

## 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, 2001. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal.

### FINANCIAL HIGHLIGHTS

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by \$5.59 billion (net assets). Of this amount, \$533.3 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 by \$565.6 million during the fiscal year.
- As of June 30, 2001, the City's governmental funds reported combined ending fund balances of \$1.49 billion. Approximately 19% of this total amount, \$277.2 million, is unreserved fund balance available for spending at the government's discretion.
- At the close of the current fiscal year, unreserved fund balance for the general fund was \$207.5 million or twelve percent of total general fund expenditures of \$1.8 billion.
- The City's total long-term debt increased by \$751.5 million (11 percent) during the current fiscal year. The key factors in this increase were issuances of \$137.2 million in certificates of participation for the San Bruno Jail Replacement Project, \$238.2 million in revenue bonds for the San Francisco Airport Improvement Project, and \$298.2 million in commercial paper by the City's enterprises including the Airport and Water Departments.
- Following the events of September 11, 2001, the City's revenues in hotel and sales tax showed significant drops from budget estimates. In addition, concession and other revenues received by the San Francisco International Airport have dropped due to new security measures and declining passenger numbers. These factors, combined with the overall slowdown in the information technology industries and in the general economy, have decreased both the unreserved fund balance and operating revenues available to the City in the fiscal year ending June 30, 2002. City management will monitor revenue streams and control expenditures and has already restricted expenditures to budget for a general fund revenue decrease of between \$60 and \$100 million over the fiscal year.

### 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.

#### 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 transit system, water and power operations, an acute care hospital, a long-term care hospital, sewer operations, and various parking facilities.

The government-wide financial statements include not only the City itself (known as the primary government), but also a legally separate redevelopment agency and a legally separate development authority for which the City is financially accountable. Financial information for these component units is reported separately from the financial information presented for the primary government itself. Included within the governmental activities of the government-wide financial statements are the operations of the San Francisco County Transportation Authority, San Francisco Finance Corporation, and 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 which 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 annual 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/Hetch Hetchy Project, Municipal Railway (Muni), Laguna Honda Hospital, General Hospital Medical Center, Clean Water Program (Clean Water), and various nonprofit parking facilities, 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, its management information systems, and its printing and mail services. 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 propriety 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 Financial Statements**

The notes to the 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**

The combining statements 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

This is the first year that the City has presented its financial statements under the new reporting model required by the Governmental Accounting Standards Board Statement No. 34 (GASB 34), Basic Financial Statements – and Management’s Discussion and Analysis (MD&A) – for State and Local Governments. Because this reporting model changes significantly both the recording and presentation of financial data, the City has not restated prior fiscal years for the purposes of providing comparative information for the MD&A. In future years when prior-year information is available a comparative analysis of government-wide data will be included in this report.

### Net Assets June 30, 2001 (in thousands)

	Governmental activities	Business-type activities	Total
<b>Assets:</b>			
Current and other assets.....	\$ 2,099,581	\$ 2,040,145	\$ 4,139,726
Capital assets.....	<u>1,821,115</u>	<u>7,782,633</u>	<u>9,603,748</u>
Total assets.....	<u>3,920,696</u>	<u>9,822,778</u>	<u>13,743,474</u>
<b>Liabilities:</b>			
Long-term liabilities outstanding...	1,844,956	4,725,413	6,570,369
Other liabilities.....	<u>617,410</u>	<u>970,662</u>	<u>1,588,072</u>
Total liabilities.....	<u>2,462,366</u>	<u>5,696,075</u>	<u>8,158,441</u>
<b>Net assets:</b>			
Invested in capital assets, net of related debt.....	779,698	2,970,198	3,749,896
Restricted.....	724,034	577,830	1,301,864
Unrestricted.....	<u>(45,402)</u>	<u>578,675</u>	<u>533,273</u>
Total net assets.....	<u>\$ 1,458,330</u>	<u>\$ 4,126,703</u>	<u>\$ 5,585,033</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 \$5.59 billion at the close of the current fiscal year.

The largest portion of the City’s net assets (67 percent) reflects its investment of \$3.75 billion 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.

