

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the City and County of San Francisco's (the City) Comprehensive Annual Financial Report (CAFR) presents a narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with additional information in our transmittal letter. Certain amounts presented as 2004-2005 summarized comparative financial information in the basic financial statements have been reclassified to conform to the presentation in the 2005-2006 basic financial statements.

### FINANCIAL HIGHLIGHTS

- The assets of the City exceeded its liabilities at the close of the fiscal year by approximately \$6.21 billion (net assets). Of this amount, \$464.6 million is unrestricted and may be used to meet the government's ongoing obligations to citizens and creditors.
- The government's total net assets increased by \$438.5 million or 7.6 percent, during fiscal year 2005-2006, more than doubling the \$148.8 million increase at the end of the prior fiscal year. This year's growth is due to primarily to an 11.5 percent rise in total revenues while overall expenses grew slightly less than 7.2 percent.
- Net assets for the City's governmental activities increased by \$293.5 million, or 19.6 percent, at the end of fiscal year 2005-2006, continuing the trend of the prior fiscal year when governmental activities net assets increased by \$194.3 million.
- At June 30, 2006, the City's total ending fund balance for governmental funds increased by \$247.3 million, or 23.2 percent, to approximately \$1.32 billion. Within this total, \$190.2 million, 8.0 percent more than last fiscal year, is unreserved and available for spending at the government's discretion within the purposes specified for the City's funds. This improvement was consistent with the City's improved economy and supported by significant increases in revenues including: property, business and other local taxes, interest and investment income, state grants, and charges for services.
- The City's General Fund had an unreserved fund balance of \$139.0 million at the end of fiscal year 2005-2006, a \$4.8 million increase over the previous fiscal year, and the total fund balance was \$461.3 million, a 50.0 percent increase over the previous fiscal year. This growth was primarily due to increasing revenue related to property taxes, business taxes, other local taxes, state and federal grants, and charges for service, coupled with only a 1.2 percent increase in expenditures this year. Due to the strong revenue growth, the City increased the General Fund's "rainy day" reserves by \$73.8 million, to a total of \$122.0 million as of June 30, 2006.
- The City's total long-term debt, including all bonds, loans, commercial paper and capital leases increased by \$473 million during fiscal year 2005-2006. This included issuance of general obligation bonds for the following capital improvement projects: \$79.4 million for the Academy of Sciences, \$29.2 for Steinhart Aquarium, \$34.0 million for Branch Libraries, \$7.5 million for the Zoo, and \$69.0 million towards the re-building of the Laguna Honda Hospital. The City also issued \$507.8 million in revenue bonds to improve and re-build the City's water system and retire commercial paper outstanding. In addition, this year the San Francisco International Airport and the San Francisco Water Department issued \$467.0 million and \$110.1 million, respectively, in revenue refunding bonds.

## 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 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>			
			<b>Governmental Funds</b>	<b>Proprietary Funds</b>	<b>Fiduciary Funds</b>	
		Statement of net assets	Balance Sheet	Statement of net assets	Statement of fiduciary net assets	
			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	
		Statement of activities	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, 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 (SFO or Airport), Port of San Francisco (Port), San Francisco Water Department (Water Department), Hetch Hetchy Water and Power (Hetch Hetchy), Municipal Transportation Agency (MTA), Laguna Honda Hospital, San Francisco General Hospital Medical Center, and the San Francisco Wastewater Enterprise (Wastewater), 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, 2006 (in thousands)

	Governmental activities		Business-type activities		Total	
	2006	2005	2006	2005	2006	2005
<b>Assets:</b>						
Current and other assets.....	\$ 2,073,433	\$ 1,942,426	\$ 2,162,036	\$ 1,757,114	\$ 4,235,469	\$ 3,699,540
Capital assets.....	<u>2,674,862</u>	<u>2,371,726</u>	<u>8,529,054</u>	<u>8,417,813</u>	<u>11,203,916</u>	<u>10,789,539</u>
Total assets.....	<u>4,748,295</u>	<u>4,314,152</u>	<u>10,691,090</u>	<u>10,174,927</u>	<u>15,439,385</u>	<u>14,489,079</u>
<b>Liabilities:</b>						
Long-term liabilities outstanding.....	2,138,652	2,017,494	5,701,283	5,319,853	7,839,935	7,337,347
Other liabilities.....	<u>815,025</u>	<u>795,576</u>	<u>577,374</u>	<u>587,595</u>	<u>1,392,399</u>	<u>1,383,171</u>
Total liabilities.....	<u>2,953,677</u>	<u>2,813,070</u>	<u>6,278,657</u>	<u>5,907,448</u>	<u>9,232,334</u>	<u>8,720,518</u>
<b>Net assets:</b>						
Invested in capital assets, net of related debt.....	1,438,010	1,159,696	3,438,397	3,391,450	4,876,407	4,551,146
Restricted.....	428,646	541,853	437,366	429,990	866,012	971,843
Unrestricted (deficit).....	<u>(72,038)</u>	<u>(200,467)</u>	<u>536,670</u>	<u>446,039</u>	<u>464,632</u>	<u>245,572</u>
Total net assets.....	<u>\$ 1,794,618</u>	<u>\$ 1,501,082</u>	<u>\$ 4,412,433</u>	<u>\$ 4,267,479</u>	<u>\$ 6,207,051</u>	<u>\$ 5,768,561</u>

### **Analysis of Net Assets**

Net assets may serve as a useful indicator of a government's financial position. For the City, assets exceeded liabilities by \$6.2 billion at the close of the fiscal year 2005-2006.

