CLIENT ALERTS & INSIGHTS

Illinois Cannabis Outlook 2024

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Since passing recreational cannabis in 2019, Illinois has emerged as one of the largest cannabis markets in the country, with total sales approaching $2 billion in 2023. Adult-use cannabis tax revenue topped that of alcohol, perhaps demonstrating a durable consumer preference for a buzz without the hangover. But a quick glance under the hood suggests Illinois cannabis is far from maximizing its full potential, with hundreds of licensees still stuck in first gear.

The licensed medical operators, who had first mover advantage in the adult use market when sales began in 2020, have continued to flourish with an outsize share of canopy space and ownership of many of the flagship dispensary locations in Illinois’ largest markets. Illinois licensed cultivators continue to set the price for trim, distillate, and bulk flower. According to a recent report by Headset, “[t]he average item price in Illinois is currently 89% higher than the rest of the U.S. market.”[1] These high prices are pushing consumers to other markets like Michigan, where there is no cap on licenses, and Missouri, which has a much lighter regulatory touch and many more active cultivators (both also permit outdoor cultivation).

While the first movers continue to enjoy an outsized market share, the picture is far less rosy for Illinois’ newer, “social equity” operators. With the industry-wide capital crunch due in large part to investors’ concerns over less than stellar returns (or none at all), and the increased cost of construction, labor, and materials, social equity operators in Illinois have been hit hard. Perhaps nothing demonstrates this one-two punch better than the fact that only 11 craft growers (out of 87 licensed) and only 10 infusers (out of 55 licensed) have become operational since 2021. To make matters worse, the Department of Agriculture recently issued what it calls the “last universal extension for craft growers’ operational deadlines.” In a rare bright spot, the Department did issue a rule which would allow craft growers to receive regulatory approval to expand up to 14,000 square feet of canopy (the maximum allowed by statute, but still 1/15th of what the original cultivation license holders are permitted to cultivate).

Social equity transporters have perhaps fared the worst of all, with nearly all of the stand-alone license holders finding no market for their services. Recognizing this frustrating reality, legislators passed a moratorium on new licenses and license fees until 2027 (although transporters did have to pay $10,000 for 2023 to keep their licenses alive). Still, nothing has been done to remedy the fact that there are already far too many licensed transporters - 134 - a number so high that not even direct-to-consumer delivery could create a reasonable path to success for the majority of transporter licensees.

With a lower initial capital investment and a quicker path to cash flows, Illinois social equity dispensaries have fared slightly better, with 68 social equity dispensaries of 199 operational. That said, an important summer deadline requiring that dispensaries “find a location or become operational" (only litigation will tell which is required!) looms large over the remaining 131 dispensary licensees. This deadline, which the legislature extended in 2023, must be extended again to avoid the political nightmare of 100+ failed social equity licenses. We should also note here that many of the social equity licensees who are operational no longer qualify as such because they've either sold their license or been diluted.

Perhaps the most significant regulatory event for social equity applicants in Illinois was last year's creation of its Direct Forgivable Loan Program, which issued fully forgivable loans directly to craft growers, infusers, and transporters who had previously applied for a Cannabis Social Equity Loans through the Department of Commerce and Economic Opportunity. The new program offers direct loans from the State of up to $1.25 million directly to the social equity applicants. While these loans are fully forgivable if spent on eligible expenses, only 12 companies were eligible for the loans. Additional funds were allocated in last year's budget, and we expect DCEO to issue applications for loans to dispensaries in the coming months, although at much smaller dollar amounts.

So, with all these issues, social equity licensees were hoping the legislature would step in to fix what they saw as broken. While the legislature did extend the deadline for dispensaries in last year's omnibus bill and provide much-needed relief from 280E, they have thus far not addressed a myriad of common-sense, seemingly noncontroversial changes.

