San Diego City Employees' Retirement System

San Diego, California

Comprehensive Annual Financial Report

For the Fiscal Year Ended June 30, 2004

A Defined Benefit Pension Plan for Employees of the City of San Diego, the Unified Port of San Diego, and the San Diego County Regional Airport Authority, and a Post-Employment Healthcare Benefit Plan for Employees of the City of San Diego.

In memory of

Paul A. Barnett

SDCERS' Assistant Retirement Administrator

May 16, 1953 — July 11, 2005

Cover Photo:
San Diego Gaslamp Quarter
San Diego, California
Taken by Oscar Medina

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The San Diego City Employees' Retirement System's (SDCERS) mission is to deliver accurate and timely benefits to its members, retirees and beneficiaries and ensure the Trust Fund's safety, integrity and growth.

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www.sdcers.org

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I. Introductory Section

Introductory Section

Transmittal Letter

sdCERS
San Diego City Employees' Retirement System

December 15, 2006

SDCERS Board of Administration, Members, Beneficiaries and Plan Sponsors
San Diego City Employees' Retirement System
401 B Street, Suite 400
San Diego, CA 92101-4298

Dear SDCERS Board Members, Beneficiaries and Plan Sponsors:

I am pleased to present this Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2004 (FY 2004), with comparative data for the fiscal year ended June 30, 2003 (FY 2003) for the San Diego City Employees' Retirement System ("SDCERS" or the "System"). The information presented here should be read in conjunction with the information furnished in Management's Discussion and Analysis in the Financial Section.

I was hired by the Board of Administration at its April 24, 2006 meeting, which concluded a nation-wide search that began in November 2005. My first day on the job was May 1, 2006. SDCERS' CAFR would usually be completed by December following the end of the fiscal year, or, in this case, December 2004 for FY 2004. Obviously, this CAFR is late. I will discuss some of the reasons for the delay, which also will be mentioned elsewhere in this report.

Before a CAFR can be issued, auditors must opine that the financial statements fairly and accurately present the financial condition of the issuer, including any contingencies that might affect the issuer's funded status. Due to investigations into the City of San Diego's (the "City") funding of SDCERS and related public disclosures, there was insufficient certainty with SDCERS' financial statements and disclosure of material contingencies to permit our auditors to opine on our financial statements. These matters have only now been sufficiently explained to permit our auditors to proceed with opining on SDCERS' FY 2004 financial statements.

For example, on September 16, 2004, the law firm of Vinson & Elkins issued a Report on Investigation outlining their review of the disclosure practices concerning the City's funding of SDCERS. (Their report is available at www.sandiego.gov/press/citywidepress/0401.shtml). In February 2005, the City retained Kroll, Inc. to evaluate the Vinson & Elkins report and to make recommendations to the City Council. Thereafter, the City formed an independent Audit Committee. The Report of the Audit Committee's investigation was issued on August 8, 2006. The City held a series of public meetings to review and discuss the recommendations in the Report and determine an implementation plan. News reports concerning these issues are available on-line at www.signonsandiego.com/news/metro/pension/.

In addition, the U.S. Securities and Exchange Commission (SEC) and other federal agencies initiated investigations. On November 14, 2006, the SEC entered an order sanctioning the City for committing securities fraud, and the City agreed to cease and desist from future securities fraud violations and to retain an independent consultant for three years to foster compliance with its disclosure obligations under the federal securities laws. The SEC's investigation continues as to individuals and other entities that may have violated the federal securities laws.

Other events also affected the preparation of this CAFR. In July 2005, Paul Barnett, SDCERS' Assistant Retirement Administrator, passed away. (This CAFR is dedicated in his memory.) His replacement, Bob Wilson, started work in November 2005. Shortly thereafter, on January 6, 2006, Lawrence B. Grissom, the former Retirement Administrator, and Lori Chapin, SDCERS' former General Counsel, were indicted by a Federal Grand Jury, along with three former members of the SDCERS Board of Administration. New Board members were appointed, then sued by the City Attorney of San Diego, causing seven to resign. Finally, at its June 2006 meeting, the Board was at full strength and operating in accordance with Proposition H passed by City voters in November 2004 (*See Note 13 Subsequent Events* in the Notes to the Financial Statements in the Financial Section).

As discussed in *Note 12 Legal Action* and *Note 13 Subsequent Events* in the Notes to the Financial Statements in the Financial Section, SDCERS has been the subject of a number of investigations and has been and continues to be involved in a number of litigation matters. After reviewing all of these pending matters, however, SDCERS management does not believe that the outcome of any of these matters will have a material adverse impact on the financial condition of SDCERS.

Fiscal Year 2004 in Review

FY 2004 was an eventful year: SDCERS was faced with long-term funding concerns, related litigation and various audits.

In October 2003, SDCERS assisted the San Diego City Council's newly created Pension Reform Commission (PRC) with its task of reviewing the long-term funding and stability of the City's SDCERS plan. SDCERS staff provided background information and education to the PRC and attended their weekly meetings in order to answer questions regarding the various issues under review. In September 2004, the PRC issued a report and presented their findings and recommendations to the San Diego City Council. A full copy of the PRC's report is available on-line at www.sandiego.gov/pensionreform.

Two of the PRC's recommendations required amendments to the City Charter. These recommendations concerned the amortization period for the City's Unfunded Actuarial Accrued Liability (UAAL) and a new composition of Board members that oversee the operations of SDCERS. Two ballot measures, Propositions G and H, were on the November 2, 2004 ballot for voter approval by the citizens of San Diego, and both measures received voter approval. The full text of these measures are on the City's Web site at www.sandiego.gov, and a summary is set out in *Note 13 Subsequent Events* in the Notes to the Financial Statements in the Financial Section.

During FY 2004, SDCERS also responded to the Gleason litigation, a consolidation of three separate lawsuits brought by City retirees in 2003 against SDCERS and the City for allegedly under funding the City's SDCERS plan and other related fiduciary violations. Ultimately, the parties reached a settlement addressing all charges in this lawsuit. For a summary of the terms of the settlement, see *Note 12 Legal Action* in the Notes to the Financial Statements in the Financial Section.

SDCERS has cooperated with requests for information from representatives of both the SEC and the United States Department of Justice regarding their investigations of the City of San Diego and its financial disclosure practices. These investigations relate to circumstances surrounding various plan sponsor (employer) Defined Benefit Pension Plan contribution agreements between SDCERS and the City and how the City has disclosed this information in official documents related to public debt offerings/issuances for capital improvement projects. For additional information about outstanding legal matters, see *Note 13 Subsequent Events* in the Notes to the Financial Statements in the Financial Section.

In 2003, SDCERS' Board requested a comprehensive audit in order to ensure the integrity, safety and soundness of SDCERS and its operations, and to identify areas for improvements in procedures and policies. In fall 2003, SDCERS' Board retained Mercer Human Resources Consulting to conduct three comprehensive audits of SDCERS' operations: 1) an Actuarial Audit; 2) an Investment Operations Audit including a Custodian Audit; and 3) an Operational Best Practices Audit including a Federal Compliance Review. A summary of Mercer's Actuarial Audit findings has been included in the Actuarial Section. Mercer's audits validated SDCERS' historical investment performance, the soundness of appropriate controls and oversight, and level of asset reconciliation. They also verified the overall soundness of SDCERS' administrative and compliance procedures. In addition, they also identified areas where SDCERS can improve its service delivery to participants and operational procedures.

In addition to Mercer's audits, SDCERS retained the accounting firm of Brown Armstrong Paulden McCown Starbuck Thornburgh & Keeter (Brown Armstrong) to conduct SDCERS' FY 2004 financial audit and to opine if SDCERS' financial statements fairly present SDCERS' financial condition.

Other FY 2004 activities included:

- SDCERS had an investment return of +20.21% for the one-year period ended June 30, 2004, ranking SDCERS in the third percentile of a representative public fund universe monitored by Callan Associates, SDCERS' investment consultant. The median investment return among this public fund universe was +14.96%.
- SDCERS' Board, as part of its annual budget process, approved the development of an Electronic Data Management System (EDMS). This system will help maintain secure participant information and improve workflow in order to serve SDCERS' participants more efficiently.
- SDCERS experienced a year-over-year increase in Defined Benefit Pension Plan Net Assets for the second year in a row. Post-Employment Healthcare Benefit Plan Net Assets are accounted for separately in the financial statements pursuant to the United States Internal Revenue Service Code 401(h) and Governmental Accounting Standards Board (GASB) Statement No. 26. As of June 30, 2004, the Defined Benefit Pension Plan Net Assets increased $612 million to $3.269 billion, as compared to $2.657 billion as of June 30, 2003, a 23.02% increase.

Please refer to Management's Discussion and Analysis in the Financial Section for further detail on SDCERS' financial condition.

Despite increases in plan net assets in FY 2004, the City experienced a decline in funded status for its Defined Benefit Pension Plan. This decline is due to increased liabilities caused by litigated and negotiated increases in member (employee) benefits and a decrease in the actuarial value of assets resulting from investment experience during the five-year period ending June 30, 2004. In addition, the City's contribution funding method over the last several years was not one of the six actuarial cost methods allowed by GASB Statement No. 25 and also may have contributed to the actuarial losses and decline in funded status of the City's SDCERS' plan. Additional information and commentary regarding the City's long-term Defined Benefit Pension Plan funded status is included in the Required Supplementary Information located after the Notes to the Financial Statements in the Financial Section.

Actuarial assumptions and data from recent actuarial valuations are presented in the Actuarial Section. SDCERS administers Post-Employment Healthcare Benefits for the City of San Diego. Since FY 1998, this separate benefit for health-eligible City retirees has been funded from a SDCERS 401(h) account. In FY 2005, the City began separately funding the Post-Employment Healthcare Benefit Plan on a pay-as-you-go basis. More information regarding the Post-Employment Healthcare Benefit Plan can be found in the Notes to the Financial Statements located in the Financial Section.

The FY 2004 Comprehensive Annual Financial Report

SDCERS' management team is responsible for both the accuracy of the data and the completeness and fairness of the presentation of the information contained in this CAFR.

This CAFR is divided into five sections:

Introductory Section

This section contains Transmittal Letters, the Members of SDCERS' Board, an Organizational Chart, and a list of firms (excluding investment management firms, which are located in the Investment Section) that provided professional services in FY 2004 to SDCERS.

Financial Section

This section presents the Independent Auditors' Report prepared by Brown Armstrong, Management's Discussion and Analysis of SDCERS' financial condition, audited financial statements prepared by the City Auditor and Comptroller's Office for FY 2004 and FY 2003, Required Supplemental Information detailing the funding progress and the Plan Sponsors' (employers') contributions to SDCERS, and Other Supplementary Information (including supporting schedules) detailing SDCERS' administrative expenses and payments made to investment professionals and consultants in FY 2004.

Investment Section

This section contains SDCERS' Investment Consultant's Statement, prepared by Callan Associates, SDCERS' asset class investment returns, a list of SDCERS' external investment management firms, SDCERS' statement of investment objectives and policies, graphs and schedules depicting asset allocation and asset diversification, and ten years of historical investment performance and asset holdings information.

Actuarial Section

This section includes SDCERS' Actuary's Certification Letter (prepared by Gabriel, Roeder, Smith & Co.), an executive summary of SDCERS' actuarial audit performed by Mercer Human Resources Consulting, and supporting schedules and information that pertain to SDCERS' participants and benefits.

Statistical Section

This section contains schedules of comparative data related to SDCERS' revenues (additions) and expenses (deductions), active and inactive members and retirees, average monthly retirement benefits, and a list of participating plan sponsors (employers).

Background on SDCERS and its Board

SDCERS was established in 1927 by the City and in accordance with: the California State Constitution Article XVI, Section 17; the San Diego City Charter Article IX Sections 141 – 149 and Article X, Section 1; and the San Diego Municipal Code Sections 24.0100 - 24.1809. SDCERS provides retirement, disability, and death benefits to its participants. SDCERS also administers a Post-Employment Healthcare Benefit for health-eligible City retirees.

SDCERS provides vested members with a specified portion of their annual salaries as a monthly annuity when they retire. In order to attain the appropriate level of funding for each member, the plan specifies a formula to calculate the amount that would need to be contributed by participating Plan Sponsors (employers) and Members (employees) each year until retirement. In an effort to minimize required contributions, SDCERS' Board utilizes a long-term investment strategy consisting of a diversified mix of equities (stocks), fixed income (bonds) and real estate. Dividends, interest earnings, real estate income, and gains from the sale of investments are reinvested or used to pay benefits and SDCERS' operational expenses.

A thirteen-member Board governs SDCERS and oversees the Retirement Administrator and SDCERS' staff in the performance of their duties. As of June 30, 2004, the Board was comprised as follows:

Board Members	Representation
Three Members	Elected by General Members
One Member	Elected by Fire/Safety Members
One Member	Elected by Police/Safety Members
One Member	Elected by Retirees
Three Members	Ex-Officio: City Manager (designee), City Treasurer, and City Auditor
Four Members	San Diego Citizens Appointed by City Council

On November 2, 2004, Proposition H was approved by San Diego voters. This changed the member composition of SDCERS' Board effective April 1, 2005. As a result, the thirteen-member Board is now comprised as follows:

Board Members	Representation
Two Members	Elected by General Members
One Member	Elected by Fire/Safety Members
One Member	Elected by Police/Safety Members
One Member	Elected by Retirees
One Member	Ex-Officio: City Manager (designee)
Seven Members	San Diego Citizens Appointed by the Mayor and confirmed by the City Council

For further information regarding Proposition H, please see *Note 13 Subsequent Events* in the Notes to the Financial Statements, located in the Financial Section.

Actuarial Funding Status

SDCERS' primary objective is to assure full and timely funding of the benefits we are responsible for delivering to our members and their beneficiaries through sound actuarial principles consistently applied over the long term. Another objective is to meet future benefit obligations by earning consistent, long-term investment returns. SDCERS retained the independent actuarial firm Gabriel, Roeder, Smith & Co. to conduct an annual actuarial valuation. (On October 21, 2005, SDCERS retained a new actuarial firm, Cheiron, to serve as its actuary.) Plan assets for the Defined Benefit Pension Plan of the City, the Unified Port of San Diego ("Port") and the San Diego County Regional Airport Authority ("Airport"), and the Post-Employment Healthcare Benefit Plan of the City are pooled for investment purposes. Separate cost-based reserve allocations are booked for each plan sponsor's Defined Benefit Pension Plan and separate actuarial valuation reports are completed annually. The Post-Employment Healthcare Benefit Plan is accounted for in a separate reserve (Trust account) per the United States Internal Revenue Service Code 401(h). Pursuant to GASB Statement No.'s 26 and 27, it is at the option of SDCERS' Board and the City, as plan sponsor (employer), to request and have prepared an actuarial valuation report for this Plan.

The funded status, Actuarial Value of Assets (AVA) and Actuarial Accrued Liabilities (AAL) as of the June 30, 2003 actuarial valuations for the City, the Port, and the Airport, are as follows (in millions):

Defined Benefit Pension Plan

	June 30, 2003	December 31, 2002[1]	June 30, 2002
City of San Diego			
Actuarial Value of Assets (AVA)	$2,375.4	n/a	$2,448.2
Actuarial Accrued Liabilities (AAL)	$3,532.6	n/a	$3,168.9
Unfunded Actuarial Accrued Liability (AVA less AAL)	$1,157.2	n/a	$720.7
Funded Status (AVA divided by AAL)	67.2%	n/a	77.3%
Unified Port of San Diego			
Actuarial Value of Assets (AVA)	$123.9	$125.6	$140.6
Actuarial Accrued Liabilities (AAL)	$154.3	$137.8	$140.2
Unfunded Actuarial Accrued Liability (AVA less AAL)	$30.4	$12.2	($0.4)
Funded Status (AVA divided by AAL)	80.3%	91.1%	100.3%
San Diego County Regional Airport Authority			
Actuarial Value of Assets (AVA)	$11.1	$11.0	n/a
Actuarial Accrued Liabilities (AAL)	$16.2	$11.5	n/a
Unfunded Actuarial Accrued Liability (AVA less AAL)	$5.1	$.50	n/a
Funded Status (AVA divided by AAL)	68.4%	95.7%	n/a

[1] Interim actuarial valuation reports were performed for the Port and the Airport as a result of the State of California creating the San Diego County Regional Airport Authority effective January 1, 2003. This agency is comprised of former Port employees as well as newly hired Airport employees that are participants of SDCERS.

The City and the Port are amortizing their SDCERS' Unfunded Actuarial Accrued Liability (UAAL), resulting from liabilities exceeding assets, over a closed, 30-year amortization period, which began July 1, 1991, with 18 years remaining as of the June 30, 2003, actuarial valuation. The Airport is amortizing its SDCERS' Unfunded Actuarial Accrued Liability over a closed, 18.5-year amortization period, which began January 1, 2003, with 18 years remaining as of the June 30, 2003, actuarial valuation.

The City's SDCERS' UAAL will be funded using an amortization period effective FY 2006 through FY 2008 resulting from the Gleason litigation settlement. (See *Note 12 Legal Action* in the Notes to the Financial Statements in the Financial Section.)

The City contribution funding method during the years depicted in the Plan Sponsors' (Employers') Contributions, located in the Required Supplementary Information in the Financial Section, was not one of the six actuarial cost methods allowed by GASB Statement No. 25.

Three schedules of historical funded status of SDCERS' Defined Benefit Pension Plan for the City, the Port and the Airport are contained in the Required Supplementary Information located in the Financial Section. The City's and the Port's schedules depict ten years of historical actuarial data, while the Airport's schedule depicts two actuarial valuation periods as it is a new Plan Sponsor (employer) with SDCERS. Notes that provide commentary, actuarial definitions, and related information follow these schedules. For further details on actuarial assumptions used in the Plan Sponsors' (employers') valuations, see the Actuarial Section. A full copy of the actuarial valuation reports for each Plan Sponsor can be found on-line at http://www.sdcers.org/forms_newsevents.jsp.

Services Provided to Participants

Since SDCERS' inception, the number of participants has continued to grow. As of June 30, 2004, SDCERS increased by 146 participants as compared to June 30, 2003. This was comprised of a net decrease of 128 members and a net increase of 274 retirees. The retirees figure includes an increase of 56 Deferred Retirement Option Plan (DROP) participants as compared to DROP participants in the prior fiscal year ended June 30, 2003. For more detailed information regarding SDCERS' membership as of June 30, 2004, with comparative data as of June 30, 2003, see the membership table located in *Defined Benefit Pension Plan, Note 5 Description* in the Notes to the Financial Statements in the Financial Section.

In order to serve its members and retirees, SDCERS' staff educates and counsels participants in a variety of venues. For FY 2004 and FY 2003, staff provided the following services to SDCERS' participants:

	June 30, 2004	June 30, 2003
Processed Purchase of Service Credit (PSC) Contracts	6,422	3,046
Completed Service and Disability Applications	423	129
Completed DROP Applications	444	363
Hosted Pre-Retirement Seminars	6	15
Advised Members in Counseling Sessions	2,330	1,469
Presented Benefit Information at New Employee Orientations	14	19

Service Enhancements

In August 2003, SDCERS launched a Web site, www.sdcers.org, that participants and interested parties can use to learn more about SDCERS, access comprehensive information regarding benefits, obtain forms, review the investment of plan assets, find a recent copy of SDCERS' newsletter *FreeSpirit*, and review an electronic copy of this CAFR as well as related actuarial valuation reports. The Web site also has interactive capabilities to assist SDCERS' members in understanding and estimating their earned benefits. New Summary Plan Descriptions, which are also available on the Web site, were written to provide up-to-date information to SDCERS' members.

Changes in SDCERS' Provisions

Effective April 1, 2004, the San Diego Unified Port District (Port) and San Diego County Regional Airport Authority (Airport) general member retirement factors were increased to 2.5% at age 55 up to a maximum of 3.0% at age 60 and over. With this enhancement, a 90% cap was also instituted. This means that a Port or Airport general member with 36 years of service at age 55 would have their retirement benefit capped at 90% of their high one-year salary. Port and Airport general members can continue to work after reaching the 90% cap and continue to increase their high one-year salary that is used in the calculation of a retirement benefit. Upon becoming age eligible to retire, SDCERS' members can enter DROP (Deferred Retirement Option Plan) and continue to work for the Port or the Airport and make and receive matching contributions (3.05% of salary) to their DROP account. Port safety members also have a 90% cap, which was implemented in 2001. Port safety members are eligible to retire at age 50 with 20 years of service. Prior to April 1, 2004, general members (Port and Airport only) had a choice of two formulas for calculating benefits, based on a scaled 2.0% per year of service (with a 10% increase added to final compensation) or 2.25% per year of service, with minimum eligibility at age 55 and twenty years of creditable service. A summary of retirement benefits administered by SDCERS is included in the Actuarial Section. For further details about specific retirement benefits, call SDCERS' offices at (800) 774-4977 or (619) 525-3600, or visit SDCERS' Web site at www.sdcers.org.

Accounting Systems and Reports

SDCERS' management is responsible for establishing and maintaining an internal control system designed to ensure that SDCERS' assets are protected from loss, theft or misuse. Brown Armstrong performed the annual audit of SDCERS' financial statements for FY 2004. This CAFR was prepared in accordance with Generally Accepted Accounting Principals (GAAP) in the United States and reporting guidelines set forth by the Governmental Accounting Standards Board (GASB). In FY 2004, SDCERS' audited financial statements were prepared by the City's Auditor and Comptroller's Office using the accrual basis of accounting. Plan Sponsor (employer) and Member (employee) contributions are recognized as additions in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the Plan. SDCERS' investments are stated at fair value. The custodian, State Street Bank and Trust Company, provides market values of SDCERS' invested assets with the exception of the fair value of directly-owned real estate assets, which are provided by SDCERS' real estate managers and independent third-party appraisal firms. Investment income is recognized in accordance with GASB Statement No. 25 and is stated net of investment management fees and related expenses. Post-Employment Healthcare Benefit Plan assets, liabilities, revenues (additions) and expenses (deductions) are administered and reported in accordance with GASB Statement No. 26.

Investments

Article XVI, Section 17 of the Constitution of the State of California provides that "notwithstanding any other provisions of law or this Constitution to the contrary, the Retirement Board of a public pension or retirement system shall have plenary authority and fiduciary responsibility for investment of moneys and administration of the system ..." Article XVI, Section 17(a) of the Constitution of the State of California provides that "the Retirement Board of a public pension or retirement system shall have the sole exclusive fiduciary responsibility over the assets of the public pension or retirement system."

Article XVI, Section 17(c) of the Constitution of the State of California, provides that "the members of the Retirement Board of a public pension or retirement system shall discharge their duties ... with care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims." ("Prudent Person Rule")

SDCERS' Board models its investment program based on principles outlined under the United States Government Code, Title 29, Chapter 18, Employee Retirement Income Security Act of 1974 (ERISA). Under ERISA, the Prudent Expert Rule ("Prudent Expert Rule") permits a Board to establish an investment policy based upon professional advice and counsel, and to delegate investment authority to professional investment advisors. SDCERS' Statement of Investment Objectives and Policies summarizes SDCERS' Board's responsibilities and the appropriate degree of risk for SDCERS investment program is available on-line at www.sdcers.org. Investment managers must execute the investment policy in accordance with specific investment guidelines incorporated in the investment management agreements between SDCERS and each of its external investment managers.

The Prudent Expert Rule differs from the Prudent Person Rule in that by diversifying the investments within a fund, the prudent expert standard may enable a fund to reduce overall risk and increase returns. SDCERS' Board is required to delegate its responsibility for the investment of plan assets to qualified investment managers. SDCERS' Board is then charged with the monitoring and oversight of SDCERS' investment managers. Under the Prudent Expert Rule, permitted investment of SDCERS' plan assets are viewed from a risk return perspective based upon their additive properties to SDCERS' diversified investment portfolio, rather than viewing the investment opportunity's risk return characteristics in isolation as the Prudent Person Rule mandated. Finally, SDCERS' Board, based on the Prudent Expert Rule, is charged with evaluating investments based upon current information at the time the investment is made and thereafter as changing circumstances warrant.

SDCERS' target and actual asset allocation, as of June 30, 2004, and June 30, 2003, and recent and long-term investment performance are all included in the Investment Section of this CAFR. SDCERS had one-year total investment returns, as follows:

June 30, 2004	June 30, 2003
20.21%	5.44%

The one-year investment performance benchmark returns for these periods were 16.05% and 4.86%, respectively.

As of June 30, 2004, SDCERS' annualized total investment return was +7.35% over the past three years, +7.18% over the past five years, and +10.65% over the past ten years. The performance benchmark returns for these same periods were +6.04%, +5.13% and +9.75%, respectively. Since the inception of SDCERS' diversified investment program in 1989, SDCERS' annualized total investment return was +10.50%, exceeding SDCERS' actuarially assumed investment rate of return of 8.00% by 2.50% annualized.

Post FY 2004 Progress: Navigant Report

On August 30, 2005, SDCERS' Board unanimously approved the retention, through its special fiduciary counsel Reish Luftman Reicher & Cohen, of Navigant Consulting Inc, to conduct an independent investigation into allegations of wrongdoing by SDCERS.

Navigant issued its report to the Board on January 20, 2006, a copy of which is available on-line at http://www.sdcers.org/forms_newsevents.jsp. Navigant's Report concluded that there had been a breach of fiduciary duty by former SDCERS Board members approving the 1996 Manager's Proposal and 2002 Contribution Agreement presented by the City. Reish Luftman Reicher & Cohen provided legal analysis of Navigant's findings and concluded that approval of these agreements also violated state and municipal law. Finally, the Navigant Report concluded that the payment of certain benefits using Trust Fund assets to pay for benefit and administrative costs of retiree health care, Corbett settlement provisions related to disability retirement benefits and Presidential Leave benefits had violated Internal Revenue Code rules, jeopardizing the Trust Fund's tax exempt status.

