HUMBOLDT COUNTY
GROWERS ALLIANCE

HCGA Comment on Measure S Suspension and Project Trellis

January 31, 2022

Dear Supervisors and Staff,

On behalf of Humboldt County Growers Alliance, representing 275 licensed cannabis businesses in Humboldt County, we appreciate the opportunity to offer comments on the Measure S and Project Trellis items agendized for tomorrow's Board of Supervisors meeting.

Since summer of 2021, HCGA has raised an alarm regarding collapsing wholesale prices for cannabis that have led to increasingly severe conditions for Humboldt cannabis farmers (see, for example " 'Times are really, really tough': Plummeting cannabis prices strain small farmers" Eureka Times-Standard, August 21, 2021).

On October 5, recognizing the depth of the crisis within the cannabis industry and inability for many farmers to pay required taxes, your Board voted to allow cultivators to defer their October 2021 Measure S cannabis tax payment until May 31, 2022.

Since that time, with the due date for both the deferred October 2021 tax payment and the additional March 2022 payment now approaching, the severity of marketing conditions affecting cannabis farmers has only deepened. With wholesale prices continuing to flatline, it has become clear that the structure of the Measure S tax itself - passed in 2016, prior to the implementation of Proposition 64, and under much different market conditions - is no longer sustainable.

Consequently, on December 23, 2021, HCGA sent your Board a letter requesting 1) a short-term, two-year suspension of the Measure S cannabis cultivation tax, and 2) a longer-term discussion on a reduction and restructuring of the tax.

This Friday, on January 28, a staff report became available for this Tuesday's February Board meeting containing a range of potential recommendations for the future of Measure S. Additionally, this staff report contains wide-ranging financial information on both revenue and expenditures for Measure S.

Both the policy recommendations and financial information included in the report are substantive and complex. Additionally, the Board has not yet had the opportunity to hear from the public in an open forum on the issue of Measure S suspension. For these reasons, we ask that your Board prioritize tomorrow's meeting to seek public input and provide further direction to staff, rather than to take any final action concerning the future of Measure S.

Below, we provide our initial response to several components of the staff report: 1) the ad hoc committee proposal for tax deferrals, 2) financial information on Measure S revenue and expenditures, 3) staff concerns regarding state cultivation taxes and the impact of Measure S suspension on county services, 4) proposals to limit tax relief only to farms under 10,000 square feet, and 5) considerations regarding Measure S and Project Trellis.

Ad Hoc Committee Recommendation for Additional Deferrals

The primary proposal contained in the staff report is a recommendation from the ad hoc committee that would allow farmers to opt-in to defer their Measure S taxes until 2024. In the calendar year 2024, the full amount of these taxes would become due, but cultivators would be able to apply for partial or complete waivers based on financial need and demonstrated profit and loss. Our understanding is that partial or full tax waivers would then be granted to farmers at the discretion of the county.

We are opposed to this recommendation, for the following reasons:

a. The ad hoc recommendation suggests that the current tax structure is a failure - a tax policy which assumes that a large proportion of taxpayers will be unable to pay is inherently unjust and unsustainable. Rather than adding further bureaucratic structure to attempt to sustain a broken system, we believe it is far more sensible to suspend the current tax while opening a conversation on the establishment of a just and equitable alternative tax.

b. Additional deferrals will push farmers deeper into debt - at the October 5 Board meeting, both supervisors and staff expressed concern that a simple deferral of Measure S tax payments would risk pushing farmers further into debt, putting farmers' licenses and homes at risk if market conditions remain the same. We are not comfortable with a policy that asks farmers to take on tens or hundreds of thousands of dollars in debt based on a speculative potential for this debt to be waived later at the county's discretion.

c. Taxation should be set by policy, not by county discretion on how much money farmers "should" be making - the ad hoc's proposal would essentially give discretion to the county on how much money farmers "should" be making, with no clear structure or due process on how these determinations would be made. This resembles a tax on profit, but would be determined on a discretionary basis rather than a basis in policy. Like any other business, cannabis farmers should be allowed to make money. Tax should be set by policy, not offered as an act of charity.

