

Foreign Trade Zone Report
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Commissioner,

Here is the report delivered in June. There have been some minor changes in property configuration since June, but everything has proceeded in accordance with the report content. The map Rick provided in the briefing package is current.

Let me know if you need anything else from me.

Regards,

Bill



Southern Dallas County Foreign Trade Zone Expansion Report _6-19-06_.pdf.zip

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**Dallas/Fort Worth International Airport
Foreign Trade Zone No. 39**

**Southern Dallas County Foreign
Trade Zone Expansion Report**



June 19, 2006

**Southern Dallas County
Foreign Trade Zone Expansion Report**

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Southern Dallas County

Foreign Trade Zone Expansion Report

Project Background

The Union Pacific Intermodal Facility has generated significant interest in development opportunities in Southern Dallas County. Already a focal point of the NAFTA Corridor Project, the convergence of the new rail opportunities and the existing highway structure make the area ripe for development to serve companies involved in international trade. This has in turn raised interest in foreign trade zone status to attract and better serve international traders.

The "entitlement" (primary) foreign trade zone grant for North Texas is held by the Dallas/Fort Worth International Airport Board ("DFW"). The grant allows DFW to administer specifically designated foreign trade zone sites throughout the region. DFW may request that the number and location of foreign trade zone sites be altered to accommodate the needs of businesses operating in the area. The final decision on the location of foreign trade zone sites is determined by the Foreign Trade Zones Board, a federal government interagency board described in more detail below.

Three developers have independently approached DFW requesting that foreign trade zone boundaries be expanded to include privately owned properties in Southern Dallas County. Consistent with the approach used by the Foreign Trade Zones Board to review requests for zone expansion, DFW reported to the developers that it preferred

developing a single comprehensive and coordinated approach to expanding the DFW Foreign Trade Zone boundaries to accommodate anticipated growth in Southern Dallas County. Following meetings with the City of Dallas and Dallas County concerning long term development opportunities in the area, DFW requested that Ernst & Young, LLP prepare a recommendation for expansion of the foreign trade zone in Southern Dallas County.

How Foreign Trade Zones Work

A foreign trade zone is an area that is physically located within the United States, but is considered outside of the Customs territory of the United States. The United States version of the free port, foreign trade zones are designed to increase the use of American labor and increase capital investment in the United States by allowing activity to occur in the United States prior to the application of U.S. Customs laws, thereby equalizing the Customs treatment of the activity with similar activities occurring off-shore or overseas. Authorized by the Foreign Trade Zones Act of 1934, foreign trade zones operate as public utilities pursuant to grants from the Foreign Trade Zones Board, an interagency board consisting of the Secretary of Commerce and the Secretary of Treasury. Operations are governed by the Foreign Trade Zones Act and by regulations issued by the Department of Commerce and the Department of Homeland Security.

Economic Benefits

A business which locates and operates within a foreign trade zone may receive a number of economic benefits. Many of the benefits relate to Customs duties on imported goods. All zone users can defer the payment of duties, paying customs duty on imported merchandise when the merchandise leaves the foreign trade zone and enters the commerce of the United States, instead of when the merchandise arrives. As a corollary to the duty deferral rule, merchandise imported into and re-exported from a foreign trade zone is not subject to duty at all.

In some cases, lower duty rates may be achieved through foreign trade zones. A foreign trade zone user that assembles or manufactures products in a zone may elect to pay duty on an imported component either at the duty rate applicable to the component or at the duty rate applicable to the finished product. In either case, U.S. value added in the zone is not subject to duty. In an inverted tariff situation, one in which the duty rate on the finished product is lower than that on the imported component, manufacturing in a foreign trade zone results in a lower overall duty to the manufacturer. Duty savings may also be achieved by operating in a foreign trade zone when foreign merchandise undergoes loss or shrinkage through storage or processing in the zone since duty is paid based on the quantity of goods actually leaving (rather than entering) the zone. Similarly, imported components can be inspected in a zone, and defective components can be replaced or destroyed without incurring duty on the defective component.

