

**CALIFORNIA ALTERNATIVE ENERGY AND
ADVANCED TRANSPORTATION FINANCING AUTHORITY**

Request to Approve Project for Sales and Use Tax Exclusion (STE)¹

**National Steel and Shipbuilding Company
Application No. 17-SM055**

Tuesday, September 19, 2017

Prepared By: *Melanie Holman, Analyst*

SUMMARY

Applicant – National Steel and Shipbuilding Company

Location – San Diego, San Diego County

Industry – Metal Fabrication and Shipbuilding

Project – Upgrade and Expansion of Shipyard to Include Production of Thin Plate Steel
(Advanced Manufacturing)

Value of Qualified Property – \$40,500,000

Estimated Sales and Use Tax Exclusion Amount² – \$3,410,100

Application Score –

Fiscal Benefits Points:	2,507
<u>Environmental Benefits Points:</u>	<u>95</u>
Net Benefits Score:	2,602
<u>Additional Benefits Points:</u>	<u>170</u>
Total Score:	2,772

Staff Recommendation – Approval

¹ All capitalized terms not defined in this document are defined in the Program’s statute and regulations.

² This amount is calculated based on the average statewide sales tax rate of 8.42%.

THE APPLICANT

National Steel and Shipbuilding Company (“NASSCO” or the “Applicant”) has been designing and building ships since 1960. NASSCO’s San Diego shipyard is one of only a handful remaining in the United States. NASSCO is a wholly owned subsidiary of General Dynamics Corporation, a publically traded company under the symbol GD.

The corporate officers of General Dynamics Corporation are:

Phebe N. Novakovic, Chairman and Chief Executive Officer

John P. Casey, Executive Vice President, Marine Systems

S. Daniel Johnson, Executive Vice President, Information Systems and Technology

Mark C. Roualet, Executive Vice President, Combat Systems

Jason W. Aiken, Senior Vice President and Chief Financial Officer

THE PROJECT

NASSCO is requesting a sales and use tax exclusion to upgrade and expand its San Diego facility in order to design, manufacture, and assemble ships using advanced materials, including steel “thin plate” panels (the “Project”). According to the Applicant, the panels will be made of high-tensile strength structural steel with a thickness of 5-10mm, compared to the typical thickness of 10-24mm, which produces ships that are lighter and more efficient compared to standard models. The Applicant represents that the Project will include equipment that will enable the company to produce the steel thin plate panels with high precision and efficiency. For example, the Project will incorporate fully automated hybrid laser arc welders and gas metal arc welding robots to ensure a more efficient production process that uses less energy and produces less solid waste. According to the Applicant, this efficiency is due to the fact that the process will be programmable with work done by robots at precise temperatures with a greater rate of output, producing more material in the same amount of time with and with greater accuracy. The Applicant represents that the Project will most likely result in an increase in jobs due to new work orders. In addition, the automation of certain tasks will result in jobs being shifted to technical positions such as engineers and technicians. NASSCO anticipates that even with automation there will be an increase in the workforce.

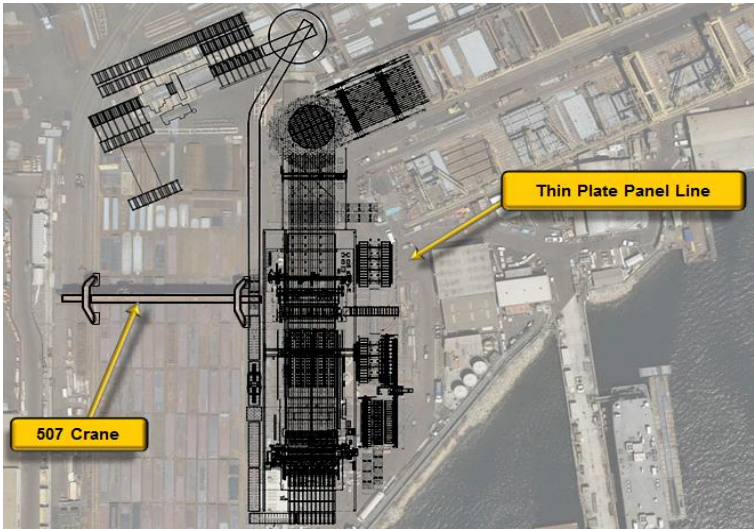


Figure 1: NASSCO's San Diego Shipyard Showing Location of Projected Panel Line

ANTICIPATED COSTS OF QUALIFIED PROPERTY

The anticipated Qualified Property purchases are listed below:

