

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

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

**Katerra Construction LLC
Application No. 18-SM023 (Amended)**

November 13, 2018

Prepared By: *Xee Moua, Program Analyst*

SUMMARY

Applicant – Katerra Construction LLC

Location – Tracy, San Joaquin County

Industry – Multifamily Unit Building

Project – New Multifamily Unit Building Component Manufacturing Facility (Advanced Manufacturing)

Value of Qualified Property – \$71,608,261

Estimated Sales and Use Tax Exclusion Amount² – \$5,986,451

Application Score –

Fiscal Benefits Points:	2,630
<u>Environmental Benefits Points:</u>	<u>39</u>
Net Benefits Score:	2,669
 <u>Additional Benefits Points:</u>	 <u>150</u>
Total Score:	2,819

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 8.36%.

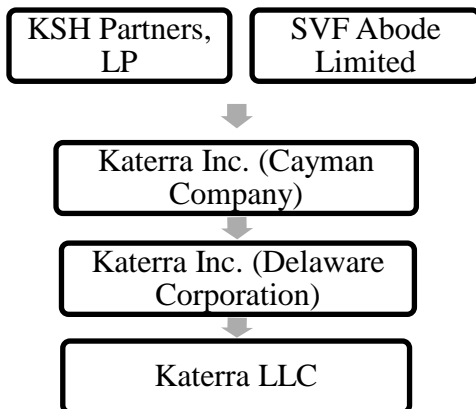
THE APPLICANT

Katerra Construction LLC (“Katerra” or the “Applicant”), a Delaware limited liability company located in Tracy, is a wholly owned subsidiary of Katerra Inc., a Delaware Corporation. Established in 2015, Katerra is a vertically integrated company that focuses on applying technology to building and designing structures. Along with its innovative manufacturing capabilities, Katerra offers services such as architecture, interior design, engineering, building material supply, general contracting, commercial construction, as well as skilled labor and renovations for affordable and market rate multi-unit housing, hospitality centers, student housing, and senior living.

The Applicant was originally approved for a Sales and Use Tax Exclusion for Qualified Property in the amount of \$53,348,261 at the CAEATFA Board meeting on September 18, 2018 (the staff report from September 18, 2018 is included as Attachment A). The Applicant is now requesting to increase its Qualified Property amount to \$71,608,261 to accommodate expenses that were not initially anticipated.

In addition, Katerra Inc. received a \$10 million tax credit through the California Competes Tax Credit Program on June 18, 2018.

The chain of ownership of Katerra Construction LLC is as follows:



The corporate officers of Katerra Construction LLC are:

Mike Rock, President

THE PROJECT

Katerra is requesting a sales and use tax exclusion to build a new, 577,000 square-foot facility located in Tracy that will manufacture multifamily unit building components (the “Project”). According to the Applicant, the Project includes automated lines for the production of wood frame walls, floors, cabinets and finish areas, floor and roof trusses, windows, and light gauge steel, with every aspect of its production controlled via a robotic CAD system. Katerra represents the Project will implement a new practice of applying Radio Frequency Identification (RFID) tags onto all components. The RFID tags are linked to an archived file showing the entire

assembly of the selected component, and can be accessed from mobile devices on the production floor or job site. Furthermore, the automated floor truss line will position wiring, venting, sprinkler systems, lighting and ceiling side drywall in the trusses, while methods such as gluing and clamping associated with traditional cabinetry production will be eliminated and replaced with a dowel-based approach. Katerra states that, in all, the Project's advanced manufacturing capabilities will be able to increase output by 300% compared to its Phoenix, Arizona manufacturing facility, and that production times will allow the company to produce the equivalent of one multifamily project a month, compared to the average development and construction timeline of 29 months for a multifamily project using traditional onsite methods.

Additionally, Katerra explains that its cutting-edge equipment is designed to conserve production materials, reduce labor costs, and increase efficiency. For example, Katerra represents that its research shows that 90% of window glass is manufactured at a standard width, focusing primarily on aesthetics and not on product components and manufacturability, which can result in as much as 20% material waste. Katerra states that it has used this knowledge to produce superior windows with little waste at a lower cost compared to traditional window manufacturing. Katerra also represents it intends to incorporate advanced materials such as an engineered cross-laminated timber that is lightweight, yet durable enough to produce structural components. According to Katerra, its components will be of higher quality when compared to onsite construction as its production will not be affected by the weather and the advanced machinery will give way to an end product that is more precise and better crafted.