Savings are also available through the avoidance of state or local laws that are inapplicable in a foreign trade zone because of federal preemption. Of particular importance in Texas, state and local ad valorem tax on inventory is not applicable to foreign origin or foreign destination goods held in a foreign trade zone. Some state licensing requirements are not applicable to companies operating in foreign trade zones.

Finally, there are a variety of potential supply chain operational savings which can benefit zone users. Through a procedure called "direct delivery" qualified foreign trade zone businesses can receive products directly at the zone, bypassing Customs clearance procedures at arrival. Shipments out of a foreign trade zone during a week can be consolidated on one Customs "weekly entry," saving administrative costs and fees.

Accessing Benefits

In order to access foreign trade zone benefits, a business must locate within the boundaries of a zone, and go through a process with the U.S. Bureau of Customs and Border Protection called "activation." Activation involves establishing an inventory control system which meets Customs requirements, and meeting physical security and personnel security requirements. "Activated" businesses are subject to Customs and Border Protection regulatory and recordkeeping requirements. Businesses that locate within a foreign trade zone but do not activate may not access foreign trade zone benefits, and have no corresponding regulatory responsibilities.

When a foreign trade zone is established in Southern Dallas County, businesses will be able to own or lease buildings within the zone, and decide on their own if and when to activate. Access to zone benefits will be "there if they need it." Based on similar projects across the country, it is anticipated that a minority of businesses located within the zone will actually be active at any point in time. The designation of property in Southern Dallas County as a foreign trade zone becomes an amenity to the property, providing potential benefits to businesses which may be interested in conducting operations at that location.

Foreign Trade Zone Expansion Process

The Foreign Trade Zones Board was established by the Foreign Trade Zones Act of 1934, codified at 19 U.S.C. § 81a, et seq. Both members of the Foreign Trade Zones Board, the Secretary of Commerce and the Secretary of Treasury, have delegated primary responsibility to Assistant Secretaries who act on behalf of the Board. The Foreign Trade Zones Board also has full-time staff, who are employees of the Department of Commerce.

The Foreign Trade Zones Board reviews applications to establish, expand, or modify zones using a public interest analysis. Expansion applications are approved upon the demonstration of a need for the expanded zone. An application can demonstrate a need by showing that the expanded zone will encourage commercial and industrial operations in the U.S., allow domestic businesses to become more competitive with their foreign counterparts, and create employment opportunities.

Local Approvals

For foreign trade zone projects in Texas and in other states which assess a property tax on inventory, the Foreign Trade Zones Board asks that applications include expressions of concurrence from affected taxing jurisdictions. DFW has adopted a policy that requires pertinent information be provided to each potentially impacted city, county and school district, and that a letter be obtained from each for inclusion with the application. In this particular case, consent letters will likely be necessary from Dallas County, the Cities of Dallas, Hutchins, Lancaster, and Wilmer, and the Dallas and Lancaster Independent School Districts.

Application Approval Process

Detailed requirements for applications are specified in Department of Commerce Regulations (15 C.F.R. Part 400) and in guidelines published by the Foreign Trade Zones Board. Once prepared, the application is submitted to the Foreign Trade Zones Board staff for pre-filing review, which verifies that all the technical requirements are satisfied. If any changes are required to the application, the Foreign Trade Zones Board staff will notify the applicant, who may make the necessary changes to the application.

At the end of the pre-filing review period, the formal application is filed. A Foreign Trade Zones Board examiner is assigned, the application is assigned a docket number, and an

announcement is published in the Federal Register. The docketing of the application triggers a sixty day public comment period. During this time, members of the public may review the application at the Foreign Trade Zones Board office or at a designated local location, and provide comments in support or against the application. The applicant is allowed the opportunity to respond to any comments provided.

