TIM CURRY
CRIMINAL DISTRICT ATTORNEY
401 WEST BELKNAP STREET
FORT WORTH, TEXAS 76196-0201 (817) 884-1620

May 15, 2006

RQ-0490-GA

FILE # ML-44810-06
I.D. # 44810

The Honorable Greg Abbott
Attorney General of Texas
Office of the Attorney General
P.O. Box 12548
Austin, Texas 78711-2548

VIA CERTIFIED MAIL, RETURN-RECEIPT REQUESTED

PRINCIPAL QUESTION PRESENTED:

(1) When a private commercial enterprise and a 4B economic development corporation form a partnership, under which the 4B gets a 20% to 25% carried interest,

(2) that partnership then subleases to another commercial enterprise on a long-term basis real property previously declared by the 4B corporation to be tax-exempt as part of a public "project," and

(3) the partnership's intended use of the property may no longer constitute a public "project," because the property is now being used for commercial purposes,

(4) should the project's underlying property and improvements be or remain tax-exempt, such that the private partner, through its 75% to 80% interest in the partnership, and the sub-lessee

(a) may receive, or continue to receive, the economic benefit that would have otherwise gone to taxing authorities (i.e. counties, cities, school districts, and hospital districts), and

(b) may enjoy, or continue to enjoy, an economic advantage over private sector developers?

Dear General Abbott:

I am requesting an opinion from your office regarding the foregoing question as I believe this inquiry is in the public interest and may have an impact on governmental entities locally as well as throughout the state. The real property that is the subject of this inquiry is within the taxing jurisdiction of the City of Westworth Village and is located wholly within Tarrant County, Texas.

The question relates to the Westworth Redevelopment Authority ("**WRA**"), an entity whose name would suggest it is a redevelopment authority. Actually, it is a small, non-profit economic development corporation created by the City of Westworth Village under

the Texas Development Corporation Act of 1979 set forth in article 5190.6 of Texas Revised Civil Statutes (the "Act").[1]

Generally, we understand the transactions which underlie this request to be structured as follows. The WRA has entered into one or more partnerships with a private commercial developer ("**PCD**") (such partnerships being referred to herein as "**PCD/WRA Partnership**," whether one or more). The PCD owns 75% to 80% of each PCD/WRA Partnership, and the WRA owns 20% to 25% of each such partnership. The PCD/WRA Partnership has leased or offered to lease the subject properties from the WRA. In turn, the new PCD/WRA Partnership has subleased or will sublease those properties to purely commercial tenants, such as residential apartments or to commercial businesses such as a fitness center, enterprises which normally do not qualify for tax-exempt status.

Because these properties have been previously granted tax-exempt status by the WRA as "projects" under the Act, the grant of such ad valorem tax-exempt status under these leaseholds will result in a loss of significant property tax revenue to several local governments and political subdivisions within the county, including, without limitation, one or more school districts and a hospital district. Unlike tax abatements and/or tax increment financing, these local governments do not have the opportunity to vote on what portion of the ad valorem tax is to be exempted. Rather, section 4B(k) of the Act appears to provide complete ad valorem tax exemption to "projects" as determined by the industrial development corporation's board of directors, without consulting or obtaining the consent of the affected local government taxing jurisdictions.

Since the loss of ad valorem taxes to the affected local governments under this framework can be significant, we believe it would be appropriate to obtain an opinion from your office regarding such transactions before their initiation or continuation establish a precedent.

Factual Background:

Several years ago, the City of Westworth Village formed the WRA. The WRA then entered into agreements with the United States Department of Defense to redevelop parts of the former Carswell Air Force Base for new non-military, residential and commercial uses.

Since its creation, the WRA has actively sought to redevelop the property. In several instances, this was accomplished by the WRA selling certain properties to private commercial interests. In those sales, we understand that no partnerships giving the WRA a carried interest in the transaction or affording tax breaks to the purchaser were involved, although the WRA may have participated in the profits realized from these sales on some basis.

---

[1] Copies of the WRA's articles of incorporation and certificates of such from the Secretary of State's office are enclosed for your reference.

More recently, however, the WRA has implemented a new transactional approach. It appears the WRA now declares certain property owned by the WRA and targeted for redevelopment to be for a public "project" and, therefore, tax-exempt.[2] At this juncture in their approach, the property is undeveloped and wholly owned and controlled by the WRA.

