

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

Request to Amend Resolution for Sales and Use Tax Exclusion (STE)¹

**Tesla Motors, Inc.
Application No. 17-SM003 (Amended)**

Tuesday, December 19, 2017

Prepared By: *Melanie Holman, Program Analyst*

SUMMARY

Applicant – Tesla Motors, Inc.

Location – Fremont, Alameda County; Palo Alto, Santa Clara County; Hawthorne, Los Angeles County; Lathrop, San Joaquin County

Industry – Electric Vehicle Manufacturing

Project – Expansion of Electric Vehicle Manufacturing Facilities

Value of Qualified Property – \$1,169,260,000

Estimated Sales and Use Tax Exclusion Amount² – \$98,451,692

Estimated Net Benefits – \$1,671,469

Application Score –

Fiscal Benefits Points:	897
<u>Environmental Benefits Points:</u>	<u>120</u>
Net Benefits Score:	1,017
<u>Additional Benefits Points:</u>	<u>27</u>
Total Score:	1,044

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%.

**Proportion of Estimated Net Benefits Attributable to Qualified Property Amount
Recommended for Approval –**

	Total Project (Based on Revised December 2017 Application)	Benefits Attributable to Amount Recommended for Conditional Approval	Benefits Attributed to January 2017 Award (Based on Previous Application)	Benefits Attributed to December 2016 Award (Based on Previous Application)
Fiscal Benefits	\$88,300,574	\$21,698,105	\$19,624,740	\$46,343,056
Environmental Benefits	\$11,822,586	\$2,905,164	\$3,338,553	\$7,883,861
Total Cost (Estimated STE)	<u>(\$98,451,692)</u>	<u>(\$24,120,664) (\$24,192,540)</u>	<u>(\$20,000,000)</u>	<u>(\$47,229,218)</u>
Net Benefits	\$1,671,469	\$410,730	\$2,963,292	\$6,997,699

Statute limits CAEATFA to granting up to \$100 million in sales and use tax exclusion per calendar year. An Application for the same Tesla Model 3 project was first approved at the December 2016 Board meeting. The December 2016 award of \$47,229,218 was for the remaining STE available under the \$100 million annual limit once all other December 2016 STE Applications were approved. Because the \$47,229,218 awarded in December 2016 only represented 48% of Tesla’s request, the Company applied and was approved in January 2017 for 2017 award allocation under the new STE Program regulations, which set a cap of \$20 million of STE per Project with the possibility to receive additional financial assistance if any STE remained at the end of the calendar year.³

On November 14, 2017, the Board voted to make available to qualified Applicants any STE remaining from the \$100 million statutory cap after all Applications submitted for the 2017 calendar year have been considered. Based on the Applications under consideration for December 2017, CAEATFA staff (“Staff”) estimates this amount to be \$4,192,540 in STE, or \$49,792,637 in Qualified Property. Tesla is the only Applicant that requested additional STE.

As required under Program Regulation Section 10032(a)(4)(A), Tesla submitted a revised Application with updated information about the Project. Because some of the values changed in Tesla’s revised Application, the estimated net benefits have also changed since the December 2016 and January 2017 Applications were approved.

Staff is recommending conditional approval, as described below, to amend the resolution passed January 2017 to increase the amount of Qualified Property to \$287,322,328, approximately 24.57% of the total \$1.17 billion requested for an estimated STE value of \$24,192,540. Because Application scoring is linear, Staff estimates the state will receive approximately 24.57% of the fiscal and environmental benefits attributable to the \$1.17 billion request. Based on this assumption, the state would appear to receive an estimated \$410,730 in net benefits if this resolution is approved, based on the current Application.

³ California Code of Regulations Title 4, Division 13, Section 10032

Staff Recommendation – Conditional approval of request to amend the original resolution, pursuant to conditions outlined under Recommendation.