The Navigant Report recommended changes to SDCERS in governance and oversight, actuarial soundness, tax compliance, training and education, and SDCERS' independence from the City. In response to Navigant's findings and recommendations, the Board established an ad-hoc committee to recommend appropriate reform actions to the Board for approval and implementation. The Navigant Report Committee met monthly from February 2006 to August 2006 and methodically reviewed the Report's major issues. The final Committee report was issued on December 15, 2006.

Post FY 2004 Progress: IRS Tax Determination Letter and Voluntary Correction Program Filings

On July 12, 2005, SDCERS filed with the Internal Revenue Service (IRS) an application for a Tax Determination Letter and a request for a compliance statement from the IRS under the Voluntary Correction Program (VCP). Ice Miller LLP is representing SDCERS before the IRS.

The initial VCP filing addressed a correction to the City's Presidential Leave Program for presidents of certain labor organizations that represent City employees. Since that time, additional VCP filings have been made concerning compensation limits under Internal Revenue Code (IRC) section 401(a)(17); minimum distribution requirements under section 401(a)(9); distribution rollover compliance under section 401 (a)(31); the DROP program; disability benefit overpayments; cashless leave/purchase of service credits; post employment health benefits and health administrative expenses under section 401(h); and benefit and compensation limits under sections 415(b), 415(c) and 415(n). All filings were made in August 2006.

In its filings, SDCERS is proposing to seek recovery from the City for the following amounts: (1) $31,618,356 for retiree medical benefits paid from the SDCERS Trust Fund per City Ordinance between 1982 and 1991 ($8,227,271 for benefits, plus $23,391,085 in interest through fiscal year 2006), (2) $2,211,895 for unreimbursed costs of administering the retiree medical benefit between 1982 and July 1, 2006 ($1,523,431 for administration costs, plus $688,464 in interest through fiscal year 2006), (3) $577,452 for the past use of Annual Leave to purchase service credit, and (4) $2,266,162 for benefits paid in excess of section 415(b) limits.

SDCERS' position is that no penalties should be imposed for any compliance failures. Although we believe this is a reasonable position, we cannot predict whether it will be accepted by the IRS. If it is, SDCERS does not anticipate any material adverse financial impact from the IRS filings.

Acknowledgments

This report reflects the combined effort of SDCERS' management and staff under the leadership of the current Board. It is intended to provide complete and reliable information with respect to the Board's stewardship of SDCERS' Defined Benefit Pension Plan assets and Post-Employment Healthcare Benefit Plan assets. This CAFR is available to all members and beneficiaries, upon request, and is also available on-line at www.sdcers.org.

A Popular Annual Financial Report (PAFR) will be mailed to all of SDCERS' active members, retirees and beneficiaries. This summary document is also available on-line at www.sdcers.org.

I would like to take this opportunity to express my appreciation to SDCERS' Board of Administration, my management colleagues and all of SDCERS' employees who have worked so hard in the face of so many distractions. I would also like to thank our investment managers, consultants, and the many City employees who work diligently to ensure the successful operation of SDCERS.

If you have questions about this CAFR or any aspect of SDCERS' operations, please contact us at (800) 774-4977 or (619) 525-3600.

Respectfully submitted,

David B. Wescoe
Retirement Administrator

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
MEMBERS OF SDCERS' BOARD OF ADMINISTRATION

As of June 30, 2004

Mr. Frederick W. Pierce, IV, President
Council Appointee
The Pierce Company

Mr. John Torres, Vice-President
Elected General Member Representative
City of San Diego Police Department - Forensics

Mr. David Crow
Elected Retiree Representative

Mr. Ray Garnica
Council Appointee
Independent Consultant

Mr. Charles Hogquist
Elected Safety (Police) Member Representative
City of San Diego Police Department

Ms. Cathy Lexin
Ex-Officio Member
City of San Diego Human Resources Manager

Mr. Steve Meyer
Elected General Member Representative
City of San Diego Metropolitan Wastewater Department

Mr. Ron Saathoff
Elected Safety (Fire) Member Representative
City of San Diego Fire Department

Ms. Diann Shipione
Council Appointee
UBS/Paine Webber

Ms. Mary Vattimo
Ex-Officio Member
City of San Diego Treasurer

Mr. Dick Vortmann
Council Appointee
National Steel & Shipbuilding Company

Ms. Terri Webster
Ex-Officio Member
City of San Diego

Ms. Sharon Wilkinson
Elected General Member Representative
City of San Diego Water - Operations

* Due to San Diego citizens' vote in favor of Proposition H on November 2, 2004, SDCERS' Board was reconstituted effective April 1, 2005.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
BOARD COMMITTEES

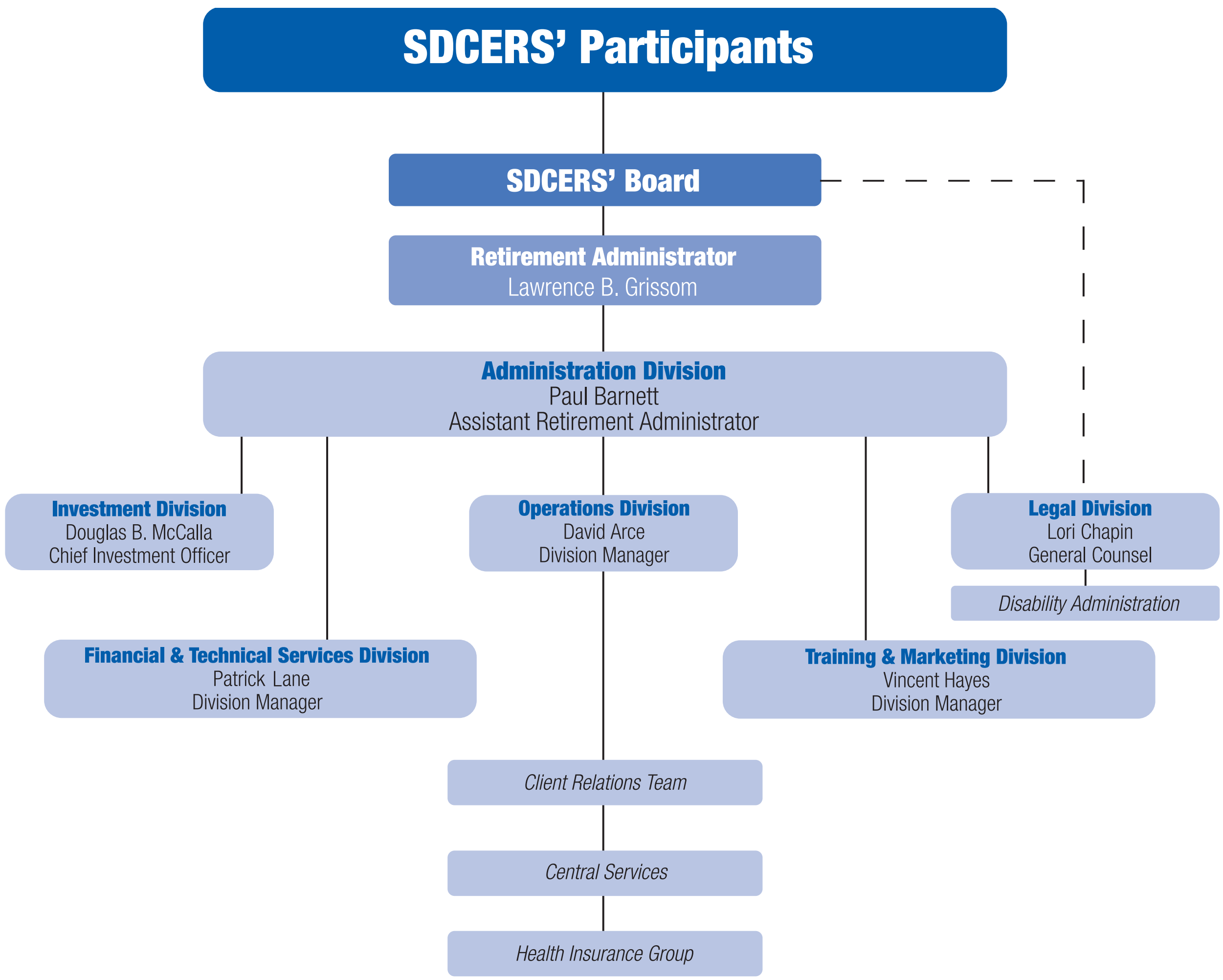
As of June 30, 2004

In addition to regular Board duties, SDCERS' Board members also participate in one or more standing committees. The standing committees review policies and procedures related to the various areas of SDCERS' administration, report their findings and make recommendations to SDCERS' Board. The responsibilities and composition of the standing committees as of June 30, 2004, were as follows:

Audit Committee Dick Vortmann (Chair) Ray Garnica (Vice-Chair) Dave Crow Frederick W. Pierce, IV Diann Shipione	Responsible for providing oversight to: the financial reporting process; the system of internal controls; the external, independent audit process; and such efforts necessary to ensure the financial integrity of SDCERS.
Business Procedures Committee Ron Saathoff (Chair) Cathy Lexin (Vice-Chair) Dave Crow Frederick W. Pierce, IV John Torres Terri Webster	Responsible for: reviewing SDCERS' procedures and making recommendations; reviewing and suggesting solutions to specific problems related to SDCERS' administration; establishing, periodically reviewing and updating strategic plans; and developing performance plans for SDCERS.
Health Advisory Committee Dave Crow (Chair) Ron Saathoff (Vice Chair) John Casey (City of San Diego Retiree) Stan Elmore (City of San Diego Retiree) Charles Hogquist Ron Moskowitz (City of San Diego Retiree) Frederick W. Pierce, IV John Torres	Responsible for addressing retiree health related issues and making recommendations to the Business Procedures Committee.
Investment Committee Mary Vattimo (Chair) Dick Vortmann (Vice-Chair) Ray Garnica Steve Meyer Frederick W. Pierce, IV Ron Saathoff	Responsible for monitoring investment performance and market conditions and recommending changes to the Investment Policy as dictated by changes in the financial marketplace.
Proxy Voting Committee Mary Vattimo (Chair) Sharon Wilkinson (Vice-Chair) Frederick W. Pierce, IV John Torres	Responsible for reviewing and updating SDCERS' Proxy Voting Policy and Guidelines as well as overseeing related corporate governance issues and voting functions.
Rules Committee John Torres (Chair) Dave Crow (Vice Chair) Charles Hogquist Steve Meyer Frederick W. Pierce, IV Sharon Wilkinson	Responsible for reviewing SDCERS' Board Rules and making recommendations for necessary changes as recommended by the Committee, the Retirement Administrator or General Counsel.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM ORGANIZATION CHART

As of June 30, 2004



SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
PROFESSIONAL SERVICES
As of June 30, 2004

Actuary

Gabriel, Roeder, Smith & Company
San Diego, CA

Consulting and Professional Services

Mellon Consultants, LLC
Los Angeles, CA

JPI Printing Inc.
San Diego, CA

Levi, Ray & Shoup
Springfield, IL

Mercer Human Resources Consulting
Denver, CO

National Direct Mailing Corporation
Poway, CA

San Diego Data Processing Corporation
San Diego, CA

Custodian

State Street Bank & Trust Company
Alameda, CA

Independent Auditor

Brown Armstrong Paulden McCown Starbuck Thornburgh & Keeter
Certified Public Accountants
Bakersfield, CA

Investment Consultant

Callan Associates
San Francisco, CA

Real Estate Consultant

Russell Real Estate Advisors
San Diego, CA

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
PROFESSIONAL SERVICES (continued)
As of June 30, 2004

Legal Services

Berstein Litowitz Berger & Grossmann LLP
New York, NY

Branton & Wilson, APC
San Diego, CA

Coughlin Semmer & Lipman
San Diego, CA

Fiduciary Counselors, Inc.
Washington, D.C.

Grant & Eisenhofer, P.A.
Wilmington, DE

Hanson, Bridgett, Marcus, Vlahos and Rudy, LLP
San Francisco, CA

Hennigan, Bennett & Dorman LLP
Los Angeles, CA

Hillyer & Irwin
San Diego, CA

Ice Miller
Indianapolis, IN

JAMS (Judicial Arbitration Services)
San Diego, CA

Law Offices of Alton J. Smith & Neil P. Bahan
Irvine, CA

Milberg Weiss Bershad & Shulman
San Francisco, CA

Office of Administrative Hearings
San Diego, CA

Peterson & Associates - Court Reporters
San Diego, CA

Pillsbury Winthrop LLP
San Diego, CA

Seltzer Caplan McMahon Vitek A Law Corporation
San Diego, CA

Sullivan, Hill, Lewin, Rez & Engel A Professional Law Corporation
San Diego, CA

A complete list of SDCERS' Investment Managers is located in the Investment Section of this CAFR.

Report from SDCERS' Current Board President

sdCERS
San Diego City Employees' Retirement System

December 15, 2006

Dear SDCERS Constituents:

Generally, a letter from the SDCERS Board President in the CAFR is written by the individual who holds the position during the period of report. Given the delay in issuing this FY 2004 CAFR, I am modifying this practice because I thought it was important that you hear from the current Board President about some of the events that occurred subsequent to the end of FY 2004 that contributed to the delay.

Board Turnover

Proposition H reconfigured the SDCERS Board of Administration to include a majority of independent outside members, appointed by the Mayor and City Council of the City of San Diego. As one of the original seven independent members appointed as of April 1, 2005, I have watched the seats around me fill up, be vacated and refilled again and again. It was only at our June 16, 2006, Board meeting that we finally had a full complement of Board members for the first time in my 15-month tenure.

The cause of this turnover is even more troubling than the turnover itself. Many of the initial appointees, who were all extremely talented and well-qualified (e.g., Tom Paige, former Chairman of SDG&E; Bob Wallace, a CPA; Thomas King, President of a regional bank; and Susan Snow, Treasurer of Maximum Systems), were forced off the Board by threats of personal lawsuits by San Diego's City Attorney who was insisting that they waive SDCERS' attorney-client privilege.

Executive Management Turnover

In July 2005, SDCERS suffered a great loss when our Assistant Retirement Administrator, Paul Barnett, suddenly passed away. Mr. Barnett was instrumental in SDCERS' day-to-day operations, including the production of the CAFR. Paul's passing created a host of challenges for the staff and delayed the long-planned retirement of SDCERS' Retirement Administrator Lawrence Grissom. On November 1, 2005, Bob Wilson joined the staff as Assistant Retirement Administrator. He subsequently assumed responsibility for the running of SDCERS through the remainder of the five-month national search process being conducted by the Board of Administration to find a new Retirement Administrator/CEO. At its April 2006 meeting, the Board unanimously voted to hire David Wescoe as CEO, and David began his duties on May 1, 2006. The Board then began a search to hire a new General Counsel, and in September 2006 approved the selection of Christopher Waddell, who had been the General Counsel of the California State Teachers Retirement System (CalSTRS). Chris started at SDCERS in November 2006. Roxanne Parks, who had served as SDCERS' Acting General Counsel, was promoted to serve as SDCERS' first Chief Compliance Officer

Other Events.

As these facts underscore, there have been significant issues necessitating system-wide introspection. Through it all, SDCERS' Board and staff have been committed to reviewing past practices, identifying areas for improvement, and implementing changes to strengthen this fine organization. Among the many achievements of the Board and staff are: participation in the Internal Revenue Service's (IRS) Voluntary Correction Program to correct past operational deficiencies and to protect the Trust's tax exempt status; filing an application with the IRS for a tax determination letter; the creation of an independent Audit Committee with a majority of independent outside representatives to create external oversight of the financial reporting process; the addition of two independent staff positions, an internal auditor and compliance officer, that report directly to the Board; and, the selection of Cheiron, a highly-respected national actuarial firm specializing in public pension systems, to replace Gabriel, Roeder and Smith.

In addition, the Board tackled an issue that should have been resolved years ago dealing with the spin-off of the Port and Airport. At that time, a group trust should have been established consistent with the language of San Diego's Municipal Code, to identify the specific assets of each plan sponsor. We expect to establish a Group Trust, along with separate trusts for each of our Plan Sponsors effective July 1, 2007 and we are amending our IRS filings to seek separate Tax Determination Letters for each plan.

Conclusion

Every organization faces challenges from time to time, and SDCERS is no different. The difference between succeeding and failing is how you respond to those challenges. SDCERS chose to confront its issues head-on. In doing so, it is on firm ground and is keeping its promise to Members and Beneficiaries to safeguard their Defined Benefit Pension Plan. By taking thoughtful and deliberate steps to strengthen governance and oversight, improve communications and rectify past operational deficiencies, SDCERS has built a solid foundation on which we can all depend for decades to come.

Sincerely,

Peter E. Preovolos
President, SDCERS Board of Administration

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II. Financial Section

BROWN ARMSTRONG
CERTIFIED PUBLIC ACCOUNTANTS

BROWN ARMSTRONG
PAULDEN McCOWN STARBUCK THORNBURGH & KEETER
CERTIFIED PUBLIC ACCOUNTANTS

Main Office
4200 Truxtun Ave., Suite 300
Bakersfield, California 93309
Tel 661·324·4971 Fax 661·324·4997
e-mail: info@bacpas.com

Shafter Office
560 Central Avenue
Shafter, California 93263
Tel 661·746·2145 Fax 661·746·1218

INDEPENDENT AUDITOR'S REPORT

The Board of Administration
San Diego City Employees' Retirement System
San Diego, California

We have audited the accompanying statement of plan net assets of the San Diego City Employees' Retirement System (SDCERS) as of June 30, 2004 and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of SDCERS management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements as of and for the year ended June 30, 2003 were audited by other auditors, whose report dated November 26, 2003, expressed an unqualified opinion on those statements.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

As discussed in Note 13 to the financial statements, SDCERS is the subject of several lawsuits and claims. The ultimate outcome of these lawsuits and claims cannot presently be determined, but management is of the opinion that they will not have a material impact on the SDCER's financial statements. Accordingly, no provision for any liability that may result has been made in the financial statements. Nevertheless, due to uncertainties with these lawsuits and claims, it is at least reasonably possible that management's view of the outcome will change in the near term.

In our opinion, the basic financial statements referred to in the first paragraph of this report present fairly, in all material respects, the plan net assets of SDCER's as of June 30, 2004, and the changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of SDCER's management. We have applied 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 we do not express an opinion on it.

Our audit was made for the purpose of forming an opinion on the financial statements taken as a whole. The Required Supplementary Information as listed in the table of contents is presented for purposes of additional analysis, as required by the Governmental Accounting Standards Board, and is not a required part of the basic financial statements. This Required Supplementary Information is the responsibility of SDCER's management. Such information has been subjected to the auditing procedures applied by us in the audit of the 2004 basic financial statements. Management has stated that several actuarial issues remain unresolved regarding that information included in the Schedules of Funding Progress and will be studied collectively in a valuation subsequent to June 30, 2004. Further, the contribution funding method used for the information presented in the Schedules of Plan Sponsors' (Employers') Contributions is not in accordance with Generally Accepted Accounting Principles. Accordingly, in our opinion, the Required Supplementary Information as listed in the table of contents is not fairly presented in accordance with Generally Accepted Accounting Principles.

Our audit was made for the purpose of forming an opinion on the financial statements taken as a whole. The Other Supplementary Information – Supporting Schedules as listed in the table of contents is not a required part of the basic financial statements but is presented for purposes of additional analysis. Such information has been subjected to the auditing procedures applied by us in the audit of the 2004 basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2004 basic financial statements taken as a whole. We did not audit the information contained in the Investment, Actuarial, or Statistical sections as listed in the table of contents and express no opinion on that information.

BROWN ARMSTRONG PAULDEN
McCOWN STARBUCK & KEETER
ACCOUNTANCY CORPORATION

Bakersfield, California
April 3, 2005

Management's Discussion and Analysis

This Management's Discussion and Analysis (MD & A) provides an overview and analysis of SDCERS' financial condition for the Fiscal Years ended June 30, 2004 (FY 2004) and June 30, 2003 (FY 2003), with results also compared to the Fiscal Year ended June 30, 2002 (FY 2002). New reporting for SDCERS' administered Post-Employment Healthcare Benefit Plan, in compliance with Governmental Accounting Standards Board (GASB) Statement No. 26 *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*, has been presented in the financial statements of this Comprehensive Annual Financial Report (CAFR). Assets of the two Trust Funds, the Defined Benefit Pension Plan and the Post-Employment Healthcare Benefit Plan, are pooled for investment purposes, but accounted for and reported separately in the financial statements according to the relevant GASB Statements.

The information presented here should be read in conjunction with the information contained in the Transmittal Letter in the Introductory Section. Also, as discussed in *Note 12 Legal Action* and *Note 13 Subsequent Events*, SDCERS has been the subject of a number of investigations and has been and continues to be involved in a number of litigation matters. After reviewing all of these pending matters, management does not believe that the outcome of any of these matters will have a material adverse impact on the financial condition of SDCERS.

Financial Highlights

Changes in Plan Net Assets

Defined Benefit Pension Plan

As of June 30, 2004, $3.084 billion in plan net assets was held in trust for the payment of pension benefits. This is compared to plan net assets of $2.520 billion for FY 2003. Plan net assets, which included Post-Employment Healthcare Benefit Plan Net Assets, totaled $2.430 billion for FY 2002. FY 2004 results represent a 22.35% increase, or $563 million, over FY 2003, plan net assets. In FY 2003, SDCERS experienced a 3.70% increase, or $89.8 million, over FY 2002, plan net assets. The FY 2004 increase is attributed to plan sponsor contributions ($214 million) plus net investment earnings ($537 million) for the year, offset by deductions for benefit payments and administrative expenses ($188 million).

Post-Employment Health Care Benefits Plan

This plan is administered by SDCERS for retirees of the City of San Diego. As of June 30, 2004, $9.1 million in plan net assets was held in trust for the payment of post-employment healthcare benefits. This is compared to plan net assets of $21.8 million for FY 2003. Plan net assets were combined with Defined Benefit Pension Plan Net Assets as of June 30, 2002; however, a beginning balance for FY 2003 of $17.7 million is included in the Statement of Changes in Plan Net Assets. FY 2004 results represent a 58.36% decrease (- $12.7 million) from FY 2003, plan net assets. The City did not fund additional contributions in FY 2004, resulting in the decline of the 401(h) account balance.

Revenues (Additions to Plan Assets)

Defined Benefit Pension Plan

As of June 30, 2004, revenues totaled $751.3 million, an increase of $464.4 million (161.94%) over FY 2003 revenues of $286.8 million. This increase is attributed to net investment earnings ($415.6 million) and increased employer and member contributions ($48.8 million) over FY 2003. In FY 2003, SDCERS experienced an increase of $230.0 million (404.7%) in revenues over FY 2002 revenues of $56.8 million.

Post-Employment Healthcare Benefit Plan

As of June 30, 2004, revenues totaled $0.4 million, a 74.85% decrease (-$1.1 million) compared to FY 2003 revenues of $1.5 million. Comparative revenue data for FY 2003 versus FY 2002 is not available due to a new presentation of FY 2004 and FY 2003 financial statements, which depicts Post-Employment Healthcare Benefit Plan Net Assets separately. FY 2002 plan net assets financial statements were a combined presentation of the Defined Benefit Pension Benefit Plan and Post-Employment Healthcare Benefit Plan.

Expenses (Deductions From Plan Assets)

Defined Benefit Pension Plan

As of June 30, 2004, expenses totaled $187.9 million, a $22.9 million increase (13.91%), compared to FY 2003 expenses of $164.9 million. In FY 2003, SDCERS experienced a -0.25% decline in expenses ($-.4 million) over FY 2002 expenses of $165.4 million. (FY 2002 expenses include $8.9 million in health insurance payments.) FY 2004 and 2003 financial statements report health insurance payments separately as an expense of the Post-Employment Healthcare Benefit Plan.

Post-Employment Healthcare Benefit Plan

As of June 30, 2004, expenses totaled $13.1 million, an increase of $1.4 million (11.82%), as compared to FY 2003 expenses of $11.7 million. Comparative expense data for FY 2003 versus FY 2002 is not available due to new presentation of FY 2004 and FY 2003 financial statements, which depicts Post-Employment Healthcare Benefit Plan Assets separately. FY 2002 plan net assets financial statements were a combined presentation of the Defined Benefit Pension Benefit Plan and the Post-Employment Healthcare Benefit Plan.

SDCERS' Funded Status

Defined Benefit Pension Plan

SDCERS Board's funding objective is to meet the long-term benefit obligations through contributions and earnings on invested assets. SDCERS currently has three plan sponsors (employers). Actuarial valuations are performed for each plan sponsor annually as of June 30th. Valuations are presented to SDCERS' Board for review and approval. Dividing the Actuarial Value of Assets (AVA) by the Actuarial Accrued Liabilities (AAL) provides for a funded ratio, which is a measure of funded status. An Unfunded Actuarial Accrued Liability (UAAL) results when the AVA is less than the AAL. Mathematically, changes in funded status can be caused by increases or decreases in the AVA or by increases or decreases in the AAL, resulting in actuarial gains and losses.

As of June 30, 2003, the date of the last actuarial valuation, the City of San Diego's (City) SDCERS' funded status was 67.2%. This means that for every dollar of benefits due (all vested liabilities), the City (SDCERS) had approximately $0.672 in assets available for payment, if all vested benefits were due and payable on that date. The City's SDCERS' funded status as of the June 30, 2002, actuarial valuation was 13.0% stronger at 77.3% funded.

As of June 30, 2003, the date of the last actuarial valuation, the Unified Port of San Diego's (Port) SDCERS' funded status was 80.3%. This means that for every dollar of benefits due (all vested liabilities), the Port (SDCERS) had approximately $0.803 in assets available for payment, if all vested benefits were due and payable on that date. The Port's SDCERS' funded status as of the December 31, 2002, (interim) actuarial valuation was 11.8% stronger at 91.1% funded.

