

## **A GROWING CONCERN**

### **Humboldt County Planning and Building Department and The Cannabis Industry**

#### **SUMMARY**

In the wake of the historic referendum, Proposition 64, that legalized recreational cannabis in California, Humboldt County had an opportunity and a responsibility to develop a safe, well-managed, and thriving industry. Four years into this new era, Humboldt County's administration of the emergent cannabis industry (permits, fines, penalties, laws, monitoring, the oversight and enforcement thereof) has undergone considerable scrutiny and revision. Cultivators and regulators alike are adapting to an unprecedented change in both the production and oversight of a formerly contraband product that remains a Schedule I controlled substance according to federal law.

There is a notable lack of in-depth reporting of revenues and expenditures that would accurately show the citizens of Humboldt County the effectiveness and the operational and fiscal efficiency of the Cannabis Planning program.

Due to the inconsistency between state and federal regulations, the new permitting and regulatory system is cash intensive. Banks will not allow cannabis cultivators to open accounts or establish lines of credit; they must conduct transactions in the form of paper currency. Humboldt County agencies must therefore accept large sums of cash in order to collect necessary permit fees and abatement fines. The Planning and Building Department assumes the risk inherent in the storage and handling of large sums of cash. The optics of a government agency dealing in significant quantities of cash is itself problematic. Doing so requires a highly transparent, very accurate system of accounting. The Planning and Building Department should provide greater transparency in accounting procedures, more robust security in handling cash, and work to meet the needs of the local cannabis industry.

#### **BACKGROUND**

Proposition 64 represented a watershed moment in the evolution away from cannabis prohibition. The County government was tasked with not only regulating and permitting cannabis cultivation, but promoting and encouraging the new industry as well. The County government was asked to create a process and protocol by which an illegal activity could be transitioned into a legal one. This was no small task. Estimates of the number of illicit grows in Humboldt County going into the legalization of cannabis ranged from 10,000 to 30,000.

Legalization is further complicated by the fact that the federal government continues to define cannabis as a Schedule I controlled substance. Because of this, banks, which are federally regulated, cannot engage in financial transactions with the cannabis industry. This means permitted cultivators cannot legally make bank deposits, write checks, or obtain lines of credit.

For decades, illicit growers lived with the constant risks of having to store, handle, and transact business with large quantities of cash. These same challenges remain serious concerns to this very day. Official financial transactions involving the cannabis industry are regularly

collected in cash, and in large quantities thereof. The Planning and Building Department has had to accept the same dangers and challenges of dealing in thousands of dollars in paper currency.

Under Ordinance 1.0, the first iteration of the County's efforts to regulate recreational cannabis production, 1,829 permits were processed by the Planning and Building Department. This increased workload caused the department to add 50 employees to their payroll.

The Planning and Building Department was tasked with:

- Developing a permitting process allowing previously illicit and medical cultivators to grow legally
- Establishing permit costs and determining amount of fines
- Creating methods for monitoring and oversight
- Hiring new cannabis planners and training them
- Continuing to identify and abate code violations
- Implementing various state and local ordinances
- Protecting the ecosystems of our beautiful county

## **METHODOLOGY**

In preparation for this report, the Humboldt County Civil Grand Jury (Civil Grand Jury):

- Conducted interviews with current and former Humboldt County Planning and Building Department employees and clients
- Conducted interviews with County officials
- Conducted interviews with community and industry leaders
- Researched county, state, and federal laws and regulations
- Reviewed financial documentation provided by Humboldt County
- Conducted internet research
- Reviewed documents at the Humboldt County Planning and Building Department
- Accessed Accela online permit management database

## **DISCUSSION**

### ***Starting from Scratch***

In the aftermath of the passage of Prop 64, the County implemented a raft of regulations, requirements, laws, and policies relating to legal cannabis. Ordinance 1.0, as it came to be known, provided an administrative, regulatory, and legal framework for allowing previously illegal operations to become legitimate. The Planning Department was flooded with permit applications, well in excess of 2,000. They quickly built from scratch a system for reviewing applications and issuing permits, and succeeded in issuing more such permits than any other county in the state. In addition, the Planning Department's Code Enforcement division continued to identify and abate illegal operations. The satellite surveillance system used for that purpose was commended by the California State Association of Counties as being particularly effective.

In mid 2018 the county introduced Ordinance 2.0. This was due to the implementation of State Licensing on January 1 of that year. Humboldt County thereby conformed the permitting process to reflect that development. Previously there existed some latitude to allow pre-existing cultivation to continue while permit applications were being processed, as the State developed its

Cannabis Licensing program. This condition no longer exists. In today's regulatory scheme, cannabis cultivation requires a local permit and a state license to be deemed legal.