After Board approval of the Project in September 2018, Staff worked with Katerra to execute its Master Regulatory Agreement. At that time, it was identified that Katerra had underestimated the expenses of its Qualified Property. Aside from additional equipment needed, the scope of the project remains the same.

On October 16, 2018, Katerra submitted a request for an additional \$18,260,000 in Qualified Property and submitted the necessary fees to make the changes. The amendment will accommodate a new floor truss system and the Applicant's underestimation of machinery and equipment for its Project. If approved, the Master Regulatory Agreement will be executed to reflect the increased Qualified Property amount of \$71,608,261.

ANTICIPATED COSTS OF QUALIFIED PROPERTY

The anticipated Qualified Property purchases are listed below:

WF Auto Wall Line 1	\$ 5,200,000
Wall Panels and Transporting Equipment	11,500,000
Saws	1,577,100
WF ZeroLabor Line 1	5,366,000
AutoFloor Production System	3,000,000
Roof Truss Production System	3,825,000
Floor Truss Production System	4,900,000

Agenda Item – 4.D.1
Resolution No. 18-SM023
Application No. 18-SM023

Window Assembly and Installation Line	7,134,000
Cabinetry Assembly Machinery	17,796,245
Counter Production Equipment	2,310,000
IT	1,999,916
Building Tenant Improvements	3,000,000
Showroom	2,000,000
Material Handling Equipment	2,000,000
Total	<u>\$71,608,261</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

According to Katerra, the facility lease has been finalized and construction began as of June 2018. The final in-service day is scheduled for April 24, 2019.

PROJECT EVALUATION

NET BENEFITS

The Project received a Total Score of 2,819 points, which exceeds the required 1,000 point threshold, and a total Environmental Benefits Score of 39 points, which exceeds the 20 point threshold.

- A. Fiscal Benefits (2,630 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 \$15,745,595 resulting in a Fiscal Benefits score of 2,630 points for the Project.
- B. Environmental Benefits (39 points).** The Project will result in an Environmental Benefits Score of 39. The Applicant received points in the following categories:
 - 1. Solid Waste (9 of 30 points).** The Applicant represents that the Project will result in a nine percent reduction in solid waste produced relative to the standard construction process for multifamily buildings.

2. **Air Pollutants (30 of 30 points).** The Applicant represents that the Project will result in a 35 percent reduction in air pollutants produced relative to the standard construction process for multifamily buildings.
- C. **Additional Benefits (150 points).** Applicants may earn additional points for their Total Score. The Applicant submitted information and received 150 additional points.
1. **Production Jobs (45 of 75 points).** The Applicant represents that the Project will support a total of 542 production-related jobs at its Facility. CAEATFA estimates that approximately 40 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 45 points for the Project.
 2. **Construction Jobs (30 of 75 points).** The Applicant represents that the Project will support a total of 138 construction jobs at its Facility. CAEATFA estimates that approximately 10 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 30 points for the Project.
 3. **Unemployment (50 of 50 points).** The Applicant's Project is located in San Joaquin County which has an average annual unemployment rate of 7.6%. This is above 110% of the statewide average annual unemployment rate which was 5.1% in 2017, the dataset used in the application. This results in an Unemployment Score of 50 points for this Project.
 4. **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 multifamily unit production process that is the subject of this Application.

STATUS OF PERMITS/OTHER REQUIRED APPROVALS

Katerra indicates that it has secured a foundation permit for operations and the necessary shell permits are underway. The Applicant represents it anticipates having all required permits before operations begin in April 2019.

LEGAL QUESTIONNAIRE

Staff reviewed the Applicant's responses to the questions contained in the Legal Status portion of the Application. The responses did not disclose any information that raises questions concerning the financial viability or legal integrity of this Applicant.

CAEATFA FEES

In accordance with CAEATFA Regulations,³ the Applicant has paid CAEATFA an Application Fee of \$10,000 for their initial application. Since the current application is considered an amendment to the original resolution, the Applicant paid an additional fee of \$2,000.⁴ Additionally, under the terms of the original resolution, the Applicant would have paid CAEATFA an Administrative Fee up to \$213,393.04. With the increased award, the Applicant will pay CAEATFA an Administrative Fee up to \$286,433.04.

RECOMMENDATION

Staff recommends approval of an amendment to Resolution No. 18-SM023, increasing Katerra Constructions LLC's purchase of Qualified Property to an amount not to exceed \$71,608,261 anticipated to result in an approximate sales and use tax exclusion value of \$5,986,451.

