



**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Financial Statements
and Supplemental Schedules

June 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

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KPMG LLP
55 Second Street
San Francisco, CA 94105

Independent Auditors' Report

The Honorable Mayor, Board of Supervisors
and Municipal Transportation Agency Board of Directors
City and County of San Francisco, California:

We have audited the accompanying financial statements of the San Francisco Municipal Railway (MUNI) and the San Francisco Municipal Railway Improvement Corporation (SFMRIC), departments of the City and County of San Francisco, California (the City) and the Municipal Transportation Agency (MTA), as of and for the years ended June 30, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the management of MUNI and SFMRIC. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MUNI's and SFMRIC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only MUNI and SFMRIC and do not purport to, and do not, present fairly the financial position of the City and MTA as of June 30, 2006 and 2005, and the changes in its financial position or, where applicable its cash flows, for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of MUNI and SFMRIC as of June 30, 2006 and 2005, and their changes in financial position and cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 27, 2006, on our consideration of MUNI's and SFMRIC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



The management's discussion and analysis on pages 3 through 10 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the basic financial statements of MUNI and SFMRIC. The accompanying supplemental schedules as listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, are fairly stated, in all material respects, in relation to the financial statements taken as a whole.

KPMG LLP

October 27, 2006

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As management of the San Francisco Municipal Railway (MUNI) and the San Francisco Municipal Railway Improvement Corporation (SFMRIC), we offer readers of MUNI and SFMRIC's financial statements this narrative overview and analysis of the financial activities of MUNI and SFMRIC for the fiscal years ended June 30, 2006 and 2005. We encourage readers to consider the information presented here in conjunction with information contained in the financial statements. All amounts, unless otherwise noted, are expressed in thousands of dollars.

Financial Highlights

- The assets of MUNI and SFMRIC exceeded their liabilities at the close of the most recent fiscal year by \$1,761,296.
- MUNI and SFMRIC's total net assets increased by \$40,786. This increase is due primarily to an increase in revenues and subsidy support.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to MUNI and SFMRIC's financial statements, which can be found on pages 11 through 15 of this report. MUNI is an enterprise fund of the City and County of San Francisco (the City). SFMRIC is a nonprofit corporation established to provide capital financial assistance on behalf of the City for the modernization of MUNI by purchasing equipment and improving facilities. SFMRIC has no employees. As explained in note 2(a) to the financial statements (page 16), MUNI and SFMRIC applies Governmental Accounting Standards Board (GASB) Statements. MUNI and SFMRIC are an integral part of the City and these financial statements are included in the City's Comprehensive Annual Financial Report. More information regarding MUNI and SFMRIC's organization and the basis of presentation is contained in notes 1 and 2(a). Only the accounts of MUNI and SFMRIC are included in these financial statements.

The statements of net assets (found on pages 11 and 12) present information on all of MUNI and SFMRIC'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 the financial position of MUNI and SFMRIC. Comparative information of MUNI and SFMRIC's financial position is presented as of June 30, 2006 and 2005.

The statements of revenues, expenses, and changes in net assets (found on page 13) present information showing how MUNI and SFMRIC's net assets changed during the most recent two fiscal years. 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. Revenues and expenses are reported in these statements for some items that will result in cash flows in future fiscal periods.

The statements of cash flows (found on pages 14 and 15) present information about the cash receipts and payments of MUNI and SFMRIC during the most recent two fiscal years. These statements show the effects on MUNI and SFMRIC's cash balances of cash flows from operating, noncapital financing, capital and related financing, and investing activities. When used with related disclosures and information in the other financial statements, the information in the statements of cash flows helps readers assess MUNI and SFMRIC's ability to

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generate net cash flows, their ability to meet their obligations as they come due, and their needs for external financing.

Notes to Financial Statements

The notes provide additional information that is essential to the full understanding of the data provided in the financial statements. The notes to financial statements can be found on pages 16 through 31 of this report.

Other Information

The supplemental schedules found on pages 32 through 39 of this report are presented for the purpose of additional analysis and are not a required part of the financial statements.

Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of an entity's financial position. In the case of MUNI and SFMRIC, assets exceeded liabilities by \$1,761,296 at the close of the most recent fiscal year.

Summary of Net Assets

June 30, 2006, 2005, and 2004

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Assets:			
Total current assets	\$ 192,405	151,742	158,873
Total restricted assets	32,487	41,477	47,425
Noncurrent deferred charges	—	—	4,000
Capital assets	<u>1,782,880</u>	<u>1,778,547</u>	<u>1,745,399</u>
Total assets	<u>2,007,772</u>	<u>1,971,766</u>	<u>1,955,697</u>
Liabilities:			
Total current liabilities	96,715	98,068	103,665
Total noncurrent liabilities	<u>149,761</u>	<u>153,188</u>	<u>151,480</u>
Total liabilities	<u>246,476</u>	<u>251,256</u>	<u>255,145</u>
Net assets:			
Invested in capital assets, net of related debt	1,782,880	1,778,547	1,745,231
Restricted net assets	31,590	40,616	46,484
Unrestricted net assets	<u>(53,174)</u>	<u>(98,653)</u>	<u>(91,163)</u>
Total net assets	<u>\$ 1,761,296</u>	<u>1,720,510</u>	<u>1,700,552</u>

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Fiscal Year 2006

MUNI and SFMRIC's net assets increased by \$40,786 with the unrestricted net asset deficit position significantly lower compared to the prior year. This is due to increase in revenues and subsidy support from general fund as compared to prior fiscal year.

Almost all of MUNI's net assets (\$1,782,880 as of June 30, 2006) reflect its investment in capital assets (specifically land, building structure and improvements, equipment, infrastructure, and construction-in-progress). The value of these assets of \$2,485,089 is offset by accumulated depreciation and amortization of \$702,209. More information can be found in note 5 on pages 22 through 24. MUNI and SFMRIC use these assets to provide services.

The remainder of MUNI's net assets is composed of restricted net assets including deposits and investments with the City and receivables and unrestricted net assets in a deficit position.

Fiscal Year 2005

MUNI and SFMRIC's net assets increased by \$19,958 compared to the prior year, due primarily to an increase in total capital assets, less accumulated depreciation and amortization. Specifically, there were increases in construction-in-progress for new projects and construction work on Third Street Light Rail and capitalization of infrastructure investments.

Almost all of MUNI's net assets (\$1,778,547 as of June 30, 2005) reflect its investment in capital assets (specifically land, building structure and improvements, equipment, infrastructure, and construction-in-progress). The value of these assets of \$2,405,235 is offset by accumulated depreciation and amortization of \$626,688. More information can be found in note 5 on pages 22 through 24.

MUNI and SFMRIC use these assets to provide services. The investment is shown reported net of related debt. As of June 30, 2005, there was no related debt outstanding. In fiscal year 2004, the related debt amounted to \$168. The related debt outstanding in fiscal year 2003 amounted to \$331.

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The remainder of MUNI's net assets is composed of restricted net assets including deposits and investments with the City and receivables and unrestricted net assets in a deficit position.

Summary of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2006, 2005, and 2004

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Revenues:			
Total operating revenues	\$ 141,135	127,431	127,317
Total nonoperating revenues, net	249,815	229,652	221,113
Capital contributions:			
Federal	43,923	42,240	60,434
State and others	46,608	81,747	107,481
Total capital contributions	90,531	123,987	167,915
Total operating transfers in	140,405	117,953	116,689
Total revenues and transfers in	621,886	599,023	633,034
Expenses:			
Total operating expenses	581,100	579,065	553,121
Change in net assets	40,786	19,958	79,913
Total net assets – beginning	1,720,510	1,700,552	1,620,639
Total net assets – ending	\$ 1,761,296	1,720,510	1,700,552

Fiscal Year 2006

Total revenues and transfers in for the year ended June 30, 2006 were \$621,886. This is \$22,863 higher than from the previous year, due primarily to increase in operating revenues, nonoperating revenues, and operating transfers offset by decrease in capital contributions.

Net operating revenues increased by \$13,704, or 11%. There was a \$14,360 increase in transit passenger fares revenue as a result of the implementation of another fare rate increase that took into effect in September 2005. Nonoperating revenues increased compared to the previous year by \$20,163 or 9%. This category includes operating support received from other sources, primarily federal and state operating grants and parking-related revenues, such as parking fines, taxes, garages, and meters. The increase was attributable to increase in parking fines and from contributions from state operating grants. Capital contributions decreased by \$33,456 or 27%. Capital contributions consist principally of funds received or receivable from federal, state and local grant agencies that provide funding for many of MUNI's capital projects. There were less capital expenditures incurred

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and billable to the funding agencies than in the prior year. Net transfers increased by \$22,452 or 19% in 2006 compared to fiscal year 2005, due to additional City's fund subsidy allocated from City General Fund and Parking and Traffic budgetary support.

Total expenses for the year ended June 30, 2006, were \$581,100. Operating expenses slightly increased by \$2,035 or 0.4% compared from the previous year. The resulting net increase is comprised of trend changes from various expenses category in fiscal year 2006. The significant trend changes occurred in three major expense categories. Personal services net increase of \$3,942 is due to increase in salaries and retirement costs offset by the decrease in workers compensation expenses. Materials and supplies increased by \$3,699 due mostly to continuing rise in fuel costs. However, general and administrative operating expenses decreased by \$6,101, attributable partly to a decrease in general liability claims.

