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CITY OF DALLAS, TEXAS

MANAGEMENT'S DISCUSSION AND ANALYSIS

SEPTEMBER 30, 2004

As management of the City of Dallas (the City), we offer readers of the City's financial statement this narrative overview and analysis of the financial activities of the City for the fiscal year ended September 30, 2004. The City's management's discussion and analysis is designed to (1) assist the reader in focusing on significant issues, (2) provide an overview of the city's financial activity, (3) identify changes in the city's financial position (its ability to address the next and subsequent year challenges), (4) identify any material deviations from the financial plan (the approved budget), and (5) identify individual major fund issues or concerns. We encourage readers to consider the information presented here in conjunction with the accompanying transmittal letter, which can be found on pages v-xii of this report. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

FINANCIAL HIGHLIGHTS

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by \$3.7 billion (net assets). The negative unrestricted net assets in the governmental activities of \$203 million are primarily related to unfunded obligations related to compensated absences of \$175 million, net pension obligations of \$100 million and risk related unfunded claims of \$105 million less other increases in net assets of \$177 million.
- The City's governmental activities net assets increased by \$30.1 million while the business-type activities net assets increased by \$76.7 million, resulting in a \$106.8 million increase in total net assets for the current fiscal year.
- As of the close of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$541 million, an increase of \$125 million in comparison to the prior year. At the City's discretion, \$278 million of these fund balances (unreserved) are available for spending.
- At the end of the current fiscal year, unreserved fund balance for the general fund was \$71 million, or 8.7% of the total general fund expenditures.
- The City's long-term debt had a net increase of \$248 million from the prior year's balance of \$2.8 billion. During the current fiscal year, the City issued \$261 million of total general obligation bonds, which included \$58 million in general obligation refunding bonds, \$174 million of general obligation bonds, \$8 million of tax increment bonds and \$21 million in equipment notes. The City also issued \$169.2 million in revenue refunding bonds.

OVERVIEW OF THE FINANCIAL STATEMENTS

The City's basic financial statements are comprised of three components: 1) government-wide financial statements, 2) fund financial statements and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide financial statements. The government-wide financial statements are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business and are made up of the following two statements: the Statement of Net Assets and the Statement of Activities. Both of these statements are prepared using the economic resources measurement focus and the accrual basis of accounting.

The statement of net assets presents information on all of the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating. The statement of net assets combines and consolidates governmental funds current financial resources (short-term spendable resources) with capital assets and long-term obligations. Other non-financial factors should also be taken into consideration, such as changes in the City's property tax base, the condition of the City's property tax base, and the condition of the City's infrastructure (i.e. roads, drainage improvements, storm and sewer lines, etc.), to assess the overall health or financial condition of the City.

The statement of activities presents information showing how the City's net assets changed during the fiscal year. All changes in net assets are reported when the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in the future fiscal periods (e.g. uncollected taxes and earned but unused compensated absences).

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City include general government, public safety, streets, environmental and health services, public works and transportation, equipment and building services, cultural and recreation services and, housing and human services.

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The business-type activities of the City include water utilities, convention center, airport revenue, municipal radio and building inspection operations.

The government-wide financial statements reflect not only the activities of the City itself (known as the primary government), but also those of the two separate legal entities in its report – Housing Finance Corporation and the Housing Acquisition and Development Corporation for which the City is financially accountable. Financial information for these “component units” is reported separately from the financial information presented for the primary government itself.

The government-wide financial statements can be found on pages 13 -15 of this report.

Fund Financial Statements. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds and fiduciary funds.

Governmental Funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on current sources and uses of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds balance sheet and the governmental fund statements of revenue, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains twenty individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general and debt service funds, both of which are considered to be major funds. Data from the other eighteen funds are combined into a single, aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the form of combining statements elsewhere in this report.

The City adopts an annual appropriated budget for its general fund. A budgetary comparison statement has been provided for the general fund to demonstrate compliance with this budget.

The basic governmental fund financial statements can be found on pages 16 and 18 of this report.

