

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

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 MARCH 31, 2021
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
Common Stock, par value \$0.001 per share	IIPR	New York Stock Exchange
Series A Preferred Stock, par value \$0.001 per share	IIPR-PA	New York Stock Exchange

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 May 6, 2021 there were 23,926,317 shares of common stock outstanding.

INNOVATIVE INDUSTRIAL PROPERTIES, INC.

FORM 10-Q – QUARTERLY REPORT

March 31, 2021

TABLE OF CONTENTS

PART I

Item 1. Financial Statements (Unaudited)	3
Condensed Consolidated Balance Sheets	3
Condensed Consolidated Statements of Income	4
Condensed Consolidated Statements of Stockholders' Equity	5
Condensed Consolidated Statements of Cash Flows	6
Notes to the Condensed Consolidated Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3. Quantitative and Qualitative Disclosures About Market Risk	28
Item 4. Controls and Procedures	28

PART II

Item 1. Legal Proceedings	29
Item 1A. Risk Factors	29
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	30
Item 3. Defaults Upon Senior Securities	30
Item 4. Mine Safety Disclosures	30
Item 5. Other Information	30
Item 6. Exhibits	31

PART I

ITEM 1. FINANCIAL STATEMENTS

Innovative Industrial Properties, Inc.

Condensed Consolidated Balance Sheets (Unaudited)

(In thousands, except share and per share amounts)

	March 31, 2021	December 31, 2020
Assets		
Real estate, at cost:		
Land	\$ 79,991	\$ 75,660
Buildings and improvements	691,529	644,932
Tenant improvements	408,610	339,647
Construction in progress	2,433	—
Total real estate, at cost	1,182,563	1,060,239
Less accumulated depreciation	(49,033)	(40,195)
Net real estate held for investment	1,133,530	1,020,044
Cash and cash equivalents	122,133	126,006
Investments	539,323	619,275
Right of use office lease asset	922	980
Other assets, net	2,022	1,776
Total assets	\$ 1,797,930	\$ 1,768,081
Liabilities and stockholders' equity		
Exchangeable senior notes, net	\$ 137,218	\$ 136,693
Tenant improvements and construction funding payable	66,074	36,500
Accounts payable and accrued expenses	2,358	4,641
Dividends payable	31,998	30,065
Office lease liability	998	1,057
Rent received in advance and tenant security deposits	41,666	34,153
Total liabilities	280,312	243,109
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 March 31, 2021 and December 31, 2020	14,009	14,009
Common stock, par value \$0.001 per share, 50,000,000 shares authorized: 23,926,317 and 23,936,928 shares issued and outstanding at March 31, 2021 and December 31, 2020, respectively	24	24
Additional paid-in capital	1,557,776	1,559,059
Dividends in excess of earnings	(54,191)	(48,120)
Total stockholders' equity	1,517,618	1,524,972
Total liabilities and stockholders' equity	\$ 1,797,930	\$ 1,768,081

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 March 31,	
	2021	2020
Revenues:		
Rental (including tenant reimbursements)	\$ 42,885	\$ 21,130
Total revenues	<u>42,885</u>	<u>21,130</u>
Expenses:		
Property expenses	770	600
General and administrative expense	5,600	3,346
Depreciation expense	8,839	4,907
Total expenses	<u>15,209</u>	<u>8,853</u>
Income from operations	27,676	12,277
Interest and other income	124	1,444
Interest expense	(1,873)	(1,849)
Net income	<u>25,927</u>	<u>11,872</u>
Preferred stock dividends	(338)	(338)
Net income attributable to common stockholders	<u>\$ 25,589</u>	<u>\$ 11,534</u>
Net income attributable to common stockholders per share (Note 8):		
Basic	<u>\$ 1.07</u>	<u>\$ 0.72</u>
Diluted	<u>\$ 1.05</u>	<u>\$ 0.72</u>
Weighted-average shares outstanding:		
Basic	23,889,398	15,784,296
Diluted	26,152,551	15,898,091

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 March 31, 2021					
	Series A Preferred Stock	Shares of Common Stock	Common Stock	Additional Paid-In Capital	Dividends in Excess of Earnings	Total Stockholders' Equity
Balance, December 31, 2020	\$ 14,009	23,936,928	\$ 24	\$ 1,559,059	\$ (48,120)	\$ 1,524,972
Net income	—	—	—	—	25,927	25,927
Issuance of unvested restricted stock, net of forfeitures	—	(10,611)	—	(3,384)	—	(3,384)
Preferred stock dividend	—	—	—	—	(338)	(338)
Common stock dividend	—	—	—	—	(31,660)	(31,660)
Stock-based compensation	—	—	—	2,101	—	2,101
Balance, March 31, 2021	<u>\$ 14,009</u>	<u>23,926,317</u>	<u>\$ 24</u>	<u>\$ 1,557,776</u>	<u>\$ (54,191)</u>	<u>\$ 1,517,618</u>

	Three Months Ended March 31, 2020					
	Series A Preferred Stock	Shares of Common Stock	Common Stock	Additional Paid-In Capital	Dividends in Excess of Earnings	Total Stockholders' Equity
Balance, December 31, 2019	\$ 14,009	12,637,043	\$ 13	\$ 553,932	\$ (19,944)	\$ 548,010
Net income	—	—	—	—	11,872	11,872
Net proceeds from sale of common stock	—	4,411,251	4	317,841	—	317,845
Exchange of exchangeable senior notes	—	14	—	1	—	1
Issuance of unvested restricted stock, net of forfeitures	—	(12,634)	—	(2,166)	—	(2,166)
Preferred stock dividend	—	—	—	—	(338)	(338)
Common stock dividend	—	—	—	—	(17,070)	(17,070)
Stock-based compensation	—	—	—	825	—	825
Balance, March 31, 2020	<u>\$ 14,009</u>	<u>17,035,674</u>	<u>\$ 17</u>	<u>\$ 870,433</u>	<u>\$ (25,480)</u>	<u>\$ 858,979</u>

See accompanying notes to the condensed consolidated financial statements.

