KPMG

AIRPORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
SAN FRANCISCO INTERNATIONAL AIRPORT

Financial Statements

June 30, 2005 and 2004

(With Independent Auditors' Report Thereon)

AIRPORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
SAN FRANCISCO INTERNATIONAL AIRPORT

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KPMG LLP
55 Second Street
San Francisco, CA 94105

Independent Auditors' Report

The Honorable Mayor and Board of Supervisors
City and County of San Francisco:

We have audited the accompanying financial statements of the Airport Commission, City and County of San Francisco, San Francisco International Airport (the Airport), an enterprise fund of the City and County of San Francisco, California (the City), as of and for the years ended June 30, 2005 and 2004, as listed in the table of contents. These financial statements are the responsibility of the Airport's management. 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. 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 includes 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 the Airport's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 the Airport and do not purport to, and do not, present fairly the financial position of the City as of June 30, 2005, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Airport Commission, City and County of San Francisco, San Francisco International Airport as of June 30, 2005 and June 30, 2004, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 through 19 is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. 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.

KPMG LLP

October 11, 2005

The management of the Airport Commission, City and County of San Francisco, San Francisco International Airport (the Airport or SFO) presents the following narrative overview and analysis of the financial activities of the Airport for the fiscal year ended June 30, 2005 with comparative data for the fiscal year ended June 30, 2004. All amounts are expressed in thousands of dollars unless otherwise indicated.

Highlights of Airport Operations

In light of global economic and political circumstances, the aviation industry continues to restructure. Uncertainty surrounding airline bankruptcies and mergers, airline restructuring, and fuel prices affect demand for air travel. Despite strong year-over-year growth in passenger traffic and load factors at SFO over the last two fiscal years, passenger traffic remains below pre-September 11 and peak fiscal year 2000 levels. Higher fuel prices combined with lower ticket revenue yields (cents per mile) continue to impact the financial condition of several major air carriers (including United Airlines, Delta Air Lines, and Northwest Airlines) at SFO.

While passenger traffic growth has been positive and load factors are at historically high levels, the number of passenger airline operations at the Airport has decreased over the last few years, and was relatively flat in fiscal year 2005. The airlines are carrying more passengers on fewer flights in response to high fuel prices and strong competition. Passenger flight operations are expected to increase in fiscal year 2006. In some markets, however, larger jet aircrafts are being replaced with regional aircrafts, so overall seat capacity at the Airport is expected to remain relatively flat over the next fiscal year. Low cost airline competition at Oakland International and Mineta San Jose International will continue to impact domestic passenger demand at SFO.

Passenger and Other Traffic Activity

In the first six months of fiscal year 2005, passenger activity growth at SFO was strong – increasing 8.9% over the first six months of fiscal year 2004. Passenger traffic growth slowed in the second half of the year due to schedule reductions by United, America West, and ATA. Total passenger traffic increased 6.0% between fiscal year 2005 and fiscal year 2004. Total aviation operations increased slightly over prior year levels. Aircraft landed weight – which determines revenue generated by landing fees – ended the year slightly above prior year levels.

The following chart presents a comparative summary of passenger and other traffic at the Airport for the fiscal years ended June 30, 2005, 2004, and 2003:

San Francisco International Airport Comparative Traffic Activities

	FY 2005	FY 2004[2]	FY 2003[1]	% Change FY 2005	% Change FY 2004
Flight operations	348,933	346,814	342,676	0.6%	1.2%
Landing weight (in 000 lbs.)	27,083,333	26,996,625	27,522,602	0.3%	(1.9)%
Total passengers	33,185,424	31,344,758	29,789,519	5.9%	5.2%
Total enplaned and deplaned passengers	32,626,818	30,771,464	29,174,129	6.0%	5.5%
Enplaned passengers	16,237,877	15,396,139	14,619,806	5.5%	5.3%
Deplaned passengers	16,388,941	15,375,325	14,554,323	6.6%	5.6%
Domestic passengers	24,789,646	23,438,173	22,437,456	5.8%	4.5%
International passengers	7,837,172	7,333,291	6,736,673	6.9%	8.9%
Cargo tonnage (in metric tons)	587,518	552,118	608,240	6.4%	(9.2)%
Parking (cars exited)	3,149,129	3,158,429	3,360,510	(0.3)%	(6.0)%

[1] Reflects revised airline data received subsequent to the 2003 fiscal year-end.
[2] Reflects revised airline data received subsequent to the 2004 fiscal year-end.

Fiscal Year 2005

Passenger Traffic

Compared to the previous year, passengers using the Airport in fiscal year 2005 increased by 5.9% from 31.3 million to 33.2 million. Domestic passengers increased by 5.8% and international passengers increased 6.9%. These increases reflect a national and regional economic recovery, increased service, and fare competition among domestic carriers, and recovery in the Airport's international business from the effects of the SARS epidemic during the spring of 2004.

Flight Operations

During fiscal year 2005, the number of aircraft operations (takeoffs and landings) increased by 2,119 flights or 0.6% over prior year levels. Revenue landing weight increased by 0.3%. The airlines continue to minimize operating costs by reducing average aircraft size and achieving higher utilization (load factors) on existing flights before adding more flights.

Cargo Tonnage

Fiscal year 2005 cargo and mail tonnage increased by approximately 35,400 metric tons or 6.4%; cargo volume increased by 8.4%. Domestic cargo volume increased by 15.7%, and international cargo volume increased by 3.2%.

Parking

Total fiscal year 2005 parking activity declined by 0.3% or 9,300 vehicle exits from prior year levels. This decrease is attributed to increased ridership on BART and increased off-Airport parking supply and price competition, including hotel-operated parking lots. Despite the decrease in parking volume at the Airport, annual parking revenue increased by approximately $4.9 million or 9.6% – largely due to increased revenues associated with the elimination of a grace period in the Airport's parking garages.

Fiscal Year 2004

Passenger Traffic

Compared to the previous year, passengers using the Airport in fiscal year 2004 increased from 29.8 million to 31.4 million or 5.2%. Domestic passengers increased by 4.5% and international passengers increased 8.9%. These increases reflect a national and regional economic recovery, increased service and fare competition among domestic carriers, and recovery in the Airport's international business from the effects of the SARS epidemic during the spring of 2003.

Flight Operations

During fiscal year 2004, the number of aircraft operations (takeoffs and landings) increased by 4,138 or 1.2% over prior year levels. However, revenue landing weight declined by 1.9% due to efforts by the airlines to minimize operating cost by reducing average aircraft size and achieve higher utilization (load factors) on existing flights before adding more flights.

Cargo Tonnage

Fiscal year 2004 cargo tonnage declined by 56,122 metric tons (9.2%). This decline reflects the lingering effects of the SARS epidemic during the spring of 2003 on cargo routed by key foreign freight carriers. Following that period, a number of carriers reduced or canceled freight operations to and from the Airport, consolidating line-haul operations at other west coast points of entry, and serving northern California by ground transportation connections.

Parking

Total fiscal year 2003/04 parking activity declined by 202,081 vehicle exits (6.0%) from prior year levels. This is attributed to (1) the effect of a 25% hourly rate increase enacted during May 2003, (2) the opening of direct BART service to the Airport in June 2003, (3) new security requirements which limit terminal access to nonticketed customers, an (4) increased off-Airport parking supply and price competition. However, annual parking revenue increased by $2.4 million (4.8%) due to the May 2003 rate increase and increased overnight garage utilization by business travelers.

Financial Operations

Although the key indicators denoted positive growth, the Airport's operating revenues decreased because of lower landing fees imposed during the fiscal year ending June 30, 2005. In addition, the airport incurred higher operating expenses due principally to increase in costs relating to the repairs and maintenance of the Airport's infrastructure. Additionally, a $50 million loss due to asset impairment was recognized during the fiscal year. The combined effects of the aforementioned events resulted in a decrease of $99 million in the Airport's net assets.

Financial Highlights, Fiscal Year 2005

- The assets of the Airport exceeded liabilities at the close of the fiscal year by $357.6 million.
- The long-term debt of the Airport decreased by $58.7 million.
- Operating revenues were $477.3 million.
- Operating expenses were $419 million.
- Nonoperating expenses net of revenues from nonoperating sources (includes revenues of $60.9 million from Passenger Facility Charges) were $127.1 million.
- Capital contributions from Airport Improvement Program (AIP) were $34.9 million.
- Annual Service Payment to the City for the fiscal year was $19.7 million.
- Net assets decreased by $99 million.

Overview of the Airport's Financial Statements

Net Asset Summary

A condensed summary of the Airport's net assets for the fiscal years 2005, 2004, and 2003 is shown below:

San Francisco International Airport's Net Assets

	FY 2005	FY 2004	FY 2003	FY 2005 Inc. (Dec.)	FY 2004 Inc. (Dec.)
Assets:					
Unrestricted current assets	$ 296,230	306,141	314,623	(9,911)	(8,482)
Restricted assets available for current outlay	59,372	63,593	75,475	(4,221)	(11,882)
Noncurrent assets	4,065	6,673	—	(2,608)	6,673
Noncurrent restricted assets	366,877	385,521	470,527	(18,644)	(85,006)
Capital assets, net	3,760,023	3,900,905	3,971,339	(140,882)	(70,434)
Bond issuance costs	48,062	45,500	45,980	2,562	(480)
Total assets	4,534,629	4,708,333	4,877,944	(173,704)	(169,611)
Liabilities:					
Current liabilities from unrestricted assets	137,331	138,040	126,441	(709)	11,599
Current liabilities payable from restricted assets	55,854	63,593	75,475	(7,739)	(11,882)
Noncurrent liabilities	3,983,849	4,050,089	4,164,424	(66,240)	(114,335)
Total liabilities	4,177,034	4,251,722	4,366,340	(74,688)	(114,618)
Net assets:					
Invested in capital assets, net of related debt	(112,954)	(30,535)	(13,205)	(82,419)	(17,330)
Restricted for debt service	163,758	191,808	224,521	(28,050)	(32,713)
Restricted for capital projects	17,877	9,721	8,550	8,156	1,171
Restricted for other purposes	—	1,419	—	(1,419)	1,419
Unrestricted	288,914	284,198	291,738	4,716	(7,540)
Total net assets	$ 357,595	456,611	511,604	(99,016)	(54,993)

Fiscal Year 2005

Total net assets serve as an indicator of the Airport's financial position. The Airport's assets exceeded liabilities by $357.6 million and $456.6 million as of June 30, 2005 and June 30, 2004, respectively, representing a 21.7% decrease or $99 million. Unrestricted net assets represent 80.8% and 62.2% of total net assets as of June 30, 2005 and June 30, 2004, respectively.

(Continued)

Unrestricted current assets consist primarily of cash and investments available to meet the Airport's current obligations. Unrestricted current assets decreased by 3.2% from $306.1 million on June 30, 2004 to $296.2 million on June 30, 2005.

Restricted assets consist of cash and investments of revenue bond proceeds and commercial paper proceeds that are used for the construction of Airport capital assets. Restricted assets decreased by 5.1% from $449.1 million in fiscal year 2004 to $426.2 million in fiscal year 2005 primarily due to construction activities.

Noncurrent assets, consisting of noncurrent accounts receivable, decreased by $2.6 million or 39.1% from $6.7 million to $4.1 million in fiscal year 2005. The decrease is due to the account becoming current during the fiscal year.

