

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the City and County of San Francisco's (the City) Comprehensive Annual Financial Report presents a narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2005. We encourage readers to consider the information presented here in conjunction with additional information in our transmittal letter. Certain amounts presented as 2003-2004 summarized comparative financial information in the basic financial statements have been reclassified to conform to the presentation in the 2004-2005 basic financial statements.

### FINANCIAL HIGHLIGHTS

- The assets of the City exceeded its liabilities at the close of the fiscal year by approximately \$5.77 billion (net assets). Of this amount, approximately \$245.6 million (unrestricted net assets) may be used to meet the government's ongoing obligations to citizens and creditors.
- The government's total net assets increased during fiscal year 2004-2005 by approximately \$148.8 million, a significant improvement over the 2003-2004 net asset increase of about \$8 million. This year's increase is due in part to improvements in property, business, and other local tax revenues, increases in grants and contribution revenues while governmental activities expenses increased less than one percent.
- Total revenues for governmental funds were approximately \$3.06 billion for the current fiscal year, an increase of approximately 6.8 percent over the prior fiscal year. Expenditures for governmental funds totaled \$2.79 billion, a 1.7 percent decrease over the same period. Overall, governmental funds revenues exceeded expenditures by approximately \$268.2 million in fiscal year 2004-2005, a significant improvement over last year's \$25.9 million.
- As of June 30, 2005, the City's governmental funds reported combined ending fund balances of \$1.07 billion. Approximately 16.5 percent of this total amount, \$176.1 million, is unreserved fund balance available for spending at the government's discretion within the purposes specified for the City's funds. This increase is about 83 percent more than 2004 unreserved fund balance of \$96.1 million. Improvements in property, business, and other local tax revenues as well as the expenditure reductions in community health, culture and recreation, and public works services were important factors in this year's increase.
- At the end of the fiscal year, the general fund unreserved fund balance was \$134.2 million, about two times more than the 2003-2004 amount of \$63.7 million and 6.9 percent of 2004-2005 general fund expenditures of \$1.94 billion. Significant contributing factors were the increases in property, business, local tax revenues, improvement in charges for services revenues and the less than one percent increase in general fund expenditures over 2003-2004.
- The City's total long-term debt, which includes all bonds, loans, and commercial paper, increased \$275 million, or approximately 3.9 percent, this fiscal year. This was primarily due to the City issuing general obligation bonds of \$230 million for the improvement of Laguna Honda Hospital, \$68.8 million for improvements to recreation and park facilities, and \$8.1 million for improvements to the Academy of Sciences. During the year, the Airport and the Port issued refunding bonds for \$311.6 million and \$19.9 million, respectively, and the City issued \$39.4 million to refund certificates of participation for the City courthouse building.
- The City's revenues from various local taxes including property, hotel, utility, parking and sales taxes were greater than budgeted in fiscal year 2004-2005, consistent with improvements in most sectors of the City's economy. Citywide, charges for services revenue also increased and included increases from water, power and sewer fees, MUNI passenger fares, net patient revenues at San Francisco General Hospital (SFGH), the City's acute care hospital, and rent and concession fees at the Port of San Francisco.

## OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis are intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise 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. These various elements of the Comprehensive Annual Financial Report are related as shown in the graphic below.

### Organization of City and County of San Francisco Comprehensive Annual Financial Report

<b>CAFR</b>	Introductory Section	<b>INTRODUCTORY SECTION</b>				
		+				
	Financial Section	<b>Management's Discussion and Analysis</b>				
		<b>Government- wide Financial Statements</b>	<b>Fund Financial Statements</b>			
		Statement of net assets	<b>Governmental Funds</b>	<b>Proprietary Funds</b>	<b>Fiduciary Funds</b>	
			Balance Sheet	Statement of net assets	Statement of fiduciary net assets	
		Statement of activities	Statement of revenues, expenditures, and changes in fund balances	Statement of revenues, expenses, and changes in fund net assets	Statement of changes in fiduciary net assets	
			Budgetary comparison statement	Statement of cash flows		
		<b>Notes to the Financial Statements</b>				
		<b>Required Supplementary Information Other Than MD&amp;A</b>				
Information on individual non-major funds and other supplementary information that is not required						
	+					
Statistical Section	<b>STATISTICAL SECTION</b>					

The following figure summarizes the major features of the financial statements. The overview section below also describes the structure and contents of each of the statements in more detail.

	Government-wide Statements	Fund Financial Statements		
		Governmental	Proprietary	Fiduciary
<b>Scope</b>	Entire entity (except fiduciary funds)	The day-to-day operating activities of the City for basic governmental services	The day-to-day operating activities of the City for business-type enterprises	Instances in which the City administers resources on behalf of others, such as employee benefits
<b>Accounting basis and measurement focus</b>	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; except agency funds do not have measurement focus
<b>Type of asset and liability information</b>	All assets and liabilities, both financial and capital, short-term and long-term	Current assets and liabilities that come due during the year or soon thereafter	All assets and liabilities, both financial and capital, short-term and long-term	All assets held in a trustee or agency capacity for others
<b>Type of inflow and outflow information</b>	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during the year or soon thereafter; expenditures when goods or services have been received and the related liability is due and payable	All revenues and expenses during year, regardless of when cash is received or paid	All additions and deductions during the year, regardless of when cash is received or paid

### **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.

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 or not the financial position of the City is improving or deteriorating.

The **statement of activities** presents information showing how the City's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as 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 future fiscal periods, such as revenues pertaining to uncollected taxes and expenses pertaining to earned but unused vacation and sick leave.

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other 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 public protection, public works, transportation and commerce, human welfare and neighborhood development, community health, culture and recreation, general administration and finance, and general City responsibilities. The business-type activities of the City include an airport, port, public transportation systems (including parking), water and power operations, an acute care hospital, a long-term care hospital, sewer operations, and a produce market.

