

DEPARTMENT OF
CANNABIS REGULATION

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April 23, 2019

Honorable Members of the City Council
Budget and Finance Committee
c/o Office of the City Clerk
City Hall, Room 395
Los Angeles, California 90012

Attention: Richard Williams, Legislative Assistant II

DEPARTMENT OF CANNABIS REGULATION 2019-20 PROPOSED BUDGET

Dear Honorable Members:

The Department of Cannabis Regulation (DCR) appreciates and supports the funding and resources included in the Fiscal Year (FY) 2019-20 Proposed Budget. The Department would like to thank the Mayor and his Budget Team for their support during the budget process and for recommending key resources needed to continue the Department's licensing and compliance programs for authorized commercial cannabis businesses, as well as new resources to begin implementation of the Department's social equity programs and public education and outreach programs.

The Department requests the Budget and Finance Committee's support for an additional \$2.25 million General Fund (GF) allocation to the Department's Special Fund (Schedule 33 - Fund No. 60E). This request would align the Business, Licensing and Compliance (BLC) Technical Assistance Program (requested \$1.5 million) with the recently adopted Budget Policy (Council File 18-1800-S2) and support a Public Information Campaign to supplement the City's enforcement strategy with education and outreach (requested \$750,000).

Social Equity Program and Business, Licensing and Compliance (BLC) Technical Assistance Program

The City's Social Equity Program (SEP) has a number of key components including Outreach and Recruitment, Priority Processing, Business, Licensing and Compliance (BLC) Technical Assistance, the review and administration of Social Equity Agreements, and a Fee Deferral Program. **The Proposed Budget provides funding for some of these programs, but does not consider the SEP in its totality or fully address the anticipated volume of applicants, approximately 1,000, seeking programmatic assistance.** Without appropriate funding, the Department will not be able to meet the anticipated demand for program services which will lead to application processing delays. This deficiency will result in servicing less applicants which subsequently reduces the total number of commercial cannabis business applications processed next fiscal year and therefore **negatively impacts the projected annual cannabis tax revenue.**

Local law requires DCR to administer two phases of Priority Processing for eligible applicants including the issuance of Temporary Approval before beginning the more comprehensive annual licensing process (Phase Three). Since January 2018, the Department has issued temporary approvals to over 180 businesses that submitted applications during Phase One Priority Processing (LAMC Sec. 104.07). These applications will move into the annual licensing process in 2019. In FY 2019-20, the Department will begin holding public meetings for annual applications deemed complete and the Cannabis Regulation Commission will consider the issuance of the City's first commercial cannabis annual licenses. The Department continues to process applications associated with over 450 businesses that submitted applications during Phase Two Priority Processing (LAMC Sec. 104.08). Over 100 Phase Two Priority Processing applicants will receive temporary approval to operate by June 30, 2019; the remaining businesses will continue to work with City agencies to comply with adopted regulations and move through the Department's Priority Processing workflows until the Department issues or denies temporary approval.

During FY 2019-20, in addition to processing annual license applications for Phase One and Phase Two Priority Processing businesses, the Department will expand its responsibilities by beginning the annual licensing process for new businesses for the first time (Phase Three). When administering the annual licensing process for new businesses, the SEP requires the Department to process applications in a specified order. For retail licenses, the Department is required to process SEP applications on a two to one (2:1) ratio to non-SEP applications; for non-retail licenses, a one to one (1:1) ratio to non-SEP applications.

In consideration of the approximately 180 Phase One businesses with Temporary Approval (non-SEP), during Phase Three the Department expects to issue approximately 250 retail storefront licenses before undue concentration is reached throughout the 35 Community Plans Areas. Based on the previously mentioned ratio requirement, the Department must provide Priority Processing to eligible SEP applicants for the remaining retail licenses.

On April 18, 2019 and pursuant to the Council's adopted actions (Council File 18-1800-S2), the Office of the City Attorney was asked to prepare and present an ordinance whereby the Department would receive **\$3 million annually for three years to fund the Business, Licensing, and Compliance (BLC) Program**. The 2019-20 Proposed Budget includes a new General Fund appropriation of \$1.5 million to support the BLC Program. This proposed funding represents **half of the adopted commitment to fund the BLC Program**.

It is important to note that the \$1.5 million General Fund appropriation from the Unappropriated Balance recently approved and allocated by the Council to this Department's Cannabis Regulation Special Revenue Fund will support the SEP Fee Deferral Program, SEP Public Info, Education, & Outreach Program, and the expanded SEP Policy and Analysis study. This critical funding was specifically allocated for these programs which are not considered BLC Programs as your Committee and the Council have previously acknowledged.

