November 28, 2011

The Honorable Mayor Edwin Lee
The Honorable Members of the Board of Supervisors
Citizens of the 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, 2011, with the independent auditor’s report. The report is submitted in compliance with City Charter sections 2.115 and 3.105, and California Government Code Sections 25250 and 25253. The Office of the Controller prepared the CAFR in conformance with the principles and standards for financial reporting set forth by the Governmental Accounting Standards Board (GASB).

The City is responsible for the accuracy of the data and for the completeness and fairness of its presentation. The existing comprehensive structure of internal accounting controls in the City provides reasonable assurance that the financial statements are free of any material misstatements. Because the cost of internal control should not exceed the anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of material misstatements. I believe that the reported data is accurate in all material respects and that its presentation fairly depicts the City’s financial position and changes in its financial position as measured by the financial activity of its various funds. I am confident that the included disclosures provide the reader with an understanding of the City’s financial affairs.

The City’s Charter requires an annual audit of the Controller’s records. The records have been audited by Macias Gini & O’Connell LLP and are presented in this CAFR. The CAFR also incorporates financial statements for San Francisco International Airport, the San Francisco Water Enterprise, Hetch Hetchy Water and Power, the Municipal Transportation Agency, the San Francisco Wastewater Enterprise, the Port of San Francisco, the City of San Francisco Market Corporation, the City and County of San Francisco Finance Corporation, the San Francisco County Transportation Authority, the City and County of San Francisco Health Service System, the San Francisco City and County Employees’ Retirement System, and the San Francisco Redevelopment Agency.

This letter of transmittal is designed to complement the Management’s Discussion and Analysis (MD&A) section of the CAFR. The MD&A provides a narrative overview and analysis of the Basic Financial Statements and is presented after the independent auditor’s report.

**KEY FINANCIAL REPORT 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** includes the MD&A, Basic Financial Statements, notes to the Basic Financial Statements, and required supplementary information. The Basic Financial Statements include the government-wide financial statements that report on all City financial operations, and also include fund financial statements that present information for all City funds. The independent auditor’s report on the Basic Financial Statements is also included.

The financial statements of several enterprise activities and of all component units of government are included in this CAFR. Some component units’ financials are blended with the City’s, such as: the San Francisco County Transportation Authority, the San Francisco Finance Corporation, and the San
Francisco Parking Authority. The reason for this is that the primary government is financially accountable for the operations of these agencies. In other instances, namely, for the San Francisco Redevelopment Agency and the Treasure Island Development Authority, financial reporting is shown separately. Supplemental combining statements and schedules for nonmajor governmental funds, internal service funds and fiduciary funds are also presented in the financial section.

The Statistical Section includes up to ten years of historical financial data and miscellaneous social and economic information that conforms to GASB standards for reporting—Statement No. 44. This section may be of special interest to prospective investors in our bonds.

SAN FRANCISCO’S ECONOMY:

Overview of Recent Trends

This past fiscal year saw the first sign of improvement in San Francisco's economy since the recession struck the state and nation in late 2007. While unemployment rates in the previous fiscal year remained stagnant, fiscal year 2010-11 showed some signs of economic recovery. Average unemployment for fiscal year 2010-11 was 9.2%, down 0.3% from the previous level of 9.5% for fiscal year 2009-10. Unemployment began the fiscal year in July 2010 at 9.5%, and closed the fiscal year in June 2011 at 9.0%.

Since the 1970s, San Francisco has shown a pattern of entering and recovering from recessions later than the rest of the state and the nation. This recession has been no exception. The national recession, which started in December 2007, did not notably affect the San Francisco job market until October 2008. By June 2009, the U.S. recession ended and by the summer of 2010 the economy began to see private sector job growth. However, the San Francisco Metropolitan Division, of which San Francisco is the largest jurisdiction, saw a job decline of 0.3% between July 2010 and July 2011.

Other local economic indicators were mixed in fiscal year 2010-11. Housing prices and industry employment remained significantly below their pre-recession peaks, while residential and commercial rent, hotel revenues, and retail sales showed significant signs of recovery.

Despite the length and severity of the recession, San Francisco has continued to fare better than the rest of California. Throughout fiscal year 2010-11, San Francisco’s unemployment rate ranked between the 4th and 6th lowest of California's 58 counties. The state's unemployment rate averaged 12.2% during fiscal year 2010-11 while San Francisco's average unemployment rate was 9.2%. California was one of the states hardest hit by the recession, largely because of the breadth of its housing bubble and subsequent high level of home foreclosure. San Francisco’s recovery has been largely conditioned by improvements in the broader regional and state economies.

