

January 22, 2002

The Honorable Mayor Willie L. Brown, Jr.
The Honorable Members of the Board of Supervisors
City and County of San Francisco
San Francisco, California

Ladies and Gentlemen:

I am pleased to present the Comprehensive Annual Financial Report (CAFR) of the City and County of San Francisco, California (the City) for the fiscal year ended June 30, 2001 with the Independent Auditors' Report, submitted in compliance with City Charter Sections 2.115 and 3.105 and California Government Code Sections 25250 and 25253. The CAFR has been prepared by the Controller's Office in conformance with the principles and standards for financial reporting set forth by the Governmental Accounting Standards Board (GASB). Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the City. I believe that the data, as presented, is accurate in all material respects; that its presentation fairly shows the financial position and the results of the City's operations as measured by the financial activity of its various funds; and that the included disclosures will provide the reader with an understanding of the City's financial affairs.

This is the first year the City prepares the CAFR using the new financial reporting requirements as prescribed by the GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* (GASB 34). This new GASB Statement requires that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of a Management's Discussion & Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The MD&A can be found immediately following the report of the independent auditors.

Our CAFR is divided into the following sections:

The Introductory Section includes information about the organizational structure of the City, the City's economy, major initiatives, status of City services, and cash management.

The Financial Section is prepared in accordance with the GASB 34 requirements by including the MD&A, the Basic Financial Statements including notes and the Required Supplementary Information. The Basic Financial Statements include the government-wide financial statements that present an overview of the City's entire financial operations and the fund financial statements that present the financial information of each of the City's major funds, as well as non-major governmental, fiduciary, and other funds. Also included in this section is the Independent Auditors' Report on the financial statements and schedules.

The Statistical Section includes tables containing historical financial data, debt statistics, and miscellaneous social and economic data of the City that are of interest to potential investors in our bonds and to other readers. The data includes ten-year revenue and expenditure information on an inflation-adjusted basis.

THE REPORTING ENTITY AND ITS SERVICES

The City and County of San Francisco (City), established by Charter in 1850, is a legal subdivision of the State of California with the governmental powers of both a city and a county under California law. The City's powers are exercised through a Board of Supervisors serving as the legislative authority, and a Mayor and other independent elected officials serving as the executive authority. The services provided by

the City include public protection, construction and maintenance of all public facilities, sanitation, water, parks, public health systems, social services, planning, tax collection, and many others.

This CAFR includes the financial activities of the primary government, which encompasses several enterprise activities, as well as all of its component units. Component units include legally separate entities for which the primary government is financially accountable and that have substantially the same board as the City or provide services entirely to the City. For reporting purposes the operations of the San Francisco County Transportation Authority, the San Francisco Parking Authority, and the San Francisco Finance Corporation, are blended with the City. In addition, there are two component units, the San Francisco Redevelopment Agency and the Treasure Island Development Authority, which are legally separate entities but which have some financial interdependency with the City. For reporting purposes these entities are shown as discretely presented component units.

SAN FRANCISCO'S GOVERNMENT, ECONOMY AND OUTLOOK

San Francisco is the economic and cultural hub of the Bay Area, a metropolitan region with more than 6.5 million residents in nine counties. The population of the City has grown by approximately 8.8 percent in the past ten years, to 793,459.ⁱ The year 2000 federal census shows that racial and ethnic diversity continues to be robust in the City, with all minorities groups combined representing a majority of the population, and, for the first time in modern history, no single racial or ethnic group representing a majority of the City's population.ⁱⁱ

San Francisco is a charter city, exercising the powers and duties of both a city and county. In November 2000, the eleven members of the Board of Supervisors were elected by district for the first time since the 1970s. Members will serve four-year terms, with the exception that in order to provide for staggered terms, the initial district-elected Board drew lots and determined that an election for seats of even-numbered districts will be conducted in November 2002. The elected Mayor of San Francisco serves as the executive, and appoints the heads of many city departments. Many departments are also advised by a commission whose members are appointed by the Mayor. Elected officials include the Assessor-Recorder, City Attorney, District Attorney, Public Defender, Treasurer, and Sheriff.

