HOUSTON MUNICIPAL EMPLOYEES PENSION SYSTEM




COMPREHENSIVE ANNUAL FINANCIAL REPORT
FOR THE YEAR ENDED JUNE 30, 2002

COMPREHENSIVE ANNUAL FINANCIAL REPORT

HOUSTON MUNICIPAL EMPLOYEES PENSION SYSTEM
A COMPONENT UNIT OF THE CITY OF HOUSTON, TEXAS

FOR THE FISCAL YEAR ENDED JUNE 30, 2002

PREPARED BY THE PENSION ADMINISTRATION STAFF
DAVID L. LONG, EXECUTIVE DIRECTOR

HOUSTON MUNICIPAL EMPLOYEES PENSION SYSTEM
1111 BAGBY, SUITE 2450, HOUSTON, TEXAS 77002-2555
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HOUSTON
MUNICIPAL
EMPLOYEES
PENSION SYSTEM


J. J. SWEENEY
JEWELRY CO.

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*ORGANIZATIONAL OVERVIEW**

ELECTED TRUSTEES

Fred Holmes, Chairman
Ray Kennedy, Vice Chairman
Barbara Chelette, Secretary
Sherry Mose, Trustee
Roderick J. Newman, Trustee
Lee Pipes, Trustee

TRUSTEES BY DESIGNATION OR APPOINT-MENT

Albertino Mays, City Treasurer
Lonnie G. Vara, Mayor's Representative
James E. Bashaw, Trustee
Robert Hu, Trustee
Ignacio Pujol, Jr., Trustee

David L. Long, Executive Director

ADMINISTRATIVE ORGANIZATION

BOARD OF TRUSTEES

Investment Committee
Budget and Oversight Committee
Disability Committee
Legislative Committee
Personnel and Procedures Committee
Ad Hoc Committee

EXECUTIVE DIRECTOR

Chief Investment Officer
Investment Managers' Services
Performance Measurement
Market Research

Benefit's Administration
Benefit's Administration
Member Services

Information Systems

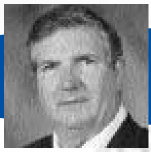
General Counsel

Communications

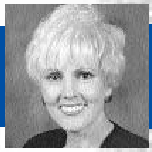
Accounting

** Information pertaining to investment-related professionals is located on page 7.*

Fred Holmes
Chairman



Ray Kennedy
Vice Chairman



Barbara Chelette
Secretary

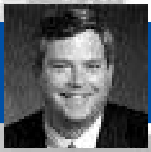
Sherry Mose
Elected Trustee

Roderick J. Newman
Elected Trustee

Lee Pipes
Elected Trustee

Albertino Mays
Treasurer

Lonnie G. Vara
Mayor's Representative



James E. Bashaw
Appointed Trustee

Robert Hu
Appointed Trustee

Ignacio Pujol, Jr.
Appointed Trustee

David L. Long
Executive Director

INTRODUCTORY SECTION

- LETTER OF TRANSMITTAL
- GFOA CERTIFICATE OF ACHIEVEMENT
- PROFESSIONAL CONSULTANTS AND INVESTMENT MANAGERS

LETTER OF TRANSMITTAL

1111 BAGBY
SUITE 2450
HOUSTON, TEXAS 77002-2555
(713) 759-9275
FAX (713) 650-1961

December 1, 2002

Mr. Albertino G. Mays, Treasurer
City of Houston, Texas
P.O. Box 1562
Houston, Texas 77251-1562

Dear Mr. Mays:

The Comprehensive Annual Financial Report (CAFR) of the Houston Municipal Employees Pension System (the System), a Component Unit of the City of Houston, Texas (the City) for the fiscal year ended June 30, 2002 (2002), is submitted herewith. The accuracy and completeness of this report are the responsibility of the Board of Trustees of the System. The information provided pertains to the records and accounts of the System and its operation.

The CAFR consists of five sections: (i) the introductory section, which contains this transmittal letter and other general information about the structure and activities of the System; (ii) the financial section, which contains the independent auditors' report and the basic financial statements, including notes to the financial statements and supplemental schedules; (iii) the investment section, which includes reports on the investment objectives and activities of the System during 2002; (iv) the actuarial section, which contains information about the actuarial evaluation of the System as of July 1, 2000, the funding objectives of the System and the progress being made toward achieving those objectives; and (v) the statistical section, which contains statistical and other significant data intended to provide a user of this CAFR additional information about the System.

The System was created in 1943 under Chapter 358, Acts of the 48th Texas Legislature, Regular Session, Article 6243g, Vernon's Annotated Revised Texas Civil Statutes, and reenacted and continued under HB1573, 77th Texas Legislature, as Art. 6243h, Vernon's Annotated Revised Texas Civil Statutes (the Statute). The System is a multi-employer defined benefit pension plan and includes contributory groups (Group A and Group C) and a noncontributory group (Group B). The System provides service retirement, disability retirement and death benefits for eligible participants including the employees of the System and the officers and employees, except police officers and fire fighters, of municipalities in the State of Texas having population of more than 1,500,000. System plan net assets are used to pay benefits for eligible participants of Group A, Group B and Group C. The System is governed by a Board of Trustees (Board) including 11 Trustees of whom four (4) are active participants elected by active participants, two (2) are retired participants elected by retirees, three (3) are appointed by the City's governing body, and two (2) are statutorily designated because of the City offices they hold.

Significant Changes During the Year

There were no significant changes in the System or its operation that affected the year included in this CAFR. However, the governing statute enacted during the 2001 Texas legislative session and effective May 11, 2001, substantially amended the provisions of the plan for the period covered by this report. Those amendments are more fully explained in the "Other Significant Information" section on page 4.

General Economic Conditions

The U.S. economy has confronted very significant challenges over the past year including major declines in global equity markets, a sharp retrenchment in investment spending, and the effects of the tragic terrorist attacks of September 11th. Budget surpluses have turned to deficits and the geopolitical climate remains cautious as Japan and Germany, the world's second and third largest economies, struggle with their own domestic economic contractions. The world continues to be challenged with a perfect storm facing the first synchronized global downturn of significant proportion in many decades.

Underpinning the U.S. economy, the American consumer has provided strong support as household spending has held up quite well and served as an important stabilizing force for the overall economy. Interest rates have declined to 40 year lows thereby stimulating home purchases and mortgage re-financings. A surge in housing activity coupled with strong auto sales and moderate retail purchases has offset the substantial contraction in business spending and manufacturing activity.

Monetary policy has played an important role in cushioning the downturn as short term interest rates have been lowered twelve times since the economic contraction commenced in the face of tame inflationary forces. Nevertheless, credit spreads for companies with less than pristine balance sheets remain at historically high levels and access to borrowing for many companies remains difficult.

Corporate profits have declined dramatically during the last few years as the overall level of economic activity has slackened from the previous robust pace. Investor concern has been heightened by an unprecedented level of misleading corporate accounting practices at many prominent businesses resulting in the demise of several well known companies.

The equity markets fell sharply in the third quarter as earnings downgrades continued and investors focused on fading global economic prospects and mounting military tensions. Valuations have fallen significantly from prior historic highs but still remain pricey based upon historic precedents. Nevertheless, the equity markets are now better positioned to gradually improve over time as investor confidence is restored and earnings visibility improves.

As expected, the economy has begun a slow road to recovery and the pace of economic activity is projected to continue its gradual pace of recovery into 2003-2004.

Investment Activities

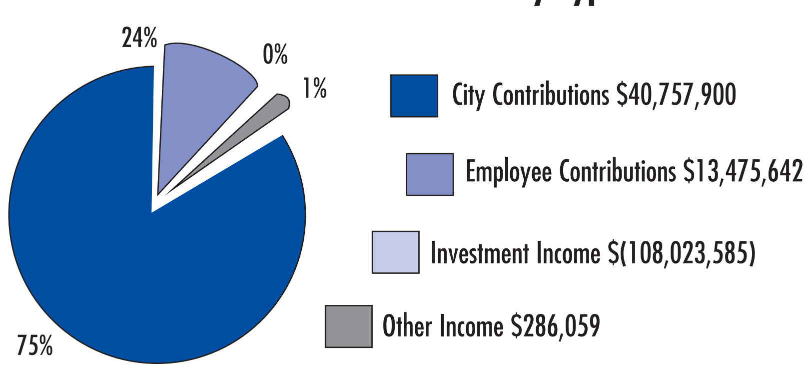
As discussed in more detail in the Investment Section of this CAFR, investments strategies have been implemented by the System that are long-term in perspective and designed to meet the expectation of working within predefined ranges among asset classes to produce returns, over market cycles, that exceed the investment return assumption adopted by the System for actuarial purposes. Diversification, professional management within stated guidelines, and periodic rebalancing from asset classes to capture gains and to reduce risks associated with market movements, are methods that have been adopted by the Pension Board to safeguard against loss due to unanticipated market declines. Returns from investing activities for the year ended June 30, 2002 amounted to -7.07% (see page 32 for more information). Time weighted returns for the 5 fiscal years and 10 fiscal years ended June 30, 2002 were 4.35% and 8.83%, respectively.

Financial Highlights

Additions to assets received by the System are used to fund current and future benefits for participants and their covered survivors. The primary sources of additions are contributions from active participants and the City, and investment income. Net investment income after deducting investment fees and costs of lending securities for the years 2002 and 2001 was $(108) million and $(65.1) million, respectively. City contributions, employee contributions, and other income for 2002 totaled $54.5 million compared to $50.5 million for 2001. The City contribution rate, 10% during 2002, is determined by required actuarial evaluation subject to a minimum rate of 10%. City contributions decreased by $.5 million during 2002 over 2001. Participant contributions increased by $4.9 million during 2002 over 2001. The chart, Additions by Type, is a relative representation of 2002 additions by components.

Deductions from assets consist of benefits paid to retired members and their eligible survivors, refunds of contributions to former members, fees for professional services, and the cost of administering the programs of the System. Total deductions for 2002 were $21.4 million

Additions By Type



more than for 2001. Benefits and contribution refunds were $20 million more, professional services were not significantly different for 2002 over 2001, and administrative costs were $1.3 million more. The chart, Deductions by Type, demonstrates the relationship among types of deductions.

The net of additions over deductions for 2002, reported in the financial statements as the net decrease in plan net assets, was $(136.1) million. That decrease in plan net assets represents the results of System operations for fiscal year 2002 and represents a decrease of plan net assets held in trust for pension benefits.

Accounting System and Internal Controls

The financial statements and related information included in the financial section of this report are the responsibility of the management of the System. The financial statements have been prepared in accordance with generally accepted accounting principles and presented in accordance with the Governmental Accounting Standards Board (GASB). The System adopted GASB Statement No. 34, as amended, during the current fiscal year. As a result of the adoption of GASB Statement No. 34, the Management's Discussion and Analysis has been included as required supplementary information and precedes the financial statements. In accordance with GASB Statement No. 34, the 2001 financial statements have been restated to reflect the capitalization and depreciation of expenditures for furniture, fixtures and equipment.

The System's independent auditors have audited the financial statements. The purpose of the audit is to give reasonable assurance to users of those financial statements, the Board, and participants of the System, that the financial statements present fairly, in all material respects, information regarding the System's net assets held in trust for pension benefits and in conformity with accounting principles generally accepted in the United States of America.

A significant responsibility of the Board is to ensure that the System has in place a proper system of internal controls. A system of internal controls is an entity's plan of organization and all of its coordinated methods and measures adopted to safeguard its assets, ensure the accuracy and reliability of the accounting system and promote adherence to management policies. These controls include strategic design of the entity's business systems, the appropriate segregation of duties and responsibilities, sound practices in the performance of those duties, capable personnel, and the organizational structure itself. We believe the System's internal controls are adequate and are working as designed.

Funding Status

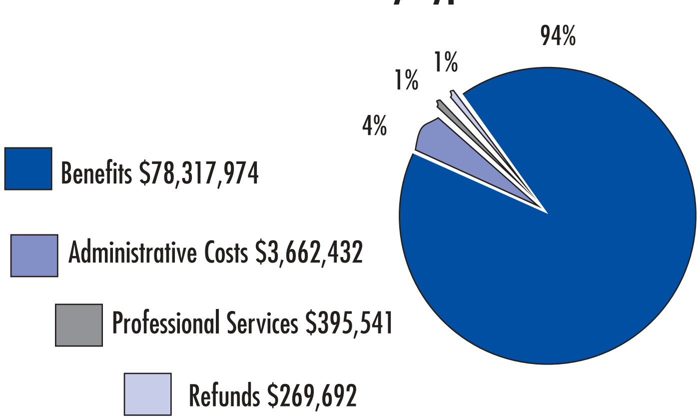
Expressing the actuarial value of assets (AVA) as a percentage of the actuarial accrued liability (AAL) provides one indication of the System's funding status on a going-concern basis. Analysis of that percentage over time indicates whether the System is becoming financially stronger or weaker. Generally, the greater that percentage, the stronger the plan. The net of AAL minus AVA is the unfunded actuarial accrued liability (UAAL). Since UAAL and annual covered payroll (ACP) are both affected by inflation, expressing the UAAL as a percentage of ACP approximately adjusts for the effects of inflation and aids analysis of the System's progress toward accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the system. The analysis (following page) indicates the System's funding progress according to the most recent five actuarial valuations.

Other Significant Information

There were significant changes in the provisions of the plan resulting from the enactment of the governing Statute during the 2001 session of the Texas Legislature. Those amendments became effective May 11, 2001, prior to the period covered by this CAFR. Primary among those are the following provisions:

Group A benefit accrual rates for eligible active members were increased to 3.25% for the first 10 years of service, 3.5% for service in excess of 10 years but less than 20, and 4.25% for service during years of service in excess

Deductions By Type



Analysis of Funding Progress
(in Millions of Dollars)

*Actuarial Valuation Date	(1) Actuarial Value of Assets	(2) Actuarial Accrued Liability	(3) Unfunded AAL (UAAL)	(4) Funded Ratio (1 ÷ 2)	(5) Annual Covered Payroll	UAAL as a Percentage of ACP (3 ÷ 5)
7/01/95	770.2	963.7	193.5	80%	378.5	51%
7/01/96	857.3	1,042.5	185.2	82%	367.6	50%
7/01/98	1,095.6	1,240.1	144.5	88%	397.7	36%
7/01/99	1,222.2	1,339.9	117.7	91%	407.7	29%
7/01/00	1,376.0	1,509.4	133.4	91%	432.6	31%

*An annual actuarial evaluation was not performed July 1, 1997.

of 20. The Group B benefit accrual rate for years of service in excess of 20 years was increased from 2.5% to 2.75%. Group B benefit accrual rates for the first and second 10 years of service remained at 1.75% and 2.00%, respectively.

The surviving spouse of a member who dies while actively employed from an off duty cause will receive a benefit equal to 100% (previously 85%) of the deceased member's accrued pension. The surviving spouse of a former member who is eligible to receive a deferred retirement pension and who dies will receive a benefit equal to 100% of the deferred retirement pension the deceased deferred participant would have otherwise been eligible to receive. The surviving spouse of a retiree who dies will receive 100% of the pension the retiree was receiving at the time of his or her death.