In the past, San Francisco has been slow to add employment after recessions. In the recession of the early 1990s, the City lost private sector employment for four consecutive years. During the early 2000s, employment also declined for four consecutive years. Nevertheless, San Francisco’s long-term economic fundamentals – the education and creativity of its workforce, its environment, technological base, and cultural amenities – remain among the strongest of any major city in the United States. These competitive advantages are likely to secure the City’s continued prosperity after the current recession ends.
Significant Economic Outcomes

Several aspects of San Francisco's recent economic performance over the past several years are discussed in more detail in the following section.

Population decline from the prior year

In 2010, the U.S. Census Bureau conducted its decennial census of the population. According to the Census Bureau, San Francisco had 805,235 residents as of April 1, 2010, a 1.2% decline from the July 1, 2009 Census estimate. This is compared to a smaller decline of 0.8% in California as estimated by the Census. The California Department of Finance (DOF) has also released different estimates of San Francisco's population, based on the 2010 decennial census. The DOF reported San Francisco's population as 818,163, a 0.4% decrease from the population in 2009. In comparison, the DOF reported that California's population increased by 1.2%.

Total employment stabilized, but with limited growth

According to the California Employment Development Department, the wage and salaried employment base of San Francisco grew by 1.4% between December of 2009 and December of 2010, the most recent month available. Compared with a 5.9% drop in employment between December of 2008 and 2009, this suggests that San Francisco's employment picture has stabilized, but not fully recovered during 2010. During the recent recession, San Francisco saw its employment fall by nearly 6%, making it a relatively mild recession. The City lost over 15% of its employment during the early 2000's recession, and over 7% of its employment during the early 1990's recession. The very high levels of unemployment witnessed in San Francisco, which exceed the level of unemployment in either past recession, may have more to do with the lack of opportunities elsewhere in the state than direct job losses in the City.

Taxable sales growth above pre-recession levels

Unlike the job market, San Francisco's taxable sales have begun to grow rapidly, with fiscal year 2010-11 sales tax revenue up 10.1% over fiscal year 2009-10. The fiscal year 2010-11 total is the highest on record, indicating that sales tax revenues have fully recovered from the recession.

Since San Francisco entered the recession after most of California, the City's taxable sales base grew through most of 2008. However, as of the second quarter of fiscal year 2008-9, the City saw annual declines in taxable sales and its associated sales tax revenue. Taxable sales declined significantly until the second half of fiscal year 2009-10 before stabilizing and steadily rising over the last four quarters.

Improvement in commercial property market, but a continuing slide in the residential market

Key indicators of the City's real estate market were mixed during fiscal year 2010-11. Commercial and residential rents showed signs of recovery, while median home prices fell. The average residential rental asking price in fiscal year 2010-11 increased by 13.7% from $1,820 in fiscal year 2009-10 to $2,070. Commercial rents saw a 9.4% increase in asking price in fiscal year 2010-11 versus fiscal year 2009-10. However, average median home prices fell by an additional 1.7% in fiscal year 2010-11 versus the prior year.

Tourism sector sees significant growth

The hotel sector, which is a key barometer of San Francisco travel and tourism industry, saw significant growth in fiscal year 2010-11 versus the previous year. Hotel room average occupancy rose to 81.1% for the fiscal year, a significant increase from the prior year, approaching a historical high. Average daily room rates grew significantly in fiscal year 2010-11, jumping 10.7% from $157 per room-night in fiscal year 2009-10 to $173 per room-night.
SAN FRANCISCO GOVERNMENT:

Profile of San Francisco Government

The City and County of San Francisco was established by Charter in 1850, and is the only legal subdivision of the State of California with the governmental powers of both a city and a county. The City’s legislative power is exercised through a Board of Supervisors, while its executive power is vested upon a Mayor and other appointed and elected officials. Key public services provided by the City include public safety and protection, public transportation, water and sewer, parks and recreation, public health, social services and land-use and planning regulation. The heads of most of these departments are appointed by the Mayor and advised by commissions and boards appointed by City elected officials.