This set of policies, fines, fees, and regulations under Ordinance 2.0 was designed to permit and regulate only new farms. After December 31, 2019, the policy of permitting pre-existing grows was terminated. Under Ordinance 1.0, a cannabis operation could be issued a temporary permit, allowing the operator a period of time to bring their farm into compliance. Version 2.0 removed that provision, allowing only fully compliant operations.

The application requirements are so complex and extensive there are consultants and lawyers who specialize in guiding applicants through the process. This adds additional cost to a start-up operation. The county's website is difficult to navigate. Other than a two-page checklist, much of the relevant information for prospective applicants is not easily accessible. Some information regarding cannabis cultivation permit applications appears to be out of date (the deadline for Ordinance 1.0 having been December 31, 2016 is still listed as current, for example). Assistance by the Planning and Building Department is another added cost, billed at a rate of \$150 per hour. Of course, this service is only available when employees are able to provide it.

### ***Creating a New Financial Burden***

The Planning and Building Department's adopted budget for fiscal year 2019-20 is \$11.5 million, of which \$3.2 million will be spent on cannabis planning with another \$2 million on code enforcement (cannabis abatements being a considerable part of that). Cannabis Planning is the single largest item in the department's budget. These two budget items, Cannabis Planning and Code Enforcement, amount to 45% of the department's total budget. Since the passage of Prop 64, in fiscal year 2015-16, the department's budget has almost doubled. In just one year, 50 employees were added to the department's payroll.

This fiscal year budget shows that the total revenue generated by Cannabis Planning was \$1.76 million. Subtracting this figure from the county cost of permitting this new industry (\$3.2 million), the difference is \$1.44 million. These overages are paid for out of the Cannabis Planning Division's trust fund. This trust is funded by the thousands of permit application fees paid by prospective new cannabis operations.

The accounting of the Trust Fund is not transparent. Concern remains that, once that account is exhausted, additional costs may be incurred in the course of the Cannabis Planning Division's operations. Those overages would need to be paid for through the General Fund. Having an industry that costs a local government more money to regulate than it generates in revenues would be disastrous in the wealthiest of counties. Humboldt County is one of the poorest.

In addition, the Code Enforcement division incurs substantial costs arising from enforcing cannabis abatements. Fines and penalties on the cannabis Industry generate revenue, but these are not accounted for separately, they are deposited directly to the General Fund. The Civil Grand Jury understands this is due to concerns over potential incentive for regulators to assess excessive fines in order to better fund their department.

There is a notable lack of detailed reporting of revenues and expenditures that would accurately show the citizens of Humboldt County the effectiveness and the operational and fiscal efficiency of the Cannabis Planning program. Obtaining a simple accounting document from the Planning and Building Department proved very frustrating despite several direct requests by the

Civil Grand Jury. Given the huge amounts of cash moving through its office and its substantial annual budget, the Planning and Building Department's accounting system appears problematic. The coordination of financial records between the Planning and Building Department and the Auditor-Controller's office is not sufficient to the task (e.g., cash receipts and documentation). In addition, the appearance of the potential for bribery, fraud, and other financial malfeasance warrant adequate scrutiny.

Since the legalization of recreational cannabis production, the Planning and Building Department has been obligated to accept cash for permitting, fines, and other associated fees. There has been a precipitous rise in the amount of cash flowing into and out of the County building on H Street.

Many payments arrive at the front desk of the Planning and Building Department in the form of paper currency. Some of these payments number in thousands of dollars. The employee gives the client a receipt for the cash, and logs the receipt in a ledger. It is then moved to a safe within the Planning and Building Department. Two county employees eventually transport the cash to the bank for deposit. Hundreds of thousands of dollars have come to the county coffers in this manner.

This stands in stark contrast to the approach taken by the Treasurer-Tax Collector's Office. Protocol followed by that department involves a vault to keep cash secured while on the premises, and contracts an armored car service to transport cash to the bank.

### ***The Reality***

Since the window for new permit applications is now closed, the workload on the Cannabis Planning side will soon begin to dwindle. In addition, given the much vaunted success of the satellite surveillance system, a presumably meaningful percentage of illicit cannabis grows has been abated: 98 fines were issued in 2018, and only 53 in 2019. It is reasonable to expect both the Cannabis Planning Division and Code Enforcement will be scaled back to meet the needs of an established and stabilized cannabis industry in Humboldt County. The overall cost of permitting and regulating cannabis cultivation should not exceed revenues collected. To that end, the County should have an accounting system that provides transparency in every aspect of the department's budget in place to assure the taxpayers that this is so. The Auditor-Controller's office should have adequate and appropriate involvement with the department's financial accounting and reporting.