An additional portion of the City’s net assets, \$1.30 billion (23 percent) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets, \$533.3 million (10 percent) may be used to meet the government’s ongoing obligations to citizens and creditors.

At the end of the current fiscal year, the City is able to report 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 \$45.4 million related in part to debt from general obligation bonds for the San Francisco Unified School district which is recorded with no corresponding assets.

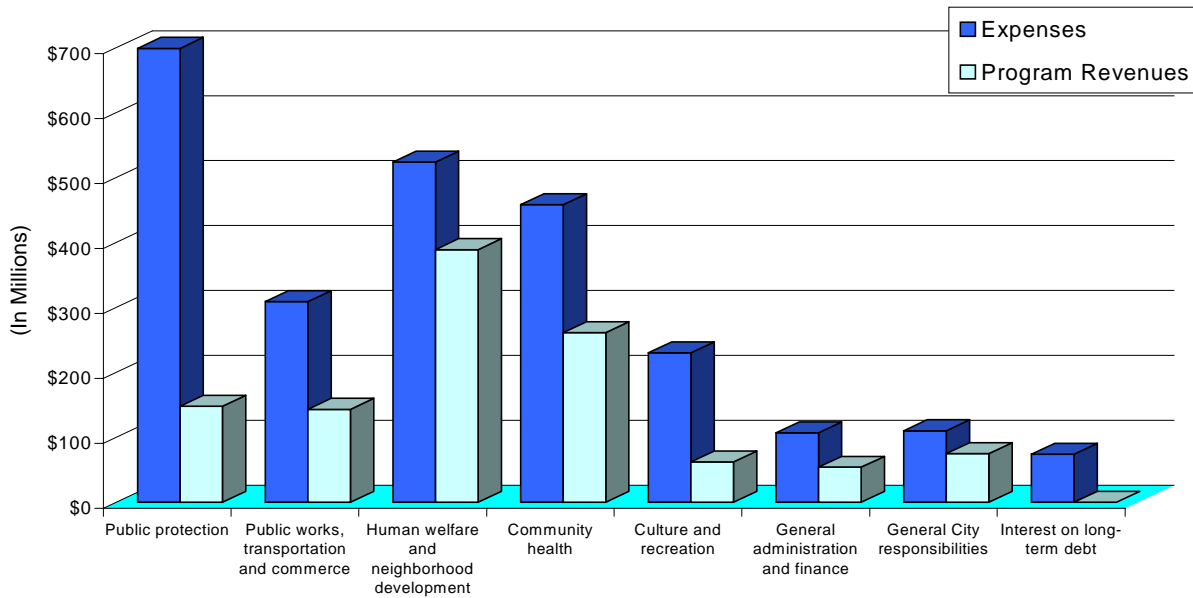
**Changes in Net Assets**  
**June 30, 2001 (in thousands)**

	<b>Governmental activities</b>	<b>Business-type activities</b>	<b>Total</b>
<b>Revenues</b>			
Program revenues:			
Charges for services.....	\$ 344,721	\$ 1,408,121	\$ 1,752,842
Operating grants and contributions.....	763,863	260,520	1,024,383
Capital grants and contributions.....	22,619	335,520	358,139
General revenues:			
Property taxes.....	628,846	-	628,846
Business taxes.....	277,822	-	277,822
Other local taxes.....	581,480	-	581,480
Interest and investment income.....	81,084	96,493	177,577
Other.....	115,695	28,779	144,474
Total revenues.....	<u>2,816,130</u>	<u>2,129,433</u>	<u>4,945,563</u>
<b>Expenses</b>			
Public protection.....	\$ 699,472	-	699,472
Public works, transportation and commerce.....	309,171	-	309,171
Human welfare and neighborhood development.....	523,827	-	523,827
Community health.....	457,500	-	457,500
Culture and recreation.....	229,721	-	229,721
General administration and finance.....	107,318	-	107,318
General City responsibilities.....	109,804	-	109,804
Unallocated Interest on long-term debt.....	73,588	-	73,588
Airport.....	-	529,002	529,002
Transit.....	-	468,753	468,753
Port.....	-	47,587	47,587
Water.....	-	145,858	145,858
Power.....	-	107,000	107,000
Hospitals.....	-	513,486	513,486
Sewer.....	-	149,687	149,687
Garage.....	-	34,155	34,155
Total expenses.....	<u>2,510,401</u>	<u>1,995,528</u>	<u>4,505,929</u>
Increase in net assets before special items and transfers.....	<u>305,729</u>	<u>133,905</u>	<u>439,634</u>
Special items.....	-	126,014	126,014
Transfers.....	<u>(102,154)</u>	<u>102,154</u>	<u>-</u>
Increase in net assets.....	203,575	362,073	565,648
Net assets at beginning of year.....	<u>1,254,755</u>	<u>3,764,630</u>	<u>5,019,385</u>
Net assets at end of year.....	<u>\$ 1,458,330</u>	<u>\$ 4,126,703</u>	<u>\$ 5,585,033</u>