The largest portion of the City's net assets reflects its \$4.9 billion (79 percent) investment in capital assets (e.g. land, buildings, and equipment), less any related outstanding debt used to acquire those assets. This percentage is substantially the same as in the prior two fiscal years. The City uses capital assets to provide services to citizens; consequently, they 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 to pay these liabilities.

Another portion of the City's net assets, \$866.0 million (14 percent) represents resources that are subject to external restrictions as to how they may be used. The remaining balance, unrestricted net assets, \$464.6 million (7 percent) may be used to meet the government's ongoing obligations to citizens and creditors. Together, these categories of net assets totaled 21 percent in fiscal year 2005-2006, essentially equivalent to the prior year's percentage.

At the end of the fiscal year 2005-2006, 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 \$72.0 million related in part to \$125 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.

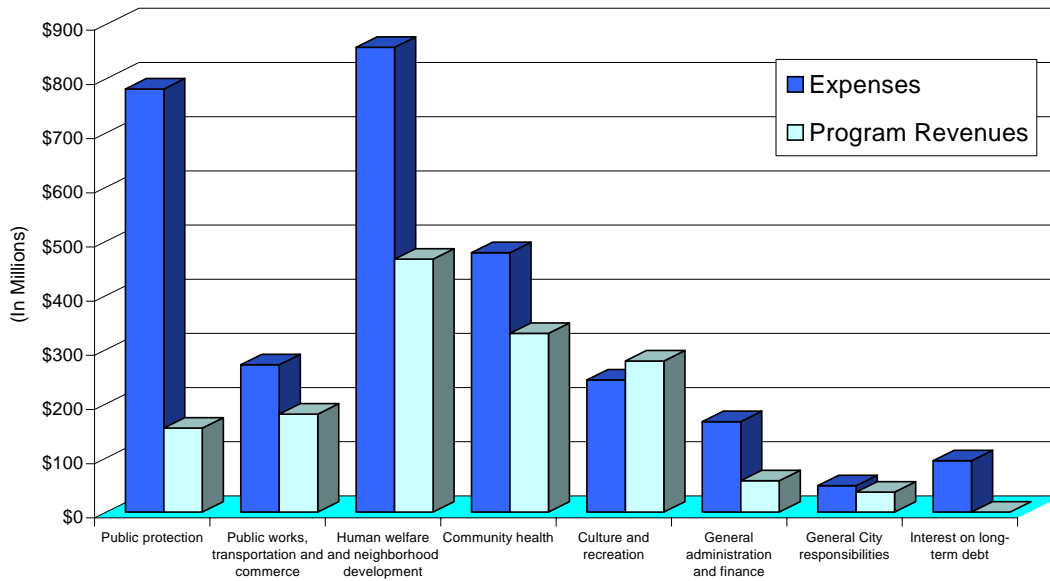
**Changes in Net Assets**  
**Year Ended June 30, 2006 (in thousands)**

	Governmental activities		Business-type activities		Total	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
<b>Revenues</b>						
Program revenues:						
Charges for services.....	\$ 399,265	\$ 351,029	\$ 1,714,488	\$ 1,683,830	\$ 2,113,753	\$ 2,034,859
Operating grants and contributions.....	859,919	834,607	188,672	180,807	1,048,591	1,015,414
Capital grants and contributions.....	248,329	55,435	110,403	93,724	358,732	149,159
General revenues:						
Property taxes.....	1,016,220	920,314	-	-	1,016,220	920,314
Business taxes.....	323,153	292,763	-	-	323,153	292,763
Other local taxes.....	595,664	538,085	-	-	595,664	538,085
Interest and investment income.....	71,129	29,490	53,161	33,268	124,290	62,758
Other.....	56,022	47,153	272,873	237,102	328,895	284,255
Total revenues.....	<u>3,569,701</u>	<u>3,068,876</u>	<u>2,339,597</u>	<u>2,228,731</u>	<u>5,909,298</u>	<u>5,297,607</u>
<b>Expenses</b>						
Public protection.....	780,642	738,688	-	-	780,642	738,688
Public works, transportation and commerce.....	272,397	213,335	-	-	272,397	213,335
Human welfare and neighborhood development.....	858,396	619,753	-	-	858,396	619,753
Community health.....	478,844	503,259	-	-	478,844	503,259
Culture and recreation.....	244,423	256,336	-	-	244,423	256,336
General administration and finance.....	167,490	152,850	-	-	167,490	152,850
General City responsibilities.....	49,054	59,024	-	-	49,054	59,024
Unallocated Interest on long-term debt.....	94,923	89,690	-	-	94,923	89,690
Airport.....	-	-	633,102	628,445	633,102	628,445
Transportation.....	-	-	695,593	711,733	695,593	711,733
Port.....	-	-	55,329	54,897	55,329	54,897
Water.....	-	-	213,584	197,848	213,584	197,848
Power.....	-	-	119,146	116,683	119,146	116,683
Hospitals.....	-	-	646,149	598,160	646,149	598,160
Sewer.....	-	-	160,701	160,650	160,701	160,650
Market.....	-	-	1,035	1,055	1,035	1,055
Total expenses.....	<u>2,946,169</u>	<u>2,632,935</u>	<u>2,524,639</u>	<u>2,469,471</u>	<u>5,470,808</u>	<u>5,102,406</u>
Increase/(decrease) in net assets before special items and transfers.	623,532	435,941	(185,042)	(240,740)	438,490	195,201
Special items.....	-	-	-	(46,358)	-	(46,358)
Transfers.....	(329,996)	(241,600)	329,996	241,600	-	-
Change in net assets.....	293,536	194,341	144,954	(45,498)	438,490	148,843
Net assets at beginning 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>
Net assets at end of year.....	<u>\$ 1,794,618</u>	<u>\$ 1,501,082</u>	<u>\$ 4,412,433</u>	<u>\$ 4,267,479</u>	<u>\$ 6,207,051</u>	<u>\$ 5,768,561</u>