The surviving spouse, or if none, the designated beneficiary, of a deceased member may, within six months of the date of the deceased member's death, make the DROP election that the deceased member would have been eligible to make the day before such deceased member's death, provided no other survivor benefits have been paid prior to such DROP election.

A member who has been reemployed by the City or the System and who has at least two years of continuous credited service after reemployment may reinstate previous service for which the member received a lump sum payment of pension benefits by paying into the pension fund the amount of the lump sum payment, plus interest on that amount of 6% per annum, not compounded, from the time of the lump sum until the time of repayment into the pension fund.

On or after September 1, 2001, members who were ineligible to participate in the System prior to September 1, 1999 because they were receiving a retirement pension from either Houston Police Officers Pension System (HPOPS) or Houston Firefighters Relief and Retirement Fund (HFRRF) may purchase credited service in Group A for all of the time that they were continuously working in an otherwise covered municipal position. The member must pay into the pension fund the amount he or she otherwise would have been required to contribute during the time period, plus 6% interest, not compounded.

Acknowledgments

The Government Finance Officers Association (GFOA) awarded its “Certificate of Achievement for Excellence in Financial Reporting” to the System for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2001. The award and a detailed description thereof are displayed on page 6 in the Introductory Section of this CAFR.

This CAFR was prepared through the combined efforts of the System staff and subject to the scrutiny of the Board. It is intended to provide information to its user that may be a basis for a general understanding of the System.

This CAFR is being forwarded to the City of Houston, the Texas State Pension Review Board, the GFOA, and other interested parties who may from time to time request it.

Sincerely,

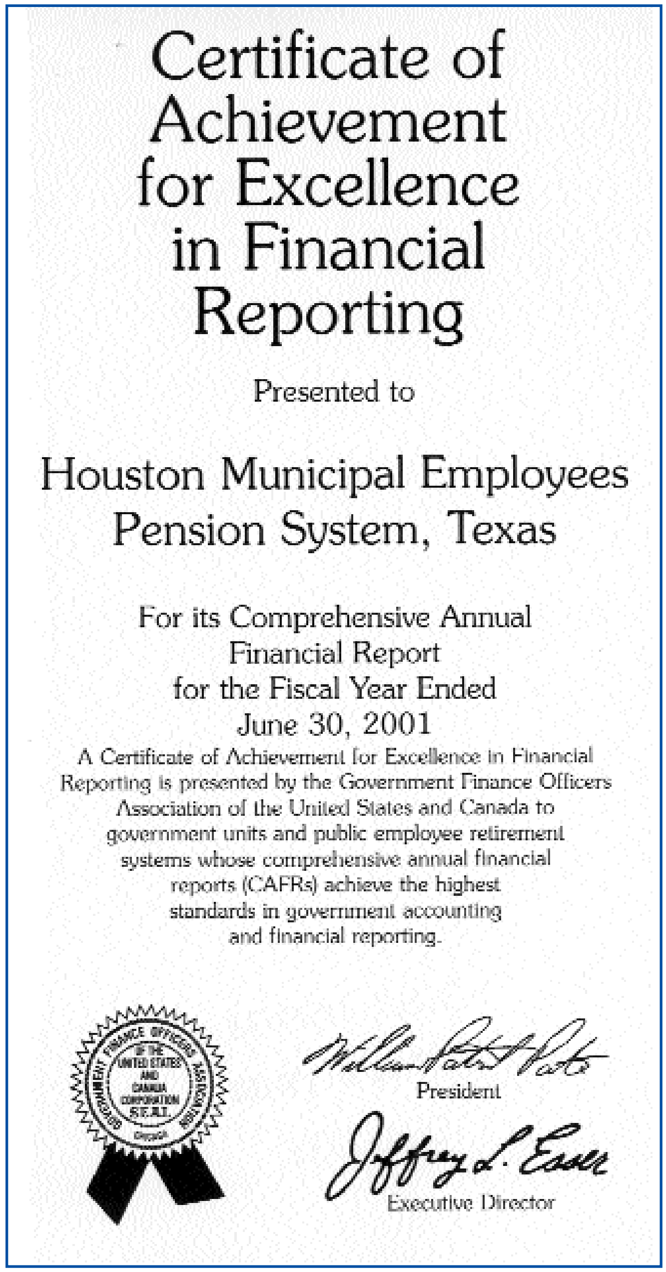
Fred Holmes
Chairman

David L. Long
Executive Director

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a "Certificate of Achievement for Excellence in Financial Reporting" to Houston Municipal Employees Pension System for its comprehensive annual financial report for the fiscal year ended June 30, 2001. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, the contents of which conform to program standards. Such CAFR must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. Houston Municipal Employees Pension System has received a Certificate of Achievement for the last 8 consecutive years (fiscal years ended June 30, 1994 through 2001). We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA for consideration.



Certificate of Achievement for Excellence in Financial Reporting

Presented to

Houston Municipal Employees Pension System, Texas

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2001

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

Government Finance Officers Association of the United States and Canada Corporation Seal Chicago

President

Executive Director

PROFESSIONAL CONSULTANTS AND INVESTMENT MANAGERS

Consultants

Auditor
Mir, Fox & Rodriguez, P.C.
Certified Public Accountants

Board Medical Advisor
Charles Schuhmacher, M.D.

Investment Consultants
Wilshire Associates, Inc.
Pension Consulting Alliance

Investment Performance Analysis
Wilshire Associates, Inc.

Legal Counsel
Baker Botts, L.L.P.
Lawson, Fields, McCue, Lee & Campbell, P.C.
Locke, Liddell and Sapp, L.L.P.

Master Custodian/Trustee
State Street Bank and Trust Co.

Actuary
Towers Perrin

Investment Managers

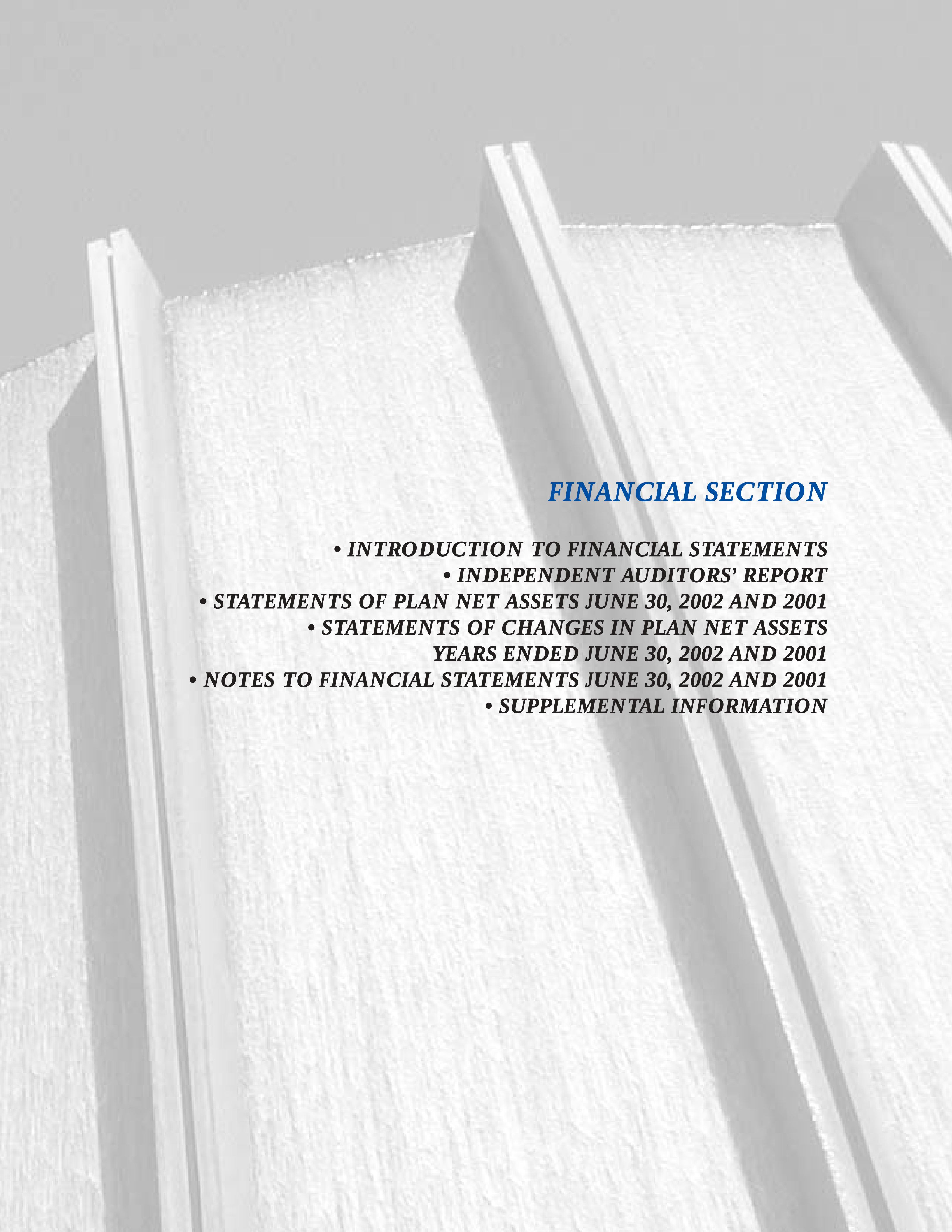
Domestic Equities
- Barclays Global Investors, N.A.
- Brown Capital Management
- DePrince, Race & Zollo, Inc.
- Legg Mason Capital Management
- Neumeier Investment Counsel
- Pacific Investment Management Co.
- Putnam Investments

Fixed Income
- Barclays Global Investors, N.A.
- Loomis, Sayles & Co.
- MDL Capital
- Smith Graham & Co.
- Taplin, Canida & Habacht
- Western Asset Management

International Equities
- Axiom International
- Brandes International
- Oechsle International
- TT International

Real Assets
- Alliance Bernstein Institutional Investment Management
- Barclays Global Investors, N.A.
- Brinson Partners, Inc.
- CB Richard Ellis Investors
- Crow Holdings
- Goldman, Sachs & Co.
- Heitman Capital Management
- L&B Realty Advisors, Inc.
- Lone Star U.S. Acquisitions, L.L.C.
- Morgan Stanley Asset Management, Inc.
- Olympus Real Estate Corp.
- PM Realty Advisors
- Prudential Investments
- Soros Private Funds Management, L.L.C.
- State Street Research & Management Co.

Alternative Investments
- Adams Street Partners
- Barclays Global Investors, N.A.
- Brera Capital Partners, L.L.C.
- Brockway Moran & Partners, Inc.
- Goldman, Sachs & Co.
- HarbourVest Partners, L.L.C.
- J.W. Childs Associates, L.P.
- Kopp Investment Advisors
- Oaktree Capital Management
- Pacven Walden Management Co., LTD.
- Pegasus Investors, L.P.
- Pharos Capital Partners, L.L.C.
- Triad Ventures, LTD.
- TSG Capital Group, L.L.C.



FINANCIAL SECTION

- ***INTRODUCTION TO FINANCIAL STATEMENTS***
- ***INDEPENDENT AUDITORS' REPORT***
- ***STATEMENTS OF PLAN NET ASSETS JUNE 30, 2002 AND 2001***
- ***STATEMENTS OF CHANGES IN PLAN NET ASSETS YEARS ENDED JUNE 30, 2002 AND 2001***
- ***NOTES TO FINANCIAL STATEMENTS JUNE 30, 2002 AND 2001***
- ***SUPPLEMENTAL INFORMATION***

INTRODUCTION TO FINANCIAL STATEMENTS

The Audited Financial Statements and the accompanying Independent Auditors' Report included in this CAFR were approved by the Board of Trustees (the Board) in its meeting of September 27, 2002.

The audit of the System's financial statements was conducted in accordance with generally accepted auditing standards (GAAS). The Independent Auditors' Report is based on that audit, and it is intended to give reasonable assurance to users of the System's financial statements that those financial statements are free of material misstatement when taken as a whole and that they present fairly the financial position and results of operations of the System at the times and for the periods reported. The audit gives reasonable assurance to the Board and members of the System that the System's assets are adequately safeguarded and that its financial transactions are properly authorized and recorded.

The financial statements provide a comprehensive overview of the financial position of the System as of June 30, 2002 and June 30, 2001 and the results of its operation for the years then ended. The financial statements are presented in conformity with accounting and reporting standards of the Government Accounting Standards Board (GASB).

The System is responsible for the accuracy of its financial statements and the completeness and fairness of their presentation. The auditors are responsible for issuing an opinion on those financial statements when taken as a whole.

The financial statements consist of Statements of Plan Net Assets, Statements of Changes in Plan Net Assets Held in Trust for Pension Benefits, Notes to the Financial Statements, and Supplemental Schedules.

The Statements of Plan Net Assets present the financial position of the System as of the end of the fiscal years reported. They are statements of the System's assets, liabilities, and net assets held in trust for pension benefits.

The Statements of Changes in Plan Net Assets Held in Trust for Pension Benefits include additions to the System's assets and deductions from them and the increase in plan net assets. Additions consist of contributions, investment income, and other income. Deductions are benefit payments, fees for professional services and costs of administering the programs of the System. The net of additions and deductions represents the change, for the years presented, in net assets held in trust for pension benefits.

Notes to the financial statements contain disclosures required by generally accepted accounting principles and GASB reporting standards. Required disclosures include a summary description of the pension plan, significant accounting policies, information about the System's funding status and progress toward achieving its funding objectives, information about the System's investments and investing activities, and information about the System's commitments.

Supplemental Schedules provide information required by GASB and additional detailed analyses of certain amounts summarized in the financial statements.

Mir • Fox & Rodriguez, P.C.
Certified Public Accountants

Board of Trustees
Houston Municipal Employees Pension System
City of Houston, Texas:

We have audited the accompanying statements of plan net assets of the Houston Municipal Employees Pension System (the System) as of June 30, 2002 and 2001, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the System'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 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, information regarding the System's net assets held in trust for pension benefits as of June 30, 2002 and 2001, and changes therein for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis (MD&A), the Required Supplemental Information and the Supplemental Information listed in the Table of Contents are not a required part of the basic financial statements but is supplementary information either required by the Governmental Accounting Standards Board or presented for the purpose of additional analysis. This information is the responsibility of the System's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and do not express an opinion it.

Mir Fox & Rodriguez

September 17, 2002

The Board of Trustees (the Board) of the Houston Municipal Employees Pension System (System) is pleased to provide this overview and analysis of the financial performance and activities of the System for the fiscal year ended June 30, 2002. We encourage the readers to consider the information presented here in conjunction with the basic financial statements.

OVERVIEW OF THE FINANCIAL STATEMENTS

The discussion and analysis is intended to serve as an introduction to the System's financial statements. The financial section consists of (1) System Financial Statements, (2) Notes to Financial Statements, and (3) Supplemental Information.