As of June 30, 2003, the date of the last actuarial valuation, the San Diego County Regional Airport Authority's (Airport) SDCERS' funded status was 68.4%. This means that for every dollar of benefits due (all vested liabilities), the Airport (SDCERS) had approximately $0.684 in assets available for payment, if all vested benefits were due and payable on that date. The Airport's SDCERS' funded status as of the December 31, 2002, (interim) actuarial valuation was 28.5% stronger at 95.7% funded. The Airport's SDCERS' funded status decreased significantly as a result of a $2 million net actuarial loss experienced since the last actuarial valuation period (as compared to an AVA totaling $16.3 million) combined with changes in the actuarial assumptions. In addition, The Airport's SDCERS' members (employees) were granted a benefit enhancement, effective as of April 1, 2004, that was incorporated into the June 30, 2003, actuarial valuation, which increased the AAL and further decreased the Airport's SDCERS' funded status. After June 30, 2004, the Airport made significant additional plan sponsor (employer) contributions in an attempt to increase the Airport's SDCERS' funded status to 95%. These additional contributions will be included in the Airport's AVA in the June 30, 2005, actuarial valuation.

SDCERS' plan sponsors (employers) have experienced a decline in their SDCERS' funded status in recent years. This is due to increases in liabilities caused by litigated and negotiated increases in member (employee) benefits (an actuarial loss) and decreases in the AVA resulting from investment experience losses during the five-year period ended June 30, 2004 where on average the System earned less than the actuarially assumed 8% rate of return (another actuarial loss).

Additionally, the City has made fixed-rate employer contributions to SDCERS at an amount less than recommended each year by the actuary over the past several years which has further decreased the City's AVA and contributed to the decline in the City's SDCERS' funded status. The Port and the Airport make annual plan sponsor (employer) contributions in accordance with Annual Required Contributions (ARC) as determined by SDCERS' actuary. Ten years of historical funded status information for the City and the Port and two valuations periods for the Airport, are located in the Required Supplementary Information in the Financial Section with associated commentary located in the Notes to the Schedules of Funding Progress. Additional information is presented in the Actuarial Section.

Post-Employment Healthcare Benefit Plan

As of June 30, 2004, there had been no actuarial valuations performed regarding the funded status of this single-employer (City) SDCERS' administered plan. In accordance with GASB Statement No. 26, the Governmental Accounting Standards Board set forth policy that plans should report healthcare assets and related liabilities separate from pension assets, revenues, liabilities and expenses. GASB Statement No. 12 *Disclosure of Information on Postemployment Benefits Other Than Pension Benefits by State and Local Governmental Employers*, which came before GASB Statement No. 26, does not require the calculation of actuarially determined information, but states that plan sponsors (employers) shall disclose certain actuarially determined information about post-employment benefits if that information is available. GASB Statement No. 43 *Financial Reporting for Post-Employment Benefit Plans Other Than Pension Plans*, issued in April 2004, with implementation for SDCERS beginning in FY 2007 (July 1, 2006), will require a minimum of three years of actuarial valuations for the Post-Employment Healthcare Benefit Plan to be presented in the Required Supplementary Information in SDCERS' CAFR. In March 2006, the City of San Diego completed its first actuarial valuation for the Post-Employment Healthcare Benefit Plan as of June 30, 2005, results of which will be disclosed in the FY 2005 CAFR.

Overview of Financial Statements

The following discussion and analysis is intended to serve as an introduction to SDCERS' audited financial statements. They are comprised of the following items:

1. Statement of Plan Net Assets
2. Statement of Changes in Plan Net Assets
3. Summary of Significant Accounting Policies
4. Notes to the Financial Statements
5. Required Supplementary Information
6. Other Required Supplementary Information - Supporting Schedules

The Statement of Plan Net Assets is a balance sheet presentation of assets and liabilities for both Trust Funds at fiscal year end, the Defined Benefit Pension Plan and the Post-Employment Healthcare Benefit Plan. It discloses the assets available for future payments of benefits to retirees and beneficiaries and current liabilities that are owed as of June 30. This Statement presents comparative balances for Fiscal Years 2004 and 2003.

The Statement of Changes in Plan Net Assets provides a view of current year additions to and deductions from plan assets for both Trust Funds at fiscal year end, the Defined Benefit Pension Plan and the Post-Employment Healthcare Benefit Plan, in an income statement presentation. Two years of comparative results, for Fiscal Years 2004 and 2003, are presented.

Both Statements are in compliance with GASB Statement No.'s 3, 5, 12, 25, 26, 28, 31, and 41. These pronouncements require certain disclosures and require State and Local Governments to use the full accrual method of accounting. SDCERS complies with all material requirements of these accounting standards. SDCERS will implement GASB Statement No. 43 *Financial Reporting for Postemployment Plans Other Than Pensions* (which supercedes GASB Statement No. 12 *Disclosure of Information on Post-Employment Benefits Other Than Pension Benefits by State and Local Governmental Employers* and the interim guidance from GASB Statement No. 26 Financial reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans) beginning in FY 2007, which begins July 1, 2006.

The Statement of Plan Net Assets and the Statement of Changes in Plan Net Assets report information about SDCERS' financial activities. These Statements include all assets and liabilities and were prepared using the accrual basis of accounting. All investment gains and losses are shown on a trade date basis using market and appraised values, and all fixed assets are depreciated over their useful lives. Responsibility for the accuracy, completeness, and fair presentation of this information, and all disclosures, rests with SDCERS' executive management team. The audited financial statements are located in the Financial Section.

The Summary of Significant Accounting Policies provides information on the assumptions and methods used in the presentation of figures in SDCERS' financial statements. It also provides for the basis for accounting treatment of stated values under Generally Accepted Accounting Principles (GAAP) in the United States and accounting practices used that are unique to a Public Employees Retirement System (PERS). The Summary of Significant Accounting Policies is located in the Financial Section before the Notes to the Financial Statements.

The Notes to the Financial Statements provide additional information that is essential to a full understanding of the data presented in the audited financial statements. This section provides a quantitative and qualitative basis for assessing SDCERS' financial condition. The Notes to the Financial Statements are located in the Financial Section.

Required Supplementary Information provides information and details concerning plan sponsors' (employers') progress in funding their obligations (see Schedules of Funding Progress), and contains the Schedules of Plan Sponsors' (Employers') Contributions and Notes that accompany each of these schedules. This information is located after the Notes to the Financial Statements in the Financial Section.

Other Required Supplementary Information - Supporting Schedules includes a Budgetary Comparison Schedule, a Schedule of Administrative Expenses (SDCERS' organizational expenses), a Schedule of Fees Paid to Investment Professionals, and a Schedule of Payments to Consultants. All Supporting Schedules are included after the Required Supplementary Information in the Financial Section.

Financial Analysis

SDCERS' financial position is measured in several ways. One example is the plan net assets (difference between total assets and total current liabilities) available to pay benefits. This measurement is performed at fiscal year end. Over time, an increase or decrease in SDCERS' plan net assets is one indicator of whether its financial condition is improving or deteriorating. Other factors, such as financial market conditions, should also be taken into consideration when measuring SDCERS' overall financial condition..

Defined Benefit Pension Plan

SDCERS' plan net assets held in trust for the payment of defined benefit pension benefits as of June 30, 2004, totaled $3.084 billion as compared to plan net assets of $2.520 billion as of June 30, 2003, a 22.35% increase. FY 2003 plan net assets were 3.70% higher than FY 2002 plan net assets of $2.430 billion. All of the plan net assets are available to meet SDCERS' ongoing retirement and disability payment obligations to members, retirees and beneficiaries. A comparative summary of this information is depicted in Table 1.

FINANCIAL SECTION

Table 1: Defined Benefit Pension Plan Net Assets

	2004	2003	Increase/ (Decrease)	Percentage Change	2003	2002[1]	Increase/ (Decrease)	Percentage Change
Cash and Cash Equivalents	$334,714,816	$290,177,426	$44,537,390	15.35%	$290,177,426	$243,596,793	$46,580,663	19.12%
Receivables	43,237,013	26,489,723	16,747,290	63.22%	26,489,723	24,300,193	2,189,530	9.01%
Securities Sold	44,965,113	50,803,727	(5,838,614)	-11.49%	50,803,727	47,377,501	3,426,226	7.23%
Investments, at Fair Value	2,937,694,387	2,390,750,008	546,944,379	22.88%	2,390,750,008	2,294,484,890	96,265,118	4.20%
Securities Lending Cash Collateral	319,748,403	209,549,322	110,199,081	52.59%	209,549,322	163,484,036	46,065,286	28.18%
Properties at Cost plus Pre-paid Expenses	193,471	244,552	(51,081)	-20.89%	244,552	291,785	(47,233)	-16.19%
Total Assets	$3,680,553,203	$2,968,014,758	$712,538,445	24.01%	$2,968,014,758	$2,773,535,198	$194,479,560	7.01%
Current Liabilities	191,483,693	140,637,794	50,845,899	36.15%	140,637,794	101,146,329	39,491,465	39.04%
Securities Purchased	85,658,151	97,539,816	(11,881,665)	-12.18%	97,539,816	78,444,557	19,095,259	24.34%
Securities Lending Obligations	319,748,403	209,549,322	110,199,081	52.59%	209,549,322	163,484,036	46,065,286	28.18%
Total Liabilities	$596,890,247	$447,726,932	$149,163,315	33.32%	$447,726,932	$343,074,922	$104,652,010	30.50%
Plan Net Assets Held in Trust for Payment of Defined Benefit Pension Benefits	**$3,083,662,956**	**$2,520,287,826**	**$563,375,130**	**22.35%**	**$2,520,287,826**	**$2,430,460,276**	**$89,827,550**	**3.70%**

[1] FY 2002 Defined Benefit Pension Plan Net Assets states values for the entire SDCERS' Trust Fund. Post-Employment Healthcare Benefit Plan Assets were not separated from Defined Benefit Pension Plan Assets until FY 2004 with comparative data restated for FY 2003 only.

Post-Employment Healthcare Benefit Plan

SDCERS' plan net assets held in trust for the payment of post-employment healthcare benefits as of June 30, 2004, totaled $9.1 million compared to plan net assets of $21.8 million as of June 30, 2003, a 58.36% decrease. Comparative data for FY 2002 is not available because Post-Employment Healthcare Benefit Plan Net Assets were combined with SDCERS' Defined Benefit Pension Plan Net Assets in FY 2002. All of the plan net assets are available to meet SDCERS' ongoing healthcare benefit payments to City health-eligible retirees. A comparative summary of this information is depicted in Table 2.

Table 2: Post-Employment Healthcare Benefit Plan Net Assets[1]

	2004	2003	Increase/ (Decrease)	Percentage Change
Pooled Investments	$9,136,409	$21,867,112	$(12,730,703)	-58.22%
Total Assets	9,136,409	21,867,112	(12,730,703)	-58.22%
Current Liabilities	52,887	55,285	(2,398)	-4.34%
Total Liabilities	52,887	55,285	(2,398)	-4.34%
Plan Net Assets Held in Trust for Payment of Post-Employment Healthcare Benefits	**$9,083,522**	**$21,811,827**	**$(12,728,305)**	**-58.36%**

[1] Post-Employment Healthcare Benefit Plan Net Assets was combined with SDCERS' Defined Benefit Pension Plan Net Assets in FY 2003 and FY 2002; therefore, comparative data for FY 2002 is not available and FY 2003 has been restated for comparison purposes only.

Despite the financial market volatility experienced over the last decade, SDCERS' management team and SDCERS' actuary believe that SDCERS' plan sponsors (employers) are in an adequate financial position to meet the current financial obligations of SDCERS' members, retirees and beneficiaries. SDCERS' financial condition (as measured by the funded status) is expected to improve over time with the receipt of increased employer contributions made by plan sponsors (employers) and consistent investment earnings. The current year increase in plan net assets is the result of strategic planning by SDCERS' Board and a successful long-term investment program.

Reserves

Pension plans may establish reserves to earmark plan net assets for various categories of anticipated liabilities. SDCERS' reserves have been established to account for employer and employee contributions, the accumulation of deferred retirement option benefits, the accumulation of current retired members' expected benefits and other various items. Reserves are credited or adjusted each fiscal year end with realized earnings and/or net plan assets valued on a cost basis.

The largest reserve balances are for accumulated benefits payable to retired members of SDCERS. These comprise approximately 61% of plan assets ($1.69 billion reserved out of $2.76 billion in total reserves) as of June 30, 2004; approximately 56% of plan assets ($1.41 billion reserved out of $2.51 billion in total reserves) as of June 30, 2003; and approximately 49% of plan assets ($1.29 billion reserved out of $2.63 billion in total reserves) as of June 30, 2002. A complete listing of SDCERS' reserves and comparative balances for the Fiscal Years 2004 and 2003 can be found in the Notes to the Financial Statements in the Financial Section.

FINANCIAL SECTION

Current Year Results

A strong recovery in the financial markets improved SDCERS' investment earnings and added to current year revenues (additions). These additions were in excess of increases in current year benefit payments and expenses (deductions), providing for an overall increase in plan net assets over FY 2003. Key elements of FY 2004's results and year-over-year comparisons are summarized below.

Revenues – Additions to Plan Assets

Revenues needed to pay current retirement benefits and accrue for future retirement benefits are accumulated through the collection of plan sponsor (employer) and member (employee) contributions and the earnings on invested assets (net of investment management fees and related expenses).

Defined Benefit Pension Plan

Total additions for FY 2004, were $751.3 million (see summary in Table 3). FY 2004's additions can be compared to additions for FY 2003 of $286.8 million and FY 2002, of $56.8 million. Comparing results for FY 2004 to FY 2003 and FY 2003 to FY 2002, illustrates that in both instances SDCERS experienced increasing additions year-over-year.

Table 3: Defined Benefit Pension Plan Contributions and Investment Earnings

	2004	2003	Increase/ (Decrease)	Percentage Change	2003	2002[2]	Increase/ (Decrease)	Percentage Change
Employers' Contributions	$87,861,650	$72,558,680	$15,302,970	21.09%	$72,558,680	$49,962,365	$22,596,315	45.23%
Members' (Employees') Contributions Paid by Employers	33,951,427	31,606,145	2,345,282	7.42%	31,606,145	28,794,143	2,812,002	9.77%
Members' (Employees') Contributions	16,299,646	20,917,653	(4,618,007)	-22.08%	20,917,653	24,192,104	(3,274,451)	-13.54%
Members' (Employees') Contributions for Purchased Service Credit	75,419,976	40,016,896	35,403,080	88.47%	40,016,896	29,353,981	10,662,915	36.33%
Earned Interest on Purchased Service Installment Contracts	907,814	477,758	430,056	90.02%	477,758	-	477,758	-
Total Net Investment Earnings[1]	536,820,063	121,233,856	415,586,207	342.80%	121,233,856	(75,934,760)	197,168,616	259.66%
Other Income	-	-	-	n/a	-	459,087	(459,087)	-100.00%
Total Additions (Revenues)	**$751,260,576**	**$286,810,988**	**$464,449,588**	**161.94%**	**$286,810,988**	**$56,826,920**	**$229,984,068**	**404.71%**

[1] Stated net of investment expenses of $14,781,389, $11,956,062 and $11,273,944 for FY 2004, FY 2003, and FY 2002, respectively.

[2] FY 2002 Additions are for the entire SDCERS' Trust Fund as Post-Employment Healthcare Benefit Plan Assets were not separated from Defined Benefit Pension Plan Assets until FY 2004 with comparative data provided for FY 2003 only.

FY 2004 plan sponsors' (employers') contributions totaled $87.9 million, an increase of $15.3 million (21.09%) compared to employers' contributions of $72.6 million in FY 2003. This is in comparison to a 45.23% prior year increase, or $22.6 million, over FY 2002's contributions of $50.0 million. The recent increases in plan sponsors' (employers') contributions are due to increased plan sponsor (employer) contributions made by the City pursuant to a contribution agreement, dated November 18, 2002, (*2002 Contribution Agreement*) and due to recent increases in Annual Required Contributions (ARC) made by the Port and the Airport due to decreases in their SDCERS' funded status. For further information regarding the *2002 Contribution Agreement*, please see Note 6, *Contributions Required and Contributions Made* in the Notes to Financial Statements and the Schedule of Plan Sponsors' (Employers') Contributions in the Required Supplementary Information, in the Financial Section.

In FY 2004, members' (employees') contributions paid by plan sponsors (employers) totaled $33.9 million, an increase of $2.3 million (7.42%) over members' (employees') contributions paid by plan sponsors (employers) of $31.6 million in FY 2003. FY 2003's contributions increased by $2.8 million (9.77%) in FY 2003 compared to members' (employees') contributions paid by plan sponsors (employers) of $28.8 million in FY 2002. Increases in members' (employees') contributions paid by plan sponsors (employers) were due to normal salary increases and increased plan sponsor (employer) paid share of members' (employees') contributions that were negotiated by labor unions and bargaining units in recent years.

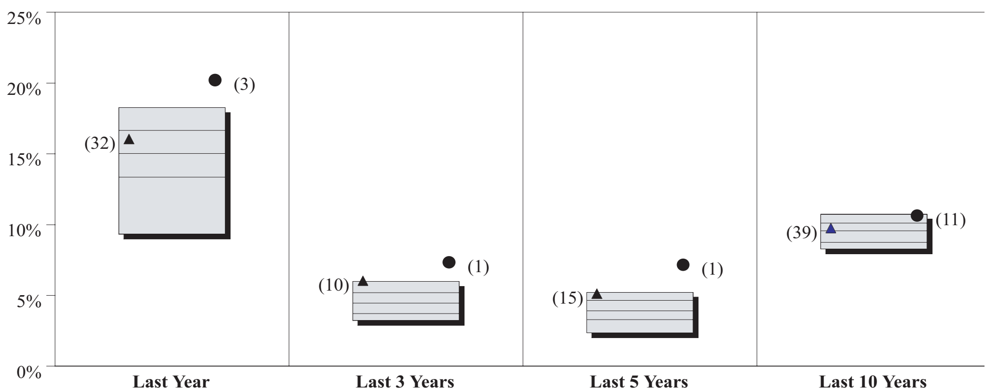
Members' (employees') contributions totaled $16.3 million, a decrease of 22.08%, or -$4.6 million, in FY 2004 as compared to members' (employees') contributions of $20.9 million in FY 2003. This is compared to a 13.54% decrease, or -$3.3 million, in FY 2003, as compared to members' (employees') contributions of $24.2 million in FY 2002. Decreases in members' (employees') contributions from FY 2003 to FY 2004 occurred as a result of increases in members' (employees') contributions paid by plan sponsors (employers).

Additionally, members' (employees') contributions for purchased service credit totaled $75.4 million, an increase of 88.47%, or $35.4 million, in FY 2004 as compared to members' (employees') contributions for purchased service credit of $40.0 million in FY 2003. This is compared to a 36.33% increase, or $10.7 million, in FY 2003 as compared to member contributions of $29.3 million in FY 2002. Year-over-year increases in members' (employees') contributions were due to increased participation in the purchase of service credit program by members (employees). SDCERS' Board increased the cost to purchase service effective November 2003. For further information on the pricing of the purchase of service credit program, see *Note 6 Contributions Required and Contributions Made* in the Notes to the Financial Statements.

The fair value of invested assets improved as of June 30, 2004, to significantly exceed the cost basis of invested assets. In FY 2004, net investment earnings totaled $536.8 million, an increase of 342.80%, or $415.6 million, over FY 2003. FY 2003 results were also positive when net investment earnings totaled $121.2 million, an increase of 259.66%, or $197.2 million, as compared to negative results in FY 2002. Investment losses of -$75.9 million were experienced by SDCERS in FY 2002. FY 2002 investment results include investment earnings for both the Defined Benefit Pension Plan and Post-Employment Healthcare Benefit Plan. The financial markets have continued to strengthen over the past eighteen months, which further provided for the significant improvement in SDCERS' investment earnings in the current fiscal year.

According to Callan Associates, SDCERS' investment consultant, SDCERS' one-year investment performance as of June 30, 2004, was +20.21%, as compared to +5.44% as of June 30, 2003. The one-year return in FY 2002 was -2.40%. Compared to other public plans, SDCERS had top decile investment performance (top 10% of public pension funds in the Callan Associates database) over one-, three-, and five-year periods. SDCERS ranked in the third percentile for one-year performance as of June 30, 2004, and in the first percentile for three-year and five-year annualized investment performance. Over a ten-year period, SDCERS' investment performance ranked in the eleventh percentile earning an annualized return of 10.65%.

Performance vs CAI Public Fund Sponsor Database



	Last Year	Last 3 Years	Last 5 Years	Last 10 Years
10th Percentile	18.27	5.99	5.22	10.74
25th Percentile	16.67	5.20	4.65	10.12
Median	15.02	4.46	3.92	9.56
75th Percentile	13.36	3.71	3.29	8.75
90th Percentile	9.33	3.23	2.36	8.28
SDCERS' Total Fund ●	20.21	7.35	7.18	10.65
SDCERS' Performance Benchmark ▲	16.05	6.04	5.13	9.75

A report on investment activity provided by Callan Associates, is included in the Investment Section. It provides commentary on SDCERS' specific asset class investment returns, index returns and peer groups' performance. The Investment Section also includes the investment performance for FY 2004 compared to FY 2003, with an additional comparison to SDCERS' long-term investment performance.

Expenses – Deductions from Plan Assets

SDCERS administers lifetime retirement annuities, survivor benefits, permanent disability benefits and other post-employment benefits such as a health benefit plan for health-eligible SDCERS' retirees (former City of San Diego employees). The cost of such programs include: recurring benefit and health insurance payments, refunds of contributions to terminated members (employees), and the cost of administering SDCERS.

Defined Benefit Pension Plan

Total deductions for the FY 2004 totaled $187.9 million (see Table 4). Deductions for FY 2003 totaled $164.9 million and for FY 2002 totaled $165.4 million. (FY 2002 expenses include health insurance payments totaling $8.9 million as all plan net assets, including all additions to and deductions from pension and healthcare benefits were reported together.)

Table 4: Defined Benefit Pension Plan Payments and Other Expenses

	2004	2003	Increase/ (Decrease)	Percentage Change	2003	2002[1]	Increase/ (Decrease)	Percentage Change
Retirement and Disability Allowances and Other Benefit Payments	$161,658,640	$146,396,141	$15,626,499	10.43%	$146,396,141	$141,037,774	$5,356,367	3.80%
Health Insurance Payments[2]	-	-	-	-	-	8,882,138	8,882,138	-
Refunds of Members' Contributions	2,108,909	1,378,787	730,122	52.95%	1,378,787	994,740	384,047	38.61%
Administrative Expenses	9,888,752	7,886,427	2,002,325	25.39%	7,886,427	7,866,835	19,592	0.25%
DROP Program Interest Expenses	12,735,149	9,218,281	3,516,868	38.15%	9,218,281	6,424,652	2,793,629	43.48%
Litigation Settlement Expense	1,249,292	-	1,249,292	-	-	-	-	-
Allowance for Uncollectable Purchased Service Payments	244,704	68,693	176,011	256.23%	68,693	147,913	(79,220)	-53.56%
Total Deductions (Expenses)	**$187,885,446**	**$164,948,329**	**$22,937,117**	**13.91%**	**$164,948,329**	**$165,354,052**	**$(405,723)**	**-0.25%**

[1] FY 2002 Deductions are for the entire SDCERS' Trust Fund as Post-Employment Healthcare Benefit Plan Assets were not separated from Defined Benefit Pension Plan Assets until FY 2004 with comparative data provided for FY 2003 only.

[2] All expenses of SDCERS, including Health Insurance Payments, were reported together in FY 2002, and are therefore included in this table as an Deduction/Expense.

In FY 2004, retirement, disability allowances and other benefit payments totaled just under $161.7 million, which was an 10.43% increase, or $15.3 million, as compared to FY 2003's payments of $146.4 million. FY 2003's retirement and disability allowances and other benefit payments were 3.80% greater ($5.4 million) than similar payments in FY 2002, which totaled $141.0 million.

In FY 2004, refunds of members' contributions totaled $2.1 million, which was a 52.95% increase ($0.7 million) compared to FY 2003, in which refunds of members' contributions totaled $1.4 million. FY 2003 refunds of members' contributions increased by 38.61%, or $0.4 million over refunds of members' contributions in FY 2002, which totaled just under $1.0 million.

FY 2004 administrative expenses totaled $9.88 million, an increase of 25.39%, or $2.0 million over FY 2003, in which administrative expenses totaled $7.88 million. FY 2003 administrative expenses increased by 0.3%, or just under $20 thousand compared to FY 2002's administrative expenses of $7.86 million. FY 2004 included a one-time litigation settlement expense accrual of just under $1.3 million in payment of SDCERS' portion of attorney and legal fees awarded to the plaintiff for the Gleason Settlement, which was paid in FY 2005.

Coverage - Total Revenues as Compared to Total Expenses

As depicted in Table 5, FY 2004 revenues (additions) of $751.3 million provided nearly four times coverage, or 399.48%, of current year expenses (deductions) of $187.9 million, as of June 30, 2004. In FY 2003, revenues (additions) of $286.8 million provided just under two times coverage, or 173.88%, of prior year's expenses (deductions) of $164.9 million, as of June 30, 2003. In FY 2004 and FY 2003, SDCERS experienced an overall increase of $563.4 million and $121.9 million in plan net assets, respectively. These results are a significant improvement over FY 2002 when additions of $56.8 million covered only one-third, or 34.37%, of FY 2002's deductions of $165.4 million, resulting in an overall net reduction of -$108.5 million in plan net assets.

Table 5: Increase (Decrease) in Defined Benefit Pension Plan Net Assets

	2004	2003	Increase/ (Decrease)	Percentage Change	2003	2002[1]	Increase/ (Decrease)	Percentage Change
Total Additions - Revenues (Table 3)	$751,260,576	$286,810,988	$464,449,588	161.94%	$286,810,988	$56,826,920	$229,984,068	404.71%
Less Total Deductions - Expenses (Table 4)	187,885,446	164,948,329	22,937,117	13.91%	164,948,329	165,354,052	(405,723)	-0.25%
Net Increase (Decrease) in Defined Benefit Pension Plan's Net Assets	**$563,375,130**	**$121,862,659**	**$441,512,471**	**362.30%**	**$121,862,659**	**$(108,527,132)**	**$230,389,791**	**212.29%**
Revenues as a Percentage of Current Year Expenses	399.85%	173.88%			173.88%	34.37%		

[1] FY 2002 Deductions are for the entire SDCERS' Trust Fund as Post-Employment Healthcare Benefit Plan Assets were not separated from Defined Benefit Pension Plan Assets until FY 2004 with comparative data provided for FY 2003 only.

