

SNAPSHOT- PANDEMIC THREATENS IMI REVENUE AND LONG-TERM VIABILITY

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The COVID-19 pandemic and accompanying closure of non-essential businesses have severely compromised the financial standing of illicit massage businesses (IMBs) across the country. Once considered a low-risk, highly profitable criminal enterprise, we assess nearly all IMBs will likely be approaching complete insolvency should the pandemic and near-zero buyer demand persist for five more months (1), with many approaching insolvency much sooner. We judge the majority of IMB revenue will continue to be generated from high-frequency commercial sex buyers, as low-frequency buyers will probably avoid IMBs in the short-to-medium term. We further assess that many IMB owners will almost certainly explore alternative revenue streams, at least temporarily, to avoid the permanent closure of their businesses, such as enrolling in small business assistance programs. While IMB owners will try to capitalize on the eventual re-opening of non-essential businesses, state and city leaders are well-positioned to prevent IMBs from returning to normal business operations.

NEAR ZERO DEMAND PROMPTS IMB OWNERS TO DIP INTO RESERVES: The recent, substantial drop in revenue is almost certainly prompting IMB owners to minimize business costs and tap into cash reserves to keep their businesses afloat. Anecdotal reporting suggests IMB owners typically have between \$10,000 to \$100,000 dollars of cash-on-hand, as well as maintain access to other assets, such as real estate and vehicles. Nevertheless, as some IMBs continue operating clandestinely, we judge most IMB owners will be reluctant to significantly bolster their cash holdings based on a heightened fear of law enforcement raids and seizures during the health crisis.

IMB FINANCES AT A GLANCE: Depending on the geography, fixed IMB overhead costs typically range from \$5,000 to \$10,000+ per month, to include rent, utilities, and some labor costs. Prior to the pandemic, we assessed each IMB storefront generated between \$23,000 to \$39,000 dollars per month in revenue. Based on our current knowledge about reduced buyer demand and staffing levels, we judge current overhead costs are likely running about 1.3x of current gross revenue, thus forcing many IMB owners to tap liquid reserves (2).

- Rent constitutes the bulk of an IMB owner's fixed costs, although such costs vary wildly depending on the locality. While some IMB owners may have already pre-paid their rent for the year, thereby improving their liquidity position relative to their peers who did not pre-pay, we lack insight into whether this practice is widely-used within the broader IMI.
- Labor costs also vary from IMB-to-IMB depending on the number of victim-workers located at each storefront and the agreed upon profit-sharing agreements between victim-workers and IMB owners. Variable costs, for items such as condoms and lubricant, almost certainly fluctuate based on a variety of factors, to include sex buyer demand.
- Some IMB owners also incur other hidden operating costs, such as maintaining off-site apartments for victim-workers, although we assess these IMB owners may demand victim-workers continue paying for these ostensible benefits regardless of their inability to generate income on account of business closures.

IMB OWNERS ARE DOWN BUT CERTAINLY NOT OUT: The current financial situation aside, we judge IMB networks remain highly adaptable to external pressure and IMB owners will almost certainly take steps to prevent the permanent closure of their businesses. We posit IMB networks with affiliated brothel footprints will seek to re-direct a number of buyers to non-storefront venues to maintain some level of short-term revenue generation. Such alternatives will probably resonate with high-frequency buyers; however, low-frequency buyers will likely avoid brothels given the increased risks associated with buying sex outside of storefront locations and their general unease about contracting the virus, as well as increased child-care and family obligations which have made it difficult for them to leave their homes.

- We judge some eligible IMB owners will seek funding assistance associated with recently enacted small-business assistance programs. These individuals will likely file fraudulent paperwork as part of these efforts, to include producing documents which claim an inflated number of employees at each storefront location.
- We further posit that IMB owners will likely avoid near-term eviction for failing to pay rent, as several states have placed temporary holds on residential and commercial evictions. Some IMB owners may seek to negotiate with resource-strapped landlords to obtain partial or total-rent forgiveness for the period covering the non-essential closures.

PREVENTING A RETURN TO NORMAL OPERATIONS: Elected leaders, both at the state and local level, are well-positioned to direct personnel not currently supporting COVID-19 response efforts to advance comprehensive counter-IMB strategies, to include what we judge to be highly effective landlord education programs which highlight suspected illegal IMB activity to landlords and seek their help in terminating IMB leases. Leaders should also take legal steps to prevent the immediate re-opening of IMBs at the conclusion of the current health crisis, such as ensuring that businesses suspected of being involved in illegal or illicit activity, to include providing sexual services, undergo a health and/or business inspection prior to re-opening. State and federal inspectors would also be wise to conduct additional due diligence on small business loans associated with suspected IMBs, with an eye towards uncovering potential fraud. Such efforts should include comparing a suspected IMB's previous tax documents with those submitted as part of these assistance programs.

FOOTNOTED ADDENDUM:

- (1) Monthly viability was calculated assuming the following formula and near-zero buyer demand (eg. average of 2 workers, servicing 15 customers each per month, at a cost of \$124/sex act):

$$Viability = \frac{Monthly\ Reserves}{Cash\ Deficit\ during\ COVID19} = \frac{(Rent + Utilities + Labor) * 1.25^*}{|Monthly\ Revenue - Monthly\ Costs|}$$

*It is estimated that owners save slightly more than one month's reserves. This assumption was based on court documents from the Thai sex trafficking investigation known as Bangkok Dark Nights, which indicated that defendant and brothel operator Michael Morris kept slightly over one month's worth of cash in his accounts to cover overhead costs for each of his three brothels.

- (2) The estimated overhead cost estimate of current gross revenue is based on the following formula:

$$Overhead\ Costs\ Estimate = \frac{Monthly\ Costs}{Monthly\ Revenue} = \frac{Rent + Utilities + Labor}{Workers * \frac{Sex\ Acts}{Worker} / Month * \frac{Cost}{Sex\ Act}} \approx 1.3$$