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, 2008. We encourage readers to consider the information presented here in conjunction with additional information in our transmittal letter. Certain amounts presented as 2006-2007 summarized comparative financial information in the basic financial statements have been reclassified to conform to the presentation in the 2007-2008 basic financial statements.

FINANCIAL HIGHLIGHTS

The assets of the City exceeded its liabilities at the end of the fiscal year by approximately $6.43 billion (net assets). Of this amount, $229.5 million is unrestricted and may be used to meet the government's ongoing obligations to its citizens and creditors.

The government's total net assets decreased by $148.9 million or 2.3 percent over the previous fiscal year. Within this, the government's total capital assets net of related debt and restricted assets increased by a total of $174.2 million, offset by a $323.1 million decrease in unrestricted net assets. A significant portion of this, $285.2 million, is due to recognition of other postemployment benefit expense in excess of the amount the City funded this year in both governmental and business-type activities.

The City's governmental funds reported total revenues of $3.67 billion; an $88.5 million or 2.5 percent increase over the prior year. This improvement was due largely to growth in property and business tax revenues offset partially by declines in interest and investment income, property transfer tax revenues, and revenues from grants and capital contributions. Governmental funds expenditures totaled $3.54 billion for this period, a 5.2 percent increase, reflecting increases in cost of living in this area and growth in demand for government services.

At the end of the fiscal year, the City's General Fund had an unreserved fund balance of $77.1 million, representing 3.2 percent of total General Fund expenditures of $2.39 billion. The General Fund's unreserved fund balance decreased by approximately 45.3 percent from the prior year amount of $141.0 million. Factors contributing to this decline include declines in federal revenues, investment earnings, local tax revenues, particularly property transfer tax, increases in demand for services and the City's related use of fund balance.

The City's total long-term debt, including all bonds, loans, commercial paper and capital leases decreased by $127.0 million during this fiscal year. The City issued a total of $1.64 billion in debt. Of this amount, $31.1 million was for general obligation bonds for public library capital projects, and $7.7 million was for general obligation bonds for seismic retrofitting of masonry buildings and $42.4 million was for lease revenue bonds for various park improvements. In addition, the City issued $271.4 million in general obligation refunding bonds and the Airport issued $1.24 billion in revenue refunding bonds and $28 million in commercial paper. This was more than offset by the repayment of debt in the amount of $1.77 billion. Of this amount, the largest repayment was to refund the Airport's debt in the amount of $1.26 billion. The Airport also repaid $10 million in commercial paper.
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

<table>
<thead>
<tr>
<th>Introductory Section</th>
<th>INTRODUCTORY SECTION</th>
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<td>Management's Discussion and Analysis</td>
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<th>Government-wide Financial Statements</th>
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<td>Governmental Funds</td>
<td>Proprietary Funds</td>
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<td>Statement of net assets</td>
<td>Statement of net assets</td>
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<tr>
<td>Balance Sheet</td>
<td>Statement of net assets</td>
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<tr>
<td>Statement of revenues, expenditures, and changes in fund balances</td>
<td>Statement of revenues, expenses, and changes in fund net assets</td>
</tr>
<tr>
<td>Budgetary comparison statement</td>
<td>Statement of cash flows</td>
</tr>
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<td>Statement of fiduciary net assets</td>
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<td>Notes to the Financial Statements</td>
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Required Supplementary Information Other Than MD&A

Information on individual non-major funds and other supplementary information that is not required

<table>
<thead>
<tr>
<th>Statistical Section</th>
<th>STATISTICAL SECTION</th>
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</thead>
</table>
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.

<table>
<thead>
<tr>
<th>Government-wide Statements</th>
<th>Fund Financial Statements</th>
<th>Governmental</th>
<th>Proprietary</th>
<th>Fiduciary</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scope</strong></td>
<td></td>
<td>The day-to-day operating activities of the City for basic governmental services</td>
<td>The day-to-day operating activities of the City for business-type enterprises</td>
<td>Instances in which the City administers resources on behalf of others, such as employee benefits</td>
</tr>
<tr>
<td><strong>Accounting basis and measurement focus</strong></td>
<td>Accrual accounting and economic resources focus</td>
<td>Modified accrual accounting and current financial resources focus</td>
<td>Accrual accounting and economic resources focus</td>
<td>Accrual accounting and economic resources focus; except agency funds do not have measurement focus</td>
</tr>
<tr>
<td><strong>Type of asset and liability information</strong></td>
<td>All assets and liabilities, both financial and capital, short-term and long-term</td>
<td>Current assets and liabilities that come due during the year or soon thereafter</td>
<td>All assets and liabilities, both financial and capital, short-term and long-term</td>
<td>All assets held in a trustee or agency capacity for others</td>
</tr>
<tr>
<td><strong>Type of inflow and outflow information</strong></td>
<td>All revenues and expenses during year, regardless of when cash is received or paid</td>
<td>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</td>
<td>All revenues and expenses during year, regardless of when cash is received or paid</td>
<td>All additions and deductions during the year, regardless of when cash is received or paid</td>
</tr>
</tbody>
</table>

**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 Enterprise (Water), 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 and other postemployment 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 and other postemployment benefits.
GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net Assets
June 30, 2008 (in thousands)

