cost basis. For a depreciable long-lived asset, the new cost basis would be depreciated (amortized) over the remaining useful life of that asset. If a real estate asset is designated as real estate held for sale, it is carried at the lower of the net carrying value or estimated fair value less costs to sell, and depreciation ceases.

Our undiscounted cash flow and fair value calculations contain uncertainties because they require management to make assumptions and to apply judgment to estimate future cash flow and property fair values, including determining our estimated holding period and selecting the discount or capitalization rate that reflects the risk inherent in future cash flow. Estimating projected cash flow is highly subjective as it requires assumptions related to future rental rates, tenant allowances, operating expenditures, property taxes, capital improvements, and occupancy levels. We are also required to make a number of assumptions relating to future economic and market events and prospective operating trends. Determining the appropriate capitalization rate also requires significant judgment and is typically based on many factors including the prevailing rate for the market or submarket, as well as the quality and location of the properties. Further, capitalization rates can fluctuate resulting from a variety of factors in the overall economy or within regional markets. If the actual net cash flow or actual market capitalization rates significantly differ from our estimates, the impairment evaluation for an individual asset could be materially affected.

For each property where such an indicator occurred, we completed an impairment evaluation. After completing this process, we determined that for each of the operating properties evaluated, undiscounted cash flows over the holding period were in excess of carrying value and, therefore, we did not record any impairment losses for these properties for the three and six months ended June 30, 2023 and 2022.

### ***Stock-Based Compensation***

Compensation cost for all share-based awards requires an estimate of fair value on the grant date and compensation cost is recognized on a straight-line basis over the service vesting period, which represents the requisite service period. The grant date fair value for compensation programs that contain market conditions, like modifiers based on total stockholder return (a "market condition"), are performed using Monte Carlo simulation pricing models that require the input of assumptions, including judgments to estimate expected stock price volatility, risk-free interest rate, and discount for post vesting restriction. The expected share price volatility was based on the historical volatility of our shares of common stock over a period of approximately the applicable performance periods. The risk-free interest rate was based on the zero-coupon risk-free interest rate derived from the Treasury Constant Maturities yield curve on the applicable valuation date. The discount for the post vesting restriction was estimated using the Finnerty model.

### **Impact of Real Estate and Credit Markets**

In the commercial real estate market, property prices generally continue to fluctuate. Likewise, during certain periods, the U.S. credit markets have experienced significant price volatility, dislocations, and liquidity disruptions, which may impact our access to and cost of capital. We continually monitor the commercial real estate and U.S. credit markets carefully and, if required, will make decisions to adjust our business strategy accordingly.

## **Interest Rate Risk**

As of June 30, 2023, we had \$300.0 million principal amount of Notes due 2026 and approximately \$4.4 million principal amount of Exchangeable Senior Notes outstanding at fixed interest rates, and therefore, if interest rates decline, our required payments may exceed those based on current market rates. It is possible that a property we acquire in the future would be subject to a mortgage, which we may assume.

## **Impact of Inflation**

The U.S. economy is experiencing a sustained increase in inflation rates. We enter into leases that generally provide for fixed increases in rent. During times when inflation is greater than the fixed increases in rent, as provided for in the leases, rent increases may not keep up with the rate of inflation.

## **Seasonality**

Our business has not been, and we do not expect our business in the future to be, subject to material seasonal fluctuations.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our Exchangeable Senior Notes bear interest at a fixed rate of 3.75% per annum until maturity and our Notes due 2026 bear interest at a fixed rate of 5.50% per annum until maturity, and collectively are the only debt we have outstanding.

Our investments in short-term money market funds, certificates of deposit and short-term investments in obligations of the U.S. government with an original maturity at the time of purchase of greater than three months are less sensitive to market fluctuations than a portfolio of long-term securities. Accordingly, we believe that a significant change in interest rates would not have a material effect on the condensed consolidated financial statements.

## **ITEM 4. CONTROLS AND PROCEDURES**

### ***Evaluation of Disclosure Controls and Procedures***

Our management has evaluated, under supervision of the Audit Committee of the Board of Directors and with the participation of our principal executive and principal financial officers, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of June 30, 2023. Based on that evaluation, our principal executive and financial officers concluded that our disclosure controls and procedures were not effective as of June 30, 2023 because of a material weakness in our internal control over financial reporting as described below.