The City boasts a strong and diverse collection of both Fortune 500 companies and locally owned small businesses. Thus while the City is home to Chevron, The Gap, Charles Schwab, and Wells Fargo, over eighty-five percent of the City's businesses employ fewer than twenty people.ⁱⁱⁱ The economy overall has demonstrated sustained growth since the recession of the early 1990s. Among California counties, the City consistently ranks in the top five in terms of lowest unemployment rates, lowest percentage of persons living in poverty, and highest in per capita incomes.

An overall economic slowdown which began in the middle of fiscal year 2001 has affected the City's economy, and the events of September 11th have compounded the impact of the general slowdown. The technology sector in particular has experienced the closing of large numbers of dot-com companies and significant losses in the value of many other businesses. The economic effects of the downturn are expected to continue in the next fiscal year. While this contraction has affected the City's economy, the overall economic and business environment continues to show strength, and employment, wage and earning trends continue to be strong overall.

Approximately 35,700 jobs have been created in the City during the past five years, showing an aggregate growth during the period of almost 9 percent.^{iv} As the business, transportation, and travel hub of the Bay Area, the City's economy is dominated by the services sector, which provides approximately 39% of all jobs. Retail trade and financial, insurance and real estate businesses are also critical to the City's employment base and economy. Overall, the unemployment rate in 2000 continued a five-year decline,

ⁱ Source: California Department of Finance

ⁱⁱ Source: United States Census

ⁱⁱⁱ Source: California Department of Finance

^{iv} Source: California Employment Development Department

dropping to 2.8 percent for the calendar year, lower than the average annual unemployment rate during the period for California of 4.9 percent. With the recent changes in the economy, as of July 2001, San Francisco's unemployment rate had risen to 5.4 percent, approximately the same rate as for the state of California as a whole (5.3 percent), and to approximately 6.1 percent by November 2001.

Tourism, at the heart of San Francisco's economy, continues to thrive. The Convention and Visitors Bureau estimates that 17.3 million visited San Francisco in 2000, representing an average daily population of 142,700. These visitors spent over \$7.6 billion in the City during 2000, over \$20.9 million per day.^v Hotel occupancy rates averaged 80% during the year. The slowing economy and the events of September 11th have changed the outlook for the travel and tourism industry however. Business, convention and tourist travel have all dropped since the spring of 2001, with hotels reporting decreased occupancy rates since September and occupancy rates for 2002 projected to be only in the 65% to 75% range overall.^{vi}

Downtown office vacancy rates, at 10% in 1992, fell below one percent during the most recent two fiscal years. However, the commercial rental market has begun to reflect the effects of the economic slowdown, with vacancy rates increasing during the fiscal year for the first time in nearly eight years. Surveys show the vacancy rate rising steadily to 4% halfway through the 2001 fiscal year, 8% by June 2001, and approximately 15% by December 2001. Asking prices for office space rents have also declined by as much as 46%, from an average of \$80 per square foot in July of 2000, to \$43 per square foot by December 2001.^{vii} The market is not anticipated to turn around before the end of fiscal year 2002.

Property values in the City remain among the highest in the nation. The housing market has been only minimally affected by the economic slowdown, with demand for housing still far in excess of supply. During calendar year 2000, new construction added 1,626 units to the City's housing stock. However, demand continues to outpace supply, as it has for several years, with a projected deficit of 9,543 needed housing units by 2006. The gap between housing demand and supply has contributed to a worsening affordability gap in the City. In the year 2000, the median price for an average single family home in San Francisco was \$540,000, a level that was affordable by only a small fraction—11% of the population.^{viii} Homeownership continues to be out of reach of many of the service workers, teachers, trade and craft workers, and other residents and workers. The jobs/ housing imbalance affects the City's ability to manage transportation networks, schools, and other important services. Housing is and will remain a critical challenge for the City's policymakers, planners, employers, and residents.