After the public comment period has ended, the examiner will prepare his or her recommendation on whether to approve the application. If the examiner's recommendation is not favorable, the applicant can either revise or withdraw the application. If examiner provides a favorable recommendation, the application and the examiner's recommendation are circulated for interagency review to both the Bureau of Customs and Border Protection, and to the Treasury Department. If both agencies concur with the examiner's recommendation, the Department of Commerce will conduct a final review before the Foreign Trade Zones Board issues a Board Order approving the application.

Time of Approval

The Foreign Trade Zones Board estimates that the application review process will take between ten to twelve months. Preparing the application itself, including researching and gathering information from the applicant and external sources may take a month or more depending on the scope and extent of information needed to demonstrate the need for the expanded zone.

Existing Foreign Trade Zone Availability

"Southport," a 766 acre industrial park in Southern Dallas County, was granted foreign trade zone status in 1990. The original application to the Foreign Trade Zones Board for the Southport property focused on the strategic highway location in relation to trade with Mexico. Foreign trade zone activity, however, has not occurred at Southport. Several factors have inhibited foreign trade zone use:

- General real estate market. A downturn in the Texas economy shortly after Southport was given foreign trade zone status significantly inhibited the original development plans.
- North American Free Trade Agreement ("NAFTA"). Effective January 1, 1994, NAFTA significantly increased trade between the U.S. and Mexico. The mechanism for doing so, however, preferential duty treatment for products originating in North America, reduced the utility of foreign trade zones for U.S. business trading with Mexico. NAFTA has largely eliminated customs duties and fees for Mexican products imported into the U.S.; NAFTA benefits have effectively superseded foreign trade zone benefits for U.S. importers of Mexican merchandise. NAFTA has also reduced the use of foreign trade zones by U.S. manufacturers that export product to Mexico. NAFTA contains a provision (Article 303) which restricts foreign trade zone benefits for component parts imported into a U.S. foreign trade zone which are used to produce NAFTA qualifying products. For businesses focused on U.S. – Mexico trade, NAFTA has effectively eliminated any duty benefits from utilizing foreign trade zones.

Freeport Exemption. The Foreign Trade Zones Act was amended effective January 1, 1983 to prohibit state and local property taxation of qualifying foreign trade zone inventory. Qualifying inventory includes inventory which has been imported from outside the U.S. into a foreign trade zone, and domestic inventory held in a foreign trade zone for export. The statute was an initiative of DFW, and was specifically designed to exempt qualifying inventory from tax in the State of Texas. See Deer Park Independent School District, et al. v. Harris County Appraisal District, et al., 132 F.3d 1095 (5th Cir. 1998), cert. denied 118 S.Ct. 2343 (1998).

In 1989 the Texas Constitution was amended to allow "freeport property" to be exempt from property tax on a local option basis. Freeport property is personal property, other than petroleum, which is held in Texas for less than 175 days. When the application to designate Southport as a foreign trade zone was filed, the freeport exemption was not available at Southport. Over time, however, the freeport exemption has been adopted by each of the taxing jurisdictions applicable to Southport, the City of Dallas, Dallas County, and the Dallas Independent School District (the Wilmer-Hutchins Independent School District had also adopted the freeport exemption.)

The foreign trade zone tax exemption and freeport tax exemption are not coterminous, but do overlap. For example, a product imported from Mexico into a distribution facility in the Southport foreign trade zone which is later shipped to Oklahoma would be exempt under both exemptions. Product imported from Mexico into a Southport foreign trade zone distribution center and later shipped to Houston,

however, would be exempt under the foreign trade zone exemption, but not under freeport. Conversely, a product made in Houston, shipped to a Southport distribution center, and then on to Oklahoma would be exempt under the freeport exemption, but not under the foreign trade zone exemption. While the optimal tax position comes from the availability of both exemptions, the incremental benefit of the foreign trade zone exemption is much less following the adoption of the freeport exemption. At Southport, the potential value of the foreign trade zone property tax exemption has been diminished by the adoption of the freeport exemption.

Absorption of the Southport industrial park has been slower than originally anticipated. The development activity that has occurred has been primarily in the last ten years, post NAFTA and the adoption of freeport exemptions. This development has not been fueled by foreign trade zone status.