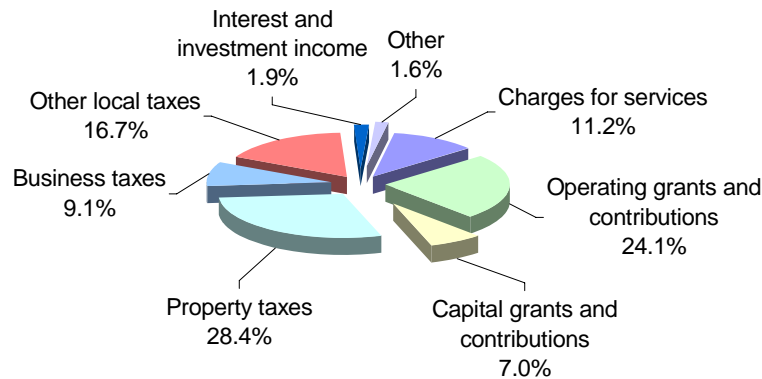
**Analysis of Changes in Net Assets**

The City's net assets overall increased by \$438.5 million during fiscal year 2005-2006, compared to a \$148.8 million increase last fiscal year. The governmental activities component of this change was a \$293.5 million increase, a significant improvement from the prior year's increase of \$194.3 million. The City's business-type activities' increase of \$145.0 million was a \$190.5 million improvement from the prior year's decrease of \$45.5 million. This significant increase was due largely to positive net asset growth at the Airport, MTA, Hetch Hetchy, Wastewater, and Laguna Honda Hospital. A discussion of the changes in both governmental and business-type activities is presented on the following pages.

### Expenses and Program Revenues - Governmental Activities



### Revenues By Source - Governmental Activities



**Governmental activities.** Governmental activities increased the City's total net assets by \$293.5 million during fiscal year 2005-2006, compared to a \$194.3 million during fiscal year 2004-2005. Key factors contributing to this year's increase are as follows:

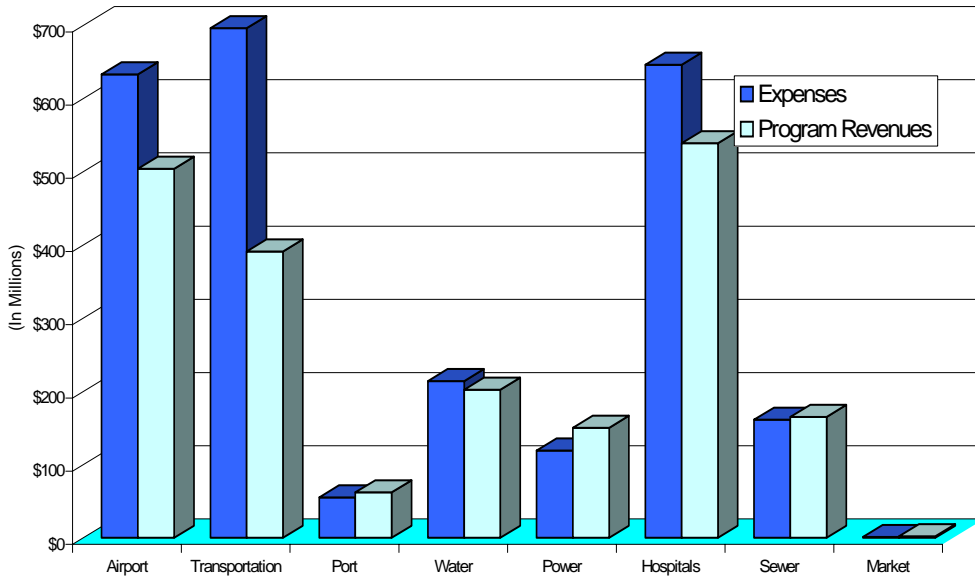
- Overall, governmental activities' revenue increased by approximately \$500.8 million, expenses increased by \$313.2 million, and net transfers increased by \$88.4 million. This resulted in a net asset increase of \$293.5 million for governmental activities at the end of fiscal year 2005-2006. The capital contribution for the City's new de Young Museum accounted for slightly more than \$202 million of the revenue increase. This amount was almost offset by recognition of an increase of \$218 million in loan allowances due to a change in accounting policy for the City's Low Income Housing program. Combined, the reporting of these two reporting events resulted in only a slight change in net assets in governmental activities.