Capital assets consist of land, buildings, structures and improvements, and equipment. The Airport financed its capital assets primarily through the issuance of revenue bonds and commercial paper notes and uses these facilities to provide services to passengers and visitors to the Airport. The debt service associated with the acquisition of these capital assets is provided annually from operations. Capital assets, net of depreciation, decreased by 3.6% and 1.8%, respectively, in fiscal years 2005 and 2004. The increase in depreciation is due to the completion of new capital projects. In addition, approximately $50 million in capitalized costs relating to runway development were written off due to asset impairment (note 5).

Current liabilities from unrestricted assets decreased by 0.5% from $138 million as of June 30, 2004 to $137.3 million as of June 30, 2005 primarily due to the increase in accounts payable.

Current liabilities payable from restricted assets decreased by 12.2% from $63.6 million as of June 30, 2004 to $55.9 million as of June 30, 2005 primarily due to the reduced construction activities funded by bond proceeds.

Noncurrent liabilities consist of long-term bonds payable and related premium and discount, and long-term liabilities representing accrual of compensated absences for vacation and vested sick leave and workers' compensation liabilities. Noncurrent liabilities decreased by 1.6% in fiscal year 2005 primarily due to the maturity of long-term bonds payable.

As of June 30, 2005, the Airport's net assets invested in capital assets, net of related debt were a negative $113 million, compared to a negative $30.5 million reduction in the prior year. The negative net assets are due to the Airport's depreciating capital assets faster than the repayment of its bonded debt. During fiscal year 2005, depreciation expense exceeded the principal retirement of outstanding debt by $83 million. In addition, approximately $50 million in capitalized costs relating to runway development were written off due to asset impairment (note 5).

Fiscal Year 2004

Total net assets serve as an indicator of the Airport's financial position. The Airport's assets exceeded liabilities by $456.6 million and $511.6 million as of June 30, 2004 and 2003, respectively, representing a 10.7% decrease of $55.0 million. Unrestricted net assets represent 62.2% and 57% of total net assets as of June 30, 2004 and 2003, respectively.

(Continued)

Unrestricted current assets consist primarily of cash and investments available to meet the Airport's current obligations. Unrestricted current assets decreased by 2.7% from $315 million on June 30, 2003 to $306.1 million on June 30, 2004.

Restricted assets consist of cash and investments of revenue bond proceeds and commercial paper proceeds that are used for the construction of Airport capital assets. Restricted assets decreased by 17.7% from $546.0 million in fiscal year 2003 to $449.1 million in fiscal year 2004 primarily due to construction activities.

Capital assets consist of land, buildings, structures and improvements, and equipment. The Airport financed its capital assets primarily through the issuance of revenue bonds and commercial paper notes and uses these facilities to provide services to passengers and visitors to the Airport. The debt service associated with the acquisition of these capital assets is provided annually from operations. Capital assets, net of depreciation, decreased by 1.8% and 1.0%, respectively, in fiscal years 2004 and 2003. The increase in depreciation is due to the completion of new capital projects.

Current liabilities from unrestricted assets increased by 9.2% from $126 million as of June 30, 2003 to $138 million as of June 30, 2004 primarily due to the increase in the amount of current maturities of bonds payable and increase in amount of revenues collected in advance.

Current liabilities payable from restricted assets decreased by 15.7% from $75 million as of June 30, 2003 to $63.6 million as of June 30, 2004 primarily due to the reduced construction activities funded by bond proceeds.

Noncurrent liabilities consist of long-term bonds payable and related premium and discount, and long-term liabilities representing accrual of compensated absences for vacation and vested sick leave and workers' compensation liabilities. Noncurrent liabilities decreased by 2.7% in fiscal year 2004 primarily due to the maturity of long-term bonds payable.

As of June 30, 2004, the Airport's net assets invested in capital assets, net of related debt were a negative $30.5 million, compared to a negative $13.2 million reduction in the prior year. The negative net assets are due to the Airport's depreciating capital assets faster than the repayment of its bonded debt. During fiscal year 2004, depreciation expense exceeded the principal retirement of outstanding debt by $53.0 million.

(Continued)

Highlights of Changes in Net Assets

The following table shows a condensed summary of changes in net assets for fiscal years 2005, 2004, and 2003:

San Francisco International Airport's Changes in Net Assets

	FY 2005	FY 2004	FY 2003	FY 2005 Inc. (Dec.)	FY 2004 Inc. (Dec.)
Operating revenues	$ 477,314	486,132	500,116	(8,818)	(13,984)
Operating expenses	418,993	400,596	447,006	18,397	(46,410)
Operating income	58,321	85,536	53,110	(27,215)	32,426
Other nonoperating expenses, net	(127,121)	(149,772)	(106,833)	22,651	(42,939)
Loss before transfer, contributions, and special item	(68,800)	(64,236)	(53,723)	(4,564)	(10,513)
Transfers to the City and County of San Francisco	(19,677)	(18,161)	(16,823)	(1,516)	(1,338)
Transfers from the city and County of San Francisco	4,611	—	—	4,611	—
Deficiency before capital contributions	(83,866)	(82,397)	(70,546)	(1,469)	(11,851)
Loss due to asset impairment	(50,043)	—	—	(50,043)	—
Capital contributions	34,893	27,404	20,678	7,489	6,726
Changes in net assets	(99,016)	(54,993)	(49,868)	(44,023)	(5,125)
Total net assets at beginning of year	456,611	511,604	561,472	(54,993)	(49,868)
Total net assets at end of year	$ 357,595	456,611	511,604	(99,016)	(54,993)

Operating Revenues

The Airport derives its revenues from rates, fees, and charges assessed to the airlines; the operation of the public and employee parking facilities; rents and fees assessed concessionaires and ground transportation operators; and fees assessed for telecommunication access services.

Aviation revenues, which represent the Airport's chief source of income, decreased by $22.2 million in fiscal year 2005 as a result of the residual calculation performed in accordance with the Lease and Use Agreements[2] (Agreements) between the Airport and various airlines.

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[2] In 1981, the City entered into long-term Lease and Use Agreements with a number of airlines covering, among other things, the procedures and formulas for the periodic setting of terminal rentals and landing fees for the use of the Airport. In January 2000, the City approved amendments to the original Lease and Use Agreements to address, among other issues, the relocation of certain tenants from the old International Terminal to the new International Complex (ITC). The City also executed new Lease and Operating Agreements with nonsignatory airlines operating in the new ITC. The Lease and Use

A brief summary of the underlying rate-setting methodology under these agreements is presented below:

The Agreements establish the methodology for the calculation of the landing fee rates and terminal rental rates using certain cost centers. In accordance with the procedures set forth in the Agreements, landing fee rates and terminal rental rates are calculated for the ensuing fiscal year using budgetary and estimated information. The Agreements provide for matching revenues each fiscal year to the Airport's expenditures by adjusting payments from the airlines. Differences between actual invoiced revenues and expenditures and amounts estimated in the calculation of airline fees and charges for that fiscal year result in adjustments of terminal rentals and landing fees in subsequent years. Such differences are recorded on the balance sheet in the financial statements of the Airport in the fiscal year to which such differences pertain. Net overcharges are recorded as liabilities, and net undercharges are recorded as assets.

The net undercharge for fiscal year 2005 is $9.4 million. This amount decreased the balance of overcharges shown in the financial statements for fiscal year 2004 from $10.2 million to approximately $818 thousand in fiscal year 2005.

The following table shows the air carriers that served the Airport in fiscal year 2004-2005:

AIR CARRIERS SERVING THE AIRPORT

Fiscal Year 2004-2005

Domestic Passenger Air Carriers	Foreign Flag Carriers	Cargo Only Carriers
AirTran Airways	Air Canada	Active Aero Charter
Alaska Airlines	Air China (CAAC)	Ameriflight, Inc.
America West Airlines	Air France	Astar Air Cargo
American Airlines	Air New Zealand	Atlas Air
American Trans Air (ATA)	All Nippon Airways	Cargolux Airlines
Comair, Inc.	Asiana Airlines	DHL Airways
Continental Airlines	Bel Air Airlines	Evergreen International
Delta Air Lines	British Airways	Express Net Airlines
Frontier Airlines	Cathay Pacific	Fedex
Hawaiian Airlines	China Airlines	Gemini Air Cargo
Independence Air	EVA Airways Corporation	Kitty Hawk Aircargo
Mesa Airlines	Iceland Air	Lufthansa Cargo
Midwest Express Airlines	Japan Airlines	Nippon Cargo Airlines
Northwest Airlines	KLM Royal Dutch Airlines	Northwest Cargo
Sun Country (MN Airlines)	Korean Air	
United Airlines	Lufthansa German Airlines	
US Airways	Mexicana Airlines	

Agreements and Lease and Operating Agreements are referred to generally as the Lease and Use Agreements, and the airlines that are parties to those agreements are referred to as the Signatory Airlines.

AIR CARRIERS SERVING THE AIRPORT

Fiscal Year 2004-2005

Commuter Air Carriers

SkyWest Airlines (Delta Connection)
SkyWest Airlines (United Express)
Horizon Air

Foreign Flag Carriers

Philippine Airlines
Singapore Airlines
TACA International Airlines
Virgin Atlantic Airlines
West Jet
World Airways

The following table shows a comparison of airline landing fees and terminal rentals for fiscal years 2005, 2004, and 2003:

San Francisco International Airport Terminal Rental Rates and Landing Fees

	FY 2005	FY 2004	FY 2003
Effective average rental rate (per sq. ft.)	$ 89.660	97.880	99.280
Landing fee rate (per 1,000 lbs.)	3.214	3.930	3.986

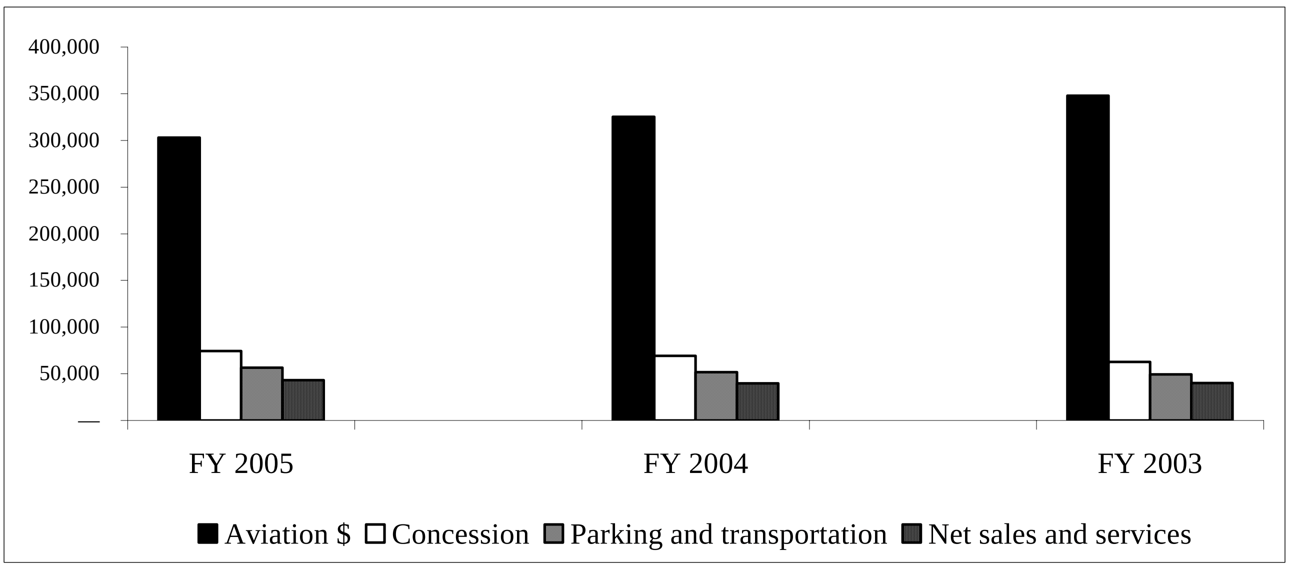
During fiscal years ended June 30, 2005, June 30, 2004, and June 30, 2003, revenues realized from the following Airport tenants exceed 5% of the Airport's total operating revenues:

	FY 2005	FY 2004	FY 2003
United Airlines	26.0%	25.5%	22.0%
AMPCO Parking Systems	10.2%	8.9%	7.0%
American Airlines	5.1%	5.4%	5.0%

The following shows a comparative summary of operating revenues for fiscal years 2005, 2004, and 2003:

Comparative Summary of Airport's Operating Revenues

	FY 2005	FY 2004	FY 2003	FY 2005 %Inc. (Dec)	FY 2004 %Inc. (Dec)
Aviation	$ 303,015	325,256	347,998	(6.8)%	(6.5)%
Concession	74,496	69,329	62,790	7.5%	10.4%
Parking and transportation	56,686	51,742	49,367	9.6%	4.8%
Net sales and services	43,117	39,805	39,961	8.3%	(0.4)%
Total operating revenues	$ 477,314	486,132	500,116	(1.8)%	(2.8)%



Fiscal Year 2005

Operating revenues decreased by 1.8% from $486.1 million in fiscal year 2004 to $477 million in fiscal year 2005 primarily due to a decrease in aviation revenues. The decrease in aviation revenues was attributed to the decrease in costs recovered from airline landing fees and terminal rentals resulting from the residual calculation of airline fees and charges performed at the end of the fiscal year in accordance with the Lease and Use Agreements.

Concession, parking, and transportation revenues, consisting of rentals and fees derived from parking facilities, duty free and retail merchandise (gifts, candy, tobacco, news), and ground transportation operations, increased by 8.4% during fiscal year 2005 from $121.1 million in fiscal year 2004 to $131.2 million in fiscal year 2005. The increase in concession revenues was primarily due to an increase in percentage rent as well as the elimination of the grace period in the parking garage.

Net sales and service revenues consist of revenues derived from utility services, telecommunication access fees, gate security fees, rental car facility fees, and reimbursement for costs of various services. Revenues from net sales and services increased by 8.3% or $3.3 million in fiscal year 2005 compared to fiscal year 2004 principally due to an increase in transportation and facility fees.

Fiscal Year 2004

Operating revenues decreased by 2.8% from $500 million in fiscal year 2003 to $486.1 million in fiscal year 2004 primarily due to a decrease in aviation revenues. The decrease in aviation revenues was attributed to the decrease in costs recovered from airline landing fees and terminal rentals resulting from the residual calculation of airline fees and charges performed at the end of the fiscal year in accordance with the Lease and Use Agreements.

Concession, parking, and transportation revenues, consisting of rentals and fees derived from parking facilities, duty free and retail merchandise (gifts, candy, tobacco, news), and ground transportation operations, increased by 7.9% during fiscal year 2004 from $112 million in fiscal year 2003 to $121.1 million in fiscal year 2004. The increase in concession revenues was primarily due to an increase to percentage rent as well as an increase in parking rates and overnight garage utilization by business travelers.

Net sales and service revenues consist of revenues derived from utility services, telecommunication access fees, gate security fees, rental car facility fees, and reimbursement for costs of various services. Revenues from net sales and services in fiscal year 2004 decreased $0.2 million compared to fiscal year 2003. In May 2002, the Transportation Security Administration terminated its cost reimbursement agreement with the Airport resulting in a net revenue loss of $6.0 million; however, this decrease was compensated by an increase in revenues from transportation and facility fees for approximately $6.0 million.

Operating Expenses

The following shows a comparative summary of operating expenses for fiscal years 2005, 2004, and 2003:

		FY 2005	FY 2004	FY 2003	%Inc. (Dec.) FY 2005	%Inc. (Dec.) FY 2004
Personnel	$	141,092	141,249	152,586	0.1%	(7.4)%
Depreciation and amortization		161,641	161,112	148,294	0.3%	8.6%
Contractual services		48,661	44,789	54,713	8.6%	(18.1)%
Write-off of airfield development costs		—	—	36,674	—%	(100.0)%
Light, heat, and power		18,474	20,303	21,028	(9.0)%	(3.4)%
Services provided by other city departments		12,335	12,314	10,837	0.2%	13.6%
Repairs and maintenance		23,809	9,647	7,823	146.8%	23.3%
Materials and supplies		6,527	6,157	6,519	6.0%	(5.6)%
General and administrative		2,619	991	4,304	164.3%	(77.0)%
Amortization of bond issuance costs		3,421	3,719	3,040	(8.0)%	22.3%
Environmental cleanup expenses		414	315	1,188	31.4%	(73.5)%
	$	418,993	400,596	447,006	4.6%	(10.4)%

(Continued)

Fiscal Year 2005

Total operating expenses increased by 4.6% ($18.3 million) in fiscal year 2005 compared to a decrease of 10.4% ($46.4 million) in fiscal year 2004. The increase in fiscal year 2005 is primarily due to the increase in repairs and maintenance of the Airports infrastructure.

Depreciation and amortization increased by 0.3% from $161.1 million in fiscal year 2004 to $161.6 million in fiscal year 2005. This increase is associated with the transfer of completed projects to active service during the fiscal year.

Contractual services increased by 8.6% from $44.8 million in fiscal year 2004 to $48.7 million in fiscal year 2005 principally due to a significant increase in costs relating to the Airport's auction rate bonds, telecommunications, marketing, and property rent.

Services provided by other city departments increased 0.2% in fiscal year 2005. Expenditures totaled $12.3 million in both fiscal years 2004 and 2005.

Repairs and maintenance increased 146.8% from $9.6 million in fiscal year 2004 to $23.8 million in fiscal year 2005. This increase is principally due to the increase in costs related to maintaining and repairing the Airport's elevators and escalators, moving walk, Air Train, the various Airport facilities, and abandonment of certain capital projects.

General and administrative costs increased by 164.3% from $1.0 million in fiscal year 2004 to $2.6 million in fiscal year 2005 principally because of an increase in provision for uncollectible accounts.

Environmental cleanup costs for fiscal year 2005 are $0.4 million compared to $0.3 million in fiscal year 2004.

Fiscal Year 2004

Operating expenses decreased by 10.4% ($46.4 million) in fiscal year 2004 compared to an increase of 9.1% ($37 million) in fiscal year 2003. The increase in fiscal year 2003 is primarily due to the write-off of costs ($37 million) associated with the runway reconfiguration project, which was suspended as of June 25, 2003. As of its suspension, approximately $80 million have already been expended on this project. Airport staff determined that approximately $43 million costs of these projects have future value and therefore remained capitalized.

Depreciation and amortization increased by 8.6% from $148 million in fiscal year 2003 to $161.1 million in fiscal year 2004. This increase is associated with the transfer of additional Near Term Master Plan Projects into active service during the fiscal year.

Contractual services decreased by 18.1% from $55 million in fiscal year 2003 to $44.8 million in fiscal year 2004. The Airport's continued cost cutting measures, by canceling or reducing contracts that are not essential to the safety and security of the Airports are not revenue producing; are not legally mandated; or are not used for the maintenance and repairs of the Airport contributed to the decrease in contractual services for the fiscal year.

Services provided by other city departments increased 13.6% from $11 million in fiscal year 2003 to $12.3 million because of the increase in litigation expenses against a prior major contractor.

Repairs and maintenance increased 23.3% from $8 million in fiscal year 2003 to $9.6 million in fiscal year 2004. This increase is principally due to the activation of the AirTrain.

General and administrative costs decreased by 77.0% from $4.3 million in fiscal year 2003 to $1.0 million in fiscal year 2004 because of the reversal of the provision for bad debts which is no longer applicable in this fiscal year.

Environmental cleanup costs for fiscal year 2004 is $0.3 million, 73.5% less than that of the prior year.

Nonoperating Revenues and Expenses

The following summary shows a comparison of nonoperating revenues and expenses in fiscal years 2005, 2004, and 2003:

		FY 2005	FY 2004	FY 2003	%Inc. (Dec.) FY 2005	%Inc. (Dec.) FY 2004
Nonoperating revenues:						
Passenger facility charges	$	60,925	57,498	51,797	6.0%	11.0%
Investment income		19,171	7,550	33,137	153.9%	(77.2)%
Other		2,478	2,941	2,541	(15.7)%	15.7%
Total		82,574	67,989	87,475	21.5%	(22.3)%
Nonoperating expenses:						
Interest expense		209,452	217,705	194,030	(3.8)%	12.2%
Loss on disposal of capital assets		243	56	278	333.9%	(79.9)%
Total		209,695	217,761	194,308	(3.7)%	12.1%
	$	(127,121)	(149,772)	(106,833)	(15.1)%	40.2%

Fiscal Year 2005

Nonoperating revenues primarily consist of Passenger Facility Charges (PFC) revenues and investment income, while nonoperating expenses primarily consist of interest expense. PFCs, which became effective in October 2001, generated an added $60.9 million in nonoperating revenues. The increase of $0.5 million in other nonoperating revenues is represented by environmental cost recoveries offset by $4.6 million transferred from the City and County of San Francisco. During the year, nonoperating expenses exceeded nonoperating revenues by $127.1 million primarily due to the excess of interest expense ($209.5 million) over nonoperating revenues of $82.5 million.

In fiscal year 2005, transfers[3] to the City and County of San Francisco (City) increased by $1.5 million, 8.3% above the previous fiscal year. This increase is proportionate to the increase in concession, parking, and transportation revenues during the year.

In 2003, the Office of the Inspector General (OIG) conducted an audit of the Airport's annual service payment to the City for the fiscal years 1998 through 2002. The audit conducted by the OIG raised issues of violations of the Revenue diversion regulations relating to certain payments totaling $512 million by the Airport to the City for indirect services expressly prohibited by the 1981 Lease and Use Agreements. The City disputes the OIG finding and has been in continuous discussion with the FAA to resolve the issue. In June 2005, the City, in anticipation of a resolution of the audit transferred $4.6 million back to the Airport which is reflected as transfers from the City and County of San Francisco and as a liability owed to the Airlines.

Capital contributions received from federal grants during the year were $34.9 million.

In fiscal year 2005, approximately $50 million in capitalized costs relating to runway development were written off due to asset impairment.

Fiscal Year 2004

Nonoperating revenues primarily consist of Passenger Facility Charges (PFC) revenues and investment income, while nonoperating expenses primarily consist of interest expense. PFCs, which became effective in October 2001, generated an added $57.5 million in nonoperating revenues. During the year, nonoperating expenses exceeded nonoperating revenues by $149.8 million primarily due to the excess of interest expense ($217.7 million) over nonoperating revenues of $68.0 million.

In fiscal year 2004, transfers[3] to the City and County of San Francisco (City) increased by $1.3 million, 8.0% above the previous fiscal year. This increase is proportionate to the increase in concession, parking, and transportation revenues during the year.

Capital contributions received from federal grants during the year were $27.4 million.