The government-wide financial statements include not only the City itself (known as the primary government), but also a legally separate redevelopment agency, the San Francisco Redevelopment Agency (RDA) and a legally separate development authority, the Treasure Island Development Authority (TIDA), 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. Included within the governmental activities of the government-wide financial statements are the San Francisco County Transportation Authority and San Francisco Finance Corporation. Included within the business-type activities of the government-wide financial statements is the operation of the San Francisco Parking Authority. Although legally separate from the City, these component units are blended with the primary government because of their governance or financial relationships to the City.

### **Fund Financial Statements**

The fund financial statements are designed to report information about groupings of related accounts that are 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 the following 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 - i.e. most of the City's basic services are reported in governmental funds. These statements, however, focus on (1) how cash and other financial assets can readily be converted to available resources and (2) the balances left at year-end that are available for spending. Such information may be useful in determining what financial resources are available in the near future to finance the City's programs.

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 fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains several individual governmental funds organized according to their type (special revenue, debt service, capital projects and permanent 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 fund, which is considered to be a major fund. Data from the remaining governmental funds are combined into a single, aggregated presentation. Individual fund data for each of the non-major governmental funds is provided in the form of combining statements elsewhere in this report.

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

**Proprietary funds.** Proprietary funds are generally used to account for services for which the City charges customers - either outside customers, or internal units or departments of the City. Proprietary funds provide the same type of information as shown in the government-wide financial statements, only in more detail. The City maintains the following 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 operations of the San Francisco International Airport (Airport), Port of San Francisco (Port), Water Department (Water), Hetch Hetchy Water and Power (Hetch Hetchy), Municipal Transportation Agency, Laguna Honda Hospital, General Hospital Medical Center, and Clean Water Program (Clean Water), all of which are considered to be major funds of the City.
- **Internal Service funds** are used to report activities that provide supplies and services for certain city programs and activities. The City uses internal service funds to account for its fleet of vehicles, management information services, printing and mail services, and for lease-purchases of equipment by the San Francisco Finance Corporation. Because these services predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements. The 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.

**Fiduciary funds.** Fiduciary funds are used to account for resources held for the benefit of parties outside the City. The City employees' pension and health plans, the external portion of the Treasurer's Office investment pool, and the 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.

#### **Notes to the Basic Financial Statements**

The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

#### **Required Supplementary 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 its employees.

#### **Combining Statements and Schedules**

The combining statements and schedules referred to earlier in connection with non-major governmental funds, internal service funds, and fiduciary funds are presented immediately following the required supplementary information on pensions.

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

### Net Assets June 30, 2005 (in thousands)

	Governmental activities		Business-type activities		Total	
	2005	2004	2005	2004	2005	2004
<b>Assets:</b>						
Current and other assets.....	\$ 1,942,426	\$ 1,445,923	\$ 1,757,114	\$ 1,823,724	\$ 3,699,540	\$ 3,269,647
Capital assets.....	<u>2,371,726</u>	<u>2,314,563</u>	<u>8,417,813</u>	<u>8,483,325</u>	<u>10,789,539</u>	<u>10,797,888</u>
Total assets.....	<u>4,314,152</u>	<u>3,760,486</u>	<u>10,174,927</u>	<u>10,307,049</u>	<u>14,489,079</u>	<u>14,067,535</u>
<b>Liabilities:</b>						
Long-term liabilities outstanding.....	2,017,494	1,820,415	5,319,853	5,426,655	7,337,347	7,247,070
Other liabilities.....	<u>795,576</u>	<u>633,330</u>	<u>587,595</u>	<u>567,417</u>	<u>1,383,171</u>	<u>1,200,747</u>
Total liabilities.....	<u>2,813,070</u>	<u>2,453,745</u>	<u>5,907,448</u>	<u>5,994,072</u>	<u>8,720,518</u>	<u>8,447,817</u>
<b>Net assets:</b>						
Invested in capital assets, net of related debt.....	1,159,696	1,096,834	3,391,450	3,416,154	4,551,146	4,512,988
Restricted.....	541,853	535,054	429,990	432,165	971,843	967,219
Unrestricted (deficit).....	<u>(200,467)</u>	<u>(325,147)</u>	<u>446,039</u>	<u>464,658</u>	<u>245,572</u>	<u>139,511</u>
Total net assets.....	<u>\$ 1,501,082</u>	<u>\$ 1,306,741</u>	<u>\$ 4,267,479</u>	<u>\$ 4,312,977</u>	<u>\$ 5,768,561</u>	<u>\$ 5,619,718</u>

### Analysis of Net Assets

As noted earlier, net assets may serve as a useful indicator of a government's financial position. For the City assets exceeded liabilities by \$5.77 billion at the close of the fiscal year 2004-2005.

The largest portion of the City's net assets reflects its \$4.6 billion (78.9 percent) investment in capital assets (e.g. land, buildings, and equipment), less any related outstanding debt used to acquire those assets. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in its 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 liquidated for these liabilities.

Another portion of the City's net assets, \$971.8 million (16.8 percent) represents resources that are subject to external restrictions on how they may be used. The remaining balance, unrestricted net assets, \$245.6 million (4.3 percent) may be used to meet the government's ongoing obligations to citizens and creditors. Together, these two categories of net assets totaled 21.1 percent, a slight increase from the prior year's total of 19.7 percent.

At the end of the fiscal year 2004-2005, the City had positive balances in all three categories of net assets for the government as a whole, as well as for the business-type activities. For the governmental activities, unrestricted net assets have a deficit of \$200.5 million related in part to \$131.8 million in debt from general obligation bonds for the San Francisco Unified School District and San Francisco Community College District, which are recorded with no corresponding assets.