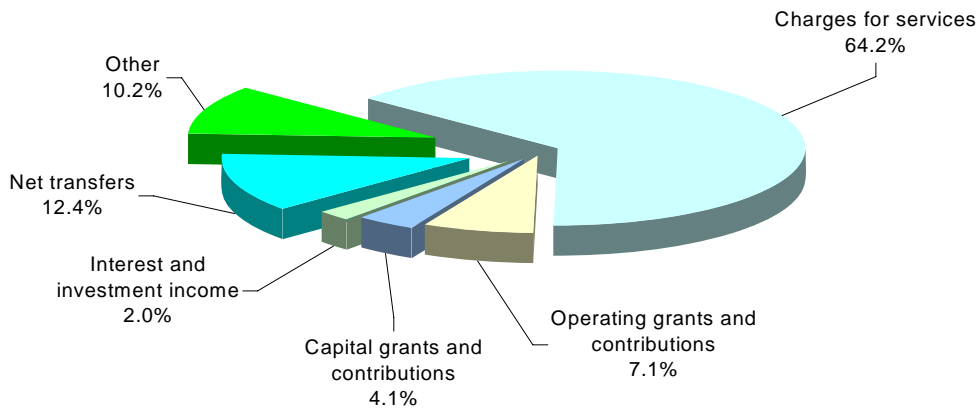
- Property tax revenue increased significantly by \$95.9 million or 10.4 percent during this fiscal year. Most of this growth, \$73.3 million, stems from increasing assessment values and lower assessment appeals activity in an improving real estate market. Much of the remaining increase, \$17.6 million, is related to State revenue shifts to local governments. For the City, this increase to property tax revenue had corresponding reductions to sales tax revenue (\$10.2 million) and Vehicle License Fee revenue (\$7.4 million). The remaining \$5.0 million in growth represents taxes for voter-approved General Obligation debt.
- Business tax revenue increased \$30.4 million or 10.4 percent, due largely to wage growth as well as moderate employment growth. San Francisco had 6,300 more jobs in calendar year 2005 as compared to calendar year 2004, representing an annual growth in jobs of 1.2 percent.
- Revenues from other local taxes, which includes real property transfer tax, hotel, sales, utility users and parking tax, had growth of \$57.6 million or 10.7 percent. The economic recovery brought increased hotel occupancy and average daily room rates in the City, increased transfer tax revenues associated with increased property sales activity, improved sales and utility user tax collections as well as increased parking tax collections due to parking rate increases and economic recovery. The largest components of growth were hotel tax (up \$21.6 million or 13.6 percent), real property transfer tax (up \$14.5 million or 12.4 percent), local sales tax (up \$8.4 million or 8.9 percent), utility user tax (up \$3.9 million or 5.3 percent), and parking tax (up \$3.1 million or 9.3 percent).
- Interest and investment income improved by about \$41.6 million, or 141 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 2.3 percent to 4.2 percent. In general, these returns reflect the City's concentration of investments in Treasury Bills and Notes and other short-term investments combined with increasing interest rates from the Federal Reserve. At the fiscal year end, deposits and investments for governmental activities with the City Treasury were \$1,511.9 million, a 22.0 percent increase over the previous year.
- The Capital contributions revenue significant increase of \$192.9 million is primarily due to recognition of the City's newly rebuilt de Young Museum (\$202.0 million less a decrease in capital grants of \$9.1 million). This premier art museum opened early in 2005-2006 and was constructed with private funding through an independent non-profit corporation. The decrease of \$9.1 million is largely due to decreases in federal grants for public protection, including homeland security funds.
- In 2005-2006 there was also a change in accounting policy regarding the reporting of long-term loan debt allowance expense for the City's Low Income Housing Program. The resulting increase in the allowance was \$218 million and is included in human welfare and neighborhood development expenses. This amount almost offsets the increase in capital contributions, noted above.
- Net transfers to business-type activities were \$330.0 million in fiscal year 2005-2006, a net \$88.4 million increase from the end of fiscal year 2004-2005. These transfers included a net increase of \$52.3 to Laguna Honda Hospital related to support for re-construction of the hospital, a \$65.6 million net increase to San Francisco General Hospital Medical Center related to the restructuring of local match requirements for State health funding, a decrease of \$20.5 million to MTA resulting from a decrease in funding for transportation projects, a net decrease of \$6.4 million in Airport transfers, and a \$2.6 million dollar decrease in other transfers.