Fiscal Year 2005

Total revenues for the year ended June 30, 2005, were \$599,023. This is \$34,011 lower than from the previous year, due primarily to the decrease in capital contributions.

Operating revenues slightly increased by \$114, or 0.09%. There was a \$5,961 increase in transit passenger fares revenue as a result of the implementation of fare increase initiative that went into effect in fiscal year 2004 and \$1,830 net increases in other operating revenues, mostly attributable from Electric Transit Inc. (ETI) noncash transaction receipt of spare parts inventory as a result of a claim settlement. However, these increases were offset by a decrease in advertising revenue amounting to \$7,679. A new advertising contract went into effect in 2005 with negotiated provision for a guarantee payment of 75% lower than the previous contract. Nonoperating revenues increased compared to the previous year by \$8,539 or 3.86%. This category includes operating support received from other sources, primarily federal and state operating grants and parking-related revenues, such as parking fines, taxes, garages, and meters. Contributions from federal, state and local capital grants increased to support projects that were operating in nature including Transbay Terminal pass-through grants. Capital contributions decreased by \$43,928 or 26.16%. Capital contributions consist principally of funds received or receivable from federal, state and local grant agencies that provide funding for many of MUNI's capital projects. There were less capitalized expenditures incurred and billable to the funding agencies than prior year. Net transfers increased by \$1,264 or 1.08% in 2005 compared to fiscal year 2004, consist primarily of an additional city's General Fund subsidy allocated from City general fund due to increase revenue from real estate market boom.

Total expenses for the year ended June 30, 2005, were \$579,065. This is higher by \$25,944 than the previous year due to increases in contractual services, materials and supplies, general and administrative expenses, and in depreciation expense by \$4,841 for newly acquired rolling stock. General and administrative expenses net increase is attributable partly to general liability claims reserves, which increased by approximately \$11,790. Contractual services are higher than prior year due an increase of Transbay Terminal project recoverable cost incurred in 2005. Fuel costs increased by \$2,500 in fiscal year 2005 due to a higher unit price of diesel as compared to prior year.

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Capital Assets and Debt Administration

Capital Assets

MUNI and SFMRIC's investment in capital assets amounts to \$1,782,880 net of accumulated depreciation at June 30, 2006. This investment includes land, building structures and improvements, equipment, infrastructure, and construction-in-progress. The capital assets net increase is \$4,333 or 0.2%, compared to the previous year. This increase is attributed to continued construction work for new and existing projects as well as capitalization of building structures and infrastructure investments.

Summary of Capital Assets

	<u>Balance, June 30, 2006</u>	<u>Balance, June 30, 2005</u>	<u>Balance, June 30, 2004</u>
Capital assets not being depreciated:			
Land	\$ 18,481	18,481	18,481
Construction-in-progress	461,214	379,203	282,779
Total capital assets not being depreciated	<u>479,695</u>	<u>397,684</u>	<u>301,260</u>
Capital assets being depreciated:			
Building structures and improvements	247,522	244,272	238,520
Equipment	1,038,806	1,046,554	1,046,790
Infrastructure	719,066	716,725	703,673
Total capital assets being depreciated	<u>2,005,394</u>	<u>2,007,551</u>	<u>1,988,983</u>
Less accumulated depreciation for:			
Building structures and improvements	105,378	99,398	93,555
Equipment	342,242	295,607	242,287
Infrastructure	254,589	231,683	209,002
Total accumulated depreciation	<u>702,209</u>	<u>626,688</u>	<u>544,844</u>
Total capital assets being depreciated, net	<u>1,303,185</u>	<u>1,380,863</u>	<u>1,444,139</u>
Total capital assets, net	<u><u>\$ 1,782,880</u></u>	<u><u>1,778,547</u></u>	<u><u>1,745,399</u></u>

The Third Street Light Rail project, a major expansion of the MUNI Metro system, will link communities in the City's southeast neighborhoods to south of Market Street, Mission Bay, downtown, and the rest of the Metro system. Construction of Phase I, which links the 4th Street and King Street areas to the Bayshore Caltrain station is continuing and is scheduled to be complete on April 2007; testing, training and operations readiness exercises have started. Revenue service is scheduled with limited weekend service starting on January 13, 2007 with full

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service on April 7, 2007. Phase II of the Third Street project, the Central Subway, will provide an underground transit link between 4th Street and King Street north to Union Square and Chinatown. In fiscal year 2006, conceptual engineering and the supplemental environmental process continued in parallel for the 4th Street alignment of the Central Subway Project.

Other capital asset events during the fiscal year 2006 included:

- Completion and capitalization of the Cable Car Renovation project amounting to \$2.9 million.
- Completion and capitalization of the Metro Access Improvement Project in the amount of \$2.2 million.

Other capital asset events during the fiscal year 2005 included:

- Acquisition of 11 New Jersey PCC Historic Streetcars.
- Completion and capitalization of the Signal Preemption Project amounting to \$1.9 million.
- Completion and capitalization of the Overhead Reconstruction Project in the amount of \$11.2 million for Line 6 and Line 7.
- Completion and capitalization of Flynn Facility lift modification project.

Leveraged Lease-Leaseback of Breda Vehicles

In April 2002, MUNI entered into the leveraged lease-leaseback transaction over 118 Breda light rail vehicles (the Equipment). The transaction was structured as a head lease of the Equipment to separate special purpose trusts and a sublease of the Equipment back from such trusts. The sublease provides MUNI with an option to purchase the Equipment in approximately 27 years, the scheduled completion date of the sublease. During the term of the sublease, MUNI maintains custody of the Equipment and is obligated to insure and maintain the Equipment throughout the life of the sublease.

MUNI received an aggregate of \$388.2 million from the equity investors in full prepayment of the head lease. MUNI deposited \$352.7 million of this lease payment into two escrows. One escrow was deposited with a debt payment undertaker whose repayment obligations are guaranteed by Financial Security Assurance, Inc., an "Aaa/AAA" bond insurance company.

MUNI recorded deferred revenue in fiscal year 2002 of \$35.5 million for the difference between the amount received of \$388.2 and the amount paid to the escrows of \$352.7 million. The deferred revenue amortized in fiscal year 2006 amounted to \$1.3 million.

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In September 2003, after obtaining final approval from the Municipal Transportation Agency (MTA) board of directors and the City and County's board of supervisors, MUNI entered into a second leveraged lease-leaseback transaction over 21 Breda light rail vehicles (the Equipment). The transaction was structured as a head lease of the Equipment to one separate special purpose trust (formed on behalf of a certain equity investor) and a sublease of the Equipment back from such trust. The sublease provides MUNI with an option to purchase the Equipment in approximately 26 years, the scheduled completion date of the sublease. During the term of the sublease, MUNI maintains custody of the Equipment and is obligated to insure and maintain the Equipment throughout the life of the sublease.

MUNI received an aggregate of \$72.6 million from the equity investors in full prepayment of the head lease. MUNI deposited approximately \$67.5 million of this head lease payment into two escrows. The deferred revenue amortized in fiscal year 2006 amounted to \$168.

Long-Term Debt

SFMRIC is authorized to issue debt to fund each of its programs, but no debt or bonds are outstanding. MUNI's Transit Improvement Program (TIP) is also authorized to issue bonds, but no bonds were outstanding as of June 30, 2006 or 2005.

Economic Factors and Next Year's Budget

The impact of the economic recession that began in April 2000 continues to affect several of the revenue sources within the MTA. In fiscal year 2002, the MTA's revenue sources began to decline as they are sensitive to economic conditions such as employment and tourism levels. At the same time, the fixed costs associated with MTA's core services have continued to rise, such as wage rates, health benefits costs, and fuel costs. In FY 2006, the MTA instituted fares/fines/rates increases to generate additional revenues. As a result of these factors, the MTA and the City and County of San Francisco implemented measures to balance the fiscal year 2007 budget by increasing the general fund contributions; increasing garage rates; implementing new revenue generating initiatives; increasing intergovernmental revenues.

Requests for Information

This report is designed to provide a general overview of MUNI and SFMRIC's finances for all those with a general interest. The financial statements and related disclosures in the notes to the financial statements and supplemental information are presented in accordance with U.S. generally accepted accounting principles. Questions regarding any of the information provided in this report or requests for additional financial information should be addressed to the Chief Financial Officer, MTA Finance and Administration, 1 South Van Ness Avenue, 7th Floor, San Francisco, CA 94103.

Questions regarding the City and County of San Francisco or request for a copy of the City's Comprehensive Annual Financial Report should be addressed to the Office of the Controller, City Hall, 1 Dr. Carlton B. Goodlett Place, Room 316, San Francisco, CA 94102.