³ California Code of Regulations Title 4, Division 13, Section 10036(a)(2)

⁴ California Code of Regulations Title 4, Division 13, Section 10036(c)(2)

**RESOLUTION AMENDING THE ORIGINAL RESOLUTION 18-SM013 APPROVING
AND AUTHORIZING EXECUTION OF A MASTER REGULATORY AGREEMENT
WITH KATERRA CONSTRUCTION LLC**

November 13, 2018

WHEREAS, the California Alternative Energy and Advanced Transportation Financing Authority (the “Authority” or “CAEATFA”) has received the Application of **Katerra Construction LLC** (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 was approved for a Sales and Use Tax Exclusion on September 18, 2018 to acquire Project equipment with an estimated cost not to exceed \$53,348,261 over a period of three years; and

WHEREAS, the Applicant has requested the Authority increase the amount of Qualified Property to an amount not to exceed \$71,608,261 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 September 18, 2018 Katerra Construction LLC. Resolution Number 18-SM023 is amended to replace the \$53,348,261 in Qualified Property with \$71,608,261.

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

Section 3. This Resolution shall take effect immediately upon its approval.

Attachment A: Katterra Constructions LLC’s Staff Summary at Board Approval

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

Request to Approve Project for Sales and Use Tax Exclusion (STE)⁵

**Katterra Construction LLC
Application No. 18-SM023**

Tuesday, September 18, 2018

Prepared By: *Xee Moua, Program Analyst*

SUMMARY

Applicant – Katterra Construction LLC

Location – Tracy, San Joaquin County

Industry – Multifamily Unit Building

Project – New Multifamily Unit Building Component Manufacturing Facility (Advanced Manufacturing)

Value of Qualified Property – \$53,348,261

Estimated Sales and Use Tax Exclusion Amount⁶ – \$4,459,915

Application Score –

Fiscal Benefits Points:	3,034
<u>Environmental Benefits Points:</u>	<u>39</u>
Net Benefits Score:	3,073
 <u>Additional Benefits Points:</u>	 <u>160</u>
Total Score:	3,233

Staff Recommendation – Approval

⁵ All capitalized terms not defined in this document are defined in the Program’s statute and regulations.

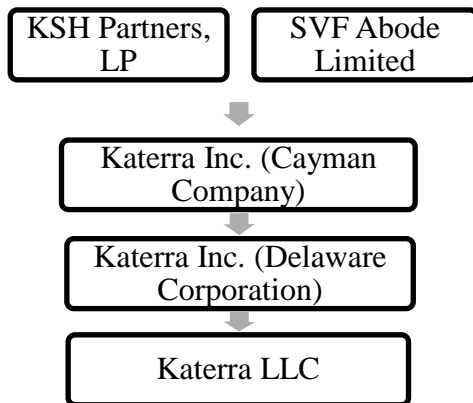
⁶ This amount is calculated based on the average statewide sales tax rate of 8.36%.

THE APPLICANT

Katerra Construction LLC (“Katerra” or the “Applicant”), a Delaware limited liability company located in Tracy, is a wholly owned subsidiary of Katerra Inc., a Delaware Corporation. Established in 2015, Katerra is a vertically integrated company that focuses on applying technology to building and designing structures. Along with its innovative manufacturing capabilities, Katerra offers services such as architecture, interior design, engineering, building material supply, general contracting, commercial construction, as well as skilled labor and renovations for affordable and market rate multi-unit housing, hospitality centers, student housing, and senior living.

Katerra Inc. received a \$10 million tax credit through the California Competes Tax Credit Program on June 18, 2018.

The chain of ownership of Katerra Construction LLC is as follows:



The corporate officers of Katerra Construction LLC are:

Mike Rock, President

THE PROJECT

Katerra is requesting a sales and use tax exclusion to build a new, 577,000 square-foot facility located in Tracy that will manufacture multifamily unit building components (the “Project”). According to the Applicant, the Project includes automated lines for the production of wood frame walls, floors, cabinets and finish areas, floor and roof trusses, windows, and light gauge steel, with every aspect of its production controlled via a robotic CAD system. Katerra represents the Project will implement a new practice of applying Radio Frequency Identification (RFID) tags onto all components. The RFID tags are linked to an archived file showing the entire assembly of the selected component, and can be accessed from mobile devices on the production floor or job site. Furthermore, the automated floor truss line will position wiring, venting,

sprinkler systems, lighting and ceiling side drywall in the trusses, while methods such as gluing and clamping associated with traditional cabinetry production will be eliminated and replaced with a dowel-based approach. Katerra states that, in all, the Project's advanced manufacturing capabilities will be able to increase output by 300% compared to its Phoenix, Arizona manufacturing facility, and that production times will allow the company to produce the equivalent of one multifamily project a month, compared to the average development and construction timeline of 29 months for a multifamily project using traditional onsite methods.