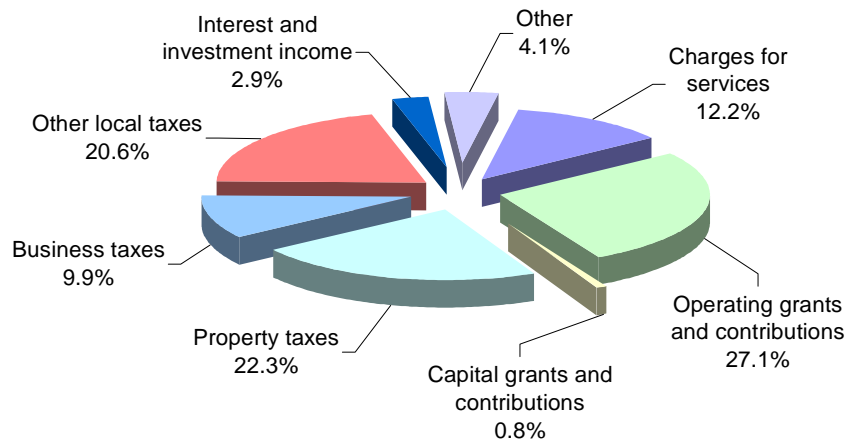
**Analysis of Changes in Net Assets**

The City's net assets overall increased by \$565.6 million during the current fiscal year. These increases are explained in the government and business-type activities discussion below, and are primarily a result of revenues increasing faster than ongoing expenses.

### Expenses and Program Revenues - Governmental Activities



### Revenues By Source - Governmental Activities



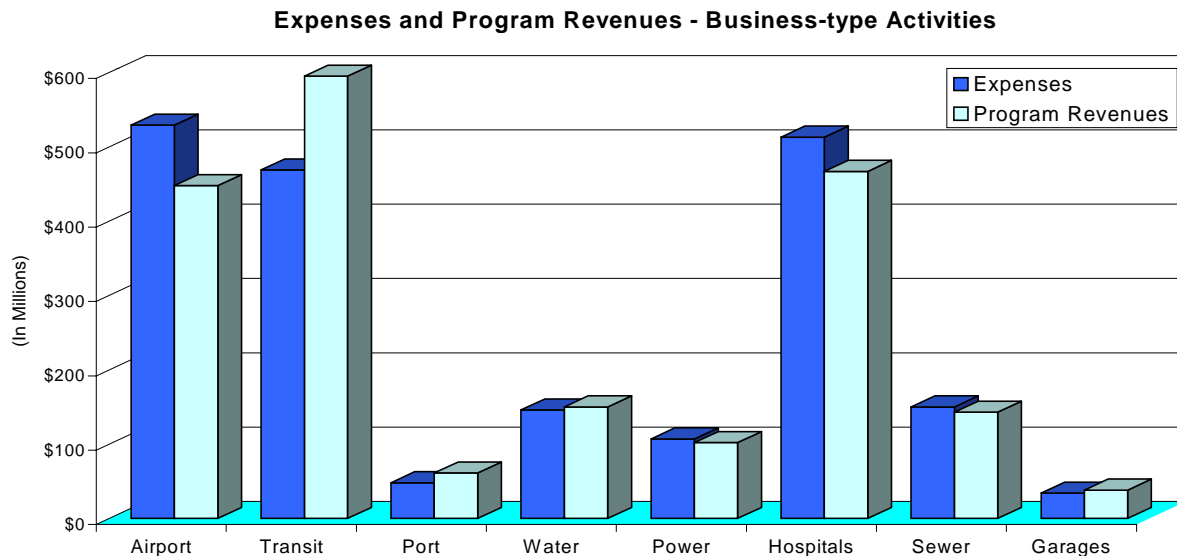
**Governmental activities.** Governmental activities increased the City's net assets by \$203.6 million, thereby accounting for 36 percent of the total growth in the net assets of the City. Key factors of this increase are as follows:

- Property tax revenues increased by approximately \$85 million or 16 percent during the year. Most of this increase is attributable to growth in the assessed value of property, and a decrease in the City's estimated assessment appeals reserve. In addition, the City is processing deeds more efficiently and thereby increasing supplemental property tax revenues.
- Other local taxes including sales, hotel and utility users taxes increased by approximately \$34 million or six percent during the year. The increases are a result of strong economic activity, continued high hotel occupancy rates during the first six months of the fiscal year, and significantly increased prices for electricity that occurred during some months of the fiscal year.

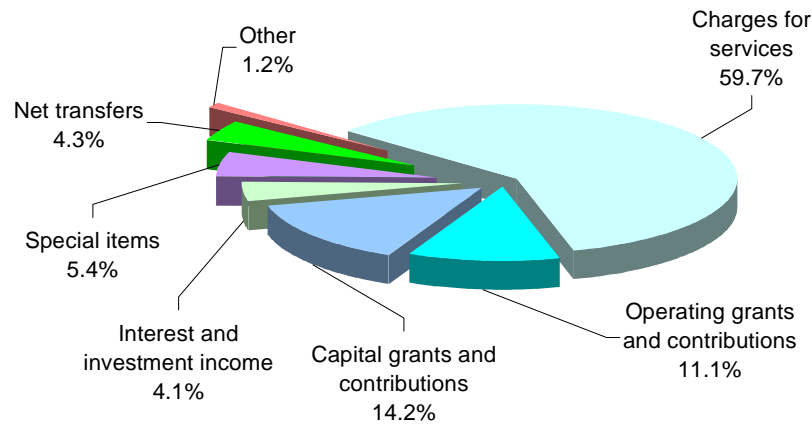
- Interest and investment income grew by approximately \$21 million or 34 percent during the year due to an increase in the average yield of City pooled investments from 5.84 percent to 6.06 percent. Growth in tax revenues also resulted in higher cash flows which allowed the City to invest and earn more interest and investment income.
- Grant and subvention revenue from state and federal sources increased by approximately three percent in the aggregate, largely related to increases of approximately \$30 million in grants for various programs received by the Department of Human Services and Department of Public Health, and to receipt of new state cigarette tax revenues received for early childhood programs through California Proposition 10.

For the most part, increases in expenses paralleled increases in the cost of living in the San Francisco Bay Area and growth in the demand for government services. One notable exception, however, is the City's creation of a reserve to settle litigation regarding the business tax, which accounts for an increase of \$18.8 million in expenses. In addition, the City's General Fund makes transfers each year to help finance the operations of two enterprises; San Francisco General Hospital and Laguna Honda Hospital. These transfers together totaled \$106 million in fiscal year 2001, an increase of 17 percent over the prior fiscal year. This change is a result of increases in the Hospital's proportion of uninsured patients, as well as the cost of health care delivery growing faster than reimbursements from insurers and other governments.

The charts above 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 (27.9 percent), followed by human welfare and neighborhood development (20.9 percent) and community health (18.2 percent). General revenues such as property, business, and sales taxes are not shown by program, but are effectively used to support program activities citywide. For governmental activities overall, without regard to program, operating grants and contributions are the largest single source of funds (27.1 percent), followed by property taxes (22.3 percent) and other local taxes (20.6 percent). As with the statement of net assets and the statement of activities, because the GASB No. 34 reporting model significantly changes the form of financial data, the City has not restated prior fiscal year revenue and expenditure information. Year to year comparisons will be included in future reports.