System Financial Statements

There are two financial statements presented herewith. The Statements of Plan Net Assets as of June 30, 2002 and 2001 indicate the net assets available to pay future payments and gives a snapshot at a particular point in time. The Statements of Changes in Plan Net Assets for the fiscal years ended June 30, 2002 and 2001 provide a view of the fiscal years additions and deductions to the System.

Notes to Financial Statements

The notes are an integral part of the financial statements and provide additional background information that is essential for a complete understanding of the data provided in the System's financial statements. The notes to the financial statements can be found on pages 9 to 18 of this report.

Supplemental Information

The required supplemental information consists of:

Schedule 1 - Schedule of Funding Progress - this provides historical trend information that contributes to the understanding of the changes in the funded status of the System over time. These are calculations made by the System's actuaries and they provide actuarial information that contributes to the understanding of the changes in the actuarial funding of and the funded status of the System over a number of years. It should be noted that actuarial information is based upon assumptions about future events, and therefore, the figures presented are estimates.

Schedule 2 - Schedule of Employer Contributions - provides historical trend information of required annual employer contributions and the contributions actually made in relation to this requirement over time.

The other supplemental information consists of:

Schedule 3 - Investment Summary - lists the System's investments by type presented both at cost and fair market value and the purchases and sales during the fiscal year.

Schedule 4 - Investment Services, Professional Services, and Administration Expenses - provides more information for purposes of more detailed analysis.

Schedule 5 - Summary of Costs of Investment and Professional Services - provides more information for purposes of more detailed analysis.

COMPARATIVE FINANCIAL STATEMENTS

On the following page is a condensed and comparative summary of major classes of Plan Net Assets at fair value.

FINANCIAL HIGHLIGHTS *(In Thousands of Dollars, Unless Otherwise Noted)*

- The System received $13,476 in employee contributions from over 12,000 participants and $40,758 in employer contributions from the City of Houston during the 2002 fiscal year. The City of Houston contribution represents the required contribution rate of 10% based on actuarial valuations of the System's assets and liabilities.
- Employee contributions increased by $4,944 or 58% in fiscal year 2002 compared to fiscal year 2001 which was attributed to an increased number of participants in Group A (Contributory group). The System has improved benefit accrual rates as a result of certain amendments to the Statute that became effective May 11, 2001.
- The net investment loss of the Plan is $108,023 during the fiscal year 2002 compared to $65,147 during the fiscal year 2001, which is an increase of 66%. This is a reflection of adverse market conditions during the past fiscal year.
- Benefit payments grew by 34% or $78,318 during the fiscal year 2002 compared to $58,296 during the fiscal year 2001. Service retirement pension benefits amounted to $53,103 (22% increase from last year) which accounted for 68% of the total benefit payments for the fiscal year 2002.

SUMMARY OF MAJOR CLASSES OF PLAN NET ASSETS AT FAIR VALUE *(In Thousands of Dollars)*

	Balance June 30, 2002	Balance June 30, 2001	Increase (Decrease)	Percent Change + (-)
Assets				
Cash and cash equivalents	$ 2,413	6,641	(4,228)	(64)%
Short term investment funds (at cost)	46,093	68,243	(22,150)	(32)
Proceeds due on asset sales	24,749	25,901	(1,152)	(4)
Receivables	19,425	41,438	(22,013)	(53)
U.S. Government securities	121,860	94,303	27,557	29
Corporate bonds	110,302	153,189	(42,887)	(28)
Capital stocks	442,135	532,684	(90,549)	(17)
Commingled funds	212,133	295,745	(83,612)	(28)
Real estate trusts, LP's	353,212	280,970	72,242	26
Securities lending collateral	84,928	124,590	(39,662)	(32)
Furniture, fixtures and equipment, net	546	324	222	69
Total assets	1,417,796	1,624,028	(206,232)	(13)
Liabilities				
Investment settlement	58,959	89,194	(30,235)	(34)
Accrued liabilities	2,218	2,404	(186)	(8)
Securities lending collateral	84,928	124,590	(39,662)	(32)
Total liabilities	146,105	216,188	(70,083)	(32)
Net assets held for pension benefits	$ 1,271,691	1,407,840	(136,149)	(10)

SUMMARY OF STATEMENTS OF CHANGES IN PLAN NET ASSETS AVAILABLE FOR PENSION BENEFITS *(In Thousands of Dollars)*

	Fiscal Year 2002	Fiscal Year 2001	Dollar Change	Percent Change + (-)
Additions				
Contributions:				
City of Houston	$ 40,758	41,298	(540)	(1)%
Participants	13,476	8,532	4,944	58
Investment income:				
Interest	17,197	20,198	(3,001)	(15)
Dividends	9,552	11,045	(1,493)	(14)
Earnings from LP's and real estate trusts	11,062	7,471	3,591	48
Net depreciation on investments	(140,619)	(97,938)	(42,681)	44
Net proceeds from lending securities	780	625	155	25
Other income	286	643	(357)	(56)
Less investment expenses	(5,995)	(6,548)	553	8
Total additions	(53,503)	(14,674)	(38,829)	265
Deductions				
Benefits paid	$ 78,318	58,296	20,022	34%
Contribution refunds	270	308	(38)	(12)
Professional fees	396	324	72	22
Administration expenses	3,662	2,367	1,295	55
Total deductions	82,646	61,295	21,351	35
Change in net assets	(136,149)	(75,969)	(60,180)	(79)
Plan net assets, prior year	1,407,840	1,483,809	(75,969)	(5)
Plan net assets, current year	$ 1,271,691	1,407,840	(136,149)	(10)

- Benefit payments exceeded total employee plus employer contributions by $24,084 during fiscal year 2002.
- Costs of administering the benefit programs of the System were $3,662 for fiscal year 2002 for almost 20,000 participants.
- Net assets decreased by $136,149 during fiscal year 2002. The decrease was primarily due to the adverse world equity market conditions.

The System capitalized expenditures for furniture, fixtures and computer equipment in accordance with Governmental Accounting Standards Board Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments, as amended. The 2001 financial statements have been restated to reflect this capitalization. Furniture, fixtures and equipment, net of accumulated depreciation, as of fiscal year end 2002 and 2001 is $546 and $324, respectively.

Total investments were $1.29 billion at fiscal year end 2002, and net loss on investments was $108 million during the fiscal year, for a negative return of 7%. This compares to a net loss of $65.1 million during 2001 with a negative return of 5%. The performances of investment classes are based on investment amounts as of June 30, 2002 (see table).

The year ended June 30, 2002 proved to be another difficult period for the investment community. Capital markets around the world reflected a lack of investor confidence due to the tragic terrorist events of September 11, 2001, corporate accounting fraud (Enron, WorldCom, Global Crossing, etc.) and continued low corporate profitability. These conditions resulted in negative world equity market performance, a declining U.S. dollar and a flight to quality in fixed-income markets. For the past three years, most equity markets have remained in negative territory, while fixed-income and real estate markets have provided the only safe haven. The S&P 500 was down 18.0% and 9.2% for the past one and three-year periods, while the fixed-income market was up 8.6% and 8.1%, respectively, as measured by the Lehman Aggregate index. The real estate market was up 5.5% and 9.6%, respectively, over the same periods as measured by the NCREIF Index.

Throughout fiscal year 2002, the System maintained its existing target asset allocation mix of 30% domestic equities, 20% international equities, 20% fixed-income, 15% real estate and 15% alternative investments. However, due to movements in the markets and rebalancing activities directed by staff, the System maintained a slight underweight to equities and a slight overweight to fixed-income and real estate.

PERFORMANCE OF INVESTMENT CLASSES

	Benchmark		System		
Investment Class	Index	Return(%)	Return(%)	Amount($)	Allocation(%)
U.S. Equities	Wilshire Target Top 2500 Index	-17.20%	-12.72%	$ 361,956	28%
International Equities	MSCI All Country World Index Free ex US (ACWI Free ex US)	-8.16	-13.16	243,696	19
Fixed-Income	Lehman Aggregate Index	8.64	2.34	282,117	22
Real Estate	NCREIF Index	5.53	5.23	230,387	18
Alternatives	S&P 500 Index	-17.99	-18.59	167,579	13
Total		-6.75	-7.06	$ 1,285,735	100%

The System's investment performance was -7.0% and 3.1% for the past one and three-year periods. The one-year performance was slightly below median relative to its peer group, ranking in the 63rd percentile. However, the three-year performance was significantly higher than its peer group, ranking in the 8th percentile. The System's negative investment performance over the past year was driven by its exposure to the equity markets and high exposure to credits in the fixed-income markets. The System's 18% exposure to real estate has been the best performer over the past one and three-year periods, returning 5.2% and 13.3%, respectively. Also contributing to the System's performance over the three-year period has been its exposure to alternative investments, which returned an average of 6.7% per annum.

The System's securities lending program obtains additional income by lending securities to broker-dealers and banks. During the years ended June 30, 2002 and 2001, the System's custodian lent, at the direction of the Board, the System's securities and received cash, securities issued or guaranteed by the United States government, and irrevocable bank letters of credit as collateral. The Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool. On June 30, 2002, the System had no credit risk exposure to borrowers.

The System's investments in limited partnerships are included in the tables appearing in note 5 under investments not categorized. In connection with those investments, the System has remaining commitments as of June 30, 2002 of approximately $299 million pursuant to terms of the respective limited partnerships.

CONTACTING THE SYSTEM'S FINANCIAL MANAGEMENT

This financial report is designed to provide our participants, employer, business partners, and taxpayers with a general overview of the System's financial activities. If you have questions about this report or need additional financial information, contact the Accounting Manager of the Houston Municipal Employees Pension System at 1111 Bagby, Suite 2450, Houston, Texas 77002.

STATEMENTS OF PLAN NET ASSETS
JUNE 30, 2002 AND 2001

	2002	2001
Assets:		
Investments, at fair value:		
United States government securities		
(cost: $122,388,783 in 2002 and $93,740,808 in 2001)	$ 121,859,607	94,302,910
Corporate bonds		
(cost: $123,447,124 in 2002 and $174,778,718 in 2001)	110,302,312	153,189,183
Capital stocks		
(cost: $456,935,751 in 2002 and $523,248,401 in 2001)	442,135,030	532,684,311
Commingled funds		
(cost: $204,148,431 in 2002 and $239,146,572 in 2001)	212,132,654	295,745,330
Limited partnerships, real estate trusts, and loans and mortgages		
(cost $360,526,672 in 2002 and $267,775,069 in 2001)	353,211,833	280,970,325
Short-term investment funds (valued at cost)	46,093,354	68,243,125
Total investments	1,285,734,790	1,425,135,184
Cash and cash equivalents	2,412,976	6,640,996
Proceeds due on asset sales	24,748,818	25,900,651
Receivables on foreign exchanges	12,990,583	33,776,370
Receivables	6,433,963	7,660,403
Collateral on securities lending arrangements, at fair value	84,928,716	124,590,077
Furniture, fixtures and equipment, net	546,375	324,389
Total assets	1,417,796,221	1,624,028,070
Liabilities:		
Amounts due on asset purchases	45,765,126	55,750,637
Payables on foreign exchanges	12,990,583	33,371,436
Accrued liabilities	2,217,701	2,404,332
Options written	203,228	71,098
Collateral on securities lending arrangements, at fair value	84,928,716	124,590,077
Total liabilities	146,105,354	216,187,580
Plan net assets held in trust for pension benefits	$ 1,271,690,867	1,407,840,490

(A schedule of funding progress for the plan is presented on page 24).

See accompanying notes to the financial statements.

STATEMENTS OF CHANGES IN PLAN NET ASSETS
YEARS ENDED JUNE 30, 2002 AND 2001

	2002	2001
Additions:		
Contributions:		
City of Houston	$ 40,757,900	41,297,973
Participants	13,475,642	8,532,063
Total contributions	54,233,542	49,830,036
Investment income:		
Interest:		
Interest on bonds and deposits	17,196,858	20,187,587
Other		10,613
Total interest	17,196,858	20,198,200
Dividends	9,552,358	11,044,942
Earnings from limited partnerships and real estate trusts	11,062,189	7,471,246
Net depreciation on investments	(140,618,885)	(97,937,763)
Total investment loss	(102,807,480)	(59,223,375)
Proceeds from lending securities	3,545,117	6,426,866
Less costs of securities lending	(2,765,594)	(5,802,017)
Net proceeds from lending securities	779,523	624,849
Less costs of investment services	(5,995,628)	(6,548,517)
Net investment loss	(108,023,585)	(65,147,043)
Other income	286,059	643,066
Total additions (reductions) - net	(53,503,984)	(14,673,941)
Deductions:		
Benefits paid to participants	78,317,974	58,295,670
Contribution refunds to participants	269,692	308,223
Professional services	395,541	323,895
Administration expenses	3,662,432	2,367,193
Total deductions	82,645,639	61,294,981
Net decrease in plan net assets	(136,149,623)	(75,968,922)
Plan net assets held in trust for pension benefits:		
Beginning of year	1,407,840,490	1,483,809,412
End of year	$ 1,271,690,867	1,407,840,490

See accompanying notes to the financial statements.

1. DESCRIPTION OF PLAN

The Houston Municipal Employees Pension System (the System) was created under Chapter 358, Acts of the 48th Texas Legislature, Regular Session, 1943 (Article 6243g, Vernon's Texas Civil Statutes) and reenacted and continued under HB1573, 77th Texas Legislature, as Article 6243h, Vernon's Texas Civil Statutes (the Pension Statute). The System is a multi-employer defined benefit pension plan and includes contributory groups (Group A and Group C) and a noncontributory group (Group B). The System provides for service, disability and survivor benefits for eligible participants including all municipal employees, except police officers and firefighters, employed full time by the City of Houston, Texas (the City), elected City Officials, and the full time employees of the System (collectively referred to as "participants"). System plan net assets are used to pay benefits for eligible participants of Group A, Group B and Group C. The System is a local governmental plan and therefore is not subject to the Employee Retirement Income Security Act of 1974.

The System's financial statements are included in the City's Comprehensive Annual Financial Report (CAFR).

PARTICIPATION

Participants hired before September 1, 1981 participate in Group A, unless they elected before December 1, 1981 or after May 1, 1996 to transfer to Group B. Participants hired or rehired after September 1, 1981 but before September 1, 1999, may make a one-time irrevocable election to participate in Group A; otherwise, they participate in Group B. Participants hired or rehired on or after September 1, 1999 participate in Group A, except that certain executive officials of the City and the Executive Director of the System (Executive Officials) participate in Group C.

At July 1, 2001, the System's participants consisted of the following:

Retirees and beneficiaries currently receiving benefits	5,738
Former employees entitled to benefits but not yet receiving them	1,226
Vested active participants	8,931
Non-vested active participants	3,997
Total participants	19,892

RETIREMENT ELIGIBILITY

A participant whose employment with the City or the System terminated before August 1, 2000 is eligible to receive a normal monthly pension benefit after at least one of the following combinations of minimum age and service requirements has been met:

(i) attainment of age 50 with 25 years of total credited service,

(ii) attainment of age 55 with 20 years of total credited service,

(iii) attainment of age 60 with 10 years of total credited service,

(iv) attainment of age 62 with 5 years of total credited service, or

(v) attainment of age 65 with any credited service in Group C.

