

## Attachment D - Equity Program Memorandum

*Drafted by Freedman & Koski*

One of the most significant tensions heard from stakeholders, appointees, and elected officials is between the community desire to create a diverse group of industry owners and the hesitancy about allowing for uncontrolled growth in the market.

### **Background**

Most of the jurisdictions across California implementing a cannabis licensing program have concerns that the economic opportunities created from the program will not be available across the socioeconomic spectrum. Some jurisdictions, mainly larger cities like Los Angeles and Oakland, have created economic development programs designed to encourage minority participation in the industry:

Cities	Support Services / Incubator	Expungement	Priority Processing	Fee Waivers / Deferrals	Diversity Hiring Incentives	Ownership Quota	Equity-Based Fund
Fresno		X					X
Los Angeles	X		X	X			X
Oakland	X		X			X	
Richmond	N/A						
Sacramento	X	X	X	X	X		
San Bernardino	N/A						
San Francisco	X				X		X

For a few reasons, it is difficult to create best practices from these programs, or any cannabis equity programs:

- Risk of abuse and litigation: Without strict oversight, the city risks abuse of an equity program. Some jurisdictions have been mired in lawsuits about their equity programs. Maryland has been unable to move forward with licensing while dealing with lawsuits as a result of their equity requirements.
- Cost of implementation and oversight: Jurisdictions with equity programs are already requesting consulting and financial services to help administer the program.
- Unproven results: The programs being implemented in other jurisdictions have not been tested and there is no data on its effectiveness.
- We do not propose sacrificing regulatory standards in order to lower barriers to entry. We suggest the city utilize best practices that show demonstrable evidence to protect public health and public safety. While these ordinances will not be draconian, they do inevitably favor actors with access to capital.

### **Community Input**

Despite these challenges, the community remains committed to pursuing an equity program. Freedman & Koski spent significant time in public meetings, stakeholder

workgroups, and informal meetings to determine what the community thought the equity program should look like. In those meetings Freedman & Koski asked three questions:

1. Who should benefit from this equity program?
2. Should the equity program focus on ownership, workforce, or tax distribution?
3. What available policies will be most helpful in achieving equity?

### **Who should benefit?**

There was significant consensus in the types of people and communities that the public wished to see benefit from an equity program. They wanted to see neighborhoods most directly impacted from the war on drugs and people of color receive economic benefits.

There was concern that the equity program could be easily coopted by well-capitalized groups that did not represent the diversity the community wished to see. Stakeholders asked that government continue to monitor equity applicants to ensure that the system was not abused. However, stakeholders also asked that application to an equity program be made simple so that applications were not overly laborious.

### **Ownership, workforce, or tax distribution**

We made clear to the stakeholders involved that our job was not to talk about where the taxes should be dispersed. Still, there was a lot of concern about how the tax revenue would be dispersed.

The community also made clear that they cared far more about ownership than workforce and wanted us to focus our efforts on creating an equity program to create minority business owners.

We also received significant feedback throughout that there is concern that we ensure a controlled growth so that we do not have an explosion of businesses. The stakeholders that sought to limit or control growth were generally concerned that having too many cannabis businesses could taint the community character and that if cannabis businesses were prevalent throughout the community, they would expose youth to cannabis and increase its availability. There was also consistent feedback that nobody wanted to see the boom and bust cycle that was seen in neighboring cities.

### **Equity Program**

#### **What policies would be the most helpful?**

After conducting a review of other equity programs and holding workgroups with the community, Freedman & Koski offers these policy recommendations:

## **Tax Revenue Distribution**

Much of the discussion in the stakeholder meetings and workgroups was focused on where the tax revenue would be distributed. Freedman & Koski were clear that discussions around tax distribution was outside the scope of the current project. Nevertheless, we believe it is important to convey the main concerns and ideas which stakeholder had for how the tax should be distributed.

Helping those most hurt by the war on drugs: Almost all stakeholders expressed concern that the tax revenue would not go to neighborhoods that were most affected by the war on drugs. They reported, often passionately and powerfully, the miscarriage of justice they have felt over previous enforcement of drug policy.

Governance: To ensure that tax revenue is distributed in a way that benefits communities hurt by the war on drugs, some stakeholders wanted to see an advisory committee established that could submit suggestions and reports to city council. This committee would be composed of community members that reside in those neighborhoods.

Job training: Some members expressed a desire to see the tax revenue specifically aimed towards job training. While some wanted to see such a job training program specifically for applying to be a cannabis licensee, others wanted a broader focus that would help minority applicants get high paying jobs.

## **Diversity Hiring Fee Incentives**

Surprisingly, even after multiple promptings from Freedman & Koski, the community was not significantly concerned that the equity program help ensure diverse hiring. The general feeling was that these licenses would naturally hire from the surrounding neighborhoods, and so there would naturally be diversity in the workforce. Additionally, many agreed with the proposition that they wanted equity in ownership, and that from that there would be equity in hiring.

Sacramento and San Francisco both offer fee reduction incentives for maintaining a diverse staff. Since diversity in hiring was not a significant community concern, we are not recommending Stockton adopt a similar incentive program at this time. Additionally, it would be helpful to have more data before offering any fee reductions so that the City could scope the size of the problem and determine what size reduction in fees would be necessary to entice businesses to adopt diverse hiring practices. Finally, fee reductions are more sustainable for large cities who have enough applications to process that they can maintain many full-time staff. Without a large number of applications to offset fee reductions, an incentive program could seriously hinder the city's ability to process and monitor licensees.