d. The ad hoc committee recommendation would likely require substantial staff time and budget to develop and implement - if a two-year deferral of Measure S tax were made available, we anticipate an extremely high rate of opt-in by cultivators - perhaps 90% or greater. While the staff report estimates a potential opt-in rate of 60%, possibly based on the rate of opt-in to deferrals for the October 2021 tax payment, we anticipate the opt-in rate for an additional two-year deferral would be much greater. The October 2021 deferral was only for six months, was not widely promoted or announced by the county, and was not available to those farmers who paid their annual taxes in full in March 2021. Additionally, extended low wholesale prices have deepened the level of need among farmers since the previous deferral in October.

A two-year deferral would potentially require staff to assess financial need for as many as 800 or more cultivators, and render a decision on whether any given cultivator must pay anywhere from tens to hundreds of thousands of dollars to the county at the end of the deferral period. This is a tremendous responsibility and investment of staff time by county officials, who would literally hold the livelihoods of hundreds of people in their hands.

e. <u>The ad hoc committee recommendation is unlikely to accomplish the county's stated budgeting goals</u> - if a large proportion of cultivators take advantage of a deferral proposal, the county would not be able to raise significant revenue to fund expenditures in calendar years 2022 and 2023. Considering the claim in the staff report that a reduction in Measure S tax revenue may result in hiring freezes and cutbacks, we are confused as to why the ad hoc's recommended solution involves a deferral that would, at a minimum, dramatically reduce county Measure S revenue in 2022 and 2023.

<u>Alternative Tax Proposals Should be Informed by a Clear Understanding of County Financials</u>

In addition to the ad hoc committee recommendation, the staff report contains a range of alternative potential tax structures for consideration.

We do not feel we have adequate time to fully review these proposed alternatives before tomorrow's meeting. In general, however, we see it as critical that any potential alternatives are assessed based on a clear understanding of county and Measure S financials.

Staff's summary of Measure S tax expenditures for 2018-2021, which is attached to Friday's staff report, is the first time that we have seen clarity on the utilization of Measure S funds dating back to the inception of the tax.

The staff summary reveals that, since 2018, Measure S revenue has been used to fund $31.4 million in one-time capital expenditures. For comparison, just $3.8 million in Measure S funds have been allocated to annual, recurring expenditures.

We believe strongly that, in the midst of a market collapse, cannabis tax revenue should not be used to fund additional one-time capital expenditures going forward. Similarly, in the midst of a market collapse, we believe it would be irresponsible for the county to utilize cannabis tax revenue to budget for new, additional staff positions or wage increases which are not already in place.

For this reason, we believe it is reasonable to focus the conversation on the $3.8 million in Measure S funds that have already been budgeted for ongoing costs, such as existing staff. Of this amount, $1.2 million is currently slated to be allocated to a countywide cannabis marketing program. As HCGA communicated to you in our January 19 letter, we do not support this program, which is ostensibly intended for the industry's benefit, and have requested that it not move forward.

If countywide marketing is excluded, the amount of Measure S funding which is currently committed to ongoing costs is reduced to just $2.6 million - a fraction of the $9.2 million that the county estimated it would collect in 2021.[1]

If the amount of ongoing funding currently committed through Measure S is just $2.6 million, the conversation over Measure S suspension is much different than if the amount of funding at issue is assumed to be the $20 million or $9.2 million. This financial background should inform any potential alternatives considered for the future of Humboldt cannabis taxes. At this more modest level of ongoing costs, are there other sources of funding that could be used to cover those programs seen as most essential?

State Cultivation Taxes Do Not Justify County Cultivation Taxes

A significant portion of the staff report is dedicated to an analysis of state cultivation taxes. Staff claims that state cultivation taxes exceed county cultivation taxes, and that it is unfair to ask the county to reduce taxes without state action.