Revenues (Additions), Expenses (Deductions) and Changes in Plan Net Assets

Post-Employment Healthcare Benefit Plan

FY 2004 total additions were just under $0.4 million compared to FY 2003, in which additions totaled $1.5 million, a 74.85% decrease, or -$1.1 million. Additions consist entirely of net investment earnings on Post-Employment Healthcare Benefit Plan assets. No plan sponsor (employer) or member (employee) contributions were made to this plan; this plan has been historically funded from SDCERS' investment earnings. The City did not make additional contributions to the plan in FY 2004, allowing benefits to be paid from the carryover balance from FY 2003 and in anticipation of funding healthcare benefits directly in FY 2005. Beginning in FY 2005, the City has funded this plan in cash from the City's annual budget.

FY 2004 total deductions were $13.1 million an 11.82% increase ($1.4 million) over FY 2003's deductions of $11.7 million. SDCERS experienced increases in the cost of health insurance benefits year-over-year, as did many public and corporate retirement plans that administer post-employment benefits. FY 2004 health insurance payments totaled $12.8 million compared to FY 2003's payments of $11.4 million, a 10.75% increase.

Table 6: Changes in Post-Employment Healthcare Benefit Plan Net Assets[1]

	2004	2003	Increase/ (Decrease)	Percentage Change
Total Net Investment Earnings[2]	$376,109	$1,495,696	$(1,119,587)	-74.85%
Total Additions (Revenues)	$376,109	$1,495,696	$(1,119,587)	-74.85%
Health Insurance Payments[3]	$12,829,903	$11,450,200	$1,379,703	10.75%
Administrative Expenses	274,511	268,778	5,733	2.09%
Total Deductions (Expenses)	$13,104,414	$11,718,978	$1,385,436	11.82%
Transfer of Plan Net Assets	-	$14,317,073	$(14,317,073)	100.00%
Net Increase (Decrease) in Post-Employment Healthcare Benefit Plan's Net Assets	**$(12,728,305)**	**$(10,223,282)**	**$2,505,023**	**24.50%**

1 The accounting for Post-Employment Healthcare Benefit Plan Net Assets was combined with SDCERS' Defined Benefit Pension Plan Net Assets in FY 2002; therefore, Post-Employment Healthcare Benefit Plan comparative data for FY 2002 is not available.

2 Stated net of investment expenses of $77,846 and $92,238 for FY 2004 and FY 2003, respectively.

3 FY 2002 Post-Employment Healthcare Benefits Payments of $8,882,138 are depicted in Table 4.

FINANCIAL SECTION

Requests for Information

This CAFR is designed to provide a general overview of SDCERS' financial condition and to show an accounting of funds received and payments disbursed.

It is available in its entirety on SDCERS' Web site (in Adobe Acrobat Portable Document Format) at www.sdcers.org.

Questions concerning any of the information provided in this CAFR should be addressed to:

San Diego City Employees' Retirement System (SDCERS)
401 B Street, Suite 400
San Diego, California 92101-4298
(619) 525-3600 or Toll Free (800) 774-4977

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF PLAN NET ASSETS

For the Years Ended June 30, 2004 and June 30, 2003

	2004		2003	
	Defined Benefit Pension Plan	Post-Employment Healthcare Benefit Plan	Defined Benefit Pension Plan	Post-Employment Healthcare Benefit Plan
ASSETS				
Cash and Cash Equivalents				
Cash or Equity in Pooled Cash and Investments with the City of San Diego	$3,642,648	-	$3,044,096	-
Cash on Deposit with Custodial Bank and Fiscal Agents	302,744,374	-	230,806,228	-
Cash Equivalents on Deposit with Custodial Bank	37,464,203		78,194,214	
Pooled Investments	(9,136,409)	$9,136,409	(21,867,112)	$21,867,112
Total Cash and Cash Equivalents	334,714,816	9,136,409	290,177,426	21,867,112
Receivables				
Plan Sponsors' (Employers') and Members' (Employees') Contributions	9,743,298		6,477,813	
Members' (Employees') - Purchased Service Payments	22,604,172		10,614,307	
Accrued Interest Receivable	10,773,396		9,267,520	
Accrued Interest on Investments Purchased	116,147		130,083	
Securities Sold	44,965,113		50,803,727	
Total Receivables	88,202,126	-	77,293,450	-
Investments, at Fair Value				
Short-Term Investments	214,401,018		70,934,651	
Domestic Fixed Income Securities	468,962,285		465,657,992	
International Fixed Income Securities	148,758,686		118,326,432	
Domestic Equity Securities	1,296,359,749		1,122,227,510	
International Equity Securities	531,526,719		382,783,361	
Mortgages	17,022		668,621	
Directly-Owned Real Estate Assets and Real Estate Equity Securities	277,668,908		230,151,441	
Total Investments	2,937,694,387	-	2,390,750,008	-
Securities Lending Cash Collateral	319,748,403		209,549,322	
Total Investments Including Securities Lending Cash Collateral	3,257,442,790	-	2,600,299,330	-
Prepaid Expenses	2,522		53,568	
Properties at cost, net of accumulated depreciation of $204,218 and $128,574, respectively	190,949	-	190,984	-
TOTAL ASSETS	**$3,680,553,203**	**$9,136,409**	**$2,968,014,758**	**$21,867,112**
LIABILITIES				
Accounts Payable	$438,653		$330,379	
Investment Related Fees Payable	3,482,179	$18,202	2,597,209	$19,890
Litigation Settlement Payable	1,249,292	-	-	-
Accrued Payroll	247,111	7,109	226,313	8,264
Accrued Annual Leave and Sick Leave	374,219	10,765	322,118	11,762
DROP Program Liability	185,107,857		136,740,861	
Pension Liability	503,117	14,473	404,281	14,762
Employee Pension Liability	81,265	2,338	16,633	607
Securities Purchased	85,658,151		97,539,816	
Securities Lending Obligations for Cash Collateral	319,748,403		209,549,322	
TOTAL LIABILITIES	**$596,890,247**	**$52,887**	**$447,726,932**	**$55,285**
NET ASSETS HELD IN TRUST FOR PAYMENT OF PENSION AND POST-EMPLOYMENT HEALTHCARE BENEFITS	**$3,083,662,956**	**$9,083,522**	**$2,520,287,826**	**$21,811,827**

For a full understanding of the Statement of Plan Net Assets, please see the accompanying Summary of Significant Accounting Policies and Notes to the Financial Statements, which follow. A Schedule of Funding Progress for each plan sponsor is presented in the Required Supplementary Information section which follows the Notes to the Financial Statements.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF CHANGES IN PLAN NET ASSETS

For the Years Ended June 30, 2004 and June 30, 2003

	2004		2003	
	Defined Benefit Pension Plan	Post-Employment Healthcare Benefit Plan	Defined Benefit Pension Plan	Post-Employment Healthcare Benefit Plan
ADDITIONS				
Contributions				
City of San Diego (City)				
Plan Sponsor (Employer)	$81,832,070		$70,099,844	
Members' (Employees') Portion Paid by Plan Sponsor (Employer)	30,204,840		28,573,503	
Members' (Employees')	14,179,107		17,719,691	
Members' (Employees') for Purchased Service	72,956,979		40,016,896	
Total City Contributions	199,172,996	-	156,409,934	-
Unified Port of San Diego (Port)				
Plan Sponsor (Employer)	4,594,580		2,210,040	
Members' (Employees') Portion Paid by Plan Sponsor (Employer)	2,692,191		2,682,984	
Members' (Employees')	1,639,724		3,054,333	
Members' (Employees') for Purchased Service	1,975,378		-	
Total Port Contributions	10,901,873	not applicable	7,947,357	not applicable
San Diego County Regional Airport Authority (Airport)				
Plan Sponsor (Employer)	1,435,000		248,796	
Members' (Employees') Portion Paid by Plan Sponsor (Employer)	1,054,396		349,658	
Members' (Employees')	480,815		143,629	
Members' (Employees') for Purchased Service	487,619		-	
Total Airport Contributions	3,457,830	not applicable	742,083	not applicable
Earned Interest on Purchased Service Installment Contracts	907,814		477,758	
Total Contributions	214,440,513	not applicable	165,577,132	not applicable
Investment Earnings				
Net Appreciation (Depreciation) in Fair Value of Investments				
Equity (Stocks)	422,170,111	-	20,522,780	-
Fixed Income (Bonds)	8,255,601		39,613,342	
Mortgages	3,462		-	
Real Estate Equity and Real Estate Securities (Stocks)	39,334,565		(4,601,189)	
Total Net Appreciation (Depreciation) in Fair Value of Investments	469,763,739	-	55,534,933	-
Investment Income				
Equity (Stocks) - Dividends, Litigation Settlements	35,795,193		31,877,448	
Fixed Income (Bonds) - Interest	34,929,745		33,395,889	
Mortgages - Income	52,221		122,668	
Real Estate - Income	10,636,311		13,078,668	
Proportionate Share of Health Reserve Earnings	(453,955)	$453,955	(1,587,934)	$1,587,934
Total Investment Income	80,959,515	453,955	76,886,739	1,587,934
Less Investment Expenses	(14,781,389)	(77,846)	(11,956,062)	(92,238)
Total Net Investment Income	535,941,865	376,109	120,465,610	1,495,696
Securities Lending Income				
Gross Earnings	3,410,299		3,178,333	
Borrower Rebates	(2,168,167)		(2,089,142)	
Administrative Expenses (Lending Agent)	(363,934)		(320,945)	
Net Securities Lending Income	878,198	-	768,246	-
Total Net Investment Earnings	536,820,063	376,109	121,233,856	1,495,696
TOTAL ADDITIONS	**$751,260,576**	**$376,109**	**$286,810,988**	**$1,495,696**

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF CHANGES IN PLAN NET ASSETS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

	2004		2003	
	Defined Benefit Pension Plan	Post-Employment Healthcare Benefit Plan	Defined Benefit Pension Plan	Post-Employment Healthcare Benefit Plan
DEDUCTIONS				
Benefit Payments				
Monthly Retirement and Disability Allowances	$161,056,037		$145,986,753	
Health Insurance Payments	-	$12,829,903	-	$11,450,200
Corbett / Andrecht Benefit Payments	-		1,453	
DROP Payments	-		-	
Death Benefit Payments	602,603		407,935	
Total Benefit Payments	161,658,640	12,829,903	146,396,141	11,450,200
Refunds of Members' (Employees') Contributions	2,108,909		1,378,787	
Administrative Expenses	9,888,752	274,511	7,886,427	268,778
Drop Program Interest Expense	12,735,149	-	9,218,281	-
Litigation Settlement Expense	1,249,292		-	
Allowance for Uncollectable Purchased Service Payments	244,704		68,693	
TOTAL DEDUCTIONS	**$187,885,446**	**$13,104,414**	**$164,948,329**	**$11,718,978**
NET ASSETS HELD IN TRUST FOR PAYMENT OF PENSION AND POST-EMPLOYMENT HEALTHCARE BENEFITS				
BEGINNING OF YEAR	$2,520,287,826	$21,811,827	$2,412,742,240	$17,718,036
Transfer of Plan Net Assets	-	-	(14,317,073)	14,317,073
NET INCREASE (DECREASE)	563,375,130	(12,728,305)	121,862,659	(10,223,282)
END OF YEAR	**$3,083,662,956**	**$9,083,522**	**$2,520,287,826**	**$21,811,827**

For a full understanding of this Statement of Changes in Plan Net Assets, please see the accompanying Summary of Significant Accounting Policies and Notes to the Financial Statements, which follow.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

For the Years Ended June 30, 2004 and June 30, 2003

Basis of Accounting

The basic financial statements of SDCERS have been prepared in conformity with U.S. Generally Accepted Accounting Principles (GAAP). The U.S. Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principals. GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, established financial reporting standards for defined benefit pension plans. GASB Statements No. 26, *Financial Reporting for Post-Employment Healthcare Plans Administered by Defined Benefit Pension Plans* and No.12, *Disclosure of Information on Post-Employment Benefits Other Than Pension Benefits by State and Local Governmental Employers*, established reporting standards for post-employment healthcare benefit plans.

SDCERS' financial statements were prepared using the accrual basis of accounting. SDCERS is considered part of the City's financial reporting entity and is included in the City's Comprehensive Annual Financial Report as a Pension Plan and Healthcare Benefit Plan Trust Fund.

Plan sponsors' (employers') and members' (employees') contributions are recognized as revenues in the period in which the contributions are due. The plan sponsors' (employers') contributions are recognized when due and a formal commitment to provide the contribution has been made. Benefits and refunds are recognized when due and payable in accordance with SDCERS' Plan. SDCERS' investments are stated at fair value. Investment income is recognized in accordance with GASB Statement No. 25 and is stated net of investment manager fees and related expenses.

Cash or Equity in Pooled Cash and Investments on Deposit with the City of San Diego

The City maintains a cash and investment pool that is available to all funds of the City and other related entities for which the City is the depository. The credit risk for this pool is disclosed in the Notes to the City of San Diego's Comprehensive Annual Financial Report. Interest is earned on the pooled funds each accounting period (13 periods each fiscal year). SDCERS had a total of $3,642,648 and $3,044,096 on deposit in the pool as of June 30, 2004, and June 30, 2003, respectively.

Cash and Cash Equivalents on Deposit with Custodial Bank and Fiscal Agents

SDCERS does not have a target investment allocation to cash. The cash balances exhibited in the audited financial statements of cash on deposit with the custodial bank totaled $340,208,577 as of June 30, 2004, and $309,000,442 as of June 30, 2003. This represents a significant portion of plan assets which is identified as the cash collateral, invested in Federal Funds, from three market neutral portfolios (long and short U.S. equity positions) held with prime brokers (fiscal agents). These market neutral portfolios totaled $301,338,979 as of June 30, 2004, and $224,087,884 as of June 30, 2003. The market neutral portfolios are classified as domestic fixed income (short duration - defensive) investment strategies for purposes of SDCERS' strategic asset allocation. A significant portion of cash equivalents on deposit with the custodial bank, that totaled $34,916,488 as of June 30, 2004, and $75,476,269 as of June 30, 2003, represents the overnight investment of residual cash holdings from SDCERS' investment managers' portfolios; the remaining balance is cash equivalents not assigned to a specific investment manager for reinvestment. The portfolio cash balances are used to effectuate investment managers' trades and to settle net positions in pending transactions resulting from trade date accounting under GASB Statement No. 25. Any residual cash equivalents on deposit are reserved to pay monthly benefits and SDCERS' expenses or to rebalance portfolio assets as needed.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

For the Years Ended June 30, 2004 and June 30, 2003

Receivables

SDCERS' receivables include items representing accrued employers' contributions due to SDCERS and members' (employees') contributions for executed purchase of service contracts where payment is pending receipt by SDCERS. SDCERS maintains an allowance for doubtful accounts for estimated losses that may result from the inability of its current active members that have purchase of service contracts outstanding and are unable to fully pay them off. Past transaction history was considered in the establishment of the allowance. The allowance for doubtful accounts is calculated at 2% of the outstanding balances at year end. Please refer to Note 6. *Contributions Required and Contributions Made* for additional discussion and disclosure regarding purchase of service contracts.

In accordance with GASB Statement No. 25, securities sold represents a receivable of cash under trade date accounting. Cash is received as of the transaction settlement date, which is typically trade date plus one to three business days.

Investments

SDCERS' Board discharges their fiduciary duties in accordance with Article XVI, Section 17 of the California State Constitution. Investment decisions are made on a risk versus return basis in a total portfolio context. SDCERS' Board has the authority to delegate investment management duties to outside advisors, to seek the advice of outside investment counsel, and to provide oversight and monitoring of the investment managers it hires. Furthermore, under the California State Constitution and other relevant authorities, SDCERS' Board may, at its discretion, and when prudent in the informed opinion of the Board, invest funds in any form or type of investment, financial instrument, or financial transaction, unless otherwise limited by the San Diego City Council. SDCERS' agents, in SDCERS' name, manage all investments. SDCERS' investments are stated at fair value in the accompanying Statement of Plan Net Assets. SDCERS' custodian, State Street Bank & Trust Company, provides the market values of exchange-traded assets. Directly-owned, real estate assets are stated at appraised values as determined by SDCERS' real estate managers and third party appraisal firms.

Fixed Assets

Purchased fixed assets are recorded at historical cost. Assets are depreciated using the straight-line method over the following useful lives:

Office Equipment	10-15 years
Computer Equipment	3 years

Liabilities

Liabilities include accrued financial obligations of SDCERS as of June 30, 2004, including the repayment of securities lending collateral at a future date. In accordance with GASB Statement No. 25, securities purchased represents a payable of cash that is required under trade date accounting to settle pending purchases on a settlement date basis, which is typically trade date plus one to three business days.

Expenses

SDCERS is an independent Trust Fund. The entire expense of SDCERS' administration is charged against the earnings and plan assets of SDCERS. Fees for investment management, actuarial services, custodial bank services and other operational costs are netted against annual additions to plan assets to arrive at plan net assets at the end of the year as provided for in Sections 24.1501 and 24.1502 of the San Diego Municipal Code.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

For the Years Ended June 30, 2004 and June 30, 2003

Income taxes

SDCERS operates as a Trust Fund under Section 401(a) of the Internal Revenue Code. Accordingly, no provision for income taxes has been made in the accompanying financial statements. The Trust Fund is considered exempt from federal and state income taxes under the provisions of the Internal Revenue Code, Section 401, and California Revenue and Taxation Code Section 23701.

Use of Estimates

The preparation of SDCERS' financial statements, in conformity with GAAP, requires SDCERS' management team to make estimates and assumptions. These estimates affect the reported amounts of Net Assets Held in Trust for the Payment of Benefits as of the date of the financial statements. They also affect the actuarial information included in the Required Supplementary Information as of the benefit information date, the changes in plan net assets during the reporting period and, when applicable, disclosures of contingent assets and liabilities at the date of the financial statements. In addition, allowance for doubtful accounts for the members' (employees') contributions receivable in payment for purchase of service credit contracts has been calculated as 2% of the outstanding balance at year end. As a result, actual results could differ from those estimates.

Reclassifications

Certain prior year balances have been reclassified or restated to conform to current year presentation. See Note 14., "Restatements", found on page 81, for the disclosure and discussion of these items related to total plan net assets as of June 30, 2003.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS

For the Years Ended June 30, 2004 and June 30, 2003

Financial Statements

The following information supplements the audited financial statements, the Statement of Plan Net Assets and the Statement of Changes in Plan Net Assets, to provide a better understanding of the component parts of these Statements. In addition, information concerning SDCERS, such as plan information, contributions, and reserve balances are disclosed to assist in assessing SDCERS' financial condition going forward. Note 12. *Legal Action* and Note 13. *Subsequent Events* provide information regarding litigation issues that may have a financial impact on SDCERS or circumstances that may have occurred after June 30, 2004, through the end of the audit period, which are relevant to consider with the presented year-end results.

1. Cash

SDCERS' cash or equity in pooled cash and investments, cash and cash equivalents, and investments were as follows at June 30, 2004, and June 30, 2003:

	June 30, 2004	June 30, 2003
Cash or equity in pooled cash and investments on deposit with the City of San Diego	$3,642,648	$3,044,096
Cash and cash equivalents on deposit with Custodial Bank and Fiscal Agents[1]	340,208,577	309,000,442
Net investments (including accrued interest receivable, plus accrued interest on investments purchased, plus receivable for securities sold less liability for securities purchased)	2,907,890,892	2,353,411,522
Totals	**$3,251,742,117**	**$2,665,456,060**

[1] Includes cash collateral from market neutral portfolios (defensive, domestic fixed income investment strategy) that totaled $301,338,979 as of June 30, 2004, and $224,087,884 as of June 30, 2003. This amount also includes residual cash of $34,916,488 as of June 30, 2004, and $75,476,269 as of June 30, 2003, for transaction settlements, held in each investment manager's portfolio, which is invested overnight by SDCERS' custodial bank. SDCERS does not have a target allocation to cash; any cash or cash equivalent balances on deposit is reserved for paying current monthly accrued benefits and SDCERS' operational expenses.

2. Investments

SDCERS' Board has exclusive control over the administration and investment of SDCERS' Trust Fund assets pursuant to Section 144 of the Charter of the City of San Diego (Charter) and pursuant to California Constitution Article XVI, Section 17.

The Plan Assets of the Defined Benefit Pension Plan and the Post-Employment Healthcare Benefit Plan are pooled for investment purposes.

The Board is authorized to invest in any securities that are allowed by general law for savings banks. The Board is further permitted to invest in additional classes or types of investments, as approved by resolution of the City Council of San Diego. The Board has further restricted the authorized investments to those believed by independent investment counsel to be appropriate for investment by trust funds operating under the "Prudent Expert Rule" as set forth under California state law. These investments include, but are not limited to, bonds, notes or other obligations, real estate investments, common stock, preferred stock and pooled vehicles. The risk versus return of all investment decisions are made in a portfolio context; an asset that may seem risky on its own could very well lessen the risk of the total portfolio due to its low correlation with other investments in the portfolio. Investment policies permit SDCERS' Board to invest in financial futures contracts provided the contracts do not leverage SDCERS' Trust Fund portfolio. Financial futures contracts, which are recorded at market value each day, must be settled at expiration date. Thus, changes in the market value of the contracts will result in the recognition of a gain or loss under GASB Statement No. 25, investment income recognition.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

Investment earnings are recorded in accordance with GASB Statement No. 25. Net investment income includes the net appreciation (depreciation) in the fair value of investments, interest income, dividend income, and other income not included in the appreciation (depreciation) in the fair value of investments, less total investment expenses, including investment management and custodial fees and all other significant investment related costs. SDCERS had current year realized gains (income earnings and net gains) that totaled $260,239,046 as of June 30, 2004, and had prior year realized losses (income earnings reduced by net losses) that totaled -$18,644,596 as of June 30, 2003. Realized gains and losses determine whether or not certain SDCERS' contingent benefits will be earned each fiscal year, in accordance with the San Diego Municipal Code, Sections 24.1501 – 24.1507. These retirement benefits include a "13th check" which is paid to retirees and beneficiaries when there are sufficient annual realized earnings as defined in the Municipal Code. The "13th check" payment ranges from $30 to $75 per year of service credit, dependent upon the retirement date of the member. If there are insufficient realized earnings to qualify the payment of the "13th check" benefit for that year, then the benefit for that year is never paid. Corbett settlement benefit payments are also contingent upon sufficient annual realized earnings as defined in the Municipal Code. For those eligible retirees who retired prior to July 1, 2000, the Corbett benefit payment amounts to 7% of their pension benefits received in the fiscal year. Corbett settlement payments not qualified for payment in any year due to insufficient realized earnings, accrue to the subsequent year(s) without interest. When Corbett benefits accrue, they remain an obligation of SDCERS until such time as they are qualified for payment in accordance with the Municipal Code. For a ten year history of realized earnings, please see Historical Investment Performance in the Investment Section of this CAFR. For further information regarding contingent retirement benefits paid from sufficient, annual realized earnings, please contact SDCERS' offices at (800) 774-4977 or (619) 525-3600.

A complete copy of SDCERS' investment objectives and policies may be obtained from SDCERS, and a policy summary is included in the Investment Section. Through its investment objectives and policies, SDCERS' Board has placed considerable importance on generating a reasonable rate of return above inflation in order to ensure the payment of benefits to retirees. SDCERS' Board also places considerable importance on the preservation of capital. Therefore, any investment opportunity considered may be entered into only after the associated risk is clearly understood and the impact to the total SDCERS' Trust Fund portfolio is analyzed and reviewed.

SDCERS attempts to preserve capital through the following risk control methods:

Credit Risk is mitigated by diversifying SDCERS' Trust Fund investment portfolio so that failure of any one issuer will not unduly harm SDCERS. This is accomplished by the following restrictions on the size of investments in non-U.S. government securities: at the time of initial investment, not more than 5% of the equity portfolio can be invested in any one stock, and not more than 10% of the fixed income portfolio can be invested in any one corporate or international government bond issue

Market Risk is mitigated by diversifying the investment portfolio among the asset classes of stocks, bonds and real estate. Further diversification within the asset classes of stocks and bonds is achieved by investing in both domestic and international markets and by investing in companies of small, medium and large market capitalization (calculated as the number of shares outstanding multiplied by the market price of the stock). Real estate portfolio diversification is achieved by investing in various property types located in different economic regions of the United States. Currently no directly-owned, international real estate investments are permitted.

SDCERS' investments at June 30, 2004, and June 30, 2003, which can be specifically identified as to credit risk, are categorized as follows:

Category 1: Insured or registered, or securities held by SDCERS or its agent in SDCERS' name.

Category 2: Uninsured and unregistered, with securities held by the counterparty's Trust department or agent in SDCERS' name.

Category 3: Uninsured and unregistered, with securities held by the counterparty, by its Trust department, or agent but not in SDCERS' name.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

Investments that are not subject to credit risk categorization, but whose carrying amounts and fair values are required to be disclosed, are also presented along with the required disclosures for securities lending activities.

