

**Dallas County Utility and Reclamation District
Management's Discussion and Analysis (Unaudited)
For The Year Ended September 30, 2011**

As management of the Dallas County Utility and Reclamation District (the District), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended September 30, 2011. Please read it in conjunction with the District's financial statements, which follow this section.

Financial Highlights

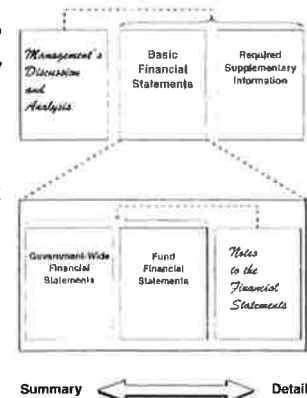
- In the government-wide financial statements, liabilities of the District exceeded assets by \$223.8 million, with \$164.7 million of unrestricted net liabilities.
- The amount invested in capital assets net of related debt has a deficit of \$60.1 million due to the fact that the long-term debt exceeds the capital assets net of depreciation. The debt includes unamortized premiums, discounts, and deferred losses on refunding and capitalized interest in addition to the original cost of the capital assets. The capital assets are mainly infrastructure in nature and were constructed to entice development within the District. Financing instruments, such as capital appreciation bonds, were used in order to defer the repayment of the debt until a sufficient tax base was developed to support the debt payments.
- The District's total general revenues were \$24.4 million for the year ended September 30, 2011, substantially all of which were property taxes.
- The District's total program revenues were \$4.4 million for the year ended September 30, 2011, of which \$1.6 million were water sales revenue.
- The total cost of the District's programs decreased 6.5% to \$25.9 million. General government and Rehabilitation expenses decreased significantly while other programs had minor fluctuations. General government decreased \$932 thousand due to funding of 2010 programs associated with federal grant funds for transit studies. Rehabilitation of District facilities decreased \$530,000 because 2010 was an unusually high expense year.
- The fund balance for all governmental funds totaled \$5.3 million. This amount is 23% higher than September 30, 2010 due to a receipt of payment from a large delinquent property tax account.

Overview of the Financial Statements

This annual report consists of three parts—*management's discussion and analysis* (this section), the *basic financial statements*, and *required supplementary information*. The basic financial statements include two kinds of statements that present different views of the District:

- The first two statements are *government-wide financial statements* that provide both *long-term* and *short-term* information about the District's *overall* financial status.

Figure A-1. Required Components of the District's Annual Financial Report



- The remaining statements are *fund financial statements* that focus on *individual parts* of the government, reporting the District's operations in *more detail* than the government-wide statements.
- The *governmental funds* statements tell how *general government* services were financed in the *short term* as well as what remains for future spending.
- *Proprietary fund* statements offer *short- and long-term* financial information about the activities the District operates *like businesses*, such as water supply.
- *Fiduciary fund* statements provide information about the financial relationships in which the District acts solely as a *trustee or agent* for the benefit of others, to whom the resources in question belong.

The financial statements also include *notes* that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of *required supplementary information* that further explains and supports the information in the financial statements. Figure A-1 shows how the required parts of this annual report are arranged and related to one another.

Figure A-2. Major Features of the District's Government-wide and Fund Financial Statements

Type of Statements	Fund Statements			
	Government-wide	Governmental Funds	Proprietary Funds	Fiduciary Funds
Scope	Entire District's government (except fiduciary funds)	The activities of the district that are not proprietary or fiduciary	Activities the district operates similar to private businesses; self insurance	Instances in which the district is the trustee or agent for someone else's resources
Required financial statements	* Statement of net assets * Statement of activities	* Balance sheet * Statement of revenues, expenditures & changes in fund balances	* Statement of net assets * Statement of revenues, expenses and changes in fund net assets * Statement of cash flows	* Statement of fiduciary net assets * Statement of changes in fiduciary net assets
Accounting basis and measurement focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus	Accrual accounting and economic resources focus
Type of asset/liability information	All assets and liabilities, both financial and capital, short-term and long-term	Only assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets included	All assets and liabilities, both financial and capital, and short-term and long-term	All assets and liabilities, both short-term and long-term; the District's funds do not currently contain capital assets, although they can
Type of inflow/outflow information	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year; expenditures when goods or services have been received and payment is due during the year or soon thereafter	All revenues and expenses during year, regardless of when cash is received or paid	All revenues and expenses during year, regardless of when cash is received or paid

Figure A-2 summarizes the major features of the District's financial statements, including the portion of the District government they cover and the types of information they contain. The remainder of this overview section of management's discussion and analysis explains the structure and contents of each of the statements.

Government-wide Statements

The government-wide statements report information about the District as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes *all* of the government's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two government-wide statements report the District's *net assets* and how they have changed. Measuring net assets, the difference between the District's assets and liabilities, is one way to analyze the District's financial health or *position*.