<table>
<thead>
<tr>
<th></th>
<th>Governmental activities</th>
<th>Business-type activities</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current and other assets</td>
<td>$1,905,426</td>
<td>$2,034,379</td>
<td>$2,109,649</td>
</tr>
<tr>
<td>Capital assets</td>
<td>2,931,077</td>
<td>2,900,769</td>
<td>9,148,394</td>
</tr>
<tr>
<td>Total assets</td>
<td>4,836,503</td>
<td>4,935,148</td>
<td>11,258,043</td>
</tr>
<tr>
<td>Liabilities:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Noncurrent liabilities outstanding</td>
<td>2,324,641</td>
<td>2,201,025</td>
<td>5,558,339</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>926,806</td>
<td>863,112</td>
<td>851,355</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>3,251,447</td>
<td>3,064,137</td>
<td>6,409,694</td>
</tr>
<tr>
<td>Net assets:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Invested in capital assets, net of related debt</td>
<td>1,436,842</td>
<td>1,454,614</td>
<td>3,935,008</td>
</tr>
<tr>
<td>Restricted</td>
<td>410,111</td>
<td>430,843</td>
<td>421,904</td>
</tr>
<tr>
<td>Unrestricted (deficit)</td>
<td>(261,897)</td>
<td>(14,446)</td>
<td>491,437</td>
</tr>
<tr>
<td>Total net assets</td>
<td>$1,585,056</td>
<td>$1,871,011</td>
<td>$4,848,349</td>
</tr>
</tbody>
</table>

Analysis of Net Assets

Net assets may serve as a useful indicator of the government's financial position. At the end of fiscal year 2007-2008, the City's total net assets exceeded liabilities by $6.43 billion.

The largest portion of the net assets reflects the City's $5.37 billion investment in capital assets (e.g. land, buildings, and equipment) less any outstanding debt related to the acquisition of these assets. This is 83.5 percent of the City's total net assets, a 2.3 percent increase over the prior year, and is largely due to growth in net capital assets at the MTA, Water, Wastewater, Laguna Honda Hospital, and General Hospital, which are business-type activities of the City. Since the government uses capital assets to provide services, these assets are not available for future spending. Further, the resources required to pay the debt related to these assets must come from other sources since the capital assets themselves cannot be liquidated to pay that liability.

Another portion of the City's net assets, $832.0 million (12.9 percent) represents restricted resources that are subject to external limitations regarding their use. The remaining balance of $229.5 (3.6 percent) reflects unrestricted net assets that may be used to meet the government's ongoing obligations to citizens and creditors. Combined, these two components of net assets totaled 16.5 percent at the end of the current fiscal year, or 20.3 percent less than the prior year. This change is due to increases in capital assets and expenses.

The government as a whole, and the business-type activities reported positive balances in all categories of net assets at the end of this fiscal year. For governmental activities, the balance of unrestricted net assets has a $261.9 deficit, due in large part to recognition of other postemployment benefit expense, in conformance and compliance with GASB Statement Number 45 requirements. For a fuller discussion, see Footnote 9(d).
## Changes in Net Assets

**Year Ended June 30, 2008 (in thousands)**

<table>
<thead>
<tr>
<th></th>
<th>Governmental activities</th>
<th>Business-type activities</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Program revenues:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Charges for services...</td>
<td>461,625</td>
<td>382,489</td>
<td>1,973,961</td>
</tr>
<tr>
<td>Operating grants &amp; cns.</td>
<td>926,099</td>
<td>927,256</td>
<td>181,725</td>
</tr>
<tr>
<td>Capital grants &amp; cns.</td>
<td>36,079</td>
<td>50,479</td>
<td>152,511</td>
</tr>
<tr>
<td><strong>General revenues:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property taxes..........</td>
<td>1,189,511</td>
<td>1,126,992</td>
<td>-</td>
</tr>
<tr>
<td>Business taxes..........</td>
<td>396,025</td>
<td>337,592</td>
<td>-</td>
</tr>
<tr>
<td>Other local taxes......</td>
<td>652,971</td>
<td>686,824</td>
<td>-</td>
</tr>
<tr>
<td>Interest &amp; inv. income.</td>
<td>57,929</td>
<td>86,233</td>
<td>67,217</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td>25,999</td>
<td>33,946</td>
<td>233,244</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td>3,746,188</td>
<td>3,612,911</td>
<td>2,096,938</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public protection.......</td>
<td>1,020,457</td>
<td>861,689</td>
<td>-</td>
</tr>
<tr>
<td>Public works,. trsnsp.</td>
<td>342,411</td>
<td>309,095</td>
<td>-</td>
</tr>
<tr>
<td>Human welfare &amp; neighborhood development</td>
<td>848,195</td>
<td>751,034</td>
<td>-</td>
</tr>
<tr>
<td>Culture &amp; recreation...</td>
<td>567,410</td>
<td>516,321</td>
<td>-</td>
</tr>
<tr>
<td>General administration &amp; fin.</td>
<td>250,295</td>
<td>194,653</td>
<td>-</td>
</tr>
<tr>
<td>General City responsibilities</td>
<td>80,887</td>
<td>67,948</td>
<td>-</td>
</tr>
<tr>
<td>Unallocated Interest on long-term debt</td>
<td>97,694</td>
<td>94,060</td>
<td>-</td>
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<tr>
<td>Airport</td>
<td>-</td>
<td>-</td>
<td>651,581</td>
</tr>
<tr>
<td>Transportation</td>
<td>-</td>
<td>-</td>
<td>830,411</td>
</tr>
<tr>
<td>Port</td>
<td>-</td>
<td>-</td>
<td>67,405</td>
</tr>
<tr>
<td>Water</td>
<td>-</td>
<td>-</td>
<td>252,802</td>
</tr>
<tr>
<td>Power</td>
<td>-</td>
<td>-</td>
<td>109,436</td>
</tr>
<tr>
<td>Hospitals</td>
<td>-</td>
<td>-</td>
<td>812,399</td>
</tr>
<tr>
<td>Sewer</td>
<td>-</td>
<td>-</td>
<td>182,712</td>
</tr>
<tr>
<td>Market</td>
<td>-</td>
<td>-</td>
<td>1,052</td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td>3,554,782</td>
<td>3,085,347</td>
<td>2,907,888</td>
</tr>
<tr>
<td>Increase/(decrease) in net assets</td>
<td>191,386</td>
<td>527,964</td>
<td>(299,230)</td>
</tr>
<tr>
<td>before special items &amp; transfers</td>
<td>-</td>
<td>-</td>
<td>(41,026)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>-</td>
<td>-</td>
<td>(477,341)</td>
</tr>
<tr>
<td>Change in net assets</td>
<td>(265,955)</td>
<td>76,303</td>
<td>137,085</td>
</tr>
<tr>
<td>Net assets at beginning of year</td>
<td>1,871,011</td>
<td>1,794,618</td>
<td>4,711,264</td>
</tr>
<tr>
<td>Net assets at end of year</td>
<td>$1,585,066</td>
<td>$1,671,011</td>
<td>$4,848,349</td>
</tr>
</tbody>
</table>