Because the revised Application received as of December 7, 2017 contained new information reflecting how the Applicant’s business projections have changed over time, and included a revised legal status questionnaire with disclosures not previously made, and given the brief period of time Staff has had to review the new information, Staff is continuing to review the information provided and requires additional time to understand the updates and request follow-up information from the Applicant, if necessary. Based on the current Application, the Project appears to meet all of the point-threshold requirements.

If left unawarded, CAEATFA does not have the authority to “roll-over” the remaining 2017 STE amount to grant in future years; therefore, Staff believes it is in the public interest and furthers the purpose of the Program to conditionally approve Tesla’s request for additional STE at this time, subject to Staff receiving clarification of the updated information, as necessary, and concluding its review of the legal status questionnaire. Staff’s findings may be presented to the Board for further consideration before an amendment to the Master Regulatory Agreement may be executed, and if not satisfied, the Authority may deny approval of the amended resolution for additional Qualified Property.

THE APPLICANT

Tesla Motors, Inc. (“Tesla” or the “Applicant”) was incorporated in 2003 in Delaware and is headquartered in Palo Alto, California. Tesla designs, manufactures and sells electric vehicles and electric vehicle powertrain components. Tesla’s products include the Model S sedan and the Model X crossover, and previously included the Roadster, which concluded production at the end of 2012. Tesla also sells electric powertrain systems and components to Daimler AG. Tesla is a publicly traded company on the NASDAQ under the symbol TSLA.

The major shareholders (10.0% or greater) of Tesla Motors, Inc. are:
Elon Musk
FMR LLC
Capital Venture International

The corporate officers of Tesla Motors, Inc. are:
Elon Musk, CEO
Deepak Ahuja, CFO
Jeffrey B. Straubel, CTO
Gregory D. Reichow, VP
Brad W. Buss, Director
Robyn M. Denholm, Director
Ira Ehrenpreis, Director
Antonio J. Gracias, Director

BACKGROUND

Tesla has benefited from six previous STE awards, the first of which was granted by CAEATFA on October 28, 2009, prior to the establishment of the existing STE Program, for up to \$320 million for the equipment and tooling required for the production of its Model S sedan and for powertrain components it manufactures for Daimler AG and, previously, for the Tesla Roadster. This award represented an estimated \$29 million in STE. Tesla has since exhausted the entirety of its award, and the agreement terminated on December 31, 2013.

The second Tesla award was granted by CAEATFA on December 13, 2011 for up to \$292 million for equipment and tooling required for the development and production of the Tesla Model X and the expansion of manufacturing activities for electric vehicle powertrain components, including those sold to Toyota. This award represented an estimated \$24 million in STE. Tesla has since exhausted the entirety of its award, and the purchase agreement terminated on December 31, 2015.

The third Tesla award was granted by CAEATFA on December 17, 2013 for up to \$415 million for equipment and tooling required for the expansion of Model S manufacturing capabilities, the expansion of electric vehicle powertrain production, and the continuous development of the Model S program for future electric vehicle development. This award represented an estimated \$35 million in STE. Tesla has since exhausted the entirety of its award, and the purchase agreement terminated on December 17, 2016.

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The fourth Tesla award was granted by CAEATFA on December 15, 2015 for up to \$463,625,000 for equipment and tooling required to expand the production of its Model S and Model X electric vehicles. This award represented an estimated \$39 million in STE. Tesla has since exhausted the entirety of its award with a final transaction report submitted to CAEATFA staff on May 15, 2017.

The fifth Tesla award was granted by CAEATFA on December 13, 2016 for up to \$560,917,080 for equipment and tooling required for the development and production of the Tesla Model 3, the same project under consideration and described below. As of June 30, 2016, Tesla has used approximately 31% of this award.

The sixth Tesla award was granted by CAEATFA on January 17, 2017 for up to \$237,529,691 for equipment and tooling required for the development and production of the Tesla Model 3, the same project approved in December 2016. The request before the Board now is to amend this award to increase the amount of Qualified Property pursuant to Program Regulation Section 10032(a)(4)(A).