Elimination of the state cultivation tax is a top priority for HCGA via our public policy partnership with Origins Council, and has been a top priority of HCGA's government affairs program for several years. However, state tax reform is highly political, and there is no way to guarantee - or for us, or the county, to fully control - whether and how the state acts on tax reform.

DCC Director Nicole Elliott was quoted on January 31, as stating the following regarding state taxes: *"It is an oversimplification to say that tax reduction will solve all of the industry's problems… it's just a vast oversimplification of the number of variables that impact the health of the legal market and that support or foster illegal activity. It is not tax alone."*

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[1] CAO Elishia Hayes June 28, 2021.pdf

While we agree with Director Elliott that the cannabis industry faces many issues in addition to onerous state taxation, her statement points to the limitations of pointing “elsewhere” for solutions that are fully within the county’s authority to address right now.

Perhaps most to the point, even in a best case scenario, the legislative calendar does not allow state taxation to be addressed any earlier than summer of 2022. Measure S taxes, however, including taxes deferred from October 2021, will be due by May, and farmers simply do not have the ability to pay. The Measure S tax is the most imminent cost affecting Humboldt farmers, as well as the only tax that is actually within the county’s control to address.

Struggles for Cannabis Farmers Are Universal, and Not Limited to Farmers Under 10,000 Square Feet

The staff report also contains a suggestion that tax relief might be targeted exclusively for outdoor farmers under 10,000 square feet. Specifically, the staff report includes the following:

> *“[An alternative recommendation is to] provide tax reduction/suspension to small (10,000 sq ft or less) outdoor cultivation farms, who have reportedly been impacted to a greater extent by the drop in market pricing and who over the long-term operate a more environmentally sustainable business model… This alternative also focuses on the small local farmers, who are more likely to have struggled with historical inequities and the transition from the illegal to legal cannabis marketplace.”*

If and when the county adopts a new tax structure to replace Measure S, HCGA supports both a substantial overall tax reduction and additional tax relief specifically for small and outdoor farms. We believe it is critical to acknowledge that all farms in Humboldt have been heavily impacted by market conditions and the costs of regulation, regardless of size, and for this reason do not support a tax policy that exclusively provides relief to farmers under 10,000 square feet.

In November of 2021, HCGA distributed a policy survey to membership and received sixty responses. All licensees responding to the survey were asked about their farm size (if they were cultivators), as well as the question: “Overall (on a scale of 1 to 5), how confident do you feel in your business' ability to succeed in the regulated market?” Survey results found near-universal struggles among farmers, with little correlation with size:

Farm Size	Average confidence in success	Number of Responses
Less than 5,000 square feet	2.7 out of 5	8
5,000-10,000 square feet	2.8 out of 5	16
10,000-20,000 square feet	2.0 out of 5	13

20,000 square feet - 1 acre	2.7 out of 5	7
More than 1 acre	2.4 out of 5	7

The Scope of Project Trellis should be Reduced to Focus Solely on The Dispersal of State Equity Funds

Both the Measure S staff report and Project Trellis staff report discuss the future of the Trellis program in light of a potential Measure S suspension.

Given that the Trellis marketing and microgrant programs are funded exclusively through Measure S taxes, there is a clear necessity to assess how a Measure S reduction or suspension would affect these Trellis programs.

At the Project Trellis stakeholder meeting held on Friday, January 21, staff acknowledged that there may be a need for the scope of Trellis to change, and asked for feedback from the community on next steps forward. Among the farmers who commented, there was broad agreement that they would like to see Trellis narrow its scope exclusively to the state-funded equity program, and that they would like for Trellis to no longer administer the microgrant or collective marketing programs which are funded exclusively through a re-allocation of Measure S taxes.