A participant whose employment with the City or the System terminated on or after August 1, 2000 is eligible to receive a normal monthly pension benefit after at least one of the following combinations of minimum age and service requirements has been met:

(i) attainment of age 65 with any credited service in Group C,

(ii) attainment of age 62 with at least 5 years of total credited service, or

(iii) completed at least 5 years of total credited service and attained any combination of age and credited service that when added together equal 70 or more.

PENSION BENEFITS

Pension benefits are based on the participant's average monthly salary, as defined in the Pension Statute, and years of credited service. The maximum pension benefit is 90% of the participant's average monthly salary.

Pension benefits are increased annually by a Cost of Living Adjustment equal to 4% of the original benefit amount, not compounded.

A participant who is eligible to receive a deferred benefit may elect to receive his or her pension benefit in an early lump sum distribution if the actuarial present value of the participant's benefit is less than $10,000 as of the later of September 1, 1995 or the date of termination. Early lump-sum distributions are subject to approval by the Board of Trustees (the Board).

DISABILITY BENEFITS

Service-connected disability benefits for covered participants are based on the participant's normal accrued benefit, but are not less than 20% of the participant's final monthly salary. There is no minimum credited service requirement to qualify for service-connected disability benefits.

Participants with at least 5 years of credited service who become disabled may qualify for a non-service connected disability allowance equal to the participant's normal accrued pension benefit.

SURVIVOR BENEFITS

Survivor benefits are provided for a participant's surviving spouse and/or dependent children. A deceased participant must have had at least five years of credited service at the time of his or her death to qualify for death benefits unless death was caused by a service-connected incident as defined by the Pension Statute.

In order to qualify for survivor benefits, a surviving spouse must have been married to the deceased participant at the time the participant's employment with the City or System was terminated and at the time of the participant's death. To qualify for benefits, a child must be the natural, or legally adopted, dependent child of the deceased participant at the time of the participant's death and (a) must be under age 21 and never have been married, or (b) have been totally and permanently disabled before age 18 and at the time of the participant's death and never have been married. Dependent benefits are payable to the legal guardian of the dependent(s) unless the dependent is at least 18 years of age.

DEFERRED RETIREMENT OPTION PLAN

A participant who is eligible to retire, except that he or she has not retired and remains a full-time employee of the City, or the System, or has been separated from service for not more than thirty (30) calendar days, may elect to participate in the Deferred Retirement Option Plan (DROP). The DROP provides that a monthly amount (monthly DROP credit) plus a participant's employee contributions, if any, attributable to the participant's salary earned during the period of DROP participation will be credited to a notional account (DROP Account). Interest at a rate equal to the average of the annual percent returns on the System's investments for the then most recent five complete fiscal years established effective January 1 each year will accrue, compounded daily, on the DROP account balance. The first day of DROP participation is the DROP Entry Date. The day a participant's fully executed DROP election is accepted by the System is the DROP Election Date. Normal pension benefits cease to accrue on DROP Entry Date.

Prior to September 1, 1999, the DROP Entry Date was established as the date a participant applied to the System for DROP election, and the monthly DROP credit was based on a participant's credit service, average monthly salary, and the benefit accrual rates in effect on DROP Entry Date. After September 1, 1999, the DROP Entry Date may precede DROP Election Date, and the monthly DROP credit is based on the participant's years of credited service and average monthly salary as of DROP Entry Date, and benefit accrual rates in effect on DROP Election Date.

DROP participation terminates when a DROP participant's employment with the City, or the System, terminates. The balance of the participant's notional DROP account (DROP Benefit) at the time of such termination is an amount equal to the sum of the participant's monthly DROP credits, employee Group A or Group C contributions, if applicable, and interest accrued on such amount up to the time the participant's employment terminates. A DROP Benefit is subject to approval by the Board. A DROP participant eligible to receive a DROP Benefit distribution may elect to receive the distribution in a lump-sum, in substantially equal periodic payments over a period of time approved by the Board, or in a combination of a lump-sum followed by substantially equal periodic payments over a period of time approved by the Board until the balance of the DROP Benefit is depleted. The DROP Benefit is not available to a DROP participant until such participant's employment with the City or the System has terminated and the participant has made a DROP distribution election.

REFUNDS OF PARTICIPANT CONTRIBUTIONS

Group A or Group C participants who terminate employment prior to retirement for reasons other than death or disability may request a refund of their accumulated employee contributions, without interest, in lieu of a pension.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying financial statements are presented in accordance with the generally accepted accounting principles established by the Governmental Accounting Standards Board (GASB), which designates the accounting principles and financial reporting standards applicable to state and local governmental units. The accompanying financial statements include solely the accounts of the System, which include all programs, activities and functions relating to the accumulation and investment of the assets and related income necessary to provide the pension benefits required by the governing statutes and amendments thereto.

BASIS OF ACCOUNTING

The basis of accounting is the method by which revenues and expenses are recognized in the accounts and reported in the financial statements. The accompanying financial statements are presented on the accrual basis of accounting. Under the accrual basis of accounting, revenues, which include contributions and investment income, are recognized when they are earned and collection is reasonably assured, and expenses, which include benefits and contribution refunds, are recognized when the liability is incurred. Accrued income, when deemed not collectible, is charged to operations.

NEW ACCOUNTING PRONOUNCEMENT

In June 1999, the GASB issued Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments (GASB 34). In June 2001, the GASB issued Statement No. 37, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus, which amended certain provisions of GASB 34. The System adopted GASB 34, as amended, during the current year. As a result of the adoption of GASB 34, the Management's Discussion and Analysis has been included as required supplementary information and precedes the financial statements. In accordance with GASB 34, the 2001 financial statements have been restated to reflect the capitalization of expenditures for furniture, fixtures and equipment.

INVESTMENTS

Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. The fair value of limited partnerships and real estate trusts are based on independent appraisals or recent financial results. Short-term investments are carried at cost, which approximates fair value. Investments that do not have an established market are reported at estimated fair value.

Purchases and sales of investments and forward foreign exchange contracts are recorded on the trade date. Gains or losses on the forward foreign exchange contracts are recognized when the contract is complete.

Dividend income is recorded on the ex-dividend date. Income from other investments is recorded when earned.

CASH AND CASH EQUIVALENT SECURITIES

The System's cash balances are classified in three categories of credit risk:

(1) insured or collateralized with securities held by the System or by its agent in the System's name,

(2) collateralized with securities held by the pledging financial institution's trust department or agent in the System's name,

(3) uncollateralized, including any bank balance that is collateralized with securities held by the pledging institution or by its agent or trust department but not in the System's name.

As of June 30, 2002 and 2001, the System had bank balances of $5,506,470 and $2,205,094, respectively, that meet the criteria of Category (1) held in demand deposits. The book balances, reflected in the financial statements, of those deposits are $2,412,976 and $(169,800), respectively. A cash balance of $6,810,796, at June 30, 2001 was held in trust by the System's master custodian that met the criteria of Category (3). The bank balance is the same as the book balance for cash amounts held in trust by the System's master custodian.

FURNITURE, FIXTURES AND EQUIPMENT

Furniture, fixtures and equipment are recorded at cost less accumulated depreciation and amortization. Depreciation and amortization expense is computed using the straight-line method over the estimated useful lives of the related assets ranging from three to ten years. Any gain or loss on the retirement of assets is recognized currently. Maintenance and repairs are charged to expense while expenditures for improvements are capitalized.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 additions and deductions during the reporting period. Actual results could differ from those estimates.

INCOME TAX STATUS

The System obtained its latest determination letter on April 23, 2002, in which the Internal Revenue Service stated that the System, as amended on May 11, 2001, is in compliance with the applicable requirements of the Internal Revenue Code. The System's management and Board believe that the System is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code.

COSTS OF ADMINISTERING THE SYSTEM

The costs of administering the System are paid by the System from current earnings pursuant to an annual fiscal budget adopted by the Board.

3. FUNDING STATUS AND PROGRESS

Participants of Group A and Group C are required to contribute to the System amounts set forth in the Pension Statute. In addition, the City is required to contribute amounts to the System which provide funding, on an actuarial reserve basis, stated as a percentage of covered payroll, for normal cost plus the level of percentages of payroll payments required to amortize the unfunded accrued liability over 40 years from January 1, 1983. The City's contribution rate is based on actuarial valuations of the System's assets and liabilities, and shall be not less than the greater of 10% of all member salaries or two times the rate contributed by Group A participants.

The latest actuarial report on the System, which was approved and accepted by the Board, is based on participant data at July 1, 2000. The significant actuarial assumptions adopted as of July 1, 2000, and used in that actuarial valuation are as follows:

Actuarial Assumptions

Investment yield rate	8.5%
Salary increases	Constant annual rate of 5.5%
Payroll growth factor	5.0%
General inflation rate	4.5%
Funding method	Entry age normal cost method
Life expectancy	1994 Group Annuity Mortality Table

The City's required contribution rate during the year ended June 30, 2002 is based on the July 1, 2000 actuarial valuation. The actuarially determined contribution requirements as of July 2000 and the contributions actually made for the year ended June 30, 2002 are as follows:

Contributions Required and Contributions Made

	(in millions)	Percentage of covered payroll
Normal cost	$ 31.0	7.5 %
Amortization of unfunded actuarial accrued liability	8.3	2.0 %
Employer contributions actually made	40.8	10.0 %
Participant contributions made	13.5	4.0 %

Seven-year historical trend information is provided as required supplementary information on page 25. This historical information is intended to demonstrate the progress the System has made in accumulating sufficient assets to pay benefits when due and the related actuarial assumptions used in determining the actuarially determined amounts.

4. DEFERRED COMPENSATION PLAN

The System offers its employees a deferred compensation plan (the DCP) created in accordance with Internal Revenue Code Section 457. The DCP, available to all employees of the System, permits employees to defer a portion of their salary until future years. Distributions from the DCP are not available to employees until termination, retirement, death or unforeseeable emergency. The DCP has a third party administrator, Nationwide Retirement Solutions (Nationwide), and the cost of administration and funding are borne by the DCP participants. Amounts deferred are held in trust by Nationwide and, because the System has no fiduciary responsibility for the DCP, these amounts are not reflected in the accompanying financial statements in accordance with GASB Statement No. 32.

5. INVESTMENTS

Portions of the System's investments are classified as security investments. A security is a transferable financial instrument that evidences ownership or creditorship. The System's security investments have been classified by risk category to indicate the level of risk assumed by the System. There are 3 categories of risk. Category 1 includes securities that are insured or registered, or securities that are held by the System or its agent in the System's name. Category 2 includes securities which are uninsured and unregistered, with securities held by the counterparty's trust department or agent in the System's

INVESTMENTS AS OF JUNE 30, 2002

	Category 1	Category 3	Not Categorized	Totals
U.S. government securities	$ 121,859,607			121,859,607
Corporate bonds	110,302,312			110,302,312
Capital stocks		442,135,030		442,135,030
Commingled funds			212,132,654	212,132,654
Limited partnerships, real estate trusts, and loans and mortgages			353,211,833	353,211,833
Short-term investment funds			46,093,354	46,093,354
Total investments	232,161,919	442,135,030	611,437,841	1,285,734,790
Investments made with securities lending cash collateral:				
U.S. government securities		29,739,087		29,739,087
Domestic equity		15,517,975		15,517,975
Domestic fixed income		5,024,850		5,024,850
International equity		34,646,804		34,646,804
Total investments made with securities lending cash collateral	-	84,928,716	-	84,928,716
Total	$ 232,161,919	527,063,746	611,437,841	1,370,663,506

INVESTMENTS AS OF JUNE 30, 2001

	Category 1	Category 3	Not Categorized	Totals
U.S. government securities	$ 94,302,910			94,302,910
Corporate bonds	153,189,183			153,189,183
Capital stocks		532,684,311		532,684,311
Commingled funds			295,745,330	295,745,330
Limited partnerships, real estate trusts, and loans and mortgages			280,970,325	280,970,325
Short-term investment funds			68,243,125	68,243,125
Total investments	247,492,093	532,684,311	644,958,780	1,425,135,184
Investments made with securities lending cash collateral:				
U.S. government securities		35,947,908		35,947,908
Domestic equity		33,199,228		33,199,228
Domestic fixed income		9,107,980		9,107,980
International equity		46,334,961		46,334,961
Total investments made with securities lending cash collateral	-	124,590,077	-	124,590,077
Total	$ 247,492,093	657,274,388	644,958,780	1,549,725,261

name. Category 3 includes securities which are uninsured and unregistered, with securities held by the counterparty, or its trust department or agent but not in the System's name.

The fair values of the System's investments at June 30, 2002 and June 30, 2001 are presented in the following tables. Investments are listed by category of credit risk. Investments not subject to credit risk classification are listed but not categorized.

The System's investment as of June 30, 2002 of $90,014,335 in BZW Alpha TILTS Fund exceeds 5% of the System's net assets as of June 30, 2002. The System's investment of $108,915,182 in BZW ALPHA TILTS Fund as of June 30, 2001 exceeded 5% of the System's net assets on that date. All investments that exceed 5% of the System's total investments as of June 30, 2002 and 2001 are included in the amounts invested in commingled funds. Schedule 5 on page 27 lists the System's investment and professional service providers.

Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of plan net assets.

6. FURNITURE, FIXTURES AND EQUIPMENT

Furniture, fixtures and equipment are comprised as follows at June 30:

	2002	2001
Office furniture and equipment	$ 221,833	$ 60,320
Computer equipment	111,190	13,650
Leasehold improvements	345,995	267,033
	679,018	341,003
Less accumulated depreciation and amortization	(132,643)	(16,614)
	$ 546,375	$ 324,389

7. SECURITIES LENDING

State statutes do not prohibit the System from participating in securities lending transactions and the Board has authorized its custodian to lend the System's securities to broker-dealers and banks pursuant to a form of loan agreement. During the years ended June 30, 2002 and 2001, the System's custodian lent, at the direction of the Board, the System's securities and received cash, securities issued or guaranteed by the United States government, and irrevocable bank letters of credit as collateral. The custodian does not have the ability to pledge or sell securities delivered for collateral, absent a borrowers default. Borrowers were required to deliver collateral for each loan equal to: (i) in the case of loaned securities denominated in United States dollars or whose primary trading market was located in the United States or sovereign debt issued by foreign governments, 102% of the market value of the loaned securities; and (ii) in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States, 105% of the market value of the loaned securities.

The Board did not impose any restrictions on the amounts of the loans that the System's custodian made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions. Moreover, there were no losses during the year resulting from a default of the borrowers or the custodian.

During the years ended June 30, 2002 and 2001, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool. As of June 30, 2002 and 2001, such investment pool had an average duration of 69 and 73 days, respectively, and an average weighted maturity of 144 and 172 days, respectively. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. On June 30, 2002, the System had no credit risk exposure to borrowers. The collateral held and the fair value of securities on loan as of June 30, 2002, were $92,757,102 and $90,605,956, respectively, and $128,614,730 and $124,255,580, respectively, as of June 30, 2001.