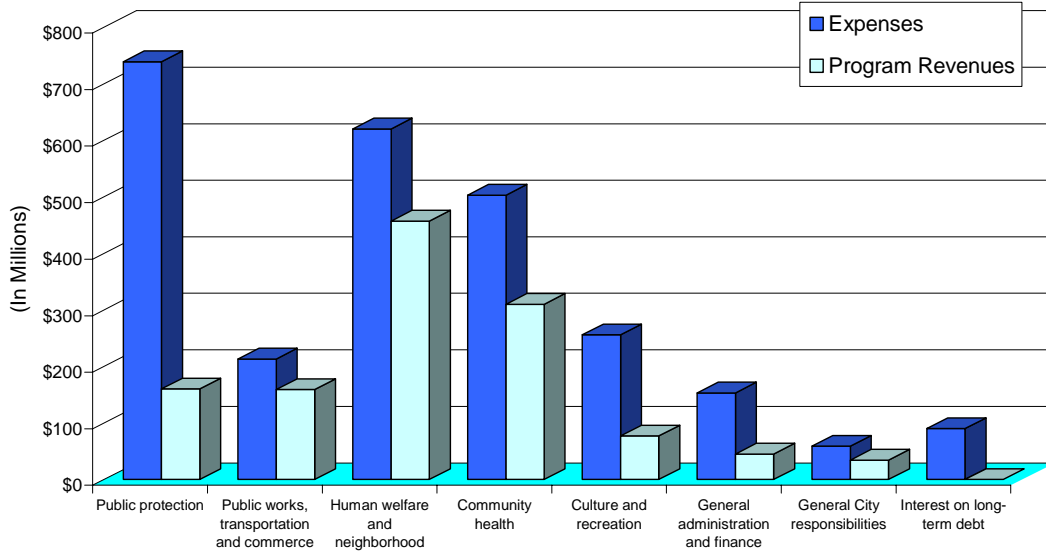
**Changes in Net Assets  
June 30, 2005 (in thousands)**

	Governmental activities		Business-type activities		Total	
	2005	2004	2005	2004	2005	2004
<b>Revenues</b>						
Program revenues:						
Charges for services.....	\$ 351,029	\$ 327,998	\$ 1,683,830	\$ 1,614,784	\$ 2,034,859	\$ 1,942,782
Operating grants and contributions.....	834,607	823,784	180,807	169,767	1,015,414	993,551
Capital grants and contributions.....	55,435	39,209	93,724	94,818	149,159	134,027
General revenues:						
Property taxes.....	920,314	723,786	-	-	920,314	723,786
Business taxes.....	292,763	264,832	-	-	292,763	264,832
Other local taxes.....	538,085	509,455	-	-	538,085	509,455
Interest and investment income.....	29,490	11,856	33,268	17,620	62,758	29,476
Other.....	47,153	170,163	237,102	237,692	284,255	407,855
Total revenues.....	<u>3,068,876</u>	<u>2,871,083</u>	<u>2,228,731</u>	<u>2,134,681</u>	<u>5,297,607</u>	<u>5,005,764</u>
<b>Expenses</b>						
Public protection.....	738,688	718,488	-	-	738,688	718,488
Public works, transportation and commerce.....	213,335	169,179	-	-	213,335	169,179
Human welfare and neighborhood development.....	619,753	651,102	-	-	619,753	651,102
Community health.....	503,259	517,066	-	-	503,259	517,066
Culture and recreation.....	256,336	232,187	-	-	256,336	232,187
General administration and finance.....	152,850	177,544	-	-	152,850	177,544
General City responsibilities.....	59,024	73,530	-	-	59,024	73,530
Unallocated Interest on long-term debt.....	89,690	86,131	-	-	89,690	86,131
Airport.....	-	-	628,445	618,301	628,445	618,301
Transportation.....	-	-	711,733	660,650	711,733	660,650
Port.....	-	-	54,897	61,185	54,897	61,185
Water.....	-	-	197,848	206,211	197,848	206,211
Power.....	-	-	116,683	121,629	116,683	121,629
Hospitals.....	-	-	598,160	562,188	598,160	562,188
Sewer.....	-	-	160,650	150,586	160,650	150,586
Market.....	-	-	1,055	949	1,055	949
Total expenses.....	<u>2,632,935</u>	<u>2,625,227</u>	<u>2,469,471</u>	<u>2,381,699</u>	<u>5,102,406</u>	<u>5,006,926</u>
Increase/(decrease) in net assets before special items and transfers.....	<u>435,941</u>	<u>245,856</u>	<u>(240,740)</u>	<u>(247,018)</u>	<u>195,201</u>	<u>(1,162)</u>
Special items.....	-	-	(46,358)	9,245	(46,358)	9,245
Transfers.....	<u>(241,600)</u>	<u>(251,937)</u>	<u>241,600</u>	<u>251,937</u>	<u>-</u>	<u>-</u>
Change in net assets.....	194,341	(6,081)	(45,498)	14,164	148,843	8,083
Net assets at beginning of year.....	1,306,741	1,312,822	4,312,977	4,298,813	5,619,718	5,611,635
Net assets at end of year.....	<u>\$ 1,501,082</u>	<u>\$ 1,306,741</u>	<u>\$ 4,267,479</u>	<u>\$ 4,312,977</u>	<u>\$ 5,768,561</u>	<u>\$ 5,619,718</u>

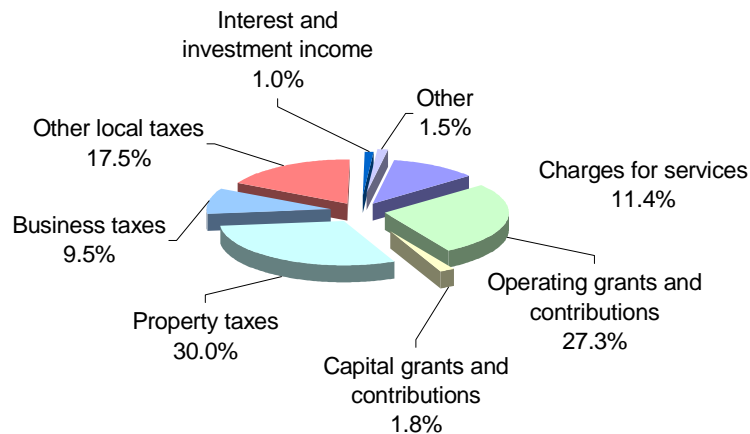
**Analysis of Changes in Net Assets**

The City's net assets overall increased by \$148.8 million during fiscal year 2004-2005, compared to an \$8.1 million increase last fiscal year. The governmental activities component of this change was a \$194.3 million increase, a significant improvement from the prior year's decrease of \$6.1 million. The City's business-type activities' decrease of \$45.5 million was largely due to the Airport's one time write off of approximately \$50 million capitalized costs associated with a runway development project due to asset impairment. A discussion of these changes is presented in the government and business-type activities below.

