

CITY OF DALLAS, TEXAS MANAGEMENT'S DISCUSSION AND ANALYSIS SEPTEMBER 30, 2003

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, 2003. The City'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 by \$3.5 billion (net assets). The negative unrestricted net assets in the governmental activities of \$193 million are primarily related to unfunded obligations related to compensated absences, net pension obligations, and risk related unfunded claims.
- The City's governmental activities net assets decreased by \$4 million while the business-type activities net assets increased by \$61 million resulting in a \$57 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 \$415 million, a decrease of \$61 million in comparison to the prior year. At the City's discretion, \$265 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 \$70 million, or 8.9% of the total general fund expenditures.
- The City's bonded debt had a net increase of \$53 million from the prior year's balance of \$2.3 billion. During the current fiscal year the City issued \$86 million of general obligation refunding bonds, \$37 million in certificates of obligation bonds and \$11 million in equipment notes. The City also issued \$510 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 and 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, 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 four separate legal entities in its report – Industrial Development Corporation, Health Facilities Development Corporation, Housing Finance Corporation and the Housing 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 governmental-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 revenues, 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 budget.

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

Proprietary Funds. Proprietary funds are generally used to account for services for which the City charges customers – either outside customer, 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 the 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 governmental-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 22-24 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 33-74 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 77 of this report.

The combining statements referred to earlier in connection with nonmajor 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 79-112 of this report.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

The City's combined net assets were \$3.5 billion as of September 30, 2003. 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 \$1.2 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; consequently these assets 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	
	2003	2002	2003	2002	2003	2002
Current and other assets	\$594,359	\$637,044	\$641,007	\$639,401	\$1,235,366	\$1,276,445
Capital assets	1,931,316	1,923,250	3,466,749	3,321,930	5,398,065	5,247,513
Total assets	2,525,675	2,560,294	4,107,756	3,961,331	6,633,431	6,521,462
Long-term debt outstanding	1,163,505	1,103,345	1,618,610	1,486,232	2,782,115	2,589,577
Other liabilities	102,034	191,933	208,037	255,515	310,071	447,448
Total liabilities	1,265,539	1,295,278	1,826,647	1,741,845	3,092,186	3,037,123
Net assets:						
Invested in capital assets, net of related debt	1,328,590	1,314,665	1,938,648	1,865,949	3,267,238	3,180,614
Restricted	124,645	191,139	140,991	53,361	265,636	244,500
Unrestricted	(193,099)	(240,788)	201,470	300,176	8,371	59,388
Total net assets	\$1,260,136	\$1,265,016	\$2,281,109	\$2,219,486	\$3,541,245	\$3,484,502

