MAHI PONO
A MAUI FARMING COMPANY

December 7, 2022

Via Electronic Mail
The Honorable Suzanne Case, Chair
and Members of the Board of Land and Natural Resources
State of Hawaii
P.O. Box 621
Honolulu, Hawaii 96809
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RE: DLNR Staff Submittal on Agenda Item D8 (*Amend Prior Board Action of November 10, 2022, Item D-5: Continuation of Revocable Permits to Alexander and Baldwin, Inc. & East Maui Irrigation Company, Limited)*

Dear Chair Case and Members of the Board,

Mahi Pono opposes the Department Staff's proposal to amend the prior Board action approvingthe continuation of revocable permits ("*RP*") for the use of water in East Maui to Alexander and Baldwin, Inc and East Maui Irrigation Company, Limited (collectively, the "*Permittees*"). The proposed amendment is focused on reversing the Board's decision to transition the RP rent structure from a flat fee to a usage-based rate.

The prospect of a usage-based rate was discussed at-length at the November 10th meeting by the Board, and the merits of the approach noted. The most significant of those merits is that the usage-based rate structure promotes the efficient use of water, which is a concept that can now be implemented because of operational (and system or infrastructure?) changes made under Mahi Pono ownership:

- **Historical HC&S Irrigation Practices –** The flat fee structure that was used for decades was appropriate for HC&S' sugarcane operation, which applied a constant amount of water to a single crop. From 1999 – 2015, HC&S diverted an average of 126 million gallons per day ("*MGD*") on an extremely consistent basis. By comparison, this amount is more than 3 times greater than the maximum diversions allowed under the 2023 RP. There was little variation in month-to-month water diversions because HC&S' practice was to irrigate sugarcane with a consistenly large amount of water. The opportunity to incentivize efficient water usage was limited because of HC&S' relatively constant irrigation applications.

- **Mahi Pono Irrigation Practices –** The usage-based rate structure that the Board approved as part of its November 10th decision is more appropriate for Mahi Pono's diversified farm, which applies a variable amount of water to a range of different crops. Between January 2021 and October 2022, Mahi Pono diverted between 12.20 MGD and 28.09 MGD from East Maui. In the same time period, the amount of water applied to Mahi Pono's crops has increased by more than 470% due to increased plantings/acreage. Irrigation decisions are driven by metrics such as soil moisture levels and crop maturity instead of convenience. The opportunity to achieve efficient water usage is significant because Mahi Pono's systems and crop mix allow for more varied and efficient irrigation applications.

The differences in the irrigation practices and crop needs of Mahi Pono and HC&S are clear. Given those differences, it is equally clear how a change in structure would be prudent, with a usage-based rate structure providing an additional incentive for efficient water use practices.

The Staff's reasoning to return to a flat fee structure also seems to be revenue-based. While we understand the budget challenges of the department, we disagree with this basis and are providing the following counterpoints for the Board's consideration:

- **Rent Payments should correspond to Water Diverted/UsedFrom State Lands** – The Staff submittal provides an initial example of a rent revenue projection that assumes 15 MGD will be diverted on average, each and every month, in 2023. This is an incorrect assumption, and presents an exaggerated decrease in projected rent vs. prior years. At the November 10th Board Meeting, Mahi Pono provided testimony which included (i) an anticipated water need of 40.49 MGD during the highest month of the year, (ii) a projected 2023 operational plan consisting of approximately 2,700 additional planted acres, and (iii) a statement on crop maturity contributing to an increased water need. It is extremely likely that these developments would cause actual water diversions to significantly exceed 15 MGD.