### Expenses and Program Revenues - Governmental Activities



### Revenues By Source - Governmental Activities



**Governmental activities.** Governmental activities increased the City's total net assets by \$194.3 million during fiscal year 2004-2005, compared to decreasing the City's total net assets by \$8.1 million during fiscal year 2003-2004. Key factors contributing to this year's change are as follows:

- Overall, governmental activities' revenues increased by approximately \$197.8 million while expenses increased by less than one percent or \$7.7 million, and net transfers decreased by \$10.3 million. The governmental activities achieved a total improvement of \$194.3 million in net assets in fiscal year 2004-2005 over fiscal year 2003-2004.
- Property tax revenue increased by \$196.5 million or 27.2 percent during this fiscal year. Approximately two-thirds of this improvement was due to the State shifting property tax revenue to local governments as part of a package, which also reduced local revenues from motor vehicle and sales taxes by a similar amount. The remainder of the increase in property



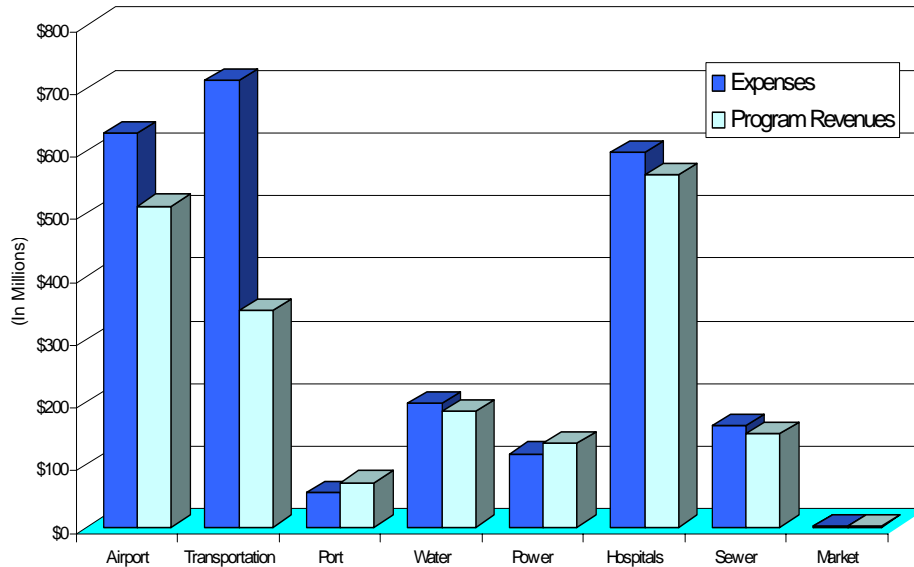
tax revenues was attributable to growth in assessed valuation and a slight improvement in assessment appeals activity.

- Revenues from business taxes increased in fiscal 2004-2005 by \$27.9 million, or 10.6 percent, due to a growth in wages with moderate employment growth. In addition, revenues from other local taxes, which includes hotel, parking and utility users tax, had a total growth of \$28.6 million, or 5.6 percent. This is consistent with stronger hotel occupancy rates and average daily room rates in the City, increases in parking rates and continued improvements in the City's economy. Fees and service charges also increased this year, improving approximately 7 percent to \$23 million.
- Interest and investment income improved by about \$17.6 million, or 148.7 percent, during the year primarily due to higher interest rates and average daily cash balances during the fiscal year. The earned yield on City pooled investments increased from 1.86 percent to 2.31 percent. In general, these returns reflect the City's concentration of investments in Treasury Bills and Notes and other short-term investments combined with the slightly higher interest rates from the Federal Reserve. At the fiscal year end, deposits and investments for governmental activities with the City Treasury were approximately \$1,238.3 million, a 69.7 percent increase over the previous year.
- Capital grants and contributions increased by \$16.2 million, or approximately 41.4 percent, largely due to increases in federal grants for human welfare and neighborhood development, community health, and public protection, which included homeland security funds.

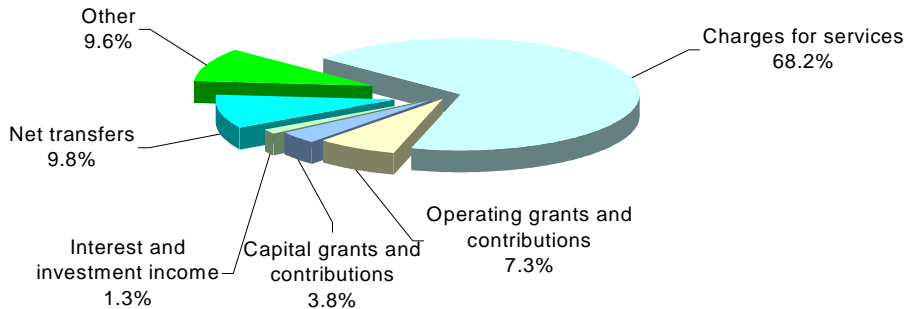
Net transfers to business-type activities were \$241.6 million in fiscal year 2004-2005, a \$10.3 million decrease from fiscal year 2003-2004. This was due in part to a \$25 million decrease to the MTA for transportation projects from non-major governmental funds, and an increase in net general fund support to the Laguna Honda Hospital of about \$14.9 million.

The charts on the previous page illustrate the City's governmental expenses and revenues by function, and its revenues by source. As shown, public protection is the largest function in expense (28 percent), followed by human welfare and neighborhood development (23.5 percent), and community health (19 percent). General revenues such as property, business, and sales taxes are not shown by program, but are essentially used to support program activities citywide. For governmental activities overall, without regard to program, property taxes were the largest single source of funds (30.0 percent) in fiscal year 2004-2005, up from 25.2 percent in fiscal year 2003-2004, due in part to the State-wide property tax revenue allocation shift noted above. The ratios for other revenue categories were essentially the same for 2005 as they were for 2003-2004: operating grants and contributions (27.3 percent), other local taxes (17.5 percent), and charges for services (11.4 percent).