### Analysis of Changes in Net Assets

The City’s total net assets decreased by a total of $148.9 million during fiscal year 2007-2008. The business-type activities realized net asset growth of $137.1 million while the City’s governmental-activities reported a decrease of $286.0 million. Six of the City’s enterprises, including Laguna Honda Hospital, Water, Wastewater and MTA reported a combined total increase of $173.1 million which was offset by decreases totaling $36.0 million at the other business-type activities.

The City’s governmental-type activities realized overall a 3.69 percent growth in total revenues with the more significant growth in revenues from property taxes, business taxes and charges for services offsetting declines from other sources. The City's governmental-type expenses also increased 15.2 percent this fiscal year. As noted above, an important component of this increase is the City’s recognition this year of other postemployment benefit expense. In addition, growth in demand for the governmental services, personnel, labor and administrative costs was seen across functions. A
discussion of these and other changes is presented in the governmental activities and business-type activities sections that follow.

Governmental activities. Governmental activities decreased the City’s total net assets by approximately $286 million. Key factors contributing to this year’s change are discussed below.

Overall, total revenues from governmental activities were $3.75 billion, a $133.3 million or 3.7 percent increase over the prior year. For the same period, expenses totaled $3.55 billion before transfers of $477.3 million, resulting in a total net asset decrease of $286.0 million by June 30, 2008.

Revenues from property taxes grew $62.5 million or 5.6 percent this year. This was primarily due to a 8.5 percent growth in assessed valuation in fiscal year 2007-2008 compared to fiscal year 2006-2007.
Business tax revenues also grew this year, realizing a $58.4 million or 17.3 percent increase. Of this, $11.7 million was due to increased collections of previously unidentified payroll taxes stemming from operational improvements in that function. The remaining increase, $46.7 million was related to moderate employment and wage growth in the sectors paying this tax. Notably, job growth in the professional and business services sectors was 4.5 percent in calendar 2007 compared to 2.3 percent overall.

Total revenues from hotel, sales, parking and utility users taxes totaled approximately $566.8 million, a $41.9 million increase over the prior year. Of this, hotel tax revenue rose $24.8 million or 12.8 percent due primarily to an increase in hotel occupancy rates and a robust 8.7 percent average daily room rate increase. Sales taxes rose 3.3 percent or $6.2 million and parking taxes improved by $2.5 million, or 3.9 percent. In addition, an $8.2 million increase in utility users tax stemmed from increases in natural gas prices and electricity rates, and growth in cellular phone use. During this same period, property transfer tax totaled $86.2 million, a decline of $57.8 million or 40.1 percent in real property transfer tax, a historically volatile revenue stream. This decrease was due to fewer large dollar commercial property sales as compared to the prior year when the City saw an unusual spike in those sales.

Total charges for services revenues reported significant increases this year, rising $79.1 million, or 20.7 percent. The City’s development impact fees contributed $43.5 million or 55.0 percent to this growth due to an increase in construction of residential and commercial properties. Another $6.7 million was due to improved estimates of uncollectible ambulance billings. The remaining $28.9 million reflects growth in a range of governmental fee-based services including building permits, safety charges, inspection fees and others.

Interest and investment income revenue was down by $28.3 million, 32.8 percent, due to decline in interest rates on the City’s pooled investments from an average of 5.2 to 4.3 percent and lower daily cash balances during the fiscal year. In general, these returns reflect the City’s concentration of investments in Treasury Bills and Notes and other short-term investments combined with the interest rate cuts made by the Federal Reserve. The Federal Funds rate was cut seven times during fiscal year 2007-2008, from 5.25 to 2.00 percent. At the end of the fiscal year, deposits and investments for governmental activities with the City Treasury were $1.16 billion, a 13.9 percent decrease over the prior year.