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

	For the Three Months Ended March 31,	
	2021	2020
Cash flows from operating activities		
Net income	\$ 25,927	\$ 11,872
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	8,839	4,907
Other non-cash adjustments	22	74
Stock-based compensation	2,101	825
Amortization of discounts on short-term investments	(116)	(1,009)
Amortization of debt discount and issuance costs	525	501
Changes in assets and liabilities		
Other assets, net	80	(93)
Accounts payable and accrued expenses	(2,283)	(2,112)
Rent received in advance and tenant security deposits	7,513	4,605
Net cash provided by operating activities	<u>42,608</u>	<u>19,570</u>
Cash flows from investing activities		
Purchases of investments in real estate	(28,390)	(72,457)
Reimbursements of tenant improvements and construction funding	(64,160)	(82,698)
Deposits in escrow for acquisitions	(550)	(838)
Purchases of short-term investments	(209,932)	(254,803)
Maturities of short-term investments	290,000	102,500
Net cash used in investing activities	<u>(13,032)</u>	<u>(308,296)</u>
Cash flows from financing activities		
Issuance of common stock, net of offering costs	—	317,845
Dividends paid to common stockholders	(29,727)	(12,638)
Dividends paid to preferred stockholders	(338)	(338)
Taxes paid related to net share settlement of equity awards	(3,384)	(2,166)
Net cash (used in) provided by financing activities	<u>(33,449)</u>	<u>302,703</u>
Net (decrease) increase in cash, cash equivalents and restricted cash	<u>(3,873)</u>	<u>13,977</u>
Cash, cash equivalents and restricted cash, beginning of period	126,006	117,316
Cash, cash equivalents and restricted cash, end of period	<u>\$ 122,133</u>	<u>\$ 131,293</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	\$ 2,695	\$ 2,695
Supplemental disclosure of non-cash investing and financing activities:		
Accrual for reimbursements of tenant improvements and construction funding	\$ 66,074	\$ 41,185
Deposits applied for acquisitions	200	550
Accrual for common and preferred stock dividends declared	31,998	17,408

See accompanying notes to the condensed consolidated financial statements.

Innovative Industrial Properties, Inc.

Notes to the Condensed Consolidated Financial Statements
March 31, 2021
(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 properties leased to experienced, state-licensed operators for their regulated state-licensed 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, 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, 2020. 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.

The Company considered the impact of COVID-19 on its assumptions and estimates used and determined that there were no material adverse impacts on the Company’s results of operations and financial position at March 31, 2021. A prolonged outbreak could have a material adverse impact on the financial results and business operations of the Company.

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, 2021.

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.

[Table of Contents](#)

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, the fair value of buildings on an as-if vacant basis and may engage third-party valuation specialists. Acquisition costs are capitalized as incurred. All of our acquisitions to date were recorded as asset acquisitions.

Depreciation. We consider the period of future benefit of the assets to determine the appropriate estimated useful lives. Depreciation of our assets is charged to expense on a straight-line basis over the estimated useful lives. We depreciate each of our buildings and improvements over its estimated remaining useful life, generally not to exceed 40 years. We depreciate tenant improvements at our buildings where we are considered the owner over the estimated useful lives of the improvements, not to exceed 40 years.

We depreciate office equipment and furniture and fixtures over estimated useful lives ranging from three to six years. We depreciate the leasehold improvements at our corporate office over the shorter of the estimated useful lives or the initial lease term.

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, including, if necessary, a probability-weighted approach if multiple outcomes are under consideration.

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 three months ended March 31, 2021 and 2020.

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 relating to the regulated cannabis industry and the uncertainty of collectability of lease payments from each tenant due to its limited operating history. 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.

Cash and Cash Equivalents. We consider all highly-liquid investments with original maturities of three months or less to be cash equivalents. As of March 31, 2021 and December 31, 2020, \$109.7 million and \$98.3 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.

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.

[Table of Contents](#)

Exchangeable Notes. The “Debt with Conversion and Other Options” Topic of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification requires the liability and equity components of exchangeable debt instruments that may be settled in cash upon exchange, including partial cash settlement, 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 is 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 is reflected within additional paid-in capital on our condensed consolidated balance sheets, and the resulting debt discount is amortized over the period during which the Exchangeable Senior Notes are expected to be outstanding (through the maturity date) as additional non-cash interest expense. The additional non-cash interest expense attributable to our Exchangeable Senior Notes will increase in subsequent periods through the maturity date as the Exchangeable Senior Notes accrete to the par value over the same period.

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 Exchangeable Senior Notes. These costs are amortized as non-cash interest expense using the effective interest method over the life of the Exchangeable Senior Notes.

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. In February 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-02, Leases; in July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases, and ASU 2018-11, Lease – Targeted Improvements; and in December 2018, the FASB issued ASU 2018-20, Narrow-Scope Improvements for Lessors. This group of ASUs is collectively referred to as Topic 842 and was effective for the Company and for its consolidated financial statements for the year ended December 31, 2019.

We adopted Topic 842 effective as of January 1, 2019 using the effective date method and elected the package of practical expedients that allows an entity not to reassess upon adoption (i) whether an expired or existing contract contains a lease, (ii) whether a lease classification related to expired or existing lease arrangements, and (iii) whether costs incurred on expired or existing leases qualify as initial direct costs, and as a lessor, the practical expedient not to separate certain non-lease components, such as common area maintenance, 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 lessor practical expedient, allowing us to continue to amortize previously capitalized initial direct leasing costs incurred prior to the adoption of Topic 842.

As lessee, we recognized a liability to account for our future obligations related to our corporate office lease, which had a remaining lease term of approximately 4.0 years and 4.3 years as of March 31, 2021 and December 31, 2020, respectively, excluding the extension option that we are not reasonably certain to exercise, and a corresponding right-of-use asset. The lease liability is measured based on the present value of the future lease payments discounted using the estimated incremental borrowing rate of 7.25%, which is 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. 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 and any other consideration exchanged 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 the three months ended March 31, 2021 and 2020, we recognized office lease expense of approximately \$57,000 and \$58,000, respectively, which are included in general and administrative expense in our

[Table of Contents](#)

consolidated statements of income. For the three months ended March 31, 2021 and 2020, amounts paid and classified as operating activities in our consolidated statements of cash flows for the office lease were approximately \$59,000 and \$22,000, 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. Our leases continued 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 revenue and as property expenses, respectively, on our consolidated statements of income. Property taxes paid directly by the lessee to a third party continue to be excluded from our consolidated financial statements.

In April 2020, in response to the coronavirus pandemic and associated severe economic disruption, we amended leases at certain of our properties to provide for temporary base rent and property management fee deferrals through June 30, 2020. The FASB has issued additional guidance for companies to account for any coronavirus related rent concessions in the form of FASB staff and board members' remarks at the April 8, 2020 public meeting and the FASB staff question-and-answer document issued on April 10, 2020. We have elected the practical expedient which allows us to not have to evaluate whether concessions provided in response to coronavirus pandemic are lease modifications. This relief is subject to certain conditions being met, including ensuring the total remaining lease payments are substantially the same or less as compared to the original lease payments prior to the concession being granted.

Lease amendments that are not associated with the coronavirus pandemic 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.

One of our leases that was entered into prior to 2019 provides the lessee with a purchase option to purchase the leased property at the end of the initial lease term in September 2034, subject to the satisfaction of certain conditions. The purchase option provision allows the lessee to purchase the leased property at the greatest of (a) the fair value; (b) the value determined by dividing the then-current base rent by 8%; and (c) an amount equal to our gross investment in the property (including the purchase price at acquisition and any additional investment in the property made by us during the term of the lease), indexed to inflation. At March 31, 2021, our gross investment in the property with the purchase option was approximately \$30.5 million. At March 31, 2021, the purchase option was not exercisable.