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Statements of Net Assets

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(In thousands)

	<u>2006</u>	<u>2005</u>
Assets:		
Current assets:		
Deposits and investments with City Treasury	\$ 44,354	11,903
Deposits and investments held outside City Treasury	100	100
Cash on hand	507	347
Receivables:		
Grants	52,626	47,812
Due from the San Francisco County Transportation Authority	24,822	26,732
Due from other City departments	—	2,574
Charges for services (net of allowance for doubtful accounts of \$933 and \$1,430 in 2006 and 2005, respectively)	6,995	1,220
Other (net of allowance for doubtful accounts of \$118)	19,413	18,094
Total receivables	103,856	96,432
Inventories	43,189	42,959
Current deferred charges	399	1
Total current assets	192,405	151,742
Restricted assets:		
Deposits and investments with City Treasury:		
Transit Impact Development Fee	23,131	32,028
Other restricted investments	885	816
Deposits and investments held outside City Treasury	3,416	3,320
Interest receivable	9	10
Transit Impact Development Fee receivable, net	5,046	5,303
Total restricted assets	32,487	41,477
Capital assets	1,782,880	1,778,547
Total noncurrent assets	1,815,367	1,820,024
Total assets	2,007,772	1,971,766

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Statements of Net Assets

June 30, 2006 and 2005

(In thousands)

	<u>2006</u>	<u>2005</u>
Liabilities:		
Current liabilities:		
Due to other funds	\$ 145	2,593
Accounts payable and accrued expenses	25,902	27,289
Accrued payroll	14,396	13,317
Accrued vacation and sick leave	12,273	12,161
Accrued workers' compensation	21,488	22,837
Accrued claims	19,356	15,975
Deferred revenue and other deferred credits	2,259	3,035
Payable from restricted assets	896	861
Total current liabilities	<u>96,715</u>	<u>98,068</u>
Noncurrent liabilities:		
Accrued vacation and sick leave	9,469	9,086
Accrued workers' compensation	72,243	79,841
Accrued claims	35,329	30,057
Deferred revenue and other deferred credits	32,720	34,204
Total noncurrent liabilities	<u>149,761</u>	<u>153,188</u>
Total liabilities	<u>246,476</u>	<u>251,256</u>
Net assets:		
Invested in capital assets, net of related debt	\$ 1,782,880	1,778,547
Restricted	31,590	40,616
Unrestricted	<u>(53,174)</u>	<u>(98,653)</u>
Total net assets	<u>\$ 1,761,296</u>	<u>1,720,510</u>

See accompanying notes to financial statements.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Statements of Revenues, Expenses,
and Changes in Net Assets

Years ended June 30, 2006 and 2005

(In thousands)

	2006	2005
Operating revenues:		
Passenger fares	\$ 134,553	120,193
Advertising	4,423	3,927
Paratransit revenue	1,411	1,375
Charter service	2	20
Rental income	631	246
Other	115	1,670
Total operating revenues	<u>141,135</u>	<u>127,431</u>
Operating expenses:		
Personal services	374,504	370,562
Contractual services	23,728	24,609
Materials and supplies	32,904	29,205
Depreciation	87,141	86,305
Services from other City departments	24,944	22,383
General and administrative	33,015	39,116
Other operating expenses	4,864	6,885
Total operating expenses	<u>581,100</u>	<u>579,065</u>
Operating loss	<u>(439,965)</u>	<u>(451,634)</u>
Nonoperating revenues (expenses and losses):		
Operating assistance:		
Department of Parking and Traffic	140,008	132,708
Federal	23,651	23,214
State and other grants	84,153	75,717
Transit Impact Development Fee, net of expenses	111	191
Capital reserve revenue	1,483	1,484
Interest income	2,040	1,699
Interest expense	(543)	(389)
Loss on disposal of capital assets	(386)	(545)
Other, net	(702)	(4,427)
Total nonoperating revenues, net	<u>249,815</u>	<u>229,652</u>
Loss before capital contributions and transfers	<u>(190,150)</u>	<u>(221,982)</u>
Capital contributions:		
Federal	43,923	42,240
State and others	46,608	81,747
Total capital contributions	<u>90,531</u>	<u>123,987</u>
Transfers in:		
City and County of San Francisco – General Fund	118,377	101,704
San Francisco County Transportation Authority	15,594	16,177
San Francisco Public Works Department	—	72
San Francisco Water Department	542	—
San Francisco Parking and Traffic Department	5,892	—
Total transfers in	<u>140,405</u>	<u>117,953</u>
Change in net assets	40,786	19,958
Total net assets – beginning	<u>1,720,510</u>	<u>1,700,552</u>
Total net assets – ending	<u>\$ 1,761,296</u>	<u>1,720,510</u>

See accompanying notes to financial statements.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Statements of Cash Flows

Years ended June 30, 2006 and 2005

(In thousands)

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Cash received from passengers and service contracts	\$ 149,448	146,977
Cash paid to employees for services	(381,909)	(374,110)
Cash paid to suppliers for goods and services	(89,245)	(95,496)
Cash paid for judgment and claims	(7,742)	(7,490)
Cash paid for quasi-external transactions	(27,777)	(22,011)
Net cash used in operating activities	<u>(357,225)</u>	<u>(352,130)</u>
Cash flows from noncapital financing activities:		
Operating grants	230,888	218,650
Transfers in	140,405	117,953
Transit Impact Development Fee received, net of expenses	410	426
Other noncapital decreases	(821)	(211)
Net cash provided by noncapital financing activities	<u>370,882</u>	<u>336,818</u>
Cash flows from capital and related financing activities:		
Capital grants	103,653	135,814
Proceeds from sale of capital assets	16	17
Payment on capital lease obligation	—	(168)
Acquisition of capital assets	(97,452)	(131,414)
Other capital increases	2,574	—
Other capital decreases	—	(670)
Net cash provided by capital and related financing activities	<u>8,791</u>	<u>3,579</u>
Cash flows from investing activities:		
Proceeds from sale of investments with trustees – restricted	460	1,285
Interest income received	1,976	1,680
Interest expense paid	(543)	(389)
Net cash provided by investing activities	<u>1,893</u>	<u>2,576</u>
Net increase (decrease) in cash and cash equivalents	24,341	(9,157)
Cash and cash equivalents – beginning of year	45,604	54,761
Cash and cash equivalents – end of year	<u>\$ 69,945</u>	<u>45,604</u>

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Statements of Cash Flows

Years ended June 30, 2006 and 2005

(In thousands)

	<u>2006</u>	<u>2005</u>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (439,965)	(451,634)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	87,141	86,305
Provision for doubtful accounts	(378)	1,404
Changes in operating assets and liabilities:		
Receivables, net	(5,788)	2,653
Inventories	(230)	(3,806)
Deferred charges	(398)	4,000
Accounts payable and accrued expenses	3,789	70
Accrued payroll	1,061	1,242
Accrued vacation and sick leave	495	(288)
Accrued workers' compensation	(8,947)	(4,502)
Accrued claims	8,653	15,687
Due to other funds	(2,448)	372
Deferred revenues and other deferred credits	(210)	(3,633)
Net cash used in operating activities	\$ <u>(357,225)</u>	<u>(352,130)</u>
Reconciliation of cash and cash equivalents to the statements of net assets:		
Deposits with City Treasury:		
Unrestricted	\$ 44,354	11,903
Restricted	24,016	32,844
Deposits held outside City Treasury:		
Unrestricted	100	100
Restricted	968	410
Cash on hand	507	347
Total cash and cash equivalents, end of year	\$ <u>69,945</u>	<u>45,604</u>

See accompanying notes to financial statements.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2006 and 2005

(Dollars in thousands, unless otherwise noted)

(1) Description of Reporting Entity

The financial statements include the San Francisco Municipal Railway (MUNI) and the San Francisco Municipal Railway Improvement Corporation (SFMRIC), whose operations are interrelated. All significant inter-entity transactions have been eliminated. The entities together are a department of the City and County of San Francisco (the City) and, as such, are reported as an enterprise fund in the City's Comprehensive Annual Financial Report.

MUNI has been the transit agency for the City since 1912, making it one of the first public transit agencies in the United States. MUNI's sources of income include passenger fares, grant funds, City subsidies, and other miscellaneous revenues. In November 1999, voters approved Proposition E, a Charter amendment, which authorized the creation of the Municipal Transportation Agency (MTA) to run MUNI and the MTA Board of Directors to oversee MUNI. The Board of Directors is comprised of seven members as appointed by the Mayor of San Francisco and confirmed by the Board of Supervisors of San Francisco. Directors' terms are staggered. Proposition E sets standards for performance and service to be provided by MUNI.

Proposition E also called for the integration of the City's Department of Parking and Traffic (DPT) into the MTA by July 1, 2002. Although the MTA includes both the DPT and MUNI, these financial statements only reflect the operations and financial position of MUNI and SFMRIC.

SFMRIC is a nonprofit corporation whose sole purpose is to provide capital financial assistance on behalf of MUNI by purchasing equipment and improving facilities. SFMRIC has no employees.

(2) Significant Accounting Policies

(a) *Measurement Focus and Basis of Accounting*

The activities of MUNI and SFMRIC are reported using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded when the related liability is incurred. MUNI and SFMRIC apply all Governmental Accounting Standards Boards (GASB) Statements, as well as the Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

(b) *Cash and Cash Equivalents*

MUNI maintains its deposits and investments and a portion of its restricted deposits and investments as part of the City's pool of cash and investments. MUNI's portion of this pool is displayed on the statement of net assets as "Deposits and investments with City Treasury." Income earned or losses arising from pooled investments are allocated on a monthly basis to appropriate funds and entities based on their average daily cash balances.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
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Notes to Financial Statements

June 30, 2006 and 2005

(Dollars in thousands, unless otherwise noted)

In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, the City reports certain investments at fair value in the statements of net assets and recognizes the corresponding change in fair value of investments in the year in which the change occurred. In accordance with GASB Statement No. 31, MUNI has reported its investments at fair value based on quoted market information obtained from fiscal agents or other sources.

