

Introductory Section



CITY OF DALLAS

Honorable Mayor and City Council
City of Dallas, Texas

September 29, 2006

Introduction

We are pleased to present the City of Dallas (The City) Comprehensive Annual Financial Report (CAFR) for the fiscal year ended September 30, 2005. This report was prepared by the City's financial staff and audited by the firm of KPMG LLP. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with the City.

The City Charter requires an annual audit of the books of account, records, and transactions of all administrative departments of the City by independent certified public accountants selected by the City Council. The CAFR is the summary of these activities for the past fiscal year. We believe this data, as presented, is accurate in all material aspects; that it is presented in a manner designed to fairly set forth the financial position and results of operations of the City as measured by the financial activity of its various funds; and all disclosures necessary to enable the reader to gain the maximum understanding of the City's financial affairs have been included.

The CAFR is presented in three sections: introductory, financial, and statistical. The introductory section includes this transmittal letter, the City's organizational chart, and a list of principal officials. The financial section includes the Management's Discussion and Analysis (MD&A), Basic Financial Statements, Required Supplementary Information, Combining Individual Fund Statements, as well as the independent auditors report on the basic financial statements and schedules. This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The City's MD&A can be found immediately following the report of the independent auditors. The statistical section includes selected financial and demographic information generally presented on a multi-year basis.

General Information

Dallas is the ninth largest city in the nation and has a Council-Manager form of government. There are 14 single-district Council Members and a Mayor elected at large. The Mayor and Council appoint the City Manager, City Attorney, City Auditor, City Secretary, and the Municipal Court Judges. The Director of the Civil Service Department is appointed by the Civil Service Board and the Director of Park and Recreation is appointed by the Park and Recreation Board. All other department directors are appointed by the City Manager.

The financial statements of the City of Dallas include all activities, organizations, and functions for which the City is financially accountable. The criteria considered in determining the activities to be reported within the City's financial statements include: 1) whether an organization is part of the City's legal entity; or 2) whether the City appoints the voting majority of the organization's governing body, and either the City is able to impose its will on the organization or there is a

potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the City. In addition, an organization may be fiscally dependent on the City and also included in its reporting entity. These criteria are based upon, and are consistent with, those set forth in the Codification of Governmental Accounting Standards, Section 2100, *Defining the Financial Reporting Entity*.

The City provides the full range of municipal services established by statute or charter. These include public safety (police and fire), streets, sanitation, health and human services, culture and recreation, public improvements, planning and zoning, and general administrative services. In addition to general government activities, the Dallas Water Utilities, Airport Revenues Department, Convention Center, Municipal Radio and several other enterprise and internal service fund activities are a part of the City's legal entity. Fourteen tax-increment-financing districts and six public improvement districts (none of which are legally separate entities) are included in the City's reporting entity because the City sets their assessment rates and approves their budgets. Although the pension trust funds are separate legal entities, they exist to exclusively serve or benefit the City's employees, retirees, and their beneficiaries and are included in the City's reporting entity.

Other legally separate entities are also included in the City's reporting entity based on the criteria discussed above:

- Housing Finance Corporation - issues tax-exempt mortgage revenue bonds to assist low-to-moderate income citizens in purchasing homes
- Housing Acquisition and Development Corporation - provides safe, affordable housing for low and moderate income persons

Related organizations not included as part of the reporting entity are the Dallas/Fort Worth International Airport, the Dallas Housing Authority, and Dallas Area Rapid Transit. The reason for not including these entities is because the City's accountability does not extend beyond appointing members to the Boards.

Economic Condition and Outlook

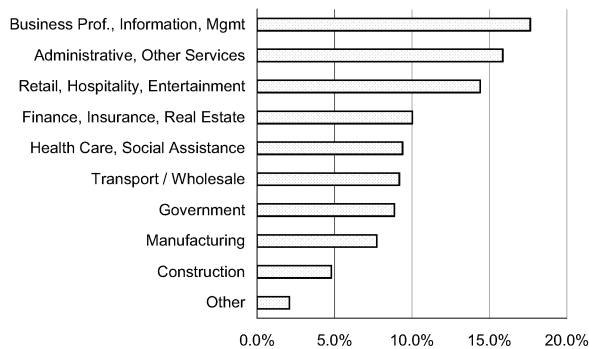
Fiscal year 2005 saw the Dallas economy continue recovering from the 2001 recession. All City economic indicators, employment, revenue and vacancy rates, improved over the previous year.