Investment Credit Risk as of June 30:

	Risk Category	2004 Fair Value	2003 Fair Value
Investments-Categorized			
Cash and Cash Equivalents with Custodial Bank (Pooled)	2	$38,869,596	$84,912,558
Cash with Prime Brokers (Market Neutral Strategy)	2	301,338,981	224,087,884
Short-Term Investments			
U.S. Government and Agency Obligations	1	66,491,561	12,692,507
Commercial Paper	1	147,909,457	58,242,144
Domestic Fixed Income - U.S. Government and Agency Obligations	1	152,281,694	185,906,475
Domestic Fixed Income - U.S. Corporate Bonds	1	217,495,608	217,715,548
Domestic Equity - U.S. Corporate Stocks	1	1,082,454,843	743,028,941
International Fixed Income - Bonds	1	148,688,620	114,942,438
International Equity - Stocks	1	395,141,490	284,445,361
Real Estate Investment Trust Securities (REITs)	1	112,203,006	91,659,957
Securities Lending Collateral			
Domestic Fixed Income - U.S. Government and Agency Obligations (Tri-Party)	3	3,488,837	6,113,334
Domestic Fixe Income - U.S. Corporate Bonds (Securities)	3	33,878	34,970
International Equity (Securities)	3	-	720,519
Total Categorized Investments		$2,666,397,569	$2,024,502,636
Investments-Non-Categorized			
Cash with City of San Diego (Pooled)		$3,642,648	$3,044,096
Domestic Equity Institutional Mutual Funds		72,727,095	293,693,236
International Equity Institutional Mutual Funds		61,120,412	42,587,090
Total Securities on Loan for Cash Collateral			
Domestic Fixed Income - U.S. Government and Agency Obligations		73,939,020	38,953,091
Domestic Fixed Income - U.S. Corporate Bonds		21,811,086	17,146,869
Domestic Equity - U.S. Corporate Stocks		140,707,214	84,435,565
International Fixed Income - Bonds		70,066	3,383,994
International Equity - Stocks		75,264,817	55,106,880
Total Securities on Loan for Securities Collateral			
Domestic Fixed Income - U.S. Government and Agency Obligations		3,434,877	5,936,009
Domestic Equity - U.S. Corporate Stocks		470,598	1,069,768
International Equity - Stocks		-	644,030
Real Estate Equity Investments (Separate Properties)		165,309,242	134,633,276
Real Estate Commingled Funds		156,660	3,858,208
Mortgage Notes		17,022	668,621
Securities Lending Collateral			
Pooled Investment Vehicle with State Street Bank and Trust Co. (Cash)		319,748,403	209,549,322
Letter of Credit		447,566	1,065,178
Total Non-Categorized Investments		$938,866,726	$895,775,233
TOTAL CASH AND INVESTMENTS		**$3,605,264,295**	**$2,920,277,869**

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

Derivative Instruments

Certain of SDCERS' investment managers may invest in or otherwise enter into transactions involving derivative financial instruments, consistent with the objectives established by the Board's investment policies. These instruments include futures, options and swaps and by Board policy may not be used to leverage SDCERS' portfolio. These instruments are used primarily to enhance portfolio performance and reduce its risk or volatility. SDCERS could be exposed to credit risk in the event of non-performance by counterparties; however, SDCERS enters into derivative transactions with high-quality institutions, and no losses due to/resulting from counterparty nonperformance on derivative financial instruments have been incurred. Credit and legal risks are also mitigated through the use of exchange traded contracts on organized exchanges. SDCERS is exposed to market risk, which is the risk that future changes in market conditions may make an instrument less valuable. Exposure to market risk is managed in accordance with investment policy guidelines, through buying or selling instruments or entering into offsetting positions.

The notional (underlying) or contractual amounts of derivatives indicate the extent of SDCERS' involvement in the various types and uses of derivative financial instruments and do not measure the exposure to credit or market risks and do not necessarily represent amounts exchanged by the parties. The amounts exchanged are determined by reference to the notional amounts and the other terms of the derivatives.

The aggregate notional or contractual amounts for SDCERS' derivative financial instruments at June 30, 2004 were as follows:

Money Market Futures	$ 60,250,000
Government Bond Futures	74,100,000
Options – calls sold	22,500,000
Options – puts sold	39,200,000
Swaps	75,000,000

Futures contracts are contracts in which the buyer agrees to purchase and the seller agrees to make delivery on a specific financial instrument on a predetermined date and price. Gains and losses on futures contracts are settled daily based on a notional (underlying) principal value and do not involve an actual transfer of the specific instrument. Futures contracts are standardized and are traded on exchanges. The exchange assumes the risk that a counterparty will not pay and generally requires margin payments to minimize such risk.

Option contracts provide the option purchaser with the right, but not the obligation, to buy or sell the underlying security at a set price during a period or at a specified date. The option writer is obligated to buy or sell the underlying security if the option purchaser chooses to exercise the option. SDCERS uses exchange traded and over-the-counter options. Options were sold and proceeds were received to enhance fixed income portfolio performance. Option contracts sold were predominately on money market and short term instruments of less than one-year to maturity. On call option contracts, if interest rates remained steady or declined during the option contract periods, the contracts would expire unexercised. By contrast, on put option contracts, if interest rates rose sufficiently to result in the purchase of the securities on or before the end of the option periods, this would occur at prices attractive to the portfolio manager.

Swap agreements are used to modify investment returns or interest rates on investments. Swap transactions involve the exchange of investment returns or interest rate payments without the exchange of the underlying principal amounts and could expose investors to credit risk in the event of nonperformance by counterparties.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

3. Securities Lending

SDCERS has agreed with a fiscal agent, currently SDCERS' custodial bank State Street Bank & Trust Company, to lend domestic and international equity and domestic and international fixed income securities to broker-dealers and banks in exchange for pledged collateral. A simultaneous agreement is entered into by which the fiscal agent agrees to return the collateral plus a fee (rebate of interest earned on the collateral) to the borrower in the future for return of the same securities originally lent. All securities loans can be terminated on demand by either party, the lender or the borrower.

State Street manages SDCERS' securities lending program and receives cash (United States currency and foreign currency), securities issued or guaranteed by the United Stated Government, sovereign debt rated "A" or better, Canadian provincial debt, convertible bonds, and irrevocable letters of credit as collateral. State Street did not have the ability to pledge or sell collateral securities delivered absent a borrower default. Borrowers were required to deliver collateral for each loan equal to: (1) in the case of loaned securities denominated in United States dollars or whose primary trading market was located in the Unites States or sovereign debt issued by foreign governments, 101.5% of the market value of the loaned securities; and, (2) in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States, 104.5% of the market value of the loaned securities.

During both prior fiscal years, SDCERS had no credit risk exposure to borrowers because the amounts provided to State Street on behalf of SDCERS, in the form of collateral plus accrued interest, exceeded the amounts broker-dealers and banks owed to State Street on behalf of SDCERS for securities borrowed. In addition, State Street has indemnified SDCERS by agreeing to purchase replacement securities or return cash collateral in the event that a borrower failed to return a loaned security or pay distributions thereon. Non-cash collateral (securities and letters of credit) cannot be pledged or sold without a borrower default and are therefore not reported as an asset of SDCERS for financial reporting purposes.

As of June 30, 2004, and June 30, 2003, securities lending transactions collateralized by cash had a fair value of $311,792,203 and $199,026,398, respectively, and a collateral value of $319,748,403 and $209,549,322, respectively, which were reported in the assets and liabilities in the accompanying Statement of Plan Net Assets for the Defined Benefit Pension Plan in accordance with GASB Statement No. 28. As of June 30, 2004, and June 30, 2003, securities lending transactions collateralized by securities or irrevocable letters of credit had a fair value of $3,905,475 and $7,649,806, respectively, and a collateral value of $3,970,280 and $7,934,000, respectively, which were not reported in the assets or liabilities in the accompanying Statement of Plan Net Assets for the Defined Benefit Pension Plan per GASB Statement No. 28. The total collateral pledged to SDCERS at fiscal year end June 30, 2004, and June 30, 2003, for its securities lending activities was $323,718,683 and $217,483,322, respectively.

The cash collateral received for lent securities was invested by State Street, together with the cash collateral of other lenders of securities of qualified tax-exempt plans, in a collective investment pool. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with the cash collateral. As of June 30, 2004, this investment pool had an average duration of 55 days and an average weighted maturity of 483 days. As of June 30, 2003, this same investment pool had an average duration of 70 days and an average weighted maturity of 438 days.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

As with other extensions of credit, SDCERS may encounter various risks related to securities lending agreements. However, State Street is required to maintain its securities lending program in compliance with applicable laws of the United States and all countries in which lending activities take place, and all rules, regulations and exemptions from time to time promulgated and issued under the authority of those laws. SDCERS' securities lending activity for the two prior years ended June 30 was as follows:

	2004	2003
Securities Lending Gross Earnings	$3,410,299	$3,178,333
Expenses		
Borrower Rebates	(2,168,167)	(2,089,142)
Fees Paid to Lending Agent	(363,934)	(320,945)
Total Expenses	(2,532,101)	(2,410,087)
Net Income from Securities Lending	**$878,198**	**$768,246**

4. Fixed Assets

The following is a summary of fixed assets during FY 2004:

	Balance July 1, 2003	Additions	Deletions	Balance June 30, 2004
Equipment	$319,558	$75,609	$0	$395,167
Accumulated Depreciation	(128,574)	(75,644)	0	(204,218)
Totals	**$190,984**	**$(35)**	**$0**	**$190,949**

The following is a summary of fixed assets during FY 2003:

	Balance July 1, 2002	Additions	Deletions	Balance June 30, 2003
Equipment	$475,513	$54,171	$(210,126)	$319,558
Accumulated Depreciation	(184,776)	(120,472)	176,674	(128,574)
Totals	**$290,737**	**$(66,301)**	**$(33,452)**	**$190,984**

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

Defined Benefit Pension Plan

5. Description

The following description of SDCERS provides only general information. Participants should refer to SDCERS' Summary Plan Descriptions for a more complete description of the various benefit provisions.

General

SDCERS is the agent of a multi-employer, defined benefit Trust Fund established in fiscal year 1927 by the City of San Diego (City). It is administered by SDCERS' Board to provide service retirement, disability retirement, and death and survivor benefits to its participants. Employees of the Unified Port of San Diego (Port) became members of SDCERS in 1963, through an agreement between the City and the Port. Pursuant to an amendment to the San Diego City Charter in 2002, the Port now contracts directly with SDCERS to administer its defined benefit plan. On January 1, 2003, the State of California established the San Diego County Regional Airport Authority (Airport) as a separate agency, initially staffed by a group of employees formerly employed by the Port, plus other newly hired employees. The Airport entered into an agreement in 2003, to continue to have SDCERS administer its defined benefit plan for its employees.

SDCERS, as the agent of a multi-employer, defined benefit pension and post-employment healthcare benefit plans Trust Fund, acts as a common, independent investment and administrative agent for the City, Port and Airport, and covers all eligible employees of each agency. As a defined benefit plan, pension benefits are determined primarily by a member's age at retirement, number of years of service credit, and final compensation based on the highest salary earned over a consecutive one-year period. SDCERS also administers a post-employment healthcare benefit plan for City health-eligible retirees.

The Port and Airport allow for five-year vesting to receive pension benefits. The City requires ten years of service to vest for a pension benefit; however, effective January 3, 2003, ten years of service can be a combination of time worked (service earned) and certain purchased service.

General benefit provisions are set out in the Summary of Benefit Provisions in the Actuarial Section. More specific information may be obtained by contacting SDCERS' at (800) 774-4977 or (619) 525-3600 to obtain a Summary Plan Description.

SDCERS is included in the City's Comprehensive Annual Financial Report as a Defined Benefit Pension Plan and Healthcare Benefit Plan Trust Fund.

Membership

All benefited (40, 60 and 80 hours bi-weekly standard) City, Port and Airport employees are eligible to participate in SDCERS. Salaried classified employees and salaried unclassified employees hired on or after August 11, 1993, became members of SDCERS upon employment.

SDCERS' participants consist of active members, inactive members entitled to benefits but not yet receiving them (deferred vested members), active and inactive non-vested members, and retired members and beneficiaries receiving benefits.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

		As of June 30, 2004				As of June 30, 2003			
		City General Members	City Safety Members	Port All Members	Airport All Members	City General Members	City Safety Members	Port All Members	Airport All Members
Members 2004: 12,713 2003: 12,841 Decrease: (128)	Active Vested	3,910	1,633	354	112	3,921	1,711	386	108
	Deferred Vested	436	87	43	3	378	71	23	-
	Active Non-Vested	3,207	999	221	153	3,495	973	223	100
	Inactive Non-Vested	1,215	146	185	9	1,135	139	171	7
Retirees 2004: 6,016 2003: 5,742 Increase: 274	Retired	2,989	1,953	279	2	2,876	1,859	270	-
	DROP Participants	410	371	11	1	347	385	4	1
Total Members and Retirees 2004: 18,729 2003: 18,583 Increase: 146	Totals	12,167	5,189	1,093	280	12,152	5,138	1,077	216

As of June 30, 2004, SDCERS' increased overall by 146 participants over the prior year. This was comprised of a net decrease of 128 members and a net increase of 274 retirees.

6. Contributions Required and Contributions Made

SDCERS' funding policy provides for periodic plan sponsor (employer) contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are designed to accumulate sufficient assets to pay vested benefits as they are earned by SDCERS' members. The normal cost and actuarial accrued liability are determined using the Projected Unit Credit (PUC) actuarial funding method.

The City makes annual plan sponsor (employer) contributions to SDCERS in accordance with the *2002 Contribution Agreement* between the City and SDCERS. However, beginning in FY 2005, the City will make contributions in accordance with the terms of the Gleason Settlement (see Note 12. Legal Action, in the Notes to the Financial Statements.) The Port and the Airport both make annual plan sponsor (employer) contributions to SDCERS based upon the required contributions as determined by SDCERS' actuary, in accordance with the PUC funding methodology.

In addition to regular plan sponsor (employer) contributions, the City's and Port's SDCERS' Unfunded Actuarial Accrued Liabilities (UAALs) are being funded as a level percent of payroll over a 30-year, closed amortization period, which began July 1, 1991 (18 years remaining as of the June 30, 2003 actuarial valuations). The Airport's SDCERS' Unfunded Actuarial Accrued Liability (UAAL) is being funded over an 18.5-year closed amortization period, which began January 1, 2003 (18 years remaining as of the June 30, 2003 actuarial valuation).

A Schedule of Plan Sponsors' (Employers') Contributions and accompanying Notes are located in the Required Supplementary Information in the Financial Section. As Noted in those schedules, the City has under funded its Annual Required Contribution (ARC) in each of the years 1999 through 2004. The cumulative under funding for these years at June 30, 2004 is $79,605,229. Further, the City's contribution funding method during 1999 through 2004 was not one of the six actuarial cost methods allowed by GASB Statement 25. The impact to the respective annual ARC amounts, year by year, if under funding had not occurred was not determined.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

The following tables illustrate the required plan sponsors' (employers') contribution rates as calculated annually by SDCERS' actuary under the Projected Unit Credit (PUC) actuarial funding methodology, adopted as of July 1, 1991.

FY 2004 Contribution Rates (As of July 1, 2003) - Current Year

Plan Sponsor (Employer) Contribution Rates by Member Class, Based on Valuation of:	City of San Diego[2] (June 30, 2002, Actuarial Valuation)					
	General	Elected Officers	Police	Fire	Lifeguard	Weighted Total
Normal Cost[1]	9.26%	21.01%	17.11%	18.91%	16.61%	12.02%
Amortization Payment[1]	6.75	43.01	16.23	16.23	16.23	9.93
Subtotal	16.01	64.02	33.34	35.14	32.84	21.95
Adjusted for payment at the beginning of the year (July 1, 2003)	15.41	61.61	32.08	33.82	31.60	21.13
Total Contribution Rates	**15.41%**	**61.61%**	**32.08%**	**33.82%**	**31.60%**	**21.13%**

[1] Rates assume that contributions are made uniformly during the plan year.

[2] These plan sponsor (employer) contribution rates do not reflect the City of San Diego's *2002 Contribution Agreement* negotiated employer contribution rates. Contribution rates in this table are actuarially determined. See the Schedule of Plan Sponsors' (Employers') Contributions in the Required Supplementary Information located in the Financial Section of this CAFR for the City's actual historic and future plan sponsor (employer) contribution rates under the *1996 Manager's Proposal* and the *2002 Contribution Agreement*. The City's contribution rates were significantly less than the rates in the table above.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

FY 2004 Contribution Rates (As of July 1, 2003) - Current Year

Plan Sponsor (Employer) Contribution Rates by Member Class, Based on Valuation of:	Unified Port of San Diego (December 31, 2002, Actuarial Valuation)[2]		
	General	Safety	Weighted Total
Normal Cost[1]	9.71%	15.72%	11.16%
Amortization Payment[1]	2.48	3.39	2.70
Subtotal	12.19	19.11	13.86
Adjusted for payment at the beginning of the year (July 1, 2003)	11.73	18.39	13.34
Total Contribution Rates	**11.73%**	**18.39%**	**13.34%**

FY 2004 Contribution Rates (As of July 1, 2003) - Current Year

Plan Sponsor (Employer) Contribution Rates by Member Class, Based on Valuation of:	San Diego Country Regional Airport Authority (December 31, 2002, Actuarial Valuation)[2]
	All Members
Normal Cost[1]	8.15%
Amortization Payment[1]	0.42
Subtotal	8.57
Adjusted for payment at the beginning of the year (July 1, 2003)	8.25
Total Contribution Rates	**8.25%**

1 Rates assume that contributions are made uniformly during the plan year.

2 Effective January 1, 2003, the State of California established the San Diego County Regional Airport Authority (Airport) separate from the Unified Port of San Diego (Port). The Airport then entered into an agreement with SDCERS to manage their defined benefit pension plan for their employees. As a result, interim actuarial valuations as of December 31, 2002, were prepared by SDCERS' actuary to reflect the actuarial value of assets and the accrued liabilities for each, the Port and the Airport, as two distinct plan sponsors (employers).

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

FY 2003 Contribution Rates (As of July 1, 2002) - Prior Year

Plan Sponsor (Employer) Contribution Rates by Member Class, Based on Valuation of:	City of San Diego[2] (June 30, 2001, Actuarial Valuation)					
	General	Elected Officers	Police	Fire	Lifeguard	Weighted Total
Normal Cost[1]	9.12%	21.65%	17.06%	19.17%	16.40%	12.01%
Amortization Payment[1]	2.25	44.95	7.83	7.83	7.83	4.19
Subtotal	11.37	66.60	24.89	27.00	24.23	16.20
Adjusted for payment at the beginning of the year (July 1, 2002)	10.94	64.09	23.94	25.98	23.32	15.59
Total Contribution Rates	**10.94%**	**64.09%**	**23.94%**	**25.98%**	**23.32%**	**15.59%**

Columns may not total due to rounding.

[1] Rates assume that contributions are made uniformly during the plan year.

[2] These plan sponsor (employer) contribution rates do not reflect the City of San Diego's *1996 Manager's Proposal* negotiated employer contribution rates. Contribution rates in this table are actuarially determined. See the Schedule of Plan Sponsors' (Employers') Contributions in the Required Supplementary Information located in the Financial Section of this CAFR for the City's actual historic and future plan sponsor (employer) contribution rates under the *1996 Manager's Proposal* and *2002 Contribution Agreement*. The City's contribution rates were significantly less than the rates in the table above.

FY 2003 Contribution Rates (As of July 1, 2002) - Prior Year

Plan Sponsor (Employer) Contribution Rates by Member Class, Based on Valuation of:	Unified Port of San Diego (June 30, 2001, Actuarial Valuation)		
	General	Safety	Weighted Total
Normal Cost[1]	9.05%	15.33%	10.17%
Amortization Payment[1]	(3.85)	(6.54)	(4.33)
Subtotal	5.20	8.79	5.84
Adjusted for payment at the beginning of the year (July 1, 2002)	5.00	8.46	5.62
Total Contribution Rates	**5.00%**	**8.46%**	**5.62%**

Columns may not total due to rounding.

[1] Rates assume that contributions are made uniformly during the plan year.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

FY 2005 Contribution Rates (As of July 1, 2004) - Next Year

Plan Sponsor (Employer) Contribution Rates by Member Class, Based on Valuation of:	City of San Diego[2] (June 30, 2003, Actuarial Valuation)					
	General	Elected Officers	Police	Fire	Lifeguard	Weighted Total
Normal Cost[1]	9.76%	18.32%	17.38%	18.60%	16.59%	12.42%
Amortization Payment[1]	12.21	49.18	25.37	25.37	25.37	16.62
Subtotal	21.97	67.50	42.75	43.97	41.96	29.04
Adjusted for payment at the beginning of the year (July 1, 2004)	21.14	64.95	41.14	42.31	40.38	27.94
Total Contribution Rates	**21.14%**	**64.95%**	**41.14%**	**42.31%**	**40.38%**	**27.94%**

1 Rates assume that contributions are made uniformly during the plan year.

2 These employer contribution rates do not reflect the City of San Diego's plan sponsor (employer) contribution rates made pursuant to the terms of the Gleason settlement. See *Note 12. Legal Action* for information regarding this settlement, located later in this section of the CAFR.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

FY 2005 Contribution Rates (As of July 1, 2004) - Next Year

Plan Sponsor (Employer) Contribution Rates by Member Class, Based on Valuation of:	Unified Port of San Diego (June 30, 2003, Actuarial Valuation)		
	General	Safety	Weighted Total
Normal Cost[1]	13.50%	17.30%	14.36%
Amortization Payment[1]	6.79	6.94	6.82
Subtotal	20.29	24.24	21.18
Adjusted for payment at the beginning of the year (July 1, 2004)	19.52	23.32	20.38
Total Contribution Rates	**19.52%**	**23.32%**	**20.38%**

[1] Rates assume that contributions are made uniformly during the plan year.

Plan Sponsor (Employer) Contribution Rates by Member Class, Based on Valuation of:	San Diego Country Regional Airport Authority (June 30, 2003, Actuarial Valuation)
	All Members
Normal Cost[1]	12.28%
Amortization Payment[1]	3.40
Subtotal	15.68
Adjusted for payment at the beginning of the year (July 1, 2004)	15.09
Total Contribution Rates	**15.09%**

[1] Rates assume that contributions are made uniformly during the plan year and assume no employee contribution increases related to the 2004 benefit enhancement for the Airport's SDCERS' participants.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)
For the Years Ended June 30, 2004 and June 30, 2003

Members (employees) are required to contribute a percentage of their annual salary to SDCERS. Contributions vary according to the member's (employee's) age at time of entry into SDCERS and member group, (e.g. safety, general, elected officers). The City, Port, and Airport, as plan sponsors (employers), contribute a portion of the members' employees') share, known as the member (employee) contribution paid by the plan sponsor (employer). This is a negotiated benefit in the unions/City management labor contracts and the amounts are subject to modification. Plan sponsors (employers) also contribute any remaining amounts necessary to fund SDCERS' Trust Fund, based upon an actuarial valuation performed at the end of the preceding year using the Projected Unit Credit (PUC) actuarial funding method.

Member (employee) average contribution rates for each member class are shown below. Averages shown apply to salary amounts over $400 per month in the case of members (employees) with social security integrated benefits.

	Current Year Member (Employee) Average Contribution Rates **(FY 2004)**		**Prior Year** Member (Employee) Average Contribution Rates **(FY 2003)**	**Next Year** Member (Employee) Average Contribution Rates **(FY 2005)**
Actuarial Valuation Dates	12/31/2002	6/30/2002	6/30/2001	6/30/2003
City of San Diego				
General Members[1]	N/A	10.02%	10.01%	10.54%
Safety Members[1]	N/A	12.85%	12.84%	12.86%
Unified Port of San Diego				
General Members[1]	10.40%	10.29%	10.27%	10.28%
Safety Members[1]	12.97%	12.96%	12.96%	12.98%
San Diego County Regional Airport Authority				
All Members	10.18%	n/a	n/a	10.31%

[1] General Members includes Elected Officers; Safety Members includes Police, Fire and Lifeguard Members, as applicable.

All or part of the member's (employee's) contribution rate is subject to a reduction for member (employee) contributions paid by employer. The rates above (actuarially determined amounts) are shown before any applicable reduction. Any such member (employee) contributions paid by employer and related accumulated interest are not refunded to members (employees) at termination; only a member's (employee's) actual contributions made plus credited interest are refunded to a member (employee) at termination of employment, upon his/her request.

As of the June 30, 2003, actuarial valuation, the City had reported member (employee) contributions paid by plan sponsor (employer) amounts, stated as a percentage of a member's (employee's) salary, as follows:

7.00% for represented general members
8.00% for non-represented general members
8.89% for elected officers
10.00% for lifeguard members
10.00% for police and fire safety members

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

The City's aggregate member (employee) contributions paid by plan sponsor (employer) made to SDCERS are discounted (prior to being contributed to SDCERS) by the anticipated savings from member (employee) terminations from City employment. As a result of a recent experience valuation and based on recommendation by SDCERS' actuary, SDCERS' Board and the City agreed to reduce the discounts applied to the aggregate member (employee) contributions paid by plan sponsor (employer) for anticipated member (employee) terminations from City employment. Over a four-year period, which began in FY 2003, these discounts will be reduced from 22.00% to 5.00% for general members and from 7.00% to 1.00% for safety members. In FY 2003, the discounts were reduced to 17.75% for general members and 5.50% for safety members. In FY 2004, the discounts were further reduced to 13.50% for general members and 4.00% for police and fire safety members.

As of the June 30, 2003, actuarial valuation, the Port had reported employee (member) contributions paid by plan sponsor (employer) amounts, stated as a percentage of a member's (employee's) salary, as follows:

7.00% for general members
8.80% for safety members
8.50% for management members

As of the June 30, 2003, actuarial valuation, the Airport had reported employee (member) contributions paid by plan sponsor (employer) amounts, stated as a percentage of a member's (employee's) salary, as follows:

7.00% for general members
8.50% for management members

Neither the Port nor the Airport discounts their aggregate member (employee) contributions paid by plan sponsors (employers) made to SDCERS by any anticipated savings from member (employee) terminations from Port or Airport employment.