### Expenses and Program Revenues - Business-type Activities



### Revenues By Source - Business-type Activities



**Business-type activities.** Business-type activities decreased the City's net assets by \$45.5 million. This decrease was more than offset by the governmental-type activities increase of \$194.3 million, bringing the government-wide increase to \$148.8 million. Key factors of this contribution to this change are:

- The Municipal Transportation Agency (MTA) had net assets of \$1.75 billion at June 30, 2005. Of this, 98.4 percent, or \$1.72 billion, belong to the MUNI, the City's transportation department. The remainder represents the combined net assets of the Department of Parking and Traffic and the Parking Authority. Between the end of fiscal year 2003-2004 and 2004-2005, MUNI's net assets

increased by approximately \$20 million, primarily due to continued work on the Third Street Light Rail Line, a major expansion project for the MUNI funded by federal, state and local capital contributions. At the MTA level, this increase was essentially offset by a like amount for the one-time recognition of depreciation expenses for the Parking Garages. MUNI's total operation revenues of \$127.4 million were essentially the same for fiscal year 2004-2005 and non-operating revenues increased slightly to \$229.7 million from \$221.1 million, primarily due to increases in federal and state operating grants. The City's General Fund subsidy to the MTA for 2004-2005 was \$101.7 million to MUNI and \$36.1 million for DPT, slightly more than the fiscal 2003-2004 amounts of \$99.3 million and \$34.4 million, respectively.

- Hetch Hetchy, which operates the City's water storage and power generating facilities in the Sierra Nevada Mountains, increased total net assets by \$22.5 million. This was largely due to a \$9.7 million increase in construction projects and a \$12.7 million decrease in total liabilities. Hetchy's total revenues were \$137.5 million this fiscal year, a \$2.0 million increase over fiscal year 2003-2004. This included \$10.4 million increase in settlement proceeds offset partially by a \$5.8 million decrease in State grants and a \$2.6 million decrease in revenue from enterprise customers due to a rate decrease. Operating expenses decreased to \$116.7 million in fiscal year 2004-2005, a drop of \$4.9 million from 2003-2004, due in part to a decrease in transmission costs.
- The Water Department's had \$8.4 million of operating income this year, compared to a \$19.1 million loss in fiscal year 2003-2004. This \$27.5 million improvement is primarily due to a \$17.2 million increase in water sales revenue in 2004-2005 and a decrease of about \$10 million in the write-off of capitalized costs. At the same time, the department's positive operating income was offset by non-operating expenses of \$14.8 million, largely net interest expense, resulting in a \$6.4 million decrease to net assets this year. The Water Department's net capital asset increase of approximately \$60.0 million was funded primarily through proceeds from \$55 million of commercial paper and other resources.
- San Francisco International Airport's net assets decreased in 2004-2005 by \$99 million to \$357.6 million, a 21.7 percent decline since the end of prior fiscal year. Slightly more than half of this, or \$50 million, was due to the recognition of an asset impairment expense associated with a runway development project. The Airport's operating expenses also increased by \$18.4 million, due to the increase in repairs and maintenance of the Airport's infrastructure and contracting expenses. Total aviation operating revenues decreased as well, by approximately \$22.2 million, due to a drop in aviation revenues attributable to a decrease in costs recovered from airline landing fees and terminal rentals. At the same time, income from rent, concessions, parking, and transportation revenues increased by \$10.1 million, primarily due to an increase in percentage rent and the elimination of the grace period in the parking garage. The transfer from the Airport to the City's General Fund was \$19.7 million, an 8 percent increase from 2003-2004.

As shown in the charts on the previous page, the two largest of San Francisco's business-type activities - the San Francisco International Airport and the Municipal Transportation Agency each had total expenses over \$600 million in fiscal year 2004-2005. The City's long-term and acute care hospitals together recorded expenses of over \$598 million. Together, these four enterprises make up almost 78.5 percent of the total expenses of the business-type activities. As in prior years, charges for services provide the largest share of revenues, 75.6 percent, for business-type activities.

## FINANCIAL ANALYSIS OF THE CITY'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 statements is to provide information on near-term inflows, outflows, and balances of resources that are available for spending. 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. Types of Governmental funds reported by the City include the General Fund, Special Revenue Funds, Debt Service Funds, Capital Project Funds, and the Permanent Fund.

As of the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of approximately \$1,068.3 million, an increase of \$350.7 million over the end of the prior year. The increase is due to a general increase in major revenues as reflected in the City's improving economy and a reduction in expenditures in fiscal year 2004-2005.

Approximately \$176.1 million of the total ending fund balance in the governmental funds constitutes unreserved fund balance. This is available for spending at the City's discretion within the purposes specified for the City's funds. The remainder is reserved, an indication that it is not available for new spending because it has already been committed. These commitments include: (1) to support a general fund "rainy day" reserve (\$48.1 million), (2) to liquidate existing contracts and purchase orders (\$155.7 million), (3) to fund continued programs or projects in future fiscal periods (\$616.1 million), (3) to pay debt service (\$45.5 million), and (4) for a limited number of other purposes (\$26.7 million).

The general fund is the chief operating fund of the City and had an unreserved fund balance of \$134.2 million at the end of fiscal year 2004-2005, a \$70.5 million increase over the 2003-2004 unreserved fund balance of \$63.7 million. The general fund's total fund balance was \$307.7 at fiscal year end, a 46.2 percent improvement over the 2003-2004 comparable balance of \$210.4 million. This rise was mainly due to a general increase in major revenues including property, business, other local taxes and charges for services, along with only a slight increase in expenditures. Overall, the general fund's performance resulted in revenues in excess of expenditures for the fiscal year ended June 30, 2005 of \$272.1 million, before transfers and other items are considered.

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. For 2004-2005, the unreserved fund balance of \$134.2 million represents 6.9 percent of total general fund expenditures of \$1.94 billion, and the total fund balance represents approximately 15.8 percent of that amount. For 2003-2004, the general fund's unreserved fund balance of \$63.7 million was 3.3 percent of the total expenditures of \$1.93 billion, and the total fund balance represented approximately 10.9 percent of expenditures.