Description of the Dallas Economy

The City of Dallas has a diverse economy with strength in several sectors. In all, approximately 64,000 businesses call Dallas home (Dun & Bradstreet). These businesses, along with a sizeable federal, state, and local government presence, employ approximately one million (City of Dallas). Dallas' diverse economy gives it an advantage over the ups and downs of the business cycle compared to cities that have specialized in a few economic sectors (Figure 1.) Several urban professional, office-based industries have large presences in Dallas. These include a broad spectrum of business professional services, finance, insurance and real estate and information. In addition to being a city of professionals, Dallas is a city of trade. The transportation, wholesale and retail sectors supply the region and the world with a variety of goods. While it is a sunbelt

central city, Dallas boasts an important manufacturing sector – larger than many northern industrial cities. Finally, Dallas’ economy enjoys a large healthcare base. Centered on five major hospital campuses and numerous smaller facilities, this healthcare employment promises to be a driving force in Dallas’ economy for years to come. Figure 1 summarizes the distribution of jobs within the City. These include suburban residents who work in Dallas. The five-year outlook for Dallas employment is expected to exceed the national growth rate because Dallas has a more favorable industry mix than the nation overall. Employment in the City should increase by 7.6 percent between 2005 and 2010 (U.S. Bureau of Labor Statistics).

Figure 1
Dallas Employment by Industry

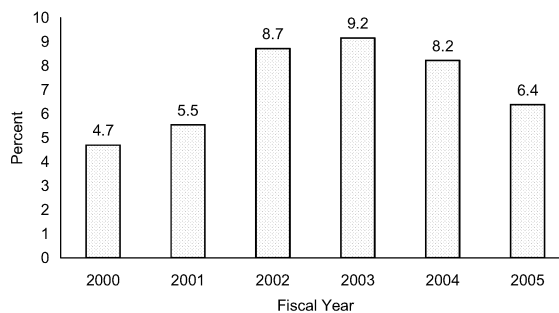


The Dallas labor force, consisting of both employed and unemployed Dallas residents only, stood at 612,754 in fiscal 2005 (U.S. Bureau of Labor Statistics). In addition to being the largest employment center in North Texas, and providing the largest number of workers to the region’s workforce, Dallas also includes the largest concentrations of commercial real estate in North Texas. In all, Dallas includes 129.5 million square feet of office space, 223.9 million square feet of industrial space, and 50.3 million square feet of retail space (CoStar).

Unemployment

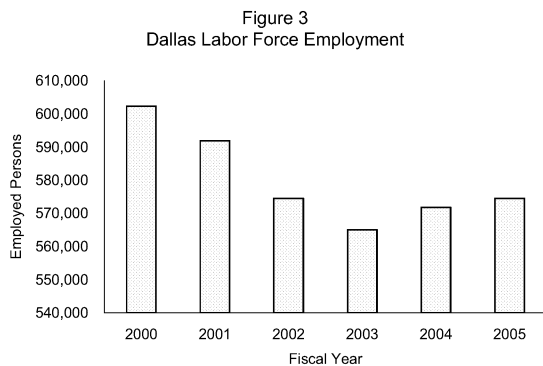
The unemployment rate in Dallas reflects the continued recovery from the 2001 recession. From a peak rate of 9.2 percent in fiscal 2003, Dallas’ unemployment rate fell for a second consecutive year to 6.4 percent in fiscal 2005 (based on fiscal year monthly average unemployment, Figure 2.)