Notwithstanding this material weakness, the Company has concluded that no material misstatements exist in the consolidated financial statements as previously filed and included in this Quarterly Report on Form 10-Q and such financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2023 and the results of its operations and its cash flows for the three and six-months period then ended, in conformity with GAAP.

### ***Material Weakness in Internal Control over Financial Reporting***

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

We have determined that we did not design and maintain effective internal control over financial reporting related to management's review and approval of requests for funding disbursements for improvements at the Company's properties. Specifically, management's controls are not designed at an appropriate level of precision to prevent or detect a material misstatement in a timely manner.

This control deficiency did not result in a misstatement of the Company's consolidated financial statements. However, this control deficiency could result in misstatements of interim or annual consolidated financial statements and disclosures that would result in a material misstatement that would not be prevented or detected in a timely manner. Therefore, management has concluded that this control deficiency constitutes a material weakness.

### ***Remediation of Material Weakness***

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We are committed to the continuous improvement of our internal controls over financial reporting. We immediately commenced measures to remediate the identified material weakness. We have provided additional training to personnel regarding policies and procedures around construction projects and the necessary approvals of requests for funding disbursements in connection with qualifying property improvements at our properties. Our remediation efforts also include (1) enhancing the design of existing procedures and controls over the review and approval of funding requests for improvements; (2) providing additional training and developing tools to implement and monitor our policies and procedures; and (3) supplementing existing resources with the engagement of third-party construction consultants.

While we believe that the efforts taken to date for remediation are appropriate and reasonable steps to remediate the material weakness, the material weakness will not be remediated until the enhanced controls have been implemented for a sufficient period of time and management has concluded, through testing and monitoring, that the new and enhanced controls are designed and operating effectively. We may conclude that additional measures, including resources, are necessary to remediate the material weakness in our internal control over financial reporting, which may necessitate additional evaluation and implementation time. We may also modify certain of the remediation efforts described above.

***Changes in Internal Control Over Financial Reporting***

Other than the material weakness discussed above, there have been no changes in our system of internal control over financial reporting during the quarter ended June 30, 2023 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II

### ITEM 1. *LEGAL PROCEEDINGS*

For a description of our legal proceedings, see Note 11 “Commitments and Contingencies — Litigation” to our condensed consolidated financial statements, which is hereby incorporated by reference.

### ITEM 1A. *RISK FACTORS*

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2022, and in Part II, “Item 1A. Risk Factors” in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2023, which could materially affect our business, financial condition and/or results of operations. Except to the extent additional factual information disclosed elsewhere in this Quarterly Report on Form 10-Q relates to such risk factors, there have been no material changes to the risk factors described in the “Risk Factors” sections in our Annual Report on Form 10-K for the year ended December 31, 2022 and in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2023. The risks as described in our Annual Report on Form 10-K and subsequent Quarterly Report on Form 10-Q are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or results of operations.

### ITEM 2. *UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS*

During the six months ended June 30, 2023, we issued 32,200 shares of our common stock upon exchange by holders of \$2.0 million of outstanding principal amount of our Exchangeable Senior Notes. Such shares of our common stock were issued in reliance on Section 3(a)(9) of the Securities Act of 1933, as amended.

### ITEM 3. *DEFAULTS UPON SENIOR SECURITIES*

None.

### ITEM 4. *MINE SAFETY DISCLOSURES*

Not applicable.

### ITEM 5. *OTHER INFORMATION*

During the three months ended June 30, 2023, no director or Section 16 officer of the Company adopted or terminated a “Rule 10b5-1 trading arrangement” or “non-Rule 10b5-1 trading agreement,” as each term is defined in Item 408(a) of Regulation S-K.



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**ITEM 6. EXHIBITS**

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
3.1*	<a href="#">Certificate of Formation of IIP-MO 1 LLC.</a>
10.1*	<a href="#">Limited Liability Company Agreement of IIP-MO 1 LLC.</a>
22.1*	<a href="#">List of Subsidiary Guarantors.</a>
31.1*	<a href="#">Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</a>
31.2*	<a href="#">Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</a>
32.1*	<a href="#">Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</a>
101INS*	Inline XBRL Instance Document – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH*	Inline XBRL Taxonomy Extension Schema Document.
101.CAL*	Inline XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	Inline XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	Inline XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	Inline XBRL Taxonomy Extension Presentation Linkbase Document.
104*	Cover Page Interactive Date File (formatted as Inline XBRL and contained in Exhibit 101).