Transportation also presents a significant challenge for the City. Added capacity in regional road and transit service, bringing workers and visitors to the City, and providing transportation within the City, are both being developed to meet growing needs. Caltrain, which carries passengers between the peninsula and the City, experienced a 9.2% increase in commuter ridership during the fiscal year. The Bay Area Rapid Transit (BART) system is adding service both in the east bay and from the peninsula, with four new BART stations to the south of the City, including one at the San Francisco International Airport, scheduled to open in the fall of 2002. These improvements should relieve congestion on some of the region's major arteries. The success of transit projects both in San Francisco and in neighboring counties remains critical to the economic growth and stability of the City.

Over the last five years, the City's property tax revenues, the single largest source of income for the general fund, have grown in some cases by as much as 16% per year, reflecting extraordinary growth in property values and prices during the time period. From fiscal year 2000 to 2001, revenue from property tax grew by approximately \$83 million, an increase of 15% from the prior year. Trends in other sources of local tax revenue were strong during the fiscal year as well, with business, sales, and other local taxes increasing by between 4% and 10%. These revenue growth results are despite the loss of approximately \$25 million per year from the elimination of the City's gross receipts tax as a result of litigation.

The energy crisis which hit all of California during the year affected the City in a wide variety of ways. Government revenues from utility user taxes increased, however the City also had to fund higher power

^v Source: San Francisco Convention and Visitor's Bureau

^{vi} Source: PKF Consulting

^{vii} Source: Grubb & Ellis, Cushman & Wakefield

^{viii} Source: California Association of Realtors

purchase costs for the Hetch Hetchy system, with an increased appropriation of \$25 million approved during the year for this purpose. Partly in response to the energy crisis, the City has initiated a \$15 million capital project in 2001 to finance energy efficiency improvements in government which is expected to save approximately \$5 million in avoided energy costs annually over the long term. Pacific Gas and Electric, which is one of the City's largest taxpayers, filed for bankruptcy in April 2001, but has continued to meet its local tax obligations to date with court permission. On a statewide basis, the budget surplus which has been spent on energy purchases is likely to restrict funding available from the state to local governments in many program areas in the next fiscal year and beyond.

Since September 11th, both business and tourist travel to San Francisco have dropped significantly, affecting passenger loads and revenues at San Francisco International Airport, and hotel and sales tax revenues to the City, among other factors. For fiscal year 2002, the City is currently projecting decreases from local tax revenue sources. Hotel tax is significant, with a projected decrease of almost 25% from fiscal year 2001—a loss of over \$32 million, followed by sales tax with a projected loss of approximately 10% or over \$12 million. In total, the City expects revenue losses in the general fund in the 2002 fiscal year of between \$60 and \$100 million and consequently has restricted its budget to lower spending to meet that range.

San Francisco International Airport (SFO) has been particularly affected by both losses in business travel which were apparent in the spring of 2001 and by the drops in air traffic of all kinds since September 11th. United Airlines, the single largest carrier at SFO, reported a 34% loss in business travel in the last quarter of fiscal year 2001, and airlines overall have reduced flights by 20% on average since September. New Department of Transportation rules which restrict access to most terminal areas to ticketed passengers only has significantly decreased business for SFO retail and restaurant tenants and as a result SFO has temporarily reduced rents for merchants. The SFO is currently forecasting that lower passenger flows, fees, and parking income will cause an operating shortfall in the range of \$100 million in the 2002 fiscal year. SFO's transfer of concession revenues to the City general fund, budgeted at \$29 million, is anticipated to be reduced by 25% or more.

MAJOR INITIATIVES AND ACHIEVEMENTS

A number of significant initiatives, outlined below, are underway in San Francisco which should have a positive effect on the City's economic health and its services to residents and businesses.