Elected officials include the Mayor, Members of the Board of Supervisors, Assessor-Recorder, City Attorney, District Attorney, Public Defender, Sheriff, Superior Court Judges, and Treasurer. Since November 2000, the eleven-member Board of Supervisors has been elected through district elections. The eleven district elections are staggered for five and six seats at a time, and held in even-numbered years. Board members serve four-year terms and vacancies are filled by Mayoral appointment.

San Francisco’s Budgetary Process

The City annually adopts budgets for all governmental funds and typically adopts project-length budgets for capital projects and certain debt service funds. The budget is adopted at the character level of expenditure within each department, and the department level and fund is the legal level of budgetary control. Note 2(c) to the Basic Financial Statements summarizes the budgetary roles of City officials and the timetable for their various budgetary actions according to the City Charter.

The voters adopted amendments to the Charter in November 2009 designed to further strengthen the City’s long-range financial planning. These changes include a required shift to the annual adoption of two-year budgets for all departments and funds by August 1st, 2012, with an option to shift to a fixed two-year budget cycle in future years. As further required by these amendments, the Board of Supervisors and Mayor approved a City five-year financial plan during this past fiscal year, and the City is required to update this document every two years going forward. Lastly, these Charter changes provided a mechanism for the Controller to propose, and the Board to adopt, various binding financial policies which can only be suspended by a supermajority of the Board. The Board approved a set of policies governing the City’s budget reserve practices in 2010 and the use of non-recurring revenues and General Fund-backed debt in 2011.

Internal and Budgetary Controls

In developing and evaluating the City’s accounting system, consideration is given 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.

The City maintains budgetary controls to ensure that legal provisions of the annual budget are in compliance and expenditures do not exceed budgeted amounts. Controls are exercised by integrating the budgetary accounts in fund ledgers for all budgeted funds. An encumbrance system is also used to account for purchase orders and other contractual commitments. Encumbered balances of appropriations at year-end are reported as assigned fund balance and are not reappropriated in the following year’s budget.
Cash Management

The City’s pooled deposits and investments are invested pursuant to policy established by the Treasurer working with the City’s Treasury Oversight Committee. The City’s investment policy seeks the preservation of capital, liquidity and a market rate of return, in that order. The policy addresses the safekeeping and custody practices with financial institutions in which the City deposits funds, types of investments permitted, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The earned income yield of fiscal year 2010-11 was 1.24%. 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 risk. 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 and supplemental appropriations. The City maintains limited coverage for certain facilities, primarily property of San Francisco International Airport, Port of San Francisco, Municipal Transportation Agency, Hetch Hetchy, Water Department, and art at City-owned museums. Additionally, various types of liability insurance are maintained by the City for the Port and the Airport. 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 are reported on the financial statements. They have been actuarially determined and include an estimate of incurred but not reported losses.

Pension Trust Fund Operations

The City has a defined benefit retirement plan in which a substantial majority of full-time employees participate. The plan’s most recent actuarial calculations, as of July 1st, 2010, estimate the plan is 91% funded. The required employer contribution rate was 13.56% of pensionable salary costs in fiscal year 2010-11 and is 18.09% in fiscal year 2011-12.

Key Government Initiatives

San Francisco’s economy depends on investments in infrastructure that benefit City residents, workers, visitors, and businesses. These economic foundations range from housing and commercial development, to transportation infrastructure, investments in health and human services, and the City’s quality of life. The City is taking steps to strengthen this infrastructure, to support San Francisco’s economic recovery and long-term prosperity. Some important initiatives are described below.

Housing and Commercial Development

San Francisco’s recovery and future economic growth depends on meeting the demand for new residential and commercial space. Despite the recession, the City has continued to make progress on these objectives. After years of planning, three significant, large-scale redevelopment projects received final approvals in fiscal year 2010-11. Upon full build-out and occupancy, these developments are planned to add more than 24,000 housing units to the City’s inventory, accommodating an estimated 55,000 new residents. Combined, the non-residential uses within these mixed-use developments are anticipated to accommodate up to 16,000 jobs at build-out.

Hunters Point Shipyard Redevelopment

The redevelopment project for the Hunters Point Shipyard, a former naval base, includes plans for a master-planned community totaling approximately 500 acres, located along the southeastern waterfront of San Francisco. The redevelopment plan amendments for the Shipyard and Bayview Hunters Point were approved by the Board in August 2010 along with other necessary land use, financing and land
transfer legislation to provide for the integrated planning and development of the Shipyard and the Candlestick Point (approximately 280 acres) consistent with Proposition G approved by the voters in 2008. Development of the Shipyard is a public-private partnership between the City, the Redevelopment Agency and a private development team.