MUNI considers its pooled deposits and investments with the City Treasury to be demand deposits and, therefore, cash equivalents for the purposes of the statements of cash flows. The City also may hold nonpooled deposits and investments for MUNI. Nonpooled restricted deposits and highly liquid investments with maturities of three months or less are considered to be cash equivalents.

Restricted deposits and investments held by the trustee are not considered to be cash and cash equivalents.

Of the restricted deposits and investments of SFRMIC which are held outside City Treasury, \$968 as of June 30, 2006, and \$410 as of June 30, 2005 are considered cash equivalents as they meet the definition of cash equivalents.

(c) Investments

MUNI and SFMRIC record investments at fair value with changes in fair value recorded as a component of nonoperating revenue (expenses and losses).

(d) Inventories

Inventories are valued using the average-cost method. Inventories are expensed using the consumption method.

Rebuilt inventory items include motors, transmission, and other smaller parts that are removed from existing coaches that are overhauled and repaired.

(e) Capital Assets

Capital assets are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets which range from 10 to 60 years for building structures and improvements, equipment, and infrastructure. No depreciation is recorded in the year of acquisition and a full year's depreciation is taken in the year of disposal.

(f) Construction-in-Progress

Construction-in-progress represents the design and construction costs of various uncompleted projects. As facilities are accepted by MUNI and become operative, they are transferred to building structures and improvements, equipment, infrastructures, accounts and depreciated in accordance

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2006 and 2005

(Dollars in thousands, unless otherwise noted)

with MUNI's depreciation policies. Costs of construction projects that are discontinued are recorded as expense in the year in which the decision is made to discontinue such projects.

(g) *Accrued Vacation and Sick Leave*

Accrued vacation pay, which vests and may be accumulated up to ten weeks per employee, is charged to expense as earned. Unused sick leave accumulated on or prior to December 6, 1978 is vested and payable upon termination of employment by retirement, death, or disability caused by industrial accident. Sick leave earned subsequent to that date is nonvesting, charged to expense when earned. The amount of allowable accumulation is set forth in various memorandums of understanding but is generally limited to six months per employee.

Effective July 1, 2002, any full-time employee leaving employment with the City upon service or disability retirement may receive payment of a portion of sick leave credits at the time of separation. The amount of this payment equals 2.5% of accrued sick leave credits at the time of separation, multiplied by the number of whole years of continuous employment, multiplied by the employee's salary rate, exclusive of premiums or supplements, at the time of separation. The number of hours for which an employee may receive cash payments cannot exceed one thousand forty (1,040) hours, including any vested sick leave.

(h) *Capital Grants and Contributions*

Capital grants and contributions from external sources are recognized as capital contribution earned at the time reimbursable expenditures related to the grants are incurred.

The U.S. Department of Transportation, through the Federal Transit Administration (FTA), provides capital assistance to MUNI for the acquisition and construction of transit-related property and equipment. This assistance generally approximates 80% of acquisition cost and is administered by MUNI and by the Metropolitan Transportation Commission (MTC). The capital assistance provided to MUNI by the California Transportation Commission and San Francisco County Transportation Authority (SFCTA) is generally used as local match to the federal capital assistance. However, additional capital assistance provided to MUNI by other agencies is administered by MTC, and is also generally used as a local match for the federal capital assistance. With the inception of the Third Street Light Rail Project, SFCTA is also a primary local funding source for capital projects. Certain MUNI expenditures for projects approved for funding by the SFCTA that are currently unbilled but will be billed to SFCTA in the near future are recorded as other current receivables.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
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Notes to Financial Statements

June 30, 2006 and 2005

(Dollars in thousands, unless otherwise noted)

(i) Operating Assistance Grants

Operating assistance grants are recognized as revenue when approved by the granting authority and/or when related expenditures are incurred.

MUNI receives operating assistance from federal and various state and local sources. Transportation Development Act funds are received from the City to meet, in part, MUNI's operating requirements based on annual claims filed with and approved by the MTC. Sales tax represents an allocation by MTC of the 1/2% transactions and use tax collected within San Francisco County for transit services. Federal operating assistance is distributed to MUNI by the FTA after approval by MTC.

(j) Transit Impact Development Fees

Transit Impact Development Fees (TIDF) are restricted for the capital and operating costs of increased peak period transit service associated with new office construction in downtown San Francisco. These fees are recorded as nonoperating revenues in the year in which they are assessed.

(k) Token Revenues

Token revenues are recognized at the time the tokens are sold.

(l) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
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IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2006 and 2005

(Dollars in thousands, unless otherwise noted)

(3) Net Assets

Net assets as of June 30, 2006 and 2005, consist of the following:

	<u>2006</u>	<u>2005</u>
Restricted assets:		
Deposits and investments with City Treasury	\$ 24,016	32,844
Deposits and investments outside City Treasury	3,416	3,320
Receivables	5,054	5,313
Total restricted assets	<u>32,486</u>	<u>41,477</u>
Restricted liabilities of:		
SFMRIC	(4)	(41)
Transit Impact Development Fee	(5)	(4)
Others	(887)	(816)
Total restricted liabilities	<u>(896)</u>	<u>(861)</u>
Restricted assets, net	<u>\$ 31,590</u>	<u>40,616</u>
Net assets:		
Restricted:		
Transit Impact Development Fee	\$ 28,172	37,328
SFMRIC	3,418	3,288
Total restricted net assets	31,590	40,616
Unrestricted	(53,174)	(98,653)
Invested in capital assets	<u>1,782,880</u>	<u>1,778,547</u>
Net assets	<u>\$ 1,761,296</u>	<u>1,720,510</u>

(4) Deposits and Investments

MUNI maintains its deposits and investments with City Treasury and a portion of its restricted asset deposits as part of the city's pool of deposits and investments. The City's investment pool is invested in an unrated pool pursuant to investment policy guidelines established by the City Treasurer. The objectives of the policy are, in order of priority, preservation of capital, liquidity, and yield. The policy addresses soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The Comprehensive Annual Financial Report of the City categorizes the level of common deposits and investment risks associated with the City's pooled deposits and investments. As of June 30, 2006 and 2005, MUNI and SFMRIC's unrestricted deposits and investments were \$44,961 and \$12,350, respectively.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
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IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2006 and 2005

(Dollars in thousands, unless otherwise noted)

The restricted assets' deposits and investments outside the City Treasury are held by a trustee. As of June 30, 2006 and 2005, MUNI and SFMRIC had deposits and investments with the trustee of \$3,416 and \$3,320, respectively. Of the deposits, \$968 and \$410 meet the definition of cash and cash equivalents as of June 30, 2006 and 2005, respectively.

The following table shows the percentage distribution of the City's pooled investments by maturity:

Investment maturities (in months)			
Under 1	1 – 6	6 – 12	12 – 36
44.9%	38.2%	2.8%	14.1%

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2006 and 2005

(Dollars in thousands, unless otherwise noted)

(5) Capital Assets

Capital asset balances and their movements as of and for the year ended June 30, 2006 and 2005 are as follows:

	<u>July 1, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2006</u>
Capital assets not being depreciated:				
Land	\$ 18,481	—	—	18,481
Construction-in-progress	379,203	90,748	(8,737)	461,214
Total capital assets not being depreciated	<u>397,684</u>	<u>90,748</u>	<u>(8,737)</u>	<u>479,695</u>
Capital assets being depreciated:				
Building structures and improvements	244,272	3,250	—	247,522
Equipment	1,046,554	4,275	(12,023)	1,038,806
Infrastructure	716,725	2,341	—	719,066
Total capital assets being depreciated	<u>2,007,551</u>	<u>9,866</u>	<u>(12,023)</u>	<u>2,005,394</u>
Less accumulated depreciation for:				
Building structures and improvements	99,398	5,980	—	105,378
Equipment	295,607	58,255	(11,620)	342,242
Infrastructure	231,683	22,906	—	254,589
Total accumulated depreciation	<u>626,688</u>	<u>87,141</u>	<u>(11,620)</u>	<u>702,209</u>
Total capital assets being depreciated, net	<u>1,380,863</u>	<u>(77,275)</u>	<u>(403)</u>	<u>1,303,185</u>
Total capital assets, net	<u>\$ 1,778,547</u>	<u>13,473</u>	<u>(9,140)</u>	<u>1,782,880</u>

**SAN FRANCISCO MUNICIPAL RAILWAY AND
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Notes to Financial Statements

June 30, 2006 and 2005

(Dollars in thousands, unless otherwise noted)

Certain motorbuses and vans were disposed of during 2006 for a net loss of \$402 offset by \$16 proceeds on the sale of these certain items.