Capital Acquisitions and Construction

Under the Lease and Use Agreements, the City is obligated to use its best efforts to finance all capital improvements (above certain de minimis amounts) through the issuance of Airport revenue bonds. The Lease and Use Agreements also provide certain airline review procedures with respect to capital projects.

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[3] Transfers – The Lease and Use Agreements provided for a payment to the City and County of San Francisco's (the City's) general fund for indirect services that the City provides to the Airport. The payment, referred to as the annual service payment, is calculated as 15% of concession revenues (including parking and transportation revenues) or a minimum of $5 million, whichever is greater.

The year's major capital additions included:

Airfield low visibility improvements	$ 8,508,880
Runway 1R-19L overlay and reconstruction	917,535
South field runway safety area construction	1,857,421
Boarding Area D apron rehabilitation	869,821
Pavement replacement and construction	1,143,442
Wastewater treatment plant expansion	5,434,506
12Kv line and BART operating system	1,148,131
Security operating center construction	1,002,375
In-line EDS domestic terminals	16,369,779
Security systems integration	3,962,465
Domestic terminals food and beverage development	12,089,995
Taxiway C and Q improvements	8,128,137
Superbay hangar asbestos abatement	3,105,924
Aircraft noise management	936,609

More detailed information about the Airport's capital acquisitions and construction is presented in note 5 to the financial statements.

Long-term Debt Administration

On January 26, 2005, the Airport issued Second Series Revenue Bonds Issue 31F in the principal amount of $111.7 million. Proceeds were used to refund certain revenue bonds previously issued by the airport and pay certain costs of issuance associated with this bond issue. The Issue 31F revenue bonds are fixed-rate bonds with interest rates ranging from 3.950% to 4.910%.

On February 7, 2005, the Airport issued Second Series Revenue Bonds Issue 32 in the principal amount of $199.9 million. Proceeds were used to refund certain revenue bonds previously issued by the Airport and to pay certain costs of issuance associated with this bond issue.

The Issue 32 Bonds were initially issued in an auction mode, subject to conversion by the commission to another interest rate mode. The initial interest rate was established by the Commission for the initial interest rate period commencing February 10, 2005 for each series of Issue 32 Bonds. Thereafter, each series of Issue 32 bonds will bear interest at an auction rate resulting from the auction conducted for each auction period.

Each series of Issue 32 Bonds may bear a different auction rate and are subject to a different auction period. As of June 30, 2005, Series 32A, 32B, 32C, 32D, and 32E were in 7 days, 35 days, 35 days, 35 days, and 7 days auction periods, respectively. For the period of February 10, 2005 to June 30, 2005, the average interest rate for the Issue 32 Bonds was 2.355%.

During fiscal year 2005 and 2004, the Airport's operating revenues, together with the permitted transfers from the Airport's contingency account, were sufficient to meet the rate covenant requirements under the Airport's Master Bond Resolution.

The airport entered into seven forward-starting interest rate swaps in December 2004 in connection with the anticipated issuance of its San Francisco International Airport Second Series Variable Rate Revenue Refunding Bonds Issue 32 on February 10, 2005 and its Variable Rate Revenue Refunding Bonds Issue 33 on February 15, 2006. Pursuant to these interest rate swaps, the Airport will receive a monthly variable rate payment from each counterparty approximate to the variable interest rates the airport will pay on the Issue 32 and 33 Bonds; the airport will then make a monthly fixed rate payment to the counterparties. The objective of the swaps is to achieve a synthetic fixed rate with respect to the Issue 32 and 33 Bonds.

More detailed information about the Airport's long-term debt and interest rate swaps are presented in note 7 to the financial statements.

Credit Ratings and Bond Insurance

The Airport's underlying bond ratings were upheld by three of the three major rating agencies in conjunction with the release of the Issue 31F and Issue 32 bonds. Moody's Investor Services, Standard & Poor's (S&P), and Fitch maintained their ratings of "A1," "A," and "A, respectively, with a stable rating outlook.

In connection with the sale of most Airport revenue bond issues, municipal bond insurance has been purchased by the underwriters to guarantee the payment of principal and interest when due. With the insurance, Moody's, S&P, and Fitch assigned their municipal bond ratings of "Aaa," "AAA," and "AAA," respectively, to each of the Airport revenue bond issues.

Fiscal Year 2006 Airline Rates and Charges

Rates and Charges, Fiscal Year 2006

Terminal rental rates and airline landing fees for fiscal year 2006 have been developed as part of the annual budget process that started in October 2005. The Lease and Use Agreements between the Airport and the Signatory Carriers provide for the rate-setting methodology for calculating the terminal rental rates and Airline landing fees as discussed earlier. Not less than 60 days prior to the start of the fiscal year, the Signatory Carriers are notified of the proposed rates and fees. These fees are subject to review by, but not the approval of, the Signatory Carriers. The terminal rental rates and airline landing fees for fiscal year 2005, which became effective as of July 1, 2005, are as follows:

Effective average terminal rental rate (per sq. ft)	$	90.160
Landing fee rate (per 1,000 lbs.)		3.213

The fiscal year 2006 airline landing fee rate remains basically unchanged ($3.214 per thousand pounds in fiscal year 2005 compared to $3.213 per thousand pounds in fiscal year 2006) while the effective average rental rate increased by 0.5% from 89.66 per sq. ft. in fiscal year 2005 to $90.16 per sq. ft. in 2006.

Requests for Information

This report is designed to provide a general overview of the San Francisco International Airport's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Office of the Airport Deputy Director, Business and Finance Division, P.O. Box 8097, San Francisco International Airport, San Francisco, California 94128.

AIRPORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
SAN FRANCISCO INTERNATIONAL AIRPORT

Statements of Net Assets

June 30, 2005 and 2004

(In thousands)

		2005	2004
Assets:			
Current assets:			
Unrestricted current assets:			
Cash and investments held in City Treasury – Operating Fund	$	264,061	271,219
Cash – Revolving Fund		10	10
Accounts receivable (net of allowance for doubtful accounts: 2005, $1,886; 2004, $1,806)		27,791	33,034
Accrued interest:			
City Treasury		2,418	493
Inventories		48	100
Other current assets		1,902	1,285
Unrestricted current assets		296,230	306,141
Restricted assets available for current outlay:			
For capital outlay:			
Cash and cash investments held in City Treasury		11,590	15,732
For revenue bond reserves and debt service:			
Investments with Trustee		46,667	47,121
Grants receivable		1,115	740
Restricted assets available for current outlay		59,372	63,593
Total current assets		355,602	369,734
Accounts receivable – noncurrent (net of allowance for doubtful accounts: 2005, $1,087; 2004, $0)		4,065	6,673
Restricted assets:			
For capital outlay:			
Cash and investments held in City Treasury		165,992	174,519
Accrued interest – City Treasury		580	339
For revenue bond reserves and debt service:			
Investments with Trustee		162,217	193,226
Accrued interest on investments with Trustee		10,616	559
Grants receivable		20,210	7,156
Passenger facility charges receivable		7,262	9,722
Total restricted assets		366,877	385,521
Capital assets, net		3,760,023	3,900,905
Unamortized bond issuance costs		48,062	45,500
Total assets		4,534,629	4,708,333

(Continued)

AIRPORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
SAN FRANCISCO INTERNATIONAL AIRPORT

Statements of Net Assets

June 30, 2005 and 2004

(In thousands)

		2005	2004
Liabilities:			
Current liabilities:			
Current liabilities payable from unrestricted assets:			
Accounts payable		20,064	11,254
Accrued payroll		5,098	4,121
Compensated absences		5,928	5,802
Accrued workers' compensation		1,339	1,186
Estimated claims payable		812	209
Due to City and County of San Francisco		1,052	1,052
Deferred aviation revenue		818	10,176
Rent collected in advance		12,829	14,726
Security deposits		23,453	24,052
Current maturities of long-term debt		65,938	65,462
Current liabilities payable from unrestricted assets		137,331	138,040
Current liabilities payable from restricted assets:			
Accounts payable		9,340	15,480
Accrued payroll		273	252
Grants received in advance		1,115	740
Accrued bond interest payable		31,938	34,028
Current maturities of long-term debt		13,188	13,093
Current liabilities payable from restricted assets		55,854	63,593
Total current liabilities		193,185	201,633
Noncurrent liabilities:			
Compensated absences, net of current portion		5,562	5,774
Accrued workers' compensation, net of current portion		3,780	3,969
Estimated claims payable, net of current portion		33	250
Long-term debt, net of current maturities		3,974,474	4,040,096
Total noncurrent liabilities		3,983,849	4,050,089
Total liabilities		4,177,034	4,251,722
Net assets:			
Invested in capital assets, net of related debt		(112,954)	(30,535)
Restricted for debt service		163,758	191,808
Restricted for capital projects		17,877	9,721
Restricted for other purposes		—	1,419
Unrestricted		288,914	284,198
Total net assets	$	357,595	456,611

See accompanying notes to financial statements.

AIRPORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
SAN FRANCISCO INTERNATIONAL AIRPORT

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2005 and 2004

(In thousands)

		2005	2004
Operating revenues:			
Aviation	$	303,015	325,256
Concession		74,496	69,329
Parking and transportation		56,686	51,742
Net sales and services		43,117	39,805
Total operating revenues		477,314	486,132
Operating expenses:			
Personnel		141,092	141,249
Depreciation and amortization		161,641	161,112
Contractual services		48,661	44,789
Light, heat, and power		18,474	20,303
Services provided by other City departments		12,335	12,314
Repairs and maintenance		23,809	9,647
Materials and supplies		6,527	6,157
General and administrative		2,619	991
Amortization of bond issuance costs		3,421	3,719
Environmental cleanup expenses		414	315
Total operating expenses		418,993	400,596
Operating income		58,321	85,536
Nonoperating revenues (expenses):			
Investment income		19,171	7,550
Interest expense		(209,452)	(217,705)
Passenger facility charges		60,925	57,498
Loss on disposal of equipment		(243)	(56)
Environmental cost recoveries		6,033	—
Other nonoperating (expenses) revenues, net		(3,555)	2,941
Total nonoperating expenses, net		(127,121)	(149,772)
Loss before contributions and transfers		(68,800)	(64,236)
Capital contributions:			
Federal grants		34,893	27,404
Loss due to asset impairment (note 5)		(50,043)	—
Transfers to the City and County of San Francisco (note 10)		(19,677)	(18,161)
Transfer from the City and County of San Francisco (note 10)		4,611	—
Changes in net assets		(99,016)	(54,993)
Total net assets – beginning of year		456,611	511,604
Total net assets – ending of year	$	357,595	456,611

See accompanying notes to financial statements.

AIRPORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
SAN FRANCISCO INTERNATIONAL AIRPORT

Statements of Cash Flows

Years ended June 30, 2005 and 2004

(In thousands)

		2005	2004
Cash flows from operating activities:			
Cash received from airline carriers, concessionaires, and others	$	489,079	513,963
Cash paid for employees' services		(140,238)	(146,136)
Cash paid to suppliers of goods and services		(102,363)	(107,431)
Net cash provided by operating activities		246,478	260,396
Cash flows from noncapital financing activities:			
Transfers to the City and County of San Francisco		(19,677)	(18,161)
Transfers from the City and County of San Francisco		4,611	—
Other noncapital financing (decreases) increases		(3,555)	163
Net cash used in noncapital financing activities		(18,621)	(17,998)
Cash flows from capital and related financing activities:			
Net proceeds from sale of revenue bonds		2,002	—
Bond issuance costs paid		(3,743)	(717)
Cash paid to escrow agent for debt refunding		(5,473)	(12,414)
Principal paid on revenue bonds		(78,555)	(108,090)
Interest paid on revenue bonds and commercial paper borrowings		(207,897)	(205,618)
Acquisition and construction of capital assets		(85,391)	(100,310)
Proceeds from insurance recoveries		3,225	—
Proceeds from sale of equipment		—	8
Proceeds from passenger facility charges		63,385	56,326
Capital contributed by federal agencies and others		21,840	27,967
Net cash used in capital and related financing activities		(290,607)	(342,848)
Cash flows from investing activities:			
Sale of investments in City Treasury		—	19,933
Sale of investments with Trustee		1,876,940	1,659,792
Purchases of investments with Trustee		(1,842,811)	(1,630,490)
Interest received on investments		8,985	12,051
Net cash provided by investing activities		43,114	61,286
Net decrease in cash and cash equivalents		(19,636)	(39,164)
Cash and cash equivalents, beginning of year		461,099	500,263
Cash and cash equivalents, end of year	$	441,463	461,099

(Continued)

AIRPORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
SAN FRANCISCO INTERNATIONAL AIRPORT

Statements of Cash Flows

Years ended June 30, 2005 and 2004

(In thousands)

		2005	2004
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	58,321	85,536
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization		161,641	161,112
Construction in progress written off		9,193	—
Environmental cost recoveries		6,033	—
Provision for doubtful accounts		1,167	—
Amortization of bond issuance costs		6,674	3,719
Changes in operating assets and liabilities:			
Accounts receivable		6,684	2,040
Inventories		52	20
Other current assets		(617)	694
Accounts payable		8,330	79
Accrued payroll		976	(4,703)
Compensated absences		(86)	419
Accrued workers' compensation		(36)	(604)
Due to City and County of San Francisco		—	732
Deferred aviation revenue		(9,358)	1,213
Rent collected in advance		(1,897)	9,305
Security deposits		(599)	834
Net cash provided by operating activities	$	246,478	260,396
Reconciliation of cash and cash equivalents to the statements of net assets:			
Cash and investments held in City Treasury – Operating Fund	$	264,061	271,219
Cash – Revolving Fund		10	10
Restricted cash and investments in City Treasury		177,582	190,251
Cash, cash equivalents, and investments		441,653	461,480
Unrealized loss on investments		(190)	(381)
Cash and cash equivalents, June 30, 2005	$	441,463	461,099

See accompanying notes to financial statements.

(1) Definition of Reporting Entity

The accompanying financial statements reflect the net assets and changes in net assets of the Airport Commission, City and County of San Francisco, San Francisco International Airport (the Airport), a commercial service airport owned and operated as a department of the City and County of San Francisco (the City). The Airport opened in 1927 and is currently the twelfth busiest airport in terms of passengers and fourteenth in terms of cargo in the United States. The Airport is also a major origin and destination point and one of the nation's principal gateways for Pacific traffic. A five-member Airport Commission is responsible for its operation, development, and maintenance. Commission members are appointed by the City's Mayor for terms of four years.

The Airport is an integral part of the City and is reported as a major enterprise fund in the City's Comprehensive Annual Financial Report. There are no component units that should be considered for inclusion in the Airport's financial reporting entity. The accompanying financial statements present only the financial operations of the Airport and do not purport to, and do not, present the financial position of the City, and the results of its operations and the cash flows of its proprietary fund types.

(2) Significant Accounting Policies

(a) Measurement Focus and Basis of Accounting

The Airport's financial activities are accounted for on a flow of economic resources measurement focus, using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (GAAP) as promulgated by the Governmental Accounting Standards Board (GASB). In addition, the Airport applies all statements and interpretations of the Financial Accounting Standards Board (FASB), the Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Airport does not apply FASB statements and interpretations issued after November 30, 1989.

The Airport distinguishes operating revenues and expenses from nonoperating revenues and expenses. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with an organization's principal ongoing operations. The principal operating revenues of the Airport are charges to airlines and concessionaires, and parking and transportation charges. Operating expenses of the Airport include the cost of sales and services, administrative expenses, the write-off of certain costs associated with abandoned capital projects, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

(b) Implementation of New Accounting Standards

(i) Governmental Accounting Standards Board Statement No. 40

The Airport has adopted the provisions of GASB Statement No. 40 – *Deposit and Investment Risk Disclosures, an amendment of GASB Statement No. 3*. This Statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. The statement requires certain disclosures of investments that have fair values highly sensitive to changes in interest rates. It also requires disclosure of deposit and investment policies related to the risks identified in the Statement.

(ii) Governmental Accounting Standards Board Statement No. 42

The Airport has adopted the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement establishes accounting and financial reporting standards for impairment of capital assets. It defines the conditions under which capital assets should be generally considered impaired which are (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstance is outside the normal life cycle of the capital asset. Both conditions must be met in considering capital asset impairment.

(c) Cash and Investments

The Airport maintains its cash and investments and a significant portion of its restricted cash and investments as part of the City's pool of cash and investments. The Airport's portion of this pool is displayed on the statement of net assets as "Cash and investments held in 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.

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, and the Airport reports its investments at fair value based on quoted market information obtained from fiscal agents or other sources.

The Airport considers its pooled deposits held with the City Treasurer to be demand deposits and therefore cash equivalents for the purposes of the statements of cash flows. The City also may hold nonpooled cash and investments for the Airport. Nonpooled restricted cash and highly liquid investments with maturities of three months or less, when purchased, are considered to be cash equivalents. Restricted cash and investments held by the trustee are not considered to be cash and cash equivalents.

(d) Capital Assets

Capital assets are stated at cost. Interest costs of tax-exempt bond funds used for specified construction purposes, net of interest earned on the temporary investment of the proceeds of such tax-exempt borrowings, are capitalized from the date of borrowing through the construction period. Interest costs of other borrowings are capitalized based on average accumulated construction expenditures.

Depreciation and amortization are computed using the straight-line method over the following estimated useful lives:

	Years
Buildings, structures, and improvements	5 – 50
Equipment	5 – 10
Easements	20

Maintenance, repairs, and minor replacements are charged against operations in the year performed. Major replacements that extend the useful life of the related assets are capitalized. No depreciation is provided on construction in progress until construction is substantially complete and the asset is placed in service. The Airport begins to record depreciation on capital assets the month following the date in which assets are placed in service.

(e) Bond Issuance Costs and Discounts

Bond issuance costs are amortized using either the effective-interest method or a method that approximates the effective interest method over the life of the bonds. Original bond issuance discounts are offset against the related debt and amortized using the effective-interest method over the life of the bonds.

(f) Compensated Absences

Vested vacation and sick leave and related benefits are accrued when incurred for all the Airport's employees.

(g) Net Assets

A significant portion of the Airport's net assets is restricted by the bond indentures and the Lease and Use Agreements with the airlines for the purpose of capital improvements and contingencies.

(h) Aviation Revenue

Aviation revenue is based on reimbursable expenditures as defined in Lease and Use Agreements with airlines. Under the Lease and Use Agreements, the airlines are required to pay terminal rents and landing fees in amounts that, when aggregated with certain other Airport revenues, will be equal to the Airport's expenditures for: operating expenses other than depreciation and amortization;

(Continued)

principal and interest on outstanding debt; continuing annual payments to the City; and certain acquisitions of capital assets. Other capital asset additions are funded with proceeds of revenue bonds for which the airlines are required to fund debt service. The Lease and Use Agreements were executed in 1981 as part of a negotiated settlement with the airlines. The majority of airlines operate under Lease and Use Agreements which expire in 2011. All other airlines operate under month-to-month permits with the same terms and conditions as the original 1981 Lease and Use Agreements.

Amounts billed to airlines are based on budgeted revenues and expenditures including all debt service such as principal and interest. Aviation revenue collected in advance will be applied to reduce future billings and is recorded as a liability in the financial statements. Aviation revenue due will be reduced by increases in future billings and is recorded as an asset in the financial statements. Pursuant to the terms of the Lease and Use Agreements, the Airport owed the Airlines approximately $818,000 and $10,176,000 on June 30, 2005 and 2004, respectively.

(i) Security Deposits

As a condition of the Airline Operating Permits (Permits), air carriers are required to deliver a security deposit to the Airport within five days after the effective date of the Permit. Such deposit shall be in the form of (a) a surety bond payable to the City or (b) a letter of credit naming the City as a beneficiary. The bonds or letters of credit are to be renewed and increased annually such that they are equal to six months of fees estimated by the Airport Director. The bonds or letters of credit shall be kept in full force and effect at all times to ensure the faithful performance by the respective Permittee of all covenants, terms, and conditions of the Permits, including payment of the monthly fees. During the year ended June 30, 2003, the Airport received a cash security deposit in the amount of $23.2 million from an air carrier operating out of the Airport’s facilities. This cash deposit was received in lieu of the air carrier maintaining a bond or letter of credit with the Airport as required under the terms of the Permit. The cash deposit of $23.5 million and $24.1 million as of June 30, 2005 and June 30, 2004, respectively, was reported in cash and investments held in City Treasury on the statement of net assets with a corresponding liability of an equal amount to reflect the Airport’s obligation to refund any unused portion of the deposit including accrued interest to the air carrier upon the termination of the Permit.

(j) Net Sales and Service Revenues

Net sales and services revenues are collected for utility, security, and miscellaneous services provided to the tenants. Utility services are provided by the City (note 10).

(k) Environmental Cleanup Expenses and Recoveries

The Airport incurs costs associated with environmental cleanup actions which arise during the normal course of business. These costs are recorded as a liability when the Airport is required to perform the cleanup and the costs can be reasonably estimated. During the year ended June 30, 2005, the Airport received environmental cost recoveries of approximately $6 million, which are recorded as nonoperating revenues in the financial statements.

(l) Capital Contributions

The Airport receives federal grants for the purpose of acquisition or construction of property and equipment. These grants are recorded as capital contributions when the grant is earned. Grants are generally earned upon expenditures of the funds.

(m) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(n) Reclassifications

Certain reclassifications have been made to prior year amounts to conform with current year presentation.

(3) Cash and Investments

The Airport maintains its cash and investments and a significant portion of its restricted asset cash and investments as part of the City's pool of cash and investments. The City's investment pool is invested 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 deposit and investment risks associated with the City's pooled cash and investments.