The legislature recently went back into session, so there is hope for the licensees. There are several changes up for evaluation, all of which have been considered before, that might receive new life. Chief among them are the following:

1. Extending the looming summer deadline for dispensaries to be operational.
2. Permitting adult use dispensaries to sell cannabis to medical patients under the same tax regime as the medical dispensaries. This change would be a boon not just to social equity dispensary licensees, but to craft grows and infusers whose products cannot be sold as medical cannabis, and for patients, who are currently limited to shopping at the relatively few medical dispensaries to receive their benefits.
3. Consolidating Illinois' two cannabis regulatory agencies into one agency or commission. The Governor's office wants an agency, but industry wants a commission, and legislators are split. Time will tell what the two sides can come up with, if anything.
4. Providing infusers with the ability to extract - infuser licenses are near worthless without this capability. Though the addition of a few dozen infusers with the ability to extract is seen as a threat by many craft growers.
5. Regulation of, or a complete ban on, psychoactive hemp products. This has been a major point of contention between hemp and cannabis operators in the State and across the country, as hemp businesses are capable of selling psychoactive THC products to consumers at a much lower price point due to cheaper production costs, lack of 280E, the ability to sell in interstate commerce, and little to no regulatory oversight. The disputes over psychoactive hemp regulation killed the omnibus bill last year. We'll see what happens this time around.
6. Drive-thru windows at dispensaries.

7. An automatic ability for craft growers to cultivate 14,000 square feet of flowering canopy, without requiring approval from the IDOA.
8. Other considerations include increasing the allowable number of home-grow plants for patients and standardizing and simplifying the employee badging process.

Outside of legislative changes, the following industry developments are on our radar:

1. An influx of M&A activity due to the federal rescheduling of cannabis from Schedule 1 to Schedule 3 and the death knell of 280E. We suspect that given the daunting task of raising money, getting operational, and maintaining consistent cash flows, buyers will continue to have a field day purchasing licenses in Illinois.
2. We expect many more brands to enter the Illinois marketplace, via white labeling or joint ventures, by partnering with struggling infusers, craft growers, and dispensaries. Headset recently put Illinois “dead last” in terms of the number of brands in the market, with only 118 active brands as of the date of the report, “52.6% less than second-to-last Arizona,” so there is plenty of room to grow. [2]
3. The release of the long-awaited disparity study, which is intended to evaluate whether discrimination exists in the State’s cannabis industry and the impact of such discrimination on the State. The question is whether the disparity study will provide the State with a “compelling interest” to support the creation of programs that specifically target minority- and women-owned businesses. If it does, the State could adopt remedial measures to remedy discriminatory barriers for MBE/WBE’s attempting to enter the cannabis space, as is done in many construction trades.
4. The issuance of 55 additional social equity conditional dispensary licenses, adding more suitors for the very active M&A market-ones that do not have a looming deadline attached to their ability to become operational.
5. The resolution of the current craft grower litigation, where scores of applicants who believe they should have been awarded licenses fight for the small number of licenses available. Whether anyone who actually receives a license from this litigation will have the ability to stand up a grow remains to be seen.
6. The offering of loans and grants, small as they may be, to social equity dispensaries. This has been promised since the CRTA was implemented 3.5 years ago and has yet to materialize.
7. Perhaps this one is more of a hope: An easing of regulatory burdens on new licensees as regulators internalize the impact of strict regulation on licensees on the cusp of failure. This is particularly true for the IDOA, which has implemented onerous and breathtakingly expensive requirements for opening and operating cannabis businesses under its purview. A good example of something we may see is an increase in the mold thresholds for growers. Illinois has some of the lowest mold thresholds in the entire country. In fact, most of the cannabis sold in Illinois is put into an irradiator (similar to a microwave) to kill the mold spores. That’s the only way to get compliant flower on the shelves, and it results in dry flower.
8.

The coalescence of different social equity license types into one association. Currently, there are several different associations claiming to represent licensees. The confusing division amongst social equity operators is making it harder for them to speak with one voice and is in turn making it difficult for legislators to respond to their needs.

9. The first failure of a social equity licensee. Whether it's a lost harvest, moldy flower, the inability to buy distillate or trim at reasonable prices, inefficient payment terms, or simply the difficulty of operating a business on slim margins in a highly regulated industry, we may, unfortunately, see the first failure of a social equity owned company.

Whether good or bad, 2024 is sure to bring some changes to the Illinois market.

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[1] A deep dive into the Illinois cannabis market (headset.io)

[2] A deep dive into the Illinois cannabis market (headset.io)