Figure 2
Dallas Unemployment Rate



Fiscal year monthly average unemployment rate

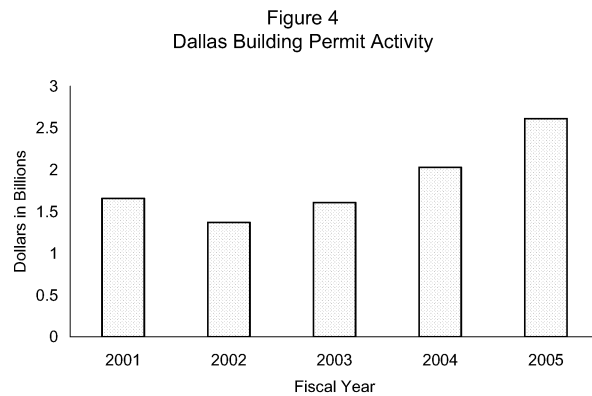
Employment



The number of employed Dallas residents grew for the second straight year to over 578,000 in fiscal 2005. This reflects an improving economy and the continued growth of Dallas' labor force, which benefits from a relatively young population compared to many other cities (Figure 3.)

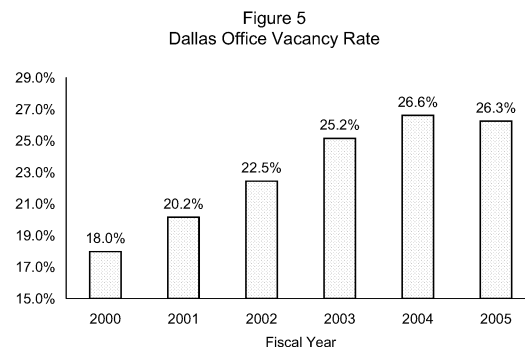
Construction Activity

A crucial barometer of a maturing central city economy is vibrant construction activity. The City of Dallas, with a new commitment to in-town redevelopment and more efficient development of its remaining land, has been able to maintain a strong level of construction activity growth. Following the decline in building permits in fiscal 2002 to \$1.3 billion, total permit activity increased to over \$2.6 billion in fiscal 2005 (Figure 4.)



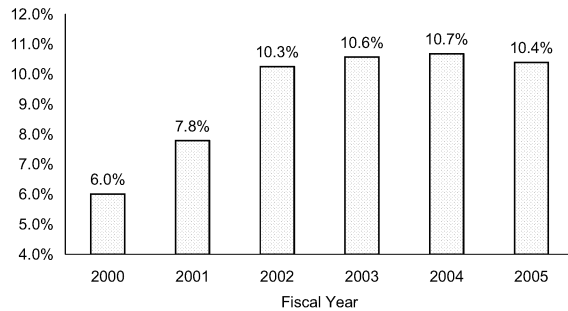
Office Vacancy

Office vacancy rates improved in fiscal 2005 after rising from a low of 18.0 percent at the peak of the telecom expansion to almost 27 percent in fiscal 2004. The vacancy rate fell because of job growth in the City and the conversion of vacant, historic downtown towers to residential uses. The small improvement in occupancy came in the face of continued increases in office construction (Figure 5.)



Industrial Vacancy

Figure 6
Dallas Industrial Vacancy Rate

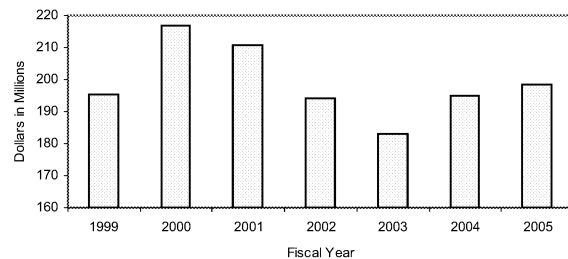


Like office vacancies, industrial vacancies declined for the first time since fiscal 2000. The small decrease occurred even in the face of a growing industrial inventory as new business parks added facilities and a number of firms took advantage of Dallas' logistical advantages for distribution operation (Figure 6.)

Sales Tax

Sales taxes grew between fiscal years 1999 and 2000, exceeding \$216 million. Then with the collapse of the technology sector, sales tax revenue fell to \$183.2 million in fiscal 2003. Sales tax revenue has continued to expand the last three years, reaching \$198.4 million in fiscal 2005 (Figure 7.)