- Over time, increases or decreases in the District's net assets are an indicator of whether its financial health is improving or deteriorating, respectively.
- To assess the overall health of the District, you need to consider additional non-financial factors such as changes in the District's tax base.

The government-wide financial statements of the District include the *Governmental activities*. Most of the District's basic services are included here, such as flood control, maintenance of lakes and channels, operation of the transit system, and general administration. Property taxes finance most of these activities. The government-wide financial statements also include *Business-type activities*, which is the District's raw water supply function.

Fund Financial Statements

The fund financial statements provide more detailed information about the District's most significant *funds*, not the District as a whole. Funds are accounting devices that the District uses to keep track of specific sources of funding and spending for particular purposes.

- Some funds are required by State law and by bond covenants.
- The Board of Directors establishes other funds to control and manage money for particular purposes or to show that it is properly using certain taxes.

Funds of the District can be classified in three categories:

- *Governmental funds*—Most of the District's basic services are included in governmental funds, which focus on (1) how *cash and other financial assets* that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental fund statements provide a detailed *short-term* view that helps the user determine whether there are more or fewer financial resources that can be spent in the near future to finance the District's programs. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental funds statement, or on the subsequent page, that explain the relationship (or differences) between them. The District maintains two governmental funds, the General Fund and Debt Service Fund.
- *Proprietary funds*—The District maintains two types of proprietary funds: enterprise funds and internal service funds. Services for which the District charges customers a fee are generally reported in enterprise funds. Proprietary funds, like the government-wide statements, provide both long- and short-term financial information. The District uses *internal service funds* to report activities that provide supplies and services for the District's other programs and activities, such as the District's Self Insurance Fund and Vehicle Maintenance Funds.
- *Fiduciary funds*—The District is the trustee, or *fiduciary*, for certain funds. The District reports the employee pension plan in a pension trust fund. The District's fiduciary activities are reported in a separate statement of fiduciary net assets and a statement of changes in fiduciary net assets. We exclude these activities from the District's government-wide financial statements because the District cannot use these assets to finance its operations.

Notes to the 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 to the financial statements can be found immediately following the basic financial statements.

Other Information—In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the District's progress in funding its obligation to provide pension benefits to the employees and certain budgetary comparison schedules. Required supplemental information can be found after the notes to the financial statements.

The combining statements referred to earlier are presented following the required supplementary information.

FINANCIAL ANALYSIS OF THE DISTRICT AS A WHOLE

Net assets. The District's net assets (liabilities) at September 30, 2011 and 2010 for governmental activities and business-type activities were approximately \$(230.2) million and \$6.4 million and \$(233.2) million and \$6.4 million respectively. (See Table A-1).

Table A-1
The District's Net Assets
(in millions of dollars)

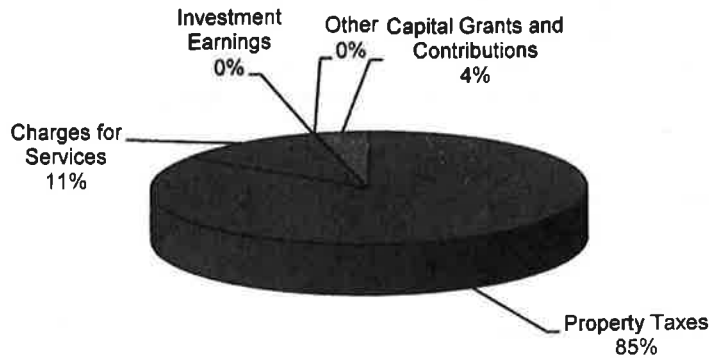
	Governmental Activities		Total % Change	Business-Type Activities		Total % Change
	2011	2010		2011	2010	
Current and Other Assets	\$ 17.0	\$ 17.3	(2%)	\$ 3.0	\$ 2.8	7 %
Capital Assets	52.0	54.0	(4%)	3.5	3.7	(5%)
Total Assets	<u>69.0</u>	<u>71.3</u>	(3%)	<u>6.5</u>	<u>6.5</u>	0 %
Current Liabilities	10.2	9.9	3 %	0.1	0.1	0 %
Long Term Liabilities	289.0	294.6	(2%)	-	-	0 %
Total Liabilities	<u>299.2</u>	<u>304.5</u>	(2%)	<u>0.1</u>	<u>0.1</u>	0 %
Net Assets (Liabilities):						
Invested in Capital Assets						
net of related debt	(63.6)	(61.5)	(3%)	3.5	3.7	(5%)
Restricted	0.9	0.0	0 %	-	-	0 %
Unrestricted	(167.5)	(171.7)	(2%)	2.9	2.7	7%
Total Net Assets (Liabilities)	<u><u>\$ (230.2)</u></u>	<u><u>\$ (233.2)</u></u>	1 %	<u><u>\$ 6.4</u></u>	<u><u>\$ 6.4</u></u>	(0 %)

The unrestricted net assets (liabilities) represent obligations that will be funded by the programs of the District in future years.