The WRA, then, enters into a PCD/WRA Partnership agreement with a PCD, under which agreement the PCD receives 75% to 80% of the partnership interest and the WRA receives a 20% to 25% carried interest.

The PCD/WRA Partnership, then, leases the property from the WRA and, in turn, subleases it on a long-term basis to other private commercial entities on various terms.

For example, the PCD/WRA Partnership may sublease the properties to entities that build residential apartments and/or engage in other private commercial enterprises. In some instances, these subleases appear to contemplate "build-to-suit" arrangements, whereby commercial enterprises sublease the improvements, which, along with the underlying real property, remain titled in the WRA.

The effects of this new approach seem two-fold.

First, because the PCD/WRA Partnership does not have to pay property taxes, the property can be subleased to third party commercial entities at rates more favorable than if the PCD/WRA Partnership had been required to pay property taxes. Local developers in competition with the PCD/WRA Partnership's development "project" have argued that this causes unfair competition for them, because they cannot offer the same ad valorem tax relief to their tenants and must, instead, include such taxes in their lease rates.

Second, while the WRA will receive a carried financial interest, the PCD will effectively receive $.80 out of every dollar that would have otherwise gone to taxing authorities in the form of ad valorem tax payments, had the properties in question not been declared a "project" under section 4B of the Act.

Accordingly, affected local governments can be expected to complain that they are losing substantial tax revenue due to the WRA's declaration of such properties as

---

[2] See definitions of "project" in sections 2(11) and 4B(a)(2) of the Act. More specifically, it is our understanding the WRA is applying the "project" section 4B(a)(2)(B) of the Act in determining whether the redevelopment at issue constitutes a project. Section 4B(a)(2)(B) provides as follows:

> (2) "Project" means land, buildings, equipment, facilities, expenditures and improvements included in the definition of that term under Section 2 of this Act, and includes job training as provided by Section 38 of this Act. For purposes of this section, the term includes recycling facilities, and land, buildings, equipment, facilities, and improvements found by the board of directors to:
>
> > B) promote or develop new or expanded business enterprises that create or retain primary jobs, including a project to provide public safety facilities, streets and roads, drainage and related improvements, demolition of existing structures, general municipally owned improvements, as well as any improvements or facilities that are related to any of those projects and any other project that the board in its discretion determines promotes or develops new or expanded business enterprises that create or retain primary jobs;

"projects" under the Act. This argument may have merit if the subleases are going to purely commercial interests that have no public purpose or function qualifying them for a public "project" designation, the prior "project" designation given the property by the WRA under 4B(a)(2) of the Act notwithstanding.

Furthermore, as previously stated, it appears local governments losing ad valorem taxes in transactions such as these have no voice or vote in whether the property is exempt from taxation, as section 4B(k) of the Act provides for exemption from ad valorem taxes upon a finding of the WRA Board that the property constitutes a "project" under 4B(a)(2) of the Act, without notice to the affected local governments.

Moreover, with the WRA now having a carried interest in the transaction and, therefore, a financial incentive to designate a project a public "project," local governments affected by this new transactional approach may argue that the WRA has created a conflict of interest for itself.

Local real estate developers, who are not in partnership with the WRA but are competing for the same commercial tenants, have similar concerns. They are concerned that these transactions, so structured, are purely commercial in nature and have no public purpose or function whatsoever. They are afraid PCDs that participate in such PCD/WRA Partnerships and reap 80% of the benefit of not having to pay property taxes may have an unfair competitive edge because the competing developers do not enjoy a similar tax benefit. This concern is especially sensitive for the competing developers when they see WRA properties, once developed, looking very much the same as their own commercial developments.

In defense of its new profit-making approach, the WRA may respond by saying it is relying on language contained in the Act. The Act provides in section 4B(k) of Article 5190.6 that leasehold interests constituting "projects," as defined by section 4B(a)(2), are exempt from ad valorem taxation, so long as the City's voters have authorized the levy of a sales and use tax for the benefit of the corporation.[3] In further defense of its position, the WRA may also say that a public purpose is being recognized by the redevelopment of the property, even if the property's use is essentially limited to commercial and private purposes.

In reviewing the WRA's new transactional approach, this office also has concerns about whether the WRA, through the use of these particular public-private partnerships, has over-reached its authority to grant tax exemptions. There is concern about the propriety of having transactions that may potentially lean more toward requiring improvements that generate carried interest income for the WRA than improvements that foster and serve a public purpose.