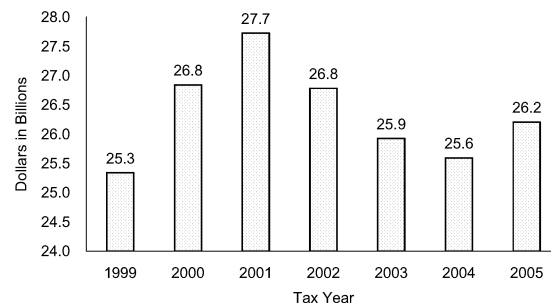
Figure 7
Dallas Sales Tax Allocation



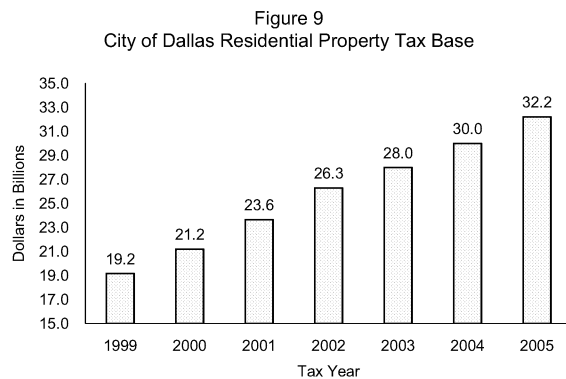
Commercial Property

Dallas saw growth in its commercial tax base from 1999 to 2001, and then entered a three year decline as area office space lost tenants to the technology bust. The recent increase in commercial values was driven by a balanced pattern of construction that included office, industrial, residential, hotel, retail and institutional developments in Central Dallas and throughout the City (DCAD certified property values summary report, Figure 8.)

Figure 8
Dallas Commercial Property Tax Base



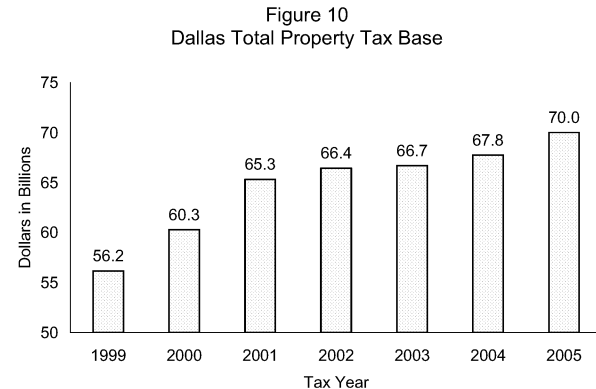
Residential Property



Residential taxable value has increased each year since 1999 (DCAD certified property values summary report, Figure 9.) This steady growth has been driven by new Southern Dallas single family subdivisions, condo and town house developments in Central Dallas, and the replenishment of North Dallas' single family housing stock. All three signal Dallas' growing attractiveness as a place to live, and promise to provide a stabilizing force to the business cycle's impact on commercial values.

Total Property

Total taxable property (including business personal property) in the City grew each year since 1999. This reflects that the cyclical commercial trend in tax base has been overcome by the steady growth in residential property values. The commercial downturn had the effect of slowing total taxable value growth during the early 2000s. With the economic recovery underway, the total level returned to solid growth in 2005 (DCAD certified property values summary report (exclusive of values under protest by property owners, Figure 10.)



Major Economic Developments of Fiscal 2005

A series of events this fiscal year reinforced Dallas' emergence from the recent recession, set the stage for long term recovery, and signaled its commitment to economic development.

Policy initiatives in 2005 will influence economic development in Dallas for years to come. First, the City's comprehensive land use plan *ForwardDallas!* drew close to completion. The plan's vision offers a balance that intensifies economic development in several areas of the City and preserves and rehabilitates Dallas' signature single-family home neighborhoods. As an essentially land-locked city, Dallas must make careful use of its real estate. By concentrating new development along its freeway corridors, the growing light rail system, and the expanding urban core around downtown, the land use plan promises to provide adequate office, retail and industrial space to meet the City's expected growth for the next two decades. These more intense developments also promise to improve the quality of life for all residents by making a growing number of urban destination developments available to the City's stable single family residences.

The second major policy initiative of Fiscal Year 2005 was the adoption of *Strategic Engagement: Dallas' Economic Development Plan*. The City Council's ratification of this plan commits the City to realizing an economic vision:

Dallas will become a diverse, vibrant urban city that works and builds on its core strengths. It will be strategically engaged in economic development, be business friendly, have a dynamic and expanded center-city economy, promote balanced growth and development opportunities in all parts of the City, and be a city of great neighborhoods.