Revenues from capital grants and contributions totaled $36.1 million this year compared to $50.5 million last year. This $14.4 million, 28.5 percent decrease was due largely to a $21.1 million decline in state grants for streets, roads and park projects offset in part by $2.6 million increase in earthquake safety grants and $3.9 million for library capital program.

Net transfers to business-type activities were $477.3 million, a 5.8 percent or $26.2 million increase over the prior fiscal year. This includes an additional $25.4 million to Laguna Honda Hospital, and $4.8 million to San Francisco General Hospital associated with increased General Fund support; and a net decrease of $11.2 million to MTA largely due to reduced capital and operation transfers from the San Francisco County Transportation Authority. In addition, the Airport’s net transfers increased by $2.5 and in the prior fiscal year (2006-2007) there was a one-time $9.8 million net transfer from Water to governmental activities for a land sale. There was no such transfer in the current year.

The increase in total governmental expenses of $469.4 million included an estimated $164.8 million related to other postemployment benefit expenses. The City recorded this liability for the first time in fiscal year 2007-2008 to be in compliance with GASB Statement Number 45 which requires recognition of these liabilities. The remaining increase of $304.6 million represents continued growth in demand for the government’s services and the cost of living increase in the San Francisco Bay Area. Major components include $74.0 million increases in police, fire and sheriff staffing levels and labor costs; an additional $44.9 million in the human welfare and neighborhood services functions due to growth in medical and professional service contracts and a rise in labor and other administrative expenses; an $11.0 million increase in cultural and recreational program expenses; an
$11.6 million increase is related to an increased number of elections this year and new voting system expenses. In addition, $26.4 million represents an increase of the City’s Public Education Enrichment Fund expenses. This fund was established after San Francisco voters approved Proposition H in 2004, a local measure which increased the City’s funding for certain public school programs for eleven years.

The charts on the previous page illustrate expenses and program revenues by functional area, and all revenues by source. As seen, public protection is the largest function (28.7 percent), followed by human welfare and neighborhood development (23.9 percent), community health (16.0 percent). General revenues are not shown by program or function because they are used to support activities citywide. The distribution of these revenues shows property tax (31.8 percent) as the single largest funding source, followed by operating grants and contributions (24.7 percent), other local taxes (17.4 percent), charges for services (12.3 percent), and business taxes (10.6 percent). This relative ranking is equivalent to the prior fiscal year and the actual percentage distributions showed only small differences. The largest change, for example, was in charges for services which accounted for 10.6 percent of funds last year compared to 12.3 percent this year.
Business-type activities increased the City's net assets by $137.1 million. Key factors contributing to this improvement are:

- The Municipal Transportation Agency (MTA) had net assets of $1.90 billion at the end of this fiscal year, a $10.1 million increase for the period. The City's municipal railway, MUNI, accounts for 97.5 percent or $1.86 billion of this. The remainder represents the combined net assets of the Department of Parking and Traffic and the Parking Authority. MUNI's net assets increased $14.3 million, the result of $717.8 million in total revenues and net transfers versus $703.5 million in total expenses. Operating revenues from passenger fares grew by $8.4 million due to increased ridership and revenues from advertising increased by $7.1 million due to an improved transit shelter ad contract that began in December 2007. Federal and state capital contributions declined by a total of $7.6 million; and net transfers rose $9.9 million. Expenses increased by $87.7 million, 14.2 percent over the prior year and approximately $31.8 million of this increase represents MUNI's other postemployment benefit expense, recognized, in accordance with GASB Statement Number 45 as required, this year for the first time. Other personnel cost increases account for $28.5 million. The remaining reflects increases in fuel costs, general administrative and depreciation expenses. This year, the City's General Fund total subsidy to MTA was $204.1 million which consisted of $154.6 million for MUNI and $49.5 million for the Department of Parking and Traffic. This was a $4.8 million and $2.2 million increase, respectively, for each entity over the prior year.

- Laguna Honda Hospital, the City's skilled nursing care hospital, increased net assets by $113.9 million or 42.3 percent this year, reflecting continued progress on construction of major new hospital complex. This increase is primarily related to a $106.3 million transfer from the non-major governmental fund for the hospitals operating and capital activities. Laguna Honda Hospital also received a $54.6 million subsidy transfer and a $2.8 operating transfer offset by $49.8 million in losses this year as compared to a $26.6 million operating loss in the prior year.

- Hetch Hetchy operates San Francisco's water storage and power generating facilities in the Sierra Nevada Mountains and had total net assets of $421.2 million at year's end, $14.7 million or a 3.4 percent decrease over the prior year. The major factors for this slight decline are an increase in net operating income of $27.0 million offset by the write-down of $41.2 million of combustion turbine assets to reflect the agency's decision to end that project. On the operating side, total revenues were $136.4 million, an increase of $17.6 million due primarily to a $11.6 million increase in electricity sales to the Modesto and Turlock Irrigation Districts and sales to other governments and City departments, plus a $6.0 million increase in non-operating revenue. Total operating expenses were $109.4 million, a $14.4 million or 15.2 percent increase over the prior year. Increases in general, administrative and other operating expenses account for about $9.3 million of this while the remainder is due to the net increase in power purchase costs of $1.5 million and an increase of $2.7 million in other postemployment benefit expenses.