### Proprietary funds

The City's proprietary fund statements provide the same type of information found in the business-activities section of the government-wide financial statements, but in more detail.

At the end of fiscal year 2004-2005, the unrestricted net assets for the San Francisco International Airport were \$288.9 million, the Water Department \$106 million, the Hetch Hetchy Water and Power \$103.4 million, the Clean Water Program \$44.1 million, the Port of San Francisco \$39.3 million, and the San Francisco Market Corporation \$2.2 million. Three proprietary funds had a deficit in unrestricted net assets: the Municipal Transportation Agency had a deficit of \$123.4 million, General

Hospital Medical Center \$2.5 million, and Laguna Honda Hospital \$12 million. The internal service funds that are used to account for certain governmental activities also had a deficit in unrestricted net assets of \$5 million.

The total decline in net assets for the enterprise funds was \$45.5 million. Factors concerning the finances of these funds have been addressed previously in the discussion of the City's business-type activities. As in the previous years, the Airport's decrease in net assets is partly related to its major capital assets being depreciated faster than the repayment of its bonded debt.

The following table shows actual revenues, expenses and results of operations (excluding capital contributions and expenses) for the current fiscal year in the City's proprietary funds (in thousands):

	Operating Revenues	Operating Expenses	Operating Income (Loss)	Non-Operating Revenues (Expense)	Capital Contributions Special Items, and Others	Interfund Transfers	Change In Net Assets
Airport.....	\$ 477,314	\$ 418,993	\$ 58,321	\$ (127,121)	\$ (15,150)	\$ (15,066)	(99,016)
Water.....	184,835	176,453	8,382	(14,789)	-	-	(6,407)
Hetch Hetchy.....	132,303	116,683	15,620	5,220	-	1,628	22,468
Municipal Transportation Agency.....	187,913	707,049	(519,136)	248,702	45,330	220,378	(4,726)
General Hospital.....	377,069	441,999	(64,930)	79,446	-	(4,746)	9,770
Clean Water.....	148,888	139,290	9,598	(17,829)	-	246	(7,985)
Port.....	57,519	53,753	3,766	510	17,186	-	21,462
Laguna Honda Hospital.....	116,527	154,838	(38,311)	17,654	-	39,160	18,503
Market Corporation.....	1,462	1,055	407	26	-	-	433
Total.....	<u>\$ 1,683,830</u>	<u>\$ 2,210,113</u>	<u>\$ (526,283)</u>	<u>\$ 191,819</u>	<u>\$ 47,366</u>	<u>\$ 241,600</u>	<u>\$ (45,498)</u>

### **Fiduciary Funds**

The City maintains fiduciary funds for the assets of the San Francisco Employees' Retirement System and Health Service System, and manages the investment of monies held in trust to benefit public services or employees. As of the end of fiscal year 2004-2005, the net assets of the Retirement System and Health Service System totaled \$13.2 billion, representing an increase of \$1.23 billion in total net assets since June 30, 2004. This 10.3 percent increase is primarily due to a second year of improved performance of the Retirement Trust's investments. The Investment Trust Fund's net assets totaled \$320.5 million, an increase in net assets of \$115.4 million or 56.2 percent since June 30, 2004 due to the increase in addition over withdrawals and distributions to external participants of the fund.

### **General Fund Budgetary Highlights**

The City's final budget differs from the original budget in that it contains carry-forward appropriations for various programs and projects, and supplemental appropriations approved during the fiscal year. In fiscal year 2004-2005, the one significant supplemental appropriation was for \$6 million to the Human Services Agency for In-Home Supportive Services (IHSS), Medi-cal, and California Work Opportunity and Responsibility to Children (CalWORKS) programs. These programs are supported by federal grants that flow through the general fund.

During the year, actual revenues and other resources were \$68.5 million more than budgeted. While the City realized \$121.2 million more revenue than budgeted for property taxes, other local taxes, franchises, interest and investment income, this was offset by shortfalls in other areas. These shortfalls included \$18.9 million less in federal subvention revenues, \$11.1 million less in business taxes, fines and forfeitures, concession and charges for service revenues, and \$17.9 million less in transfers from the San Francisco General Hospital Fund for the City's participation in the State's cost-

sharing program among county hospitals. The City also received approximately \$11.6 million less than budgeted for motor vehicle license fees because the State reduced the allocation of this revenue to local government. In return, this decrease was offset by a similar increase in the property tax allocation.

Differences between the final budget and the actual (budgetary basis) resulted in a \$68.7 million decrease in total charges to appropriations. This is primarily due to the following factors:

- A decrease in expenditures by the Human Services Agency of approximately \$21.2 million related to reduced costs under programs such as IHSS, County Adult Assistance Programs (CAAP), Personal Assisted Employment Services (PAES), CalWORKS Aid and Operations, and various aid programs. These expense reductions are partly offset by decreases in the federal and state funds that the City is able to claim under these programs.
- A decrease in expenditures of approximately \$2.3 million in Fire Department, due to personnel, worker's compensation and work order savings.
- A decrease in expenditures of approximately \$5.6 million in Recreation and Park Department is mainly due to planned reductions by rotating closures of recreation centers one day a week and savings due to position vacancies.
- The General Fund was able to reduce its transfers to other funds by \$11.4 million from budget, primarily through improved revenue performance at San Francisco General Hospital.
- Budgetary reserves and designations of \$12.8 million for various programs and payments that had been anticipated and included in the budget were not used due to management restrictions on spending and were able to be liquidated at the close of the fiscal year.

The net effect of the under-utilization of appropriations and the receipt of some actual revenues greater than estimates resulted in a positive budgetary fund balance variance of \$ 137.2 million at the end of the fiscal year.

In creating its budget for the fiscal year ending June 30, 2006, the City used an estimated budgetary fund balance of \$118 million (see Note 4 to the Basic Financial Statements).