The San Diego Municipal Code Chapter 2, Article 4, Division 13 provides the basis for City SDCERS' members (employees) to purchase service credit. For both Airport SDCERS' members (employees) and Port SDCERS' members (employees), their respective Plan Documents outline the Purchase of Service Credit program. Historically, SDCERS' members (employees) were allowed to purchase certain types of service credit, usually related to periods of missing service credit or missing employee contributions. Beginning in 1997, SDCERS' City and Port members became eligible to purchase an additional 5 years of service credit, in addition to their actual employment service credit. The Airport's SDCERS' members became eligible to purchase an additional 5 years of service credit at inception of their Plan on January 1, 2003. The five-year purchase may be applied toward the vesting requirements for the City SDCERS' members (employees), but not for Port or Airport SDCERS' members (employees).

Purchases of service credit may be paid for by an SDCERS' member (employee) from several sources: (1) Lump sum payments from a SDCERS' member's personal funds; (2) Direct transfers from the City's Supplemental Pension Savings Plan (SPSP), 401(k) account, Deferred Compensation account (except for a 5-Year purchase), qualified IRAs, or any other qualified retirement plan; or (3) Bi-weekly installment payment plans. Both pre-tax and post-tax payment plans are permitted. The term length of installment contracts varies, usually not to exceed more than 15 years or the member's (employee's) first eligible retirement date.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)
For the Years Ended June 30, 2004 and June 30, 2003

The table below describes the costs to Purchase Service Credit:

	Original Cost (% of Recent One-Year Salary)	New Cost* (% of Current Salary)
City of San Diego		* As of November 2003
General Members	15%	27%
Safety Members	26%	37%
Legislative Members	15%	50%
Port/Airport		* As of July 2004
General Members	15%	32%
Safety Members	23%	38%
Executive Members	15%	34%

As of June 30, 2004, a total of 787 members (employees) were making payments on installment contracts. As of June 30, 2003, 368 members (employees) were making payments on installment contracts. Service credit purchased under an installment contract is not an actuarial accrued liability of SDCERS until completion of the contract. A receivable for contributions from members' (employees') for purchased service payments (both installment payments and pending lump sum payments) totaling $22,604,172 and $10,614,307, stated net of the allowance for uncollectible purchased service installment contract payments, has been included in the accompanying Statement of Plan Net Assets for the Defined Benefit Pension Plan representing the balance of payments due at June 30, 2004, and June 30, 2003, which are shown net of allowances of $461,310 and $216,606, respectively. The allowance is established by charges to operating expenses (deductions) included in the Statement of Changes in Plan Net Assets. A portion of this receivable, related to purchase service installment contract payments, is being written-off each year as an expense and is included in the accompanying Statement of Changes in Plan Net Assets for the Defined Benefit Pension Plan. This expense is an allowance for uncollectible purchased service installment contract payments. The expense amounts included as of June 30, 2004 and June 30, 2003, totaled $244,704 and $68,693, respectively.

Post-Employment Healthcare Benefit Plan

7. Description
San Diego City Employees' Retirement System (SDCERS) administers a single-employer (City), post-employment healthcare benefit plan for health-eligible retirees of the City of San Diego, in accordance with San Diego Municipal Code Article 4, Division 12.

8. Eligibility Requirements
Post-employment healthcare benefits for members retiring from City employment are based on their health-eligibility status. City retirees are either health-eligible or non-health-eligible. SDCERS also administers a special healthcare benefit for spouses and dependents of eligible City employees killed in the line of duty.

Health-eligible Benefit (3,288 recipients as of June 30, 2004)

- Was on the Active Payroll of the City of San Diego on or after October 5, 1980, and
- Retired on or after October 6, 1980, and
- Is eligible for and is receiving a pension allowance from SDCERS

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

SDCERS' health-eligible retirees may obtain health insurance coverage with the company and plan of their choice including any City-sponsored, union-sponsored or privately-secured health plan. Medicare eligible retirees may receive reimbursement for their Medicare Part B premium and reimbursement/payment of their health premiums up to $528.41 per month in addition to the monthly Medicare Part B premium ($66.60 per month for 2004). These amounts change annually. Non-Medicare eligible retirees may receive reimbursement/payment of health premiums only, up to $561.08 per month. This amount changes annually.

Non-Health-eligible Benefit (666 recipients as of June 30, 2004)

- Retired or terminated employment as a vested member of the City of San Diego prior to October 6, 1980, and
- Is eligible for and is receiving a pension allowance from SDCERS.

The health benefit for non-health-eligible retirees is a reimbursement of up to $1,200 per fiscal year for a combination of both Medicare Part B premiums and medical expenses (including co-pays, prescription costs, premiums for health and hospital insurance coverage).

Death in the Line of Duty Widows/Widowers (32 recipients as of June 30, 2004)

The Death in the Line of Duty Widow/Widower healthcare benefit is paid to eligible surviving spouses. Death in the Line of Duty Widows/Widowers and their dependent children are eligible to be enrolled in a City-sponsored health plan. They receive payment for health insurance premiums and Medicare Part B premiums up to the annual flexible dollar amount for active City SDCERS' members (employees).

9. Contributions

The Post-Employment Healthcare Benefit Plan is funded by the City of San Diego, the plan sponsor (employer). As of June 30, 2004, and June 30, 2003, there were no annual contributions made to the Plan. Payments for retiree healthcare insurance premiums are made in cash from the City's annual operating budget. Beginning in FY 2005, the City made contributions to a separate City health insurance fund for this Plan. These contributions are not actuarially based, but rather budgeted as a current year expense of the City.

As of June 30, 2004, there had been no actuarial valuations performed regarding the funded status of this single-employer (City) SDCERS' administered plan. However, in March 2006, the City of San Diego did complete its first actuarial valuation for the Post-Employment Healthcare Benefit Plan. This valuation was as of June 30, 2005, and reported a post-employment healthcare actuarial liability of approximately $978 million. Per GASB Statement No. 26, the Governmental Accounting Standards Board set forth policy that plans should report healthcare assets and related liabilities separate from pension assets and revenues and liabilities and expenses. GASB Statement No. 12, which came before GASB Statement No. 26, stated that plan sponsors (employers) shall disclose certain actuarially determined information about post-employment benefits, if that information is available; the Statement does not require the calculation of actuarially determined information. GASB Statement No. 43, *Financial Reporting for Post-Employment Benefit Plan Other Than Pension Plans*, issued in April 2004, with implementation for SDCERS beginning in FY 2007 (July 1, 2006), will require a minimum of three years of actuarial valuations to be presented in the Required Supplementary Information in SDCERS' CAFR.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

Total Reserves - All Plans

10. Reserve Balances

The San Diego Municipal Code authorizes SDCERS' Board to establish reserve accounts based on the advice of its actuary. Annual adjustments to the Trust Fund's reserves are a result of realized investment gains or losses and member (employee) and plan sponsor (employer) contributions received. These changes are distributed in accordance with the San Diego Municipal Code. Reserves are adjusted annually by allocating assets valued at cost.

Reserve balances at June 30 each year, valued at cost:

	2004	2003
Reserved for Investments in Properties	$190,949	$190,984
Reserved for Receivables	22,621,338	10,614,307
Reserved for Encumbrances	1,640,732	1,035,461
Reserved for Members' (Employees') Contributions	481,069,841	407,903,833
Reserved for Plan Sponsors' (Employers') Contributions	258,796,193	556,138,768
Reserved for Current Retired Members	1,690,624,783	1,410,001,316
Plan Continuation Liability	1,192,746,102	720,296,548
Fund Deficit - Equivalent to Plan Continuation Liability	(1,192,746,102)	(720,296,548)
Reserve for Post-Employment Healthcare Benefit Plan	7,910,366	20,740,269
Reserve for Supplemental COLA	21,739,416	25,726,019
Reserve for Members (Employees) Contribution Rate Increase Payments	21,391,905	34,487,109
Undistributed Earnings Reserve	163,616,059	(56,066,953)
Reserve for Liabilities	91,926,143	101,331,303
Total Reserves[1]	**$2,761,527,725**	**$2,512,102,416**

[1] Reserves are established using cash, receivables, and other assets added to invested assets valued on a cost basis of $2,854,597,336 as of June 30, 2004, and $2,568,261,182 as of June 30, 2003. Total Reserves will differ from Plan Net Assets Held in Trust for Payment of Benefits in the audited financial statements as investments are stated at fair value (market value) which, at June 30 of each year, can be higher or lower than the cost basis of the investments.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

Reserved for Investments in Properties - Depreciated cost of office equipment owned by SDCERS.

Reserved for Receivables - Balance of receivables expected to be received in the future consisting mainly of member (employee) contributions made to SDCERS for purchase of service credit installment contracts and any invoiced contributions.

Reserved for Encumbrances - Balance of contractual liabilities incurred but not yet paid at year-end.

Reserved for Members' (Employees') Contributions - Funds representing the accumulated contributions, plus accumulated allocated interest, held on account for all active and inactive members.

Reserved for Plan Sponsors' (Employers') Contributions - Funds representing the otherwise unallocated accumulated contributions, plus accumulated allocated interest, of all participating plan sponsors, the City, the Port and the Airport.

Reserved for Current Retired Members -Funds sufficient, based upon advice of the actuary, to pay present and future benefits of current retired members. Upon retirement, members' (employees') funds are transferred from Reserved for Members' (Employees') Contributions to this reserve, along with sufficient funds from the Plan Sponsors' (Employers') Contributions Reserve, to fund the expected present and future cost of benefits for existing retirees.

Plan Continuation Liability - Represents the dollar amount of a traditional indicator of funded status. It is calculated from the ratio of actuarial value of assets to the actuarial present value of credited projected benefits and totaled for all three plan sponsors (employers); this is the same as the Unfunded Actuarial Accrued Liability (UAAL) totaled for all three plan sponsors. Values are based on the latest actuarial valuations available, as of June 30, 2003.

Fund Deficit - Equivalent to Plan Continuation Liability - Represents the dollar amount not reserved for the portion of Unfunded Actuarial Accrued Liabilities (UAAL) of the City's, Port's and Airport's plans. The City's and Port's SDCERS' UAALs are being amortized over a closed, 30-year period with 18 years remaining, as of the June 30, 2003, actuarial valuations. The Airport's SDCERS' UAAL is being amortized over a closed, 18.5-year period with 18 years remaining as of the June 30, 2003, actuarial valuation.

Reserve for Post-Employment Healthcare Benefit Plan - Funds set aside in a 401(h) trust to provide health benefits to health eligible and non-health eligible retirees.

Reserve for Supplemental COLA - Funds sufficient to pay this benefit to retirees whose effective date of retirement was prior to June 30, 1983, for the rest of their lives. These payments will continue until this reserve is depleted.

Reserve for Member (Employee) Contribution Rate Increase Payments - Funds sufficient to satisfy the 0.49% contribution rate increase (beginning July 1, 1998) to active members associated with benefit enhancements adopted by the City Council, effective January 1, 1997. Effective July 1, 2002, this reserve was also used to pay for an additional 1.70% of the safety member (employee) contribution offset. Effective July 1, 2003, this reserve was also used to pay for an additional 1.60% of the general member (employee) contribution offset, and an additional 1.00% safety member (employee) contribution offset. These payments will continue until this reserve is depleted.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)
For the Years Ended June 30, 2004 and June 30, 2003

Undistributed Earnings Reserve - Represents the balance of earnings remaining after the annual distribution to the members' (employees') and plan sponsors' (employers') reserve accounts in accordance with SDCERS' Board established assumed rate of interest. At the beginning of each fiscal year, SDCERS' Board shall credit all Surplus Undistributed Earnings to the Reserve for Employers' Contributions in order to reduce SDCERS' current liabilities.

Reserve for Liabilities - Funds sufficient to pay liabilities incurred as of June 30, 2004, and June 30, 2003. Payables includes a large liability (90%+ of payables) classified as "Securities Purchased" which recognizes investments purchased and booked as an asset on a trade date basis per GASB Statement No. 25. The liability for purchases must be booked because cash settles at a later date (settlement date), when the securities are actually received and the trade is completed.

Other Notes
11. SDCERS' Investment Managers
Putnam Investments
The SEC charged Putnam, one of SDCERS' investment managers, with committing securities fraud by failing to disclose improper market timing trading by Putnam's portfolio managers. On April 8, 2004, the SEC announced settlements in which Putnam agreed to pay a total of $55 million; $5 million in disgorgements and $50 million in penalties. The SEC said that all of the money would be distributed to investors harmed by the market timing trading. In addition, the Securities Division for the Commonwealth of Massachusetts obtained another $55 million settlement from Putnam. As of June 30, 2004, SDCERS had (and continue to have) three strategies managed by Putnam investments: domestic equity small cap growth (DESCG), domestic equity small cap value (DESCV) and international equity growth (IEG). All three of these strategies are in separately managed portfolios, not in mutual fund investment vehicles, and had market values as of June 30, 2004, as follows: DESCG $63,619,303; DESCV $68,544,942; and, IEG $200,233,191. To date, SDCERS has not been harmed by the actions of Putnam's portfolio managers, and has not suffered any direct loses resulting from the improper market trading activities. As a result, SDCERS has not received any monies from the litigation and settlement. SDCERS' Board, executive management team and SDCERS' investment consultant continue to monitor Putnam's activities as part of SDCERS' normal manager oversight processes.

12. Legal Action
In the normal course of business, SDCERS is subject to pending or threatened legal actions or other potential unasserted claims, some of which seek substantial relief or damages. After reviewing pending and threatened litigation with counsel, management believes that the outcome of these actions will not have a material adverse effect on the financial condition of SDCERS.

Gleason Settlement

James F. Gleason, et al., v. San Diego City Employees' Retirement System, et al., *San Diego Superior Court case number GIC 803779*

In January 2003, a putative class action complaint was filed against the City of San Diego and SDCERS alleging that beginning in FY 1997 and continuing to the date of the complaint the City did not contribute to SDCERS the annual amount required by certain provisions of the San Diego City Charter and San Diego Municipal Code. Plaintiff's counsel estimated the past under funding at approximately $140 million, exclusive of interest. The parties agreed to a settlement which was approved by the court on July 26, 2004. Under the terms of the settlement agreement, the City made a $130 million contribution to SDCERS for FY 2005 on July 1, 2004. This contribution was made pursuant to the settlement and was not actuarially determined. In addition, for Fiscal Years 2006-2008, the City's contribution will be determined by

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)
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SDCERS' actuary using a 30-year fixed amortization period. That amortization period was "re-started" for calculation purposes beginning with FY 2005.

To secure the City's contribution obligations, the City provided SDCERS collateral worth $375 million of real property, which will be released in equal installments of $125 million annually on July 1, or when SDCERS receives payment, whichever occurs later. The last City payment to SDCERS under the settlement agreement, and corresponding release of lien on the City's real property, should occur no later than July 1, 2007 (applicable to FY 2008).

In addition, the trial court awarded the plaintiff's attorneys fees and legal costs totaling $3,086,529. The City was ordered to pay 60%, and SDCERS was ordered to pay 40% of the total due. SDCERS' portion, including interest, was $1,249,292. SDCERS accrued its portion of the attorneys' fees award as a Litigation Settlement Payable in the FY 2004 Statement of Plan Net Assets and as a Litigation Settlement Expense in the FY 2004 Statement of Changes in Plan Net Assets. On January 25, 2005, SDCERS paid the $1,249,292 due.

13. Subsequent Events

The City of San Diego's Pension Reform Commission (PRC) made various recommendations to the City Council in its September 2004 report. Two recommendations required amending the City Charter, which requires a vote of the citizens of the City of San Diego. Accordingly, two ballot measures – Propositions G and H – were put before the voters in the November 2, 2004 City of San Diego General Election. Both passed.

Proposition G adds language into the City Charter which, beginning July 1, 2008 (FY 2009), sets amortization schedules recommended by the PRC for SDCERS' Board and the City to use in making the calculations necessary to determine the component of the City's annual contribution associated with paying down the Unfunded Actuarial Accrued Liability (UAAL). In addition, this measure adds language into the City Charter that precludes the City and SDCERS' Board from entering into any future multi-year contracts or agreements delaying full funding of City's contribution obligations to SDCERS, except for court-approved settlement agreements. Proposition G passed receiving 53.5% of the vote.

In October 2005, the California Attorney General issued opinion No. 04-710, 88 Op. Atty Gen. Cal 165. In response to a question from Assemblyman Jerome Horton, the Attorney General concluded that a city charter may not require a city employees' retirement board to place the cost of the past service liability associated with a new retirement benefit on a specified amortization schedule or place the cost associated with net accumulated actuarial gains and losses on a time specific amortization schedule.

Proposition H changed the term of office of SDCERS' Board Members from six to four years, and changed the composition of the Board as follows: seven citizens with professional qualifications appointed by the Mayor and confirmed by the City Council; two employee members elected by active general member employees; one member elected by City retirees; one employee member elected by active members from Fire Safety, one employee member elected by active members from Police Safety, and one City management employee appointed from the administrative service of the City. Prior to Proposition H, a majority of the Board were employees of the City (including representatives from labor and management).

Proposition H also requires that the seven citizen appointees to the Board have a college degree in finance, economics, law, business, or other relevant field of study, or a relevant professional certification. Additionally, a citizen appointee must have a minimum of 15 years experience in pension administration, pension actuarial practice, investment management, real estate, banking, or accounting. To prevent conflicts of interest, the measure provides that "no person who is a City employee or participant in SDCERS or a City union representative may be eligible for appointment in this category." Also, "appointees shall not have any other personal interest which would create a conflict of interest with the duties of a Board member and trustee." Proposition H passed with 64.6% of the vote.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

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Outstanding Legal Matters

In the normal course of business, SDCERS is subject to pending or threatened legal actions or other potential unasserted claims, some of which seek substantial relief or damages. After reviewing pending and threatened litigation with counsel, management believes that the outcome of these actions will not have a material adverse effect on the financial condition of SDCERS.

People of the State of California v. Lawrence Grissom et. al., San Diego Superior Court case number GIC 850246

The City Attorney filed this civil action on behalf of the People of the State of California against SDCERS' former Retirement Administrator Lawrence B. Grissom, General Counsel Loraine Chapin, and certain former SDCERS' Board members. The action seeks monetary penalties, an order setting aside specified Board actions, injunctive relief, costs and attorneys' fees for alleged violations of the Political Reform Act of 1974, as amended. Mr. Grissom, Ms. Chapin and former trustees Ron Saathoff and Teri Webster, remain as defendants in the lawsuit. SDCERS is not a party to the litigation, but has agreed to pay the legal expenses of Ms. Chapin and Mr. Grissom.

SDCERS v. City of San Diego & City Attorney, Michael Aguirre, and related cross complaint, San Diego Superior Court case number GIC 841845 and SDCERS v. City of San Diego,, San Diego Superior Court case number GIC 851286.

On January 27, 2005, the Board filed a lawsuit against the City of San Diego and its City Attorney, Michael Aguirre, seeking judicial declaration that SDCERS is entitled to retain its own legal counsel and demanding return of SDCERS' privileged documents seized from a SDCERS Board member's City office. The case is assigned to Judge Jeffrey Barton. Seltzer Caplan McMahan & Vitek ("SCMV") represents SDCERS.

The City Attorney filed a cross-complaint on behalf of the City seeking a declaration that he is entitled to represent SDCERS as its Counsel, and a declaration that retirement benefits granted by the City in 1996 and 2002 are illegal and void. After various challenges, the cross-complaint is now in its sixth version. SDCERS has filed an answer to the Fifth Amended Cross-Complaint.

On July 26, 2005, SDCERS filed an action for declaratory relief seeking a judicial determination of the legality of paying contested retirement benefits to its members. This case, *SDCERS v. City of San Diego, San Diego Superior Court case number GIC 851286*, has been consolidated with case number GIC 841845 before Judge Jeffrey Barton.

SDCERS' Motion for Summary adjudication for a declaration that SDCERS is empowered to employ legal counsel of its own choosing for all purposes, separate and independent from the City of San Diego and Office of the City Attorney of the City of San Diego, was granted on March 6, 2006. The City Attorney filed a Petition for Writ of Mandate on April 3, 2006 seeking to set aside Judge Barton's ruling. The Petition was denied.

The City filed a Motion for Summary Judgment on its Fourth Amended Cross-Complaint (notwithstanding it has been superseded by the Fifth Amended Cross-Complaint), the SDCERS complaint in Case No. GIC851286, and the various unions' complaints in intervention. The Court denied the City's Motion for Summary Judgment. The City filed a Petition for Writ of Mandate with the Fourth District Court of Appeal. The Court of Appeal denied the City's Writ Petition.

SDCERS also filed a compulsory cross-complaint to the City's cross-complaint, seeking recovery of all monies owed by the City to SDCERS but not paid because of Manager's Proposal I and II. The City answered SDCERS compulsory cross-complaint on April 26, 2006.

Trial is currently set for three phases. Phase 1 of the trial began October 25, 2006 and is currently ongoing.

SDCERS cannot predict the outcome of this matter, but believes its payment of the disputed benefits is lawful and does not believe that the resolution of these cases will have a material adverse effect on SDCERS' financial statements. If SDCERS prevails on its compulsory cross-complaint against the City, the City will be required to provide SDCERS additional funds, above and beyond its required employer contributions.

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NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

SDCERS v. City of San Diego, San Diego Superior Court case number GIC 851125.

On February 9, 2006, SDCERS filed a complaint seeking recovery of approximately $900,000 paid to attorneys for its former City-employee Board members during their cooperation in the civil matter of Gleason v. City of San Diego, et. al. and related consolidated cases, and the S.E.C. and U.S. Attorney investigations related to City bond disclosures and Manager's Proposal 2. On May 3, 2006, the City filed a demurrer to SDCERS' complaint, which was overruled. SDCERS dismissed the case on November 22, 2006.

San Diego Police Officers' Association v. Michael Aguirre, et al., United States District Court Case No. 05CV1581.

On August 9, 2005, the San Diego Police Officers' Association (POA) filed a complaint in federal court for Damages, Declaratory and Injunctive Relief against the City Attorney, City of San Diego, Retirement System, former Retirement Administrator Larry Grissom, past and present members of the City Council, certain former SDCERS Board Members, the former City Auditor and the past and present City Manager.

This case appears to be primarily based upon what the POA alleges have been unfair labor negotiation tactics by the City (e.g., docking police DROP participants 3.2% to match the decrease in the City "pick up" of employee contributions by active employees). In addition, however, it asserts claims related to MP1, MPII and health care benefits. After various pleading challenges, on April 17, 2006, SDCERS filed its Answer to the POA's Third Amended Complaint.

The Court and the parties participated in an Early Neutral Evaluation conference in which the parties discussed various issues including the status of pleadings, written discovery and depositions. Significantly, any claim for money damages against SDCERS on behalf of POA members has been eliminated, leaving only a theoretical monetary claim by the POA itself, and a claim for declaratory relief.

Two motions for Summary Judgment filed by the POA began in mid-October, 2006. The first motion requests an adjudication of the issue of whether the benefits granted to POA members should be deemed a vested property interest. The first motion was denied. The second motion sought an accounting from SDCERS of all economic activity going back to 1996. The second motion was denied.

Trial in this case is currently scheduled for April 3, 2007.

Aaron, et al. v. Aguirre, et al., Case No. 06CV1451.

On July 18, 2006, the attorneys for the POA filed a class action lawsuit on behalf of the members of the POA in the Southern District of California. SDCERS is a named defendant. The case was assigned to the Honorable James Miller, but may be transferred to Judge Huff's court as a related matter. This lawsuit is essentially identical in substance to the POA's Case No. 05CV1581. The primary difference between that case and this class action is that class members are permitted to seek their individual alleged damages from defendants, which is an amount that far exceeds what the POA could seek as a representative body.

City of San Diego v. San Diego City Employees' Retirement System, San Diego Superior Court case number GIC 865543.

On May 5, 2006, the City Attorney, in the name of the City of San Diego, filed a complaint against SDCERS seeking administrative mandate for an immediate stay of SDCERS' administrative decisions and declaratory relief. The complaint alleged that the SDCERS' Board improperly approved payment of criminal defense costs for Mr. Grissom, the former SDCERS' administrator, and Ms. Chapin, the former SDCERS' general counsel. SDCERS filed a demurrer and motion to strike the complaint. The City dismissed this action without prejudice.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

Michael Abramsky, et al. v. Alstom S.A. et al., United States District Court, Southern District of New York (Manhattan), case number 03-CV-6595 (VM).

This is a securities class action lawsuit in which SDCERS has been appointed co-lead plaintiff, along with three other public retirement funds. The defendants are the French corporation Alstom and a number of its affiliates. A second-amended Complaint was filed in March 2006. The New York City office of Berstein, Litowitz, Berger and Grossman is representing SDCERS.

San Diego City Employees' Retirement System v. Hanson, Bridgett, Marcus, Vlahos & Rudy, et. al., San Diego Superior Court case number GIC 831983.

SDCERS filed a Complaint for legal malpractice and breach of fiduciary duty against its former fiduciary counsel for actions and advice involving the Board's adoption of Manager's Proposal 2. The matter settled and SDCERS recovered approximately $11,000,000, net of attorney's fees, in September 2005.

Newsome v. San Diego City Employees' Retirement System, San Diego Superior Court case number GIC856841.

On November 14, 2005, William Newsome, a former employee of the City of San Diego, filed a complaint against SDCERS and the City of San Diego for Breach of Fiduciary Duty, Aiding and Abetting and Conspiracy. On January 25, 2006, SDCERS filed an answer to the complaint and filed a cross-complaint against the City of San Diego for declaratory relief. On September 7, 2006, the parties entered into a stipulation that dismissed the case without prejudice. In addition, the plaintiff agreed not to re-file the lawsuit if within five years the City made an additional contribution above the McGuigan settlement amounts of the lesser of (a) $100 million; or (b) an amount sufficient to allow SDCERS to achieve a funded ratio of 82.3%.

City of San Diego v. Callan Associates, Inc., Gabriel Roeder Smith & Company, San Diego Superior Court case number GIC 852419.

On August 16, 2005, the City of San Diego filed a Complaint for Damages against SDCERS' investment consultant and actuary for professional negligence, intentional fraud-affirmative misrepresentation and intentional fraud-concealment. SDCERS is not a party to this case.