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.

Recent Accounting Pronouncements. In August 2020, the FASB issued 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. 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. ASU 2020-06 is effective for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years, and is to be adopted through a cumulative-effect adjustment to the opening balance of retained earnings either at the date of adoption or in the first comparative period presented. Early adoption is permitted but only as of the beginning of the fiscal year. Upon adoption of ASU 2020-06, convertible debt proceeds, unless issued with a substantial premium or an embedded conversion feature, will no longer be allocated between debt and equity components. Upon our adoption, it will reduce the issue discount and will result in less non-cash interest expense in our consolidated financial statements. Additionally, ASU 2020-06 will result in the reporting of diluted earnings per share, if the effect is dilutive, in our consolidated financial statements, regardless of our settlement intent. We will be required to adopt ASU 2020-06 on January 1, 2022.

[Table of Contents](#)

Concentration of Credit Risk. As of March 31, 2021, we owned 68 properties located in Arizona, California, Colorado, Florida, Illinois, Maryland, Massachusetts, Michigan, Minnesota, Nevada, New Jersey, New York, North Dakota, Ohio, Pennsylvania, Texas, Virginia and Washington. 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.

The following table sets forth the five tenants in our portfolio that represented the largest percentage of our total rental revenues for the three months ended March 31, 2021 and 2020, including tenant reimbursements:

	For the Three Months Ended March 31, 2021	
	Number of Leases	Percentage of Rental Revenue
PharmaCann Inc. ⁽¹⁾	5	13 %
Ascend Wellness Holdings, LLC ⁽¹⁾	3	10 %
Cresco Labs Inc. ⁽¹⁾	5	9 %
Curaleaf Holdings, Inc. ⁽¹⁾	4	8 %
Green Thumb Industries, Inc. ⁽¹⁾	3	7 %

	For the Three Months Ended March 31, 2020	
	Number of Leases	Percentage of Rental Revenue
PharmaCann Inc. ⁽¹⁾	5	24 %
Ascend Wellness Holdings, LLC ⁽¹⁾	2	9 %
Cresco Labs Inc. ⁽¹⁾	3	8 %
Holistic Industries Inc. ⁽¹⁾	2	6 %
Vireo Health, Inc. ⁽¹⁾	4	6 %

(1) Includes leases with affiliates of the entity, for which the entity has provided a corporate guaranty.

As of March 31, 2021 and December 31, 2020, none of our properties individually represented more than 5% of our net real estate held for investment.

We have deposited cash with a financial institution that is insured by the Federal Deposit Insurance Corporation (“FDIC”) up to \$250,000. As of March 31, 2021, we had cash accounts in excess of FDIC insured limits. We have not experienced any losses in such accounts.

3. Common Stock

As of March 31, 2021, the Company was authorized to issue up to 50,000,000 shares of common stock, par value \$0.001 per share, and there were 23,926,317 shares of common stock issued and outstanding.

4. Preferred Stock

As of March 31, 2021, the Company was authorized to issue up to 50,000,000 shares of preferred stock, par value \$0.001 per share, and there were issued and outstanding 600,000 shares of 9.00% Series A Cumulative Redeemable Preferred Stock, \$0.001 par value per share (the “Series A Preferred Stock”). Generally, the Company is not permitted to redeem the Series A Preferred Stock prior to October 19, 2022, except in limited circumstances relating to the Company’s ability to qualify as a REIT and in certain other circumstances related to a change of control/delisting (as defined in the articles supplementary for the Series A Preferred Stock). On or after October 19, 2022, 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.

[Table of Contents](#)

5. Dividends

The following table describes the dividends declared by the Company during the three months ended March 31, 2021:

Declaration Date	Security Class	Amount Per Share	Period Covered	Dividend Paid Date	Dividend Amount (In thousands)
March 15, 2021	Common stock	\$ 1.32	January 1, 2021 to March 31, 2021	April 15, 2021	\$ 31,660
March 15, 2021	Series A preferred stock	\$ 0.5625	January 15, 2021 to April 14, 2021	April 15, 2021	\$ 338

6. Investments in Real Estate

Acquisitions

The Company acquired the following properties during the three months ended March 31, 2021 (dollars in thousands):

Property	Market	Closing Date	Rentable Square Feet ⁽¹⁾	Purchase Price	Transaction Costs	Total
Harvest FL	Florida	January 22, 2021	295,000	\$ 23,800	\$ 16	\$ 23,816 ⁽²⁾
Kings Garden CA	California	February 5, 2021	180,000	1,350	7	1,357 ⁽³⁾
Parallel TX	Texas	March 10, 2021	63,000	3,400	17	3,417 ⁽⁴⁾
Total			538,000	\$ 28,550	\$ 40	\$ 28,590 ⁽⁵⁾

- (1) Includes expected rentable square feet at completion of construction of certain properties.
- (2) The tenant is expected to complete tenant improvements at the property, for which we agreed to provide reimbursement of up to approximately \$10.8 million.
- (3) The purchase price related to the acquisition of additional land adjacent to one of our existing properties. In connection with the acquisition, we entered into a lease amendment for the existing property, which provided a tenant improvement allowance that resulted in a corresponding adjustment to the base rent for the lease at the property. The tenant is expected to complete construction of two new buildings at the property comprising approximately 180,000 square feet in the aggregate, for which we agreed to provide reimbursement of up to approximately \$51.4 million.
- (4) The tenant is expected to construct three buildings at the property, for which we agreed to provide reimbursement of up to \$24.0 million.
- (5) Approximately \$4.3 million was allocated to land and approximately \$24.3 million was allocated to building and construction in progress.

The properties acquired during the three months ended March 31, 2021 generated approximately \$911,000 of rental revenues (including tenant reimbursements) and approximately \$743,000 of net operating income after deducting property and depreciation expenses, during that period. The properties acquired during the three months ended March 31, 2020 generated approximately \$766,000 of rental revenues (including tenant reimbursements) and approximately \$460,000 of net operating income after deducting property and depreciation expenses, during that period.

New Lease and Lease Amendments

In January 2021, we executed a new lease at our Los Angeles, California property with a subsidiary of Holistic Industries Inc., pursuant to which we agreed to make available up to \$11.0 million in funding for future tenant improvements at the property.

In February 2021, we amended our lease with a subsidiary of LivWell Holdings, Inc. at one of our Michigan properties, increasing the tenant improvement allowance under the lease by approximately \$6.9 million to a total of approximately \$29.9 million, which also resulted in a corresponding adjustment to the base rent for the lease at the property.