	<u>July 1, 2004</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2005</u>
Capital assets not being depreciated:				
Land	\$ 18,481	—	—	18,481
Construction-in-progress	282,779	101,762	(5,338)	379,203
Total capital assets not being depreciated	<u>301,260</u>	<u>101,762</u>	<u>(5,338)</u>	<u>397,684</u>
Capital assets being depreciated:				
Building structures and improvements	238,520	5,752	—	244,272
Equipment	1,046,790	4,787	(5,023)	1,046,554
Infrastructure	703,673	13,052	—	716,725
Total capital assets being depreciated	<u>1,988,983</u>	<u>23,591</u>	<u>(5,023)</u>	<u>2,007,551</u>
Less accumulated depreciation for:				
Building structures and improvements	93,555	5,843	—	99,398
Equipment	242,287	57,781	(4,461)	295,607
Infrastructure	209,002	22,681	—	231,683
Total accumulated depreciation	<u>544,844</u>	<u>86,305</u>	<u>(4,461)</u>	<u>626,688</u>
Total capital assets being depreciated, net	<u>1,444,139</u>	<u>(62,714)</u>	<u>(562)</u>	<u>1,380,863</u>
Total capital assets, net	<u>\$ 1,745,399</u>	<u>39,048</u>	<u>(5,900)</u>	<u>1,778,547</u>

MUNI has capital assets acquired from 1945 to 1987 with estimated lives of over 50 years, mainly cable car barn rehabilitation and substations, with a total cost of \$25,701 and a net book value of \$16,064 as of June 30, 2006.

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(Dollars in thousands, unless otherwise noted)

Construction-in-progress consists of the following projects as of June 30, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Third Street light rail	\$ 358,646	301,207
Articulated trolley coaches	5,101	1,995
Rail replacement	4,846	2,671
Metro Access Improvement	—	2,236
Cable Car Renovation	—	1,770
Islais Creek-Woods Annex	4,634	4,369
Trolley Overhead Reconstruction	11,819	7,215
Vehicle Scheduling System	2,861	2,129
Flynn Facility Lift Construction	982	982
Vehicle Inventory Management	2,171	—
Automatic Vehicle Location	3,690	3,013
Burke Ave Central Warehouse	10,130	9,966
New Central Subway	13,308	9,538
Motor Bus Replacement	1,180	3,184
Bayshore & Geary Corridor	9,469	9,476
Light rail vehicles	5,496	1,955
Others	26,881	17,497
	<u>\$ 461,214</u>	<u>379,203</u>

(6) Long-Term Debt

SFMRIC is authorized to issue debt to fund each of its programs under separate indentures. Transit Equipment Progress bonds totaling \$51,500 have been authorized, of which \$30,500 is available for issuance and none are outstanding. Transit Improvement Program (TIP) bonds amounting to \$44,000 have been authorized, of which \$7,800 is available for issuance. As of June 30, 2006 and 2005, no bonds were outstanding under the TIP.

(7) Employee Benefit Plans

(a) Retirement Plan – City and County of San Francisco

Plan Description

The City has a single-employer defined benefit retirement plan (the Plan) which is administered by the San Francisco City and County Employees' Retirement System (the Retirement System). The Plan covers substantially all full-time employees of MUNI along with other employees of the City. The Plan provides basic retirement, disability, and death benefits based on specified percentages of final average salary, and provide cost-of-living adjustments after retirement. The Plan also provides pension continuation benefits to qualified survivors. The San Francisco City and County Charter and Administrative Code are the authority which establishes and amends the benefit provisions and

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employer obligations of the Plan. The Retirement System issues a publicly available financial report that includes financial statements and required supplemental information for the Plan. That report may be obtained by writing to the San Francisco City and County Employees' Retirement System, 30 Van Ness Avenue, Suite 3000, San Francisco, CA 94102, or by calling (415) 487-7020.

Funding Policy

Contributions are made to the basic plan by both MUNI and the participating employees. Employee contributions are mandatory. Employee contribution rates for 2006 and 2005 varied from 7% to 8% as a percentage of covered payroll. MUNI is required to contribute at an actuarially determined rate. For fiscal year 2006 and 2005, the actuarially determined contribution rate as a percentage of covered payroll was 6.58% and 4.48%, respectively. MUNI's required contribution was approximately \$16 million in 2006 and \$11 million in 2005.

MUNI's contributions to the Retirement System on behalf of its employees amounted to \$10,288 and \$10,016 for the years ended June 30, 2006 and 2005, respectively. MUNI paid 2.5% percent of the 7.5% employee contribution for most miscellaneous employees in FY2006. For those groups of employees not mandated to contribute to the Retirement System, MUNI's contributions remained at 7% to 8% of covered payroll. MUNI's contributions in fiscal years 2006 and 2005 were equal to required employee contributions.

(b) Deferred Compensation Plan

The City offers its employees, including MUNI employees, a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan is available to all employees and permits them to defer a portion of their salaries until future years. The deferred compensation is not available to employees or other beneficiaries until termination, retirement, death, or unforeseeable emergency.

MUNI has no administrative involvement and does not perform the investing function. MUNI has no fiduciary accountability for the plan, and accordingly, the plan assets and related liabilities to the plan participants are not included in these financial statements.

(c) Healthcare Benefits

Healthcare benefits for employees, retired employees, and surviving spouses (beneficiaries) are financed by beneficiaries and by the City through the City Health Service System, an employee benefit trust fund. The contribution for all of the City's fund groups is mandated and determined by a Charter provision based on similar contributions made by the ten most populous counties in California. The costs to MUNI for the years ended June 30, 2006 and 2005 were \$45,088 and \$44,446, respectively. Included in these amounts are \$14,073 and \$13,103 for fiscal year 2006 and fiscal year 2005, respectively, to provide postretirement healthcare benefits for retired employees.

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Notes to Financial Statements

June 30, 2006 and 2005

(Dollars in thousands, unless otherwise noted)

(8) Peninsula Corridor Joint Powers Board

The City is a participant in the Peninsula Corridor Joint Powers Board (PCJPB), along with the Santa Clara Valley Transportation Authority and the San Mateo County Transit District. PCJPB is governed by a separate board composed of nine members, three from each participant. The PCJPB was formed in October 1991 to plan, administer, and operate the Peninsula CalTrain rail service. The PCJPB began operating the Peninsula CalTrain rail service on July 1, 1992; prior to that time, such rail service was operated by the California Department of Transportation. The agreement establishing the PCJPB expired in 2001, upon which it will continue on a year-to-year basis thereafter, until a participant withdraws, which requires one-year notice. MUNI contributes for 11.6% of the net operating costs and administrative expenses of the PCJPB. MUNI contributed only for operating needs of \$6.6 million in fiscal year 2006. In fiscal year 2005, MUNI also contributed only for operating needs amounting to \$6.4 million.

(9) Self-Insurance

MUNI is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. MUNI is fully self-insured for its general liability and auto liability, and public transportation bus and light rail liabilities, respectively. In addition, claims liabilities are calculated considering the effect of inflation, recent claim settlement trends, including frequency and amount of payments, and other economic and social factors. MUNI is self-insured for workers' compensation claims. The respective liabilities as of June 30, 2006 and 2005 have been actuarially determined and include an estimate of incurred but not reported claims. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amount of payouts, and other economic social factors.

Changes in the balances of claims liabilities and workers' compensation liabilities for the years ended June 30, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Accrued claims liabilities, beginning of fiscal year	\$ 46,032	30,345
Incurred claims and changes in estimates	17,221	23,367
Claims payments	<u>(8,568)</u>	<u>(7,680)</u>
Accrued claims liabilities, end of fiscal year	<u>\$ 54,685</u>	<u>46,032</u>
Accrued workers' compensation, beginning of fiscal year	\$ 102,678	107,180
Incurred workers' compensation and changes in estimates	7,030	14,965
Workers' compensation payments	<u>(15,977)</u>	<u>(19,467)</u>
Accrued workers' compensation, end of fiscal year	<u>\$ 93,731</u>	<u>102,678</u>

Workers' compensation expense is part of personal services, while claims expense is part of general and administrative under operating expenses in the accompanying financial statements.

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(10) Transactions with the City

The amount of operating subsidy provided to MUNI each year is limited to the amount budgeted by the City. Such subsidy is recognized as revenue in the year received. At times, a budget deficit can be caused by a revenue shortfall for which there is an expectation that those or other revenues will be received in the subsequent year relating to the prior years. In those circumstances, the City allows MUNI to show a deficit on a budgetary basis. This policy does not provide cash to finance receivables. Consequently, MUNI at times maintains a cash overdraft with the City, which can be repaid only through collection of receivables.

The General Fund support from the City reflected in the accompanying financial statements includes a revenue transfer of \$543 to fund additional interest expense for the year ended June 30, 2006, that was recorded relating to any overdraft with the City Treasurer during the fiscal year.

(11) Federal, State, and Local Assistance

MUNI receives capital grants from various federal, state, and local agencies to finance transit-related property and equipment purchases. As of June 30, 2006, MUNI had approved capital grants with unused balances amounting to \$312 million. Capital grants receivable as of June 30, 2006, totaled \$40 million.

MUNI also receives operating assistance from various federal, state, and local sources including Transit Development Act funds and sales tax allocations. As of June 30, 2006, MUNI had various operating grants receivable of \$37 million. In fiscal year 2006, MUNI's operating assistance also includes BART ADA revenues of \$1.3 million and other federal, state, and local grants of \$8 million to fund project expenses that are operating in nature.