On November 28, 2006, Callan and the City agreed to settle the complaint. Although Callan paid $4.5 million to the City, the City agreed that it found no proof that Callan engaged in "pay to play" practices or any other unfair business practices in connection with the hiring of money managers, nor proof that Callan engaged in unfair business practices in connection with the hiring of money managers within the meaning of Section 17200 of the California Business and Professions Code.

McGuigan v. the City of San Diego, San Diego Superior Court case number GIC 849883.

William J. McGuigan filed a complaint on June 28, 2005, claiming that Defendant City of San Diego failed to fund the retirement plan as required by the City Charter and SDMC § 24.0801. On June 8, 2006, the parties signed a term sheet agreeing to settle the case on the following terms: the City will (1) receive credit for paying SDCERS $100 million, consisting of bond proceeds from a tobacco securitization transaction, and (2) an additional $73 million over 5 years, secured by property of comparable value. On June 21, 2006, SDCERS received the $100 million payment referenced in the term sheet. SDCERS is not a party to this case and does not have any further details concerning this settlement agreement.

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NOTES TO THE FINANCIAL STATEMENTS (continued)

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The City of San Diego v. Loraine Chapin, San Diego Superior Court case number GIC 863096.

The City Attorney in the name of the City filed a complaint on March 21, 2006 against Ms. Chapin alleging violation of California Government Code section 1090. The City alleges that Ms. Chapin as a deputy city attorney had a conflict of interest when she opined on whether SDCERS was entitled to legal counsel independent from the City Attorney's office. The City has dismissed this action and agreed to pay Ms. Chapin's legal fees. SDCERS was not a party to this case.

City of San Diego v. Orrick Herrington & Sutcliff (attorneys), Calderon, Jahan & Osborn (accountants), and Webster & Anderson (attorneys), San Diego Superior Court case number GIC 857632.

This action was filed by the City of San Diego against accountants and attorneys hired by the City, alleging their the firms' legal advice and accountancy practices fell below the standard of care for similarly situated and compensated professionals. SDCERS is not a party to this action.

Federal Felony Indictments

A Federal Grand Jury was impaneled to investigate issues relating to whether the City of San Diego made material misrepresentations in certain bond disclosures regarding the method by which it funds its pension system, and potential conflicts of interest by certain SDCERS Board members and staff relating to Manager's Proposal 2. SDCERS has cooperated fully with all lawful requests for interviews, information and documentation by the U.S. Attorney's Office in this matter.

On January 6, 2006, the Grand Jury filed indictments against former SDCERS' Board members, Ron Saathoff, Cathy Lexin and Terri Webster, as well as SDCERS' former Retirement Administrator, Lawrence B. Grissom and SDCERS' former General Counsel, Loraine Chapin. The indictment states charges arising from alleged violations of Title 18, U.S.C. section 371, conspiracy to commit wire and mail fraud; Title 18, U.S.C. sections 1343 and 1346, mail fraud; and Title 18, U.S.C. Section 2, Aiding and Abetting.

In March 2006, the SDCERS Board approved a resolution to pay attorneys' fees for Mr. Grissom and Ms. Chapin arising from the defense of this action. The indemnity agreement is secured by collateral and requires repayment to SDCERS of all attorneys' fees in the event of any conviction or guilty plea arising from this action. Other than the ongoing legal expenses in responding to the United States Attorney's requests for information, and the defense costs for Mr. Grissom and Ms. Chapin, SDCERS does not believe this investigation will have a material adverse effect on the financial statements of SDCERS.

Securities and Exchange Commission (SEC) Investigation

The SEC is investigating whether the City of San Diego made material misrepresentations in certain bond disclosures regarding the method by which it funds its pension system. SDCERS is a witness from whom the SEC is gathering information in the course of its investigation. SDCERS is cooperating fully with all lawful requests by the SEC for information and documentation.

On November 14, 2006, the SEC entered an order sanctioning the City for committing securities fraud by failing to disclose information about its pension and retiree healthcare obligations in the sale of its municipal bonds in 2002 and 2003. This investigation is ongoing, and SDCERS is unable to predict when it might be concluded. Other than on-going legal expenses in response to the SEC investigation, SDCERS does not believe this investigation will have a material adverse effect on the financial statements of SDCERS.

State of California Felony Complaint

On May 17, 2005, the District Attorney's Office for the County of San Diego filed felony conflict of interest charges against five former SDCERS Board members, Cathy Lexin, Ronald Saathoff, Mary Vattimo, Teresa Webster and Sharon Wilkinson, and one then-current SDCERS Board Member, John Torres. (Mr. Torres resigned from the Board in October, 2005.)

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The complaint alleges that the named Board members violated the conflict of interest provisions of California Government Code Section 1090 et. seq. in the course of their deliberations and voting as SDCERS Board members in the 2002 decision to approve Manager's Proposal 2. At the conclusion of the preliminary hearing, the court found that there was sufficient evidence for the matter to proceed to trial.

SDCERS is not a party to this case, and therefore does not believe the outcome of this litigation will have a material adverse effect on its financial statements. SDCERS is cooperating with all lawful requests from the District Attorney's office for information and documentation.

IRS Tax Determination Letter and Voluntary Correction Program Filings
On July 12, 2005, SDCERS filed with the Internal Revenue Service (IRS) an application for a Tax Determination Letter (TDL), and a request for a compliance statement from the IRS under the Voluntary Correction Program (VCP). Ice Miller LLP is representing SDCERS before the IRS.

The initial VCP filing addressed a correction to the City's Presidential Leave Program for presidents of certain labor organizations that represent City employees. Since that time, additional VCP filings have been made concerning compensation limits under Internal Revenue Code (IRC) section 401(a)(17); minimum distribution requirements under section 401(a)(9); distribution rollover compliance under section 401 (a)(31); the DROP program; disability benefit overpayments; cashless leave/purchase of service credits; post employment health benefits and health administrative expenses under section 401(h); and benefit and compensation limits under sections 401(b), 401(c) and 401(n). All filings were made by the end of August 2006.

In its filings, SDCERS is proposing to seek recovery from the City for the following amounts: (1) $31,618,356 for retiree medical benefits paid from the SDCERS Trust Fund per City Ordinance between 1982 and 1991 ($8,227,271 for benefits, plus $23,391,085 in interest through fiscal year 2006), (2) $2,211,895 for unreimbursed costs of administering the retiree medical benefit between 1982 and July 1, 2006 ($1,523,431 for administration costs, plus $688,464 in interest through fiscal year 2006), and (3) $577,452 for the past use of Annual Leave to Purchase Service Credit.

SDCERS position is that no penalties should be imposed for any compliance failures. Although this is a reasonable position, we cannot predict whether it will be accepted by the IRS. However, SDCERS does not anticipate any material adverse financial impact from the IRS filings.

Navigant Report
On August 30, 2005, SDCERS' Board unanimously approved the retention of Navigant Consulting Inc, through its special fiduciary counsel Reish Luftman Reicher & Cohen, to conduct an independent investigation into allegations of wrongdoing by the city and SDCERS.

Navigant issued its report to the Board on January 20, 2006. A copy of which is available on SDCERS' web site at http://www.sdcers.org/forms_newsevents.jsp.

Navigant's Report concluded that there had been a breach of fiduciary duty by former SDCERS Board members approving the *1996 Manager's Proposal* and *2002 Contribution Agreement* presented by the City. Reish Luftman Reicher & Cohen provided legal analysis of Navigant's findings and concluded that approval of these agreements also violated state and municipal law. Finally, the Navigant Report concluded that the payment of certain benefits using Trust Fund assets including administration costs of retiree health care, Corbett Settlement provisions, and Presidential Leave benefits, had violated Internal Revenue Code rules, jeopardizing the Trust Fund's tax exempt status.

The Navigant Report recommended changes to SDCERS in governance and oversight, actuarial soundness, tax compliance, training and education, and SDCERS' independence from the City. In response to Navigant's findings and recommendations, the Board established an ad hoc committee to recommend appropriate reform actions to the Board for approval and implementation. The Navigant Report Committee met monthly from February to August 2006 to review the

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findings and major issues. As a result of the Navigant Report Committee meetings, the Board established a new committee structure including a Business and Governance committee as well as an Audit Committee comprised of two board members and three outside, independent members. The Board created an internal audit position to report directly to the Audit Committee and established a Compliance Officer Position, which reports directly to the Board of Administration.

Other significant changes the Board has embarked upon following the Navigant Report include: developing a fiduciary training curriculum for Board members and Executive Staff; re-evaluation of the treatment of the Corbett benefit as it relates to non-service eligible disability recipients; and appointing outside, independent professionals to the vacant Administrator and the General Counsel positions.

In addition, SDCERS' Board voted to provide previously unreleased documents to the investigative agencies who had subpoenaed SDCERS including the U.S. Attorney, the SEC and the District Attorney. SDCERS' Board also voted to provide these documents to the City's independent audit committee, Kroll. The release of these documents should assist the City in the completion of their FY 2003 and FY 2004 financial audits.

Allegations of Illegal Benefits
The City Attorney has alleged that the benefits granted by the City Council to its employees who are members of SDCERS since at least 1996 may be illegal. The City Attorney directed the City Auditor to cease paying these allegedly illegal benefits, but the City Auditor refused to do so and has indicated that only a court can determine whether or not the benefits are illegal. As noted earlier, the City Attorney raised this contention in a cross-complaint against current and former SDCERS Board members in July 2005.

As noted above, SDCERS filed a Complaint for Declaratory Relief in the San Diego Superior Court seeking a judicial determination of the legality of payment of the contested retirement benefits to its members and beneficiaries. The Court granted SDCERS' Motion for Summary Judgment, ruling that it may continue to pay benefits established by the Municipal Code unless and until they are rescinded by the City Council or otherwise declared unenforceable.

City Attorney's Interim Reports
The San Diego City Attorney has issued twelve interim reports alleging misconduct by former City officials, former members of SDCERS' Board and others as well as other subjects. The interim reports are available on the City's web page at http://www.sandiego.gov/cityattorney/reports/index.shtml.

Plan Sponsors' (Employers') Contributions
As a result of the Gleason settlement, all contribution agreements between the City and SDCERS were terminated. Also, as a term of the settlement, the City made an advanced plan sponsor (employer) contribution to SDCERS on July 1, 2004, that totaled $130 million for FY 2005. This contribution was made pursuant to settlement negotiations and was not actuarially determined. Contributions for Fiscal Years 2006-2008 will be at actuarially determined rates in accordance with terms of the settlement. The Board and the actuary will analyze and adopt appropriate actuarial assumptions to determine employer contributions for Fiscal Year 2009 and thereafter.

The Unified Port of San Diego (Port) made an advanced plan sponsor (employer) contribution to SDCERS on July 1, 2004, that totaled $7,568,769 for FY 2005. This payment was based on the Port's Annual Required Contribution (ARC) rate of 20.38% as calculated in the Port's June 30, 2003, actuarial valuation.

The San Diego County Regional Airport Authority (Airport) made an advanced plan sponsor (employer) contribution to SDCERS on July 1, 2004 totaling $2,557,357 for FY 2005. This payment was based on the Airport's Annual Required Contribution (ARC) rate of 15.09% as calculated in the Airport's June 30, 2003, actuarial valuation. The Airport made a second plan sponsor (employer) contribution to SDCERS on September 16, 2004, that totaled $3,900,000, and a third

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plan sponsor (employer) contribution on January 27, 2005, that totaled $164,889. These three advanced plan sponsor (employer) contributions for FY 2005, totaling $6,622,246, are expected to improve the Airport's funded status of 68.4% (as of the June 30, 2003 valuation) with the results of the Airport's June 30, 2005, actuarial valuation. The Airport's SDCERS' Unfunded Actuarial Accrued Liability (UAAL), as of the most recent actuarial valuation, dated June 30, 2003, totaled $5,137,000.

Member (Employee) Contributions Paid by Plan Sponsors (Employers)

Beginning in FY 2005, member (employee) contributions paid for by plan sponsors (employers), known as a member contribution offset, were modified. A brief discussion of these payments is included in *Note 6. Contribution Required and Contributions Made* located in the Notes to the Financial Statements. For non-represented general members of the City (mostly comprised of City management), the member (employee) contribution paid by plan sponsor (employer) was reduced by 5.8% of the member's (employee's) salary, from 8.0% of the member's (employee's) salary in prior years, to 2.2% of the member's (employee's) salary. Effectively, this means that beginning in FY 2005, member (employee) contributions paid by City non-represented general members to SDCERS will increase and member (employee) contributions paid by plan sponsor (employer) made by the City to SDCERS will be reduced.

Corbett Settlement Payments

A judgment known as the "Corbett Settlement" was entered into effective July 1, 2000, in settlement of issues regarding the definition of certain salary items includable or excludable from the definition of pensionable salary. The terms of the Corbett litigation provided for a 7% increase to the pension allowances being paid to the City's SDCERS' retirees (or their beneficiaries) that retired prior to July 1, 2000. The terms of the settlement provided that this would be a vested benefit in which payment would accrue and be paid in the following fiscal year if at June 30th SDCERS had earned sufficient realized gains. This benefit is payable contingent upon sufficient realized gains, however, the year-to-year liability of this benefit accrues and is due to the City's SDCERS' retirees (or their beneficiaries) when funds are available. In FY 2002 and FY 2003, there were not sufficient realized gains to pay this accrued benefit. As a result of earning sufficient realized gains in FY 2004, all current year and accrued Corbett benefit payments that were due to the City's SDCERS' retirees and their beneficiaries were paid as scheduled in November 2004. The amount paid to this group totaled $16,023,838; $5,639,382 represented current year Corbett payments due in FY 2004 and $10,384,456 represented accrued Corbett payments for FY 2003 and FY 2002.

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14. Restatements
SDCERS' total plan net assets as of June 30, 2003 have been restated as follows:

Plan Net Assets as of June 30, 2003, as stated	$2,679,049,807
1. Adjustment to reclassify DROP Plan assets as a plan liability instead of a reserved component of plan net assets.	(136,740,861)
2. Adjustment to Receivable for Members' (Employees) - Purchased Service Payments due to a change in methodology, including an Allowance for Uncollectible Purchased Service Installment Contracts Payments	634,195
3. Adjustment to Directly-Owned Real Estate Assets and Real Estate Equity Securities (Stocks)	(382,044)
4. Adjustment made to Securities Lending Cash Collateral to remove securities collateral and letters of credit pledged by borrowers	7,934,000
5. Cumulative Adjustment to Pension Liability	(419,043)
6. Cumulative Adjustment to Employee Pension Liability	(17,240)
7. Adjustment made to Securities Lending Obligations for Cash Collateral to remove securities collateral and letters of credit pledged by borrowers	(7,934,000)
8. Adjustment to Accrued Wages and Benefits	(25,161)
Plan Net Assets as of June 30, 2003, as restated	**$2,542,099,653**

In this CAFR, as of June 30, 2004, the presentation of the Statement of Plan Net Assets and Statement of Changes in Plan Net Assets for the Defined Benefit Pension Plan and the Post-Employment Healthcare Benefit Plan were separated. The above restated plan net assets as of June 30, 2003, is the combined amount of $2,520,287,826 in Defined Benefit Pension Plan Net Assets and $21,811,827 in Post-Employment Healthcare Benefit Plan Net Assets.

Receivables
An analysis of the members' (employees') - purchased service payments within the Defined Benefit Pension Plan identified various adjustments that were needed for the reporting of this receivable. Contracts entered into for purchased service credit payable by lump sum amounts (pending receipt at June 30) had not been included in the receivable and have now been included; interest on installment contracts had been included but has now been excluded and is identified as earned interest on purchased service installment contracts in the Statement of Changes in Plan Net Assets; and the allowance for uncollectible purchased service payments was created and included in the Statement of Changes in Plan Net Assets, which reduced the members' (employees') - purchased service payments receivable. The net impact was an increase to the members' (employees') - purchased service payments receivable and to the Defined Benefit Pension Plan Net Assets.

Investments
The fair value of directly-owned real estate and equity securities disclosed in the Statement of Plan Net Assets for the Defined Benefit Pension Plan was restated for FY 2003. This restatement was necessary to include the June 30, 2003, appraised values for all of SDCERS' directly-owned real estate assets; real estate fair values that were published in the FY 2003 CAFR included any appraisal activity only through March 31, 2003. This restatement allows for a direct comparison of the year-over-year data (FY 2004 and FY 2003) as presented in the Statement of Plan Net Assets. The net impact of this restatement for FY 2003 was a decrease of $382,044 in the fair value of directly-owned real estate and equity securities and an identical decrease in the Defined Benefit Pension Plan Net Assets.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

Other Assets

The value of the securities lending cash collateral in the Statement of Plan Net Assets for the Defined Benefit Pension Plan was restated for FY 2003. This restatement was necessary to reflect that amount which only represents cash that is pledged by borrowers to SDCERS as collateral for securities on loan. This presentation is consistent with GASB Statement No. 28 in that SDCERS bears the risk and reward of investing the cash collateral while SDCERS' securities are out on loan. The securities and letters of credit pledged to SDCERS as collateral for securities on loan are not accounted for in the Statement of Plan Net Assets because SDCERS does not have the ability to obtain or control the economic benefits of this collateral without a borrower default. This restatement provides for a year-over-year comparison (FY 2004 and FY 2003) as presented in the Statement of Plan Net Assets. The net impact of this restatement was a decrease of $7,934,000 in the value of the securities lending cash collateral. This did not cause a corresponding decrease in the Defined Benefit Pension Plan Net Assets as the liability for securities lending obligations for cash collateral was also decreased by an identical amount, reducing the liability owed for securities lending cash collateral to provide for a zero net impact of to the Net Assets Held in Trust for Payment of Pension Benefits. Please see Liabilities below for further commentary on the corresponding adjustment made to securities lending obligations for cash collateral.

Liabilities

The Net Pension Obligation (NPO) for the City of San Diego was recomputed for prior fiscal years, back to the implementation of GASB Statement No. 27, beginning in FY 1997, which required the reporting of a NPO, including a ten year look back period to FY 1987. This NPO recalculation was mostly due to the City's treatment of post-employment health care benefits. The City, in accordance with San Diego Municipal Code Sections 24.1502 and 24.1203, was designating a portion of its ARC payment to SDCERS for deposit into the Reserve for Post-Employment Health-care Benefit Plan. The City had recognized the full amount of their annual payment, including the amount that was designated for retiree health, as an Annual Required Contribution (ARC) payment to SDCERS' Defined Benefit Pension Plan. After the close of FY 2004, it has been determined that the portion of the City's ARC payment to SDCERS designated for retiree health, for pension accounting purposes, should not be recognized as part of the ARC payment to the City's SDCERS' Defined Benefit Pension Plan. In addition, Corbett settlement payments have also been included in the re-computation of the NPO. The resulting adjustment is an increase in NPO identified as a pension liability (pro-rata share for employees of SDCERS who are also members of SDCERS) and a decrease in the Defined Benefit Pension Plan Net Assets.

An analysis was performed on the funding of contributions for the members' (employees') portion paid by plan sponsor (employer) made by the City (known as the member (employee) contribution offset). In FY 1998, the City set aside funds from the Defined Benefit Pension Plan's undistributed surplus earnings to fund the Reserve for Member (Employee) Contribution Rate Increase Payments and annually added interest to this reserve based on the balance at each fiscal year end using Undistributed Surplus Earnings. It has now been determined that the portion of the offset payment funded from Undistributed Surplus Earnings should be recognized as a liability by the City. The resulting adjustment was an increase in Employee Pension Liability (pro-rata share for employees of SDCERS who are also members of SDCERS) and a decrease in the Defined Benefit Pension Plan Net Assets.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS (continued)

For the Years Ended June 30, 2004 and June 30, 2003

The value of the securities lending obligations for cash collateral in the Statement of Plan Net Assets for the Defined Benefit Pension Plan was restated for FY 2003. This restatement was necessary to reflect only the repayment obligation of cash that is pledged by borrowers to SDCERS as collateral for securities on loan pursuant to GASB Statement No. 28. Securities and letters of credit provided to SDCERS as collateral does not meet the definition that SDCERS has control over the collateral nor the risk and reward of managing that collateral, unless there is a borrower default. As such, there would be no corresponding liability for SDCERS for the repayment of securities and letters of credit collateral. This restatement provides for a year-over-year comparison (FY 2004 and FY 2003) as presented in the Statement of Plan Net Assets. The net impact of this restatement was a decrease of $7,934,000 in the value of the liability for securities lending obligations for cash collateral. This did not cause a corresponding decrease in the Defined Benefit Pension Plan Net Assets as the asset for securities lending cash collateral was also decreased by an identical amount, which reduced the value of the collateral asset held by SDCERS. Please see Other Assets above for an explanation of the corresponding adjustment made to securities lending cash collateral.

Accrued Wages and Benefits were restated for FY 2003 to accrue for compensated absences. The resulting adjustment was an increase in accrued wages and benefits and a decrease in net assets.

Ending Plan Net Assets for fiscal year 2003 were reduced $136,740,861, reflecting a change in accounting treatment of the DROP ("Deferred Retirement Option Program") program assets to report DROP as a plan liability. An analysis of the method for reporting plan liabilities under GASB 25 was performed, which led to a conclusion that it was preferable to report the SDCERS DROP program as a liability, rather than as a component of plan net assets. Monies that are accumulated in DROP accounts are a vested right to those funds and are payable in full to the member under prescribed distribution rules. The liability thus recorded is fully funded per plan provisions and is backed in full by assets of SDCERS. This reduction in Plan Net Assets at June 30, 2003 corresponds to a like increase of $136,740,861 labeled as "DROP Program Liability", in the Liabilities section of the Statement of Plan Net Assets. Detailed information about the benefit provisions of the DROP Program can be found in the Actuarial Section of this report, within the "Summary of SDCERS' Benefit Provisions".

* * *

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION

City of San Diego
Schedule of Funding Progress

For the Years Ended June 30 (Ten Years 2003 - 1994)
($ in Thousands)

		Continuation Indicators				
Valuation Date	Valuation Assets	AAL	Funded Ratio	UAAL	Member Payroll	UAAL Ratio to Member Payroll
6/30/03	$2,375,431	$3,532,626	67.2%	$1,157,194	$533,595	216.9%
6/30/02	2,448,208	3,168,921	77.3	720,713	535,157	134.7
6/30/01[4]	2,525,645	2,809,538	89.9	283,893	481,864	58.9
6/30/00[3]	2,459,815	2,528,774	97.3	68,959	448,502	15.4
6/30/99	2,033,153	2,181,547	93.2	148,394	424,516	35.0
6/30/98[1]	1,852,151	1,979,668	93.6	127,517	399,035	32.0
6/30/97	1,632,361	1,748,868	93.3	116,507	382,715	30.4
6/30/96[2]	1,480,772	1,620,373	91.4	139,602	365,089	38.2
6/30/95	1,316,903	1,421,150	92.7	104,247	350,584	29.7
6/30/94[1]	1,216,063	1,290,927	94.2	74,864	338,440	22.1

1 Reflects revised actuarial and economic assumptions.
2 After *1996 Manager's Proposal.*
3 Reflects non-contingent Corbett benefit increases.
4 Funded status was slightly overstated due to the unavailability and thus unincorporated liabilities resulting from purchases of service credit by members (employees).

Note – Actuarial gains and losses reduce or increase the Unfunded Actuarial Accrued Liability (UAAL) which is being amortized over a closed, 30-year period which began July 1, 1991 (18 years remaining as of the June 30, 2003, actuarial valuation).

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION

Unified Port of San Diego
Schedule of Funding Progress

For the Years Ended June 30 (Ten Years 2003 - 1994)
($ in Thousands)

		Continuation Indicators				
Valuation Date	Valuation Assets	AAL	Funded Ratio	UAAL	Member Payroll	UAAL Ratio to Member Payroll
6/30/03[5,6]	$123,884	$154,300	80.3%	$30,415	$34,164	89.0%
12/31/02[4]	125,619	137,824	91.1	12,205	33,995	35.9
6/30/02	140,613	140,197	100.3	(416)	39,063	(1.1)
6/30/01[3]	145,278	123,126	118.0	(22,152)	36,425	(60.8)
6/30/00	133,183	97,160	137.1	(36,023)	30,621	(117.6)
6/30/99	110,310	89,809	122.8	(20,501)	30,035	(68.3)
6/30/98[2]	98,007	81,633	120.1	(16,374)	26,672	(61.4)
6/30/97[1]	84,511	73,564	114.9	(10,947)	25,390	(43.1)
6/30/96	72,511	62,231	116.5	(10,280)	23,557	(43.6)
6/30/95	63,533	55,560	114.4	(7,973)	22,383	(35.6)
6/30/94	57,765	47,353	122.0	(10,412)	21,733	(47.9)

1 Reflects benefit increase for Port general members.
2 Reflects revised actuarial assumptions.
3 Reflects Andrecht Settlement.
4 Effective January 1, 2003, the State of California established a separate agency, the San Diego County Regional Airport Authority (Airport), separate from but comprised of former Unified Port of San Diego (Port) employees and newly hired employees. An interim actuarial valuation, as of December 31, 2002, was performed by SDCERS' actuary to separate the Airport's accrued liabilities and actuarial value of assets from the Port's accrued liabilities and actuarial value of assets. All retirees remained with the Port for valuation purposes.
5 Reflects revised actuarial assumptions and benefit increases effective April 1, 2004.
6 Reflects benefit increases for Port general employees.

Note – Actuarial gains and losses reduce or increase the Unfunded Actuarial Accrued Liability (UAAL) which is being amortized over a closed, 30-year period which began July 1, 1991 (18 years remaining as of the June 30, 2003, actuarial valuation).