8. COMMITMENTS

As described in note 1, certain participants of the System are eligible to receive, upon request, a refund of their accumulated Group A and/or Group C contributions, without interest, upon termination of employment with the City, or System, prior to being eligible for pension benefits. At June 30, 2002 aggregate contributions from active participants of the System were approximately $46,893,000.

The System's investments in Limited Partnerships are included in the tables appearing in note 5 under investments not categorized. In connection with those investments, the System has remaining commitments as of June 30, 2002 of approximately $298,738,000 pursuant to terms of the respective Limited Partnerships.

The System leases office facilities and parking spaces under an operating lease expiring in 2011. Future minimum lease obligations required under such lease are as follows:

Year Ending June 30	
2003	$ 251,040
2004	251,040
2005	251,040
2006	251,040
2007	359,824
Thereafter	1,439,296
	$ 2,803,280

Additional amounts are assessed for use of common areas, utilities and maintenance. Total rental expense, including these assessments, amounted to approximately $384,800 and $228,700 during the years ended June 30, 2002 and 2001, respectively.

SUPPLEMENTAL INFORMATION

SCHEDULE 1 - REQUIRED SUPPLEMENTAL INFORMATION

SCHEDULE OF FUNDING PROGRESS (UNAUDITED IN MILLIONS OF DOLLARS)

Actuarial Valuation Date	(1) Actuarial Value of Assets (AVA)	(2) Actuarial Accrued Liability (AAL)	(3) Unfunded (UAAL)	(4) Funded Ratio (1):(2)	(5) Covered Payroll	(6) UAAL as a Percentage of Covered Payroll
07/01/93	$ 660.6	840.3	179.7	79 %	$ 340.2	53 %
07/01/94	713.7	886.7	173.0	80 %	366.6	47 %
07/01/95	770.2	963.7	193.5	80 %	378.5	51 %
07/01/96	857.3	1,042.5	185.2	82 %	367.6	50 %
07/01/98	1,095.6	1,240.1	144.5	88 %	397.7	36 %
07/01/99	1,222.2	1,339.9	117.7	91 %	407.7	29 %
07/01/00	1,376.0	1,509.4	133.4	91 %	432.6	31 %

Analysis of the dollar amounts of actuarial value of assets, actuarial accrued liability, and unfunded actuarial accrued liability in isolation can be misleading. Expressing the actuarial value of assets as a percentage of the actuarial accrued liability provides one indication of the System's funding status on a going-concern basis. Analysis of this percentage over time indicates whether the plan is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the plan. Trends in unfunded actuarial accrued liability and covered payroll are both affected by inflation. Expressing the unfunded actuarial accrued liability as a percentage of covered payroll approximately adjusts for the effects of inflation and aids analysis of the System's progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the plan.

See accompanying independent auditors' report.
See accompanying note to supplemental schedules.

SCHEDULE 2 - REQUIRED SUPPLEMENTAL INFORMATION

SCHEDULE OF EMPLOYER CONTRIBUTIONS (UNAUDITED)

Fiscal Year	Annual Required Contributions (in millions)	Percentage Contributed
06/30/94	$ 31.6	98.4%
06/30/95	32.2	100.0%
06/30/96	33.5	97.0%
06/30/97	33.5	100.0%
06/30/98	33.5	100.0%
06/30/99	36.0	100.0%
06/30/00	38.3	100.0%
06/30/01	41.3	100.0%
06/30/02	41.3	98.8%

See accompanying independent auditors' report.
See accompanying note to supplemental schedules.

NOTES TO REQUIRED SUPPLEMENTAL SCHEDULES (UNAUDITED)

This information presented in the required supplemental information was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation date	July 1, 2000
Actuarial cost method	Entry age
Amortization method	Level percentage, closed
Remaining amortization period	23 years
Asset valuation method	5-year, smoothed market
Actuarial assumptions:	
Investment rate of return	8.5%, net of expenses
Salary increases	Constant annual rate of 5.5%
Payroll growth factor	5.0% per year
General inflation rate	4.5% per year

See accompanying independent auditors' report.

SCHEDULE 3

INVESTMENT SUMMARY ($000) YEAR ENDED JUNE 30, 2002

Type of Investment	June 30, 2001 Cost	June 30, 2001 Fair Value	Purchases	Sales and Redemptions	June 30, 2002 Cost	June 30, 2002 Fair Value	Percent of Fair Value
Fixed income:							
U.S. government securities	$ 93,740,808	94,302,910	507,118,074	478,470,099	122,388,783	121,859,607	9.48%
Corporate bonds	174,778,718	153,189,183	42,853,812	94,185,406	123,447,124	110,302,312	8.58%
Total fixed income	268,519,526	247,492,093	549,971,886	572,655,505	245,835,907	232,161,919	18.06%
Capital stocks	523,248,401	532,684,311	696,714,423	763,027,073	456,935,751	442,135,030	34.39%
Commingled funds	239,146,572	295,745,330	70,921,286	105,919,427	204,148,431	212,132,654	16.50%
Limited partnerships, real estate trusts and loans and mortgages	267,775,069	280,970,325	364,816,702	272,065,099	360,526,672	353,211,833	27.47%
Short-term investment funds	68,243,125	68,243,125	982,896,686	1,005,046,457	46,093,354	46,093,354	3.58%
Total investments	$ 1,366,932,693	1,425,135,184	2,665,320,983	2,718,713,561	1,313,540,115	1,285,734,790	100.00%

Space and cost restrictions make it impractical to print the entire investment portfolio in this report.
A portfolio listing is available for review at the System's office by appointment upon request.
See accompanying independent auditors' report.

SCHEDULE 4

INVESTMENT SERVICES, PROFESSIONAL SERVICES, AND ADMINISTRATION EXPENSES YEARS ENDED JUNE 30, 2002 AND 2001

	2002	2001
Investment services:		
Custodial services	$ 190,593	152,082
Money management services	5,383,535	5,994,935
Consulting services	421,500	401,500
Total investment services	$ 5,995,628	6,548,517
Professional services:		
Actuarial services	117,050	151,960
Auditing and consulting services	54,299	47,031
Legal services	224,192	124,904
Total professional services	$ 395,541	323,895
Administration expenses:		
Office costs	419,951	310,878
Insurance costs	109,340	28,147
Costs of staff and benefits	2,417,370	1,712,195
Costs of equipment and supplies	527,559	70,975
Costs of education and research	188,212	244,998
Total administration expenses	$ 3,662,432	2,367,193

See accompanying independent auditors' report.

SCHEDULE 5

SUMMARY OF COSTS OF INVESTMENT AND PROFESSIONAL SERVICES YEARS ENDED JUNE 30, 2002 AND 2001

Service Provider	Service Provided	2002	2001
DePrince, Race and Zollo, Inc.	Money Management	$ 511,168	542,285
Brandes Investment Partners	Money Management	13,730	
Taplin, Canida and Habacht	Money Management	148,785	137,507
PM Realty Advisors	Money Management	59,339	178,968
Oechsle International Advisors	Money Management	681,731	801,117
Kopp Investment Advisors	Money Management	199,023	256,930
Barclays Global Investors, N.A.	Money Management	312,223	377,221
Loomis, Sayles and Company, L.P.	Money Management	373,271	546,587
Neumeier Investment Counsel, L.L.C.	Money Management	364,632	354,694
Putnam Advisory Company, Inc.	Money Management	269,881	243,990
UBS Brinson Resource Investments	Money Management	41,622	41,312
Brinson Partners, Inc.	Money Management	344,689	306,147
State Street Research Company	Money Management		161,068
Alliance Capital Management, L.P.	Money Management	256,995	303,831
John McStay Investment Counsel	Money Management		122,267
TT International Investment Management	Money Management	447,804	556,170
Brown Capital Management	Money Management	218,536	256,556
Legg Mason Capital Management, Inc.	Money Management	276,526	306,159
L&B Real Estate	Money Management	76,468	51,013
Smith Graham	Money Management	90,609	113,700
Western Asset Management	Money Management	255,456	153,149
MDL Capital Management	Money Management	98,977	93,306
Axiom Int'l Investors, L.L.C.	Money Management	342,070	90,958
State Street Bank and Trust Company	Custodial Services	190,593	152,082
Willshire Associates, Inc.	Consulting Services	244,000	229,000
Pension Consulting Alliance	Consulting Services	177,500	172,500
Total investment services		5,995,628	6,548,517
Baker Botts, L.L.P.	Legal Services	83,886	40,272
Locke, Liddell and Sapp, L.L.P.	Legal Services	123,398	72,946
Lawson, Fields, McCue, Lee & Campbell, P.C.	Legal Services	16,908	11,686
Mir, Fox & Rodriguez, P.C.	Auditing Services	28,550	47,031
Pension Benefits Information	Auditing Services	2,249	
Lloyd Brown Search Consultants	Consulting Services	23,500	
Towers Perrin, Inc.	Actuarial Services	117,050	151,960
Total professional services		395,541	323,895
Total costs of investment and professional services		$ 6,391,169	6,872,412

See accompanying independent auditors' report.

INVESTMENT SECTION

- ***DISCUSSION OF INVESTMENT POLICIES AND ACTIVITIES***
- ***SCHEDULE OF TOP INVESTMENTS***
- ***INVESTMENT RETURNS FOR FIVE YEARS ENDED JUNE 30, 2002***
- ***PERFORMANCE BY FISCAL YEAR LAST TEN YEARS***
- ***SUMMARY OF INVESTMENTS BY TYPE AS OF JUNE 30, 2002***
- ***SCHEDULE OF FEES AND COMMISSIONS***

The Board of Trustees (the Board) of the Houston Municipal Employees Pension System (System) has adopted a Statement of Investment Policies and Objectives (Statement) as a framework for the investment of the System's assets. The authority to amend the Statement rests solely with the Board. The Board may delegate to the Investment Committee (Committee) the authority to act on certain matters relating to the System's investments. The Committee is made up of the full Board of Trustees. The following provides an outline of the Statement.

GENERAL

The Board recognizes the following investment responsibilities: a) to establish investment policy, guidelines and objectives for the investment of System assets, b) to select independent investment managers to implement management strategies in conformity with stated investment policies and guidelines, and c) to monitor investment activities and progress toward attaining investment objectives.

INVESTMENT POLICIES

STRATEGIC ASSET ALLOCATION POLICY AND MAINTENANCE

The Board periodically undertakes strategic studies to address the appropriateness of asset classes to be considered for inclusion in the allocation plan, and to define the targeted percentage to each asset class to achieve the desired level of diversification. If market conditions cause one or more asset levels to move significantly outside the targeted range for that class, the Board authorizes appropriate actions to re-balance toward desired diversification levels.

MANAGER STRUCTURE CONSIDERATIONS

For major asset classes (U.S. Equities, International Equities, and Fixed Income), the Board diversifies investments by engaging the services of professional investment portfolio managers with demonstrated skills and expertise in managing portfolios with characteristics comparable to the desired asset class. The managers retained are expected to utilize varied investment approaches that, when combined, will exhibit characteristics that are similar to the asset class proxy utilized in the strategic asset allocation plan. Cash inflows and outflows are directed, within the targeted asset class, to the various managers so that actual characteristics of the portfolio will be consistent with the strategic plan. No investment manager is permitted to have more than 15% of the fair value of the fund's assets in a single investment style.

INVESTMENT MANAGER GUIDELINES AND EVALUATION

Investment managers are subject to guidelines and objectives incorporated in the investment management agreement entered into by the Board and the respective investment managers. Investment managers are expected to perform their fiduciary duties as prudent people skilled in such matters and, further, are expected to comply with all applicable State and Federal statutes governing the investment of retirement funds. Within the context of the guidelines, investment managers have full discretion with respect to the purchase and sale of individual securities and concentrations of similar securities. Portfolios are to be managed in a manner similar to other portfolios within an organization with similar guidelines and performance objectives.

The Board requires that all investment managers seek best execution for all trades ordered on behalf of the System. Domestic equity managers are encouraged to direct a designated percentage of their brokerage activity to an approved list of brokers. Domestic fixed income managers are encouraged to direct primary trading activity wherever there is an opportunity to recapture a portion of the syndication costs for the System.

MANAGER EVALUATION

Managers of portfolios are evaluated periodically against predetermined benchmarks such as an appropriate market index or a comparable peer group. All managers are required to make formal reports to the Board of their activities and performance according to standards set forth in the Statement. In addition, System personnel and professional consultants engaged by the Board monitor, pursuant to instructions by the Board, managers' performance and conformity with their guidelines and objectives.

PERFORMANCE EVALUATION

The Board reviews System investment performance on a periodic basis to evaluate conformity to the goals and objectives established in the strategic plan. The Board recognizes that financial markets from time to time may not support attainment of those goals and objectives. During such times, progress toward conformity is evaluated by comparing performance to a percentage equal to the weighted average of the performances of indexes and peer groups comparable in class and weight to the styles in the System's investment portfolio.

Investment results were calculated using a time-weighted rate of return based on the market rate of return, which is not materially different from the AIMR Performance Presentation Standards.

PROXY VOTING

The Board authorizes each investment manager to vote all proxies relating to shares of securities under management, and requires each Investment Manager to provide a written proxy voting policy statement. Each manager is expected to promptly vote all proxies and related actions in a manner consistent with the long-term interests of the System and its participants and beneficiaries. Each investment manager is required to keep detailed records of all voting of proxies and related actions and to comply with all related regulatory obligations. The System's management staff periodically review each investment manager's policies and actions in respect to proxy voting.

INVESTMENT ACTIVITIES

During the period covered by this CAFR, investment strategies were employed that are long-term in perspective and designed to work within predefined ranges among asset classes to produce returns that, over market cycles, will exceed the investment return assumption adopted by the Board for actuarial purposes. Diversification provides safeguards against unanticipated market disfavor of one or more asset classes. The Chief Investment Officer, Neal Wallach, has provided a summary in the table (see following page) of actual investment allocation among asset classes compared to the targeted allocation.

To facilitate execution of the strategic investment plan, the System engages the services of a master custodian which utilizes a multi-currency reporting system that reports investments at fair value stated in terms of the base currency, the US dollar. Professional portfolio managers that specialize in a targeted asset class are engaged to perform investment activities within specified guidelines. A nationally recognized institutional investment consulting firm is engaged to provide expert advice to the System in matters pertaining to perceived market conditions and prognosis, portfolio manager selection, and performance measurement and evaluation.

The schedules in this section of this CAFR display information that pertains to the System's investing activities.