The capital and operating grants identified above include funds received and due from SFCTA. During the fiscal year ended June 30, 2006, new capital grants were approved by SFCTA in the amount of \$48 million and payments received by MUNI for capital grants totaled \$46 million. As of June 30, 2006, MUNI had funds due from SFCTA for capital grants in the amount of \$17 million. Similarly, MUNI receives operating grants from SFCTA. During the fiscal year ended June 30, 2006, SFCTA approved new operating grants in the amount of \$15 million and payments received by MUNI totaled \$10 million. As of June 30, 2006, MUNI had \$8 million of funds due from SFCTA for operating grants.

(12) Property Rights in Perpetuity with the Port of San Francisco

Given that the proposed Metro East Light Rail Vehicle Maintenance and Operating Facility (Metro East) is an integral part of the Third Street Light Rail Project and is vital for relieving overcrowded conditions at MUNI's existing light rail facility, MUNI identified an approximately 17-acre site of the Western Pacific Railroad under the jurisdiction of the Port of San Francisco (Port) as the best location for the Metro East facility.

In March 2001, MUNI and the Port entered into a Memorandum of Understanding (MOU) under which MUNI may use the Metro East facility in perpetuity for rail vehicle maintenance, operations, and other operational needs at a cost of \$25.7 million.

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The MOU also required MUNI to pay the Port an additional \$4 million to construct the Illinois Street Bridge over Islais Creek. Construction of this bridge will mitigate traffic in the area and improve coordination with MUNI's Metro East and Third Street Light Rail Project. In the event the Port fails to expend the money toward construction of the bridge within three years after the effective date of the MOU, the Port shall return the \$4 million to MUNI. Any such return of funds shall have no effect on the rights granted to MUNI as specified in the MOU. The Port started construction of Illinois Street Bridge in May 2005 with substantial completion scheduled by the end July 2006. The entire \$4 million fund had been expended as of the previous fiscal year.

(13) Commitments and Contingencies

(a) Grants and Subventions

Receipts from federal and state grants and other similar programs are subject to audit to determine if the monies were expended in accordance with appropriate statutes, grant terms, and regulations. MUNI believes that no significant liabilities will result.

(b) Operating Leases

MUNI leases certain equipment and various properties for use as office space, fleet storage space, and machine shops under lease agreements that expire at various dates through fiscal year 2030. These agreements are accounted for as operating leases. Rent expense was \$5,841 and \$6,207 for the years ended June 30, 2006 and 2005, respectively.

MUNI has operating leases for certain buildings and equipment that require the following minimum annual payments:

Years ending June 30:		
2007	\$	4,837
2008		4,860
2009		5,355
2010		5,368
2011		837
2012 – 2016		4,417
2017 – 2021		4,867
2022 – 2026		5,349
2027 – 2031		5,992
Total	\$	<u>41,882</u>

(c) Other Commitments

As of June 30, 2006, MUNI has outstanding commitments of approximately \$150,131 with third parties for various capital projects. Grant funding is available for the majority of this amount. MUNI

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also has outstanding commitments of approximately \$9,253 with third parties for noncapital expenditures. Various local funding sources are used to finance these expenditures.

MUNI is also committed to numerous capital projects for which it anticipates that federal and state grants will be the primary source of funding. SFMRIC's board of directors has authorized SFMRIC to extend financial guarantees to MUNI for certain projects. The projects for which SFMRIC has guaranteed funding and the maximum amounts of such guarantees as of June 30, 2006, are as follows:

Central Control and Revenue Center	\$	80
Local Match for Paratransit Program		112
Historic Streetcar Shed		775
Islais Creek Storage Facility		816
New Orleans Historic Street Car		849
Total		<u><u>\$ 2,632</u></u>

In addition, MUNI is involved in various lawsuits, claims, and disputes, which have arisen in MUNI's routine conduct of business. In the opinion of management, the costs that might be incurred, if any, would not materially affect MUNI's or SFMRIC's financial position or changes in their net assets.

(14) Leveraged Lease-Leaseback of Breda Vehicles

Tranche 1

The Municipal Transportation Agency board of directors authorized the Director of Transportation to solicit proposals regarding a leveraged lease-leaseback transaction involving up to 150 BRED A light rail vehicles. The transaction would not involve financing or procurement of any new vehicles. Rather, MUNI's intention was to obtain an upfront economic benefit in return for entering into a lease-leaseback transaction involving the Breda light rail vehicles, without impairing the day-to-day operations of the transit system.

In April 2002, MUNI entered into the leveraged lease-leaseback transaction for over 118 Breda light rail vehicles (the Tranche 1 Equipment). The transaction was structured as a head lease of the Tranche 1 Equipment to separate special purpose trusts and a sublease of the Tranche 1 Equipment back from such trusts. The sublease provides MUNI with an option to purchase the Tranche 1 Equipment in approximately 27 years, the scheduled completion date of the sublease. During the term of the sublease, MUNI maintains custody of the Tranche 1 Equipment and is obligated to insure and maintain the Tranche 1 Equipment throughout the life of the sublease.

MUNI received an aggregate of \$388.2 million from the equity investors in full prepayment of the head lease. MUNI deposited \$352.7 million of this head lease payment into two escrows. One escrow was

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deposited with a debt payment undertaker whose repayment obligations are guaranteed by Financial Security Assurance, an "Aaa/AAA" rated bond insurance company. The other escrow was invested in U.S. government bonds with maturity dates that match the completion of the sublease. Payments under these escrows are to be made at such times and in such amounts so as to fund MUNI's scheduled payments under the sublease as well as to provide a source of funding for MUNI's purchase option if it chooses to exercise it. Although these escrows do not represent a legal defeasance of MUNI's obligations under the sublease, management believes that the creditworthiness of these escrows is such that they will fund MUNI's obligations under the sublease and that the possibility that MUNI will need to access other monies to make sublease payments is remote. Therefore, the trust assets and the sublease obligations are not recorded on the financial statements of MUNI as of June 30, 2006 or 2005.

As a result of the cash transactions above, MUNI recorded deferred revenue in fiscal year 2002 of \$35.5 million for the difference between the amount received of \$388.2 million and the amount paid to the escrows of \$352.7 million. The deferred revenue will be amortized over the life of the sublease. The deferred revenue amortized amounts were \$1.3 million in fiscal year 2006 and 2005, respectively.

As of June 30, 2006, the outstanding payments to be made on the sublease through fiscal year 2027 are \$284.2 million and the payments to be made on the purchase option of the Tranche 1 Equipment would be \$643.1 million, if exercised. All of these payments are to be funded from the amounts in escrow. If MUNI does not exercise the purchase option, MUNI would be required to either: 1) pay service and maintenance costs related to the continued operation and use of the vehicles beyond the term of the sublease; or 2) arrange for another party to be the "service recipient," under a "service contract," and to perhaps guarantee the obligations of that party under the service contract if the replacement service recipient does not meet specified credit or net worth criteria.

Tranche 2

In September 2003, after obtaining final approval from the Municipal Transportation Agency board of directors and the City and County's board of supervisors, MUNI entered into a second leveraged lease-back transaction for over 21 BREDAs light rail vehicles (the Equipment). The transaction was structured as a head lease of the Equipment to one separate special purpose trust (formed on behalf of a certain equity investor) and a sublease of the Equipment back from such trust. The sublease provides MUNI with an option to purchase the Equipment in approximately 26 years, the scheduled completion date of the sublease. During the term of the sublease, MUNI maintains custody of the Equipment and is obligated to insure and maintain the Equipment throughout the life of the sublease.

MUNI received an aggregate of \$72.6 million from the equity investors in full prepayment of the head lease. MUNI deposited approximately \$67.5 million of this head lease payment into two escrows. One escrow was deposited with a debt payment undertaker whose repayment obligations are guaranteed by Financial Security Assurance, an "Aaa/AAA" rated bond insurance company. The other escrow was invested in U.S. government bonds with maturity dates that match the completion of the sublease.

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IMPROVEMENT CORPORATION**

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June 30, 2006 and 2005

(Dollars in thousands, unless otherwise noted)

Payments under these escrows are to be made at such times and in such amounts so as to fund MUNI's scheduled payments under the sublease as well as to provide a source of funding for MUNI's purchase option if it chooses to exercise it. Although these escrows do not represent a legal defeasance of MUNI's obligations under the sublease, management believes that the creditworthiness of these escrows is such that they will fund MUNI's obligations under the sublease and that the possibility that MUNI will need to access other monies to make sublease payments is remote.

The deferred revenue will be amortized over the life of the sublease. The deferred revenue amortized in fiscal year 2006 amounted to \$168.

As of June 30, 2006, the outstanding payments to be made on the sublease through 2029 are \$57.6 million and the payments to be made on the purchase option of the Equipment would be \$198.5 million, if exercised. All of these payments are to be funded from the amounts in escrow. If MUNI does not exercise the purchase option, MUNI would be required to either: 1) pay service and maintenance costs related to the continued operation and use of the vehicles beyond the term of the sublease; 2) arrange for another party to be the "service recipient," under a "service contract," and to perhaps guarantee the obligations of that party under the service contract if the replacement service recipient does not meet specified credit or net worth criteria.