The District's liabilities for government activities exceed its assets resulting in a deficit of \$230.2 million. The main reason for the deficit is the issuance costs, capitalized interest, and interest accretion on capital appreciation bonds. The District was created to construct certain infrastructure in an undeveloped area in order to entice development within the District. Financing instruments, such as capital appreciation bonds, were used in order to defer the repayment of the debt until after sufficient tax base was developed to support the debt payments. That has in fact occurred as the tax base within the District now exceeds \$2 billion. The District expects to pay off the debt from collection of future property tax levies.

Changes in net assets. The District's total revenues were \$28.9 million. Eighty-four percent of the District's revenue comes from taxes. (See Figure A-3.) Another eleven percent relates to charges for services.

**Figure A-3 District
Sources of Revenue for Fiscal Year 2011**



The total cost of all programs and services was \$25.9 million; 66% of these costs are for interest expense.

Governmental Activities

Property tax rates increased 28.7 cents to \$2.05 while the total tax base remained just under \$2.1 billion, resulting in an increase of tax revenue to \$24.4 million.

**Table A-2
Changes in the District's Net Assets
(in millions of dollars)**

	Governmental Activities		Total % Change	Business-Type Activities		Total % Change
	2011	2010		2011	2010	
Revenues						
<u>Program Revenues</u>						
Charges for Services	\$ 1.7	\$ 1.6	6%	\$ 1.6	\$ 1.5	7 %
Capital Grants and Contributions	1.1	2.9	(62%)	-	-	0 %
<u>General Revenues</u>						
Property Taxes	24.4	23.4	4 %	-	-	0 %
Other	0.1	0.3	100 %	-	-	0 %
Total Revenues	<u>27.3</u>	<u>28.2</u>	(3%)	<u>1.6</u>	<u>1.5</u>	7 %
Expenses						
General Government	1.0	1.9	(47%)	-	-	0 %
Finance and Administration	1.0	1.0	0 %	-	-	0 %
Systems Maintenance	4.1	4.3	(5%)	-	-	0 %
Reclamation Maintenance	-	0.0	(100%)	-	-	0 %
Area Personal Transit System	0.9	0.9	0 %	-	-	0 %
Service Center Operation	0.2	0.2	0 %	-	-	0 %
Rehabilitation	0.1	0.7	(86%)	-	-	0 %
Interest Expense	17.0	17.1	(1%)	-	-	0 %
Raw Water Supply	-	-	0 %	1.6	1.6	0 %
Total Expenses	<u>24.3</u>	<u>26.1</u>	(7%)	<u>1.6</u>	<u>1.6</u>	0 %
Excess (Deficiency) of Revenues Over Expenditures	<u>3.0</u>	<u>2.1</u>	43%	<u>-</u>	<u>(0.1)</u>	(100%)
Transfers In (Out)	-	0.2	100%	-	(0.2)	(100%)
Change in Net Assets	3.0	2.3	31 %	-	(0.3)	(100%)
Beginning Net Assets (Liabilities)	<u>(233.2)</u>	<u>(235.5)</u>	(1%)	<u>6.4</u>	<u>6.7</u>	(4%)
Ending Net Assets (Liabilities)	<u>\$ (230.2)</u>	<u>\$ (233.2)</u>	(1%)	<u>\$ 6.4</u>	<u>\$ 6.4</u>	(0 %)

FINANCIAL ANALYSIS OF THE DISTRICT'S FUNDS

Revenues for general governmental functions totaled \$28.3 million, up \$1 million from the preceding year. Tax revenues increased \$1.9 million from 2010 to 2011 while intergovernmental and other revenues decreased \$1.3 million from 2010 to 2011. Property tax collections, the largest source of revenue received by the District, was \$24.9 million. The taxable value of property within the District decreased while the tax rate was increased by \$0.287.

Expenditures for general governmental operations totaled \$27,339,780 during 2010-2011 and \$28,614,444 during 2009-2010, a decrease of \$1,274,664 or 4.5% from 2009-2010. This decrease is due mainly to the decreased cost of funding transit studies, which were funded by grant funds in 2010.

The governmental funds reported a combined fund balance of \$5,321,305, an increase of \$1,012,779. The net increase of the combined fund balances was comprised of fund balance increase in the General Fund of \$108,848, and fund balance increase in the Debt Service Fund of \$903,931. Out of the combined fund balances, \$3,320,554 constitutes unassigned fund balance. The remainder of the fund balances of \$906,662, \$27,273 and \$1,066,816 is restricted for payment of principal and interest on the District's general obligation debt, nonspendable, and assigned for capital projects, respectively.