Investments, at fair value, held by the City as of June 30, 2005 and 2004 are as follows (in thousands):

		2005	**2004**
Pooled cash and investments:			
Cash and investments held in City Treasury – operating	$	264,061	271,219
Cash and investments held in City Treasury – capital outlay		177,582	190,251
Total cash and investments in City Treasury	$	441,643	461,470

The restricted assets for revenue bond reserves and debt service are held by an independent trustee. As of June 30, 2005, the Airport had investments with maturities as follows (in thousands):

	June 30, 2005		June 30, 2004	
Investments	**Maturities**	**Fair value**	**Maturities**	**Fair value**
Federal Home Loan Mortgage Discount Notes	November 1, 2005	$ 3,276	March 8, 2004	$ 34,998
Federal Home Loan Mortgage Discount Notes		—	June 28, 2005	48,847
Federal Home Loan Mortgage Discount Notes		—	July 6, 2004	40,300
Federal Home Loan Mortgage Discount Notes		—	September 21, 2004	24,917
Federal Home Loan Bank Discount Note	July 5, 2005	4,546		—
Federal Home Loan Bank Discount Note	July 8, 2005	6,772		—
Federal Home Loan Bank Discount Note	November 1, 2005	100,153		—
Federal Nation Mortgage Association Discount Notes	July 1, 2005	7,646	November 1, 2005	43,189
Federal Nation Mortgage Association Discount Notes	July 6, 2005	39,690	July 6, 2004	45,617
Federal Nation Mortgage Association Discount Notes	November 1, 2005	42,676		—
Federal Nation Mortgage Association Discount Notes	May 26, 2006	14,741		—
US Treasury Bills		—	October 28, 2004	1,562
JP Morgan Treasury Plus Money Market		—	N/A	1,476
Total		$ 219,500		$ 240,906

The primary objectives of the Airport's policy on investments of debt service reserve funds and debt service funds (including principal and interest accounts) held by the bond trustee are safety, liquidity, and yield.

Safety is the foremost objective of the investment program. Investments undertaken seek to ensure the preservation of capital in the overall portfolio the objective of which is to mitigate credit and interest rate risk.

The term of any investments is based on the cash flow needs of the Airport's debt service requirements. Consequently, investment of any debt service reserve funds are limited to seven (7) years or less and investments of any principal and interest payment account are to mature no later than the dates on which the principal or interest payments are due.

(Continued)

The Airport will maximize the retainable earnings of all bond proceeds after meeting the requirements of safety and liquidity. After these objectives are met, the Airport's investment policy will attempt to achieve net investment yields as close to each bond fund's arbitrage yield.

Funds held by the Trustee in funds and accounts established under the 1991 Master resolution are invested in "Permitted Investments" as defined in the 1991 Master Resolution.

Funds held by the Trustee in funds and accounts established under the 1997 Subordinate Resolution are invested in "Permitted Investments" as defined in the 1997 Subordinate Resolution (excluding Banker's Acceptances which are permitted investments only for funds relating to the 1991 Master Resolution). The Airport's policy on Banker's Acceptances of a banking institution requires the highest short-term rating category by at least two Rating Agencies, and must not exceed 270 days maturity or forty percent (40%) of moneys invested pursuant to the 1991 master Resolution. In addition, no more than twenty percent (20%) of moneys invested pursuant to the 1991 Master Resolution are to be invested in the Banker's Acceptances of any one commercial bank. The Airport has approximately $219.5 million and $240.9 million in investments held by, and in the name of, the fiscal agent as of June 30, 2005 and 2004, respectively.

All other funds of the Airport are invested in accordance with the (1) Treasurer's policy and (2) the 1991 Master Resolution of the 1997 Subordinate Resolution, as appropriate if such funds are also subject to the 1991 Master Resolution or the 1997 Subordinate Resolution, respectively.

(4) Grants Receivable

Grants receivable of $21,325,000 and $7,896,000 as of June 30, 2005 and June 30, 2004, respectively, are based on actual costs incurred, subject to federal reimbursement limits.

Project costs are subject to audit by the Federal Aviation Administration (FAA) to ensure that the costs are allowable under the grant agreements. If any project costs are disallowed, amounts recorded as grants receivable will be reduced or refunded to the FAA. During the years ended June 30, 2005 and 2004, the Airport experienced no reduction to its grants receivable or refunded any amounts to the FAA.

(5) Capital Assets

Capital assets consist of the following (in thousands):

	July 1, 2004	Increases	Decreases	June 30, 2005
Capital assets not being depreciated:				
Land	$ 2,316	—	—	2,316
Construction in progress	126,574	77,399	(158,931)	45,042
Total capital assets not being depreciated	128,890	77,399	(158,931)	47,358
Capital assets being depreciated/ amortized:				
Buildings, structures, and improvements	4,670,864	102,009	(3,329)	4,769,544
Equipment	70,207	739	(5,077)	65,869
Easements	135,598	3,011	—	138,609
Total capital assets being depreciated/amortized	4,876,669	105,759	(8,406)	4,974,022
Less accumulated depreciation/ amortization for:				
Buildings, structures, and improvements	(998,507)	(150,311)	—	(1,148,818)
Equipment	(59,702)	(4,700)	4,938	(59,464)
Easements	(46,445)	(6,630)	—	(53,075)
Total accumulated depreciation/ amortization	(1,104,654)	(161,641)	4,938	(1,261,357)
Total capital assets being depreciated/ amortized, net	3,772,015	(55,882)	(3,468)	3,712,665
Total capital assets, net	$ 3,900,905	21,517	(162,399)	3,760,023

	July 1, 2003	Increases	Decreases	June 30, 2004
Capital assets not being depreciated:				
Land	$ 2,316	—	—	2,316
Construction in progress	106,967	90,164	(70,557)	126,574
Total capital assets not being depreciated	109,283	90,164	(70,557)	128,890
Capital assets being depreciated/ amortized:				
Buildings, structures, and improvements	4,604,727	66,137	—	4,670,864
Equipment	70,240	1,241	(1,274)	70,207
Easements	131,848	3,750	—	135,598
Total capital assets being depreciated/amortized	4,806,815	71,128	(1,274)	4,876,669
Less accumulated depreciation/ amortization for:				
Buildings, structures, and improvements	(850,011)	(148,496)	—	(998,507)
Equipment	(54,953)	(5,966)	1,217	(59,702)
Easements	(39,795)	(6,650)	—	(46,445)
Total accumulated depreciation/ amortization	(944,759)	(161,112)	1,217	(1,104,654)
Total capital assets being depreciated/ amortized, net	3,862,056	(89,984)	(57)	3,772,015
Total capital assets, net	$ 3,971,339	180	(70,614)	3,900,905

Total interest cost was approximately $212,777,000 for 2005 and $220,361,000 for 2004, of which approximately $3,325,000 and $2,656,000, respectively, were capitalized. Total interest income was approximately $19,200,000 for 2005 and $12,758,000 for 2004, none of which were capitalized.

Total disposals for fiscal year 2005 and 2004 were approximately $5,077,000 and $1,274,000, respectively.

Prior to suspension of activities of the Airfield Development Bureau (ADB) in June 2003, approximately $80 million in costs relating to environmental and planning efforts, including work related to environmental studies, potential runway configurations and potential construction methods, were capitalized. After the project was suspended, approximately $37 million in costs related to industry forecasting, legal services, public relations, and program management were expensed. The remaining amount of approximately $43 million (excluding capitalized interests) relating to potential runway reconfigurations and construction methods and materials were considered by management to have future economic value and accordingly remained capitalized.

The Airport recognized a loss due to asset impairment of approximately $50 million (including capitalized interest of $5 million in 2005 as management has determined that the future economic value has been impaired).

(6) Commercial Paper

In May 2002, the Airport obtained a standby letter of credit with a maximum stated principal amount of $200 million. The Subordinate Lien Resolution authorizes a maximum authorized principal amount of notes of $400 million.

There were no commercial paper borrowings during fiscal years 2005 and 2004.

(7) Long-term Debt

(a) Second Series Revenue Bonds

The Airport Commission has authorized the issuance of up to $2.9 billion of San Francisco International Airport Second Series Revenue Bonds for the purposes of refunding, paying, calling, and retiring a portion or all of one or more Series of Outstanding 1991 Resolution Bonds and all or a portion of the San Francisco International Airport's outstanding subordinate commercial paper notes, funding debt service reserves, and for paying costs of issuance, including any related redemption premiums therewith.

(i) Second Series Revenue Bonds Issue 31F

On January 26, 2005, the Airport issued Second Series Fixed Rate Revenue Bonds Issue 31F in the amount of $111.7 million with interest rates ranging from 3.95% to 4.91%. Proceeds from Issue 31F were deposited into an irrevocable trust with an escrow agent to advance refund certain of the Airport's Second Series Revenue Bonds as follows (in thousands):

	Amount refunded	Interest rates	Call price
Second series revenue bond issuance:			
Issue 13	$ 100,400	6.75% – 7.13%	$ 102.000

The refunded Second Series Revenue Bonds have final maturity dates ranging from May 1, 2009 to May 1, 2026 and a call date of May 1, 2006.

The net proceeds of $109.1 million (after payment of $2.6 million in underwriting fees, insurance, surety, premium, and cost of issuance account) were used to purchase U.S. Treasury Securities. The securities were deposited in an irrevocable trust with an escrow agent to provide debt service payment on the refunded bond identified above until called on May 1, 2006.

The refunded bonds are considered legally defeased where the debt is legally satisfied based on certain provisions in the debt instrument even though the debt is still outstanding. Accordingly, the liability for the refunded bonds has been removed from the accompanying statements of net assets.

Although the advance refunding resulted in the recognition of a deferred accounting loss of $8.2 million for the year ended June 30, 2005, the Airport in effect reduced its aggregate debt service payments by approximately $47 million over the next 22 years and obtained an economic gain (the difference between the present values of the old and new debt service payments) of $19.8 million.

(ii) Second Series Revenue Bonds Issue 32

On February 10, 2005, the Airport issued Second Series Variable Rate Revenue Refunding Bonds Issue 32 (Issue 32) in the amount of $199.9 million. The Issue 32 bonds were initially issued in an Auction Mode, subject to conversion by the Commission to another interest rate mode. The initial interest rate was established by the Commission for the interest rate period commencing February 10, 2005 for each series of Issue 32 bonds.

Each series of Issue 32 bonds may bear a different auction rate and be subject to a different auction period. As of June 30, 2005, series issue 32A, 32B, 32C, 32D, and 32E were in 7 days, 35 days, 35 days, 35 days, and 7 days auction periods, respectively. For the period February 10, 2005 through June 30, 2005, the average interest rate on the Issue 32 bonds was 2.360%.

Proceeds of the Issue 32 bonds were deposited into an irrevocable trust with an escrow agent to advance refund certain of the Airport’s Second Series Revenue Bonds as follows (in thousands):

	Amount refunded	Interest rates	Call price
Second series revenue bond issuance:			
Issue 9	$ 191,380	5.00% – 5.90%	$ 101.000

The refunded Second Series Revenue Bonds have final maturity dates ranging from May 1, 2006 to May 1, 2025 and a call date of May 1, 2005.

 (Continued)

The net proceeds of $197.7 million (after payment of $5.8 million in underwriting fees, insurance, surety premium, and cost of issuance account) plus an additional $3.6 million of available debt service funds were used to purchase U.S. Treasury Securities – State and Local Government Series. These securities were deposited in an irrevocable trust with an escrow agent to provide debt service payments on the refunded bonds identified above until called on May 1, 2005.

The refunded bonds are considered legally defeased where the debt is legally satisfied based on certain provisions in the debt instrument, even though the debt is still outstanding. Accordingly, the liability for the refunded bonds has been removed from the accompanying statements of net assets.

Although the advance refunding resulted in the recognition of a deferred accounting loss of $5.1 million for the year ended June 30, 2005, the Airport in effect reduced its aggregate debt service payments by approximately $11.7 million (based on an assumed interest rate of 3.44% over the next 22 years and obtained an economic gain (the difference between the present values of the old and new debt service payments), of $30.3 million.

During fiscal year 2005, the Airport issued Second Series Revenue Bonds Issue 31F and Issue 32 to refund previously issued debt. The $109.1 million in proceeds from Issue 31F and the $197.7 million in proceeds from Issue 32 were deposited immediately into irrevocable trusts for the defeasance of $291.8 million of Second Series Revenue Bonds.