\* Filed herewith.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, hereunto duly authorized.

INNOVATIVE INDUSTRIAL PROPERTIES, INC.

By: /s/ Paul Smithers

Paul Smithers

President, Chief Executive Officer and Director  
(Principal Executive Officer)

By: /s/ David Smith

David Smith

Chief Financial Officer and Treasurer  
(Principal Financial Officer)

Dated August 3, 2023

**STATE *of* DELAWARE**  
**LIMITED LIABILITY COMPANY**  
**CERTIFICATE *of* FORMATION *of***

**IIP-MO 1 LLC**

The undersigned, being an authorized person, for the purpose of forming a limited liability company under the Delaware Limited Liability Company Act, Chapter 18, Title 6, Delaware Code, Section 18-101 et seq (the “Act”), hereby certifies pursuant to Section 18-201.

**FIRST:** The name of the limited liability company is IIP-MO 1 LLC.

**SECOND:** The address of its registered office in the State of Delaware is 1209 Orange Street, Wilmington, Delaware 19801, County of New Castle. The name of its Registered Agent at such address is The Corporation Trust Company.

**THIRD:** This Certificate of Formation shall be effective upon filing.

IN WITNESS WHEREOF, the undersigned has executed this Certificate of Formation of IIP-MO 1 LLC this 17<sup>th</sup> day of June, 2021.

/s/ Brian Wolfe

Brian Wolfe, Authorized Person

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**LIMITED LIABILITY COMPANY AGREEMENT**

**OF**

**IIP-MO 1 LLC**

a Delaware limited liability company

Effective as of June 22, 2021

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## LIMITED LIABILITY COMPANY AGREEMENT

### OF IIP-MO 1 LLC

This **LIMITED LIABILITY COMPANY AGREEMENT** (“Agreement”) of IIP-MO 1 LLC (the “Company”) is effective as of the 22nd day of June, 2021.

1. **Formation of Limited Liability Company.** IIP Operating Partnership, LP, a Delaware limited partnership (the “Member”), through its attorney in fact, formed the Company as a limited liability company pursuant to the provisions of the Delaware Limited Liability Company Act (as such may be amended or succeeded from time to time, the “Act”). The rights and obligations of the Member and the administration of the Company shall be governed by this Agreement and the Act. To the extent this Agreement is inconsistent in any respect with the Act, this Agreement shall control.

2. **Member.** The Member is the sole member of the Company.

3. **Purpose.** The Company may engage in any and all businesses or activities in which a limited liability company may be engaged under applicable law (including, without limitation, the Act).

4. **Name.** The name of the Company shall be “IIP-MO 1 LLC.”

5. **Principal Place of Business; Other Places of Business.** The principal place of business of the Company is 11440 West Bernardo Court, Suite 100, San Diego, CA 92127. The Company may have such other offices as the Member may designate from time to time.

6. **Designated Agent for Service of Process.** The agent for service of process in Delaware as of the effective date of this Agreement is The Corporation Trust Company, 1209 Orange Street, Wilmington, Delaware 19801.

7. **Term of Company.** The Company commenced on the date the Certificate of Formation was properly filed with the Secretary of State of the State of Delaware and shall exist in perpetuity or until its business and affairs are earlier wound up following proper dissolution.

8. **Management of Company.** All decisions relating to the business, affairs, and properties of the Company shall be made by the Member. The Member may appoint one or more managers and/or officers of the Company using any titles and may delegate all or some decision-making duties and responsibilities to such persons. Any such managers and/or officers shall serve at the pleasure of the Member. To the extent delegated by the Member, managers and/or officers shall have the authority to act on behalf of, bind, and execute and deliver documents in the name and on behalf of the Company. In addition, unless otherwise determined by the Member, any officer(s) so appointed shall have such authority and responsibility as is generally attributable to the holders of such offices in corporations incorporated under the laws of the State of Delaware. No delegation of authority hereunder shall cause the Member to cease to be a Member. The following individuals are hereby designated as the initial officers of the Company:

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<u>Name</u>	<u>Title</u>
Alan Gold	Executive Chairman
Paul Smithers	President and Chief Executive Officer
Catherine Hastings	Chief Financial Officer and Treasurer
Brian Wolfe	Vice President, General Counsel and Secretary

9. **Other Activities.** The Member and its agents, representatives and affiliates may engage or invest in, and devote their time to, any other business venture or activity of any nature and description (independently or with others), whether or not such other activity may be deemed or construed to be in competition with the Company. The Company shall not have any right by virtue of this Agreement or the relationship created hereby in or to such other venture or activity (or to the income or proceeds derived therefrom), and the pursuit thereof, even if competitive with the business of the Company, shall not be deemed wrongful or improper.

10. **Standards of Conduct.** Whenever the Member is required or permitted to make a decision, take or approve an action, or omit to do any of the foregoing, then the Member shall be entitled to consider only such interests and factors, including its own, as it desires, and shall have no duty or obligation to consider any other interests or factors whatsoever. To the extent that the Member has, at law or in equity, duties (including, without limitation, fiduciary duties) to the Company or other person bound by the terms of this Agreement, the Member acting in accordance with this Agreement shall not be liable to the Company or any such other person for its good faith reliance on the provisions of this Agreement. The provisions of this Agreement, to the extent that they restrict the duties of the Member otherwise existing at law or in equity, replace such other duties to the greatest extent permitted under applicable law.

11. **Limited Liability.** Except as otherwise required by any non-waivable provision of the Act or other applicable law, the Member shall not be personally liable in any manner whatsoever for any debt, liability, or other obligation of the Company, whether such debt, liability, or other obligation arises in contract, tort, or otherwise.

12. **Contributions.** The capital contributions of the Member are reflected on the books and records of the Company.

13. **Distributions.** Each distribution of cash or other property by the Company shall be made 100% to the Member. Each item of income, gain, loss, deduction, credit, and other tax items of the Company shall be allocated 100% to the Member.

14. **Indemnification.** The Company shall indemnify and hold harmless the Member to the full extent permitted by law from and against any and all losses, claims, demands, costs, damages, liabilities, expenses of any nature (including attorneys' fees and disbursements), judgments, fines, settlements, and other amounts (collectively, "Costs") arising from any and all claims, demands, actions, suits, or proceedings (civil, criminal, administrative, or investigative) (collectively, "Actions") in which the Member may be involved, or threatened to be involved as a party or otherwise, relating to the performance or nonperformance of any act concerning the activities of the Company. In addition, to the extent permitted by law, the Member may cause the Company to indemnify and hold harmless any managers and/or officers from and against any and all Costs arising from any or all actions arising in

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connection with the business of the Company or by virtue of such person's capacity as an agent of the Company. Notwithstanding the foregoing, any and all indemnification obligations of the Company shall be satisfied only from the assets of the Company, and the Member shall have no liability or responsibility therefor.

15. **Dissolution and Winding Up.** The Company shall dissolve and its business and affairs shall be wound up pursuant to a written instrument executed by the Member. In such event, after satisfying creditors, all remaining assets shall be distributed to the Member.

16. **Amendments.** This Agreement may be amended or modified from time to time only by a written instrument executed by the Member.

17. **Governing Law.** The validity and enforceability of this Agreement shall be governed by and construed in accordance with the laws of Delaware without regard to other principles of conflicts of law.

*[Remainder of page intentionally left blank]*

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IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement effective as of the date first set forth above.