### Revenues By Source - Business-type Activities



**Business-type activities.** Business-type activities increased the City's net assets by \$362.1 million, accounting for 64 percent of the total growth in the City's net assets. Key factors of this increase are as follows:

- The Municipal Railway's net assets overall increased by \$223.2 million primarily due to the receipt of capital contributions. MUNI received \$291.1 million in capital contributions from various state, federal, and local funding sources for equipment and construction projects to improve transit services. New rolling stock was acquired including articulated buses, and there were increases in the value of construction in progress, primarily through the Third Street Light Rail Project. The capital contribution amount also includes \$25.7 million which was received from the San Francisco County Transportation Authority and paid out to the Port of San Francisco under a Memorandum of Understanding allowing MUNI to use Port property in perpetuity for the Metro East maintenance facility.
- The Water Department net assets increased by \$129 million, primarily due to a one-time gain on the sale of property of \$126 million. The Department sold approximately 500 acres of land in Alameda County.
- The Port's net assets increased by \$42.3 million primarily related to the recognition of a payment of \$25.7 million from the Municipal Railway for the right to use a 17 acre site of Port property for MUNI's Metro East maintenance and repair facility. The Port also received capital contributions related to construction work on the Downtown Ferry Terminal Project, and other projects.
- At the San Francisco International Airport, capital assets increased by approximately \$460 million (13 percent) largely due to projects associated with the Near Term Master Plan, and the ongoing Air Train System project to construct a transportation network between the terminals and parking facilities. The increase in capital assets was partially offset by additional depreciation expense of \$57.0 million.

As shown in the charts above, the largest of San Francisco's business-type activities, the San Francisco International Airport, and the City's two hospitals together, each had expenses in excess of \$500 million in fiscal year 2001, followed closely by transit (the Municipal Railway) with operating expenses of approximately \$468 million. For the fiscal year, revenues exceeded expenses in four areas of business activity—transit, port, water and power, and garages. For all of the business-type activities, fees provide the largest share of revenues (59.7 percent) followed by capital grants and contributions (14.2 percent), and operating grants (11.1 percent), which are primarily received by the Municipal Railway.



## **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 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 \$1.49 billion, an increase of \$309.3 million in comparison with the prior year. Approximately \$277.2 million of this total amount constitutes unreserved fund balance, which is available for spending at the City's discretion. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed, (1) to liquidate existing contracts and purchase orders (\$410.8 million), (2) to fund continued programs or projects in future fiscal periods (\$586 million), (3) to pay debt service (\$63.3 million), and (4) for a variety of other restricted purposes (\$155.1 million).

Revenues for governmental functions overall totaled approximately \$2.81 billion in the fiscal year ended June 30, 2001, which represents an increase of nine percent from the fiscal year ended June 30, 2000. Expenditures for governmental functions, totaling \$2.79 billion, increased by approximately ten percent from the fiscal year ended June 30, 2000. In the fiscal year ended June 30, 2001, revenues for governmental functions exceeded expenses by approximately \$20.5 million, or slightly less than one percent.

The general fund is the chief operating fund of the City. At the end of the current fiscal year, the unreserved fund balance of the general fund was \$207.5 million, while total fund balance was \$479.2 million. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 12 percent of total general fund expenditures of \$1.8 billion, while total fund balance represents 27 percent of that same amount.

The fund balance in the City's general fund increased by \$95.4 million during the fiscal year mainly due to continued growth in local revenues, especially property taxes, other local taxes including hotel, utility and parking taxes, and intergovernmental revenues, particularly state grants and subventions. As noted above, the City's general fund property tax collections increased by approximately 16 percent during the fiscal year related to growth in assessed values, reduced assessment appeals, and growth in supplemental property tax revenues. In addition, many general fund program expenses grew more slowly than projected. Overall, the general fund's performance resulted in revenues in excess of expenditures in the fiscal year ended June 30, 2001 of \$217.7 million, an increase of 33 percent over the comparable figure from the prior year of \$164 million.