This five point economic vision encapsulates the variety of strategies the City will follow to ensure economic success. The plan emphasizes research-based decision making, reducing barriers to business expansion in the City, targeting recruitment efforts on sectors that build on Dallas core strengths in finance, information technology, advanced manufacturing, healthcare and distribution, and creating catalyst projects to redevelop Southern Dallas and downtown.

After creating a free-standing Office of Economic Development in December 2004 to implement this new economic development strategy, the City Council again designated economic development as a critical priority in 2005. The Office includes new divisions focusing on Southern Dallas, downtown, and international business. The budget for the Office was increased and staffing has more than doubled since fiscal 2004.

Three major development trends dominated in fiscal 2005. First, downtown and Central Dallas developments continued toward making Dallas the urban center of the Southwest. Second, construction of a number of projects associated with the Trinity River Corridor moved the City closer to reclaiming its most important ecological and economic asset. Third, numerous smaller stories cumulatively signaled that Dallas' Southern Sector economy is leading the economic recovery.

This fiscal year represented one of the largest economic development commitments by the Dallas City Council to enhancing downtown's position as the leading employment center in the region by also making it a great urban neighborhood.

Analysis commissioned by the City indicates that downtown can reach the critical mass needed to become a self-sustaining residential neighborhood with 10,000 residential units and an additional 200,000 square feet of retail space.

This year saw numerous signature redevelopments and new construction in the central business district. Continuing the residential conversion of historic office buildings, the Interurban Building (134 residential units, 20,000 sq. ft. retail space) and the Dallas Power & Light Building (158 residential units, 25,000 s.f. retail space) opened. Downtown's first grocery store opened in the Interurban Building in the summer. In addition to historic conversions, announcements were made for hundreds of new residences, beginning the process of reclaiming surface parking lots for more productive uses. The City Council committed approximately \$70 million to the redevelopment of the Mercantile block, Continental and Atmos buildings, which will bring over 700 new residential units on line in a formerly blighted part of downtown.

A new corporate headquarters for 7-Eleven in a mixed-use building with residential and retail on the eastern edge of the Arts District will bring new business and household tenants to the burgeoning area. Ground breaking for the next expansion phase of the Arts District in November 2005, will signal the start of a \$270 million expansion that will bring four new performing arts venues to the district. These buildings, along with existing facilities will make Dallas the only city with four buildings within one contiguous block designed by Pritzker prize winners, the architecture equivalent of the Nobel Prize. The Nasher Sculpture Center by Renzo Piano and the Morton H. Meyerson Symphony Center, designed by I.M.Pei will be joined by the Dee and Charles Wyly Theatre (by Rem Koolhaas) and the Margot and Bill Winspear Opera House (by Norman Foster).

While most public-private efforts will continue to focus on the central business district, the Council recognizes that only an expanded downtown, connected to thriving urban neighborhoods all around can drive sufficient property investment to secure the City's long-term success. Numerous developments in 2005 are completing the integration of the traditional downtown with its surrounding neighborhoods creating a seamless, prosperous Central Dallas. At the end of fiscal year 2005, there were 12,570 residential units, with an additional 5,288 planned or under construction within a mile of the central business district (Office of Economic Development). Highlights of this year's urban developments surrounding the central business district include the following.

North: The Victory development on the north side of downtown is bringing a wave of modern office, residential and entertainment projects. Currently, there are 616 residential units and 120,000 square feet of office and 657,000 square feet of retail and entertainment space under construction. Subsequent phases in Victory will add more than 1.8 million square feet of development. In addition to Victory, the Uptown neighborhoods continued to add market rate housing and retail at rates that rivaled or exceeded Dallas' suburbs.

The Design District and Southwestern Medical TIF districts were created to the northwest of the central business district to improve the integration of this growing mix-use area with the urban core. Focusing, respectively, on the new center for galleries and interior design in Dallas, and one of the world's foremost medical research schools, these two TIF districts saw announcements for hundreds of new residential units taking advantage of the upcoming DART northwest rail line.