## Capital Assets and Debt Administration

### Capital Assets

The City's capital assets for its governmental and business type activities as of June 30, 2005, decreased by \$8.4 million to \$10.8 billion (net of accumulated depreciation). Capital assets include land, buildings and improvements, machinery and equipment, park facilities, roads, streets, and bridges. The increase of \$57.2 million, or 2.5 percent, in capital assets for governmental activities was offset by a \$65.5 million decrease for business-type activities for 2004-2005. Details are shown in the table below.

**Capital Assets , Net of Accumulated Depreciation  
(in thousands)**

	<u>Governmental Activities</u>		<u>Business-type Activities</u>		<u>Total</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Land.....	\$ 143,640	\$ 143,640	\$ 193,781	\$ 193,781	\$ 337,421	\$ 337,421
Facilities and Improvement..	1,704,266	1,695,198	6,081,285	6,149,996	7,785,551	7,845,194
Machinery and equipment....	46,021	52,674	847,935	912,707	893,956	965,381
Infrastructure.....	185,223	176,838	485,043	494,671	670,266	671,509
Property held under lease....	536	536	2,667	2,248	3,203	2,784
Easements.....	-	-	85,534	89,153	85,534	89,153
Construction in progress.....	292,040	245,677	721,568	640,769	1,013,608	886,446
Total.....	<u>\$ 2,371,726</u>	<u>\$ 2,314,563</u>	<u>\$ 8,417,813</u>	<u>\$ 8,483,325</u>	<u>\$ 10,789,539</u>	<u>\$ 10,797,888</u>

Major capital asset events during the current fiscal year included the following:

- The Municipal Transportation Agency's (MTA) net capital assets increased by \$2.9 million this fiscal year. This was primarily due to ongoing construction work on the Third Street Light Rail project, a major expansion of the MUNI Metro system in the City's southeast neighborhoods.
- The Water Department's net capital assets increased by \$60 million. This included improvements at the Lombard Reservoir Seismic Upgrade, Sunset Pipeline, East Bay Fluoride, Third Street Light Rail and Alemany Water Main totaling approximately \$35 million, and an increase in structure, buildings, and equipment totaling approximately \$24 million.
- Hetch Hetchy Water and Power increased net capital assets by \$6.7 million. This included the capital additions for O'Shaughnessy Dam discharge modifications, Early Intake Fire Emergency improvement, Holm Powerhouse Generator rehabilitation, and Priest Reservoir By-Pass improvements, totaling \$15.8 million.
- The Airport reported a decrease in net capital assets of \$140.9 million or 3.6 percent for fiscal year 2004-2005 due largely to the net effect of depreciation against completed projects of the Near Term Master Plan for SFO in recent years. This plan includes the new International Terminal (completed in 2001), the Bay Area Rapid Transit (BART) Station at SFO and Air Train people mover (completed in 2003) and new parking facilities, roadways, runway improvements, and other Airport facilities. In addition, as noted above, approximately \$50 million capitalized costs of a runway development project were expensed due to asset impairment.
- Under governmental activities, net capital assets increased by \$57.2 million. This included construction in progress of Harding Park Club House, the North Beach Recreation Center and

pool, Page Street Community Garden, Excelsior Branch Library renovation, and various street improvement and traffic signal upgrades.

At the end of the year, the City's business type activities had approximately \$196 million in commitments for various capital projects. Of this, MTA had approximately \$50 million, Water Department had \$73 million, Hetch Hetchy had \$16 million, Clean Water had \$40 million, and the Airport had \$17 million. In addition, there was approximately \$41 million reserved for encumbrances in capital project funds for the general government.

For government-wide financial statement presentation, all depreciable capital assets were depreciated from acquisition date to the end of the current fiscal year. Fund financial statements record capital asset purchases as expenditures.

For governmental activities, no net infrastructure assets were recorded in fiscal year 2000-2001 - the first year of presentation in the GASB 34 format, because the historical costs did not meet the threshold established by GASB. Beginning in fiscal year 2001-2002, newly completed projects are capitalized and ongoing infrastructure projects are accounted for in construction in progress.

Additional information about the City's capital assets can be found in note 7 to the Basic Financial Statements.

### **Debt Administration**

At the end of the current fiscal year, the City had total long-term debt outstanding of \$7.3 billion. Of this amount, \$1.1 billion is general obligation bonds backed by the full faith and credit of the City and \$6.2 billion is revenue bonds, loans, certificates of participation, capital leases, and other debts of the City secured solely by specified revenue sources.

As noted previously, the City's total long-term debt including all bonds, loans, commercial papers and capital leases increased by \$275 million during fiscal year 2004-2005, primarily due to issuance of bonded debt in the governmental activities.

The City also took advantage of favorable interest rates to reduce debt payments by issuing \$371 million in refunding bonds. Of this amount, the Airport issued \$311.6 million and the Port Commission \$19.9 million in refunding revenue bonds; the City issued the remaining \$39.4 million to refund certificates of participation. The City also issued \$68.8 million and \$8.1 million in general obligation bonds for improvements to the City's recreation and park facilities and the Academy of Sciences respectively. In addition, the City issued \$230 million in general obligation bonds for the improvement of Laguna Honda Hospital.

The City's Charter imposes a limit on the amount of general obligation bonds the City can have outstanding at any given time. That limit is three percent of the taxable assessed value of property in the City - approximately \$106.5 billion in value (net of unreimbursable exemptions) as of the close of the fiscal year. As of June 30, 2005, the City had \$1.1 billion in authorized, outstanding property tax-supported general obligation bonds, which is equal to approximately 0.98 percent of gross (1.02 percent of net) taxable assessed value of property. As of June 30, 2005, there were an additional \$565.2 million in bonds that were authorized but un-issued. If all of these bonds were issued and outstanding in full, the total debt burden would be approximately 1.49 percent of gross (1.55 percent of net) taxable assessed value of property.

The City's underlying ratings on general obligation bonds as of June 30, 2005 were:

Moody's Investors Service, Inc.	Aa3
Standard and Poor's	AA
Fitch Ratings	AA-



During the fiscal year, Moody's Investors Service and Standard and Poor's affirmed their ratings and revised the outlook to stable from negative reflecting the City's continued economic recovery and efforts to improve finances. In addition, Fitch Ratings affirmed its ratings and outlook on the City's outstanding bonds.