The first phase of the Shipyard's development is already underway and includes up to 1,600 homes, 27% to 40% of which will be affordable, and 26 acres of open space. The balance of the Shipyard development will be built in conjunction with Candlestick Point as one development project. This second phase of the program provides for an additional 10,500 new housing units, 32% of which will be affordable, including the rebuilding of the Alice Griffith public housing development. The second phase also includes up to three million square feet of research and development space centered around a clean tech business incubator and the headquarters for the United Nations Global Compact Sustainability Center, which will be located in the project area. The redevelopment plan also includes over 300 acres of parks and open space, including a complete renovation of the Candlestick Point State Recreation area, and a potential stadium site. Development will be phased over approximately 20 years, and upon completion is anticipated to house approximately 25,000 residents and support more than 12,000 permanent jobs within the planned commercial space.

Treasure Island Redevelopment

After a 15-year planning and entitlement process the Board of Supervisors granted final approval for the redevelopment of Treasure Island in June 2011, a plan that will convert the former Navy base into one of the most environmentally sustainable developments in U.S. history. The City, acting by and through the Treasure Island Development Authority (TIDA) as the local reuse authority, is responsible for the long-term redevelopment of Treasure Island. Over the past decade, the City has crafted redevelopment plans for what has been widely heralded as one of the most environmentally sustainable developments in U.S. history.

These plans include a mixed-use development containing a new commercial town center and residential neighborhood with up to 8,000 new homes (30% of which will be below market rate homes including for hundreds of formerly homeless through the nationally-recognized Treasure Island Homeless Development Initiative), two hotels, and hundreds of acres of parks and open space. The project will generate thousands of construction jobs annually for the 10-20 year life of the project. Once realized, Treasure Island will generate over 3,000 permanent jobs.

Park Merced Complex

A public-private redevelopment plan for the Park Merced complex in the City’s southwest corner, was approved in May 2011. The redevelopment of the existing 3,200-unit 1950's-era Park Merced is expected to occur in phases and is projected to add 5,600 net new residential units and 300,000 square feet of new neighborhood-serving retail and office uses. Additionally, the plan anticipates the extension of a light rail line into the heart of a new transit-oriented neighborhood. When completed, the project plans to house 12,300 new residents and create 1,600 new full-time jobs.

Improving the City’s Public Transportation Systems

San Francisco is ideally situated to serve the Bay Area’s need to rapidly bring a large numbers of workers into a transit-accessible employment center, and efficiently navigate the dense City on foot, mass transit, taxi or bicycle.

Plans for a multi-modal transit hub located in the City’s core – the Transbay Transit Center – are targeted to meet this regional need. The center is designed to provide expanded bus, commuter train, and ultimately high-speed rail connections into the City from within the region and state, and to provide pedestrian connections to nearby intracity subway, surface rail, and bus services within the City. The former terminal at the site has been demolished with completion of the new center targeted for fiscal year 2016-17. The $1.6 billion transit center is funded through a host of revenue sources, including federal stimulus funding, tax increment and other revenues generated from planned dense, mixed-use development adjacent to the site.
The City has begun preliminary construction work on the Central Subway project, the second phase of a program designed to create a light-rail line running from Chinatown, under the heart of downtown, and connecting to the most-recent extension of the light-rail system to the Southeast portion of the City. The subway will connect to Bay Area Rapid Transit (BART) and Caltrain, the region’s two largest regional commuter rail services. The Central Subway project, with an estimated budget of $1.6 billion and a targeted completion date of 2018, is estimated to provide approximately 35,000 daily boardings at four stations along the new 1.7 mile line. Once completed, the project will reduce travel times and congestion along some of the most congested vehicular and public transit routes in California.

The City completed the renovation of Terminal 2 at San Francisco International Airport (SFO) during this past fiscal year. This $383 million project, featured on the cover of this report, provides a state-of-the-art domestic terminal at the airport. The terminal expands the number of gates available at SFO by 17%, and is now home to both American Airlines and Virgin America. The project was necessitated by the continued growth in passenger volumes at SFO, which accounts for 96% of international air travel and 69% of all air travel into the Bay Area.