(15) Wellness Incentive Program

Effective July 1, 2002, the City established a pilot "wellness incentive program" (the Wellness Program) to promote workforce attendance. Under the Wellness Program, any full-time employee leaving the employment of the City upon service or disability retirement may receive payment of a portion of accrued sick leave credits at the time of separation.

The amount of this payment shall equal to 2.5% of accrued sick leave credits at the time of separation times the number of whole years of continuous employment times an employee's salary rate, exclusive of premiums or supplements, at the time of separation. Vested sick leave credits, as set forth under Civil Service Commission Rules, shall not be included in this computation.

SUPPLEMENTAL SCHEDULES

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule – Schedule of Net Assets

June 30, 2006

(In thousands)

	<u>MUNI</u>	<u>SFMRIC</u>	<u>Eliminations</u>	<u>Total</u>
Assets:				
Current assets:				
Deposits and investments with City				
Treasury	\$ 44,354	—	—	44,354
Deposits and investments held outside				
City Treasury	100	—	—	100
Cash on hand	507	—	—	507
Receivables:				
Grants	52,626	—	—	52,626
Due from the San Francisco County				
Transportation Authority	24,822	—	—	24,822
Due from other City departments	—	—	—	—
Charges for services, net	6,995	—	—	6,995
Other, net	19,460	789	(836)	19,413
Total receivables	103,903	789	(836)	103,856
Inventories	43,189	—	—	43,189
Current deferred charges	596	—	(197)	399
Total current assets	192,649	789	(1,033)	192,405
Restricted assets:				
Deposits and investments with City				
Treasury:				
Transit Impact Development Fee	23,131	—	—	23,131
Other restricted investments	885	—	—	885
Deposits and investments held outside City				
Treasury	3	3,413	—	3,416
Interest receivable	—	9	—	9
Transit Impact Development Fee				
receivable, net	5,046	—	—	5,046
Total restricted assets	29,065	3,422	—	32,487
Noncurrent deferred charges	592	—	(592)	—
Capital assets	1,782,880	—	—	1,782,880
Total noncurrent assets	1,812,537	3,422	(592)	1,815,367
Total assets	\$ 2,005,186	4,211	(1,625)	2,007,772

**SAN FRANCISCO MUNICIPAL RAILWAY AND
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Supplemental Schedule – Schedule of Net Assets

June 30, 2006

(In thousands)

	<u>MUNI</u>	<u>SFMRIC</u>	<u>Eliminations</u>	<u>Total</u>
Liabilities:				
Current liabilities:				
Due to other funds	\$ 934	—	(789)	145
Accounts payable and accrued expenses	25,902	—	—	25,902
Accrued payroll	14,396	—	—	14,396
Accrued vacation and sick leave	12,273	—	—	12,273
Accrued workers' compensation	21,488	—	—	21,488
Accrued claims	19,356	—	—	19,356
Deferred revenue and other deferred credits	2,259	197	(197)	2,259
Payable from restricted assets	892	51	(47)	896
Total current liabilities	<u>97,500</u>	<u>248</u>	<u>(1,033)</u>	<u>96,715</u>
Noncurrent liabilities:				
Accrued vacation and sick leave	9,469	—	—	9,469
Accrued workers' compensation	72,243	—	—	72,243
Accrued claims	35,329	—	—	35,329
Deferred revenue and other deferred credits	32,720	592	(592)	32,720
Total noncurrent liabilities	<u>149,761</u>	<u>592</u>	<u>(592)</u>	<u>149,761</u>
Total liabilities	<u>\$ 247,261</u>	<u>840</u>	<u>(1,625)</u>	<u>246,476</u>
Net assets:				
Invested in capital assets, net of related debt	\$ 1,782,880	—	—	1,782,880
Restricted	28,172	3,371	47	31,590
Unrestricted	(53,127)	—	(47)	(53,174)
Total net assets	<u>\$ 1,757,925</u>	<u>3,371</u>	<u>—</u>	<u>1,761,296</u>

See accompanying independent auditors' report.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule – Schedule of Revenues, Expenses,
and Changes in Net Assets

Year ended June 30, 2006

(In thousands)

	MUNI	SFMRIC	Eliminations	Total
Operating revenues:				
Passenger fares	\$ 134,553	—	—	134,553
Advertising	4,423	—	—	4,423
Paratransit revenue	1,411	—	—	1,411
Charter service	2	—	—	2
Rental income	631	—	—	631
Other	115	—	—	115
Total operating revenues	141,135	—	—	141,135
Operating expenses:				
Personal services	374,504	—	—	374,504
Contractual services	23,728	—	—	23,728
Materials and supplies	32,904	—	—	32,904
Depreciation	87,141	—	—	87,141
Services from other City departments	24,944	—	—	24,944
General and administrative	33,187	25	(197)	33,015
Other operating expenses	4,864	—	—	4,864
Total operating expenses	581,272	25	(197)	581,100
Operating loss	(440,137)	(25)	197	(439,965)
Nonoperating revenues (expenses and losses):				
Operating assistance:				
Department of Parking and Traffic	140,008	—	—	140,008
Federal	23,651	—	—	23,651
State and other grants	84,153	—	—	84,153
Transit Impact Development Fee, net of expenses	111	—	—	111
Capital reserve revenue	1,483	—	—	1,483
Interest income	1,952	88	—	2,040
Interest expense	(543)	—	—	(543)
Loss on disposal of capital assets	(386)	—	—	(386)
Capital assistance of SFMRIC to MUNI	78	(78)	—	—
Other, net	(702)	197	(197)	(702)
Total nonoperating revenues, net	249,805	207	(197)	249,815
Loss before capital contribution and transfers	(190,332)	182	—	(190,150)
Capital contributions:				
Federal	43,923	—	—	43,923
State and others	46,608	—	—	46,608
Total capital contributions	90,531	—	—	90,531
Transfers in:				
City and County of San Francisco – General Fund	118,377	—	—	118,377
San Francisco County Transportation Authority	15,594	—	—	15,594
San Francisco Public Works Department	—	—	—	—
San Francisco Water Department	542	—	—	542
San Francisco Parking & Traffic Department	5,892	—	—	5,892
Total transfers in	140,405	—	—	140,405
Change in net assets	40,604	182	—	40,786
Total net assets – beginning	1,717,321	3,189	—	1,720,510
Total net assets – ending	\$ 1,757,925	3,371	—	1,761,296

See accompanying independent auditors' report.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule of Grants – Federal

Year ended June 30, 2006

(In thousands)

	Authorized grants as of July 1, 2005	New grants approved	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2006	Amounts not expended as of June 30, 2006	Grants receivable as of June 30, 2006
Capital grants:							
Construct Islais Creek Facility	\$ 2,467	7,771	—	—	10,238	(10,237)	1
Construct Islais Creek	4,798	—	—	—	4,798	(4,798)	—
LRV Purchase	124	—	(124)	—	—	—	—
Section 9 Fiscal Year 1989/90	—	—	—	—	—	—	—
Section 9 Fiscal Year 1990/91	180	—	(180)	—	—	—	—
Section 9 Fiscal Year 1992/93	—	—	—	—	—	—	—
Section 9 Fiscal Year 1993/94	554	—	(419)	—	135	(132)	3
Section 9 Fiscal Year 1994/95	80	—	(80)	—	—	—	—
Section 9 Fiscal Year 1995/96	114	—	(23)	—	91	(27)	64
Section 9 Fiscal Year 1998/99	3,443	—	(250)	—	3,193	(3,192)	1
Section 9 Fiscal Year 1999/00	12,447	—	(3,741)	—	8,706	(8,539)	167
Section 9 Fiscal Year 2000/01	2,456	—	(388)	—	2,068	(2,068)	—
Section 9 Fiscal Year 2001/02	30,473	—	(18,465)	—	12,008	(10,918)	1,090
Section 9 Fiscal Year 2002/03	24,718	—	(1,912)	—	22,806	(20,793)	2,013
Section 9 Fiscal Year 2003/04	26,726	9,200	(13,222)	—	22,704	(22,459)	245
Section 9 Fiscal Year 2004/05	47,087	—	(41)	—	47,046	(46,715)	331
Section 3 -Central Control Facility	950	—	(128)	—	822	(709)	113
Section 3 New Central Subway	7,310	9,920	(4,609)	—	12,621	(11,907)	714
Section 3 Third Street Metro East	35,352	188	(404)	—	35,136	(24,741)	10,395
Section 3 -PM Traps Fleet	3,960	—	(872)	—	3,088	(3,088)	—
Section 3 -Fixed Guideway	—	23,306	—	—	23,306	(23,306)	—
Section 15 Radio Replacement	—	4,000	(825)	—	3,175	(1,500)	1,675
Alternative Fuel	—	497	—	—	497	(497)	—
Radio Replacement	207	—	—	—	207	(207)	—
Automatic Vehicle Location	1,987	—	(863)	—	1,124	(1,080)	44
Total capital grants	<u>\$ 205,433</u>	<u>54,882</u>	<u>(46,546)</u>	<u>—</u>	<u>213,769</u>	<u>(196,913)</u>	<u>16,856</u>
Pass-through grants:							
Transbay Terminal CA90-0212	\$ 955	—	—	—	955	(955)	—
Transbay Terminal CA90-0124	3,414	—	(2,671)	—	743	(422)	321
Total Pass Through Grants	<u>\$ 4,369</u>	<u>—</u>	<u>(2,671)</u>	<u>—</u>	<u>1,698</u>	<u>(1,377)</u>	<u>321</u>
Operating grants:							
Operating assistance	\$ 18,754	—	(18,754)	—	—	—	—
Paratransit	—	3,697	—	—	3,697	—	3,697
SRTP-CPT529 and 473 and 548	—	82	—	—	82	(54)	28
Preventive Maintenance	—	16,991	—	—	16,991	—	16,991
Treasure Island	—	274	(274)	—	—	—	—
Total operating grants	<u>\$ 18,754</u>	<u>21,044</u>	<u>(19,028)</u>	<u>—</u>	<u>20,770</u>	<u>(54)</u>	<u>20,716</u>