Profile of Expanded Foreign Trade Zone Users

The Union Pacific Intermodal Facility has created new transportation efficiencies for moving product imported from Asia directly into the Dallas/Fort Worth region. A product may move in container by ocean and then be transported by rail directly to the Union Pacific facility.

Trade with Asia, particularly with China, has increased dramatically in the past few years. In 2005, China was Dallas/Fort Worth's top trading partner with over \$13 billion in trade, a 94% increase over 2003. The region's growing trade activities with China

follows the national trend, but the rate of growth is nearly double the national average. See Greater Dallas Chamber of Commerce, DFW International Fast Facts Report (2006). In 2003, the region's trade with China accounted for approximately 19% of Dallas/Fort Worth's total international trade. That figure increased to 26% in 2006. The Intermodal Facility will position the Dallas/Fort Worth area to further expand trading opportunities with Asia. The Dallas Morning News estimates that Dallas/Fort Worth will be the third largest gateway for Chinese goods into the United States by 2010.

Businesses that trade with Asia continue to receive significant benefits from foreign trade zone utilization. The U.S. has only one free trade agreement in Asia, with Singapore, and while negotiations are underway with Korea and Thailand, there is very little likelihood of any agreement with China in the foreseeable future. Additionally, it is important to note that more recent free trade agreements (e.g., Australia and CAFTA) do not contain restrictions that would inhibit foreign trade zone use for U.S. manufacturers exporting product to free trade agreement countries. Consequently, manufacturers producing products in the U.S. for export to Asian markets will continue to be motivated to use foreign trade zones for manufacturing.

With foreign trade zones continuing to provide benefits to U.S. businesses trading with Asia, the increased volume of Asian trade, and the new transportation links, it seems likely that Southern Dallas County foreign trade zone status would be of particular interest to companies which will be importing or exporting containerized freight to Asia. These companies could include manufacturers importing component parts from Asia,

large volume distributors of product manufactured in Asia, and manufactures of specialty products destined for Asia.

Property Criteria

Southport remains a viable foreign trade zone location. With a portion of Southport absorbed by non-foreign trade zone use, and with the Union Pacific Intermodal Facility changing transportation patterns since Southport's original designation, it is recommend that foreign trade zone presence be expanded to include a larger area.

The selected parcels do not need to be contiguous. They do need to have common attributes which are responsive to the anticipated needs of businesses for foreign trade zone services in the area. To best accommodate business which meet the profile of likely foreign trade zone users, we sought to identify property with the following attributes:

- Directly influenced by the Union Pacific Intermodal Facility
- Road access for intermodal container traffic
- Utilities available for short to mid-term development
- Suitable for "big box" facilities typically desired by foreign trade zone users
- Properly zoned
- Consistent with the long range development plans of the cities of Dallas, Hutchins, Lancaster, and Wilmer, and of Dallas County
- Interested property owners

Property Selection Process

Ernst & Young requested that each of the Cities of Dallas, Hutchins, Lancaster and Wilmer identify property meeting the criteria specified above. The determination of the appropriate City of Dallas property was straightforward. Most of the property located within the City of Dallas which meets the criteria is part of Southport, and already has foreign trade zone status. The remaining City of Dallas property is owned by the Allen Group, one of the developers that originally approached DFW.

Following the receipt of information from the Cities of Hutchins, Lancaster, and Wilmer on potential foreign trade zone locations in those cities, Dallas County held a public hearing on April 12, 2006, to allow public comment on the foreign trade zone report generally, and on possible foreign trade zone locations in the portion of Southern Dallas County located outside the City of Dallas. Comments provided at the public hearing were all supportive of the project, and the properties discussed were largely consistent with the input received from the cities. Discrepancies between information provided at the hearing and the areas originally identified by the cities were returned to the appropriate city for resolution.

