



CITY OF LOS ANGELES
INTER-DEPARTMENTAL CORRESPONDENCE

Date: April 28, 2023

To: The Honorable Planning and Land Use Management Committee

From: Michelle Garakian, Interim Executive Director 
Department of Cannabis Regulation

Diana Mangioglu, Director/City Treasurer 
Office of Finance

Subject: **ESTIMATED REVENUE LOSS ASSOCIATED WITH UNAUTHORIZED CANNABIS ACTIVITY; COUNCIL FILE 21- 1087**

On September 29, 2021, the Planning and Land Use Management Committee (PLUM) directed the Department of Cannabis Regulation (DCR) and the Office of Finance (Finance) to report back on “*the estimated valuation of revenue loss associated with the production and sale of unlicensed cannabis*” ([CF 21-1087 Rodriguez - O’Farrell](#)). The Department of Cannabis Regulation, in collaboration with the Office of Finance, hereby submits this report in response to the PLUM Committee motion.

BACKGROUND

The Department of Cannabis Regulation was established in 2017 to administer and implement the requirements of the Cannabis Procedures ordinance and the Department’s Rules and Regulations. Starting in early 2018, DCR was instructed to begin issuing licenses to qualifying Existing Medical Marijuana Dispensaries (EMMDs) first. Some of these businesses are vertically integrated and include one or more non-retail activities (manufacturing, cultivation, distribution) at the same location. As of the date of this report, DCR has issued licenses to approximately 800 businesses. Of these businesses, 270 are authorized to engage in on-site retail sales and 530 locations have one or more commercial cannabis activities, such as delivery, cultivation, and non-volatile manufacturing, but may not engage in on-site sales.

In the City of Los Angeles, the number of commercial cannabis licenses available is based on a pre-established cap for retail and cultivation and is further restricted by the distancing requirements from sensitive uses and other retail cannabis businesses. Furthermore, issuance of these license types is limited to Social Equity Applicants until January 1, 2025.

The Rodriguez - O’Farrell Motion (Motion) reflects concerns regarding the increase in illegal cannabis grow houses in residential neighborhoods resulting in more calls for service by LAPD, an increase in water and power utilization, and an infusion of untested, potentially dangerous cannabis products into the market.

DISCUSSION

To provide the information requested in the Motion, DCR met with and requested that Finance provide the average and the median values for gross receipts tax payments made by authorized cannabis businesses for calendar year 2022, broken down by activity type including all parts of the supply chain from cultivation to retail sales (Fig 1). Because cannabis businesses are required to pay their gross receipts tax on a monthly basis, this data correlates to business activity from December 2021 to November 2022. The mean and median figures shown are monthly payments, and do not include businesses that may be permitted and registered with the City but did not make a tax payment that month.

Fund/Class	Revenue Description	Total Tax Paid 2022	Average Tax Paid (Annual)	Median Tax Paid (Annual)
L711	Medical Cannabis Sales	\$ 5,026,492.51	\$ 20,685.15	\$ 8,507.92
L712	Adult-Use Cannabis Sales	\$ 86,314,848.43	\$335,855.44	\$ 211,099.10
L714	Cannabis Testing	\$ 172,874.67	\$ 28,812.45	\$ 26,362.00
L716	Cannabis Cultivation	\$ 4,188,839.89	\$ 26,511.64	\$ 8,800.00
L718	Cannabis Miscellaneous	\$ 19,408,737.96	\$ 98,521.51	\$ 10,153.30

Fig 1. Business Tax Collected from Cannabis Business Locations by Fund/Class. Transaction dates from January 1, 2022 to December 31, 2022.