The charts shown previously illustrate the City's governmental expenses and revenues by function, and its revenues by source. As shown, human welfare and neighborhood development is the largest function in expense (29.1 percent), followed by public protection (26.5 percent), and community health (16.3 percent). General revenues such as property, business, and sales taxes are not shown by program, but are used to support program activities citywide. For governmental activities, property taxes were the largest single source of funds (28.4 percent) in fiscal year 2005-2006, as compared to 30.0 percent in fiscal year 2004-2005. In addition, operating grants and contributions were the second largest source of funds (24.1 percent) in fiscal year 2005-2006 down from 27.3 percent in fiscal year 2004-2005. The ratios for other revenue categories shifted only slightly since the prior fiscal year and were as follows for fiscal year 2005-2006; business taxes (9.1 percent), other local taxes (16.7 percent), and charges for services (11.2 percent). The slight decrease in some ratios is partly due to the increase in capital contributions this year which was previously discussed.

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



**Revenues By Source - Business-type Activities**



**Business-type activities.** Business-type activities increased the City's net assets by \$145.0 million. A significant increase from the prior year decrease of \$45.5 million. Key factors of this improvement are:

- The Municipal Transportation Agency (MTA) had net assets of \$1.8 billion at June 30, 2006, an increase of approximately \$53.0 million over the prior fiscal year. The total net assets include \$1.76 billion (98 percent) for MUNI, the City's municipal railway. The remainder represents the combined net assets of the Department of Parking and Traffic and the Parking Authority. Between the end of fiscal year 2004-2005 and 2005-2006, MUNI's net assets increased by approximately \$40.8 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. MUNI's total operating revenues of \$141 million were \$13.7 million higher for fiscal year 2005-2006 over the prior year. Non-operating revenues increased about 8.8 percent, or \$20.1 million, to \$249.8 during this same period. This increase was primarily due to increases in parking fines revenues and state operating grants. The City's General Fund subsidy to the MTA for 2005-2006 totaled \$161.8 million including \$118.4 to MUNI and \$43.4 million for the Department of Parking and Traffic, slightly more than the fiscal 2004-2005 amounts of \$101.7 million and \$36.1 million, respectively.
- Laguna Honda Hospital, the City's long term care hospital, had an increase to net assets of \$68.2 million. This increase included \$49.6 million in transfers from the non-major governmental funds which account for the Laguna Honda Hospital General Obligation Bond proceeds and capital project activity. In addition, the hospital received a \$39.9 million transfer from the City's General Fund and \$1.2 million from the San Francisco General Hospital Medical Center. This \$90.7 million of inflow was offset by approximately \$22.5 million in operating and non-operating losses, compared to last year's loss of \$20.7 million.
- Hetch Hetchy, which operates the City's water storage and power generating facilities in the Sierra Nevada Mountains, increased total net assets by 11.2 percent or \$41.6 million for fiscal year 2005-2006. Approximately \$29.0 million of this increase is seen in increases to cash deposits and \$9.0 million in current receivables. The latter includes a \$4.8 million increase in a settlement receivable from litigation with Pacific Gas & Electric. Hetch Hetchy's net asset increase for fiscal year 2005-2006 was approximately \$19.1 million more than the \$22.5 million increase for fiscal year 2004-2005. Power sales increased \$18.0 million to \$139.6 during the current fiscal year and other operating revenues increased by \$4.0 million to \$7.7 million. For the current year, there was a small increase in total expenses, \$2.4 million, due primarily to general administrative costs.
- The Water Department's net assets were \$433.1 million at the end of fiscal year 2005-2006, essentially equal to the prior fiscal year. Since 2003, the department has been working on a massive capital project to rebuild the water system, a multi-billion dollar, ten-year program approved by the voters in November 2002. Related to this work, the Water Department's total assets and total liabilities each increased by about \$429.2 million at the end of this fiscal year. These increases were due mostly to cash proceeds from revenue bond sales and the associated liability. Operationally, the department saw an improvement of approximately \$6.5 million at the end of fiscal year 2005-2006 compared to the prior fiscal year. This effectively offset a decrease to net assets by the same amount at the end fiscal year 2004-2005. A \$15.7 million increase in revenue from water sales, primarily to retail customers, contributed to this positive change. There was also a \$6.6 million increase in interest and investment income due largely to higher average daily balances and increasing interest rates. On the expense side, operating expenses increased by \$10.5 million and interest expense rose by \$5.3 million, a 24.6% increase due to interest expense on bonds payable.

- The Airport's net assets decreased by \$42.7 million, or 11.9 percent, at the end of fiscal year 2005-2006. Operating revenues decreased by a total of \$22.0 million due primarily to a \$39.6 million decline in aviation revenues offset by a \$17.6 million increase in parking, transportation, concession, and rental revenues which included the reinstatement of the duty free minimum rent agreements. The Airport's operating expenses rose close to \$13.8 million. This change included increases in personnel and contractual services (\$16 million), repairs and maintenance and environmental cleanup (\$3 million), offset by a decrease in repairs and maintenance costs (\$5 million). The transfer from the Airport to the City's General Fund was \$21.5 million for fiscal year 2005-2006, an increase of \$1.8 million increase over 2004-2005.