In February 2021, we amended our lease with PharmaCann Inc. at one of our New York properties, increasing the tenant improvement allowance under the lease by \$2.5 million to a total of approximately \$33.5 million, which also resulted in a corresponding adjustment to the base rent for the lease at the property.

Including all of our properties, during the three months ended March 31, 2021, we capitalized costs of approximately \$93.7 million and funded approximately \$64.2 million relating to tenant improvements and construction activities at our properties.

[Table of Contents](#)

Future contractual minimum rent (including base rent, supplemental base rent (for one of our properties in New York) and property management fees) under the operating leases as of March 31, 2021 for future periods is summarized as follows (in thousands):

Year	Contractual Minimum Rent
2021 (nine months ending December 31)	\$ 142,960
2022	201,297
2023	208,143
2024	214,374
2025	220,894
Thereafter	3,263,013
Total	\$ 4,250,681

7. Exchangeable Senior Notes

As of March 31, 2021, our Operating Partnership had outstanding approximately \$143.75 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 March 31, 2021 was 15.10243 shares of our common stock per \$1,000 principal amount of Notes and the exchange price at March 31, 2021 was approximately \$66.215 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.

Upon our issuance of the Exchangeable Senior Notes in February 2019, we recorded an approximately \$5.8 million discount based on the implied value of the exchange option and an assumed effective interest rate of 4.65%, as well as approximately \$5.2 million of initial issuance costs, of which approximately \$5.0 million and \$200,000 were allocated to the liability and equity components, respectively, based on their relative fair values. Issuance costs allocated to the liability component are being amortized using the effective interest method and recognized as non-cash interest expense over the expected term of the Exchangeable Senior Notes.

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

	For the Three Months Ended March 31,	
	2021	2020
Cash coupon	\$ 1,348	\$ 1,348
Amortization of debt discount	282	268
Amortization of issuance cost	243	233
Total interest expense	<u>\$ 1,873</u>	<u>\$ 1,849</u>

The following table details the carrying value of our Exchangeable Senior Notes on our condensed consolidated balance sheets (in thousands):

	March 31, 2021	December 31, 2020
Principal amount	\$ 143,749	\$ 143,749
Unamortized discount	(3,503)	(3,785)
Unamortized issuance costs	(3,028)	(3,271)
Carrying value	<u>\$ 137,218</u>	<u>\$ 136,693</u>

Accrued interest payable for the Exchangeable Senior Notes as of March 31, 2021 and December 31, 2020 was approximately \$225,000 and \$1.6 million, respectively, and is included in accounts payable and accrued expenses on our condensed consolidated balance sheets.

8. Net Income Per Share

Grants of restricted stock of the Company and restricted stock units (“RSUs”) 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 March 31, 2021, 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 months ended March 31, 2021 and 2020 have been included in net income attributable to common stockholders to calculate net income per basic and diluted share. The 2,170,959 shares necessary to settle the Exchangeable Senior Notes on the if-exchanged method basis were dilutive for the three months ended March 31, 2021 and were included in the computation of diluted earnings per share. The 2,117,422 shares necessary to settle the Exchangeable Senior Notes on the if-exchanged method basis were anti-dilutive for the three months ended March 31, 2020 and were excluded from the computation of diluted earnings per share. Performance share units (“PSUs”) granted to certain employees during the three months ended March 31, 2021 were not included in dilutive securities as of March 31, 2021 as the performance thresholds for vesting of any performance share units were not met (see Note 10 for further discussion of the PSUs).

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

	March 31,	
	2021	2020
Net income	\$ 25,927	\$ 11,872
Preferred stock dividends	(338)	(338)
Distribution to participating securities	(126)	(115)
Net income attributable to common stockholders used to compute net income per share - basic	25,463	11,419
Dilutive effect of Exchangeable Senior Notes	1,873	—
Net income attributable to common stockholders used to compute net income per share - diluted	\$ 27,336	\$ 11,419
Weighted-average common shares outstanding:		
Basic	23,889,398	15,784,296
Restricted stock and RSUs	92,194	113,795
Dilutive effect of Exchangeable Senior Notes	2,170,959	—
Diluted	26,152,551	15,898,091
Net income attributable to common stockholders per share:		
Basic	\$ 1.07	\$ 0.72
Diluted	\$ 1.05	\$ 0.72

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.

[Table of Contents](#)

The following table presents the carrying value in the condensed consolidated financial statements and approximate fair value of financial instruments at March 31, 2021 and December 31, 2020:

	At March 31, 2021		At December 31, 2020	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Investments ⁽¹⁾	\$ 539,323	\$ 539,390	\$ 619,275	\$ 619,270
Exchangeable Senior Notes ⁽²⁾	\$ 137,218	\$ 391,669	\$ 136,693	\$ 397,663

(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 were trading in the private market.

As of March 31, 2021 and December 31, 2020, cash equivalent instruments consisted of \$109.7 million and \$98.3 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 three months ended March 31, 2021 is included in the table below:

	Unvested Restricted Stock	Weighted- Average Grant Date Fair Value
Balance at December 31, 2020	76,346	\$ 50.14
Granted	7,692	\$ 189.41
Vested	(28,816)	\$ 50.90
Forfeited ⁽¹⁾	(18,303)	\$ 31.99
Balance at March 31, 2021	36,919	\$ 87.57

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

The remaining unrecognized compensation cost of approximately \$2.8 million for restricted stock awards is expected to be recognized over a weighted-average amortization period of approximately 2.0 years as of March 31, 2021. The fair value of restricted stock that vested during the three months ended March 31, 2021 was approximately \$8.6 million.

[Table of Contents](#)

The following table summarizes our RSU activity for the three months ended March 31, 2021. 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, 2020	36,687	\$ 76.06
Granted	21,873	\$ 189.41
Balance at March 31, 2021	58,560	\$ 118.40

The remaining unrecognized compensation cost of approximately \$5.3 million for RSU awards is expected to be recognized over an amortization period of approximately 2.5 years as of March 31, 2021.

In January 2021, we issued 70,795 “target” PSUs to a select group of officers, which vest and are settled in shares of common stock (“Award Shares”) based on the Company’s total stockholder return over a period commencing on January 11, 2021 and ending on December 31, 2023 (the “Performance Period”) relative to two different comparator groups of companies. At the end of the Performance Period, a recipient of PSUs may receive as few as zero Award Shares or as many as 150% of the number of target PSUs in Award Shares, plus deemed dividends. PSUs will also be reduced as necessary so the total value at the vesting date does not exceed 800% of the grant date PSU price, and if the Company’s absolute total stockholder return during the Performance Period is negative, the payout of Award Shares is capped at the target number of PSUs, notwithstanding the Company’s outperformance of comparator groups. No dividends are paid to the recipient during the Performance Period. At the end of the Performance Period, if the Company’s total stockholder return is such that the recipient earns Award Shares, the recipient will receive additional shares of common stock relating to dividends deemed to have been paid and reinvested on the Award Shares. The recipient of the Award Shares may not sell, transfer or otherwise dispose of the Award Shares for a one-year period following the vesting date of the Award Shares.