Asset Class	Target	Actual
U.S. Equities	30.0 %	28.6 %
International Equities	20.0	19.2
Fixed Income	20.0	20.5
Real Assets	15.0	18.1
Alternative Investments	15.0	13.2
Cash	0	0.4

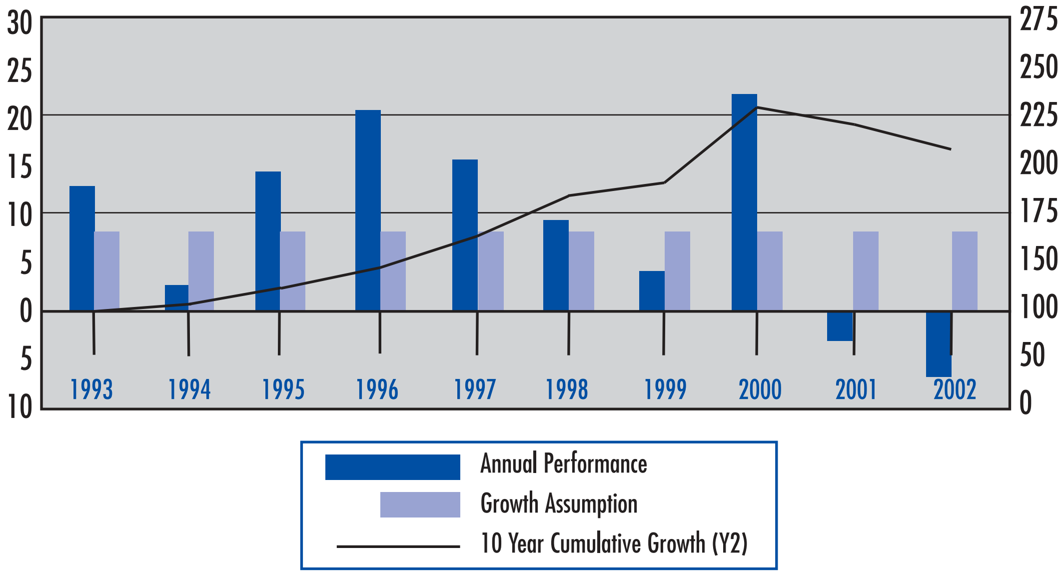
SCHEDULE OF TOP INVESTMENTS ($000) AS OF JUNE 30, 2002

Name of Investment	Fair Value of Investment	Percent of Portfolio
Barclays Alpha TILTS (Enhanced S&P 500 Index)	$ 90,014	7.1%
Brandes International Value Fund	62,732	4.9%
PIMCO Stock Plus (Enhanced S&P 500 Index)	57,754	4.5%
Barclays US Equity Index	46,330	3.6%
CB Richard Ellis Strategic Partners	26,403	2.1%

COMPARISON OF INVESTMENT RETURNS - YEARS ENDED JUNE 30

Period	Total Fund	Wilshire Cooperative Public Fund Universe	Domestic Equity	Wilshire Target Top 2500 Index	S&P 500 Index	Int'l. Equity	MSCI ACW Free ex US Index	MSCI EAFE Index	Fixed Income	Lehman Aggregate Index
1996	21.25%	15.37%	14.03%	26.03%	25.99%	8.84%		13.28%	-0.77%	5.01%
1997	16.91%	19.17%	17.24%	30.10%	34.70%	18.38%		12.84%	12.36%	8.16%
1998	9.16%	17.97%	19.29%	30.07%	30.18%	4.22%		6.09%	8.58%	10.54%
1999	3.42%	10.66%	7.87%	20.23%	22.74%	1.61%		7.59%	0.52%	3.13%
2000	22.94%	7.86%	12.14%	9.74%	7.27%	44.02%		17.18%	8.54%	4.56%
2001	-4.08%	(2.02)%	-2.00%	-14.94%	-14.82%	-26.31%		-23.61%	2.30%	11.23%
2002	-7.07%	(4.64)%	-12.80%	-17.20%	-17.99%	-12.13%	-8.45%	-9.49%	2.34%	8.63%
3 Yrs.	3.13%	0.01%	-1.41%	-8.23%	-9.17%	-2.30%		-6.78%	4.35%	8.11%
5 Yrs.	4.37%	4.82%	4.28%	3.86%	3.67%	-0.25%		-1.55%	4.40%	7.57%

Performance By Fiscal Year Last Ten Years



SUMMARY OF INVESTMENTS BY TYPE AS OF JUNE 30, 2002

Type of Investment	Fair Value	Subtotal	Percent of Total (%)
Fixed income:			
U.S. Government securities	$ 121,859,607		9.47
Corporate bonds	110,302,312		8.58
Total fixed Income		$ 232,161,919	18.05
Capital stock	442,135,030		34.39
Commingled funds	212,132,654		16.49
Limited partnerships, real estate trusts, loans and mortgages	353,211,833		27.47
Short-term investments funds	46,093,354		3.60
Total equities		1,053,572,871	81.95
Total investments		$ 1,285,734,790	100.00

SCHEDULE OF FEES & COMMISSIONS PAID IN FISCAL YEAR 2002

	Shares	Commissions	cents/share
UBS/Warburg/Paine Webber	7,475,270	$245,025	3.3
Merrill Lynch	10,577,169	$231,202	2.2
Lehman Bros	8,533,771	$198,327	2.3
Credit Suisse First Boston	13,433,007	$164,838	1.2
Capital Institutional Svcs (Gross Commission)	2,456,865	$130,401	5.3
Salomon Smith Barney	7,779,370	$125,673	1.6
Lynch Jones Ryan (Gross Commission)	3,547,396	$122,053	3.4
Morgan Stanley	5,466,127	$115,338	2.1
Goldman Sachs	6,964,576	$103,333	1.5
JP Morgan/Chase	7,146,432	$87,244	1.2
Deutsche Bank	6,549,943	$72,324	1.1
Cantor Fitzgerald	1,658,553	$71,899	4.3
HSBC / Capel James	4,193,004	$68,657	1.6
ABN Amro	3,568,487	$65,112	1.8
Dresdner Kleinwort Benson	2,342,196	$63,945	2.7
Morgan Grenfell	5,092,035	$61,604	1.2
Prudential Securities	1,047,287	$45,526	4.3
NBD Capital Markets	909,500	$34,570	3.8
Daiwa Securities	56,664,017	$33,809	0.1
Brockhouse & Cooper	1,710,095	$28,249	1.7
Nomura Securities	4,161,064	$27,508	0.7
SG Securities/SG Cowen	2,162,254	$25,706	1.2
Friedman Billings Ramsey	1,198,500	$25,420	2.1
Credit Lyonnais	2,113,650	$25,019	1.2
Bear Stearns	1,395,266	$23,182	1.7
Cazenove & Co	2,297,146	$21,255	0.9
Bank Julius Baer	268,966	$17,152	6.4
Carnegie	309,572	$17,082	5.5
Gerard Klauer Mattison	284,650	$16,100	5.7
Charles Schwab	438,150	$16,000	3.7
Indosuez/WI Carr Securities/Credit Agricole Indosuez	365,495	$14,657	4.0
ING Baring Securities	595,676	$14,323	2.4
BNP Paribas	344,057	$13,990	4.1
Auerbach Grayson	173,540	$12,520	7.2
Bank of America	486,371	$11,933	2.5
ABG Securities	289,392	$11,343	3.9
Paribas Quilter	192,486	$11,145	5.8
Bridge Trading	364,880	$10,907	3.0
Thomason Institutional	217,925	$10,896	5.0
Investec/Henderson Crossthwaite/Investment Technology Group	745,852	$10,868	1.5
Pereire TOD Ltd	312,417	$10,410	3.3
Fox Pitt Kelton	690,613	$10,363	1.5
Macquarie Equities	1,164,173	$9,490	0.8
Jardine Fleming	12,360	$9,292	75.2
LG Securities	148,050	$9,058	6.1
West LB Panmure	184,025	$8,849	4.8
CIBC Oppenheimer/Woodgundy	197,950	$8,552	4.3

	Shares	Commissions	cents/share
Greenstreet	169,050	$8,478	5.0
Hoare Govett Securities	349,959	$8,046	2.3
Hoenig	367,082	$7,987	2.2
Euromobiliare Sim SPA	437,900	$7,944	1.8
Goodmorning Securities	43,520	$7,834	18.0
Donaldson Lufkin & Jenrette/Pershing	518,095	$7,227	1.4
Commerzbank AG	227,202	$6,502	2.9
Scotia Capital/Scotia McLeod	222,900	$6,386	2.9
Abel Noser	125,900	$6,295	5.0
Collins Stewart	698,284	$6,110	0.9
Exane	108,639	$5,913	5.4
Sprott Securities	462,000	$4,986	1.1
Enskilde	91,000	$4,592	5.0
RBC/Dain Rauscher/Dominion Securities	185,773	$4,567	2.5
KBC Bank NV	34,610	$4,351	12.6
First Union	92,600	$4,239	4.6
Lombard Odier	16,830	$4,046	24.0
Griffiths McBurney	141,500	$4,025	2.8
Nesbitt Burns/BMO Nesbitt Burns	126,900	$4,000	3.2
TIR Securities	62,577	$3,846	6.1
Sanford C. Bernstein	108,665	$3,817	3.5
JB Were & Son	509,963	$3,746	0.7
Hyundai Securities	3,710	$3,645	98.3
Kim Eng Securities (HK)	122,200	$3,196	2.6
Hitchens Harrison & Co.	505,157	$3,174	0.6
Davidson DA & Co.	62,900	$3,062	4.9
Pictet & Cie	12,990	$2,982	23.0
GK Goh Securities	132,000	$2,853	2.2
Legg Mason Wood Walker	14,900	$2,515	16.9
SSB Brokerage/State Street	227,700	$2,357	1.0
BNY/Goodbody	59,880	$2,351	3.9
Ssangyong Investment	7,390	$2,338	31.6
CDC	33,800	$2,284	6.8
Ryan Beck & Co.	51,600	$2,088	4.0
Keefe Bruyette & Woods	34,200	$2,036	6.0
Others	2,132,473	$40,550	1.9
TOTAL	186,731,429	$2,672,518	1.4

ACTUARIAL SECTION

• ACTUARY'S LETTER TO THE BOARD OF TRUSTEES
• ACTUARIAL CERTIFICATION
• SUMMARY OF KEY RESULTS ($000)
• ASSET INFORMATION
• FUNDING INFORMATION
• CONTRIBUTION INFORMATION
• CASH FLOW PROJECTION
• PARTICIPANT INFORMATION
• SUMMARY OF METHODS AND ASSUMPTIONS
• CHANGES IN METHODS AND ASSUMPTIONS SINCE THE PRIOR VALUATION
• CHANGES IN PLAN PROVISIONS SINCE THE PRIOR VALUATION

Towers Perrin

October 24, 2000

Board of Trustees
Houston Municipal Employees
Pension System
1111 Bagby, Suite 1450
Houston, Texas 77002

Dear Board Members:

We certify that the information contained in this July 1, 2000 Actuarial Report for the Houston Municipal Employees Pension System has been prepared in accordance with generally accepted actuarial principles and practices. To the best of our knowledge, the information is accurate and fairly presents the actuarial position of the System as of July 1, 2000.

In preparing the actuarial results, we have relied upon information provided by the Board of Trustees regarding plan provisions, plan participants, plan assets and other matters. Historical information for the years prior to 1993 was prepared by the prior actuaries and was not subjected to our actuarial review.

Frequency of Actuarial Valuations

Actuarial valuations are prepared at least every three years. The last actuarial valuation was performed as of July 1, 1999.

Financing Objectives of the System

Contribution rates are established that, over time, will remain level as a percentage of payroll. The contribution rate has been determined to provide for normal cost plus the level percentage of payroll required to amortize the unfunded actuarial accrued liability (or surplus) over 40 years from January 1, 1983.

Progress Toward Realization of Financing Objective

The summary of accrued and unfunded accrued liabilities on page 24 of this report illustrates the progress toward realization of the financing objective.

Disclosure of Pension Information

Effective for fiscal years beginning on or after July 1, 1996, the Board of Trustees has adopted compliance with the requirements of Governmental Accounting Standards Board (GASB) Statement No. 25. The information required to be disclosed by GASB No. 25 in the notes to the System's financial statements is shown on pages 26 and 27 of this report.

Data

In preparing the July 1, 2000 actuarial valuation, we relied upon data provided by the Board. As part of this valuation, we tested the data for reasonableness. We did not, however, subject this data to any auditing procedures.

Actuarial Methods and Assumptions

The actuarial methods and assumptions described on pages 47 through 49 of the report were selected by the Board of Trustees based upon our recommendation. The Board has sole authority to determine the actuarial assumptions. Changes in the actuarial methods and assumptions since the prior valuation are described on page 49. In our opinion, the actuarial assumptions used are appropriate for the purposes of the valuation and, in the aggregate, are reasonably related to the experience of the System and to reasonable expectations.

Plan Provisions

The plan provisions used in the actuarial valuation are described in the Financial Section of this report. Changes in the plan provisions since the prior valuation are described on page 49.

We are available to answer any questions on the information contained in the report, or to provide any additional information you may need.

Sincerely,

Alan S. Taper, F.S.A., M.A.A.A.
Principal

Actuarial Certification

We certify that the information contained in this Actuarial Report has been prepared in accordance with generally accepted actuarial principles and practices. To the best of our knowledge, the information is accurate and fairly presents the actuarial position of the Pension System as of July 1, 2000.

In preparing the actuarial results, we have relied upon information provided by the Board of Trustees regarding plan provisions, plan participants, plan assets and other matters. Historical information for years prior to 1993 was prepared by the prior actuaries and was not subjected to our actuarial review.

The actuarial methods and assumptions used in this valuation were selected by the Board of Trustees. The Board has sole authority to determine the actuarial assumptions. In our opinion, the actuarial assumptions used are appropriate for purposes of the valuation and, in the aggregate, are reasonably related to the experience of the Pension System and to reasonable expectations.

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Alan S. Taper, F.S.A., M.A.A.A.

SUMMARY OF KEY RESULTS ($000)

City Contribution Rate	July 1, 2000	July 1, 1999
Normal Cost (City Portion)	7.5%	7.1%
Amortization of Unfunded Actuarial Accrued Liability (Surplus)	2.0%	1.8%
Preliminary City Contribution Rate	9.5%	8.9%
Additional Statutory Requirement	0.5%	0.9%
Final City Contribution Rate	10.0%*	9.8%*
Summary of Assets		
Market Value	$ 1,483,809	$ 1,219,649
Actuarial Value	1,376,020	1,222,240
Summary of Liabilities		
Actuarial Accrued Liability	$ 1,509,373	$ 1,339,933
Actuarial Value of Assets	(1,376,020)	(1,222,240)
Unfunded Actuarial Accrued Liability (Surplus)	133,353	117,693
Summary of Data		
Number of Participants Included in the Valuation		
• Active participants	13.126	13, 286
• DROP participants	277	309
• Vested terminated participants	1,029	1,078
• Retirees and beneficiaries	5,104	4,999
• Total	19,536	19,672
Annual Base Pay Included in the Valuation		
• Active participants	$ 421,591	$ 396,617
• DROP participants	11,012	11,116
• Total	$ 432,603	$ 407,733

* Average for the year (8.9% for 2 months; 10% for 10 months).