### **Proprietary funds**

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

At the end of the fiscal year, the unrestricted net assets for the San Francisco International Airport were \$272.3 million, the Water Department/Hetch Hetchy Project \$216.6 million, the Clean Water Program \$20.9 million, the Port of San Francisco \$72.2 million, and the Parking Garages were \$62.9 million. Three proprietary funds had deficits in unrestricted net assets—the Municipal Railway fund had a deficit of \$42.7 million, and the San Francisco General Hospital and the Laguna Honda Hospital had deficits in unrestricted net assets of \$9.6 million and \$13.8 million respectively. The internal service funds which are used to account for certain governmental activities also had a deficit in unrestricted net assets of \$3.9 million.

The total growth in net assets for the proprietary funds was \$362.1 million. Factors concerning the finances of these funds have been addressed previously in the discussion of the City's business-type activities. In particular, the San Francisco International Airport's net assets decreased by \$57.4 million due to an increase in net bonded debt, the issuance of additional commercial paper, and decreased revenues.

### **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 2000-2001, the net assets of the Retirement System totaled \$11.2 billion, representing a decrease of \$1.7 billion in total net assets since June 30, 2000. The change is primarily related to decreases in the market value of the Retirement System's investments. The Investment Trust Fund's net assets totaled \$275.2 million, with an increase in net assets over the fiscal year of \$80.5 million, primarily resulting from increased contributions from external participants to 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 2001, significant supplemental appropriations were approved for the Sheriff and Fire departments to fund unanticipated overtime and other expenses (approximately \$2.9 million in each case), for a program to provide rental subsidies for non-profit arts organization (\$3 million), and to fund additional expenses for the Department of Elections related to the cost of new election technology and a run-off election (\$2.4 million).

Differences between the final budget and the actual (budgetary basis) resulted in a \$97.9 million decrease in total charges to appropriations. This is primarily due to the following factors:

- A decrease in expenditures by the Human Services Department of approximately \$31 million related to reduced need for aid payments and other costs under federal and state welfare programs. In particular, the City spent approximately \$25 million less than budgeted in direct aid, services such as employment training, and administrative costs under the CalWorks program. Expenses were also less than budgeted in the foster care and cash assistance to immigrants programs. However, these expense reductions are almost entirely offset by decreases in the subvention funds which San Francisco is able to claim under these programs.
- A decrease in expenditures by the Department of Public Health of approximately \$36.5 million, primarily associated with a reduction in the local match requirement for the SB 855 Medi-Cal disproportionate share program. This decrease is non-program related and does not result in service reductions.
- A decrease in expenditures of approximately \$2.4 million in the General City Responsibilities area resulting primarily from required debt service payments which were less than the budgeted level.
- The General Fund was able to reduce its transfers to other funds by \$3 million, stemming primarily from unanticipated state revenues which were received by San Francisco General Hospital and Laguna Honda Hospital, thus allowing for reduced subsidy transfers.
- Budgetary reserves of \$5.8 million for various programs and payments which had been anticipated and included in the revised budget were liquidated at the close of the fiscal year.

During the year, actual revenues and other resources exceeded budgetary estimates by \$101 million. The majority of this amount is attributable to local taxes—specifically the property, sales, hotel, and utility taxes where actual performance was greater than estimates. The City also started the fiscal year with an available fund balance approximately \$21 million greater than anticipated when the fiscal year 2001 final budget was

developed. The net effect of the under-utilization of appropriations and the receipt of actual revenues greater than estimates resulted in a positive budgetary fund balance of \$199 million.

In creating its budget for the fiscal year ended June 30, 2002, the City used a budgetary fund balance of \$148.7 million (see Note 4 to the 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, 2001, amount to \$9.6 billion (net of accumulated depreciation). Capital assets include land, buildings and improvements, machinery and equipment, park facilities, roads, streets, and bridges. The total increase in the City's capital assets for the current fiscal year was 10.33 percent (a 1.61 percent increase for governmental activities and a 8.72 percent increase for business-type activities) as shown in the table below.