**MEMBER**

IIP Operating Partnership, LP

a Delaware limited partnership

By: Innovative Industrial Properties, Inc.,  
its sole general partner

By: /s/ Brian Wolfe  
Name: Brian Wolfe

Title: Vice  
President

**COMPANY**

IIP-MO 1 LLC,

a Delaware limited liability company

By: IIP Operating Partnership, LP,  
its sole Member

By: Innovative Industrial Properties, Inc.,  
its sole general partner

By: /s/ Brian Wolfe  
Name: Brian Wolfe  
Title: Vice President





## Guarantor Subsidiaries

<b>Subsidiary</b>	<b>State of Formation/Organization</b>
IIP-AZ 1 LLC	Delaware
IIP-AZ 2 LLC	Delaware
IIP-AZ 3 LLC	Delaware
IIP-CA 1 LP	Delaware
IIP-CA 2 LP	Delaware
IIP-CA 3 LP	Delaware
IIP-CA 4 LP	Delaware
IIP-CA 5 LP	Delaware
IIP-CA 6 LP	Delaware
IIP-CO 1 LLC	Delaware
IIP-CO 2 LLC	Delaware
IIP-CO 3 LLC	Delaware
IIP-CO 4 LLC	Delaware
IIP-FL 1 LLC	Delaware
IIP-FL 2 LLC	Delaware
IIP-FL 3 LLC	Delaware
IIP-GP LLC	Delaware
IIP-IL 1 LLC	Delaware
IIP-IL 2 LLC	Delaware
IIP-IL 3 LLC	Delaware
IIP-IL 4 LLC	Delaware
IIP-IL 5 LLC	Delaware
IIP-IL 6 LLC	Delaware
IIP-MA 1 LLC	Delaware
IIP-MA 2 LLC	Delaware
IIP-MA 3 LLC	Delaware
IIP-MA 4 LLC	Delaware
IIP-MA 5 LLC	Delaware
IIP-MA 6 LLC	Delaware
IIP-MA 7 LLC	Delaware
IIP-MA 8 LLC	Delaware
IIP-MD 1 LLC	Delaware
IIP-MD 2 LLC	Delaware
IIP-MD 3 LLC	Delaware
IIP-MI 1 LLC	Delaware
IIP-MI 2 LLC	Delaware
IIP-MI 3 LLC	Delaware
IIP-MI 4 LLC	Delaware
IIP-MI 5 LLC	Delaware
IIP-MI 6 LLC	Delaware
IIP-MI 7 LLC	Delaware
IIP-MI 8 LLC	Delaware
IIP-MN 1 LLC	Delaware
IIP-MO 1 LLC	Delaware
IIP-ND 1 LLC	Delaware
IIP-NJ 1 LLC	Delaware
IIP-NJ 2 LLC	Delaware
IIP-NJ 3 LLC	Delaware
IIP-NV 1 LLC	Delaware

IIP-NY 1 LLC	Delaware
IIP-NY 2 LLC	Delaware
IIP-OH 1 LLC	Delaware
IIP-OH 2 LLC	Delaware
IIP-OH 3 LLC	Delaware
IIP-OH 4 LLC	Delaware
IIP-PA 1 LLC	Delaware
IIP-PA 2 LLC	Delaware
IIP-PA 3 LLC	Delaware
IIP-PA 4 LLC	Delaware
IIP-PA 5 LLC	Delaware
IIP-PA 6 LLC	Delaware
IIP-PA 7 LLC	Delaware
IIP-PA 8 LLC	Delaware
IIP-PA 9 LLC	Delaware
IIP-TX 1 LLC	Delaware
IIP-TX 2 LLC	Delaware
IIP-VA 1 LLC	Delaware
IIP-WA 1 LLC	Delaware

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**Innovative Industrial Properties, Inc.**  
**Certification of Chief Executive Officer**  
**Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Paul Smithers, certify that:

- 1) I have reviewed this Quarterly Report on Form 10-Q of Innovative Industrial Properties, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report, any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting, which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2023

/s/ Paul Smithers

Paul Smithers

Chief Executive Officer, President and Director

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**Innovative Industrial Properties, Inc.**  
**Certification of Chief Financial Officer**  
**Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, David Smith, certify that:

- 1) I have reviewed this Quarterly Report on Form 10-Q of Innovative Industrial Properties, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report, any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting, which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2023

/s/ David Smith

David Smith

Chief Financial Officer and Treasurer

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**Innovative Industrial Properties, Inc.  
Certification Pursuant to  
18 U.S.C. Section 1350,  
as Adopted Pursuant to  
Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report on Form 10-Q of Innovative Industrial Properties, Inc. (the "Company") for the period ended June 30, 2023, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Paul Smithers, Chief Executive Officer, President and Director of the Company, and I, David Smith, Chief Financial Officer and Treasurer of the Company, each certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

August 3, 2023

/s/ Paul Smithers

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Paul Smithers

Chief Executive Officer, President and Director

/s/ David Smith

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David Smith

Chief Financial Officer and Treasurer

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