Proprietary Funds. Proprietary funds are generally used to account for services for which the City charges customers – either outside customers, or to other units within the City. The proprietary funds financial statements provide the same type of information as shown in the government-wide financial statements, only in more detail. The City maintains two types of proprietary funds:

- Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses enterprise funds to account for the airport, convention center, municipal radio, building inspection and water utilities operations. All of the City's enterprise funds, except the municipal radio and building inspection are considered major funds.
- Internal Service funds accumulate and allocate costs internally among the City's various functions. The City uses its internal service funds to account for its equipment services, communication equipment, office supplies, information services, and risk management programs. Because these services predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements. All internal service funds are combined into a single aggregated presentation in the proprietary fund financial statements. Individual fund data for the internal service funds is provided in the form of combining statements elsewhere in this report.

The basic proprietary fund financial statements can be found on pages 22-29 of this report.

Fiduciary Funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the City. The City's pension trust and agency funds are reported under the fiduciary funds. Since the resources of these funds are not available to support the City's own programs, they are not reflected in the government-wide financial statements. The accounting used for fiduciary funds is much like that used for proprietary funds. The basic fiduciary fund financial statements can be found on pages 30-31 of this report.

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Notes to the Basic Financial Statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes can be found immediately following the basic financial statements. The notes to the financial statements can be found on pages 33-70 of this report.

Other Information. In addition to the basic financial statements and accompanying notes, this report presents certain required supplementary information concerning the City's progress in funding its obligation to provide pension benefits to City employees and budgetary information for the general fund. Required supplementary information can be found on page 73 of this report.

The combining statements referred to earlier in connection with non-major governmental funds and internal service funds are presented immediately following the required supplementary information on pensions. Combining and individual fund statements and schedules can be found on pages 77-109 of this report.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

The City's combined net assets were \$3.6 billion as of September 30, 2004. Analyzing the net assets and net expenses of governmental and business-type activities separately, the business-type activities net assets are \$2.3 billion and the governmental type activities are \$1.3 billion. This analysis focuses on the net assets (table 1) and changes in general revenues (table 2) and significant expenses of the City's governmental and business-type activities.

The largest portion of the City's net assets reflects its investments in capital assets (e.g., land, building, equipment, improvements, construction in progress and infrastructure), less any debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide service to citizens and consequently, are not available for future spending. Although the City's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

**Table 1
Net Assets
(In thousands)**

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2004	2003	2004	2003	2004	2003
Current and other assets	\$732,749	\$594,359	\$661,399	\$641,007	\$1,394,148	\$1,235,366
Capital assets	1,979,979	1,931,316	3,697,329	3,466,749	5,677,308	5,398,065
Total assets	2,712,728	2,525,675	4,358,728	4,107,756	7,071,456	6,633,431
Long-term debt outstanding	1,285,180	1,163,505	1,744,715	1,618,610	3,029,895	2,782,115
Other liabilities	137,263	102,034	256,202	208,037	393,465	310,071
Total liabilities	1,422,443	1,265,539	2,000,917	1,826,647	3,423,360	3,092,186
Net assets:						
Invested in capital assets, net of related debt	1,385,085	1,328,590	2,070,434	1,938,648	3,455,519	3,267,238
Restricted	108,138	124,645	162,494	140,991	270,632	265,636
Unrestricted	(202,938)	(193,099)	124,883	201,470	(78,055)	8,371
Total net assets	\$1,290,285	\$1,260,136	\$2,357,811	\$2,281,109	\$3,648,096	\$3,541,245

An additional portion of the City's net assets (7%) represents resources that are subject to external restrictions on how they may be used. The negative net assets in the governmental activities are primarily related to unfunded obligations related to compensated absences, net pension obligations, and risk related unfunded claims.