Changes in Capital Assets , Net of Depreciation  
(in thousands)

	Governmental Activities		Business-type Activities		Total	
	2001	2000	2001	2000	2001	2000
Land.....	\$ 131,539	\$ 124,772	\$ 184,299	\$ 182,137	\$ 315,838	\$ 306,909
Facilities and Improvement...	1,214,496	1,226,524	5,316,447	4,842,297	6,530,943	6,068,821
Machinery and equipment.....	88,372	90,307	493,757	350,718	582,129	441,025
Infrastructure.....	-	-	454,899	473,662	454,899	473,662
Property held under lease.....	536	536	515	721	1,051	1,257
Easements.....	-	-	98,482	94,445	98,482	94,445
Construction in progress.....	386,172	238,999	1,234,234	1,079,585	1,620,406	1,318,584
Total.....	<u>\$ 1,821,115</u>	<u>\$ 1,681,138</u>	<u>\$ 7,782,633</u>	<u>\$ 7,023,565</u>	<u>\$ 9,603,748</u>	<u>\$ 8,704,703</u>

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

- The Airport incurred \$533 million in capital expenditures due primarily to completion of the Near Term Master Plan, opening of the new International Terminal in December 2000, and completion of ramps and elevated roadways for access to the new terminal from the highway.
- MUNI capital assets increased by \$219.9 million due to progress on the Third Street Light Rail Project, acquisition of 160 motor coaches and 25 light rail vehicles, renovation of Woods Division, and a stepped up rail replacement program.
- The Water Department sold approximately 500 acres of land in Alameda County resulting in a net gain of approximately \$126 million.
- Clean Water's capital expenditures included \$7.7 million to complete pump station and primary treatment upgrade projects at the Southeast Plant and to complete the Southeast Water Pollution Control Plan Anaerobic Digestion Facility.
- Hetch Hetchy capital expenditures included \$4.3 million to complete the Moccasin Sewer Replacement, San Joaquin Pipeline repairs, and the Grizzly Creek Canal upgrade.

- Governmental activities construction in progress increased by \$147.2 million due to progress on the Moscone Center Expansion, the Asian Art Museum, and various recreation and park, and public works improvement projects.

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 major net infrastructure assets are reported at the beginning of the year because the historical costs did not meet the threshold established in GASB 34. In fiscal year 2001, 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 financial statements.

### Debt Administration

At the end of the current fiscal year, the City had total long-term obligations outstanding of \$8.3 billion. Of this amount, \$953.5 million is general obligation bonds backed by the full faith and credit of the City and \$5.4 billion is revenue bonds, commercial paper, loans, and other obligations of the City's business enterprises. The remainder includes revenue bonds, certificates of participation, and other obligations of City parking garages, the Moscone Center, and other governmental activities.

During fiscal year 2001, the City's total bonded debt increased by approximately \$511.6 million. The key factors were the issuances of \$137.2 million for the San Bruno Jail Replacement Project, \$157.5 million for the Moscone Expansion Project, and \$238.2 million for the San Francisco Airport Improvement Project.

The ratio of net general obligation bonded debt to taxable valuation and the amount of bonded debt per capita are useful indicators of the City's debt position to management, citizens, and investors. A comparison of these indicators follows:

	FY 2001	FY 2000
Net General Bonded debt	\$941,926,000	\$909,857,000
Net General Bonded debt per capita	\$1,187.11	\$1,136.46
Ratio of net General Bonded debt to net assessed value	1.26%	1.40%
Debt service tax rate per \$100 taxable valuation	\$0.1348	\$0.1277

The City's Charter also imposes a limit on the amount of general obligation bonds the City can have outstanding at any given time. That limit is 3% of the assessed value of property in the City—currently about \$2.4 billion. As of June 30, 2001, the City had \$956.7 million in authorized, outstanding property tax-supported general obligation bonds. This amount is reduced by net assets in the General Obligation Bonds Fund of \$14.8 million for net tax supported bonded debt of \$941.9 million, which is equal to approximately 1.26% of the assessed value of property (net of exemptions). There are an additional \$969.5 million in bonds that are authorized but unissued. If all of these bonds were issued and outstanding, the total debt burden would be 2.55% of the assessed value of property (net of exemptions).