Health Facilities and Systems

The City operates two major hospitals—San Francisco General for acute care, and Laguna Honda for long-term care. The City is in the process of designing and constructing a new campus on the Laguna Honda Hospital site, and a rebuild of the existing hospital, that will provide housing and a complete continuum of long-term healthcare services. The hospital will be built to modern environmental and seismic standards, and will provide for a technologically advanced and flexible facility serving the City's growing need for rehabilitation facilities and residential care. The new Laguna Honda campus is being financed by a \$299 million general obligation bond issue approved by the voters in November 1999. The property tax burden of the bond issue will be reduced by using tobacco settlement funds to be distributed to California counties over the next several years, and by the use of supplemental Medicaid payments made available for the project's debt service through new state legislation. The project is now engaged in the design and community consultation process, with design and environmental review expected to be complete in 2002, and construction to begin in 2003 on the first of the new facilities.

Expansions of Convention Center and Cultural Facilities

The City's Moscone Convention Center draws business and industry meetings from around the world, and continues to develop to meet the convention business demand in San Francisco. The Moscone West expansion of the center will add a new, free-standing facility located one half block west of the existing Moscone Convention Center. Moscone West increases the size of the City's convention facilities by fifty percent--adding 300,000 square feet of exhibit and meeting space on three floors. Structural steel erection is about 90% complete and other building trades have begun their work on site, following closely on the

heels of steel erection. Moscone West is scheduled to open in the Spring of 2003 and events are currently being booked.

A number of cultural institutions are currently in the process of major expansions or the construction of new facilities. The Asian Art Museum, to be housed in the renovated Old Main Library, is scheduled to open in the Civic Center in early 2003, and is financed with a combination of \$51 million of voter-approved bonds and \$69 million in private donations. Currently, the museum has the space to display only about six percent of its collection at any time. Once the move is completed, the museum will have the space and facilities to display a much larger portion of its collection. The DeYoung Fine Arts Museum and the Academy of Sciences both are in the process of constructing new facilities in Golden Gate Park. In December of 2000 the DeYoung Museum closed its doors in preparation for replacing its seismically unsafe building. The new DeYoung Museum is scheduled to open in 2005 and will be financed entirely by private contributions. The new Academy building is funded through a combination of \$118 million in local bonds, approved by voters in 1995 and 2000, state funds, and private donations. Design for new Mexican, African-American, and Jewish Museums has begun. These facilities will join the San Francisco Museum of Modern Art in the Yerba Buena district, immediately adjacent to the Moscone Convention Center. All three are scheduled for completion by 2005.

In November 2000, voters approved the Branch Library Improvement Bond measure. The bond program authorizes the sale of approximately \$105.9 million in General Obligation Bonds to renovate nineteen branch libraries including upgrades for earthquake safety and disability access, interior renovations, and some facility expansions. The first \$17.6 million bond sale will fund planning for seven branches and cover the costs of acquiring sites for the four branch libraries that are currently in leased space.

The transfer of the former Presidio Army Base to civilian uses which was carried out in 1994 has created an array of new recreational, cultural, and development opportunities in San Francisco. Among these is the restoration of Crissy Field and the adjacent shoreline for public recreational use by the National Park Service. This project was completed and a grand opening for the restored Crissy Field was held in May 2001. The park's over 100 acres includes a restored salt marsh and tidal lagoon, beaches, dunes, and over a mile of new shoreline promenade, which are expected to draw thousands of local users and new visitors annually to San Francisco's waterfront.

Affordable Housing Projects

In November 1996, the voters of San Francisco approved the issuance of \$100 million in general obligation bonds ("Proposition A") to fund the Affordable Housing and Home Ownership Bond Program. The Board of Supervisors adopted legislation to implement the program in 1997, providing that 85% of the bond proceeds be dedicated to the development of rental housing, and 15% for downpayment assistance to first-time homebuyers.

In March 1998, the first \$20 million of bonds were sold, and the program began full operation in June 1998. In June 1999, the second \$20 million of bonds were sold, and in June 2000 the third \$20 million series, the latter time as a tax-exempt issue. Because of the urgent need for affordable housing in San Francisco, the Mayor's Office of Housing recommended to the Board of Supervisors that the remaining \$40 million be issued for the 2001-2002 fiscal year, and the Board approved that issuance. The final \$40 million were issued in July 2001.