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Analysis of the City's Operations

The following table provides a summary of the City's operations for the year ended September 30, 2004. Business-type activities increased the City's net assets by \$76.7 million and governmental activities increased by 30.1 million thereby accounting for the total growth in net assets of the City. Key elements of this increase are as follows:

**Table 2
Changes in Net Assets
(In thousands)**

	Governmental Activities		Business-type Activities		Total	
	2004	2003	2004	2003	2004	2003
Revenues:						
Program revenues:						
Charges for services	\$218,078	\$193,064	\$414,238	\$384,849	\$632,316	\$577,913
Operating grants and contributions	73,925	56,641	0	0	73,925	56,641
Capital grants and contributions	11,642	67,428	77,068	58,574	88,710	126,002
General revenues:						
Ad valorem tax	458,137	477,596	0	0	458,137	477,596
Sales tax	194,989	183,229	0	0	194,989	183,229
Franchise taxes	114,313	115,751	47,105	46,076	161,418	161,827
Investment income	12,263	15,824	9,864	12,784	22,127	28,608
Miscellaneous	13,341	3,855	16,643	5,743	29,984	9,598
Total revenues	1,096,688	1,113,388	564,918	508,026	1,661,606	1,621,414
Expenses:						
General government	138,258	148,380	0	0	138,258	148,380
Public safety	532,891	533,689	0	0	532,891	533,689
Streets, street lighting, sanitation	130,377	129,552	0	0	130,377	129,552
Environmental and health services	26,960	26,012	0	0	26,960	26,012
Public works and transportation	30,404	12,362	0	0	30,404	12,362
Equipment and building services	30,864	29,054	0	0	30,864	29,054
Culture and recreation	113,135	109,886	0	0	113,135	109,886
Housing	1,515	1,308	0	0	1,515	1,308
Human services	31,750	31,781	0	0	31,750	31,781
Interest on long-term debt	34,161	34,862	0	0	34,161	34,862
Water utilities	0	0	341,238	290,327	341,238	290,327
Convention center	0	0	77,486	69,641	77,486	69,641
Airport	0	0	41,499	33,991	41,499	33,991
Municipal radio	0	0	3,789	2,914	3,789	2,914
Building inspection	0	0	20,428	14,105	20,428	14,105
Total expenses	1,070,315	1,056,886	484,440	410,978	1,554,755	1,467,864
Increase in net assets before transfers	26,373	56,502	80,478	97,048	106,851	153,550
Transfers	3,776	11,470	(3,776)	(11,470)	0	0
Increase in net assets	30,149	67,972	76,702	85,578	106,851	153,550
Loss on disposal of capital assets	0	(72,852)	0	(23,955)	0	(96,807)
Net assets – October 1, 2003	1,260,136	1,265,016	2,281,109	2,219,486	3,541,245	3,484,502
Net assets – September 30, 2004	\$1,290,285	\$1,260,136	\$2,357,811	\$2,281,109	\$3,648,096	\$3,541,245

The most significant governmental expense for the City was in providing public safety, which incurred expenses of \$532.8 million. Revenues collected from a variety of sources, with the largest being from fines (\$30 million for the fiscal year ended September 30, 2004) offset these expenses. The most significant portion of police activity is the cost of personnel, which is approximately at \$280 million. Other significant governmental expenses for the City include fire, which incurred approximately \$169 million in expenses (including reimbursement of \$14 million), of which \$169 million represented personnel charges. The streets, street lighting, sanitation, and code enforcement activities of the City incurred \$130 million in expenses, of which \$68 million represented personnel expenses.

Business-type Activities

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Revenues of the City's business-type activities were \$564.9 million for the fiscal year ending September 30, 2004. Expenses for the City's business-type activities were \$484 million for the year, resulting in an increase of net assets before transfers of \$80.5 million. Key elements of this increase:

- Net Income increased \$15.1 million as compared to fiscal year 2003; revenues from Customer Charges were sufficient to provide income before transfers and contributions of \$18.1 million. Much of this excess was reinvested in long-lived assets or restricted for the future construction thereof.
- Contributions of infrastructure from outside sources were \$17.5 million
- Airport Revenues fund had \$59 million increase in capital contributions by tenants at the two city owned airports.