The General Fund appropriations to support the SEP are reflected in the Department's special purpose fund schedule (Schedule 33) which can be found on page 315 of the FY 2019-20 Proposed Budget.

The table below outlines the SEP programs and associated funding (existing and proposed) available next fiscal year.

	FY 2018-19 Amended Budget	FY 2019-20 Proposed Budget	Expended or Encumbered	Available Funding in FY 2019-20
SEP Business, Licensing, and Compliance	\$ 0	\$1,500,000	\$ 0	\$1,500,000
SEP Fee Deferral Program	\$ 750,000	\$ 0	\$250,000*	\$500,000
SEP Public Info, Education, & Outreach	\$ 850,000	\$ 0	\$ 0	\$850,000
SEP Policy and Analysis	\$150,000**	\$ 0	\$ 0	\$150,000
TOTAL	\$1,750,000	\$1,500,000	\$250,000	\$3,000,000

*The Department was allocated \$250,000 in December 2018 to launch the Fee Deferral Program. This funding was encumbered to support fee deferrals for Phase 2 applicants. An additional \$500,000 was added to the FDP in April 2019 which will support Phase 3 applicants.

**Funding was identified for the expanded SEP analysis; during funding deliberations, Councilmembers expressed an interest in moving unused funding at the completion of the study to the fee deferral program. The Department will report back to the Budget and Finance Committee upon the completion of this work program to identify how any used funds should be expended.

As previously mentioned, underfunding the BLC Program, a key component of the SEP, will lead to application processing delays. This will result in servicing less applicants which subsequently reduces the total number of commercial cannabis business applications processed next fiscal year and therefore **reduces projected annual cannabis tax revenue.**

Public Information Campaign and Enforcement

At this time, the Department does not have the authority to enforce against unlawful commercial cannabis activity or to otherwise cite or levy code violation inspection fees, non-compliance fees, or other fees against unlicensed or otherwise unlawful cannabis businesses.

A collaborative enforcement strategy against unlawful commercial cannabis activity is critical to the success of the City’s newly established commercial cannabis regulatory program. For decades, the City of Los Angeles has experienced the adverse impacts associated with a proliferation of unlawful cannabis businesses despite a general prohibition on cannabis activity, and significant enforcement action by law enforcement agencies.

The Department is currently collaborating with the Mayor, Council and other City Departments to develop and implement a collaborative enforcement strategy to reduce the size of the illicit market and to address complaints from constituents and the regulated industry regarding unlawful commercial cannabis activity. For example, the Department developed the Cannabis Complaint portal in collaboration with ITA and is currently developing a citywide complaint management system to effectively respond to complaints about illegal cannabis establishments. Further, the Department worked in collaboration with LADWP and LAPD to establish the process and procedures for the Utility Shut Off Ordinance. Given the interdependence of commercial cannabis licensing and enforcement, the Department will continue to play a central role in the City’s enforcement strategy.

As such, the Department recommends that this committee consider the Department’s request to fund Education and Outreach through a public information campaign a part of the City’s enforcement strategy. A well-resourced Public Information Campaign would promote lawful authorized retail stores as a safer alternative to illegal cannabis establishments and would encourage cannabis consumers to patronize licensed operators subsequently **increasing tax revenue for the City.**

Although we support the Mayor’s FY 2019-20 budget proposal to allocate \$250,000 towards a Public Information Campaign, the Department respectfully requests that this Committee support an additional General Fund appropriation of \$750,000 to allow the Department to develop and implement a critical and long overdue information campaign to educate the general public and consumers in what is the second largest city in the United States and is often referred to as the largest cannabis market in the world.

Overview of Commercial Cannabis Tax Receipts

Since the City’s transition to its regulatory program on January 1, 2018, the commercial cannabis business activities reported to the Office of Finance have increased from \$213 million in 2017 to \$420 million in 2018. As anticipated, reported measures associated with retail medical cannabis activities have decreased and reported measures associated with adult-use (recreational) cannabis activities have increased. Based on 2018 actuals, business taxes levied on adult-use cannabis sales now represent 60% of the reported tax measures and 77% of all commercial cannabis taxes levied. The table below lists the retail commercial cannabis measures reports and corresponding taxes levied in 2018 broken down by cannabis activity type.