- The City's Water Enterprise reported net assets of $461.3 million, a $22.8 million or 5.2 percent increase over the prior year. Since 2003, the enterprise has been engaged in a massive, multi-billion dollar, ten-year program to rebuild the City's water system. This year's $193.8 million increase in net capital assets and the related use of $181.5 of current assets, primarily cash restricted for this effort, reflects continued progress on this critical project, reported as a $12.3 million growth in total assets. During this year, there was also a $10.5 million net reduction in liabilities due largely to repayment of $19.2 million in bond principal offset by the recognition of a $15.0 million liability for other postemployment benefit expenses, consistent with the City's implementation of GASB Statement Number 45 this year.

- The City's Wastewater Enterprise had net assets of $983.9 million at the end of this fiscal year, a $24.7 million or 2.6 percent increase for the period. Total revenues for the year were $207.5 million, a $5.4 million or 2.7 percent increase over fiscal 2006-2007. This revenue growth included approximately $11.5 million associated with an 8.0 percent rate increase, offset by a
decline of $6.1 million in non operating, interest on investments, and other revenues. Total expenses increased by $13.6 million due to personnel cost increases including $5.7 million to reflect GASB Statement Number 45 other postemployment benefit expenses.

- The Airport’s net assets were $313.4 million at the end of fiscal year 2007-2008, representing only a small decrease, slightly more than one percent, over the prior year. This year, operating revenues totaled $535.8 million, a $31.8 million growth driven largely by a 8.4 percent growth in passenger enplanements. Aviation revenue increased $9.9 million, concession revenues increased $8.0 million and parking, transportation and net sales and service grew by a total of $13.8 million. Total expenses increased by a net $20.2 million due to personnel costs, repairs and maintenance and materials and supplies. As in all other City entities, the Airport’s personnel related expenses included other postemployment benefits this year. The transfer from the Airport to the City’s General Fund was $25.9 million this year, a $2.5 million growth over fiscal year 2006-2007.

As shown in the previous charts, the City’s largest business-type activities, the MTA and the Airport, had total expenses of over $800 million and $600 million respectively, accounting for slightly more than 50 percent of all business-type activities. San Francisco’s long term and acute care hospitals together also had total expenses over $800 million. Together, these four enterprises make up 78.9 percent of total expense for business-type activities. As in the past, revenues from charges for services account for the largest share of funding for these 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 available for future spending. Such information is useful in assessing the City’s financing requirements. The 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.

At the end of the current fiscal year, the City reported combined ending governmental fund balances of $971.7 million, a decrease of $280.3 million over the prior year. While the City realized a growth in total governmental funds revenues, including growth in property and business tax revenues, the City also reported a decline in federal and state revenue and a decline in interest and investment income as discussed earlier. These factors, along with expenditures increasing at a faster rate than the net revenue gain contributed to the reduction in governmental funds combined ending fund balance.

Approximately $55.0 million of the governmental funds balance represents 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, a measure of the fund resources already committed and not available for new spending. These commitments include support for (1) a General Fund “rainy day” reserve ($117.8 million), (2) encumbrances for existing contracts and purchase orders ($256.5 million), (3) funds continued for programs or projects in future fiscal years ($463.9 million), and (4) assets not available for appropriation ($31.2 million).

The General Fund is the chief operating fund of the City and had an unreserved fund balance of $77.1 million and a total fund balance of $405.6 million at the end of the fiscal year. For the year, the General Fund’s total revenues exceeded expenditures by $331.8 million, before transfers and other items of $467.6 million. In the aggregate, the resulting total fund balance decreased by $135.8 million for the fiscal year ended June 30, 2008. Overall, this was due to smaller than expected increase in revenues, particularly in real estate property transfer tax, grants and subventions, and an increased rate of expenditure growth due to growth in demand for services and personnel costs across City functions. These factors were partly offset by management controls on the General Fund expenditures put in place during the middle of this fiscal year.

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 this fiscal year, the unreserved fund balance of $77.1 represents 3.2 percent of total General Fund expenditures of $2.39 billion, and the total fund balance of $405.6 million represents essentially 17.0 percent of that amount. At the end of the prior fiscal year, the General Fund’s unreserved fund balance of $141.0 million was 6.5 percent of total expenditures of $2.16 billion, and the total fund balance represented approximately 25.1 percent of expenditure. This change also reflects the City’s relatively higher use of budgetary use of balances and reserves in fiscal 2007-2008.
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 details.

At the end of the current fiscal year, the unrestricted net assets for the Airport were $253.0 million, the Water Enterprise $109.8 million, the Hetch Hetchy Water and Project were $161.8 million, the Wastewater Program were $42.0 million, and the Port were $60.1 million. In addition, the MTA, the San Francisco General Hospital and Laguna Honda Hospital had deficits in unrestricted net assets of $88.8 million, $22.3 million and $29.0 million, respectively.

The following table shows actual revenues, expenses and results of operations for the current fiscal year in the City's proprietary funds (in thousands). As seen here, the total net assets for these funds increased by approximately $137.1 million. Reasons for this change are discussed in the previous section on the City's business-type activities.