Financial Analysis of the Government's Funds

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of the City's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$540.6 million an increase of \$125.3 million in comparison with the prior year. Approximately \$277.7 million constitutes unreserved, undesignated fund balance, which is available for spending at the government's discretion. The remainder of fund balance is reserved or designated to indicate that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior period (\$192.2 million), 2) to pay debt service (\$11.9 million), or 3) the remainder for a variety of other restricted purposes.

The general fund is the chief operating fund of the City. At the end of the current fiscal year, unreserved fund balance of the general fund was \$28.8 million while total fund balance reached \$83.2 million. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 3.4 percent of total general fund expenditures, while total fund balance represents 6.6 percent of that same amount.

The fund balance of the City's general fund increased by a moderate \$2.4 million during the current fiscal year. Due to the uncertain economic conditions, expenditures were closely monitored and correlated to revenues received.

The debt service fund has a total fund balance of \$15.9 million all of which is reserved for the payment of debt service. The overall net increase in debt service fund balance during the current year (\$6.1 million) was partly due to an increase in transfers during the current period of \$7 million.

Proprietary funds. The City's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

Unrestricted net assets in Dallas Water Utilities at the end of the year amounted to \$20 million, Convention Center was \$50.5 million and Airport Revenue was \$48.9 million. The total change in net assets was an increase of \$36.1 million in Dallas Water utilities, a decrease of \$9 million in Convention Center and an increase of \$50.7 million in the airport funds.

General Fund Budgetary Highlights

Differences between the original budget and the final amended budget were \$2.8 million. All midyear budget adjustments were funded from the contingency reserve. Primarily due to increasing sales taxes, revenues were \$23.7 million above budgeted revenues. Expenditures exceeded the original budget by \$11.3 million. These overages were primarily due to an unexpected increase in employee health care costs and utility expenses.

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CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

As of September 30, 2004, the City had \$5.7 billion invested in a broad range of capital assets, including police and fire equipment, buildings, park facilities, roads, bridges, and water and sewer lines. (See Table 3 below.) This amount represents a net increase (including additions and deductions) of \$279 million or 5.2 percent, over the prior fiscal year.

**Table 3
Capital Assets
(Net of Depreciation, in Thousands)**

	Governmental Activities		Business-type Activities		Totals	
	2004	2003	2004	2003	2004	2003
Land	\$317,893	\$299,998	\$213,741	\$213,822	\$531,634	\$513,820
Water rights	0	0	280,267	283,813	280,267	283,813
Buildings	395,356	345,675	960,826	727,706	1,356,182	1,073,381
Improvements other than buildings	100,078	76,517	119,928	117,935	220,006	194,452
Infrastructure	776,083	774,932	269,208	278,573	1,045,291	1,053,505
Equipment	96,274	113,641	183,513	198,608	279,787	312,249
Artwork	48,702	48,677	0	0	48,702	48,677
Utility property	0	0	1,101,178	1,113,214	1,101,178	1,113,214
Construction in progress	245,593	271,876	568,668	533,078	814,261	804,954
Totals	\$1,979,979	\$1,931,316	\$3,697,329	\$3,466,749	\$5,677,308	\$5,398,065

Some of this year's major additions included (in millions):

Street and Transportation Improvements	\$54.4
Flood and Storm Drainage Improvements	4.3
Library Facilities	9.5
Police and Fire Facilities	2.8
Animal Control Facilities	11.7
Lake fork pipeline	35.1
Completion of Cell 5- McCommas Bluff Landfill	1.4
Neighborhood and Community Park Improvements	<u>10.8</u>
Total	<u>\$130.0</u>

In addition to the itemized list above, major capital asset additions for FY04 included approximately \$235.7 million in water and wastewater improvements, \$2.6 million for major maintenance of City facilities, \$.75 million for renovations of the fifth floor at the Central Library, and \$1.2 million for demolition projects in Code Compliance.

The City's fiscal year 2005 capital budget provides another \$408.4 million for capital projects, principally for two major categories: \$172.3 million for General Purpose Capital Improvements and \$236.1 million for Water Utilities Capital Improvements.