Station 1 – Plate Infeed and Storage	\$ 2,720,325
Station 2 – Plate Milling/Seam Welding/NDT Inspection and Repair Pit	9,934,850
Station 3 – Cutting, Blasting and Marking	2,703,650
Station 4A – Automatic Stiffener Fit and Weld	5,830,500
Station 4B – Profile Prep (Milling)	3,379,850
Station 5 – Transverse Member Fit with Two Mount Gantries	1,591,600
Station 6 – Panel Transfer Integration to Table 9	483,000
Station 7 – Robotic Weld (Gantries and Robots)	3,666,200
Station 8 – Offload Tray	86,250
Plate Grade	155,250
Spare Parts	381,800
Crane Modification	287,500
Table 11 Modification – Table 11 New Infrastructure (I Beams/Lift Trains/Weld Gantries)	977,500
Material Transport Units – Cassettes	2,301,725
507 Crane	6,000,000
Total	<u>\$40,500,000</u>

Note: The Qualified Property purchases reported in the Application and shown here in staff's report are estimated costs. At the termination of the master regulatory agreement a finalized project equipment list will be prepared detailing the value of the Project equipment acquired and detailing the actual tax benefit realized pursuant to Revenue and Tax Code Section 6010.8. Variance from the costs shown in the Application and in this report may occur prior to the closing due to increased costs of certain components (of the Project) over original estimates, and other reasons. In addition, such costs may vary after closing due also to increased costs, as well as common design and equipment modifications during construction, differences in equipment due to future changes in law or regulation, or for other reasons.

TIMELINE

A ground-breaking ceremony has already taken place. Initial payments have been made to at least one vendor with delivery of crucial pieces of equipment expected in 2018. NASSCO represents that they plan to complete all purchases over the next one to three years.

PROJECT EVALUATION

NET BENEFITS

The total cost of the Qualified Property purchases is anticipated to be \$40,500,000 and the total net benefits are valued at \$5,139,658 for the Project. The Project received a Total Score of 2,772 points, which exceeds the required 1,000 point threshold and a total Environmental Benefits Score of 95 points, which exceeds the 20 point threshold.

- A. Fiscal Benefits (2,507 points).** The net present value of the total fiscal benefits over the lifetime of the Qualified Property is derived from the Applicant's sales taxes, personal income taxes paid by the firm's employees, firm taxes on profits, property taxes and other indirect fiscal benefits of the Applicant which amounts to \$8,549,758 resulting in a Fiscal Benefits score of 2,507 points for the Project.
- B. Environmental Benefits (95 points).** The Project will result in an Environmental Benefits Score of 95 points. The Applicant received points in the following categories:
- 1. Environmental Sustainability Plan (20 of 20 points).** The Applicant will implement an environmental sustainability plan for its Project that it represents will result in decreased landfilling, higher efficiency over time, and reductions in greenhouse gas emissions.
 - 2. Energy Consumption (15 of 30 points).** The Applicant represents that its manufacturing process will result in a 15% reduction in energy consumption relative to the industry standard manufacturing process.
 - 3. Water Use (10 of 30 points).** The Applicant represents that its manufacturing process will result in a 10% reduction in water use relative to the industry standard manufacturing process.
 - 4. Solid Waste (10 of 30 points).** The Applicant represents that its manufacturing process will result in a 10% reduction in solid waste produced relative to the industry standard manufacturing process.
 - 5. Air Pollutants (30 of 30 points).** The Applicant represents that its manufacturing process will result in a 30% reduction in air pollutants produced relative to the industry standard manufacturing process.

6. **Other Pollutants (10 of 30 points)**. The Applicant represents that its manufacturing process will result in a 10% reduction in other pollutants produced relative to the industry standard manufacturing process.

C. **Additional Benefits (170 points)**. Applicants may earn additional points for their Total Score. The applicant submitted information and received 170 additional points.

1. **Permanent Jobs (75 of 75 points)**. The Applicant represents that the Project will support a total of 5,000 permanent jobs at its Facility. CAEATFA estimates that approximately 69 of these jobs will be attributable to a marginal increase in jobs created due to the approved STE resulting in a Permanent Jobs Score of 75 points for the Project.
2. **Construction Jobs (20 of 75 points)**. The Applicant represents that the Project will support a total of 220 construction jobs at its Facility. CAEATFA estimates that approximately three of these jobs will be attributable to a marginal increase in jobs created due to the approved STE resulting in a Construction Jobs Score of 20 points for the Project.
3. **Research and Development Facilities (25 points)**. The Applicant has verified that it has a facility located in California that performs research and development functions related to the engineering creative process.
4. **Workforce Partnerships (25 points)**. The Applicant has a partnership with San Diego Workforce Partnership for the purpose of assisting in the training of potential future workers.
5. **Industry Cluster (25 points)**. The industry associated with this Application has been identified by the San Diego Regional Economic Development Corporation as an industry cluster.

STATUS OF PERMITS/OTHER REQUIRED APPROVALS

Permits will be obtained from the City of San Diego and the San Diego Air Pollution Control District (APCD). Permitting from the City of San Diego is expected to be obtained in September 2017. Permitting from the San Diego APCD is expected in December 2017.