Properties Meeting Criteria

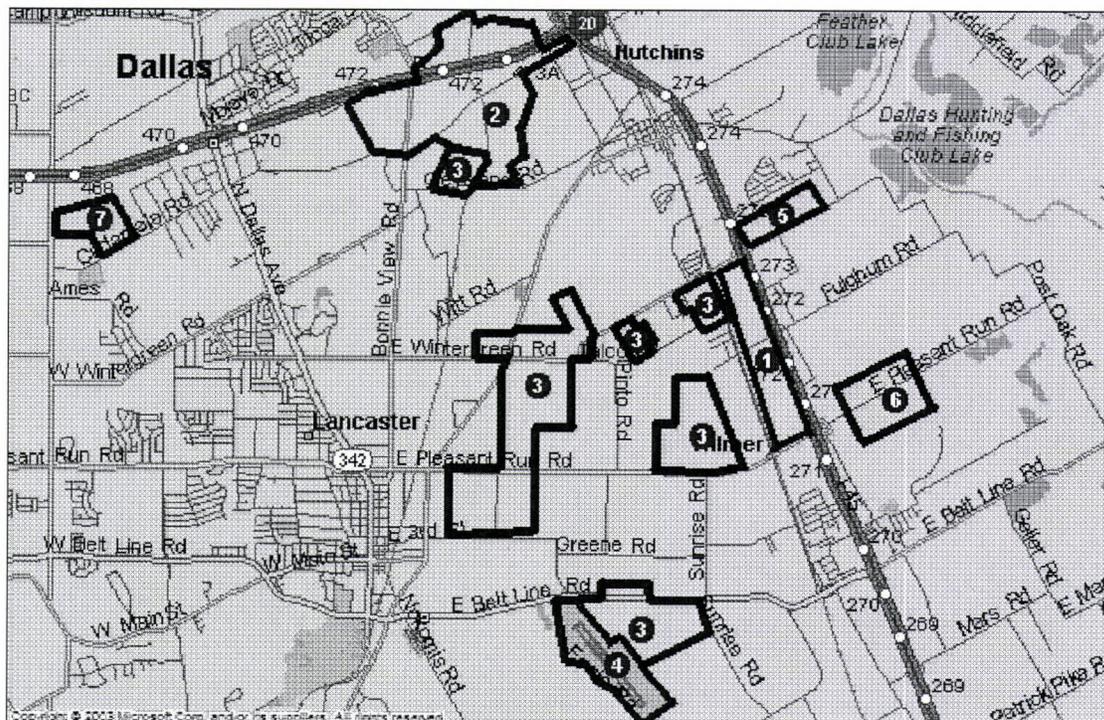
Five property owners have presented property which they believe meet the stated criteria. Each of the cities has agreed with the property owner recommendations. All of the property is located East of I-35, South of I-20, and West of the Trinity River.

Following is a list of property owners and approximate acreage of properties meeting the stated criteria.

<u>Property Owner</u>	<u>City(ies)</u>	<u>Approximate Acreage</u>
Allen Group	Dallas, Hutchins, Lancaster, Wilmer	1303
City of Lancaster	Lancaster	50
Duke Realty	Hutchins	38
Prime Rail Interests	Wilmer	433
ProLogis	Lancaster	<u>175</u>
Total Additions		1999
Current Southport FTZ		<u>766</u>
Approximate Post-Expansion Total		2765

Following is a map noting the locations of the Union Pacific Intermodal Facility, the existing SouthPort foreign trade zone location, and the proposed expansion sites.

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1	Union Pacific	5	Duke Realty
2	SouthPort FTZ	6	Prime Rail Interests
3	Allen Group	7	ProLogis
4	City of Lancaster		

As explained in more detail below, the actual property to be included in the foreign trade zone application will be dependent on receipt of final consents and property information from the property owners.

Future Boundary Adjustments

It is not possible to accurately predict the exact location of future development. As foreign trade zone status is an amenity which influences property development, but is rarely a determinative factor in business location. It is important that a structure be

established which can allow some flexibility in adapting foreign trade zone boundaries to accommodate the actual needs of business.