As of August 2001, the City has funded almost \$40 million in loans or grants for the development of rental housing, assisting development of 1,185 units of rental housing and 264 beds in group housing. About \$25 million more has been committed to specific projects in the development pipeline, and the remaining funds will be allocated through a Notice of Funding Availability process in Fall 2001. Altogether, the City expects to develop about 2,350 units and 500 beds of group housing with the Proposition A funds.

The Downpayment Assistance Loan Program funded by the bonds has assisted approximately 175 low and moderate-income households to become first time homebuyers. With a median household income of less than \$45,000, participants in the program have few other opportunities to become homeowners in San Francisco, and the program has been an essential tool to allow these families to remain in the City.

Transportation System Improvements

Significant large-scale transportation development projects are underway both to accommodate a growing number of travelers into the region and to improve transportation options and services for the City's residents, workers and businesses.

San Francisco International Airport serves as the key connection between the Bay Area, national, and international economies, receiving 54 percent of the region's air traffic and 94 percent of international traffic. A \$2.4 billion airport construction plan was completed in December 2000 and is designed to accommodate an estimated increase of 11 million passengers – growth of 26 percent – annually by 2006. The centerpiece of the program is the construction of an International Terminal Complex, consisting of a new terminal, new parking garages, a light rail system and improved airport roadways. The recent decreases in passenger and freight traffic using SFO is expected to continue to affect the city in the next fiscal year and beyond, however projections of long-term demand for the airport's new facilities are robust.

The new international terminal opened in December 2000 while construction on the connection to Bay Area Rapid Transit (BART) will be completed in 2002 and will provide a direct rail line from San Francisco and Oakland to the Airport.

The approval of Proposition E by the voters in November 1999 has improved the long-term financial stability of the municipal transportation system. This amendment to the City's Charter changes the funding and operation of the City's public transit system. Proposition E guarantees a minimum level of general revenue support for the system and establishes a more autonomous governing body to direct the system.

Since the adoption of Proposition E, the Municipal Railway (MUNI) has posted major accomplishments. Service has been expanded in the South of Market—an area that has experienced growing demand for transit due to its development as the center of the City's multimedia and internet industries, and to a significant increase in residential housing in the last five years. MUNI expanded the F Line with its historic streetcars to Fisherman's Wharf, and initiated the Castro Shuttle, serving downtown MUNI stations out to Castro Street, in response to customer demand along the Market Street corridor. Progress continues to be made on the Third Street Light Railway, which beginning in 2004 will provide a direct rail link between the Financial District, Mission Bay, and the residential neighborhoods of the southeast portion of the City. Finally, MUNI has been actively replacing its rolling stock, putting into service over 125 motor coaches and 18 light rail vehicles and has expanded its efforts to maintain the existing fleet.

Status of City Services

In the spring of 2001, the City, through the Controller's Office, conducted its sixth annual Citizen Survey.

A total of 2,148 San Franciscans were surveyed, providing their opinions of City services such as recreation programs and parks, public transportation (MUNI), libraries, streets, public safety and general City performance.

The 2001 major survey results indicated that:

- Library services, park grounds and MUNI routes continue to receive favorable ratings.
- Ratings of MUNI's timeliness and reliability continue to improve, after reaching a low point in 1999. MUNI's ratings for cleanliness, safety, courtesy and fares have also improved over time.
- Cleanliness and maintenance of park facilities show a positive trend for the past four years.
- Ratings of the pavement condition and cleanliness of City streets are less favorable than a year ago, but remain "fair" on average.
- Feelings of safety walking downtown (both day and night) have improved over the past four years.
- Feelings of safety crossing the street are the worst they have been since 1997.
- About half of respondents rate overall City performance as "fair." People are somewhat less satisfied in 2001 than in previous years.

- Residents of the southeastern quarter of the City are generally less satisfied with City services and with the conditions and safety of their neighborhoods.