Figure 1: Tesla Motors, Inc. Awards to Date					
Board Meeting	Project	QP Amount	QP Purchases	Estimated STE Awarded	Estimated STE Used
10/28/2009	Model S	\$320,000,000	\$320,000,000	\$26,600,262	\$26,600,262
12/13/2011	Model X	\$292,000,000	\$291,889,530.09	\$23,652,000	\$24,546,044.83*
12/17/2013	Model S Expansion	\$415,000,000	\$414,840,044.17	\$34,735,500	\$34,929,531.72*
12/15/2015	Models S and X Expansion	\$463,625,000	\$463,622,419.75	\$39,037,225	\$39,037,007.74
12/13/2016	Model 3	\$560,917,080	\$175,819,988	\$47,229,218	\$14,804,042
01/17/2017	Model 3	\$237,529,691	\$0	\$20,000,000	\$0
Totals:		\$2,289,071,771	\$1,666,171,982.01	\$191,254,205	\$139,916,888.29

*Estimated STE Used is higher than Estimated STE Awarded due to average statewide sales tax rate increasing from 8.37% to 8.42% in 2014.

THE PROJECT

Tesla is requesting an STE award to expand its body shop, stamping line, vehicle assembly, plastics shop, production control, tooling, and prototyping to design and manufacture the newest model in Tesla’s line of fully electric vehicles, the Model 3 (the “Project”). On March 31, 2016, Tesla unveiled the Model 3, a lower-priced sedan designed for the mass market, with an anticipated average price of \$43,000. Pre-orders for the Model 3 have begun, and the Applicant represents the Model 3’s first delivery is planned for late 2017.

Tesla anticipates spending approximately \$1.17 billion to support the design, development, and prototyping of the Model 3, primarily to expand its factory in Fremont, corporate headquarters in

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Palo Alto, and design studio in Hawthorne. Tesla represents the Project will launch the Model 3 and provide the capacity to produce and deliver an average of 195,000 units per year over a five-year period, in addition to its Model S and Model X production. Tesla also represents that production of the Model 3 will support an additional 2,000 direct manufacturing jobs. These production and job estimates have decreased since Tesla’s prior application submissions as Tesla revised the previous estimates to show more accurate figures based on available information, according to the Applicant.

ANTICIPATED COSTS OF QUALIFIED PROPERTY

The anticipated Qualified Property purchases are listed below:

Tooling	\$ 49,060,000
Body Shop Equipment	376,000,000
Vehicle Assembly Equipment	284,500,000
Fremont Material Flow	161,000,000
Press Equipment	80,000,000
Paint Shop	85,000,000
Returnable Packaging	14,700,000
Seat Assembly	35,000,000
Manufacturing Test Equipment	32,000,000
Plastic Shop Equipment	24,000,000
Facility Improvements	16,000,000
Seat Frame Welding Line	<u>12,000,000</u>
Total	<u>\$1,169,260,000</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

The Applicant represents equipment orders began in early 2016 and will continue through 2019, and that application approval would accelerate the pace of investment. The Applicant anticipates delivery of Model 3 vehicle orders to begin in late 2017.

PROJECT EVALUATION

NET BENEFITS

The total cost of the Qualified Property purchases is anticipated to be \$1,169,260,000 and the total net benefits based on the current Application appear to be valued at \$1,671,469 for the Project. Based on the current Application, the Project appears to receive a Total Score of 1,044 points, which exceeds the required 1,000 point threshold and a total Environmental Benefits Score of 120 points, which exceeds the 20 point threshold.