SUMMARY OF ASSETS AS OF JULY 1, 2000 ($000)

Investment Category	Market Value	Amount Percent
Cash and Cash Equivalents	$ 21,474	1.4%
Fixed Income Investments		
Government bonds	19,305	1.3
Corporate bonds	172,925	11.7
Short-term interest-bearing deposits	53,100	3.6
Total	245,330	16.6
Equity Investments		
Capital stock	617,795	41.6
Commingled funds	387,221	26.1
Total	1,005,016	67.7
Other Investments		
Limited partnerships and real estate investment trusts	200,070	13.5
Other Assets (Liabilities)		
Miscellaneous receivables	101,397	6.8
Miscellaneous payables	(89,432)	(6.0)
Written options	(46)	0.0
Net	11,919	.8
Total	$1,483,809	100.0%

CHANGE IN ASSETS SINCE THE PRIOR VALUATION ($000)

Market Value as of July 1, 1999	$ 1,219,649
Contributions and Disbursements	
City contributions	38,306
Employee contributions	7,341
Benefit payments	(50,143)
Contributions refunds	(337)
Miscellaneous	0
Net	(4,833)
Net Investment Return	
Interest	15,524
Dividends	14,072
Realized gains (losses)	344,567
Other income	772
Earnings from limited partnerships and real estate investment trust	2,365
Change in unrealized appreciation	(98,955)
Administrative expenses	(9,352)
Net	268,993
Market Value as of June 30, 2000	1,483,809
Approximate Annual Rate of Return (Net of Expenses)*	22.1%

* Calculated using a dollar-weighted rate of return assuming all contributions and disbursements are made uniformly throughout the year.

DEVELOPMENT OF ACTUARIAL VALUE OF ASSETS ($000)

Actuarial Investment Gain (Loss) for the Year

Market Value of Assets as of July 1, 1999	$ 1,219,649
City Contributions	38,306
Employee Contributions	7,341
Benefit Payments and Contribution Refunds	(50,480)
Miscellaneous Contributions and Disbursements	0
Expected Interest at 8.5%	103,469
Expected Market Value of Assets as of June 30, 2000	1,318,285
Actual Market Value of Assets as of June 30, 2000	1,483,809
Actuarial Investment Gain (Loss)	165,524

SCHEDULE OF ACTUARIAL INVESTMENT GAINS (LOSSES) ($000)

Plan Year Ended	Initial Actuarial Gain (Loss)	Five-Year Amortization	Unrecognized Gain (Loss) as of July 1, 1999*
June 30, 2000	$ 165,524	$ 33,105	$ 132,419
June 30, 1999	(70,960)	(14,192)	(42,576)
June 30, 1998	5,146	1,029	2,059
June 30, 1997	79,436	15,887	15,887
			$ 107,789

* Deferred for recognition in future years.

ACTUARIAL VALUE OF ASSETS

Market Value as of July 1, 2000	$ 1,483,809
(Gain) Loss to be Recognized in Future Years	(107,789)
Actuarial Value as of July 1, 2000	1,376,020

UNFUNDED ACTUARIAL ACCRUED LIABILITY (SURPLUS) ($000)

	July 1, 2000	July 1,1999
Actuarial Present Value of Future Benefits		
- Active participants	$ 1,200,914	$ 1,044,743
- DROP participants	92,470	91,907
- Vested terminated participants	25,459	22,226
- Retirees and beneficiaries	528,682	485,137
- Total	1,847,525	1,644,013
Actuarial Present Value of Future Employee Contributions	(54,724)	(44,992)
Actuarial Present Value of Future Normal Costs (City Portion)	(283,428)	(259,088)
Actuarial Accrued Liability	1,509,373	1,339,933
Actuarial Value of Assets	(1,376,020)	(1,222,240)
Unfunded Actuarial Accrued Liability	133,353	117,693

CHANGE IN UNFUNDED ACTUARIAL ACCRUED LIABILITY (SURPLUS) SINCE THE PRIOR VALUATION ($000)

Unfunded Actuarial Accrued Liability (Surplus) as of July 1, 1999	$ 117,693
Expected Change due to Normal Operation	
- Normal cost (City portion)	29,023
- City contributions	(38,306)
- Interest	9,617
- Recognition of prior asset losses (gains)	(22,039)
- Net change	(21,705)
Change due to Actuarial Experience	
- Actuarial (gain) loss from asset sources	(35,449)
- Actuarial (gain) loss from liability sources	22,072
- Net change	(13,377)
Unfunded Actuarial Accrued Liability as of July 1, 1999 Before Changes	82,611
Change in Actuarial Assumptions	15,104
Change in Actuarial Methods	0
Change in Plan Provisions	35,638
Unfunded Actuarial Accrued Liability as of July 1, 2000	133,353

HISTORICAL UNFUNDED ACTUARIAL ACCRUED LIABILITY ($000)

Valuation Date	Actuarial Accrued Liability (AAL)	Actuarial Value of Assets (AVA)	AVA as a Percentage of AAL	Unfunded AAL	Covered Payroll	UAAL as a Percentage of Covered Payroll
July 1, 1990	$ 596,939	$ 557,820	93%	$ 39,119	$ 258,556	15%
July 1, 1991	688,322	558,144	81	130,178	284,914	46
July 1, 1992	765,299	608,524	80	156,775	314,686	50
July 1, 1993	840,321	660,637	79	179,684	340,249	53
July 1, 1994	886,699	713,696	80	173,003	366,561	47
July 1, 1995	963,712	770,189	80	193,523	378,511	51
July 1, 1996	1,042,459	857,332	82	185,127	367,610	50
July 1, 1998	1,240,141	1,095,617	88	144,524	397,698	36
July 1, 1999	1,339,933	1,222,240	91	117,693	407,733	29
July 1, 2000	1,509,373	1,376,020	91	133,353	432,604	31

HISTORICAL SOLVENCY TEST ($000)

		Actuarial Accrued Liability for:			Portion of Actuarial Accrued Liability Covered by Assets		
Valuation Date	Employee Contributions	Retirees, Beneficiaries, Vested Terminated and DROP Participants (1)	Active Participants (City-Financed Portion) (2)	Actuarial Value of Assets (3)	(1)	(2)	(3)
July 1, 1990	$ 32,085	$ 281,518	$ 283,336	$ 557,820	100%	100%	86%
July 1, 1991	32,606	289,174	366,542	558,144	100	100	64
July 1, 1992	32,850	317,849	414,600	608,524	100	100	62
July 1, 1993	32,866	369,561	437,894	660,637	100	100	59
July 1, 1994	32,410	384,100	470,189	713,696	100	100	63
July 1, 1995	31,130	420,830	511,752	770,189	100	100	62
July 1, 1996	45,819	438,486	558,154	857,332	100	100	67
July 1, 1998	34,781	502,335	703,025	1,095,617	100	100	79
July 1, 1999	33,985	599,270	706,678	1,222,240	100	100	83
July 1, 2000	38,292	646,611	824,470	1,376,020	100	100	84

CITY CONTRIBUTION RATE

	July 1, 2000 through June 30, 2001	July 1, 1999 through June 30, 2000
City Normal Cost Rate	7.5%	7.1%
Rate to Amortize Unfunded Actuarial Accrued Liability Over 40 Years from January 1, 1983	2.0%	1.8%
City Contribution Rate	9.5%	8.9%
Additional Statutory Requirement	.5%	.9%
Final City Contribution Rate	10.0%	9.8%*

*Average for the year (8.9% for 2 months; 10% for 10 months).

CHANGE IN CITY CONTRIBUTION RATE SINCE THE PRIOR VALUATION

City Contribution Rate as of July 1, 1999	8.9%
Change in the City Contribution Rate	
Actuarial (gain) loss from asset sources	(0.9)%
Actuarial (gain) loss from liability sources	0.2%
Change in actuarial assumptions	0.4%
Change in plan provisions	0.9%
Change in actuarial methods	0.0%
City Contribution Rate as of July 1, 2000	9.5%

HISTORICAL CITY CONTRIBUTIONS AS A PERCENTAGE OF COVERED PAYROLL

Actuarially Calculated City Contribution Rate		Actual City Contribution Rate	
Valuation Date	Rate	Period	Rate
July 1, 1986	5.15 %	January 1, 1987 through December 31, 1987	5.15 %
July 1, 1987	5.83	January 1, 1988 through December 31, 1988	5.15
July 1, 1988	6.27	January 1, 1989 through December 31, 1989	5.15
July 1, 1989	6.88	January 1, 1990 through December 31, 1990	6.27
July 1, 1990	6.23	January 1, 1991 through December 31, 1991	6.27
July 1, 1991	8.77	January 1, 1992 through June 30, 1993	6.27
July 1, 1992	9.11	July 1, 1993 through June 30, 1994	9.11
July 1, 1993	9.3	July 1, 1994 through June 30, 1995	9.3
July 1, 1994	8.8	July 1, 1995 through June 30, 1996	8.8
July 1, 1995	9.2*	July 1, 1996 through June 30, 1997	9.2
July 1, 1996	9.1	July 1, 1997 through June 30, 1999	9.1
July 1, 1998	9.3	July 1, 1999 through June 30, 2000	9.3
July 1, 1999	9.8*	July 1, 2000 through June 30, 2001	10.0
July 1, 2000	9.5	July 1, 2001 through June 30, 2002	10.0

*Average for the year. Minimum (10%) applies for fiscal years beginning after September 1, 1999.

Note: Since January 1, 1983, the actual City contribution rate has been based on results of actuarial valuations prepared at least every three years. From January 1, 1983 through June 30, 1993, changes in the City's contribution rate are effective the first of the calendar year beginning after the date of the actuarial valuation resulting in a change. Since July 1, 1993, required City contribution rates are effective the first of the fiscal year beginning after the date of the then most recent actuarial valuation.

PROJECTION OF ESTIMATED ASSETS AND LIABILITIES ($000)

Year Beginning July1	Annual Covered Payroll	City Contributions	City Contribution Rate*	Employee Contributions	Benefit Payments	Net Cash Flow	Market Value of Assets at Beginning of Year	Unfunded Actuarial Liability at Beginning of Year
2000	432,604	43,260	10.0	6,595	52,030	(2,175)	1,483,809	133,353
2001	454,234	45,423	10.0	6,925	56,117	(3,769)	1,607,668	202,493
2002	476,945	55,803	11.7	7,271	67,848	(4,774)	1,740,394	238,347
2003	500,793	62,599	12.5	7,634	92,122	(21,889)	1,883,354	222,199
2004	525,832	64,677	12.3	8,016	78,158	(5,465)	2,020,639	187,267
2005	552,124	66,598	11.7	8,417	87,264	(12,249)	2,186,702	185,485
2006	579,730	67,828	11.7	8,838	92,541	(15,875)	2,357,730	186,118
2007	608,717	71,220	11.7	9,280	101,194	(20,694)	2,541,602	186,048
2008	639,152	74,781	11.7	9,744	111,312	(26,787)	2,736,081	185,177
2009	671,110	78,520	11.7	10,231	122,250	(33,499)	2,940,745	183,398
2010	704,666	82,446	11.7	10,742	134,355	(41,167)	3,155,814	180,591
2011	739,899	86,568	11.7	11,280	148,127	(50,279)	3,381,178	176,627
2012	776,894	90,897	11.7	11,843	162,049	(59,309)	3,616,206	171,359
2013	815,738	94,626	11.6	12,436	177,409	(70,347)	3,861,806	164,630
2014	856,525	99,357	11.6	13,057	193,860	(81,446)	4,116,783	157,114
2015	899,352	104,325	11.6	13,710	210,236	(92,201)	4,381,873	147,883
2016	944,319	109,541	11.6	14,396	228,626	(104,689)	4,658,292	136,739
2017	991,535	115,018	11.6	15,116	246,504	(116,370)	4,945,199	123,462
2018	1,041,112	120,769	11.6	15,871	264,932	(128,292)	5,244,326	107,811
2019	1,093,168	126,807	11.6	16,665	284,149	(140,677)	5,556,461	89,522

* Based on actuarially determined rate from the prior year's valuation.

SUMMARY OF ACTIVE PARTICIPANTS AS OF JULY 1, 2000*

Age Last Birthday		Completed Years of Service 0-4	5-9	10-14	15-19	20-24	25-29	30-34	Over 34	Total
15-19	Number	20								20
	Tot Pay	428,373								428,373
	Avg Pay	21,419								21,419
20-24	Number	389	9							398
	Tot Pay	8,239,468	227,650							8,467,118
	Avg Pay	21,181	25,294							21,274
25-29	Number	674	229	9						912
	Tot Pay	16,221,529	5,647,004	233,476						22,102,009
	Avg Pay	24,068	24,659	25,942						24,235
30-34	Number	676	541	219	13					1,449
	Tot Pay	17,759,485	15,131,993	6,159,286	367,558					39,418,322
	Avg Pay	26,271	27,970	28,125	28,274					27,204
35-39	Number	583	611	408	293	20				1,915
	Tot Pay	15,846,942	18,757,120	12,613,394	8,812,331	605,870				56,635,656
	Avg Pay	27,182	30,699	30,915	30,076	30,293				29,575
40-44	Number	521	629	418	441	353	19			2,381
	Tot Pay	14,534,959	20,804,846	14,563,930	15,406,905	11,791,771	631,231			77,733,642
	Avg Pay	27,898	33,076	34,842	34,936	33,404	33,223			32,647
45-49	Number	445	504	377	408	400	222	4		2,360
	Tot Pay	13,614,056	17,685,292	13,568,423	14,469,745	14,743,652	8,043,531	187,832		82,312,531
	Avg Pay	30,593	35,090	35,991	35,465	36,859	36,232	46,958		34,878
50-54	Number	348	400	311	370	258	170	27		1,884
	Tot Pay	10,829,448	13,737,457	11,374,003	14,130,043	10,219,129	6,953,043	1,131,088		68,674,211
	Avg Pay	31,119	34,344	37,537	38,189	39,609	40,900	41,892		36,451
55-59	Number	196	287	195	271	134	61	23	3	1,170
	Tot Pay	6,356,524	10,114,148	7,362,740	9,638,908	5,140,681	2,431,194	768,726	87,364	41,900,285
	Avg Pay	32,431	35,241	37,758	35,568	38,363	39,856	33,423	29,121	35,812
60-64	Number	68	131	93	105	57	21	7		482
	Tot Pay	2,269,718	4,657,682	3,642,698	3,836,223	2,202,845	938,909	298,574		17,846,649
	Avg Pay	33,378	35,555	39,169	36,535	38,646	44,710	42,653		37,026
Over 64	Number	27	41	25	21	22	16	1	2	155
	Tot Pay	788,002	1,608,100	1,058,857	757,170	1,026,920	726,976	46,097	60,319	6,072,442
	Avg Pay	29,185	39,222	42,354	36,056	46,678	45,436	46,097	30,160	39,177
Total	Number	3,947	3,382	2,055	1,922	1,244	509	62	5	13,126
	Tot Pay	106,888,504	108,371,291	70,876,807	67,418,884	45,730,867	19,724,884	2,432,318	147,683	421,591,238
	Avg Pay	27,081	32,044	34,490	35,077	36,761	38,752	39,231	29,537	32,119

Average Age = 43.7 Average Service = 10.3

* Excludes DROP participants.