The City's ratings on uninsured general obligation bonds as of June 30, 2001 were:

Moody's Investors Service, Inc.	Aa3
Standard and Poor's Corporation	AA
Fitch IBCA, Inc.	AA

The City's enterprise activities have experienced some changes in debt ratings since June 30, 2001. On July 9, 2001, the Water Department's underlying rating on outstanding debt was downgraded by Standard & Poor's from AA- negative outlook to A+ stable outlook, affecting approximately \$233 million of uninsured Water Department debt. Following the events of September 11<sup>th</sup>, Standard & Poor's placed all its North American airport and airport-related facilities, including the San Francisco International Airport, on CreditWatch with negative implications. Moody's Investors Service affirmed its A1 rating for the Airport, but revised the outlook from developing to negative, and Fitch IBCA, Inc. affirmed its AA- rating for the Airport, but revised the outlook from evolving to negative.

In October 2001, related to the events of September 11, and to the expansion of the state budget deficit, a negative outlook was placed on the debt ratings of most California counties. All counties in the state except San Francisco were affected by this action. The City's higher proportion of discretionary revenues, its demonstrated willingness to control spending in response to current economic conditions, and its relatively conservative 2002 budget were credited with San Francisco's retaining a stable outlook on its debt.

Since the close of the 2001 fiscal year, the City has issued additional debt of \$488.5 million in Airport Revenue bonds, \$50.8 million of subordinated commercial paper notes, \$140 million of Water Revenue bonds, \$60.8 million in Settlement Obligation Bonds for business tax obligations related to litigation against the City, \$17.7 million in General Obligation bonds to finance improvements and construction of branch library facilities, and \$52.7 million in Certificates of Participation and Refunding Certificates of Participation related to the financing of City office buildings.

Additional information in the City's long-term debt can be found in Note 8 to the financial statements.

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

- During the current fiscal year, the City appropriated \$148.7 million out of \$199 in available fund balance in the General Fund for spending in fiscal year 2002. It is intended that this use of fund balance will avoid the need to raise fees or charges during fiscal year 2002.
- The City currently faces a less favorable economic environment resulting from the decline in the technology industries. San Francisco's unemployment rate has almost doubled from its low point of 2.9 percent in 2000 to approximately 5.4 percent by the end of June 2001 and 6.1 percent as of November 2001.
- While the City showed a preliminary increase in real property assessments as of January 1, 2001 by approximately 12 percent, slower property tax growth is nonetheless budgeted in fiscal year 2002.
- Sales tax revenue, with slower growth already experienced related to the economic downturn generally and layoffs of information technology workers particularly, has been somewhat aggravated by the September 11 tragedy. The City has restricted departmental spending to budget for this and other reductions in local revenue sources.
- Hotel Room Tax revenue has grown at an average rate of 7.2 percent over the last 15 years. As with sales tax, the economic downturn which began in April of the last fiscal year, coupled with the effect of September 11 events on the tourist market, has resulted in a significant drop in hotel tax revenues. During the first six months of fiscal year 2002, hotel tax revenues have decreased by approximately 25 percent compared to the same period in fiscal year 2001.
- Revenues from airlines and concessionaires at the San Francisco International Airport, including those at the new International Terminal were already projected to be less than expected due to the declining economy. The decrease in passenger traffic following the events of September 11 has accelerated this trend.

- Increased energy costs stemming from California's energy crisis had a significant impact on the City's budget, causing San Francisco to budget for higher energy costs. In addition, due to higher energy costs, and to long-term commitments to sell power, Hetch Hetchy has reduced its transfer to the General Fund from approximately \$29.9 million in fiscal year 2001 to zero budgeted for fiscal year 2002.
- The financial position of the City hospitals continues to deteriorate. Medicare and Medicaid reimbursements and insured patients cover a smaller proportion of the hospitals' costs than in prior years, while the cost of staff, drugs, supplies and medical equipment is increasing significantly faster than the rate of inflation.

All of the above factors were considered in preparing the City's budget for fiscal year 2002.

### **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. If you have questions about this report or need additional financial information, contact the Controller's Office of the City and County of San Francisco at City Hall, Room 316, #1 Dr. Carlton B. Goodlett Place, San Francisco, CA 94102