- A. Fiscal Benefits (897 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 \$88,300,575 resulting in a Fiscal Benefits score of 897 points for the Project.
- B. Environmental Benefits (120 points).** The Project will result in \$11,822,586 of total pollution benefits over the life of the Project resulting in an Environmental Benefits Score of 120 points for the Project. These benefits derive from the manufacturing of electric vehicles since these vehicles deliver a net reduction in energy consumption and CO2 emissions relative to a comparable gasoline powered vehicle.
- C. Additional Benefits (27 points).** Applicants may earn additional points for their Total Score. The applicant submitted information and received 51 additional points.

 - 1. Permanent Jobs (20 of 75 points).** The Applicant represents that the Project will support a total of 2,000 permanent jobs at its Facility. CAEATFA estimates that approximately 85 of the 2,000 jobs will be attributable to a marginal increase in jobs created due to the total requested STE resulting in a Permanent Jobs Score of 20 points for the Project.
 - 2. Construction Jobs (0 of 75 points).** The Applicant represents that the Project will support a total of 55 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. Zero points were awarded because the marginal increase in jobs does not meet the required threshold.
 - 3. Non-CA Environmental Benefits (7 of 40 points).** The Applicant’s total out-of-state non-greenhouse gas pollution benefits are valued at \$1,329,990 resulting in a Non-CA Environmental Benefits Score of 7 points for the Project.

STATUS OF PERMITS/OTHER REQUIRED APPROVALS

Permits and necessary approvals for all four sites have already been obtained.

LEGAL QUESTIONNAIRE

As part of the updated Application submitted December 7, 2017, Tesla provided a revised legal status questionnaire, which included disclosures not previously made. Staff is reviewing the Applicant's responses to the questions contained in the Legal Status portion of the Application; however, the Executive Director requires additional information in order to make a determination as to whether the legal issues disclosed affect the financial viability or legal integrity of the Applicant.

CAEATFA FEES

In accordance with CAEATFA Regulations,⁴ the Applicant has paid CAEATFA an Application Fee of \$10,000 and will pay CAEATFA an Administrative Fee of up to \$350,000.

RECOMMENDATION

Statute limits CAEATFA to granting up to \$100 million in sales and use tax exclusion per calendar year. Tesla was previously awarded \$47,229,218 in STE at the December 2016 Board Meeting for the Model 3 Application that was submitted under the prior STE regulations. The Company also was awarded \$20,000,000 in STE at the January 17, 2017 Board Meeting for a Model 3 Application that was submitted under the current regulations, which set a cap on the award with the possibility to receive additional STE if any remains at the end of the year. Staff estimates that \$4,192,540 in STE will remain for 2017, assuming the Board approves all December Applicants. No other Applicant requested STE above the \$20 million cap.

After the November 14, 2017 Board approval to make available additional STE to qualified Applicants, on November 17, 2017, Tesla submitted a revised Application as required by CAEATFA regulations. The revised Application contained new information reflecting how the Applicant's business projections have changed over time, and both the estimated number of jobs and annual production estimates decreased significantly. Staff requested additional information on the status of the Project, to which Tesla provided a response on December 1, 2017. After further review, Staff requested an updated Application with some additional clarifying information, which Tesla provided on December 7, 2017. While based on the values of the current Application, the Project appears to meet minimum point-threshold requirements, Staff is continuing to review the information provided and requires additional time to review the updates and request follow-up information from the Applicant, if necessary.

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

Additionally, Tesla submitted a revised legal status questionnaire on December 7, 2017, which included disclosures not previously made; therefore Staff requires time to complete its due diligence of the responses to make a determination as to whether the legal issues disclosed affect the financial viability or legal integrity of the Applicant.

This marks the first year that the regulations allowing Applicants capped at \$20 million in STE to receive additional award if any remains at the end of the year has been implemented. When the regulation was adopted, Staff did not anticipate the significant amount of time and consideration that may be required for preparing these action items for the Board. Generally Staff has at least 60 days to work with an Applicant before a Board meeting. However, given the short period of time between the November 2017 approval of making available the additional STE and the December 2017 Board meeting, compounded by the Thanksgiving holiday, as well as the nature of the changes to Tesla's Application, Staff requires additional time to review the calculations and assumptions in the Application and to make a determination as to whether the legal issues disclosed do not affect the financial viability or legal integrity of the Applicant.