The grant date fair value of the PSUs granted in January 2021 was \$12.0 million. The fair value was calculated using a Monte Carlo simulation pricing model based on the following assumptions:

	PSU Award Fair Value Assumptions
Valuation date	January 6, 2021
Fair value per share on valuation date	\$169.51
Expected term	3 years
Expected price volatility	57.64%
Risk-free interest rate	0.20%
Discount for post vesting restriction	12.44%

The expected share price volatility was based on the historical volatility of our shares of common stock over a period of approximately the Performance Period. 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 valuation date. The discount for the post vesting restriction was estimated using the Finnerly model.

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 Performance Period. For the three months ended March 31, 2021, we recognized stock-based compensation expense of \$1.0 million relating to the PSU awards. As of March 31, 2021, the remaining unrecognized compensation cost of approximately \$11.0 million relating to PSU awards is expected to be recognized over the remaining Performance Period of approximately 2.8 years.

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 our condensed consolidated balance sheets as of March 31, 2021 is presented in the table below (in thousands):

Year	Amount
2021 (nine months ending December 31)	\$ 176
2022	242
2023	249
2024	256
2025	88
Total future contractual lease payments	1,011
Effect of discounting	(13)
Office lease liability	<u>\$ 998</u>

Tenant Improvement Allowances. As of March 31, 2021, we had approximately \$263.9 million of commitments related to tenant 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.

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. We may, from time to time, be a party to legal proceedings, which arise in the ordinary course of our business. We are not aware of any pending or threatened litigation that, if resolved against us, would have a material adverse effect on our consolidated financial position, results of operations or cash flows.

12. Subsequent Events*Acquisitions*

Subsequent to March 31, 2021, we acquired a 175,000 square foot industrial property in Michigan for approximately \$15.6 million and executed a lease with Green Peak Industries, LLC (“Skymint”) for the entire property. Skymint is expected to complete tenant improvements at the property, for which we agreed to provide reimbursement of up to approximately \$14.4 million.

Lease Amendments Providing for Additional Tenant Improvement Allowances

In April 2021, we amended our lease with a subsidiary of Jushi Holdings, Inc. at one of our Pennsylvania properties, increasing the tenant improvement allowance under the lease by \$30.0 million to a total of approximately \$40.0 million, which also resulted in a corresponding adjustment to the base rent for the lease at the property.

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: the impact of the COVID-19 pandemic, or future pandemics, on us, our business, our tenants, or the economy generally; 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; rates of default on leases for our assets; 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 cultivation and processing facilities; 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 expected medical-use or adult-use cannabis legalization in certain states; shifts in public opinion regarding regulated cannabis; 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 expected leverage; 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, 2020, 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. 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 medical-use cannabis facilities. We have leased and expect to continue to

[Table of Contents](#)

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, 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 March 31, 2021, we had 16 full-time employees.

As of March 31, 2021, we owned 68 properties that were 100% leased to state-licensed cannabis operators and comprising an aggregate of approximately 5.9 million rentable square feet (including approximately 2.1 million rentable square feet under development/redevelopment) in 18 states, with a weighted-average remaining lease term of approximately 16.7 years. As of March 31, 2021, we had invested approximately \$1.1 billion in the aggregate (excluding transaction costs) and had committed an additional approximately \$330.0 million (including tenant improvements and construction costs accrued but not yet funded as of March 31, 2021) to reimburse certain tenants and sellers for completion of construction and tenant improvements at our properties.

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 current outbreak of the novel coronavirus, or COVID-19, or the future outbreak of any other highly infectious or contagious diseases, could materially and adversely impact or cause disruption to our tenants and their operations, and in turn our performance, financial condition, results of operations and cash flows. The extent to which COVID-19 impacts our operations and those of our tenants will depend on future developments, which are highly uncertain and cannot be predicted with confidence, including the scope, severity and duration of the outbreak, the actions taken to contain the outbreak or mitigate its impact, and the direct and indirect economic effects of the outbreak and containment measures, among others.

Our tenants' ability to pay their rent obligations to us depends, in part, on whether our tenants can continue their regulated cannabis operations and the ability and willingness of consumers to visit dispensary businesses. In the large majority of states that have legalized cannabis, state governmental authorities have recognized both medical-use and adult-use cannabis operations, including supply chain activities such as cultivation, processing, distribution and dispensary activities, as "essential businesses", allowing them to remain open and operational. While laws and practices vary from state to state, state and local governmental authorities and regulated cannabis businesses have taken additional measures to ensure the safety and well-being of employees, patients and consumers, including but not limited to restrictions associated with social distancing requirements and additional levels of protection for medical cannabis patients with more vulnerability to health complications from COVID-19. Despite these measures, cannabis dispensaries may experience declines in customer traffic or may be required to close in response to new government regulatory orders, which could have a significant adverse financial impact on certain of our tenants.

[Table of Contents](#)

In 2020, we undertook in-depth discussions with each of our tenants as they navigated the COVID-19 pandemic and associated severe economic disruption. In light of those discussions, in 2020, we granted temporary base rent and property management fee deferrals to three affected tenants. In connection with these deferrals, we entered into lease amendments with the three affected tenants to apply a portion of the security deposits that we hold under the leases to pay a portion of the March 2020 rent (for one tenant), pay April 2020 rent in full, defer rent for May and June 2020 in full, and provide for the pro rata repayment of the security deposit and deferred rent over an 18 month time period starting July 1, 2020. Pursuant to these amendments, a total of approximately \$940,000 of security deposits were applied to the payment of base rent, property management fees and associated lease penalties for March and April 2020, including approximately \$185,000 related to the partial payment of the March 2020 base rent and property management fees for one of the tenants; and a total of approximately \$1.5 million in rent was deferred for May and June 2020. As of March 31, 2021, we have not executed deferrals for any other tenants, other than the deferrals for the three tenants discussed above.

Significant Tenants and Concentrations of Risk

As of March 31, 2021, we owned 68 properties located in 18 states. 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 March 31, 2021, none of our properties accounted for 5% or more of our net real estate held for investment. 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 months ended March 31, 2021.

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.

[Table of Contents](#)

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 three months ended March 31, 2021.

Comparison of the Three Months Ended March 31, 2021 and 2020

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

	For the Three Months Ended March 31,	
	2021	2020
Revenues:		
Rental (including tenant reimbursements)	\$ 42,885	\$ 21,130
Total revenues	<u>42,885</u>	<u>21,130</u>
Expenses:		
Property expenses	770	600
General and administrative expense	5,600	3,346
Depreciation expense	8,839	4,907
Total expenses	<u>15,209</u>	<u>8,853</u>
Income from operations	27,676	12,277
Interest and other income	124	1,444
Interest expense	(1,873)	(1,849)
Net income	<u>25,927</u>	<u>11,872</u>
Preferred stock dividends	(338)	(338)
Net income attributable to common stockholders	<u>\$ 25,589</u>	<u>\$ 11,534</u>

Revenues.