See accompanying independent auditors' report.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule of Grants – Metropolitan Transportation Commission

Year ended June 30, 2006

(In thousands)

	Authorized grants as of July 1, 2005	New grants approved	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2006	Amounts not expended as of June 30, 2006	Grants receivable as of June 30, 2006
Capital grants:							
Bridge toll:							
Accessible Vans	\$ 124	80	(21)	—	183	(183)	—
Cable Car Renovation	232	3,590	(151)	—	3,671	(3,610)	61
F-Embarcadero Extension	1,265	—	(219)	—	1,046	(1,030)	16
Motor Coach Replacement	3,405	—	(1,387)	—	2,018	(1,861)	157
Tract Replacement	1,178	—	(604)	—	574	(574)	—
Third Street Light Rail	11,000	19,000	(5,291)	—	24,709	(21,634)	3,075
Cable Car Guideway	463	—	(42)	—	421	(356)	65
Historic rail Enclosure	624	—	(85)	—	539	(539)	—
Bus Catalyst Devices	294	—	(246)	—	48	(44)	4
MC Procurement Hybrids	331	—	(157)	—	174	(131)	43
Paratransit Mini Vans	85	—	(7)	—	78	(75)	3
New Jersey PCC	1,206	—	(1,206)	—	—	—	—
E-line Embarcadero Streetcar	4,285	2,051	(1,372)	—	4,964	(3,203)	1,761
Match to Capital Grants	2,946	—	(59)	—	2,887	(2,852)	35
Diesel Bus Purchase	—	—	406	—	406	(406)	—
Total capital grants	\$ 27,438	24,721	(10,441)	—	41,718	(36,498)	5,220
Operating grants:							
AB1107 Sales Tax	\$ 2,639	31,990	(31,856)	—	2,773	—	2,773
State Transit Assistance	2,398	18,362	(15,965)	—	4,795	—	4,795
Transportation Development Act	—	31,198	(31,198)	—	—	—	—
Owl Operations	—	117	(117)	—	—	—	—
Third Street Start Up Operations	—	923	—	—	923	—	923
STA – Treasure Island	—	52	(52)	—	—	—	—
Total operating grants	\$ 5,037	82,642	(79,188)	—	8,491	—	8,491

See accompanying independent auditors' report.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule of Grants – San Francisco County Transportation Authority

Year ended June 30, 2006

(In thousands)

	Authorized grants as of July 1, 2005	New grants approved	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2006	Amounts not expended as of June 30, 2006	Grants receivable as of June 30, 2006
Capital grants:							
3rd Light Rail-Preliminary Design	\$ 63,642	32,139	(39,166)	—	56,615	(43,318)	13,297
Articulated Trolley Bus Purchase	1,441	1	(445)	—	997	(871)	126
Cable Car Infrastructure	178	—	(4)	—	174	(174)	—
Central Subway	—	—	—	—	—	—	—
Diesel Bus Purchase	2,540	—	(865)	—	1,675	(1,641)	34
Escalator Replacement Study	110	—	—	—	110	(110)	—
F-Line Embarcadero Extension	822	—	(39)	—	783	(783)	—
Facilities Rehabilitation and Improvement	7,201	423	(2,714)	(1,052)	3,858	(3,659)	199
Financial Capacity Study	240	—	—	—	240	(240)	—
Fueling Facility – Islais Creek	—	—	—	—	—	—	—
Geneva Building Demolition	187	—	—	—	187	(118)	69
Gillig Motor Coaches	3,735	—	(1,221)	—	2,514	(1,854)	660
Historic Trolley Shed	91	—	—	—	91	(67)	24
Metro East LRV Facility	2	—	—	—	2	(2)	—
Overhead Rehab Program	3,169	159	(1,031)	—	2,297	(514)	1,783
Rail Replacement/Maintenance Equipment	2,166	—	(12)	—	2,154	(1,857)	297
Streetcar Rehabilitation	771	—	(96)	—	675	(646)	29
Woods Division Renovation	1,428	—	(158)	—	1,270	(1,269)	1
Wood/Potrero Roof Replacement	763	—	—	—	763	(763)	—
Cowcap 2002 Outstanding Receivable	—	—	—	—	—	—	—
Auto Vehicle Location & ETI Bus Lifts	405	—	(232)	—	173	(170)	3
TPS Corridor	—	77	(4)	—	73	(67)	6
Hybrid Buses	—	15,500	—	—	15,500	(15,136)	364
Total capital grants	<u>\$ 88,891</u>	<u>48,299</u>	<u>(45,987)</u>	<u>(1,052)</u>	<u>90,151</u>	<u>(73,259)</u>	<u>16,892</u>

See accompanying independent auditors' report.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule of Grants – San Francisco County Transportation Authority

Year ended June 30, 2006

(In thousands)

	Authorized grants as of July 1, 2005	New grants approved	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2006	Amounts not expended as of June 30, 2006	Grants receivable as of June 30, 2006
Operating grants:							
F-Line Operations and Maintenance	\$ —	—	—	—	—	—	—
Graffiti Preventions	14	—	(11)	—	3	(3)	—
Capital Grant Staffing	61	380	(99)	—	342	(117)	225
Emergency Pavement Repairs	409	—	—	—	409	(409)	—
Muni Metro Extension Operations and Maintenance	—	5,003	(1,184)	—	3,819	—	3,819
Paratransit Contract	2,500	9,670	(8,662)	—	3,508	—	3,508
Transit Preferential Streets	34	—	(14)	—	20	(20)	—
Trolley Bus Lifts Operations and Maintenance	613	—	(402)	582	793	(415)	378
Total operating grants	\$ <u>3,631</u>	<u>15,053</u>	<u>(10,372)</u>	<u>582</u>	<u>8,894</u>	<u>(964)</u>	<u>7,930</u>

See accompanying independent auditors' report.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule of Grants – Others

Year ended June 30, 2006

(In thousands)

	Authorized grants as of July 1, 2005	New grants approved	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2006	Amounts not expended as of June 30, 2006	Grants receivable as of June 30, 2006
Capital grants:							
Bay Area Air Quality Management District:							
Alternative Fuel Demonstration Project – R&D	\$ 20	—	—	(20)	—	—	—
Bike Rack Retrofit	10	—	—	—	10	(10)	—
Bus Signal & Communication Equipments	22	—	—	—	22	—	22
PM Traps Fleet	555	1	(536)	2	22	(22)	—
Gillig Motor Coaches Retrofit	—	506	—	—	506	(317)	189
Lighting Retrofit	150	—	—	(150)	—	—	—
Department of Justice	2,100	—	(1,003)	—	1,097	(348)	749
Bay Area Rapid Transit	50	—	—	—	50	(11)	39
Total capital grants	<u>\$ 2,907</u>	<u>507</u>	<u>(1,539)</u>	<u>(168)</u>	<u>1,707</u>	<u>(708)</u>	<u>999</u>
Operating in nature:							
State Homeland Security	\$ 290	—	(213)	—	77	(1)	76
Office of Emergency Services – Homeland Security	200	—	—	—	200	(145)	55
CA Office of the Governor – Homeland Security	—	2,852	—	—	2,852	(2,825)	27
Translink Project	213	—	(198)	—	15	(15)	—
Total capital grants	<u>\$ 703</u>	<u>2,852</u>	<u>(411)</u>	<u>—</u>	<u>3,144</u>	<u>(2,986)</u>	<u>158</u>

See accompanying independent auditors' report.



KPMG LLP
55 Second Street
San Francisco, CA 94105

**Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Honorable Mayor, Board of Supervisors
And Municipal Transportation Agency Board of Directors
City and County of San Francisco, California:

We have audited the financial statements of the San Francisco Municipal Railway (MUNI) and the San Francisco Municipal Railway Improvement Corporation (SFMRIC), departments of the City and County of San Francisco, California (the City) and the Municipal Transportation Agency (MTA), as of and for the year ended June 30, 2006, and have issued our report thereon dated October 27, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered MUNI's and SFMRIC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether MUNI's and SFMRIC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of MUNI's and SFMRIC's in a separate letter dated November 28, 2006.



This report is intended solely for the information and use of the Honorable Mayor, Board of Supervisors and Municipal Transportation Agency Board of Directors, and management and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

October 27, 2006