Further, competing developers have begun to inquire whether it is legal or appropriate for the WRA to be able to simply declare property and a transaction a public "project" and, then, through the use of a PCD/WRA Partnership, let a PCD sublease and build out

[3] The voters of the City of Westworth Village in 2004 passed such a sales and use tax, which allows the WRA public-private partnerships to offer ad valorem tax exemption to private commercial interests willing to enter into long-term subleases on WRA property, including "build-to-suit" arrangements.

the property in a commercial way that, because of the tax-exempt component of the transaction[4] allows the PCD and the WRA to make more money than they would have otherwise made.

Legal Analysis:

The intent of the Act, in allowing for the creation and the exercise of authority by industrial revenue corporations, is described in Section 3 of the Act. This section sets forth the Legislature's findings that the promotion of new and expanded business, commerce, industry, and job training is essential to the economic growth of the state and to the full employment, welfare, and prosperity of its citizens.[5] A review of other sections of the Act, especially those sections 2(11) and 4B(a)(2) that define "projects," leads to the argument that "projects" are those which further a public purpose or from which a public benefit will be derived -- projects like roadways, utility infrastructure, and public facilities, or projects that will generate a large number of primary, permanent jobs that will significantly impact an area's economy, jobs that may be created and sustained by the building of a large manufacturing plant or other large facility, for example. *See*, Art. 5190.6 at secs. 2(11) and 4B(a)(2).

In the instant case, however, there are questions about whether commercial entities, which, pursuant to the approach described above, have structured their real property developments to include only non-public leaseholds that generate income from other commercial entities, should be able to maintain their status as a "project" under the Act, especially when such status was declared by the WRA Board at a time when no such commercial development existed on the subject properties.

The closest case on point appears to be the unpublished opinion rendered in *Northwest ISD v. City of Fort Worth, Texas et al., Cause no. 03-96-00397-C, Tex. App LEXIS 2679, 1997 WL 269095* (Tex. App. – Austin 1997). In that case, the Northwest ISD sought review of the trial court's denial of an injunction that the school district sought to prohibit the City of Fort Worth, the Fort Worth Sports Authority (FWSA), Inc. (a corporation created under the Act), and the owners and managers of the property constituting the Texas Motor Speedway, from entering into an agreement to provide long-term property tax exemption to the Texas Motor Speedway.

The proposed transaction, which led to the filing of the lawsuit by the Northwest ISD, was structured to allow the FWSA to take title to the Texas Motor Speedway property and, then, lease it back to the owners of the Texas Motor Speedway to permit the property to be titled in the FWSA and then become exempt from property taxes under section 4B(k) of the Act. The Northwest ISD argued that this scheme was violative of certain provisions of the Texas Constitution, including article III, sections 51 and 52(a)

---

[4] Such transactions may be intentionally structured as leaseholds, rather than sales, thus triggering the section 4B(k) tax exemption for leaseholds.

[5] The Act further provides in section 3(4) that "the means and measures authorized by this Act and the assistance provided in this Act, especially with respect to financing, are in the public interest of the state in promoting the welfare of the citizens of the state economically by the securing and retaining of business enterprises and their resulting maintenance of a higher level of employment, economic activity, and stability." (emphasis added)

(prohibiting granting of public monies and lending of credit); article VIII, section 1 (mandating equal and uniform taxation of all property); article VIII, section 2 (requiring exempt public property to be used for public purposes); and article XI, section 9 (requiring property of counties, cities, and towns to be owned and held only for public purposes).

The case was dismissed for lack of subject matter jurisdiction because the trial court found that the Northwest ISD had not exhausted its administrative remedies under the Tax Code, including the pursuit of a hearing and a decision from the Appraisal Review Board. Accordingly, the court was not able to reach the constitutional issues.

Following the court's dismissal for lack of subject matter jurisdiction, the matter was settled. The transaction was re-structured to permit the Northwest ISD to participate in the tax increment financing district revenues associated with the Texas Motor Speedway development, in an amount approximating $70 million over the remaining life of the TIF. See, Dallas Morning News article, August 12, 1999, (NORTHEAST TARRANT COUNTY; Pg. 2N; SCHOOL BRIEFS), copy enclosed.

We found no decisive controlling authority on point. We seek an opinion from your office on the principal question referenced above and the following related issues.