During fiscal year 2004, the Airport issued Second Series Revenue Bonds Issue 30 and Issue 31 to refund previously issued debt. The $35.8 million in proceeds from Issue 30 and the $224.0 million in proceeds from Issue 31 were deposited immediately into irrevocable trusts for the defeasance of $259.8 million of Second Series Revenue Bonds.

The Issue 31 bonds were initially issued and remain in auction mode, subject to conversion by the Commission to another interest rate mode. The initial interest rate was established by the Commission for the interest rate period commencing March 25, 2004, for each series of Issue 31 bonds.

Each series of Issue 31 auction rate bonds may bear a different interest rate and is subject to different auction periods. As of June 30, 2005, Series 31A was in a 343-day auction period, Series 31B, 31C, and 31D were in a 35-day auction period, and Series 31E was in a 7-day auction period. For the period from July 1, 2004, through June 30, 2005, the average interest rate on the Issue 31 bonds was 1.805%.

Bond issuance costs of $5.4 million and $5.5 million for the years June 30, 2005 and 2004, respectively, that were deducted from the proceeds of the Second Series Revenue Bonds were capitalized and will be amortized over the debt repayment period.

(Continued)

Certain of the Second Series Revenue Bonds are subject to optional and mandatory redemption under certain conditions. All bonds are secured by a pledge of, lien on, and security interest in net revenues of the Airport.

Under the terms of the Second Series Revenue Bonds, the Airport is required to deposit with the trustee an amount equal to the maximum debt service accruing in any year during the life of such bonds, or substitute a credit facility meeting those requirements. While revenue bonds are outstanding, the Airport may not create liens on its property essential to operations, may not dispose of any property essential to maintaining revenues or operating the Airport, and must maintain specified insurance.

Under the terms of the bond resolutions, the Airport has covenanted that it will establish and at all times maintain rentals, rates, fees, and charges for the use of the Airport and for services rendered by the Airport so that:

(a) Net revenues (as defined in the bond resolutions) in each fiscal year will be at least sufficient (i) to make all required debt service payments and deposits in such fiscal year with respect to the bonds, any subordinate bonds, and any general obligation bonds issued by the City for the benefit of the Airport and (ii) to make all payments required to be made to the City; and

(b) Net revenues, together with any transfer from the contingency account to the revenue account (both contained in investments with trustee), in each fiscal year will be at least equal to 125% of aggregate annual debt service with respect to the bonds for such fiscal year.

The methods required by the resolutions for calculating debt service coverage differ from the accounting principles generally accepted in the United States of America used to determine amounts reported in the Airport’s financial statements.

In addition to the long-term obligations discussed above, there is $114,930,000 and $117,810,000 in Special Facilities Lease Revenue Bonds outstanding at June 30, 2005, and June 30, 2004, respectively, for SFO Fuel. SFO Fuel is required to pay facilities rent to the Airport in an amount equal to debt service payments and required bond reserve account deposits on the bonds. The principal and interest on the bonds will be paid solely from the facilities rent payable by SFO Fuel to the Airport. The Airport assigned its right to receive the facilities rent to the bond trustee to pay and secure the payment of the bonds. Neither the Airport nor the City and County of San Francisco is obligated in any manner for the repayment of these obligations, and as such, they are not reported in the accompanying financial statements.

As of June 30, 2005, and June 30, 2004, long-term debt consisted of the following (in thousands):

Description	Date of issue	Interest rate	2005	2004
Second series revenue bonds:				
Issue 5	04/01/94	4.50% – 6.50%	$ —	1,900
Issue 6	11/01/94	5.00% – 6.60%	—	2,475
Issue 7	04/01/95	4.50% – 6.15%	—	510
Issue 8	08/01/95	4.25% – 6.30%	—	1,150
Issue 9	11/01/95	4.90% – 6.00%	—	196,355
Issue 10	03/01/96	5.00% – 5.70%	194,075	198,450
Issue 11	06/01/96	5.75%	—	1,625
Issue 12	10/01/96	5.50% – 5.90%	196,155	199,345
Issue 13	11/01/96	5.40% – 8.00%	68,310	172,150
Issue 14	11/01/96	5.40% – 8.00%	56,150	57,300
Issue 15	01/01/98	3.80% – 5.60%	459,345	464,425
Issue 16	04/01/98	4.80% – 5.50%	195,425	199,480
Issue 17	04/01/98	5.20% – 5.25%	30,235	30,895
Issue 18	07/01/98	4.75% – 6.25%	209,145	211,520
Issue 19	07/01/98	4.75% – 5.25%	22,970	23,445
Issue 20	10/01/98	4.25% – 5.00%	256,235	265,375
Issue 21	10/01/98	4.25% – 5.00%	75,055	76,490
Issue 22	12/01/98	4.40% – 6.00%	118,045	120,480
Issue 23	05/01/99	4.00% – 5.50%	238,125	241,135
Issue 24	03/01/00	4.75% – 6.00%	125,855	127,565
Issue 25	03/01/00	4.75% – 6.00%	112,040	113,970
Issue 26	12/07/00	4.50% – 6.50%	227,120	228,550
Issue 27	07/11/01	4.00% – 5.50%	467,475	474,370
Issue 28	03/14/02	3.00% – 5.50%	331,910	342,090
Issue 29	02/05/03	1.55% – 5.50%	154,020	156,975
Issue 30	02/10/04	3.60% – 5.25%	34,820	34,820
Issue 31A/E	03/25/04	Auction rate	230,325	230,325
Issue 31F	01/26/05	3.95% – 4.91%	111,696	—
Issue 32	02/10/05	Auction rate	199,900	—
Total			4,114,431	4,173,170
Less current portion			(79,126)	(78,555)
Unamortized discount			(17,350)	(19,059)
Unamortized deferred amount on refunding			(60,590)	(53,004)
Unamortized premium			17,109	17,544
			$ 3,974,474	4,040,096

Revenue bond debt service requirements to maturity are as follows:

	Principal	Interest
Fiscal year:		
2006	$ 79,126,000	201,213,942
2007	86,505,000	198,118,527
2008	105,720,000	192,997,174
2009	110,865,000	188,512,229
2010	118,795,000	182,488,366
2011-2015	759,270,000	816,444,271
2016-2020	940,920,000	614,584,229
2021-2025	1,116,380,000	368,838,271
2026-2030	742,520,000	122,052,447
2031-2032	54,330,000	3,636,688
	$ 4,114,431,000	2,888,886,144

(b) Changes in Long-term Liabilities

Long-term liability activity for the years ended June 30, 2005 and 2004, was as follows (in thousands):

	July 1, 2004	Additions	Reductions	June 30, 2005	Due within one year
Revenue bonds payable	$ 4,173,170	311,596	(370,335)	4,114,431	79,126
Less unamortized discount	(19,059)	—	1,709	(17,350)	—
Unamortized deferred amount on refunding	(53,004)	(13,281)	5,695	(60,590)	—
Add unamortized premium	17,544	—	(435)	17,109	—
Total revenue bonds payable	4,118,651	298,315	(363,366)	4,053,600	79,126
Compensated absences	11,576	7,788	(7,874)	11,490	5,928
Accrued workers' compensation	5,155	2,316	(2,352)	5,119	1,339
Estimated claims payable	459	575	(189)	845	812
Total long-term liabilities	$ 4,135,841	308,994	(373,781)	4,071,054	87,205

		July 1, 2003	Additions	Reductions	June 30, 2004	Due within one year
Revenue bonds payable	$	4,270,600	265,145	(362,575)	4,173,170	78,555
Less unamortized discount		(19,946)	—	887	(19,059)	—
Unamortized deferred amount on refunding		(41,193)	(16,408)	4,597	(53,004)	—
Add unamortized premium		15,489	2,269	(214)	17,544	—
Total revenue bonds payable		4,224,950	251,006	(357,305)	4,118,651	78,555
Compensated absences		11,157	8,183	(7,764)	11,576	5,802
Accrued workers' compensation		5,759	1,822	(2,426)	5,155	1,186
Estimated claims payable		459	178	(178)	459	209
Total long-term liabilities	$	4,242,325	261,189	(367,673)	4,135,841	85,752

(c) Interest Rate Swaps

General Terms

The Airport entered into seven forward-starting interest rate swaps in December 2004 in connection with the anticipated issuance of its San Francisco International Airport Second Series Variable Rate Revenue Refunding Bonds, Issue 32, on February 10, 2005, and its Variable Rate Revenue Refunding Bonds, Issue 33, on February 14, 2006. Pursuant to these interest rate swaps, the Airport will receive a monthly variable rate payment from each counterparty equal to 63.5% of USD-LIBOR-BBA, plus 0.29%, times the notional amount of the swap, which is intended to approximate the variable interest rates the Airport will pay on the Issue 32 and 33 Bonds. The Airport will make a monthly fixed rate payment to the counterparties as set forth below. The objective of the swaps is to achieve a synthetic fixed rate with respect to the Issue 32 and 33 Bonds.

The four interest rate swaps relating to the Issue 32 Bonds went into effect on February 10, 2005, the date of issuance of the Issue 32 Bonds, and the first payments commenced on March 1, 2005. The three interest rate swaps relating to the Issue 33 Bonds are expected to go into effect concurrently with the issuance of the Issue 33 Bonds on February 15, 2006, with the first payments commencing on March 1, 2006. All of the interest rate swaps are terminable at any time at the option of the Airport at their fair value.

The interest rate swaps relating to the Issue 32 Bonds terminate by their terms on May 1, 2026, the final maturity date for the Issue 32 Bonds. The following is additional information regarding each swap and the counterparties as of June 30:

Counterparty/guarantor	Initial notional amount	Counterparty credit ratings (S&P/Moody's)	Fixed rate payable by Commission	Fair value to Commission
J.P. Morgan Chase Bank, N.A	$ 70,000,000	AA-/Aa2	3.444%	$ (2,485,569)
Bear Sterns Capital Markets, Inc.	30,000,000	A/A1	3.444%	(1,065,244)
J.P. Morgan Chase Bank, N.A	69,930,000	AA-/Aa2	3.445%	(2,491,182)
Bear Sterns Capital Markets, Inc.	29,970,000	A/A1	3.445%	(1,067,650)
(Aggregate notional amount)	$ 199,900,000			$ (7,109,645)

The interest rate swaps relating to the Issue 33 Bonds terminate by their terms on May 1, 2019, the final maturity date for the Issue 33 Bonds. The following is additional information regarding each swap and counterparties as of June 30:

Counterparty/guarantor	Initial notional amount	Counterparty credit ratings (S&P/Moody's)	Fixed rate payable by Commission	Fair value to Commission
Lehman Brothers Special Financial Inc.	$ 73,570,000	A/A1	3.393%	$ (1,889,060)
Bear Sterns Capital Markets, Inc.	31,530,000	A/A1	3.393%	(809,597)
Lehman Brothers Special Financial Inc.	100,000,000	A/A1	3.379%	(2,460,207)
(Aggregate notional amount)	$ 205,100,000			$ (5,158,864)

Risks Disclosure

The aggregate fair value to the Airport from time to time, if any, of the interest rate swaps with any single counterparty is the maximum amount of credit exposure the Commission will have to that counterparty. The Airport has limited counterparty credit risk by limiting its exposure to any one counterparty. Under the terms of the swaps, counterparties are required to post collateral consisting of specified U.S. Treasury and Agency securities for the fair value of a swap that exceeds specified thresholds which are linked to the counterparty's credit ratings. Any such collateral will be held by the Airport's custodial bank. There is limited basis risk with respect to the interest rate swaps, as the Airport has chosen a variable rate index designed to closely approximate the variable rates payable on the Issue 32 and 33 Bonds. The Airport has limited termination risk with respect to the interest rate swaps. That risk would arise primarily from certain credit-related events or events of default on the part of the Commission, the municipal swap insurer, or the counterparty. The Airport has secured municipal swap insurance for its payments due under each interest rate swap from insurers currently rated AAA/Aaa. The Airport has limited market access risk with respect to the Issue 33 Bonds and the related interest rate swaps, as the Airport has secured a forward municipal bond insurance commitment from an insurer currently rated AAA/Aaa with respect to the Issue 33 Bonds.