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, 2003. Business-type activities increased the City's net assets by \$36 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	
	2003	2002	2003	2002	2003	2002
Revenues:						
Program revenues:						
Charges for services	\$193,064	\$182,104	\$384,849	\$384,637	\$577,913	\$566,741
Operating grants and contributions	56,641	88,524	0	0	56,641	88,524
Capital grants and contributions	67,428	13,779	58,574	13,614	126,002	27,393
General revenues:						
Ad valorem tax	477,596	452,413	0	0	477,596	452,413
Sales tax	183,229	194,133	0	0	183,229	194,133
Franchise taxes	115,751	122,029	46,076	48,348	161,827	170,377
Investment income	15,824	10,063	12,784	12,121	28,608	22,184
Miscellaneous	3,855	4,913	5,743	0	9,598	4,913
Total revenues	1,113,388	1,067,958	508,026	458,720	1,621,414	1,526,678
Expenses:						
General government	148,380	138,324	0	0	148,380	138,324
Public safety	533,689	482,106	0	0	533,689	482,106
Streets, street lighting, sanitation	129,552	153,659	0	0	129,552	153,659
Environmental and health services	26,012	24,807	0	0	26,012	24,807
Public works and transportation	12,362	37,868	0	0	12,362	37,868
Equipment and building services	29,054	42,237	0	0	29,054	42,237
Culture and recreation	109,886	118,904	0	0	109,886	118,904
Housing	1,308	3,382	0	0	1,308	3,382
Human services	31,781	19,160	0	0	31,781	19,160
Interest on long-term debt	34,862	52,779	0	0	34,862	52,779
Water utilities	0	0	290,327	294,685	290,327	294,685
Convention center	0	0	69,641	68,672	69,641	68,672
Airport	0	0	33,991	32,089	33,991	32,089
Municipal radio	0	0	2,914	3,095	2,914	3,095
Building inspection	0	0	14,105	11,389	14,105	11,389
Total expenses	1,056,886	1,073,226	410,978	409,930	1,467,864	1,483,156
Increase (decrease) in net assets before transfers	56,502	(5,268)	97,048	48,790	153,550	66,156
Transfers	11,470	12,673	(11,470)	(12,673)	0	0
Increase in net assets	67,972	7,405	85,578	36,117	153,550	43,522
Loss on disposal of capital assets	(72,852)	0	(23,955)	0	(96,807)	0
Net assets – October 1, 2002	1,265,016	1,257,611	2,219,486	2,183,369	3,484,502	3,440,980
Net assets – September 30, 2003	\$1,260,136	\$1,265,016	\$2,281,109	\$2,219,486	\$3,541,245	\$3,484,502

The most significant governmental expense for the City was in providing public safety, which incurred expenses of \$534 million. These expenses were offset by revenues collected from a variety of sources, with the largest being from fines and forfeitures, which are \$32 million for the fiscal year ended September 30, 2003. 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 \$161 million in expenses (including reimbursement of \$17 million), of which \$164.3 million represented personnel charges. The streets, street lighting, sanitation, and code enforcement activities of the City incurred \$129.5 million in expenses, of which \$66.6 million represented personnel expenses.

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Business-type Activities

Revenues of the City's business-type activities were \$508 million for the fiscal year ending September 30, 2003. Expenses for the City's business-type activities were \$410.9 million for the year, resulting in net revenues of \$97.1 million. Key elements of this increase was from Dallas Water Utilities as follows:

- While Net Income decreased \$1,274 as compared to Fiscal Year 2002, revenues from Customer Services were sufficient to provide income before transfers and contributions of \$32,898. Much of this excess was reinvested in long-lived assets or restricted for the future construction thereof.
- Contributions of infrastructure from outside sources was \$14,652.

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 \$415,311, a decrease of \$60,579 in comparison with the prior year. Approximately \$265,009 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 (\$128,244), 2) to pay debt service (\$9,837), 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 \$26,718, while total fund balance reached \$80,804. 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 3.5 percent of total general fund expenditures, while total fund balance represents 10.2 percent of that same amount.

The fund balance of the City's general fund increased by a moderate \$2,208 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 \$9,837 all of which is reserved for the payment of debt service. The net increase in fund balance during the current year in the debt service fund \$2,090 was due to a decrease in interest expenditures during the current period (\$16,283). This decrease was as the result of a refunding that occurred during the year.

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 of the Dallas Water Utilities at the end of the year amounted to \$61,978, Convention Center was \$71,860 and Airport Revenue was \$60,995. The total growth (decline) in net assets \$41,964, \$19,248 and (\$546) respectively. Other factors concerning the finances of these funds have already been addressed in the discussion of the City's business-type activities.

General Fund Budgetary Highlights

Differences between the original budget and the final amended budget were relatively minor (\$600). All midyear budget adjustments were funded from the contingency reserve.

Primarily due to declining sales taxes, revenues were \$8.7 million below budgeted revenues. As a result of this, expenses were curtailed, therefore, causing actual expenses to be below budget by 11 million.

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CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

During the fiscal year, the City had \$5.4 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 \$150 million or 1.0 percent, over the prior fiscal year.