South: Southern Dallas neighborhoods joined the urban revival of Central Dallas this year. The Grand Park South TIF district was created to support a new middle income townhouse community targeted to working professionals such as police, fire fighters and teachers. In the Cedars TIF district, scores of residential units and new retail were approved by the Council.

East: Bryan Place and Old East Dallas are undergoing a wave of townhouse and condo construction and have hundreds of units under construction along east-west streets of Live Oak, Bryan and Ross stretching to the entertainment districts of lower Greenville

Avenue. With the coming of DART light rail, east Dallas neighborhoods, including Deep Ellum will become more conveniently accessible to the CBD and the rest of the City. With a combination of historic homes, and new modernist developments, this area promises to be one of the most vital of Dallas' new urban neighborhoods.

West: Directly across the Trinity River from downtown, the Oak Cliff Gateway community joined the in-town urban residential revival in 2005. Refurbishment of historic structures such as Lake Cliff Tower and the Belmont Hotel were complemented by new townhouse developments, all with dramatic views of downtown. The completion of the Fort Worth Avenue development plan will guide the revitalization of a historic strip into a destination for tourists and residents.

Whereas, the City had historically depended primarily on the northern portion of the City for economic expansion, increasingly, the revitalization of the urban core and developments in Southern Dallas will characterize Dallas' economy. Indeed, Southern Dallas has led the way in new construction investment. Over \$2.5 billion in construction investments have been installed in Southern Dallas since 1998 (Development Services Department.) Priority projects in the southern sector include Pinnacle Park, Mountain Creek, Southport, and Dallas Executive Airport business parks. The University of North Texas at Dallas will break ground in late 2005 beginning what will ultimately be a 30,000 student campus.

In Southern Dallas, commercial development has been concentrated in the areas' new business parks, while residential development has been spread among infill projects and new subdivisions.

A significant new development for Southern Dallas is the signature of a memorandum of understanding between the Port of Houston, the Port of Manzanillo, Mexico, the U.S. Maritime Administration and the City to create an inland intermodal port that will maintain Dallas' status as a leading transportation and distribution hub. Additional agreements with the Port of Topolobampo, Mexico, and the Panama Canal Authority, promise to increase the cargo trade passing through the Dallas economy.

These new trade arrangements, and associated infrastructure investments in intermodal facilities will strengthen Dallas' already formidable transportation system. Two components that deserve special mention because of their increasing role in shaping Dallas real estate and business climate are the public transit rail system and the City's aviation assets.

As Dallas Area Rapid Transit (DART) continues to expand, it provides greater express transportation between suburban communities and downtown Dallas. A \$2.8 billion DART Transit System Plan is being implemented. Recent Congressional approval of the federal transportation reauthorization bill delivers \$260 million toward the Northwest – Southeast light rail line to be completed by 2009. Another \$10.7 million provide bus facilities. By 2010, a total of 44 rail stations will be within the City limits. These stations will serve as a web of development clusters to anchor Dallas' emerging urban and long-standing suburban neighborhoods giving the City the best of both worlds.

The Dallas economy is served by a full spectrum of airports: Dallas/ Fort Worth (D/FW) International; Dallas Love Field; and Dallas Executive. D/FW International is the third busiest airport in the world, moving over 59.2 million passengers and 818,000 metric tones of cargo in 2005. The airport is within four hours or less to other commercial centers including New York, Los Angeles, Chicago, Toronto and Mexico City. City-owned and operated, Dallas Love Field provides scheduled air and general aviation services, and Dallas Executive is a general aviation airport with foreign trade zone status.

Financial Information

Discussion of Controls. The City's management is responsible for establishing and maintaining internal controls designed to ensure that the assets of the government are protected from loss, theft or misuse, and to ensure adequate accounting data are compiled to allow for preparation of financial statements in conformity with generally accepted accounting principles.

Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding: 1) the safeguarding of assets against loss from unauthorized use or disposition, 2) the reliability of financial records for preparing financial statements, and 3) accountability for assets. The concept of reasonable assurance recognizes the cost of a control should not exceed the benefits likely to be derived, and the evaluation of costs and benefits requires estimates and judgments by management.

The City Council is required by Charter to appoint a City Auditor who is independent of City management and reports directly to the City Council. The City Auditor supports the internal control structure within the City by performing independent evaluations of existing accounting and administrative controls and by ascertaining compliance with existing plans, policies and procedures.