Rental revenues for the three months ended March 31, 2021 increased by approximately \$21.8 million, or 103%, to approximately \$42.9 million, compared to approximately \$21.1 million for the three months ended March 31, 2020. Approximately \$911,000 of the increase in rental revenues was generated by the properties acquired during the three months ended March 31, 2021. The remaining approximately \$20.8 million increase in rental revenues was generated by properties we acquired in prior periods, including annual escalations and related rents on amendments which increased the tenant improvement allowances on certain of the leases.

Rental revenues also include tenant reimbursements related to reimbursements by tenants for property insurance premiums and property tax paid at certain properties.

Expenses.

Property Expenses. Property expenses related to property insurance premiums and property taxes paid at certain of our properties.

General and Administrative Expense. General and administrative expense for the three months ended March 31, 2021 increased by approximately \$2.3 million to approximately \$5.6 million, compared to approximately \$3.3 million for the three months ended March 31, 2020. The increase in general and administrative expense was primarily due to higher compensation to employees, the hiring of additional employees and higher public company costs, travel and occupancy costs. Compensation expense for the three months ended March 31, 2021 included approximately \$2.1 million of non-cash stock-based compensation. Compensation expense for the three months ended March 31, 2020 included approximately \$825,000 of non-cash stock-based compensation.

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

Interest and Other Income. Interest and other income for the three months ended March 31, 2021 decreased by approximately \$1.3 million compared to the three months ended March 31, 2020. The decrease was due to lower interest rates on our interest-bearing investments, partially offset by higher balances of interest bearing investments, resulting from proceeds from our common stock offerings.

[Table of Contents](#)

Interest Expense. Interest expense related to our Exchangeable Senior Notes. Interest expense for the three months ended March 31, 2021 and 2020 included approximately \$525,000 and \$501,000, respectively, of non-cash interest expense.

Cash Flows***Comparison of the Three Months Ended March 31, 2021 and 2020***

	March 31,		Change
	2021	2020	
Net cash provided by operating activities	\$ 42,608	\$ 19,570	\$ 23,038
Net cash used in investing activities	(13,032)	(308,296)	295,264
Net cash (used in) provided by financing activities	(33,449)	302,703	(336,152)
Ending cash, cash equivalents and restricted cash	122,133	131,293	(9,160)

Operating Activities

Cash flows provided by operating activities for the three months ended March 31, 2021 and 2020 were approximately \$42.6 million and \$19.6 million, respectively. Cash flows provided by operating activities were generally from contractual rent and security deposits from our properties, partially offset by our general and administrative expense.

Investing Activities

Cash flows used in investing activities for the three months ended March 31, 2021 were approximately \$13.0 million, of which approximately \$93.1 million related to the purchases of investments in real estate and funding of a portion of the tenant improvement allowances and construction funding at our properties, partially offset by cash provided by investing activities of approximately \$80.1 million related to net purchases and maturities of short-term investments. Cash flows used in investing activities for the three months ended March 31, 2020 were approximately \$308.3 million, of which approximately \$155.2 million primarily related to the purchase of investment in real estate and funding of a portion of the tenant improvement allowances and construction funding at our properties, approximately \$838,000 related to deposits to escrow for acquisitions, and the remaining approximately \$152.3 million related to the net purchases and maturities of short-term investments.

Financing Activities

Net cash used in financing activities of approximately \$33.4 million during the three months ended March 31, 2021 was the result of dividend payments of approximately \$30.1 million to common and preferred stockholders and approximately \$3.3 million 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 \$302.7 million during the three months ended March 31, 2020 was the result of approximately \$317.8 million in net proceeds from the issuance of our common stock, partially offset by dividend payments of approximately \$13.0 million to common and preferred stockholders and approximately \$2.2 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 meet other general business needs.

[Table of Contents](#)*Sources and Uses of Cash*

We derive 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, Exchangeable Senior Notes interest payments, 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. 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.

We are party to equity distribution agreements with six sales agents, pursuant to which we may offer and sell from time to time through an “at-the-market” offering program, or ATM Program, up to \$500.0 million in shares of our common stock. As of March 31, 2021, we had approximately \$231.7 million in shares of common stock available for issuance under the ATM Program and did not issue any shares of common stock under the ATM Program during the three months ended March 31, 2021.

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.

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 make accretive new investments.

The following table describes the dividends declared by the Company during the three months ended March 31, 2021:

Declaration Date	Security Class	Amount Per Share	Period Covered	Dividend Paid Date	Dividend Amount (In thousands)
March 15, 2021	Common stock	\$ 1.32	January 1, 2021 to March 31, 2021	April 15, 2021	\$ 31,660
March 15, 2021	Series A preferred stock	\$ 0.5625	January 15, 2021 to April 14, 2021	April 15, 2021	\$ 338

Contractual Obligations

The following table summarizes our contractual obligations as of March 31, 2021 (in thousands):

Payments Due by Year	Exchangeable Senior Notes	Interest	Office Rent	Total
2021 (nine months ending December 31)	\$ —	\$ 5,391	\$ 176	\$ 5,567
2022	—	5,391	242	5,633
2023	—	5,391	249	5,640
2024	143,749	764	256	144,769
2025	—	—	88	88
Total	\$ 143,749	\$ 16,937	\$ 1,011	\$ 161,697

Additionally, as of March 31, 2021, we had approximately \$263.9 million outstanding in commitments related to tenant 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 March 31, 2021, these amounts had not been requested by the tenants. The commitments

[Table of Contents](#)

discussed in this paragraph are excluded from the table of contractual obligations above, as tenant 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.

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 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 and 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.

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 adding to FFO certain non-cash or infrequent or unpredictable expenses which may impact comparability, consisting of non-cash stock-based compensation expense and non-cash interest expense generally.

For the three months ended March 31, 2021, FFO (diluted), AFFO and 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 2,170,959 shares for the period, which were the potentially issuable shares as if the Exchangeable Senior Notes were exchanged at the beginning of the period. These adjustments applied only for the three months ended March 31, 2021. The Exchangeable Senior Notes were anti-dilutive for purposes of calculating earnings per diluted share for the three months ended March 31, 2020, and as such, were treated as anti-dilutive for purposes of calculating FFO, AFFO and FFO and AFFO per diluted share for the three months ended March 31, 2020.

Our computation of FFO and AFFO may differ from the methodology for calculating 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 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 and AFFO should be considered only as supplements to net income computed in accordance with GAAP as measures of operations.