Cannabis Activity Type	Tax Period	Total Reported Measures	Taxes Levied plus Penalties	Outstanding Balance Due
Medical Cannabis Sales	2018	\$125,059,373.61	\$ 6,037,459.43	\$ 495,363.37
Adult-Use Cannabis Sales	2018	\$252,315,904.79	\$23,398,112.49	\$3,817,314.14
Cannabis Transportation	2018	\$ 5,776,380.15	\$ 57,645.18	\$ 3,542.84
Cannabis Testing	2018	\$ 2,312,401.00	\$ 24,126.15	\$ 6,911.73
Cannabis Cultivation	2018	\$ 11,293,138.15	\$ 220,688.12	\$ 12,256.28
Cannabis Miscellaneous	2018	\$ 22,942,826.00	\$ 362,387.31	\$ 94,766.77
ALL CANNABIS ACTIVITIES	2018	\$419,700,023.70	\$30,100,418.68	\$4,430,155.13

Projected commercial cannabis tax receipts, as outlined in the 2019-20 Proposed Budget, may not be realized until sufficient Phase Three applications are processed and conclude with a positive licensing determination. Expanding the number of businesses authorized to engage in commercial cannabis retail sales (Storefront and Non-Storefront Delivery) will increase the number of businesses subject to the City’s commercial cannabis taxes and is one way to expand the City’s underlying commercial cannabis tax base. Although the number of authorized commercial cannabis businesses within the City will increase by several hundred due to the processing of Phase 2 applications, these businesses pay 1-2% in business taxes which, on its own, will not generate sufficient tax receipts to account for the proposed cannabis tax revenue increases.

Based on the policies currently under consideration, the earliest Phase Three could begin is November 2019 after the Department completes an initial 60-day SEP eligibility verification filing period and presents an analysis of the expanded SEP study to the Council. The expanded SEP study was requested by the Council to evaluate variables which may identify additional disproportionately impacted areas. If additional areas are identified and adopted into the formal SEP by ordinance, the Department is required to reopen the SEP eligibility verification filing period for an additional 30 days. Once those steps are completed, the Department would initially accept and process 100 Social Equity eligible Retail-Storefront applications. Upon completion of the review and vetting of the initial 100 Phase Three applications, the Department would accept and process an additional 150 Social Equity eligible Retail-Storefront applications. Once the first two rounds of Retail-Storefront applications are processed, the Department may begin

accepting Non-Storefront Delivery applications. In order to realize proposed tax revenues, the City will likely need to amend some of the policies currently under Council consideration to allow the Department to process Non-Storefront Retail/Delivery Only applications before November 2019.

Summary of Authorized Commercial Cannabis Businesses and Tax Liabilities:

Over 200 business locations have authorization from the Department to engage in commercial cannabis activity within the City and have received cannabis business tax registration certificates (BTRCs) from the Office of Finance. Businesses that are not in good standing with the Office of Finance may have their temporary authorization revoked and lose their local authorization to engage in commercial cannabis activity. The below summary does not include taxes levied in 2019.

- 31 businesses have reported no taxable activity and thus had no outstanding liabilities to due.
- 106 of the authorized businesses have paid their tax obligations in full. These businesses account for \$16.5 million in receipts.
- 41 businesses have unpaid liabilities, but have paid the majority of their tax obligations (over 80%). These businesses account for \$10.8 million in receipts to date and have \$1.0 million in outstanding liabilities.
- 27 businesses have paid between 50% and 80% of their tax obligations. These businesses have remitted \$3.8 million in payments and have \$1.8 million in outstanding liabilities.
- 30 businesses have paid less than 50% of their taxable liabilities. These businesses have remitted approximately \$753,000 in payments and have \$3.4 million in outstanding liabilities.
- 14 businesses have essentially paid no tax liabilities. Nine of these businesses have outstanding liabilities of between \$100,000 and \$400,000.

Conclusion:

The Department of Cannabis Regulation aims to be a trusted resource for community members and cannabis businesses seeking cannabis related information. We appreciate your careful consideration and look forward to discussing these important items with the Committee.

As mentioned, the Department requests the Budget and Finance Committee's support for an additional \$2.25 million General Fund (GF) allocation to the Department's Special Fund (Schedule 33 - Fund No. 60E). This additional funding for BLC and a Public Information Campaign will result in servicing more applicants which subsequently increases the total number of commercial cannabis business applications processed next fiscal year and therefore meets the projected annual cannabis tax revenue of \$65 million in FY 2019-2020.

Thank you for this opportunity to address your Committee. If you have any questions, please contact me at (213) 978-0738.

Honorable Members of the City Council
Department of Cannabis Regulation 2019-20 Proposed Budget
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Sincerely,

A handwritten signature in black ink that reads "Cat Packer". The signature is written in a cursive, flowing style.

CAT PACKER
Executive Director
Department of Cannabis Regulation

c: Honorable Herb Wesson, City Council President
Miguel Sangalang, Deputy Mayor for Budget and Innovation
William Chun, Deputy Mayor for Economic Development
Richard Llewellyn, City Administrative Officer
Sharon Tso, Chief Legislative Analyst