As HCGA, we share this perspective. Ultimately, with the exception of the equity program, the funds distributed by Project Trellis are our funds. To place a special tax on the industry, and then return pennies on the dollar back to us through a complex administrative process, is not an effective way to support struggling farmers, and should not be offered as a reason to retain Measure S. A Measure S suspension would not affect the availability of state equity funds, nor would it affect other state-funded grants such as the recent $18 million allocated for water storage and solar through the Local Jurisdiction Assistance Grant Program.

The Board Should Give Staff Substantive Direction on the Future of Trellis

Considering staff's framing at the January 21 Trellis stakeholder meeting, we were disappointed to find that the staff report for this item is not focused on an open discussion on the future of the Trellis program. Instead, the staff report is largely focused on the FPPC's determination to disqualify HCGA from consideration under the Trellis collective marketing RFP, and asks your Board to "affirm" this FPPC decision.

While your Board may affirm the FPPC's decision if you wish, we do not see this as useful or necessary. After seeking legal counsel to understand the scope of the FPPC determination, it was made clear to us as HCGA that, while we may disagree with the FPPC's decision philosophically, from a practical perspective it is final. HCGA does not seek to challenge the FPPC's decision, no longer seeks the marketing contract in light of this decision and subsequent discoveries regarding the constraints of public contracting, and would not accept a public marketing contract if it were offered to us.

Additionally, over the past several months, we have come to understand that the public contracting process itself is incompatible with democratic participation and governance by the farmers who are the sole funders, critical stakeholders, and intended beneficiaries of a collective marketing effort.

While we see no need for your Board to adjudicate the wisdom of the FPPC's determination, then, we do see an urgent need for your Board to provide substantive direction on the future of the collective marketing program, as well as Project Trellis more broadly.

As you know, on January 19, HCGA sent your Board and staff a letter expressing our opposition to a county-funded or administered collective marketing program for the cannabis industry, a position unanimously endorsed by our ten-person policy committee and four-person board.

To be clear, HCGA still strongly supports the concept of collective marketing. It is evident to us, however, that this marketing effort must be carried out via direct funding and governance from the industry itself rather than through a reallocation of Measure S tax funds through the county. This is for a number of reasons outlined in greater detail to you in our January 19 letter, including the non-disclosure of marketing proposals to the public, the framing of a public contracting process as for the benefit of the county rather than for farmers, and the unprecedented exclusion of HCGA, as the industry trade association, from the marketing of our own industry through a public contract.

In the staff report, staff suggests that *"In September of 2021, HCGA performed a survey of local cultivators which highlighted the Project Trellis marketing initiative as a top priority."* This is incorrect. HCGA's survey found that a collective marketing effort in general - not the Project Trellis marketing initiative in particular - was a top priority for membership. HCGA still supports a collective marketing effort modelled off of successful efforts in Napa, where the Napa Valley Vintners accept no money from Napa County and the county is not involved in the industry's self-determined collective marketing efforts.

Considering the urgent need for Measure S suspension, and the similarly urgent need for clarity on how the industry will approach its own collective marketing, we ask that your Board act sooner rather than later to provide direction to staff on the substantive future of the Trellis program.

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<u>Recommended Next Steps</u>

In sum, we recommend the following:

- Utilize tomorrow's hearing to take feedback from the community, and give further direction to staff, rather than making a final decision.
- Give direction to staff to bring back an item that includes a recommendation for a two-year suspension of the Measure S tax, which includes the following payments: October 2021, March 2022 (FY 2021/2022), October 2022, and March 2023 (FY 2022/2023). This recommendation is not currently included for consideration in tomorrow's agenda.
- Give direction to staff to delay mailing bills for the March 15 tax period until the Board can give final direction on the future of Measure S. As staff notes in their survey of other county's local tax policies, Sonoma County has taken similar measures to delay billing in order to provide time for a more robust discussion on tax policy.
- Give direction to staff to narrow the scope of Trellis exclusively to the administration of the equity program.

Thank you for your consideration,

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