As shown in the previous charts, 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 2005-2006. The City's long-term and acute care hospitals together also had total expenses of \$646 million. Together, these four enterprises make up over 78 percent of the total expenses for business-type activities. As in prior years, charges for services provided the largest share of revenues, 64.2 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 fund 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 \$1.32 billion, an increase of \$247.3 million over the end of the prior year. The increase is due to revenue sources increasing at a faster rate than expenditures, consistent with the City's improving economy.

A total of \$190.2 million of the 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 support for: (1) a General Fund "rainy day" reserve (\$122.0 million), (2) encumbrances for existing contracts and purchase orders (\$461.3 million), (3) funds continued for programs or projects in future fiscal years (\$453.8 million), (3) pay debt service (\$57.4 million), and (4) for a limited number of other purposes (\$30.9 million).

The General Fund is the chief operating fund of the City and had an unreserved fund balance of \$139.0 million at the end of fiscal year 2005-2006, a \$4.8 million increase over the fiscal year 2004-2005 unreserved fund balance of \$134.2 million. The General Fund's total fund balance was \$461.3 for fiscal year 2005-2006, a 50 percent improvement over the prior year balance of \$307.7 million. This increase was mainly due to a general increase in revenues from property, business, other local taxes and charges for services, coupled with only a moderate increase in expenditures. Overall for the fiscal year ended June 30, 2006, the General Fund's revenues exceeding expenditures by \$506.0 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 fiscal year 2005-2006, the unreserved fund balance of \$139.0 million represents 7.1 percent of total General Fund expenditures of \$1.97 billion, and the total fund balance represents approximately 23.4 percent of that amount. For the prior fiscal year, 2004-2005, the General Fund's unreserved fund balance of \$134.2 million was 6.9 percent of the total expenditures of \$1.94 billion, and the total fund balance represented approximately 15.8 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 2005-2006, the unrestricted net assets for the Airport were \$280.2 million, the Water Department 78.2 million, Hetch Hetchy \$142.0 million, Wastewater \$58.2 million, the Port \$34.5 million, San Francisco General Hospital Medical Center \$0.8 million, and the San Francisco Market Corporation \$3.1 million. Two proprietary funds had a deficit in unrestricted net assets: the Municipal Transportation Agency had a deficit of \$44.8 million; and Laguna Honda Hospital \$15.7

million. The internal service funds that are used to account for certain governmental activities also had a deficit in unrestricted net assets of \$5.5 million.

The total increase in net assets for the enterprise funds was \$145.0 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.....	\$ 455,342	\$ 432,811	\$ 22,531	\$ (92,234)	\$ 48,544	\$ (21,513)	(42,672)
Water.....	201,833	186,934	14,899	(14,250)	-	(602)	47
Hetch Hetchy.....	149,500	119,146	30,354	11,299	-	-	41,653
Municipal Transportation Agency.....	210,692	691,100	(480,408)	275,138	58,399	199,850	52,979
General Hospital.....	341,035	473,991	(132,956)	73,973	-	61,551	2,568
Wastewater Enterprise.....	164,703	140,954	23,749	(12,439)	-	-	11,310
Port.....	58,588	54,429	4,159	2,726	3,460	-	10,345
Laguna Honda Hospital.....	131,292	170,035	(38,743)	16,215	-	90,710	68,182
Market Corporation.....	1,503	1,035	468	74	-	-	542
Total.....	\$ 1,714,488	\$ 2,270,435	\$ (555,947)	\$ 260,502	\$ 110,403	\$ 329,996	\$ 144,954

### **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 2005-2006, the net assets of the Retirement System and Health Service System totaled \$14.54 billion, representing an increase of \$1.36 billion in total net assets since June 30, 2005. This 10.3 percent increase is primarily due to a third year of improved performance of the Retirement Trust's investments. The Investment Trust Fund's net assets totaled \$547.4 million, an increase in net assets of \$227.0 million or 70.8 percent since June 30, 2005 due to the increase in additions 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 2005-2006, the City approved \$64.0 million in General Fund supplemental appropriations for various departments primarily for capital projects including affordable housing, street resurfacing and recreation facilities.

During the year, actual revenues and other resources were \$133.0 million more than budgeted. While the City realized \$208.2 million more revenue than budgeted for property taxes, business taxes, other local taxes, franchises, interest and investment income, these increases were partially offset by \$50.9 million less in transfer funding primarily related to the State's restructuring of public health funding for indigent care along with other key variances of, \$11.1 million less in federal and \$9.2 million in state subvention revenues (though these shortfalls were more than offset by savings in social service costs), \$7.9 million less in general government service charges due to lower internal

service cost recoveries, and \$5.4 million less in other revenues due to postponed property sales. All budgetary revenue is shown on page 31.

Differences between the final budget and the actual (budgetary basis) expenditures resulted in \$148.2 million in appropriation savings. This is primarily due to the following factors:

- A savings of \$76.5 million in the Department of Public Health, due largely to \$50.5 million in savings related to the State's restructuring of public health funding for indigent care wherein counties were no longer required to send the State matching funds as well as \$26.0 million in operating cost savings.
- A savings of \$24.1 million in the Human Services Agency, due largely to lower program costs related to CalWORKS Childcare and Aid, Medi-Cal Eligibility, County Adult Assistance Programs (CAAP), In-Home Supportive Services and related operations costs. These savings are partly offset by shortfalls in federal and state social service funding.
- A savings of \$20.2 million in transfers to other funds because higher hospital revenues and cost savings resulted in lower required subsidy transfers for San Francisco General Hospital Medical Center and Laguna Honda Hospital.
- A close-out savings of \$22.7 million in budgetary reserves and designations largely due to unspent General Reserve savings not used for supplemental appropriation or other contingencies during fiscal year 2005-2006.