OTHER FINANCIAL INFORMATION

Internal Controls

In developing and evaluating the City's accounting system, consideration is given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding: (1) the safeguarding of assets against loss from unauthorized use or disposition; and (2) the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the evaluation of costs and benefits requires estimates and judgments by management. All internal control evaluations occur within the above framework. We believe that the City's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

Budgetary Process

The City's budget is a detailed operating plan, which identifies estimated costs and results in relation to estimated revenues. The budget includes: (1) the programs, projects, services, and activities to be carried on during the fiscal year; (2) the estimated revenue available to finance the operating plan; and (3) the estimated spending requirements of the operating plan. The budget represents a process where policy decisions by the Mayor and Board of Supervisors are made, implemented, and controlled. Note 2(d) to the basic financial statements summarizes the budgetary roles of various City officials and the timetable for their various budgetary actions according to the City Charter.

Pension Trust Fund Operations

The City has a defined benefit retirement plan in which substantially all full-time employees participate. The plan's most recent actuarial calculations, as of July 1, 2000, estimate the plan is 138.8% funded.

Cash Management

The City's pooled deposits and investments are invested pursuant to policy established by the Treasurer. This policy seeks the preservation of capital, liquidity and yield, in that order of priority. The policy addresses soundness of financial institutions holding our assets and the types of investments permitted by the California Government Code. The earned yield for the fiscal year 2000-01 was 6.056%. The Employees' Retirement System and the Redevelopment Agency deposits and investments are maintained outside the City Treasury and follow policies established by their respective governing boards.

Risk Management

With certain exceptions, it is the policy of the City not to purchase commercial insurance against property or liability risks. Instead, the City believes it is more economical to manage its risks internally and set aside funds as needed for estimated current claim settlements and unfavorable judgments through annual appropriations and supplemental appropriations. The City maintains limited coverage for certain facilities, primarily property of the San Francisco International Airport, Port of San Francisco, Municipal Railway, Hetch Hetchy, Water Department, Moscone Convention Center and art at City-owned museums. Additionally, various types of liability insurance coverage are maintained by the City for the Port and the Airport. The City is self-insured for workers' compensation claims. Claims payment history (experience) and payroll costs (exposure) are considered when calculating the claims liabilities and workers' compensation outstanding liabilities for each department. The City's insurance/self-insurance program is reviewed annually in the budget process. The claims liabilities and workers' compensation liabilities reported on the balance sheet have been actuarially determined and include an estimate of incurred but not reported losses.

INDEPENDENT AUDIT

The City's Charter requires an annual audit of the Controller's records. These records, represented in the Comprehensive Annual Financial Report, have been audited by a consortium headed by the nationally recognized certified public accounting firm, KPMG LLP. The consortium also includes Calvin Louie CPA (representing a separate consortium known as Associated Asian CPA Firms), Lamorena and Chang CPAs, Yano and Associates, and Rodriguez, Perez, Delgado and Company. The various enterprise funds, the Health Service System, the Employees' Retirement System, the San Francisco County Transportation Authority and the Redevelopment Agency have been separately audited. The Independent Auditors' Report on our current financial statements is presented in the Financial Section.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2000. This was the nineteenth consecutive year (fiscal years ended June 30, 1982 – 2000) that the City has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized CAFR. The CAFR must satisfy both GAAP and applicable legal requirements.

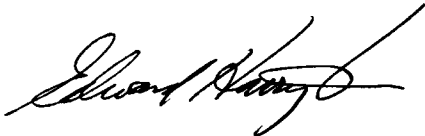
A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

The California Society of Municipal Finance Officers awarded a Certificate of Award for Outstanding Financial Reporting to the City for its CAFR for the fiscal year ended June 30, 2000. This was the third consecutive year that the City has achieved this prestigious award. In order to be awarded a certificate for outstanding financial reporting, a government must publish easily readable and efficiently organized CAFR.

ACKNOWLEDGMENTS

I would like to express my appreciation to the entire staff of the Controller's Office whose professionalism, dedication and efficiency are responsible for the preparation of this report. I would also like to thank KPMG LLP for their invaluable professional support in the preparation of the CAFR. Finally, I want to thank the Mayor and the Board of Supervisors for their interest and support in planning and conducting the City's financial operations.

Respectfully submitted,



Edward Harrington
Controller