<table>
<thead>
<tr>
<th></th>
<th>Operating Revenues</th>
<th>Operating Expenses</th>
<th>Operating Income (Loss)</th>
<th>Non-Operating Revenues</th>
<th>Non-Operating Expenses</th>
<th>Non-Operating (Expense)</th>
<th>Capital Contributions</th>
<th>Interfund Transfers</th>
<th>Change in Net Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Airport</td>
<td>$535,771</td>
<td>$451,258</td>
<td>$84,513</td>
<td>$102,978</td>
<td>$11,595</td>
<td>$11,595</td>
<td>(41,060)</td>
<td>(25,942)</td>
<td>(3,347)</td>
</tr>
<tr>
<td>Water</td>
<td>223,216</td>
<td>222,062</td>
<td>11,164</td>
<td>11,595</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>22,759</td>
</tr>
<tr>
<td>Hetch Hetchy</td>
<td>109,436</td>
<td>109,436</td>
<td>10,141</td>
<td>16,596</td>
<td>(41,224)</td>
<td>(450)</td>
<td>(14,699)</td>
<td>-</td>
<td>10,005</td>
</tr>
<tr>
<td>Municipal Transportation Agency</td>
<td>877,183</td>
<td>(569,842)</td>
<td>236,654</td>
<td>107,509</td>
<td>236,744</td>
<td>236,744</td>
<td>10,005</td>
<td>-</td>
<td>10,005</td>
</tr>
<tr>
<td>General Hospital</td>
<td>419,405</td>
<td>603,350</td>
<td>183,945</td>
<td>62,698</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Wastewater Enterprise</td>
<td>202,549</td>
<td>105,245</td>
<td>37,304</td>
<td>(12,641)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>24,663</td>
</tr>
<tr>
<td>Port</td>
<td>64,498</td>
<td>68,813</td>
<td>(2,315)</td>
<td>(836)</td>
<td>4,140</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>999</td>
</tr>
<tr>
<td>Laguna Honda Hospital</td>
<td>138,762</td>
<td>208,268</td>
<td>(69,506)</td>
<td>19,695</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>113,917</td>
</tr>
<tr>
<td>Market Corporation</td>
<td>1,564</td>
<td>1,052</td>
<td>512</td>
<td>202</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>714</td>
</tr>
<tr>
<td>Total</td>
<td>$1,973,961</td>
<td>2,655,657</td>
<td>(681,696)</td>
<td>$229,955</td>
<td>$111,485</td>
<td>$477,341</td>
<td>$137,085</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

Fiduciary Funds

The City maintains fiduciary funds for the assets of the San Francisco Employee’s Retirement System and Health Service System, and manages the investment of monies held in trust to benefit public service employees. At the end of the current fiscal year, the net assets of the Retirement System and Health Services System combined totaled $15.9 billion, representing a $1.14 billion decrease over the prior year, a 6.7 percent change. This decrease is essentially due to a decrease in the fair value of the Retirement System’s investments. The Investment Trust Fund’s net assets were $538.4 million at year’s end, compared to $646.2 million at the end of the previous fiscal year. This 16.7 percent decrease represents an increase in withdrawals or distributions to external participants of the fund over additions in the current year.

General Fund Budgetary Highlights

The City’s revised budget of $3.4 billion includes $422.5 million of budgetary revisions above the $3.0 billion original budget. These revisions were made up of $466.9 million in carry-forward appropriations for various programs and projects, $16.6 million in supplemental appropriations approved during the fiscal year, offset by $61.0 million in deappropriations of projects and reserves.

During the year, actual revenues and other resources were $12.4 million less than budgeted. The City realized $70.0 million more revenue than budgeted for property taxes, business taxes, other local taxes (excluding property transfer tax), licenses permits and franchises, fines forfeitures and penalties, rents and concessions, charges for services, and other resources. Those surpluses were
more than offset by a $37.3 million shortfall in real property transfer tax, $38.0 million shortfall in federal, state and other grants and subventions (linked to expenditure savings noted below), a $4.3 million shortfall in interest and investment income, a $1.6 million shortfall in charges for services, and a $1.3 million shortfall in other financing sources, primarily proceeds from issuance of bonds and loans.

Differences between the final budget and the actual (budgetary basis) expenditures resulted in $84.1 million in expenditure savings. Major factors include:

- $43.3 million savings in the Human Services Agency, due largely to lower than budgeted client assistance costs and grants to community-based service organizations. These savings are partially offset by reductions in Human Service federal and state subvention revenues.

- $15.2 million in savings due to close-out of unspent General Reserve not used for supplemental appropriation or other contingencies during fiscal year 2007-2008.

- $12.6 million in savings on general administration and finance and other general city responsibilities.

An additional net $33.3 million addition to budgetary reserves was provided by deappropriations of project carryforward budgets and unneeded reserves.

The net effect of expenditure savings and deappropriations of reserves and project expenditures exceeding revenue shortfalls was a positive unreserved budgetary fund balance available for subsequent year appropriation of $105.1 million at the end of fiscal year 2007-2008. The City’s fiscal year 2008-2009 Adopted Original Budget assumed an available balance of $81.7 million, so an additional $23.4 million remains available. (See also Note 4 to the Basic Financial Statements for additional fund balance details.)