As a result of the strong revenue growth, the City made record deposits into the Rainy Day Reserves during fiscal year 2005-2006, including an additional \$49.8 million into the Economic Stabilization Account and an additional \$24.9 million into the One-Time Spending Account. Combined these two Rainy Day Reserve accounts totaled \$122.0 million by fiscal year end 2005-2006.

The net effect of the strong revenue growth, expenditure savings and record deposits into the Rainy Day Reserve accounts was a positive budgetary fund balance available for subsequent year appropriation of \$145.6 million at the end of fiscal year 2005-2006. The City's fiscal year 2006-2007 Adopted Original Budget assumed an available balance of \$99.5 million, so an additional \$46.1 million remains available. (See also Note 4 to the Basic Financial Statements for additional fund balance reserve details.)

## **Capital Assets and Debt Administration**

### **Capital Assets**

The City's capital assets for its governmental and business type activities as of June 30, 2006, increased by \$414.4 million, 3.8 percent, to \$11.2 billion (net of accumulated depreciation). Capital assets include land, buildings and improvements, machinery and equipment, park facilities, roads, streets, and bridges. Governmental activities contributed \$303.2 million or 2.8 percent to this total while \$111.2 million or one percent was from business-type activities. 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>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
	Land.....	\$ 143,640	\$ 143,640	\$ 194,783	\$ 193,781	\$ 338,423
Facilities and Improvement...	1,884,952	1,704,266	5,974,331	6,081,285	7,859,283	7,785,551
Machinery and equipment....	44,246	46,021	799,846	847,935	844,092	893,956
Infrastructure.....	240,601	185,223	464,477	485,043	705,078	670,266
Property held under lease....	536	536	2,607	2,667	3,143	3,203
Easements.....	-	-	79,358	85,534	79,358	85,534
Construction in progress.....	360,887	292,040	1,013,652	721,568	1,374,539	1,013,608
<b>Total.....</b>	<b>\$ 2,674,862</b>	<b>\$ 2,371,726</b>	<b>\$ 8,529,054</b>	<b>\$ 8,417,813</b>	<b>\$ 11,203,916</b>	<b>\$ 10,789,539</b>

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

- Under governmental activities, approximately \$202 million of \$303 million net increase was due to a capital contribution of the newly re-built de Young Museum, part of the Fine Arts Museums of San Francisco, discussed earlier under the analysis of net assets. The remaining \$101 million increase was mainly due to construction-in-progress work at various park and recreational sites, branch libraries, as well as various street improvement and traffic signal upgrades, and work at Juvenile Hall and the San Bruno Jail.
- The Water Department's net capital assets increased by \$95.6 million. Close to 81.4 percent of this, or \$77.8 million, reflects the net increase in construction-in-progress on the department's ten-year water system improvement project. This change includes a \$136.8 million increase in construction projects offset by \$46.6 million in transfers to facilities and improvements, \$6.7 million transfers to equipment, and \$5.7 million expensed for projects not continued. The increase included water main replacements at various locations, progress on the Lincoln Way Transmission Line and the Sunset Upgrade Project. The remaining net increase of \$17.8 million reflects the increase to facilities, improvements and equipment less increase to depreciation.
- MUNI had a \$90 million increase to construction-in-progress. This was largely due to \$57.4 million in continued work on the Third Street Light Rail, a major expansion of the transportation system in the City's southeast neighborhoods, as well as \$24.6 million in work on Trolley Overhead reconstruction, New Central Subway, Bayshore and Geary Corridor and other system projects.
- Laguna Honda Hospital's net capital assets increased by \$65.8 million due almost entirely to construction-in-progress on the capital project to rebuild the hospital. This work is partially funded by the Laguna Honda General Obligation Bonds.
- The Port's net capital assets increased about 7.0 percent, or \$17.2 million. This increase included completion of security projects at the Port's cruise, ferry and cargo facilities' completion of the Ferry Terminal Public Pier, improvements to parking lots and progress on the Illinois Street Intermodal Bridge.
- Hetch Hetchy increased net capital assets by \$3.1 million or 1.1 percent. This included the completion of a \$3.7 million project to improve electrical reliability in San Francisco and a \$3.1 million project to replace turbine generators.



- The Airport reported a decrease in net capital assets of \$83.3 million or 2.2 percent 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.