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Figure 1: Automated machinery at Katerra's Phoenix factory



Figure 2: Example of an open wall panel constructed at Katerra's factory before being shipped to the job site for assembly

ANTICIPATED COSTS OF QUALIFIED PROPERTY

The anticipated Qualified Property purchases are listed below:

WF Auto Wall Line 1	\$ 5,200,000
Wall Panels and Transporting Equipment	3,120,000
Saws and Blades	2,627,100
WF ZeroLabor Line 1	5,366,000
AutoFloor Production System	3,000,000
Truss Production System	4,725,000
Window Assembly and Installation Line	6,764,000
Cabinetry Assembly Machinery	12,796,245
Counter Production Equipment	750,000
IT	1,999,916
Building Tenant Improvements	3,000,000
Showroom	2,000,000
Material Handling Equipment	2,000,000
Total	<u>\$53,348,261</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

According to Katerra, the facility lease has been finalized and construction began as of June 2018. The final in-service day is scheduled for April 24, 2019.

PROJECT EVALUATION

NET BENEFITS

The Project received a Total Score of 3,233 points, which exceeds the required 1,000 point threshold, and a total Environmental Benefits Score of 39 points, which exceeds the 20 point threshold.

- D. Fiscal Benefits (3,034 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 \$13,532,500 resulting in a Fiscal Benefits score of 3,034 points for the Project.
- E. Environmental Benefits (39 points).** The Project will result in an Environmental Benefits Score of 39. The Applicant received points in the following categories:
 - 3. Solid Waste (9 of 30 points).** The Applicant represents that the Project will result in a nine percent reduction in solid waste produced relative to the standard construction process for multifamily buildings.
 - 4. Air Pollutants (30 of 30 points).** The Applicant represents that the Project will result in a 35 percent reduction in air pollutants produced relative to the standard construction process for multifamily buildings.
- F. Additional Benefits (160 points).** Applicants may earn additional points for their Total Score. The Applicant submitted information and received 160 additional points.
 - 5. Production Jobs (55 of 75 points).** The Applicant represents that the Project will support a total of 542 production-related jobs at its Facility. CAEATFA estimates that approximately 35 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 55 points for the Project.
 - 6. Construction Jobs (30 of 75 points).** The Applicant represents that the Project will support a total of 138 construction jobs at its Facility. CAEATFA estimates that approximately nine 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 30 points for the Project.

7. **Unemployment (50 of 50 points).** The Applicant's Project is located in San Joaquin County which has an average annual unemployment rate of 7.6%. This is above 110% of the statewide average annual unemployment rate which was 5.1% in 2017, the dataset used in the application. This results in an Unemployment Score of 50 points for this Project.
8. **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 multifamily unit production process that is the subject of this Application.

STATUS OF PERMITS/OTHER REQUIRED APPROVALS

Katerra indicates that it has secured a foundation permit for operations and the necessary shell permits are underway. The Applicant represents it anticipates having all required permits before operations begin in April 2019.

LEGAL QUESTIONNAIRE

Staff reviewed the Applicant's responses to the questions contained in the Legal Status portion of the Application. The responses did not disclose any information that raises questions concerning the financial viability or legal integrity of this Applicant.

CAEATFA FEES

In accordance with CAEATFA Regulations,⁷ the Applicant has paid CAEATFA an Application Fee of \$10,000 and will pay CAEATFA an Administrative Fee of up to \$213,393.04.

RECOMMENDATION

Staff recommends approval of Resolution No. 18-SM023 for Katerra Construction LLC's purchase of Qualified Property in an amount not to exceed \$53,348,261 anticipated to result in an approximate sales and use tax exclusion value of \$4,459,915.

⁷ California Code of Regulations Title 4, Division 13, Section 10036

**RESOLUTION APPROVING AND AUTHORIZING EXECUTION OF A MASTER
REGULATORY AGREEMENT WITH KATERRA CONSTRUCTION LLC**

September 18, 2018

WHEREAS, the California Alternative Energy and Advanced Transportation Financing Authority (the “Authority” or “CAEATFA”) has received the Application of **Katerra Construction LLC** (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 \$53,348,261 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.

Agenda Item – 4.D.1
Resolution No. 18-SM023
Application No. 18-SM023

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.