(8) Concession Revenue and Minimum Future Rents

Certain of the Airport's rental agreements with concessionaires specify that rental payments are to be based on a percentage of tenant sales, subject to a minimum amount. Concession percentage rents in excess of minimum guarantees were approximately $7,200,000 and $6,774,000 in fiscal years 2005 and 2004, respectively. Rental car companies pay 10% of gross revenues or a minimum guaranteed rent, whichever is higher. Under the terms of their concession agreement, the minimum guarantee for the rental car operators does not apply if the number of deplaning passengers on all scheduled airlines during one calendar month is less than 70% of the number of deplaning passengers for the same calendar month of the base year (1996). In December 2003, the minimum guaranteed rent for the rental car operators was reduced by 10% and agreements were extended to expire on December 29, 2008. The minimum guarantee attributable to the rental car companies is approximately $20,293,000 in both fiscal years 2005 and 2004.

Minimum future rents under noncancelable operating leases having terms in excess of one year are as follows (in thousands):

Fiscal year ending:		
2006	$	56,954
2007		47,487
2008		45,818
2009		38,694
2010-2011		50,352
	$	239,305

During fiscal year 2002, the Airport suspended the minimum annual guaranteed (MAG) rental payments for Airport concessionaires in response to declining flight operations and passenger traffic. As of June 30, 2005, MAG payments have been reinstated at certain concessionaires. The above schedule of future minimum rental payments reflects all originally scheduled MAG payments.

(9) 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 the Airport along with other employees of the City. The Plan provides basic service retirement, disability, and death benefits based on specified percentages of final average salary and provides 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 is the authority which establishes and amends the benefit provisions and employer obligations of the Plan. The Retirement System issues a publicly available financial report that includes financial statements and required supplementary 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 the Airport and its employees. Employee contributions are mandatory. Employee contribution rates for 2005 and 2004 varied from 7% to 8% as a percentage of covered payroll. The Airport is required to contribute at an actuarially determined rate. Airport contributions were required for 2005, but not for 2004. The actuarially determined contribution rate as a percentage of covered payroll was 4.48% in 2005 and 0% in 2004. The Airport's required contribution was approximately $3,637,000 in 2005 and $0 in 2004.

Due to certain bargaining agreements effective in 2003, which mandated certain groups of employees to contribute 7.5% of covered payroll as employee-paid employee contributions, the Airport's contributions to the Retirement System on behalf of some of its employees were reduced to 0% for 2005 and 2004. The Airport did not contribute to the Retirement System on behalf of its employees in 2005 and 2004. For those groups of employees not mandated to contribute to the Retirement System, the Airport's contributions remained at 7% to 8% of covered payroll.

(b) Health Care Benefits

Health care benefits of Airport employees, retired employees, and surviving spouses are financed by beneficiaries and by the City through the City and County of San Francisco Health Service System (the Health Service System). The Airport's contribution, which amounted to approximately $13,053,000 and $11,564,000 in fiscal years 2005 and 2004, respectively, is determined by a Charter provision based on similar contributions made by the ten most populous counties in California. Included in these amounts are approximately $2,770,000 and $2,145,000 for 2005 and 2004, respectively, to provide postretirement health care benefits for retired employees. The Airport's liability for both current employees and postretirement health care benefits is limited to its annual contribution. The Health Service System issues a publicly available financial report that includes financial statements for the health care benefits plan. The report may be obtained by writing to the San Francisco Health Service System, 1145 Market Street, Second Floor, San Francisco, CA 94103, or by calling (415) 554-1700.

(10) Related Party Transactions

The Airport receives services from various other City departments which are categorized in the various operating expense line items in the statements of revenues, expenses, and changes in net assets. These services include utilities provided to tenants (note 2) and the Airport. The cost of all services provided by City departments totaled approximately $85,871,087 and $96,053,956 in fiscal 2005 and 2004, respectively. Included in personnel operating expenses are approximately $39,111,000 and $46,214,000 in fiscal 2005 and 2004, respectively, related to police and fire services. Included in noncurrent accounts receivable is approximately $1 million related to services provided by the Airport to SFO Enterprises, Inc., and cost reimbursements owed to the Airport by SFO Enterprises, Inc. The entire amount is fully reserved as of June 30, 2005.

The Lease and Use Agreements with the airlines provide for continuing annual service payments to the City equal to 15% of concession revenues (net of certain adjustments) but not less than $5,000,000 per fiscal year. Payments to the City were $19,677,000 and $18,161,000 in fiscal 2005 and 2004, respectively. The annual service payments are reported as transfers on the statements of revenues, expenses, and changes in net assets.

In 2003, the Office of the Inspector General (OIG) conducted an audit of the Airport’s annual service payment to the City for the fiscal years 1998 through 2002. The audit conducted by the OIG raised issues of violations of the revenue diversion regulations relating to certain payments totaling $12 million by the Airport to the City for indirect services expressly prohibited by the 1981 Lease and Use Agreements. The City disputes the OIG finding and has been in continuous discussion with the FAA to resolve the issue. In June 2005, the City, in anticipation of a resolution of the audit transferred approximately $4.6 million back to the Airport which is reflected as transfers from the City and County of San Francisco and as a liability owed to the airlines in the accompanying financial statements.

(11) Passenger Facility Charges

In July 2001, the FAA approved the Airport’s first application (PFC #1) for the collection and use of passenger facility charge for $112,739,000 to pay for the development activities and studies relating to the runway reconfiguration project which has since been suspended. The collection period for this application is October 1, 2001 to June 1, 2003. In January 2004, the FAA approved the Airport’s amendment to delete PFC #1 as a result of the suspension of the runway reconfiguration project.

In March 2002, the FAA approved the Airport’s second application (PFC #2) for $224,035,000 to pay for debt service on a portion of the bonds issued to finance certain eligible costs relating to the new International Terminal complex. This application extended the PFC collection period to April 2008. In January 2004, the FAA approved the Airport’s amendment to delete PFC #1; receipts from PFC #1 were applied to PFC #2 and the FAA then revised PFC #2s collection period to expire in January 2006.

In November 2003, the FAA approved the Airport's third application (PFC #3) for $539,108,000 to pay for debt service costs related to the construction of the new international terminal building and boarding areas A and G. The collection period for this application, as originally approved, was from November 1, 2008 to November 1, 2018. In January 2004, the collection period was revised to commence January 2006 and the charge expiration date to January 2016.

In June 2005, the Airport Commission authorized the fourth application (PFC #4) for $70 million.

PFC collections and related interest earned for the 12 months ended June 30, 2005 are as follows (in thousands):

Amount collected	$	60,925
Interest earned		480
	$	61,405

Interest earned on PFC revenue is included in investment income in the accompanying financial statements.

(12) Commitments, Litigation, and Contingencies

(a) Commitments

Purchase commitments for construction, material, and services as of June 30, 2005 are as follows (in thousands):

Construction	$	17,224
Operating		13,091
Total	$	30,315

The Airport has a Memorandum of Understanding with various surrounding communities to insulate residential and nonresidential structures such as schools, churches, and hospitals. The total estimated funding for this program is approximately $154 million funded by bond proceeds, by federal grant reimbursements to the local communities, and by operating and other internally generated funds. As of June 30, 2005 and June 30, 2004, approximately $123.6 million and $121 million, respectively, have been disbursed under this program.

(b) Agreements with Airlines

To accomplish settlement of disputes among the City, Airport, and airlines, the parties agreed to enter into a Settlement Agreement and simultaneously the Lease and Use Agreements. These agreements provide for terms and restrictions related to use of Airport revenues, payments to the City, calculation of landing fees, bond financing, capital projects, and certain other matters. These agreements expire in 2011.

(c) Litigation

The Airport is a defendant in various legal actions and claims which arise during the normal course of business, some of which may be covered by insurance. Although certain lawsuits and claims are significant in amount, the final dispositions are not determinable, and in the opinion of management, the outcome of any litigation of these matters will not have a material effect on the financial position or results of operations of the Airport.

(d) Risk Management

The Airport has a loss prevention program that includes a risk manager, a safety officer, property loss control engineering by insurers, ongoing employee training programs, and an automated claims information system. The Airport carries liability insurance coverage of $750,000,000 and commercial property insurance coverage for full replacement value on all facilities at the Airport owned by the Commission. The Airport does not carry insurance for losses due to seismic activity.

The Airport is self-insured for general liability up to the first $10,000; for any amounts in excess of $10,000, the Airport carries liability insurance.

The estimated claims payable is actuarially determined as part of the City's self-insurance program. Changes in the reported amount since June 30, 2003 resulted from the following activity (in thousands):

Balance, June 30, 2003	$	459
Claim payments		(178)
Claims and changes in estimates		178
Balance, June 30, 2004		459
Claim payments		(189)
Claims and changes in estimates		575
Balance, June 30, 2005	$	845

The Airport is self-insured as part of the City's program for workers' compensation. All self-insurance claims are processed by the City. Liability and risk are retained by the Airport. Accrued workers' compensation includes provisions for claims reported and claims incurred but not reported. This accrued workers' compensation liability is actuarially determined as part of the City's program as follows (in thousands):

Balance, June 30, 2003	$	5,759
Claim payments		(2,426)
Claims and changes in estimates		1,822
Balance, June 30, 2004		5,155
Claim payments		(2,352)
Claims and changes in estimates		2,316
Balance, June 30, 2005	$	5,119

(e) Grants

Grants that the Airport receives are subject to audit and final acceptance by the granting agency. Current and prior year costs of such grants are subject to adjustment upon audit.

(f) Loan Guarantees

The Airport continues to serve as the guarantor of certain loans on behalf of various food and beverage concession tenants within the International Terminal. The Airport's remaining maximum exposure under these loan guarantee agreements is approximately $2.7 million.

(g) Concentrations of Credit Risk

The Airport leases facilities to the airlines pursuant to the Lease and Use Agreements (note 2) and to other businesses to operate concessions at the Airport. For fiscal years ended June 30, 2005 and June 30, 2004, revenues realized from the following Airport tenants exceeded 5% of the Airport's total operating revenues:

	2005	**2004**
United Airlines	26.0%	25.5%
AMPCO Parking Systems	10.2%	8.9%
American Airlines	5.1%	5.4%

(h) Noncancelable Operating Leases

The Airport has noncancelable operating leases for certain buildings and equipment that require the following minimum annual payments, net of sublease income (in thousands):

Fiscal years:		
2006	$	5,320
2007		5,727
2008		5,741
2009		4,631
Total	$	21,419

Operating lease expense incurred for the fiscal years ended 2005 and 2004 was approximately $5.9 million and $6.7 million, respectively.