  The Staff submittal also provides a second example of a rent revenue projection which assumes a hypothetical scenario where the Permittees diverted the maximum 40.49 MGD of water allowed under the revocable permit. Under this scenario, the Permittees would pay $243,668.82 per year under the usage-based rate structure, which the staff notes would be less than their proposed 2023 flat fee. What this conclusion neglects to consider is that the

amount of water allowable uder the 2023 RP(40.49 MGD) is 10% less than the amount of water allowable under the 2022 RP (45 MGD), yet, the Staff's proposed 2023 flat fee is almost 14% more than the flat fee charged in 2022. The increased flat fee that the Staff is proposing is not equitable to the decreased amount of water that Mahi Pono can access. There should be a nexus between the rent paid and the amount of water collected off of state lands.
For convenient reference, the Permittee's proposed usage based rent structure and corresponding calculation, as presented at the November 10, 2023 hearing, is provided below:

- Basis of Permittee's Recommended 2023 Usage-Based Rate = 2022 RP Cap & Rent = 45 MGD @ Approximately $238k

- 2022 Rent / 2022 RP Cap = 2022 Per MGD Rent Payment

- 2022 Per MGD Rent Payment = $238,000 / 45 MGD = $5,289 per annual average MGD

- Staff Recommended 2023 CPI Adjustment = 13.79% Increase over 2022 RP Rent

- 2022 Per MGD Rent Payment X Staff Recommended 2023 CPI Adjustment = Permittee's Recommended 2023 Per MGD Usage-Based Rate

- <u>*Permittee's Recommended 2023 Usage-Based Rate*</u> = $5,289 per annual average MGD * 1.1379 = **$6,018 per annual average MGD**

- **Budget Deficits should not be used to justify a renewed commitment to an archaic rent structure –** The Staff provides a footnote which states the following:

  "The decrease in the revocable permit rent resulting from the Board's decision will increase an already existing deficit between revenues from water dispositions and expenses for water resource management and protection"

  Additional details on this deficit – such as the amount of the deficit, the actual impact of this particular decision on the overall deficit, and the other factors that have contributed to this deficit – are not provided. However, it can be reasonably assumed that the Board's decision to transition the RP to a usage-based rate, on one water disposition, does not account for the entirety of the deficit. Also, by the Staff's own admission, the deficit existed prior to the Board's decision on this particular matter. Finally, the difference – if any – in rent collected from a flat fee vs. a usage-based rate structure is unknown, because it is not known what the actual usage will be. for all of these reasons, it does not seem proper to return to a flat-fee rent structure that is ill-fitted for the current water use situation for the sake of addressing an unknown portion of a pre-existing deficit.

- **The Watershed Management Fee will compensate the State for Permittees' use of Forrest Reserve Lands –** The Staff implies that the rent collected under the RP also compensates the Department for use of State lands. Yet, the conditions placed on the RP also require that the Permittees work with DOFAW on the establishment of a watershed management fee and that the fee be paid retroactively to Jan 1, 2023. The Permittees understanding is that the watershed management fee reflects the use of the land covered by the RP (and the eventual lease), but the rent collected under the RP is for the use of water. If the rent under the RP also pays for the use of land covered by the RP, then there appears to be some redundancy with the watershed management fee that will soon be established and paid.

Template for Long-term Lease Rent - It is important to establish the proper rent structure if the RP is to serve as a guiding precedent for a long-term water lease, as has been suggested by staff and this Board's own discussions during the adoption of its guidelines for water lease appraisals last year. The long-term lease rent will be a commitment for many years, not a single year, and will have to be supported by the economics of the farming activity that will use that water.

Finally, the Staff cites the absence of a fair market appraisal as a basis for maintaining a flat fee rent structure. The Staff submittal states the following:

> *"While the staff understands the value in adopting a usage based rental rate to create an incentive to use water more efficiently, staff believes that such an important and complex issue should be addressed in the appraisal process which would allow for further study and evaluation by an appraiser with the necessary knowledge and expertise.*

While we are in agreement that a completed appraisal would be extremely helpful to a variety of processes – none more important than the long-term water lease process – we disagree with the Staff's proposed course of action in the interim, which is to continue the implementation of a flat fee that is not based on acutal usage, just because there is no appraisal. We have agreed to use the state's flat fee lease rent as the basis for the RP rent, even though this flat fee is also not based on an appraisal. It is the methodology that we believes needs to be changed to better reflect the amount of water actually received from state lands.

We support the Board's original decision to adopt a rent structure that reflects the acutal use of water. We look forward to working collaboratively with all involved parties to implement the Board's original decision. Thank you for the opportunity to testify.

Sincerely,

Grant Nakama

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