At the end of the year, the City's business type activities had approximately \$346.6 million in commitments for various capital projects. Of this, MTA had approximately \$150.0 million, Water Department had \$84.6 million, Hetch Hetchy had \$17.3 million, Wastewater had \$39.1 million, Port had \$6.3 million, Laguna Honda Hospital had \$8.6 million and the Airport had \$40.7 million. In addition, there was approximately \$345.0 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 \$7.8 billion. Of this amount, \$1.23 billion is general obligation bonds backed by the full faith and credit of the City and \$6.5 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 paper and capital leases increased by \$473 million during fiscal year 2005-2006, 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 \$577.1 million in refunding bonds. Of this amount, the Airport issued \$467.0 million and the Water Department \$110.1 million in refunding revenue bonds. The City also issued general obligation bonds for the improvement of California Academy of Sciences for \$79.4 million, Steinhart Aquarium for \$29.2 million, Branch Libraries for \$34.0 million and Zoo Facilities for \$7.5 million, totaling \$150.1 million. In addition, the City issued \$69 million in general obligation bonds for the improvement of Laguna Honda Hospital, \$507.8 million in revenue bonds to improve the City's water system and to retire the commercial paper outstanding and \$19.6 million in lease revenue bonds to finance equipment through the San Francisco Finance Corporation.

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 \$114 billion in value as of the close of the fiscal year. As of June 30, 2006, the City had \$1.23 billion in authorized, outstanding property tax-supported general obligation bonds, which is equal to approximately 1.04 percent of gross (1.08 percent of net) taxable assessed value of property. As of June 30, 2006, there were an additional \$346.1 million in bonds that were authorized but unissued. If all of these general obligation bonds were issued and outstanding in full, the total

debt burden would be approximately 1.33 percent of gross (1.38 percent of net) taxable assessed value of property.

The City's underlying ratings on general obligation bonds as of June 30, 2006 were:

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

During the fiscal year, Moody's Investors Service, Inc and Standard & Poor's affirmed their ratings with a stable outlook. Fitch Ratings affirmed its ratings and revised the outlook from stable to positive on the City's outstanding bonds.

The City's enterprise activities maintained their underlying debt ratings this fiscal year. SFO'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. With municipal bond insurance purchased for revenue bond issues, Moody's Investor Service, Poor's and Fitch have assigned SFO the ratings of "Aaa", "AAA", and "AAA" respectively. The Water Department carried underlying ratings of A1 and A+ from Moody's Investor Service and Standard & Poor's, respectively, based on Municipal Bond Insurance Policies issued by MBIA and FSA, respectively.

Since the close of fiscal year 2005-2006, the City has issued \$206.0 in refunding bonds. Of this amount, the Water Department issued \$48.7 million in revenue refunding bonds, and the City issued \$157.3 million in general obligation refunding bonds.

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's unemployment rate has continued to improve. After peaking at 7.0 percent during calendar year 2002, the unemployment rate stood at 4.6 percent, as of June 2006 compared to 5.3 percent in June 2005. The recent improvement in unemployment is mainly attributed to job growth in San Francisco and the Bay Area generally.
- The San Francisco metro area (including Marin and San Mateo counties) experienced jobs growth of 1.3 percent or 12,500 jobs from June 2005 through June 2006. The largest gains in employment were in the service sector including professional, technical and scientific services, leisure and hospitality services, administrative and support services, and government services. For San Francisco County, jobs grew by 1.2 percent or 6,300 in calendar year 2005 (the most recent period for which county-level data is available).
- San Francisco's commercial real estate sector continued to rebound over the prior year, leading to occupancy gains, and increases in rental rates and commercial building sales. As of the third quarter of 2006, San Francisco had seen 13 consecutive quarters when more space was being rented than new space was becoming available for rent. This positive trend resulted in increasing asking rental rates. As of the third quarter of 2006, the average direct asking rental rates were \$33.60 per square foot – a 23 percent increase compared to the end of 2004. The overall vacancy rate was 13.3 percent in the third quarter of 2006 – a significant improvement from the historic high of almost 23 percent in the second quarter of 2003.
- The continuing gradual economic recovery is favorably impacting local tax revenue growth, including property, real property transfer, business, hotel room, sales, payroll, and parking

taxes. This growth has helped to balance the City's budget in recent years, ensuring the continued ability to fund ongoing services and capital improvements.

- San Francisco faced a projected General Fund shortfall of \$12.5 million at the beginning of fiscal year 2006-2007 - a shortfall significantly lower than previous years. This improvement was largely attributable to the economic rebound, resulting in increasing revenues as well as continued control over expenditure growth. These factors combined with the use of one-time sources, including the use of fund balance and prior year reserves, meant that the City was able to avoid making reductions in public safety, health and human services, and many other critical programs in the 2006-2007 budget year.

## 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, The Embarcadero  
San Francisco, CA 94111

San Francisco Water Department  
Hetch Hetchy Water and Power  
San Francisco Wastewater Enterprise  
Director of Accounting Financial Services  
1155 Market Street, 4th 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  
1 South Van Ness Avenue, 7<sup>th</sup> Floor  
San Francisco, CA 94103

Health Service System  
1145 Market Street, Suite 200  
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  
One South Van Ness Avenue, 5<sup>th</sup> Floor  
San Francisco, CA 94103

### Blended Component Units Financial Statements

San Francisco County Transportation Authority  
Deputy Director for Administration and Finance  
100 Van Ness Avenue, 26<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

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