The City's enterprise activities maintained their underlying debt ratings this fiscal year. The Airport's underlying debt ratings were upheld by Moody's Investors Service, Standard & Poor's, and Fitch Ratings at A1, A, and A, respectively, with a stable rating outlook. At fiscal year end 2004-2005, the San Francisco Water Department carried underlying ratings of A1 and A+ from Moody's Investor Service and Standard and Poor's respectively.

Since the close of the 2004-2005 fiscal year, the City has issued additional debt of \$150.1 million in general obligation bonds for improvements to the California Academy of Sciences, the Steinhart Aquarium, the Branch Library facilities and the Zoo facilities. In addition, general obligation bonds for \$69 million were issued for the improvement of Laguna Honda Hospital.

Additional information in the City's long-term debt can be found in Note 8 to the Basic Financial Statements.

#### **Economic factors and next year's budget and rates**

- San Francisco faced a projected General Fund shortfall of \$102.2 million at the beginning of its fiscal 2005-2006 annual budget process. The shortfall was significantly lower than previous years as the economy had begun to recover, resulting in increasing revenues, and expenditure growth had been further controlled. Most San Francisco public employees' unions agreed in labor contracts to continue to contribute up to 7.5 percent of salary to fund the employee-share cost of pension benefits, helping to constrain expenditure growth. Further, the improving revenues and savings strategies implemented by the City resulted in additional available fund balance at the end of fiscal year. The City was able to appropriate \$120.5 million in estimated available fund balance and reserves in the General Fund budget for fiscal year 2005-2006. The general improvement in revenues as well as the use of one-time sources, including the use of fund balance, prior year reserves and the State's early repayment of the vehicle license fee gap loan, meant that the City was able to avoid making even further reductions in public safety, health and human services, and many other critical programs in the 2005-2006 budget year.
- As noted in our transmittal letter, San Francisco's unemployment rate has gradually improved over the last two years, dropping to 5.2 percent in June 2005 from 6.1 percent in June 2004 after a peak of 7.7 percent in June 2003. While the unemployment rate has decreased, this is generally attributed to two factors: 1) that unemployed workers have moved to less expensive areas to live, or 2) that they are no longer included in the California Economic Development Department's count because they are not actively seeking new employment. Employers have been slow to expand their employee ranks given the lagging recovery in our region; however, the reduced unemployment rate is one sign that some improvements are emerging. Additionally, the San Francisco metro area experienced year-over-year jobs growth of 0.8 percent (7,300 jobs) from June 2004 through June 2005. On a related note, as of the third quarter of 2005, San Francisco saw 9 consecutive quarters of net positive absorption (i.e. declining office vacancy rates) in our commercial office sector. This reflects significant improvement from the second quarter of 2003 peak in office vacancy rates.
- During the fiscal 2005-2006 budget cycle, the City's budget continued to reflect the State's negotiated, two-year agreement with local governments to close the State's budgetary shortfall, in part, by shifting an additional \$25.2 million in property taxes (ERAF III) to fund the State's public education obligation. On-going shifts related to the State's permanent rollback of vehicle license

fees and the State's issuance of Economic Recovery Bonds backed by local sales taxes were budgeted along with an offsetting backfill in property taxes. City management continues to closely monitor all State funding.

- A gradual economic recovery is continuing as noted in improving local tax revenue growth, including property, real property transfer, business, hotel room, sales, and parking taxes. After a three-plus year downturn, these signs are encouraging news. Jobs growth is positive, though still weaker than we would like to see at this point in the recovery, as employers have been cautious in their hiring.
- While the above factors were considered in preparing the City's budget for fiscal year 2005-2006, voters rejected the proposed  $\frac{1}{4}$  percent increase to sales tax (Proposition J) and the temporary (four-year) 0.1 percent gross receipts tax (Proposition K) in November 2004. Immediately following the election, the Mayor's Office implemented an 18-month savings plan to cover the resulting 18-month shortfall. This savings plan, in part, helped to further improve the fund balance, which ended fiscal year 2004-2005 with an \$19 million surplus over and above the \$118 million assumed in the City's adopted fiscal year 2005-2006 budget.

## REQUESTS FOR INFORMATION

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the City's finances and to demonstrate the City's accountability for the money it receives. Below are the contacts for questions about this report or requests for additional financial information.

City and County of San Francisco  
Office of the Controller  
1 Dr. Carlton B. Goodlett Place, Room 316  
San Francisco, CA 94102-4694

### Individual Department Financial Statements

San Francisco International Airport  
Office of the Airport Deputy Director  
Business and Finance Division  
PO Box 8097  
San Francisco, CA 94128

Port of San Francisco  
Fiscal Officer  
Pier 1  
San Francisco, CA 94111

San Francisco Water Department  
Hetch Hetchy Water and Power  
San Francisco Clean Water Program  
Director of Accounting Financial Services  
1155 Market Street, 5th Floor  
San Francisco, CA 94103

Laguna Honda Hospital  
Chief Financial Officer  
375 Laguna Honda Blvd.  
San Francisco, CA 94116

Municipal Transportation Agency  
MTA Finance and Administration  
875 Stevenson Street, Room 260  
San Francisco, CA 94103

Health Service System  
Department of Human Resources  
44 Gough Street  
San Francisco, CA 94103

San Francisco General Hospital Medical Center  
Chief Financial Officer  
1001 Potrero Avenue, Suite 2A7  
San Francisco, CA 94110

San Francisco Employees'  
Retirement System  
Executive Director  
30 Van Ness Avenue, Suite 3000  
San Francisco, CA 94102

### Component Unit Financial Statement

San Francisco Redevelopment Agency  
Finance Department  
770 Golden Gate Avenue, Third Floor  
San Francisco, CA 94102

### Blended Component Units Financial Statements

San Francisco County Transportation Authority  
Deputy Director for Administration and Finance  
100 Van Ness Avenue, 25<sup>th</sup> Floor  
San Francisco, CA 94102

San Francisco Finance Corporation  
Mayor's Office of Public Finance  
City Hall, Room 336  
1 Dr. Carlton B. Goodlett Place  
San Francisco, CA 94102