**Capital Assets and Debt Administration**

**Capital Assets**

The City's capital assets for its governmental and business-type activities as of June 30, 2008, increased by $311.2 million, 2.6 percent, to $12.1 billion (net of accumulated depreciation). Capital assets include land, buildings and improvements, machinery and equipment, park facilities, roads, streets, and bridges. Governmental activities contributed $30.3 million or 0.2 percent to this total while $280.9 million or 2.4 percent was from business-type activities. Details are shown in the table below.
Capital Assets, Net of Accumulated Depreciation  
(in thousands)

<table>
<thead>
<tr>
<th></th>
<th>Governmental Activities</th>
<th>Business-type Activities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>$ 151,917</td>
<td>$ 151,917</td>
<td>$ 196,264</td>
</tr>
<tr>
<td>Facilities and Improvement..</td>
<td>2,188,543</td>
<td>2,106,299</td>
<td>6,114,993</td>
</tr>
<tr>
<td>Machinery and equipment...</td>
<td>60,701</td>
<td>53,546</td>
<td>780,793</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>281,329</td>
<td>261,179</td>
<td>794,180</td>
</tr>
<tr>
<td>Property held under lease..</td>
<td>-</td>
<td>-</td>
<td>2,464</td>
</tr>
<tr>
<td>Easements</td>
<td>-</td>
<td>-</td>
<td>65,448</td>
</tr>
<tr>
<td>Construction in progress..</td>
<td>248,587</td>
<td>325,828</td>
<td>1,194,252</td>
</tr>
<tr>
<td>Total</td>
<td>$ 2,931,077</td>
<td>$ 2,900,769</td>
<td>$ 9,148,394</td>
</tr>
</tbody>
</table>

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

- Under governmental activities, net capital assets increased by $30.3 million mainly due to the increase in construction-in-progress work at various park and recreational sites such as Academy of Science and Upper Noe Recreation Center, branch libraries, various street improvement and traffic signal upgrades. About $173.4 million worth of construction-in-progress work was substantially completed and capitalized as facilities and improvement and infrastructure as appropriate. Of the completed projects, $61.6 million is for the Juvenile Hall and approximately $63.3 million for various Recreation Centers such as Ocean View, Joseph Lee and Moscone and various park improvement projects including the Golden Gate Park. The remaining completed projects includes public works and traffic signal projects.

- The Water Enterprise’s net capital assets increased by $193.7 million. Close to 57.8 percent, or $112.0 million, of the change reflects the net increase in construction-in-progress on the enterprise’s ten-year water system improvement project. This change includes a $242.9 million increase in construction projects offset by $121.3 million in transfers to facilities and improvements, $1.7 million transfers to equipment, and $7.9 million expended for projects not continued. The increase included Sunset Reservoir North Basin and Stanford Heights Reservoir Rehabilitation and Upgrade, East/West Transmission Main and others Water System Improvement Program. The remaining net increase of $81.8 million reflects the increase to facilities, improvements and equipment less increase to depreciation. Water had $5.4 million in development costs and $9.9 million in site acquisition as of June 30, 2008 for an office building located at 525 Golden Gate Avenue. The project was placed on hold in July 2008 to allow management to evaluate construction cost estimates and alternative course of action given current market conditions.

- MTA’s net capital assets increased by $31.3 million, was largely due MUNI’s purchase and modification of the passenger coaches, and completion of capital improvements at maintenance and other facilities. This totaled approximately $38.3 million and was offset by an approximately $7.0 million growth in depreciation expense for capital assets under Parking and Traffic and the Parking Garages.

- Laguna Honda Hospital’s net capital assets increased by $74.4 million due almost entirely to construction-in-progress on the capital project to rebuild the hospital. This work is principally funded by the Laguna Honda General Obligation Bonds.

- General Hospital’s net capital assets increased by $13.1 million, primarily due to the design and rebuild costs for the hospital in the amount of $9.9 million, and for seismic retrofitting of $3.3
million. General Hospital is beginning to rebuild its facilities and in November 2008, the voters approved a bond measure to fund the $887.4 million project.

- The Wastewater Enterprise reported an a net increase of $25.4 million due to completion of the Mission/Mount Vernon Sewer Improvements, Oceanside Pump Station/Westside Bar Screens, and other capital projects throughout the system.

- Hetch Hetchy net capital assets decreased by a total of $19.4 million due largely to the net effect of a $14.8 million increase in structures, buildings and equipment offset by a $34.6 net decrease to construction projects. The latter included the write-off of combustion turbines as that project was discontinued.

- The Airport’s net capital assets decreased $40.3 million or 1.1 percent largely due to the depreciation against completed projects of the Near Term Master Plan for the Airport in recent years. Major capital additions this fiscal year included Runway Overlay and Reconstruction, Boarding Area Gate Activation, Terminal Remodeling and Boarding Area Renovation.

At the end of the year, the City’s business-type activities had approximately $321.6 million in commitments for various capital projects. Of this, Water Enterprise had an estimated $134.7 million, MTA had $46.7 million, Wastewater had $33.9 million, Airport had $30.1 million, Hetch Hetchy had $20.3 million, Port had $5.4 million, Laguna Honda had $50.5 million. In addition, there was approximately $97.2 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 and commercial paper debt outstanding of $7.7 billion. Of this amount, $1.1 billion is general obligation bonds backed by the full faith and credit of the City and $6.6 billion is revenue bonds, loans, certificates of participation, capital leases, and other debts of the City secured solely by specified revenue sources.