Related Legal Questions Presented:

The Principal Question presented above raises a subset of legal questions. We would appreciate your opinion regarding these questions when you respond to this request.

QUESTION 1. Do the above-described PCD/WRA Partnership transactions constitute "projects" under section 4B(a)(2) of the Act because the WRA Board of Directors declares them to be such prior to their redevelopment? Is this the case even when the PCD/WRA Partnership subleases to a commercial tenant for commercial purposes? Is there, as a matter of law, still a public function and/or purpose supporting the property's tax-exempt status at that point? Further, to what extent, if any, must the WRA Board of Directors objectively be able to show a public function and/or a public purpose for it to be able to declare a project a "project" under the Act?[6]

QUESTION 2. Assuming the WRA Board of Directors has the sole authority to declare such a structured transaction a "project" under section 4B(a)(2) of the Act, is such a designation reviewable by the Tarrant County Appraisal District, Tarrant County, a Tarrant County District Court, the impacted school district(s), the Tarrant County Hospital District, or other affected local government or political subdivision? In this connection, assume the decision of whether a "project" qualifies for an exemption rests with the Tarrant County Appraisal District. Is the Tarrant County Appraisal District required to accept *ipse dixit* the declaration and findings of the WRA Board of Directors that such a project qualifies as a "project," as that term is defined under section 4B(a)(2)

[6] As indicated, concerns have been voiced to this office that these long-term leaseholds of WRA property to private commercial enterprises for private use may not possess the requisite public function and/or public use and, therefore, may not meet the definition of "project" under the Act.

of the Act? If not, what procedure(s) is/are available to challenge such a declaration, and by whom may such a challenge be brought?

QUESTION 3. Would a local taxpayer who can show economic harm as a result of the granting of ad valorem tax exemptions to WRA properties on the basis described above have standing to challenge the finding of the WRA Board of Directors that such properties constitute "projects" under section 4B(a)(2) of the Act?

QUESTION 4. Once an economic development corporation declares a transaction a "project", under what circumstances, if any, would or could that designation be lost? Would a significant change in use, such as privatization through a "build-to-suit" leasehold arrangement with a commercial tenant, result in an automatic loss of the "project" designation? Stated differently, can the "project" designation be lost automatically once the project does not meet or no longer meets the definition of "project" under the Act? Are there reasons for deeper concerns, such as for potential fraud, when a PCD and an economic development corporation like the WRA set up a partnership with the express intent of making more money for themselves by subleasing tax-exempt property to subtenants they know, or should know, will not be serving a public purpose?

QUESTION 5. Is the granting of ad valorem tax relief to commercial enterprises, through these long-term sublease arrangements with PCD/WRA Partnerships, constitutional? In this connection, questions have been raised regarding the constitutionality of the statute as being applied to the facts of this matter.

For example, Article 8, section 1 of the Texas Constitution requires an "equal and uniform system of taxation" in the State. If the WRA, acting under its interpretation of section 4B(k) of the Act, effectively grants (through public-private partnerships) long-term leasehold interests to private commercial enterprises, which thereby enjoy property tax exemption, is the system of property taxation in Tarrant County still equal, or will this structure have effectively shifted over to the remaining taxpayers and property owners of the county, school district, and other taxing entities an unfair and illegal burden to fund local government services within the area? In short, do these transactions, structured as described above, infringe on the "equal and uniform" taxation guarantees of article 8, section 1 of the Texas Constitution?

Further, questions arise under Article 3, section 52(a) of the Texas Constitution, which prohibits municipalities and their instrumentalities from granting or gifting public money or things of value to private interests. It could be argued by an affected local government, or by another damaged party, that a grant of long-term property tax exemptions to private commercial enterprises would fall under this provision. This argument was raised in the *Northwest ISD v. City of Fort Worth, et al.,* case referenced above, but the issue was not reached or addressed by the court before the case was settled. The question, then, remains - is the effect of granting a property tax exemption that local governments and competing developers might say is granted less for a governmental or public purpose, and more for the economic benefit of a commercial recipient as described above, an unconstitutional granting of a "thing of value"?

Given that the redevelopment of various properties by different local governmental authorities across the State may result in questions and issues similar to those raised here, it is in the public interest, as well as in the interest of several affected local governments, for your office to issue an opinion on these matters.

Please contact my office if you have any questions regarding this request.

Sincerely,

Tim Curry

Enclosures: WRA Articles of Incorporation
Dallas Morning News article