Staff anticipates revising its processes and procedures, and, if necessary, Program regulations to ensure there is sufficient time in the future.

Because if left unawarded, CAEATFA does not have the authority to "roll-over" the remaining STE amount to grant in future years, Staff believes it is in the public interest and furthers the purpose of the Program to conditionally approve Tesla's request for additional STE at this time.

Staff recommends a conditional approval of amending Resolution No. 17-SM003 for Tesla Motors, Inc.'s purchase of Qualified Property in an amount not to exceed \$287,322,328 anticipated to result in an approximate sales and use tax exclusion value of \$24,192,540, subject to the following conditions:

1. The Applicant must clarify the basis for the updated estimated job and production calculations, as well as what factors have contributed to the reduced numbers and what the Applicant is doing to address any production delays, as may be requested by Staff to complete its review of the updated information.
2. Staff must continue its due diligence of the revised legal status questionnaire and make a determination as to whether the disclosures affect the financial viability or legal integrity of the Applicant.

Upon receipt of any additional information and the conclusion of Staff's review of the legal status questionnaire, Staff's findings may be presented to the Board for further consideration before an amendment to the Master Regulatory Agreement may be finalized, and if not satisfied, the Authority may deny final approval of the amended resolution for additional Qualified Property.

**RESOLUTION APPROVING AND AUTHORIZING EXECUTION OF A MASTER
REGULATORY AGREEMENT WITH TESLA MOTORS, INC.**

December 19, 2017

WHEREAS, the California Alternative Energy and Advanced Transportation Financing Authority (the “Authority” or “CAEATFA”) has received the Application of **Tesla Motors, Inc.** (the “Applicant”), for financial assistance in the form of a master regulatory agreement (the “Agreement”) regarding tangible personal property utilized to process Recycled Feedstock, or 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 was approved for a Sales and Use Tax Exclusion on January 17, 2017 and has entered into an Agreement on February 2, 2017 to acquire Project equipment with an estimated cost not to exceed \$237,529,691 over a period of three years; and

WHEREAS, the Authority approved a resolution to make available at the December 2017 Authority meeting, additional sales and use tax exclusion to Applicants that qualified for additional sales and use tax exclusion but were capped at \$20 million of sales and use tax exclusion pursuant to CAEATFA Regulations Section 10032(a)(4)(A); and

WHEREAS, the Applicant has requested the Authority increase the amount of Qualified Property pursuant to CAEATFA Regulations Section 10032(a)(4)(A); and

WHEREAS, \$4,192,540 in Sales and Use Tax Exclusion will remain for 2017 calendar year, and no other Applicant requested additional Sales and Use Tax Exclusion; 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 January 17, 2017 Tesla Motors, Inc. Resolution Number 17-SM003 is amended to replace the \$237,529,691 of Qualified Property with \$287,322,328.

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Section 2. With the exception of the changes described above, all other provisions, terms, obligations, and covenants contained in the Agreement shall remain in full force and effect.

Section 3. Prior to executing an amendment to the Agreement, the Applicant must clarify the basis for the updated estimated job and production calculations, as well what factors have contributed to the reduced numbers and what the Applicant is doing to address any production delays, as may be requested by CAEATFA staff to complete its review of the updated information. Additionally, CAEATFA staff must continue its due diligence of the revised legal status questionnaire and make a determination as to whether the disclosures affect the financial viability or legal integrity of the Applicant. Upon receipt of any additional information and the conclusion of staff’s review of the legal status questionnaire, staff’s findings may be presented to the Authority for consideration at a future meeting date before executing an amendment to the Agreement.

Section 4. This Resolution is effective immediately and will remain in full force and effect unless the amendment to 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.