**Strengthening the Region’s Water and Sewer Infrastructure**

The City is half-way complete with a $4.6 billion program to upgrade the City’s local and regional water system, known as the Water System Improvement Program (WSIP). The WSIP delivers capital improvements that enhance the system’s ability to provide reliable, affordable, high-quality drinking water to the system’s wholesale and regional retail customers in Alameda, Santa Clara and San Mateo counties, collectively serving some 1.7 million people outside of San Francisco, as well as another 800,000 retail customers in San Francisco. The program is structured to cost effectively meet water quality requirements, improve seismic and delivery reliability, and meet long-term water supply objectives. The WSIP is projected to be fully completed by the middle of 2016.

Planning work is underway for a needed upgrade to the City’s wastewater system, a system predominantly built out over the past century. Although significant investment occurred in the mid 1970s through the mid 1990s to comply with the Clean Water Act, today many of the existing facilities are in need of upgrade and major improvement to prepare San Francisco for the future. The sewer system includes nearly 1,000 miles of collection and transmission mains, four treatment plants, a solids handling system, and major force mains and interceptors. The total cost of the sewer system improvement program is projected to be between $6 to $7 billion over a period of up to 30 years, including an estimated $4 billion during the coming ten years. Planning, design, and environmental work will progress during the coming two fiscal years.

**Rebuilding the City’s Public Hospitals**

The City is in the process of replacing and modernizing both of its public hospitals, Laguna Honda Rehabilitation Center and San Francisco General Hospital.

The replacement of Laguna Honda Hospital was largely completed in fiscal year 2009-10. The $585 million project has been funded with a mix of General Obligation bonds, tobacco settlement revenues, and certificates of participation. Three new seismically-safe buildings, home to 780 residents, were occupied in December 2010.

The voters approved a General Obligation bond measure to fund the replacement of San Francisco General Hospital in November 2008. This $887 million project is required given changes to state law governing seismic requirements for hospitals. It will replace the existing facility with a new nine-story building on the existing hospital campus. The hospital is the only trauma center in San Francisco, and also acts as the safety net hospital for our residents. Construction of the project has begun, with completion expected in fiscal year 2014-15.
Expanding Access to Healthcare

Public health and human services are important to the long-term health and well-being of City residents, and to the overall productivity of the City’s workforce. The City offers a host of health and safety net services, including operation of two public hospitals, the administration of federal, state, and local entitlement programs, and a vast array of community-based health and human services.

The City launched the Healthy San Francisco program in 2007 with the goal of increasing access to healthcare for San Francisco residents. The program creates a mandate for many businesses in San Francisco to either provide employer-paid health insurance for their employees or to pay into an expansion of the City’s public health network. The program is funded with a mix of local and federal funding, employer-paid contributions, and participant fees.

During this past fiscal year, the City’s Department of Public Health has focused on expanding enrollment and broadening the medical provider network participating in the program. The provider network now includes 36 public and private medical facilities. By the end of fiscal year 2010-11, over 54,000 uninsured adult residents had enrolled in the program, or approximately 85% of the City’s estimated adult uninsured population.

Modernizing the City’s Parks and Libraries

San Francisco voters have approved a number of bond measures to fund capital improvements to the City’s parks and libraries during the past decade, including the most recent approval of a $185 million general obligation bond for improvements to neighborhood parks in February 2008. This most-recent parks improvement measure includes funds for seismic improvement, disability access, and facility renovation at key facilities and parks throughout the City. Design or construction work is now underway on the majority of the planned program, and is scheduled for completion by fiscal year 2013-2014.

A comprehensive capital improvement program intended to renovate the City’s branch library system is proceeding, with planned improvements in 22 of the 24 branch libraries included within the capital program now complete. The $187 million program, funded with a mix of general obligation and lease-revenue bonds, focuses on seismic safety, accessibility, and modernization of facilities for current uses. Final completion of the improvement program is scheduled by fiscal year 2013-14.

Other Information

Independent Audit

The City’s Charter requires an annual audit of the Controller’s records. These records, represented in the Comprehensive Annual Financial Report (CAFR) have been audited by the nationally recognized certified public accounting firm, Macias Gini & O’Connell LLP. 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 year’s financial statements is presented in the Financial Section.

Award for Financial Reporting

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, 2010. This was the 29th consecutive year, beginning with the fiscal year ending June 30, 1982, that the City has achieved this prestigious award. A Certificate of Achievement is valid for a period of one year only. 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 Generally Accepted Accounting Principles (GAAP) and applicable legal requirements.
Acknowledgements

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 Macias Gini & O’Connell 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,

[Signature]

Ben Rosenfield
Controller