[Table of Contents](#)

The table below is a reconciliation of net income attributable to common stockholders to FFO and AFFO for the three months ended March 31, 2021 and 2020 (in thousands, except share and per share amounts):

	For the Three Months Ended March 31,	
	2021	2020
Net income attributable to common stockholders	\$ 25,589	\$ 11,534
Real estate depreciation	8,839	4,907
FFO attributable to common stockholders (basic)	34,428	16,441
Cash and non-cash interest expense	1,873	—
FFO attributable to common stockholders (diluted)	\$ 36,301	\$ 16,441
Stock-based compensation	2,101	825
Non-cash interest expense	—	501
AFFO attributable to common stockholders	\$ 38,402	\$ 17,767
FFO per common share – basic	\$ 1.44	\$ 1.04
FFO per common share – diluted	\$ 1.39	\$ 1.03
AFFO per common share – basic	\$ 1.55	\$ 1.13
AFFO per common share – diluted	\$ 1.47	\$ 1.12
Weighted average common shares outstanding – basic	23,889,398	15,784,296
Restricted stock and RSUs	92,194	113,795
Dilutive effect of Exchangeable Senior Notes	2,170,959	—
Weighted average common shares outstanding – diluted	26,152,551	15,898,091

Critical Accounting Policies

Our 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 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. Set forth below is a summary of our accounting policies that we believe are critical to the preparation of our condensed consolidated financial statements. Our accounting policies are more fully discussed in Note 2 to the condensed consolidated financial statements.

Acquisition of Rental Property, Depreciation and Impairment

Upon acquisition of 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, the fair value of buildings on an as-if vacant basis and may engage third-party valuation specialists. Acquisition costs are capitalized as incurred since all of our acquisitions to date were recorded as asset acquisitions.

We depreciate each of our buildings and improvements over its estimated remaining useful life, not to exceed 40 years. We depreciate tenant improvements at our buildings where we are considered the owner over the estimated useful lives of the improvements, not to exceed 40 years.

We review current activities and changes in the business conditions of all of our properties 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, including, if necessary, a probability-weighted approach if multiple outcomes are under consideration.

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

[Table of Contents](#)

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.

Revenue Recognition and Accounts Receivable

Our existing tenant leases and future tenant leases are generally expected to be triple-net leases, an arrangement under which the tenant maintains the property while paying us rent and property management fees. We account for our leases as operating leases. Operating leases that have fixed and determinable rent increases are recognized on a straight-line basis over the lease term, unless the collectability of lease payments is not probable. Rental increases based upon changes in the U.S. Consumer Price Index are recognized only after the changes in the indexes have occurred and are then applied according to the lease agreements. 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 incurred. Contractually obligated real estate taxes that are paid directly by the tenant to the tax authorities are not reflected in our consolidated financial statements.

We record revenue for each of our properties on a cash basis due to the uncertain regulatory environment in the United States relating to the regulated cannabis industry and the uncertainty of collectability of lease payments from each tenant due to its limited operating history.

Exchangeable Notes

The “Debt with Conversion and Other Options” Topic of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification requires the liability and equity components of exchangeable debt instruments that may be settled in cash upon exchange, including partial cash settlement, 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 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 our 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 is 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 is reflected within additional paid-in capital on our condensed consolidated balance sheets, and the resulting debt discount is amortized over the period during which the Exchangeable Senior Notes are expected to be outstanding (through the maturity date) as additional non-cash interest expense. The additional non-cash interest expense attributable to our Exchangeable Senior Notes will increase in subsequent periods through the maturity date as the Exchangeable Senior Notes accrete to the par value over the same period.

Lease Accounting

In February 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-02, Leases; in July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases, and ASU 2018-11, Leases — Targeted Improvements; and in December 2018, the FASB issued ASU 2018-20, Narrow-Scope Improvements for Lessors. This group of ASUs is collectively referred to as Topic 842 and was effective for the Company for its consolidated financial statements for the year ended December 31, 2019.

We adopted Topic 842 effective as of January 1, 2019 using the effective date method and elected the package of practical expedients that allows an entity not to reassess upon adoption (i) whether an expired or existing contract contains a lease, (ii) whether a lease classification related to expired or existing lease arrangements, and (iii) whether costs incurred on expired or existing leases qualify as initial direct costs, and as a lessor, the practical expedient not to separate certain non-lease components, such as common area maintenance, 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 lessor practical expedient, allowing us to continue to amortize previously capitalized initial direct leasing costs incurred prior to the adoption of Topic 842.

As lessee, we recognized a liability to account for our future obligations related to our corporate office lease, which has a remaining lease term of approximately 4.0 years and 4.3 years as of March 31, 2021 and December 31, 2020, respectively, excluding the extension option that we are not reasonably certain to exercise, and a corresponding right-of-use asset. The lease liability is measured based on the present value of the future lease payments discounted using the estimated incremental borrowing rate of 7.25%, which is the interest rate that we estimate we would have to pay to borrow on a collateralized basis over a similar term for an

[Table of Contents](#)

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 and any other consideration exchanged 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.

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. Our leases continued 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 revenue and as property expenses, respectively, on our consolidated statements of income. Property taxes paid directly by the lessee to a third party continue to be excluded from our consolidated financial statements.

In April 2020, in response to the coronavirus pandemic and associated severe economic disruption, we amended leases at certain of our properties to provide for temporary base rent and property management fee deferrals through June 30, 2020. The FASB has issued additional guidance for companies to account for any coronavirus related rent concessions in the form of FASB staff and board members' remarks at the April 8, 2020 public meeting and the FASB staff question-and-answer document issued on April 10, 2020. We have elected the practical expedient which allows us to not have to evaluate whether concessions provided in response to coronavirus pandemic are lease modifications. This relief is subject to certain conditions being met, including ensuring the total remaining lease payments are substantially the same or less as compared to the original lease payments prior to the concession being granted.

Lease amendments that are not associated with the coronavirus pandemic 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.

One of our leases that was entered into prior to 2019 provides the lessee with a purchase option to purchase the leased property at the end of the initial lease term in September 2034, subject to the satisfaction of certain conditions. The purchase option provision allows the lessee to purchase the leased property at the greatest of (a) the fair value; (b) the value determined by dividing the then-current base rent by 8%; and (c) an amount equal to our gross investment in the property (including the purchase price at acquisition and any additional investment in the property made by us during the term of the lease), indexed to inflation. At March 31, 2021, our gross investment in the property with the purchase option was approximately \$30.5 million. At March 31, 2021, the purchase option was not exercisable.

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.

Income Taxes

We have been organized to operate 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

[Table of Contents](#)

for U.S. federal income tax purposes. As long as our dividends equal or exceed our taxable net income, we generally will not be required to pay U.S. federal income tax on such income. As we intend to maintain dividends at a level sufficient to meet the REIT distribution requirements, we will continue to evaluate whether the current levels of distribution are sufficient to do so throughout 2021.