Based on the the table above, the cannabis activity that yielded the most tax sales revenue is retail as shown in Figure 2:

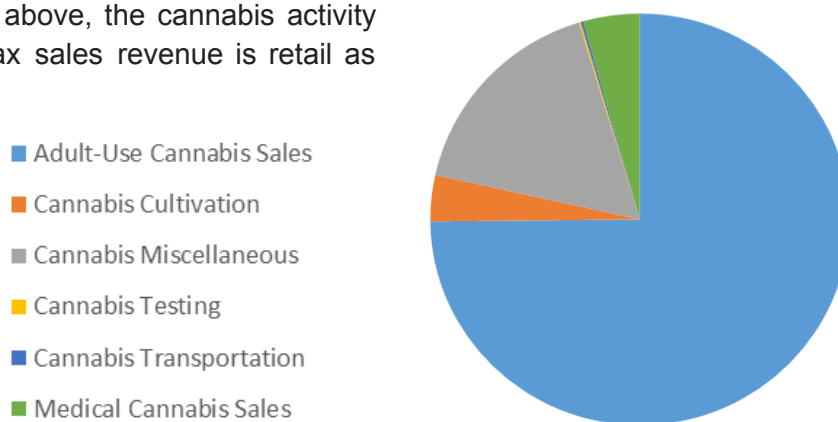


Fig. 2. Total Tax Paid by Revenue Type

Secondly, DCR looked at the LAPD year end statistics from 2022 to obtain the number of illegal retailer businesses at the end of the year to calculate the estimated loss of revenue that would otherwise be collected from these businesses if they were to enter the legal market. **At the end of 2022, there were 78 unlicensed retailer cannabis businesses¹.**

¹ Source: LAPD GND Monthly Activities Report, December 2022 (Cannabis Support Unit)

In addition to the directive for DCR, the Rodriguez - O'Farrell Motion requested the LAPD to "report on the volume of service calls regarding illegal grow houses and best enforcement practices when responding to these calls." In response to the Motion, LAPD submitted its [October 4, 2022 report](#), which provides the number of unlicensed cultivation locations under investigation. For the purpose of estimating the revenue loss in cultivation dollars, DCR assumed that the cultivation locations under investigation by LAPD are equal to the number of illegal cultivation locations. The October 4, 2022 report, reflects the following number of unauthorized locations at the end of 2022 broken down by Police Bureau:

Operations- Valley Bureau	100
Operations - Central Bureau	57
Operations - South Bureau	33
Operations - West Bureau	11
Citywide Total number of unauthorized locations	201

In order to provide a rough estimate of the revenue loss in cultivation and retailer dollars, the following assumptions were made:

- Unlicensed cultivation locations under investigation per the 10/4/2022 LAPD Report are equal to the average number of unlicensed cultivation locations.
- Initial investment costs are negligible
- The location is eligible for licensure (i.e. zoning, sensitive uses, etc)

Estimated Revenue Loss Calculation:

Based on Figure 1, the following dollar amounts were used in calculating revenue loss:

- Median tax payment collected from retail cannabis businesses of \$211,099.10.
- Median tax payment collected from cultivation cannabis businesses of \$8,800.00.

	Median Tax Collected	Unlicensed Locations	Estimated Revenue Loss
Estimated Retail Revenue Loss	\$ 211,099.10	78	\$16.46 Million
Estimated Cultivation Revenue Loss	\$ 8,800.00	201	\$ 1.77 Million
Estimated Total Revenue Loss (Retail + Cultivation)			\$18.23 Million

CONCLUSION:

Providing a reliable estimate of any tax revenue loss from these cultivation operations is virtually impossible because these businesses are illegal and therefore do not report any sort of data to the City. DCR and Finance had to make rough and extreme assumptions in order to prepare a response. The \$21.24 million in estimated cultivation tax revenue loss does not take into account any initial investments that would affect their bottom line the first few years in operation, such as finding a compliant property, capital, inventory, testing, consulting, permitting and licensing fees and the time to transition into the regulated market. In addition, at this time, there is not enough citywide capacity to accommodate all these businesses coming into compliance. However, DCR can look at potential legislative options to bring these illegal cannabis businesses (both retailers and cultivation) into the legal marketplace if requested.