The General Purpose Capital Improvement Program provides for improvements to and/or construction of the City's street system; parks and recreational facilities; libraries; police and fire protection facilities; cultural art facilities; and the flood protection and storm drainage system. General Obligation Bonds are the primary financing mechanism for these capital improvements.

The Capital Improvement Program for the enterprise departments consists of improvements to and/or construction of water and wastewater systems; venues for convention activities, and air transportation facilities. Primarily the transfer of enterprise revenues and the issuance of debt such as commercial paper and/or revenue bonds fund these projects.

More detailed information about the City's capital assets is presented in Note 7 to the financial statements.

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Debt

At year-end, the City had \$2.5 billion in bonds outstanding as compared to \$2.3 billion at the end of the prior fiscal year, an increase of 1.0 percent – as shown in Table 4.

Table 4
Outstanding Debt at Year End
(In Thousands)

	Governmental Activities		Business-type Activities		Totals	
	2004	2003	2004	2003	2004	2003
General obligation bonds	\$741,889	\$626,856	\$0	\$84	\$741,889	\$626,940
Equipment Acquisition Contractual	43,323	43,171	0	0	43,323	43,171
Certificates of obligation	52,067	60,321	0	0	52,067	60,321
Tax increment bonds	14,943	9,195	0	0	14,943	9,195
Revenue bonds	0	0	1,681,305	1,581,102	1,681,305	1,581,102
Contractual obligation	0	0	7,233	18,745	7,233	18,745
Totals	\$852,222	\$739,543	\$1,688,538	\$1,599,931	\$2,540,760	\$2,339,474

During the fiscal year, the City issued \$261.9 million in general obligation bonds and equipment acquisition and tax increment bonds. Bond proceeds will be used to pay costs of various equipment purchases, replenishment of emergency reserve, improvement of street and thoroughfare, playgrounds, recreation facilities, library facilities, and other City facilities.

The City also issued \$169.2 million of Waterworks and Sewer System Revenue Refunding and Improvement Bonds (Series 2003-A).

The City's General Obligation, Tax Increment Financing Reinvestment Zone No. 2, Waterworks and Sewer System, Civic Center Convention Complex, and Sports Arena Project Special Tax Revenue Bond ratings are listed below.

	Moody's Investors Service	Standard & Poor's
General Obligation Bonds.....	Aa1	AA+
Tax Increment Financing Reinvestment Zone No.2 (*).....		AA
Revenue Bonds:		
Waterworks and Sewer System.....	Aa2	AA+
Civic Center Convention Complex (*).....	Aaa	AAA
Sports Arena Project Special Tax (*).....	Aaa	AAA
Airport System (*).....	Aaa	AAA

(*) These bonds are insured and the ratings are those of the bond insurer.

More detailed information about the City's long-term liabilities is presented in Note 10 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

In the 2004-05 Budget, core city services will be maintained at current levels and increased funding for significant improvements in the five City Council-designated priority areas: public safety, economic development, neighborhood quality of life, the Trinity River Corridor Project and staff accountability. Current sales tax revenues, while improving during the current year, indicate a need for continued prudence in building future budgets. There will be a \$1.99 increase in the property tax rate, which will provide an additional \$13 million for public safety enhancements.

The 2004-05 Budget also includes a 7.9 percent increase in water and wastewater rates. Dallas Water Utilities provides efficient, high-quality service at a reasonable cost. Additional funds are needed to meet continued increases in service demands, continue upgrading aging infrastructure and to operate recently constructed facilities required by state and federal regulatory agencies. In addition, funds will be used to offset the increased costs of electricity and chemicals that are required to operate these facilities.

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In fiscal year 2004-05, work will continue on the Trinity River Corridor Project, the Fair Park Master plan, downtown redevelopment, business parks development, and Runyon Springs. These significant investments will help assure future fiscal stability for the city and its citizens.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

The financial report is designed to provide our citizens, taxpayers, customers, investors and creditors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need any additional financial information, contact the City Controller's Office, at City of Dallas, 1500 Marilla, Room 4BN, Dallas, Texas 75201.