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

	Governmental Activities		Business-type Activities		Totals	
	2003	2002	2003	2002	2003	2002
Land	\$299,998	\$298,094	\$213,822	\$218,460	\$513,820	\$516,554
Water rights	0	0	283,813	287,492	283,813	287,492
Buildings	345,675	376,847	727,706	736,129	1,073,381	1,112,976
Improvements other than buildings	76,517	75,570	117,935	15,354	194,452	90,924
Infrastructure	774,932	826,034	278,573	362,055	1,053,505	1,188,089
Equipment	113,641	136,343	198,608	213,479	312,249	349,822
Artwork	48,677	12,158	0	0	48,677	12,158
Utility property	0	0	1,113,214	1,081,179	1,113,214	1,081,179
Construction in progress	271,876	198,205	533,078	410,114	804,954	608,319
Totals	\$1,931,316	\$1,923,251	\$3,466,749	\$3,324,262	\$5,398,065	\$5,247,513

This year's major additions included (in millions):

Utility Property Improvements:	
Eastridge Drive	\$2.8
Frankford Road Improvements	1.5
8 th Street DART ROW	1.6
Trinity River Corridor Project	4.5
Airport lighting upgrade	6.2
Lake Fork Raw Water Transmission	27.1
CWWTP Force Main to SSWWTP	5.7
Heavy equipment purchases	<u>1.5</u>
Total	<u>\$50.9</u>

In addition to the itemized list above, major fixed asset additions for FY03 included approximately \$28.8 million in water and wastewater improvements, \$20.7 million in street and alley paving, \$2.5 million in storm drainage improvements, \$2.3 million in library books, and \$1.7 million in economic development projects.

The City's fiscal year 2004 capital budget calls for it to spend another \$459.4 million for capital projects, principally for two major categories: \$235.2 million for General Purpose Capital Improvements and \$224.2 million for Enterprise Fund 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. These projects are funded primarily by the transfer of enterprise revenues and the issuance of debt such as commercial paper and/or revenue bonds.

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 \$2,339 million in bonds outstanding as compared to \$2,277 million at the end of the prior fiscal year, an increase of 2.45 percent – as shown in Table 4.

Table 4
Outstanding Debt at Year End
(in Thousands)

	Governmental Activities		Business-type Activities		Totals	
	2003	2002	2003	2002	2003	2002
General obligation bonds	\$626,856	\$695,393	\$84	\$165	\$626,940	\$695,558
Equipment Acquisition Contractual	43,171	55,430	0	0	43,171	55,430
Certificates of obligation	60,321	30,300	0	0	60,321	30,300
Tax increment bonds	9,195	10,090	0	0	9,195	10,090
Revenue bonds	0	0	1,581,102	1,455,816	1,581,102	1,455,816
Contractual obligation	0	0	18,745	30,251	18,745	30,251
Totals	\$739,543	\$791,213	\$1,599,931	\$1,486,232	\$2,339,474	\$2,277,445

During the fiscal year, the City issued \$85.6 million in general obligation bonds. Bond proceeds will be used to pay costs of various equipment purchases, replenishment of emergency reserve, improvement of street and thoroughfare, playground, recreation facilities, library facilities, and other City facilities.

The City also issued \$510 million of Waterworks and Sewer System Revenue Refunding and Improvement Bonds (\$183 of Series 2002-A and \$326 of Series 2003).

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	AAA
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 2003-04 Budget, revenue is expected to continue to decline so during the current fiscal year management recognized the challenges ahead by reducing expenditures in the current year to position the city until the economy stabilized. Sales tax revenue was lowered by \$5.8 million from the 2003 budget. Fee increases were made in the water and wastewater, sanitation; stormwater, development processes, and other areas which will continue to move the City toward full cost recovery. Other action was a sharing of health benefits cost increases with employees and retirees and no merit increases for civilian employees.

As a result of the potential impact in revenue, the City has made a concerted effort to limit appropriations to only those items considered necessary.

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In fiscal year 2003-04, 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.