LEGAL QUESTIONNAIRE

Staff has reviewed the Applicant's responses to the questions contained in the Legal Status portion of the Application. The Executive Director, in consultation with legal counsel, has determined that the legal issues disclosed do not affect the financial viability or legal integrity of the Applicant.

CAEATFA FEES

In accordance with CAEATFA Regulations,³ the Applicant has paid CAEATFA an Application Fee of \$10,000 and will pay CAEATFA an Administrative Fee of \$162,000.

RECOMMENDATION

Staff recommends approval of Resolution No. 17-SM055 for National Steel and Shipbuilding Company's purchase of Qualified Property in an amount not to exceed \$40,500,000 anticipated to result in an approximate sales and use tax exclusion value of \$3,410,100.

³ California Code of Regulations Title 4, Division 13, Section 10036

**RESOLUTION APPROVING AND AUTHORIZING EXECUTION OF A MASTER
REGULATORY AGREEMENT WITH NATIONAL STEEL AND SHIPBUILDING
COMPANY**

September 19, 2017

WHEREAS, the California Alternative Energy and Advanced Transportation Financing Authority (the “Authority” or “CAEATFA”) has received the Application of **National Steel and Shipbuilding Company** (the “Applicant”), for financial assistance in the form of a master regulatory agreement (the “Agreement”) regarding tangible personal property utilized in an Advanced Manufacturing process or for the design, manufacture, production or assembly of Advanced Transportation Technologies or Alternative Source products, components, or systems (“Qualified Property”) as more particularly described in the staff summary and in the Applicant’s Application to the Authority (collectively, the “Project”); and

WHEREAS, the Applicant has requested the Authority to enter into the Agreement to acquire Project equipment with an estimated cost not to exceed \$40,500,000 over a period of three years; and

WHEREAS, the Applicant believes that this form of financial assistance will enable it to avail itself of the benefits of an exclusion from sales and use taxes relative to the Qualified Property pursuant to California Revenue and Taxation Code Section 6010.8; and

WHEREAS, approval of the terms of the Agreement and authority for the Executive Director, Deputy Executive Director, or Chair of the Authority to execute the necessary documents to effectuate the Agreement is now sought;

NOW, THEREFORE, BE IT RESOLVED by the California Alternative Energy and Advanced Transportation Financing Authority, as follows:

Section 1. The Project constitutes a “project” within the meaning of Public Resources Code Section 26003(a)(8)(B).

Section 2. The requested master regulatory agreement constitutes “financial assistance” within the meaning of Public Resources Code Section 26003(a)(6).

Section 3. The Applicant is a “participating party” within the meaning of Public Resources Code Section 26003(a)(7).

Section 4. The Executive Director, Deputy Executive Director, or Chair of the Authority (the “Authorized Signatories”) are hereby authorized for and on behalf of the Authority to approve any changes to the Project as the Executive Director shall deem appropriate, provided that the amount of the Qualified Property to be purchased may not be increased above the amount approved by the Authority.

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Section 5. The proposed form of the Agreement between the Applicant and the Authority, as filed with the Authority prior to this meeting, is hereby approved. The Authorized Signatories are hereby authorized and directed, for and on behalf and in the name of the Authority, to execute, acknowledge and deliver to the Applicant the Agreement in substantially the form filed with or approved by the Authority, with such insertions, deletions or changes therein as the Authorized Signatory executing the same may require or approve, and with particular information inserted therein in substantial conformance with the staff summary and in the Applicant's Application to the Authority, such approval to be conclusively evidenced by the execution and delivery thereof. The Authority understands and agrees that pursuant to the terms of the Agreement, the obligations of the Applicant may, under some circumstances, be carried out or assumed by a successor or assignee entity, or by an affiliate of the Applicant.

Section 6. Each of the Authorized Signatories, acting alone, is hereby authorized and directed to do any and all ministerial acts, including (without limitation) the execution and delivery of any and all documents and certificates they may deem necessary or advisable in order to consummate the Agreement and otherwise effectuate the purposes of this Resolution.

Section 7. The Applicant shall assure CAEATFA that all Qualified Property listed in the semi-annual reports pursuant to the Agreement shall be installed, maintained and operated in compliance with all applicable local, state and federal laws.

Section 8. The Agreement shall only apply to Qualified Property that the Applicant certifies will be installed, maintained and operated at facilities within the State of California.

Section 9. The adoption by the Authority of this Resolution for the Applicant shall not be referred to in any application before any governmental agency as evidence of the feasibility, practicality or suitability of the Project or in any application for any required permission or authority to acquire, construct or operate the Project.

Section 10. This Resolution is effective immediately and will remain in full force and effect unless the Regulatory Agreement, as defined in CAEATFA Regulations Section 10035(a), is not executed within thirty (30) days of the date of this Resolution. The Executive Director may extend the thirty days if necessary.