HISTORICAL ACTIVE PARTICIPANT DATA

Valuation Data	Number of Participants	Average Age	Annual Payroll ($000)	Average Annual Salary	Annual Percentage Increase In Average Salary
January 1, 1980	10,617	N/A	$ 137,400	$ 12,752	--
January 1, 1982	12,338	N/A	207,100	16,906	15.1%
July 1, 1984	12,407	N/A	227,000	18,429	3.5
July 1, 1986	11,459	N/A	234,300	20,342	5.1
July 1, 1987	12,149	N/A	239,500	19,832	(2.5)
July 1, 1988	11,344	N/A	227,900	19,934	0.5
July 1, 1989	11,356	N/A	235,400	20,771	4.2
July 1, 1990	12,037	40.0	258,556	21,480	3.4
July 1, 1991	12,488	40.3	284,914	22,815	6.2
July 1, 1992	12,913	40.5	314,686	24,370	6.8
July 1, 1993	13,112	40.9	340,249	25,949	6.5
July 1, 1994	14,027	40.9	366,561	26,133	0.7
July 1, 1995	14,364	41.3	378,511	26,351	0.8
July 1, 1996	14,067	41.8	367,610	26,133	(0.8)
July 1, 1998*	13,764	42.8	394,919	28,692	9.8
July 1, 1999*	13,286	42.9	396,617	29,852	4.0
July 1, 2000*	13,126	43.7	421,591	32,119	7.6

* Excludes DROP participants.

SUMMARY OF INACTIVE PARTICIPANTS AS OF JULY 1, 2000

	Number	Annual Benefits ($000)	Average Annual Benefit
DROP Participants*	277	$ 5,823	$ 21,023
Retirees	3,241	39,664	12,238
Beneficiaries	1,346	6,816	5,064
Disabled Participants	517	3,490	6,750
Deferred Vested	1,029	5,114	4,970
Total	6,410	60,907	9,502

* Annual payroll for DROP participants is $11,012,287.

RETIREES, BENEFICIARIES AND DISABLED PARTICIPANTS ADDED TO AND REMOVED FROM ROLLS

	Added to Rolls		Removed from Rolls		Rolls at the End of the Year		
Period Ended	Number	Annual Benefits ($000)	Number	Annual Benefits ($000)	Number	Annual Benefits	Average Annual Benefits
June 30, 1993	473	$ 3,714	309	$ 1,534	4,189	$ 32,419	$ 7,739
June 30, 1994	306	2,474	227	1,593	4,268	33,971	7,959
June 30, 1995	393	3,044	220	1,307	4,441	36,482	8,215
June 30, 1996	416	3,119	239	1,438	4,618	38,815	8,405
June 30, 1998	693	5,840	441	3,212	4,870	43,394	8,910
June 30, 1999	432	2,131	303	1,515	4,999	46,732	9,348
June 30, 2000	360	3,412	255	1,380	5,104	49,970	9,755

SUMMARY OF ACTUARIAL METHODS AND ASSUMPTIONS

Actuarial Methods

Actuarial Value of Assets — Gains and losses in the Market Value of Assets, based on the difference between the actual rate of return and the assumed rate of return are recognized in the Actuarial Value of Assets over five years.

Actuarial Cost Method — Entry Age Method with liabilities allocated from date of entry to age 70. The Unfunded Actuarial Accrued Liability (Surplus), including the effects of actuarial gains and losses, is amortized as a level percentage of payroll ending December 31, 2022. The contribution is increased for interest for one-half of a year to reflect timing of payments.

Economic Assumptions

Investment Return	8.5% per year, net of expenses
Individual Pay Increase Rate	5.5% per year
Payroll Growth Rate	5.0% per year
General Inflation Rate	4.5% per year

DEMOGRAPHIC ASSUMPTIONS

Retirement and DROP Participation Rates

	Contributory Plan		Noncontributory Plan	
Age	Probability of Retiring Within One Year	Probability of Electing the DROP Within One Year	Probability of Retiring Within One Year	Probability of Electing the DROP Within One Year
Under 55	4 %	1 %	2 %	0.5 %
55 - 59	4	1	4	1
60	8	2	4	1
61	8	2	4	1
62	20	5	8	2
63	8	2	4	1
64	8	2	4	1
65	32	8	20	5
66 - 69	8	2	8	2
70 and Over	80	20	80	20

DROP Duration — Five years

Mortality Rates

- **Active participants and nondisabled retirees** — 1994 Group Annuity Mortality Table (GAM 94) (see associated table for sample rates).
- **Disabled retirees** — 1987 Commissioners Group Disabled Mortality Table (see associated table for sample rates).

Disability Rates — Graduated rates (see associated table for sample rates).

Percentage of Service-Connected Deaths and Disabilities — 10%

Termination Rates — Graduated rates (see associated table for sample rates).

Rehire Rates — Each year 2% of the nonvested terminations are assumed to be rehired in the future.

SUMMARY OF ACTUARIAL METHODS AND ASSUMPTIONS (CON'T)

Marital Status at Benefit Eligibility	
• Percentage married	60%. (No beneficiaries other than the spouse assumed).
• Age difference	Husbands assumed to be three years older than wives.
Valuation Payroll	Pay reported by the City for the 12 months prior to the valuation date projected with one year of assumed pay increases.

Missing Data Assumptions

Current Age:	
• Active participants	Contributory Plan - 45.9
	Noncontributory Plan - 41.6
• Retirees and spouses	65
• Deferred vested participants	40
Service for Active Participants	Contributory Plan - 14.2
	Noncontributory Plan - 8.1
Pay	Contributory Plan - $34,000
	Noncontributory Plan - $28,700
Form of Payment:	
Contributory Plan	
• Retirees and spouses	75% joint and survivor annuity
• Deferred vested participants	50% joint and survivor annuity
Noncontributory Plan	
• Retirees and spouses	75% joint and survivor annuity
• Deferred vested participants	50% joint and survivor annuity

SUMMARY OF ACTUARIAL METHODS AND ASSUMPTIONS (CON'T)

Sample Rates

Sample Rates Per 100 Participants

	Nondisabled Mortality (GAM94)		Disabled Mortality (Ultimate)	Termination		Disability
Age	Male	Female	All	First 3 Years	After 3 Years	All
20	0.05	0.03	2.82	36.20	21.20	0.05
25	0.07	0.03	2.82	30.80	15.80	0.05
30	0.08	0.04	2.82	26.60	11.60	0.05
35	0.09	0.05	2.82	23.40	8.40	0.06
40	0.11	0.07	2.82	21.20	6.20	0.09
45	0.16	0.10	2.82	19.20	4.20	0.18
50	0.26	0.14	2.82	17.60	2.60	0.40
55	0.44	0.23	2.82	0.00	0.00	0.85
60	0.80	0.44	3.14	0.00	0.00	1.74

Changes in Methods and Assumptions Since the Prior Valuation

The actuarial methods and assumptions used in this valuation are the same as those used in the prior valuation except for the following:

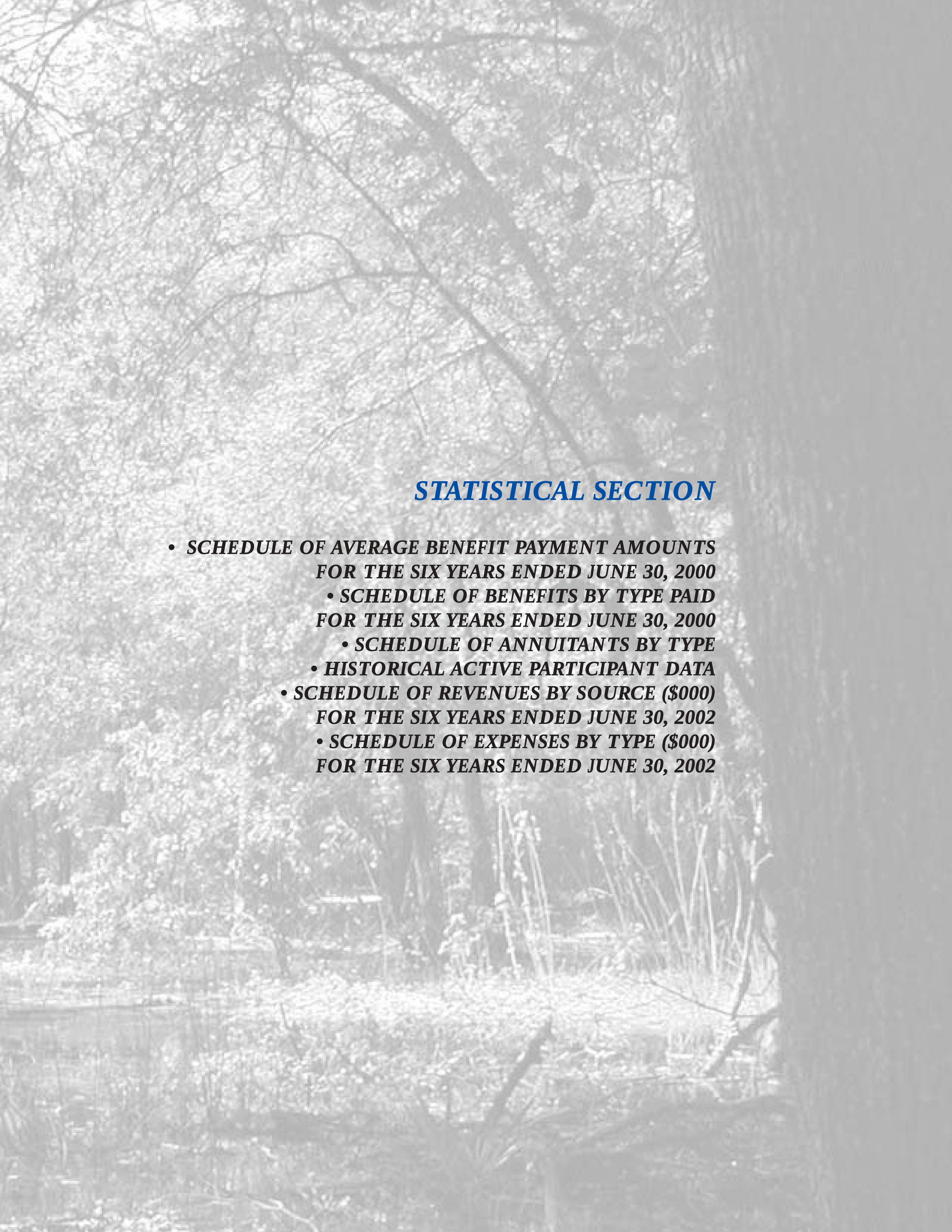
The mortality table was changed to the 1994 Group Annuity Table from the 1983 Group Annuity Table phasing into the 1994 Group Annuity Table at 20% per year until July 1, 2002.

Changes in Plan Provisions Since the Prior Valuation

Plan provisions have changed since the prior actuarial valuation. Effective September 1, 1999, the Preretirement and Postretirement Survivor benefits were enhanced.

Plan Provisions Effective After July 1, 2000

Future plan changes have been recognized in determining forecast results only.



STATISTICAL SECTION

• SCHEDULE OF AVERAGE BENEFIT PAYMENT AMOUNTS FOR THE SIX YEARS ENDED JUNE 30, 2000

• SCHEDULE OF BENEFITS BY TYPE PAID FOR THE SIX YEARS ENDED JUNE 30, 2000

• SCHEDULE OF ANNUITANTS BY TYPE

• HISTORICAL ACTIVE PARTICIPANT DATA

• SCHEDULE OF REVENUES BY SOURCE ($000) FOR THE SIX YEARS ENDED JUNE 30, 2002

• SCHEDULE OF EXPENSES BY TYPE ($000) FOR THE SIX YEARS ENDED JUNE 30, 2002

SCHEDULE OF AVERAGE BENEFIT PAYMENT AMOUNTS FOR THE SIX YEARS ENDED JUNE 30, 2000

Year Ended	Number Receiving Benefits	Benefits Paid ($000)	Average Annual Benefit
June 30, 1995	4,441	36,482	8,215
June 30, 1996	4,618	38,815	8,406
June 30, 1997	4,740	40,981	8,646
June 30, 1998	4,870	43,394	8,911
June 30, 1999	4,999	46,732	9,348
June 30, 2000	5,104	50,142	9,824

SCHEDULE OF BENEFITS BY TYPE ($000) FOR THE SIX YEARS ENDED JUNE 30, 2000*

Fiscal Year Ended	Normal Retirement Benefits	Disability Retirement Benefits	Survivors' Benefits	Total Benefits
June 30, 1995	28,640	2,529	4,274	35,443
June 30, 1996	30,373	2,777	4,527	37,677
June 30, 1997	*	*	*	40,643
June 30, 1998	34,509	3,062	5,540	43,111
June 30, 1999	37,370	3,320	6,061	46,751
June 30, 2000	39,836	3,490	6,816	50,142

* Information not available for year ended June 30, 1997

SCHEDULE OF ANNUITANTS BY TYPE

Type Benefit	Number	Benefits ($000)	Average Benefit
Retirees receiving benefits	3,241	$ 39,836	$ 12,291
Retired on disability	517	3,490	6,750
Survivors and beneficiaries	1,346	6,816	5,064
Total retirees, survivors and beneficiaries	5,104	50,142	9,824
Former participants eligible but not yet receiving benefits	1,029	5,114	4,970
Total Eligible for Benefits	6,133	$ 55,256	$ 9,010

HISTORICAL ACTIVE PARTICIPANT DATA

Valuation Date	Number of Participants	Annual Payroll $(000)	Average Salary ($)	% Salary Increase
July 1, 1990	12,037	258,556	21,480	3.4
July 1, 1991	12,488	284,914	22,815	6.2
July 1, 1992	12,913	314,686	24,370	6.8
July 1, 1993	13,112	340,249	25,949	6.5
July 1, 1994	14,027	366,561	26,133	0.7
July 1, 1995	14,364	378,511	26,351	0.8
July 1, 1996	14,067	367,610	26,133	(0.8)
July 1, 1998	13,764	394,919	28,692	9.8
July 1, 1999	13,286	396,617	29,852	4.0
July 1, 2000	13,126	421,591	32,119	7.6

SCHEDULE OF REVENUES BY SOURCE ($000) FOR THE SIX YEARS ENDED JUNE 30, 2002

Year (June 30)	Sponsor Contributions	Member Contributions	Investment Income	Other Income	Total Income
1997	34,526	5,931	148,480	8,813	197,750
1998	35,343	6,198	94,656	406	136,603
1999	36,030	6,184	32,344	276	74,835
2000	38,306	7,341	270,991	407	317,045
2001	41,298	8,532	(65,147)	643	(14,674)
2002	40,758	13,476	(108,024)	286	(53,504)

SCHEDULE OF EXPENSES BY TYPE ($000) FOR THE SIX YEARS ENDED JUNE 30, 2002

Year (June 30)	Benefits Paid	Contributions Refunded	Professional Service Fees	Cost of Administration	Total Expenses
1997	40,643	339	735	1,308	43,025
1998	43,111	284	142	1,634	45,171
1999	46,751	232	238	2,043	46,264
2000	50,142	337	263	2,143	52,885
2001	58,296	308	324	2,367	61,295
2002	78,318	270	396	3,662	82,646