Annually, each department is required to conduct a self-assessment of internal controls. The results of this assessment are reported to the City Manager with an action plan to correct any identified deficiencies.

The City Auditor reviews, on a sample basis, one or more departments' internal control evaluations each year to ensure the integrity of the program and provide constructive comments for improvement.

Furthermore, as a recipient of federal and state assistance, the City is also responsible for ensuring adequate internal controls are in place to comply with applicable laws, regulations, contracts, and grants related to those programs. Internal controls are subject to periodic evaluation by management and the City Auditor. As part of the City's single audit, tests are made to determine the adequacy of the internal control, including that portion relative to federal and state financial awards, as well as to determine whether the City has complied with applicable laws, regulations, contracts, and grants.

Budgetary controls. The City Charter provides that the City Council shall annually appropriate adequate funds in an amount to execute the policies and service delivery plans of the City. City management annually prepares the plan of services for the upcoming fiscal year and their

estimated costs. The plan is reviewed by the City Council and is formally adopted by the passage of a budget ordinance. The ordinance provides for budgetary control at the department level and these budgets cannot be exceeded without Council approval. Budgetary control is enforced at the department level by reserving appropriations and by encumbering purchase orders and contracts. Open encumbrances are reported, where applicable, as reservations of fund balance.

General Government Functions

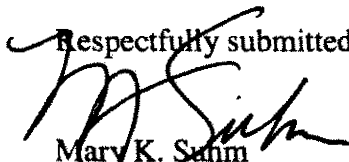
Cash Management. The objectives of the City's Investment Policy, in order of priority, are: safety of principal, liquidity, diversification, maturity and yield. Deposits are fully collateralized by government securities held in third party safekeeping. Cash not needed for day-to-day operations is invested pursuant to the Investment Policy. These monies were invested in U.S. government and U.S. government agency securities, repurchase agreements, and overnight investments.

Other Information

Awards. The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City for its Comprehensive Annual Financial Report for the fiscal year ended September 30, 2004. This was the 23rd consecutive year the City has achieved this award. In order to be awarded a Certificate of Achievement, the City must publish an easily readable and efficiently organized Comprehensive Annual Financial Report, which conforms to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is applicable to a CAFR presenting the financial position and operations of one particular year.

Acknowledgments. We wish to take this opportunity to thank each member of the City Council for their interest and support in planning and conducting the financial operations of the City in a responsible and progressive manner. In closing, the preparation of this report is not accomplished without the efficient and dedicated services of key staff in the Office of Financial Services (City Controller's Office and Budget and Management Services Division); Dallas Water Utilities; Department of Aviation; Department of Communication and Information Services; and the Department of Development Services, Economic Development Division. Thanks to each individual involved.

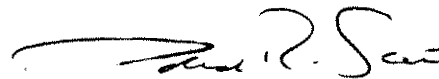
Respectfully submitted,


Mary K. Suhm
City Manager



David Cook
Chief Financial Officer


Maria Alicia Garcia, CPA
Director of Financial Services


Edward R. Scott, CPA
City Controller

(THIS PAGE LEFT BLANK INTENTIONALLY)

ELECTED OFFICIALS

Laura Miller	Mayor Place 15
Donald W. Hill	Mayor Pro Tem Place 5
Dr. Elba Garcia	Deputy Mayor Pro Tem Place 1
Pauline Medrano	Councilmember Place 2
Ed Oakley	Councilmember Place 3
Dr. Maxine Thornton-Reese	Councilmember Place 4
Steve Salazar	Councilmember Place 6
Leo V. Chaney, Jr.	Councilmember Place 7
James L. Fantroy	Councilmember Place 8
Gary Griffith	Councilmember Place 9
Bill Blaydes	Councilmember Place 10
Linda Koop	Councilmember Place 11
Ron Natinsky	Councilmember Place 12
Mitchell Rasansky	Councilmember Place 13
Angela Hunt	Councilmember Place 14

