

Where to Build the Model S? The Case for Manufacturing in California



One focus we have is to educate entrepreneurs about the programs that exist to attract businesses into low and moderate income areas. It's just not part of the knowledge set of start-ups. So we help connect the dots."

—NANCY PFUND, DBL MANAGING PARTNER

Before Tesla was TSLA

In 2013, Tesla Motors' market capitalization reached \$16.6 billion and MotorTrends named its Model S Car of the Year. However, seven years earlier, in 2006, Tesla was a fledgling startup with a mere 51 employees facing technology issues and trying to innovate and scale up quickly. The company had recently closed an early round of financing and was set to begin work on its second model, the sedan, but, first, it needed a factory. The key considerations for a site would be production cost, quality control, and time to market.

Should We Stay or Should We Go?

In the first decade of the 21st century, many US companies were accustomed to siting their factories where they could take advantage of cheap labor and reduced regulatory standards to lower production costs. Between August 2000 and February 2004, manufacturing jobs in the US declined for a stunning 43 consecutive months—the longest such stretch since the Great Depression—as companies moved factories to China, South America and Mexico.

Tesla's sedan, however, was a make or break product for the company: the first car that Tesla would entirely design and build. Given the importance of the project for Tesla's future and its reputation, they prioritized time to market and quality control.

A US factory would be more accessible to the engineering team based in Tesla's Silicon Valley headquarters, and their constant attention and ability to iterate would increase the sedan's chance of being a success.

In Search of a US Manufacturing Facility

While members of the Tesla Board of Directors knew that a California factory, close to the engineers at their Silicon Valley headquarters, would provide the best opportunity to integrate manufacturing and engineering teams, they were concerned that manufacturing in California would mean higher costs attributable to labor, taxes, and regulations. With limited bandwidth to devote to the search and a desire to constrain their manufacturing costs, the Board first honed in on Michigan and North Carolina as obvious candidates due to state-based incentives, automobile supply chain efficiencies, and affordable labor.

DBL Managing Partner, Nancy Pfund, had another idea. She realized that siting in a low-to-moderate income (LMI) area would not only improve the tax base in communities that have historically lacked investment capital but also help Tesla access low-interest loans, tax credits, grants, and other financial incentives. To help Tesla with its siting decision, DBL worked with Tesla executives to complete an analysis of the financial incentive packages provided by the cities and states for various sites.

In addition to identifying existing incentives, DBL worked side by side with Tesla to negotiate new incentives by demonstrating to community leaders the long-term employment and community development that could result from a local Tesla factory. The first financial incentive package that DBL and Tesla Motors secured was for a site in Pittsburg, CA, which benefited from a dozen different state and local incentives worth an estimated \$20.7 - \$25.3 million.

Tesla Fields a Succession of Competitive Site Bids

The Pittsburg package set the bar for other city officials to attract Tesla manufacturing to their city. Over the next few years, additional communities in California—including San Jose and Long Beach—as well as one in New Mexico offered Tesla financial incentives such as subsidized rent, infrastructure improvement incentives, business tax credits, tax-free financing, and sales tax exemptions. While New Mexico temporarily displaced the Pittsburg package, California remained in the competitive bidding process and it was clear the state was committed, in the words of Governor Schwarzenegger, to having “these cutting-edge companies not to just start in California and do their research and development here [but] *build* in California.”

Finding a Home in California

By the spring of 2010, Tesla had yet to finalize the procurement of a site. The company was eager to have the new assembly facility sited and prepared to come on-line. In 2010, the last major auto assembly plant in California, a Toyota plant in Fremont, with a production capacity of 300,000 vehicles per year and a workforce of 4,500, ceased operations. Unemployment in Fremont climbed over 8 percent, an all-time high.

Political leaders at all levels of government were invested in the rejuvenation of Fremont, and, building upon earlier efforts by Tesla and DBL in other communities, worked to provide Tesla up to \$100 million in tax-free equipment financing to locate there. In May 2010, Tesla and Toyota announced a partnership for developing and producing electric vehicles and components, as well as an agreement for Tesla to purchase the NUMMI factory building (once valued at \$1 billion) for \$42 million. Tesla also acquired over \$17 million of manufacturing equipment at a dramatic discount to its market value. Soon thereafter, Tesla was able to rebuild the plant to begin production of the sedan.

Conclusion

Tesla’s decision to site in California represented a deviation from the prevailing traditional approaches to siting factories, which emphasize low labor costs and reduced regulations. Early in the siting process, DBL helped the Tesla team develop a foundation to understand the financial and social value of siting in California. Years later, the ultimate decision to locate in Fremont not only provided enormous financial and operational benefits but also allowed Tesla to influence the resurgence in American manufacturing and ultimately create 3,000+ jobs across the company as of 2013.

As DBL Managing Partner, Nancy Pfund, put it, “Through a process that broke apart the conventional wisdom about whether California was an appropriate place to manufacture, the Tesla team’s perspicacity helped it grab a plant many thought was out of its reach, creating a strategic win for both the company and the community.”