The General Fund is the primary operating fund of the District. At September 30, 2011, unassigned fund balance of the General Fund was \$3,320,554. This fund balance represents 57% of the total General Fund expenditures. The fund balance of the General Fund increased during the current fiscal year by \$108,848.

The Debt Service Fund had a total fund balance of \$906,662, all of which is restricted for the payment of debt service. The District makes semi-annual debt service interest payments and principal payments in February of each year. Debt service payments for the year ended September 30, 2011, included all scheduled payments.

Proprietary Funds – The District maintains both enterprise and internal service funds. Information is presented separately in the proprietary fund statement of net assets and in the proprietary statement of revenues, expenses and changes in fund net assets for the Raw Water Supply Fund, which is considered to be a major fund. Net assets in the Raw Water Supply Fund as of September 30, 2011, were \$6,396,103. Of this amount, \$3,527,546 represented the investment in capital assets. Net assets for the fiscal year decreased by \$16,150.

General Fund Budgetary Highlights

The District revised its budget once during the year. Actual expenditures were \$345,496 below final budget amounts while resources available were \$1,647,284 over the final budgeted amount. This large variance in actual resources over budget is due mainly to the collection of a large outstanding property tax account, which was unbudgeted. The collection occurred late in the year after all budget amendments had taken place.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of 2011, the District had invested \$129.7 million in a broad range of capital assets, including land, equipment, buildings, and vehicles. (See Table A-3.) This amount is unchanged from last year.

Table A-3
District's Capital Assets
(in millions of dollars)

	Governmental Activities		Total % Change	Business-Type Activities		Total % Change
	2011	2010		2011	2010	
Land	\$ 16.6	\$ 16.6	0 %	\$ -	\$ -	0 %
Buildings and improvements	4.1	4.1	0 %	-	-	0 %
Vehicles, Furniture and Equipment	1.5	1.5	0 %	0.7	0.7	0 %
Flood Control System	47.8	47.8	0 %	-	-	0%
Area Personal Transit System	38.0	38.0	0 %	-	-	0%
Engineering Fees	11.5	11.5	0 %	-	-	0%
Water and Sewer Systems	2.4	2.4	0 %	7.1	7.1	0 %
Totals at historical cost	<u>121.9</u>	<u>121.9</u>	0 %	<u>7.8</u>	<u>7.8</u>	0 %
Total accumulated depreciation	<u>(69.9)</u>	<u>(67.9)</u>	(3 %)	<u>(4.3)</u>	<u>(4.1)</u>	(5 %)
Net capital assets	<u>\$ 52.0</u>	<u>\$ 54.0</u>	(4 %)	<u>\$ 3.5</u>	<u>\$ 3.7</u>	(5 %)

The District's fiscal year 2012 capital budget projects spending another \$116,900 for capital projects, principally for flood control and water supply system improvements. More detailed information about the District's capital assets is presented in Note 6 to the financial statements.

Long-Term Debt

Table A-4
District's Long Term Debt
(in millions of dollars)

	Governmental Activities		Total % Change
	2011	2010	
Bonds payable (including bond premium and deferred loss on refunding)	<u>\$297.0</u>	<u>\$302.2</u>	(2%)
Total bonds payable	<u>\$297.0</u>	<u>\$302.2</u>	(2%)

At year-end the District had \$297.0 million in bonds and notes outstanding as shown in Table A-4. More detailed information about the District's debt is presented in Note 7 to the Financial Statements.

Except for the \$3.3 million Series 2008 bonds, the District's bonds are covered by municipal bond insurance. The District's underlying ratings are as follows: Moody's Investor Services "A3", Standard & Poors "BBB+", and Fitch "A-".

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

Appraised value used for the 2012 budget preparation decreased \$38.5 million, or 2% from 2011. The decrease in appraised values is primarily the result of decreased taxable value of Class A commercial office buildings within the District. The taxable values are declining due to market conditions, which are not unique to the District. While occupancy rates were down 1% from one year ago, leasing rates have declined for building leases, which results in lower taxable values.

New development continues in the District mainly in the residential market. Two projects of single-family homes are under development and one multi-family for lease development was started during the fiscal year ended September 30, 2011.

These indicators were taken into account when adopting the operating budget for 2012. The general fund budget for 2012 is \$5.5 million, which is \$600,000 less than the final 2011 budget. This budgeted reduction is due to budgeted projects being completed in 2011 which will not recur in 2012, such as flood control improvements of \$315,000. Property taxes will decrease due to a decrease in tax values, which will be partially offset by increasing the tax rate from \$2.05 to \$2.122.

Expenditures are budgeted to be \$5.5 million. If these estimates are realized, the District's budgetary general fund balance is not expected to change by the close of 2012.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our constituents, taxpayers, customers, investors and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's Finance and Accounting Department.