APPOINTED OFFICIALS

**Mary K. Suhm
City Manager**

**Thomas P. Perkins, Jr.
City Attorney**

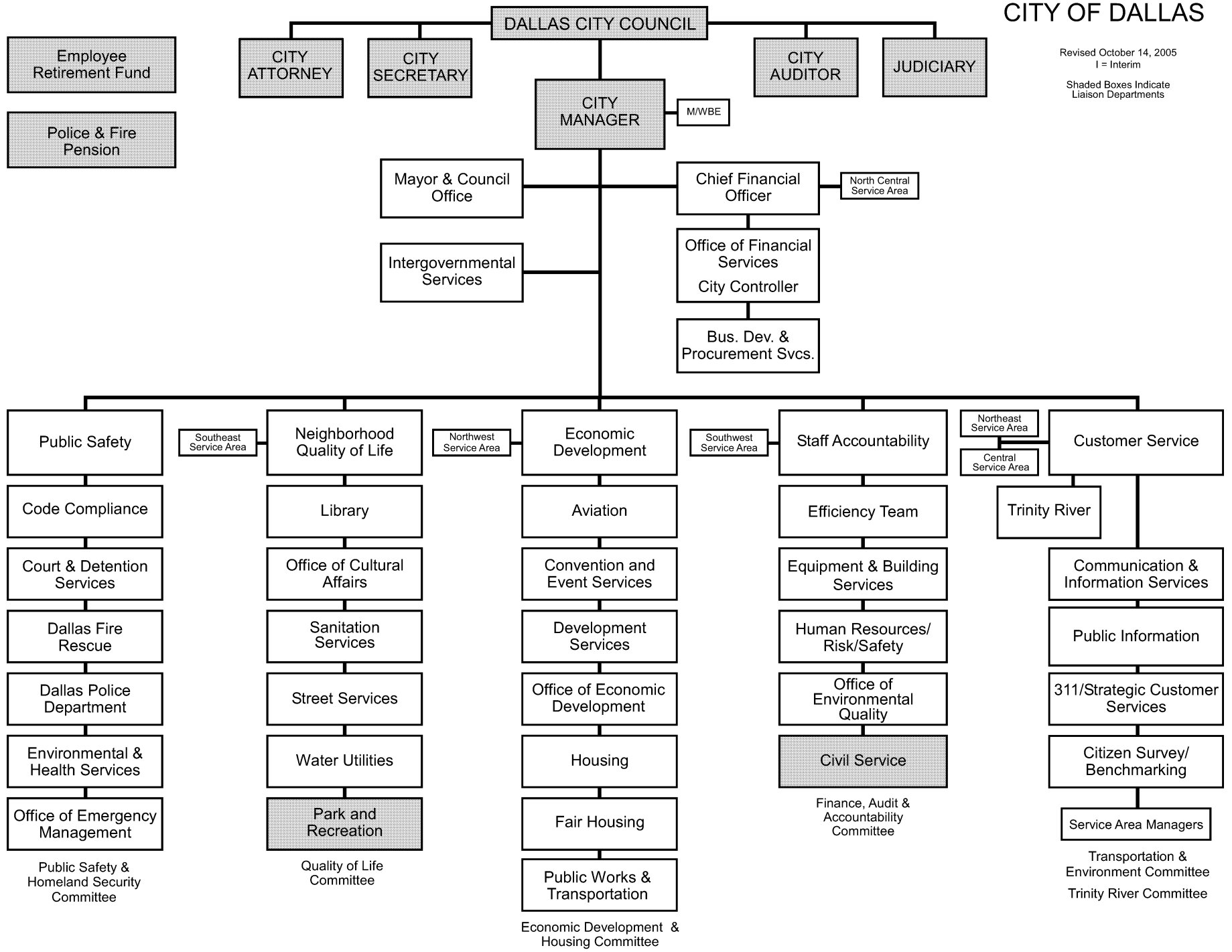
**Shirley Acy
City Secretary**

**Paul T. Garner
Interim City Auditor**

**Nathan McClellan
City Treasurer**

CITY OF DALLAS

Revised October 14, 2005
 I = Interim
 Shaded Boxes Indicate
 Liaison Departments



Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Dallas,
Texas

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
September 30, 2004

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



Carla E. Perry

President

Jeffrey R. Emmer

Executive Director

(THIS PAGE LEFT BLANK INTENTIONALLY)