Fortunately, foreign trade zone regulations provide a mechanism for making "minor boundary modifications." A request for minor boundary modification is a fairly simple process. The request is in the form of a letter to the Foreign Trade Zones Board with details of the proposed change and an indication as to why the change is minor. A change is deemed minor if: similar type space is being substituted; space is being shifted within a "facility" (e.g. airport or industrial park); or the change is consistent with the zone plan already approved by the Foreign Trade Zones Board in terms of size, scope of operations and public interest goals. The Foreign Trade Zones Board generally takes 30 days to review the request and make a decision.

As the minor boundary modification process effectively is a "swap" of foreign trade zone status from one property to another, one of the difficulties in administering minor boundary modifications is promptly obtaining the consent of the property owner whose property is being removed from the foreign trade zone. To ensure that property owners are cooperative when requested, we propose that each property owner provide advance consent to the removal of foreign trade zone status of any portion of its unimproved property to accommodate an actual foreign trade zone user within that portion of Dallas County South of I-20, and between I-35 and the Trinity River. A provision will also be made for the re-designation of any removed property if it becomes occupied by a business interested in zone use.

Foreign Trade Zones Board guidelines also require that local taxing jurisdictions approve boundary modifications when the "swap" involves properties in different jurisdictions. Because of the acreage and configuration of the recommended zone properties within the City of Dallas, this requirement should not impact Dallas properties. It could, however, impact swaps of properties among Hutchins, Lancaster, and Wilmer, which could also involve two school districts, Dallas and Lancaster.

Details of the boundary modification process will be provided to each of these cities and school districts as part of the information packages. The information packages will also request that each of the cities and school districts acknowledge support of both the foreign trade zone designation of the recommended properties, and also support the concept of a foreign trade zone of an estimated size in the area under any configuration which may be developed in the future.

Next Steps

If DFW decides to move forward with an expansion project along the lines of that outlined in this report, the following are the next steps:

- Property Owner Subscription Packages. Property owners identified in this report will receive a subscription package. The package will contain:
 - Description of the project
 - Required landowner agreement with DFW

- Current schedule of DFW fees and charges, including the allocation of costs for participation in this project
- A list of required information for the foreign trade zone application
- A subscription form to be returned committing the property owner's participation in the project for specific property designated by the property owner

Property owners will be asked to return the subscription packages and information in order for their property to be included in the zone expansion application. As part of the subscription process, DFW will retain the right to accept or reject any subscription form returned by a property owner based on the actual content of the subscription received.

School District Information Packages. Both the Dallas Independent School District and the Lancaster Independent School District will receive an information package. The package will contain a complete description of the project, an explanation of the property tax consequences of the project, and an explanation of the school finance consequences of the project. Additionally, the package will explain the potential for boundary modifications. The package will also contain a sample of the requested consent letter. Final consent letters will be sent to each school district following acceptance of the subscription packages by DFW.

City Information Packages. The Cities of Hutchins, Lancaster, and Wilmer will each be provided an information package describing the project, the property tax consequences of foreign trade zone designation, and the potential for future

boundary modifications. A sample consent letter will also be included with these packages. The final consent letter will be provided following acceptance of the subscription packages by DFW.

Required Approvals. The information provided in the subscription packages will allow DFW to establish the detailed boundaries of the proposed foreign trade zone expansion. With the actual boundaries designated, DFW will request from Dallas County, each of the impacted cities, and each of the impacted school districts a consent letter specifically referencing the final boundaries of the proposed foreign trade zone, as well as the possibility of modification of those boundaries in the future. Once the consent letters are received, the project will be placed on the DFW Board agenda for approval.

Application. Preparation of the application to the Foreign Trade Zones Board may begin immediately following approval of the plan outlined in this report by DFW. Details necessary to complete the application will be contained in the subscription packages. It is anticipated that the application can be completed by the time the project is slated for final approval by DFW. The application may then be submitted to the Foreign Trade Zones Board for final approval.

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