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.

Off-Balance Sheet Arrangements

We have no unconsolidated investments or any other off-balance sheet arrangements.

Interest Rate Risk

As of March 31, 2021, we had approximately \$143.75 million of Exchangeable Senior Notes outstanding at a fixed interest rate, 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

We enter into leases that generally provide for limited increases in rent as a result of increases in the U.S. Consumer Price Index or fixed increases. We expect these lease provisions to result in rent increases over time. During times when inflation is greater than 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 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 consolidated financial statements.

ITEM 4. *CONTROLS AND PROCEDURES*

Evaluation of Disclosure Controls and Procedures

Our management, under the supervision and with the participation of our principal executive and financial officers, has evaluated the effectiveness of our disclosure controls and procedures in ensuring that the information required to be disclosed in our filings under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, including ensuring that such information is accumulated and communicated to our Company's management, as appropriate, to allow timely decisions regarding required disclosure. Based on such evaluation, our principal executive and financial officers have concluded that such disclosure controls and procedures were effective as of March 31, 2021 (the end of the period covered by this Quarterly Report).

Changes in Internal Control Over Financial Reporting

There have been no changes in our system of internal control over financial reporting during the quarter ended March 31, 2021 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

We may, from time to time, be a party to legal proceedings, which arise in the ordinary course of our business. We are not aware of any pending or threatened litigation that, if resolved against us, would have a material adverse effect on our consolidated financial position, results of operations or cash flows.

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, 2020, which could materially affect our business, financial condition and/or results of operations. Except to the extent updated below or 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” section in our Annual Report on Form 10-K for year ended December 31, 2020. The risks as updated below and as described in our Annual Report on Form 10-K 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.

Competition for the acquisition of properties suitable for the retail sale, cultivation or production of regulated cannabis and alternative financing sources for licensed operators may impede our ability to make acquisitions or increase the cost of these acquisitions, which could adversely affect our operating results and financial condition.

We compete for the acquisition of properties suitable for the retail sale, cultivation or production of regulated cannabis with other entities engaged in retail, agricultural and real estate investment activities, including corporate agriculture companies, cultivators and producers of cannabis, private equity investors, and other real estate investors (including public and private REITs). These competitors may prevent us from acquiring desirable properties, may cause an increase in the price we must pay for properties or may result in us having to lease our properties on less favorable terms than we expect. Our competitors may have greater financial and operational resources than we do and may be willing to pay more for certain assets or may be willing to accept more risk than we believe can be prudently managed. In particular, larger companies may enjoy significant competitive advantages that result from, among other things, a lower cost of capital and enhanced operating efficiencies. Our competitors may also adopt transaction structures similar to ours, which would decrease our competitive advantage in offering flexible transaction terms. In addition, due to a number of factors, including but not limited to potential greater clarity of the laws and regulations governing cannabis by state and federal governments, the number of entities and the amount of funds competing for suitable investment properties may increase, resulting in increased demand and increased prices paid for these properties. If we pay higher prices for properties or enter into leases for such properties on less favorable terms than we expect, our profitability and ability to generate cash flow and make distributions to our stockholders may decrease.

We also compete as a provider of capital to regulated cannabis operators with alternative financing sources to these companies, including both equity and debt financing alternatives. For example, many larger, publicly traded multi-state cannabis operators are able to raise significant capital through public equity offerings, in addition to access to significant debt financing options. Furthermore, changes in federal regulations pertaining to cannabis could also lead to increased access to U.S. capital markets for our competitors and for regulated cannabis operators (including but not limited to access to the Nasdaq Stock Market and/or the New York Stock Exchange). According to analysis by Viridian Capital Advisors, North American cannabis companies either closed or announced more than \$5.0 billion in capital raising through April 9, 2021, representing a significant increase in the pace of capital raising for regulated cannabis operators versus the prior year period.

Increased competition for properties as a result of greater clarity of the federal regulatory environment may also preclude us from acquiring those properties that would generate attractive returns to us.

By way of example, Congress introduced several proposed bills in the past legislative cycle focused on the regulated cannabis industry, including the Marijuana Opportunity Reinvestment and Expungement Act (the “MORE Act”) and the Secure and Fair Enforcement (SAFE) Banking Act (the “SAFE Banking Act”). If it became law, the MORE Act, which was passed by the U.S. House of Representatives in December 2020, would, among other things, remove cannabis as a Schedule I controlled substance under the CSA and make available U.S. Small Business Administration funding for regulated cannabis operators. If it became law, the SAFE Banking Act would, among other things, provide protection from federal prosecution to banks and other financial institutions that provide financial services to state-licensed, compliant cannabis operators, which may include the provision of loans by financial

[Table of Contents](#)

institutions to such operators. In April 2021, the SAFE Banking Act was reintroduced again for the fourth time in the U.S. House of Representatives and passed; the bill is expected to be reintroduced in the U.S. Senate for consideration.

If any of the proposed bills in Congress became law, there would be further increased competition for the acquisition of properties that can be leased to licensed cannabis operators, and such operators would have greater access to alternative financing sources with lower costs of capital. These factors may reduce the number of operators that wish to enter into lease transactions with us or renew leases with us, or may result in us having to enter into leases on less favorable terms with tenants, each of which may significantly adversely impact our profitability and ability to generate cash flow and make distributions to our stockholders.

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

None.

ITEM 3. *DEFAULTS UPON SENIOR SECURITIES*

None.

ITEM 4. *MINE SAFETY DISCLOSURES*

Not applicable.

ITEM 5. *OTHER INFORMATION*

None.

ITEM 6. EXHIBITS

Exhibit Number	Description of Exhibit
10.1	Director Compensation Policy . ⁽¹⁾
10.2	Form of Performance Share Unit Award Agreement . ⁽¹⁾
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	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.
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 Data File (formatted as Inline XBRL and contained in Exhibit 101).

* Filed herewith.

(1) Incorporated by reference to Innovative Industrial Properties, Inc.'s Current Report on Form 8-K filed with SEC on January 15, 2021.

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/ Catherine Hastings

Catherine Hastings

Chief Financial Officer and Treasurer

(Principal Financial Officer)

Dated May 6, 2021

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: May 6, 2021

/s/ Paul Smithers

Paul Smithers

Chief Executive Officer, President and Director

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

I, Catherine Hastings, 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: May 6, 2021

/s/ Catherine Hastings

Catherine Hastings

Chief Financial Officer and Treasurer

**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 March 31, 2021, 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, Catherine Hastings, 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.

May 6, 2021

/s/ Paul Smithers

Paul Smithers

Chief Executive Officer, President and Director

/s/ Catherine Hastings

Catherine Hastings

Chief Financial Officer and Treasurer