## Tax Assistance

Similarly, we are not recommending any tax assistance for equity applicants. In addition to the reasons stated above, we worry that providing monetary aid in this manner might have an adverse effect on the communities we are trying to aid. Starting a cannabis business is a capital heavy endeavor. By some estimates, a potential cannabis business will require at least \$1 million in start-up capital. We are concerned that any small amount of capital assistance or capital relief will entice entrants into the market place that will leverage their own personal finance as well as friends and family.

## Lower barriers of entry

One area we believe that the city can responsibly allow for greater socioeconomic equity is by being flexible with business models. The suggested ordinances allow for some licenses that will require lower barriers of entry.

The state provides what it calls a “microbusiness” license. The purpose of this license is to allow for smaller businesses that may want to provide a farm-to-table model of growing, manufacturing, and retailing its own product onsite. The license type is meant to create smaller, more flexible business models that won’t require large amounts of capital. Our suggested ordinances allow for these microbusinesses but restrict them in the same ways we restrict all other forms of licenses.

Additionally, the non-storefront retail license requires relatively fewer upfront capital costs to begin operation. The proposed code allows for this model and is a viable path forward to lowering barriers of entry into the marketplace.

These flexible business models will help alleviate some of the problems surrounding access to capital and barriers to entry. However, we want to acknowledge that this industry will still be easier to access for those with large amounts of capital.

## ~~Criminal justice reform/~~ Criminal background

Another idea to create equity mentioned in a few workgroups would be to allow for ~~criminal justice reform in the form of~~ expungement of previous drug crimes. Freedman & Koski made clear that such decisions were outside of the scope of our engagement but that we would report the suggestion to City Council.

There is, however, an equity issue involved with criminal background that is addressed in the proposed code. The state has created some restrictions to working in the industry if the potential employee has a felony. In the past, the City of Stockton has created more stringent hiring restrictions of than the state. In the revised code, we bring the City’s restrictions on criminal background in better alignment with the State’s restrictions and allow for ~~more~~-continued flexibility for the Chief of Police to grant a work permit to the applicant.

## Technical Assistance

We received significant feedback that the community wished to see the city provide technical assistance to help equity applicants create and execute a business plan. These sorts of support systems are available in every jurisdiction that has an equity program. This is one area where the city can encourage and promote equity applicants while expending relatively less revenue.

## Creating an equity applicant selection process

Creating equity of ownership will require Stockton to expand the number of licenses, either by allowing for more license types or by allowing for more retail and cultivation licenses.

Other cities have employed two strategies in an attempt to create equity owners. The first is by giving assistance, either financial or technical. We discuss this part of the equity program at length above. The second strategy, which we discuss here, is to reserve a portion of permits or licenses for equity applicants. Currently, the City of Oakland has done the most to create an equity applicant process.

To be effective, an equity application process should meet the following criteria:

1. Scarcity of licenses: In order for an equity applicant pool to be of value, there has to be a limit on the number of permits available at any one-time.
2. Economic value of scarcity: Additionally, there should be some economic value to being in a limited license system.

We normally do not recommend jurisdictions set a cap on the number of licenses available. The caps are often either arbitrary or else based on questionable economic studies. This problem is particularly true with cannabis licenses where there is little data or empirical evidence to help guide where the jurisdiction should set the cap. Additionally, it becomes more difficult over time for jurisdictions to remove these caps as industry becomes more powerful and seeks to protect its market advantage.

Providing caps does have some advantages: preventing over-saturation, allowing the regulatory systems to keep pace with industry, and slowing the rollout to be able to control any unforeseen consequences.

We generally try to achieve these advantages through well thought-out locational criteria that can solve for density, conform with community culture, and ensure licenses do not expand to areas where there is not proper public health and public safety infrastructure. We offer those locational criteria in the proposed code amendments as well.

However, public safety and public health officials had a separate concern: a large initial increase on some of the license types would stress their staff resources to the point where they would not be able to properly vet potential licensees and not perform the

necessary annual audits. This was a significant concern for retail stores, cultivations, and manufacturing businesses where there is both significant inspections required, and where the license types have the potential to cause the most harm to the community if they fail to meet industry standards.

To ensure that these license types do not expand faster than the ability for public health and public safety resources to keep pace, we recommend limiting the annual number of licenses that will be issued.

This annual limitation is relevant to the equity discussion because it provides a natural scarcity of licenses and thus an opportunity to give a significant advantage to equity applicants.

There is no doubt that there is an economic advantage to being one of the first licenses for retail, cultivating, or manufacturing adult-use cannabis. We suggest that this is the best place to introduce an equity application process in order to create equity in ownership. The proposed ordinance provides a process for this equity applicant selection.

Finally, there was concern from the community that an equity applicant process may be manipulated by some equity applicants who use it to obtain a license, then quickly sell his or her license to a non-equity owner. While this is a valid concern, we did not restrict the equity applicant's ability to transfer his or her license. To do so would place a restriction on equity applicants that is not placed on non-equity applicants. This would create a perverse outcome where the equity license is in effect not as valuable as a non-equity license.

#### **The Equity Program, in brief:**

1. Allows for license types that require less capital such as microbusinesses and non-store front retail stores.
2. Creates a Limited Cannabis Business Expansion Process for new retail stores, cultivators, and volatile manufacturers that ensures that at least half of the new permits go to equity applicants.
3. ~~Gives~~ Continues to provide ~~more~~ flexibility for chief of police to grant work permits that would otherwise be denied due to past criminal activity.