The cannabis industry is a fact of life in this County. Profits generated by this industry result in increased revenues from income, excise, property, and business taxes. Profitable operations spend money at other local businesses. Even prior to legalization, cannabis growers have been a major economic force in Humboldt County. However, the advent of legalized recreational cannabis production seems to have blunted the profitability of the local cannabis industry. According to Sheriff William Honsal, "[T]he price per pound is gonna become so low that the industry is gonna be driven out of Humboldt County...."

As the County confronts a budget deficit this year, and will probably do so into the future, the issue of justifying the cost of a large and expensive bureaucracy becomes an ever more pressing concern. Accurate bookkeeping and accountability is of great importance to the Board of Supervisors and to the Public. Administrators have a responsibility to design and implement procedures and regulations in a transparent manner.

Meanwhile, the old, pre-Prop 64 business model of growing and selling cannabis in the underground economy still works in the present climate. By creating so many financial and regulatory obstacles for a legitimate operation, the County maintains incentive for illicit cannabis cultivation. As one interviewee put it, “the black market is still more lucrative than the white market.”

Given the large amounts of cash moving through the Planning and Building Department, coupled with their vague accounting procedures, the Department is left open to accusations of fraud. Indeed, there have been concerns expressed regarding the potential of bribery, fraud, and other financial malfeasance.

## **FINDINGS**

F-1: The handling of large sums of cash used by applicants to conduct transactions with the Planning and Building Department lacks transparency and creates the perception of potential for fraud. (R-2, 3, 4)

F-2: Cash transactions jeopardize the safety of the public and department personnel due to a lack of robust security infrastructure. (R-2, 3, 4)

F-3: Lack of transparent accounting for cannabis-related revenues (permit fees, Trust Fund monies, fines) makes it difficult to determine the economic impact of the legalization of the cannabis industry on the county. (R-2, 3)

F-4: The cumbersome permitting process defeats the purpose of legalization. It creates the incentive for cultivators to remain in the illicit market.

F-5: The Planning and Building Department website is not user-friendly. Applicants are disadvantaged by lack of access to clear instructions and guides. Some information also appears to be out of date. (R-1)

## **RECOMMENDATIONS**

R-1. The Humboldt County Planning and Building Department website should be updated to make relevant information regarding permit applications for cannabis cultivation easily searchable. Information presented on the website should be regularly updated to reflect any change in relevant regulations. This should be addressed by September 1, 2020. (F-5)

R-2: The Humboldt County Civil Grand Jury recommends that the Humboldt County Planning and Building Department have an audit conducted by the Auditor/Controller’s office of all incoming receipts collected for each fiscal year. This assessment should be presented to the Board of Supervisors and made public. This should be done starting fiscal year 2020-2021. (F-1, 2, 3)

R-3: The Humboldt County Civil Grand Jury recommends that the Humboldt County Planning and Building Department have a dedicated accountant on staff to organize and maintain current

financial records. This person should be a fresh hire with proven experience and necessary credentials. This should be done by January 1, 2021. (F-1, 2, 3)

R-4: The Humboldt County Civil Grand Jury recommends that the Humboldt County Planning and Building Department direct customers paying in cash to remit said payments directly through the Treasurer-Tax Collector's office. Payment receipts will be accessible to the Humboldt County Planning and Building Department. This should be in effect by January 1, 2021. (F-1, 2)

## **REQUEST FOR RESPONSES**

Pursuant to Penal Code sections 933 and 933.05, the Civil Grand Jury requests responses as follows:

From the following governing bodies within 90 days:

Humboldt County Board of Supervisors (F-1, F-2, F-3, F-4, F-5; R-1, R-2, R-3, R-4 )

Humboldt County Planning and Building Department (F-1, F-2, F-3, F-4, F-5; R-1, R-2, R-3, R-4 )

From the following elected county officials within 60 days:

Humboldt County Auditor-Controller (F-1, F-2, F-3; R-2, R-3, R-4 )

Humboldt County Treasurer-Tax Collector (F-1, F-2, F-3; R-4 )

Reports issued by the Grand Jury do not identify individuals interviewed. Penal Code section 929 requires that reports of the Grand Jury not contain the name of any person or facts leading to the identity of any person who provides information to the Grand Jury.

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