As noted previously, the City’s total long-term debt including all bonds, loans, commercial papers and capital leases decreased by $127.0 million during fiscal year 2007-2008, primarily due to maturities of existing debt exceeded the issuance of new debt in the governmental and business-type activities. Additional obligations, interest accretion and net increases in governmental activities were $378.6 million. For the business type activities the additional obligations were $1.26 billion which is the composed primarily of $1.24 billion of revenue refunding bonds and $28 million of commercial paper issued by the Airport. For governmental activities, maturities, retirements and net decreases for general obligation bonds, lease revenue bonds, certificates of participation, settlement obligation bonds were $404.7 million and $17.7 million for loans and capital leases. For business type activities, current maturities and net decreases for revenue bonds, lease revenue bonds and accreted interest were $1.34 billion, and repaid $10 million in commercial paper.
The City issued $1.5 billion in refunding bonds. Of this amount, the City issued a total amount of $271.4 million in general obligation refunding bonds to take advantage of the favorable interest rates to reduce debt payments. The Airport issued $1.26 billion, of which $291.3 million was refunded for savings and the $963.9 million was refunded to stabilize rates. This was necessitated by the downgrade of various insurance companies by credit agencies in January 2008. In addition, the City issued $31.1 million in general obligation bonds for the improvement of public libraries and made the second and third borrowing in the amount of $7.7 million on the Seismic Safety Loan Program general obligation bonds under the Board of Supervisors Resolution No. 65-07 for loans to finance the seismic retrofitting of masonry buildings within the City. The City also issued, through the San Francisco Finance Corporation, $11.9 million in lease revenue bonds to finance equipment and $42.4 million to finance the design, construction and renovation of various parks located within the City. In addition, the City entered into a contract with the Department of Housing and Urban Development for a loan of $1.8 million to finance the rehabilitation of the Hunter’s Point Clubhouse Community Center. The Airport issued commercial papers in the amount of $28 million and repaid $10 million.

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 $135 billion in value as of the close of the fiscal year. As of June 30, 2008, the City had $1.1 billion in authorized, outstanding property tax–supported general obligation bonds, which is equal to approximately 0.78 percent of gross (0.81 percent of net) taxable assessed value of property. As of June 30, 2008, there were an additional $490.3 million in bonds that were authorized but un-issued. If all of these general obligation bonds were issued and outstanding in full, the total debt burden would be approximately 1.13 percent of gross (1.18 percent of net) taxable assessed value of property.

The City’s underlying ratings on general obligation bonds as of June 30, 2008 were:

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

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

The City’s enterprise activities maintained their underlying debt ratings this fiscal year. SFO’s underlying debt ratings were upheld by Moody’s Investors Services, Standard & Poor’s, and Fitch Ratings at “A1”, “A”, and “A”, respectively, with a stable rating outlook.

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**

- By the end of fiscal year 2007-2008, San Francisco’s economy had slowed, but was outperforming other Bay Area cities, and regions throughout the State. The fundamental cause of the downturn in California, as well as several other states in the United States, has been the downturn in the housing market. Housing prices across California have rapidly declined after more than a decade of double-digit annual appreciation. Housing prices have declined by a much lower level in San Francisco.

- This slowing economic activity has resulted in projected General Fund tax revenue losses in the current fiscal year 2008-2009 of between $90 and $125 million, primarily due to slower than budgeted growth rates in hotel and sales taxes and real losses in property transfer tax. The Mayor, per Charter authorization to reduce spending in cases of revenue weakness, has adopted
targeted spending cuts, slowed capital spending, and instituted other measures to close this current year revenue shortfall. Considerable uncertainty exists regarding the severity or duration of this downturn and its corresponding effect on the fiscal year 2009-2010 budget.

- The wage and salary employment base of San Francisco grew by 17,500 jobs between March 2007 and March 2008, the latest data available. This 2.9 percent growth is the fastest rate of job increase since 1999-2000, and ranked San Francisco 16th in job growth among over 3,000 U.S. counties during that time. San Francisco's recent job growth rate surpassed every other major county in the Bay Area. However, since the end of fiscal year 2007-2008, annual job declines have been registered in the San Francisco metropolitan division, particularly at the end of calendar year 2008.

- Unemployment in San Francisco rose during fiscal year 2007-08 to an annual average of 4.6 percent, up from 4.1 percent in 2006-07. Nevertheless, this rate was far below the state average of 6.0 percent during that time, and further confirms the relative strength of the City's economy compared to the State. San Francisco's June 2008 unemployment rate of 5.4 percent was the 6th lowest among California's 58 counties. It has risen to 6.6% by December, 2008, but was still the 4th lowest among California counties.

- The office market also remained healthy in fiscal year 2007-2008, with the vacancy rate declining from 11.4 percent in the third quarter of 2007 to 10.2 percent in the second quarter of 2008. During the same period, office rental rates increased 6.5 percent to $50.98 as of the second quarter of 2008. In addition, the market experienced about 750,000 square feet of net absorption during this time period. Since the end of fiscal year 2007-2008, commercial rents have declined, and there has been a slight increase in vacancy rates, particularly in the fourth quarter of calendar year 2008.

- San Francisco's long-term economic fundamentals—the quality of its workforce, environment, technological base, and cultural amenities—are among the strongest of any city in the United States. These competitive advantages are likely to secure the City's continued prosperity during and after the economic recovery. Commercial property investors and developers agree; according to a recent report from the Urban Land Institute and PriceWaterhouseCoopers, San Francisco is the second best multifamily and office investment market in the country, ahead of New York, Washington D.C., San Jose, and Los Angeles. According to the same report, San Francisco leads the nation in residential and commercial development potential.

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2 Source: State of California Employment Development Department (EDD).  
3 Source: Grubb & Ellis.  
4 Source: Emerging Trends in Real Estate 2009, Urban Land Institute and PriceWaterhouseCoopers
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 Enterprise
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, 7th 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, 5th 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, 26th 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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