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION

San Diego County Regional Airport Authority

Schedule of Funding Progress

For the Years Ended June 30 (Ten Years 2003 and 2002 only)
($ in Thousands)

		Continuation Indicators				
Valuation Date	Valuation Assets	AAL	Funded Ratio	UAAL	Member Payroll	UAAL Ratio to Member Payroll
6/30/03[2]	$11,142	$16,279	68.4%[3]	$5,137	$11,577	44.4%
12/31/02[1]	11,028	11,526	95.7	498	8,871	5.6

[1] Effective January 1, 2003, the State of California established a separate agency, the San Diego County Regional Airport Authority (Airport), separate from but comprised of former Unified Port of San Diego (Port) employees and newly hired employees. An interim actuarial valuation, as of December 31, 2002, was performed by SDCERS' actuary to separate the Airport's accrued liabilities and actuarial value of assets from the Port's accrued liabilities and actuarial value of assets. All retirees remained with the Port for valuation purposes.

[2] Reflects revised actuarial assumptions and benefit increases effective April 1, 2004.

[3] The decline in the Airport's SDCERS' funded ratio from 95.7% to 68.4% occurred for the following reasons: a $2 million net actuarial loss experienced since the last valuation period; increases in members' (employees) liabilities resulting from a benefit enhancement (effective on April 1, 2004), that was incorporated into the June 30, 2003 valuation; and, due to updated actuarial assumptions.

Note – Actuarial gains and losses reduce or increase the Unfunded Actuarial Accrued Liability (UAAL) which is being amortized over a closed, 18.5-year period which began January 1, 2003 (18 years remaining as of the June 30, 2003, actuarial valuation).

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION
Notes to the Schedules of Funding Progress
For the Years Ended June 30

A schedule of funding progress presents a consolidated snapshot of a retirement system's ability to meet current and future liabilities with the assets of a plan. Of particular interest to most is the status of the funded ratio. This ratio quickly conveys a retirement system's level of assets to liabilities, which is important in determining the financial health of a retirement system. The closer a retirement system is consistently around a 100% funded status, the better position it will be in to meet all of its future liabilities.

1. Key Actuarial Assumptions

The most recent annual actuarial valuations for the City of San Diego (City), the Unified Port of San Diego (Port) and the San Diego County Regional Airport Authority (Airport) were performed as of June 30, 2003.

SDCERS' utilizes the Projected Unit Credit (PUC) actuarial funding methodology (adopted by SDCERS' Board as of July 1, 1991) in determining age and service allowance actuarial liabilities at normal cost.

Key assumptions, adopted by SDCERS' Board as of July 1, 1997, and affirmed in subsequent actuarial experience studies, were also used in the most recent valuations, and are as follows:

Investment rate of return:	8.00%
Inflation rate:	4.25%
Real rate of return on investments:	3.75%
Actuarial discount rate:	8.00%

Active member payroll was assumed to increase annually as follows:

Inflation rate:	4.25%
Salary increases:	0.50%
Total member payroll increase:	4.75%

The assumed, annual pension cost-of-living adjustment is generally 2% per annum, compounded.

The member statistical data on which the annual actuarial valuations were based was furnished by SDCERS' executive management team and is combined with pertinent data on financial operations. Data was reviewed for reasonableness, but was not audited by the actuary.

The actuarial valuation computations were made by or under the supervision of a Member of the American Academy of Actuaries (MAAA).

For further information regarding the actuarial valuations and assumptions, please refer to the Actuarial Section of this CAFR.

2. Actuarial Terms Defined

Valuation Assets: Using the net market value and the net book value of plan assets, the actuary deducts all liabilities as indicated in the financial statements. The percentage differences between the net market value and the net book value over the most recent five-year period are calculated. The resulting percentages are averaged for the five-year period and applied to the current year's net book value of plan assets to arrive at valuation assets (five-year smoothing methodology).

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION

Notes to the Schedules of Funding Progress (continued)
For the Years Ended June 30

Actuarial Accrued Liabilities (AAL): The difference between the actuarial present value of plan benefits and the actuarial value of future normal costs.

Funded Ratio: This ratio measures the proportion of accrued service to projected total service and provides a measure of the plan's overall health. The ratio is calculated by dividing Valuation Assets by the Actuarial Accrued Liabilities (AAL). Over time, the ratio is expected to increase toward 100% in the absence of benefit improvements or modification of actuarial assumptions.

Unfunded Actuarial Accrued Liabilities (UAAL): The difference between Actuarial Accrued Liabilities and Valuation Assets.

Member Payroll: Each plan sponsor's (employer's) estimated total annual compensation for all active members (covered payroll) of a retirement system, as reported in the actuarial valuation.

UAAL Ratio to Member Payroll: This ratio is calculated by dividing the Unfunded Actuarial Accrued Liability (UAAL) by the Member Payroll. The ratio is a relative index of condition where inflation is present in both items. Over time, the ratio is expected to decrease toward 0% in the absence of benefit improvements or making changes in actuarial assumptions.

For further information regarding actuarial assumptions and policies, please refer to the Actuarial and Statistical Sections of this CAFR.

3. Commentary and Trend Information

According to a 2004 report by Wilshire Associates, of the 63 United States cities and counties with actuarial valuations on or after June 30, 2003, the average funded ratio of their defined benefit pension plans was 84%.

As of June 30, 2003, the date of the last actuarial valuation, the City of San Diego (City) had a SDCERS' funded status of 67.2%. This is compared to the City's SDCERS' funded status of 77.3% as of the June 30, 2002, actuarial valuation.

As of June 30, 2003, the date of the last actuarial valuation, the Unified Port of San Diego (Port) had an SDCERS' funded status of 80.3%. As of June 30, 2003, the date of the last actuarial valuation, the San Diego County Regional Airport Authority (Airport) had an SDCERS' funded status of 68.4%. In the prior fiscal year (FY 2003), effective January 1, 2003, the State of California established a separate agency, the San Diego County Regional Airport Authority (Airport), separate from but comprised of former Port employees, and newly hired employees. As a result, an interim actuarial valuation as of December 31, 2002, was performed by SDCERS' actuary to separate the Airport's accrued liabilities and actuarial value of assets from the Port's accrued liabilities and actuarial value of assets. Retirees of the Port remained with the Port as the new Airport agency was created from current active and newly hired employees; as of December 31, 2002, the Airport had no SDCERS' retirees. As of December 31, 2002, the prior year's (interim) actuarial valuation, the Port had a SDCERS' funded status of 91.1% and a SDCERS' funded status of 100.3% as of the June 30, 2002, actuarial valuation. As December 31, 2002, the prior year's (interim) actuarial valuation, the Airport had an SDCERS' funded status of 95.7%.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION

Notes to the Schedules of Funding Progress (continued)
For the Years Ended June 30

City of San Diego (City)

In this schedule, ten years of historical information is presented with respect to the funding progress of the City, a plan sponsor of SDCERS. The City has experienced, on average, an 89.01% SDCERS' funded status ratio over the past ten years. This has been achieved through solid long-term earnings on invested assets provided by a well-diversified investment program as administered by SDCERS' Board. However, over more recent years, the funded ratio has declined as a result of increased liabilities due to litigated and negotiated benefits enhancements, and experience losses during the period July 1, 2000 through June 30, 2004 where the combined average return on investments was less than the actuarially assumed 8% rate of return.

Additionally, the City's SDCERS' funded status has been reduced as a result of the City making fixed-rate contributions rather than actuarially required contributions to SDCERS as approved under the *2002 Contribution Agreement*, dated November 18, 2002, between the City and SDCERS' Board. As a result, the city cumulatively contributed $79,605,229 less than what was actuarially required as of June 30, 2004. For more information on the City's contributions to SDCERS, please see the Schedule of Plan Sponsor (Employer) Contributions and associated Notes located after this section.

As a result of having a less than 100% funded status, the City has an Unfunded Actuarial Accrued Liability (UAAL). As of the June 30, 2003 actuarial valuation, the City's SDCERS' UAAL was $1,157,194,039. This can be compared to the prior year's actuarial valuation results as of June 30, 2002, where the City's SDCERS' UAAL was $720,712,870; a year-over-year increase of 60.56%. Over the ten-year historical time period depicted in this schedule, the City's SDCERS' UAAL has grown by 31.50% (compounded), on average, each year starting at a UAAL of $74.9 million as of June 30, 1994, growing to almost $1.16 billion as of June 30, 2003. This is a result of Actuarial Accrued Liabilities (AAL) growing 10.59% (compounded), on average, each year, starting at $1.29 billion as of June 30, 1994, growing to $3.53 billion as of June 30, 2003. By contrast, during the same ten-year historical time period, the Valuation of Assets grew by 6.93% (compounded), on average, each year starting at $1.22 billion as of June 30, 1994, growing to $2.37 billion as of June 30, 2003.

The City's SDCERS' UAAL is being funded (contributions being made) over a closed, 30-year amortization period that began July 1, 1991 (18 years remaining as of the June 30, 2003, actuarial valuation). For the June 30, 2005 actuarial valuation the amortization period will be reset to a 30-year, closed amortization in accordance with the terms of the Gleason settlement. For further information on this settlement, please see *Note 12. Legal Action* in the Notes to the Financial Statements located in the Financial Section of this CAFR. The funding/contributions disclosed above have resulted in litigation as discussed in the Notes to the Financial Statement, *Note 12. Legal Action* and *Note 13. Subsequent Events*. Those notes should be read in conjunction with these notes.

Unified Port of San Diego (Port)

In this schedule, ten years of historical information is presented (in addition to the December 31, 2002, (interim actuarial valuation) with respect to the funding progress of the Unified Port of San Diego (Port), a plan sponsor of SDCERS. The Port has experienced an average funded status ratio in excess of 100% over the past ten years. This average funded status indicates that the Port has historically been in a strong position to fund current and future member and retiree liabilities. A stable, funded status provides for level and predictable employer contributions year to year. This consistent average funded status has been further strengthened by solid long-term earnings on invested assets provided by a well-diversified investment program administered by SDCERS' Board.

Over the 10-year annual historical time period depicted in this schedule, the Port's SDCERS' plan was over-funded (funded status grater than 100%) for nine out of ten years. Only recently has the Port experienced a UAAL as detailed below. As of the June 30, 2003, actuarial valuation the Port's funded status declined to 80.3% and the Port had a UAAL of

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION

Notes to the Schedules of Funding Progress (continued)
For the Years Ended June 30

$30,415,307. The size of this UAAL represents a 149.21% increase compared to the prior mid-year's (interim) actuarial valuation results, as of December 31, 2002, where the Port's UAAL was $12,204,929. The Port's SDCERS' UAAL is being funded over a closed, 30-year amortization period that began July 1, 1991 (18 years remaining as of the June 30, 2003, actuarial valuation).

San Diego County Regional Airport Authority (Airport)
Effective January 1, 2003, the State of California established a separate agency, the San Diego County Regional Airport Authority (Airport), separate from but comprised of former Unified Port of San Diego (Port) employees, and newly hired Airport employees. An actuarial valuation as of December 31, 2002, was performed by SDCERS' actuary to separate the actuarial value of assets and accrued liabilities from the Port. As a result of having a less than 100% funded status, at 68.4% funded as of the most recent actuarial valuation, the Airport had an Unfunded Actuarial Accrued Liability (UAAL). As of the date of the last actuarial valuation, June 30, 2003, the Airport's SDCERS' Unfunded Actuarial Accrued Liability (UAAL) was $5,136,756. This is compared to the prior year's (interim) actuarial valuation results, as of December 31, 2002, where the Airport's UAAL was $497,881; an increase of 931.72% between measurement periods. The significant increase in the Airport's SDCERS' UAAL (and resulting decline in their SDCERS' funded status) was due to a $2 million net actuarial loss experienced since the last actuarial valuation period combined with changes to the actuarial assumptions. In addition, members' (employees') were granted a benefit enhancement, effective as of April 1, 2004, which increased the actuarial accrued liability that contributed to the increase in the UAAL. The Airport's UAAL is being funded over a closed, 18.5-year amortization period that began January 1, 2003, (18 years remaining as of the June 30, 2003, actuarial valuation).

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION

City of San Diego
Schedule of Plan Sponsors' (Employers') Contributions

For the Years Ended June 30 (Six Years 2004 - 1999)

SDCERS' actuary calculates annual employer contribution rates using an actuarial funding methodology, currently based upon projected unit credit (PUC). The City's *Contributions Made to SDCERS* differ from the Annual Required Contributions (ARC) recommended by SDCERS' actuary. This was approved by SDCERS' Board in accordance with their authority under the Charter of the City of San Diego, Article IX, Section 143, Contributions. Further, the City's contribution funding method during 1999 through 2004 was not one of the six actuarial cost methods approved by GASB Statement 25.

	2004	2003	2002	2001	2000	1999
Annual Required Contributions (ARC)[1]	$103,357,539	$81,716,136	$66,333,211	$56,477,767	$47,471,430	$42,478,109
Contributions Made to SDCERS	81,832,070[3]	70,099,844[2]	49,743,747	43,385,069	38,700,769	34,467,464
Difference - Over/(Under) Contributed	(21,525,469)	(11,616,292)	(16,589,464)	(13,092,698)	(8,770,661)	(8,010,645)
Percentage of ARC Contributed	79.17%	85.78%	74.99%	76.82%	81.52%	81.14%

[1] ARC figures provided by SDCERS' actuary; ARC calculated using annual covered payroll.

[2] Included in the City's FY 2003 *Contributions Made to SDCERS* is a $9,923,538 contribution applicable to fiscal years 1997 - 2002 for the City's net pension obligation. This resulted from the differential amount of Annual Required Contributions (ARC), as calculated by SDCERS' actuary, versus the "Minimum City-Paid Blended Rates" for employer contributions paid by the City on behalf of the Proprietary and Fiduciary Funds.

[3] The FY 2004 City's plan sponsor (employer) contribution included Annual Required Contributions (ARC) for its Proprietary and Fiduciary Funds and the "Minimum City-Paid Blended Rates" for its General Funds. This contribution also included an amortization payment pursuant to the *2002 Contribution Agreement* due to the City's SDCERS' funded status being below 82.3% as of the June 30, 2002 actuarial valuation. This City's advanced employer contribution (payment made on July 1, 2003) represented 13.43% of the FY 2004 budgeted (covered) payroll.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Plan Sponsors' (Employers') Contributions (continued)

For the Years Ended June 30 (Six Years 2004 - 1999)

Pursuant to the "City Manager's Retirement Proposal" dated July 23, 1996 (*1996 Manager's Proposal*), the following City of San Diego employer contribution rates were in effect for fiscal years 1997 - 2003. An "Agreement Regarding Employer Contributions" (*2002 Contribution Agreement*), effective November 18, 2002, established new, fixed employer contribution rates as follows, beginning in FY 2004. The *2002 Contribution Agreement* was in effect though FY 2009 but has since been nullified due to the Gleason settlement. See *Note 12. Legal Action* in the Notes to the Financial Statements in the Financial Section of this CAFR.

City of San Diego Fixed-Rate Plan Sponsors' (Employers') Contribution Schedule

Fiscal Year	From Agreement	Minimum City Paid Blended Rate[1]	Valuation Payroll
1999	*1996 Manager's Proposal*	8.33	382,715,084
2000	*1996 Manager's Proposal*	8.83	399,035,094
2001	*1996 Manager's Proposal*	9.33	424,515,968
2002	*1996 Manager's Proposal*	9.83	448,501,827
2003	*1996 Manager's Proposal*	10.33	481,863,318
2004	*2002 Contribution Agreement*	11.89	535,156,545
2005	Gleason Settlement	n/a	533,595,405

[1] City-Paid Blended Rate is stated as a percentage of the City's active payroll.

This contribution rate schedule was applicable as long as the City's SDCERS' funded status was above 82.3%. If the funded status fell below this level, the City would make additional employer contributions as calculated under an amortized payment approach pursuant to the *2002 Contribution Agreement*.

This employer contribution funding method is not one of the six recognized actuarial cost methods.

For every year that the *1996 Manager's Proposal* and the *2002 Contribution Agreement* has been in effect, the City has made employer contributions to SDCERS in an amount less than has been recommended by SDCERS' actuary. As a result, a Net Pension Obligation (NPO) is included in the City of San Diego's Comprehensive Annual Financial Report's Financial Statements. The cumulative amount of the NPO is $163,661,000 as reported in the City of San Diego's FY 2004 CAFR.

As of July 7, 2004, a settlement agreement regarding the Gleason Class Action lawsuit was reached that invalidated the *2002 Contribution Agreement*. The City has agreed beginning in FY 2006 to move to full actuarial contributions. For further information, please see *Note 12. Legal Action*, in the Notes to the Financial Statements located in the Financial Section of this CAFR.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION

Unified Port of San Diego
Schedule of Plan Sponsors' (Employers') Contributions
For the Years Ended June 30 (Six Years 2004 - 1999)

	2004	2003	2002	2001	2000	1999
Annual Required Contributions (ARC)[1]	$4,594,580	2,210,040	218,618	1,213,404	1,301,929	1,433,903
Contributions Made to SDCERS	4,594,580	2,210,040	218,618	1,213,404	1,301,929	1,433,903
Difference - Over/(Under) Contributed	-	-	-	-	-	-
Percentage of ARC Contributed	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

[1] ARC figures provided by SDCERS' actuary; ARC calculated using annual covered payroll.

San Diego County Regional Airport Authority
Schedule of Plan Sponsors' (Employers') Contributions
For the Years Ended June 30 (2004 and 2003 only)

	2004	2003
Annual Required Contributions (ARC)1	$1,435,000	n/a
Contributions Made to SDCERS	$1,435,000	$248,796[2]
Difference - Over/(Under) Contributed	-	
Percentage of ARC Contributed	100.00%	n/a

[1] ARC figures provided by SDCERS' actuary; ARC calculated using annual covered payroll.

[2] Effective January 1, 2003, the State of California established a separate agency, the San Diego County Regional Airport Authority (Airport), separate from but comprised of former Unified Port of San Diego (Port) employees and newly hired employees. An interim actuarial valuation was performed as of December 31, 2002, by SDCERS' actuary to establish the Annual Required Contributions (ARC) for FY 2004. FY 2003 Contributions Made represents that portion of Port employer contributions made which covers Airport employees, plus one-half of fiscal year 2003 accrued employer contributions paid to SDCERS by the Airport.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION

Notes to the Schedule of Plan Sponsors' (Employers') Contributions

For the Years Ended June 30

1. Commentary and Trend Information

The sources of revenues that fund a retirement system are: plan sponsors' (employers') contributions; members' (employees') contributions; and, earnings on invested plan assets. Each year, SDCERS' actuary determines the amount of plan sponsor (employer) contributions (expressed as a contribution rate) required to fund a given schedule of benefits (current and future liabilities). These benefit schedules are calculated for each actuarial valuation from: SDCERS' benefit structure for the City, Port, or Airport; statistical data about the City's, Port's, or Airport's employees that are members of SDCERS; and, current and predicted future retirees and beneficiaries of SDCERS. Assumptions must be made to estimate how many employees (SDCERS' members) will: terminate employment; leave on a disability retirement or service retirement; and, the average ages of members (employees) at retirement and at mortality. Finally, the preceding data is combined with an actuarially assumed investment rate of return and assumed salary increases of the City's, Port's and Airport's employees (SDCERS' members). All of this information taken together is presented in actuarial valuation reports in which the actuary recommends employer contribution rates (stated as a percentage of valuation payroll) to each of the plan sponsors (employers). The actuarially determined contribution rate percentages are applied to the annual (covered) payroll for each of the participating plan sponsors' (employers') employees (SDCERS' members). The resulting dollar amounts, as depicted in this schedule, are the Annual Required Contributions (ARC) necessary to fund the promised benefits to SDCERS' members.

City of San Diego (City)

This schedule contains six years of historical information with respect to the City's Annual Required Contributions (ARC) versus the actual employer contributions made by the City, on an annual basis. Over the past six years, the City has contributed, on average, 79.91% of the amount recommended by SDCERS' actuary.

Under the "City Manager's Retirement Proposal" (1996 Manager's Proposal) dated July 23, 1996, the City negotiated with SDCERS' Board to contribute a "Minimum City-Paid Blended Rate" according to a fixed plan sponsor (employer) contribution rate schedule. This agreement established a base rate in FY 1997 (advanced payment made to SDCERS July 1, 1996) at 7.33% of that year's City's budgeted/actual payroll; the scheduled contribution rates increased by 0.50% each year thereafter. This agreement between the City and SDCERS' accounts for the average annual difference of 19.58% in employer contributions actually paid by the City versus the rate at which the actuary calculated required contributions under the Projected Unit Credit (PUC) actuarial funding methodology. The 1996 Manager's Proposal set contribution rates through FY 2006; however, in 2002, the City requested changes to this agreement. The actuarial valuation of June 30, 2002, triggered a provision in the 1996 Manager's Proposal to increase annual required plan sponsor (employer) contributions from the City, based on the 82.3% funded status floor.

Additionally, as detailed in the Schedule of Plan Sponsors' (Employers') Contributions, under FY 2003 Contributions Made, an additional plan sponsor (employer) contribution was made by the City to SDCERS on June 30, 2003. Of the total $70,099,844 in employer contributions received by SDCERS from the City in FY 2003, as depicted in the June 30, 2003, audited financial statements, $60,176,306 of plan sponsor (employer) contributions were for FY 2003. In this year, the City made employer contributions on behalf of the Proprietary and Fiduciary Funds at the full actuarial contribution rate. The remaining $9,923,538 represented additional plan sponsor (employer) contributions (net pension obligations) paid to SDCERS on June 30, 2003, on behalf of the City's Proprietary and Fiduciary Funds for Fiscal Years 1997 through 2002.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION
Notes to the Schedule of Plan Sponsors' (Employers') Contributions (continued)
For the Years Ended June 30

Effective November 18, 2002, the City entered into a new "Agreement Regarding Employer Contributions" (*2002 Contribution Agreement*) with SDCERS' Board. Under this new agreement, the City increased its FY 2004 annual plan sponsor (employer) contribution rate to 10.83% per the contribution rate schedule plus 1.06% for benefit enhancements for the City's SDCERS' general members, for a total of 11.89% versus the previous year's 10.33% contribution rate paid by the City in FY 2003 under the *1996 Manager's Proposal*. Beginning in FY 2005, and each year thereafter, the City's employer contribution rates will increase by 1.00% (minimum), versus the 0.50% per year increase that was in effect under the *1996 Manager's Proposal*. The new *2002 Contribution Agreement* rates are depicted in the City's portion of the Schedule of Plan Sponsors' (Employers') Contributions. The goal of increasing the City's annual employer contribution rate was to close the contribution rate gap by FY 2009, between the City's fixed-rate contribution schedule and the Annual Required Contributions (ARC) as calculated by SDCERS' actuary under the PUC methodology.

Beginning in FY 2009, the City has agreed to contribute plan sponsor (employer) contributions based on the full ARC rate. Beyond FY 2009, the City has agreed to move to an Entry Age Normal (EAN) funding methodology as quickly as fiscally possible. The FY 2003 ARC rate under PUC was calculated at 15.59% of the City's valuation payroll; under EAN, the FY 2003 Annual Required Contribution rate would be 17.75% of the City's valuation payroll. These contribution rates would apply to FY 2005, and are identified here for comparison purposes.

Another commitment under the *2002 Contribution Agreement* was that additional employer contributions will be made by the City to SDCERS, based on an amortized formula, in any year that the City's SDCERS' funded status is below 82.3%. This formula is based upon the difference between the fixed City employer contribution rates and the employer contributions rates as calculated by SDCERS' actuary under the PUC actuarial funding methodology based upon actuarial funding assumptions in effect as of the June 30, 2001, valuation. This difference is then divided by the number of years remaining until FY 2009, to establish a pro-rated additional employer contribution to be made in a particular fiscal year in which the City's SDCERS' funded status is below 82.3%. A complete copy of the *2002 Contribution Agreement* can be obtained from the City of San Diego Clerk's office or SDCERS' office.

This *2002 Contribution Agreement* funding arrangement is not one of the six recognized employer contribution (actuarial cost) funding methods. For every year that the *1996 Manager's Proposal* and *2002 Contribution Agreement* has been in effect, the City has made plan sponsor (employer) contributions to SDCERS in an amount less than has been recommended by SDCERS' actuary. As a result, a net pension obligation is included in the City of San Diego's Comprehensive Annual Financial Report's Financial Statements. Additionally, SDCERS' actuary has noted that the current practice of paying less than the computed Annual Required Contribution rate will foster an environment of additional declines in the City's SDCERS' funded status, absent investment returns significantly in excess of the assumed 8% actuarial investment rate of return.

As of July 7, 2004, a settlement agreement regarding the Gleason Class Action lawsuit was reached that invalidated the *2002 Contribution Agreement*. Effective in FY 2006 through FY 2008, the City will make full actuarial contributions based on terms of this agreement. The funding/contributions discussed above have resulted in litigation as discussed in the Notes to the Financial Statements, *Note 12. Legal Action* and *Note 13. Subsequent Events*, and should be read in conjunction with these notes.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION

Notes Schedule of Plan Sponsors' (Employers') Contributions (continued)
For the Years Ended June 30

Unified Port of San Diego (Port)
This schedule contains six years of historical information with respect to the Port's Annual Required Contributions (ARC) versus the actual plan sponsor (employer) contributions made by the Port. Over the past six years, the Port has contributed 100% of the amount recommended by SDCERS' actuary. Making stable contributions each year provides the Port with the flexibility to grow its employee workforce, to provide services to the region's citizens without having to substantially increase its annual employer contribution to SDCERS. Additionally, the Port has enjoyed a SDCERS' funded status of over 100%, on average, over the last decade. The Port's current SDCERS' funded status is 80.3%, which in the opinion of SDCERS' actuary, establishes the Port as being in sound condition in accordance with actuarial principles of level-cost financing, despite recent lower investment returns, accounted for in the five-year smoothing methodology used to calculate the actuarial value of assets.

San Diego County Regional Airport Authority (Airport)
This schedule depicts one-and-a-half years of historical information with respect to the Airport's Annual Required Contributions (ARC) versus the actual plan sponsor (employer) contributions made by the Airport. In FY 2004, the Airport contributed 100% of the amount recommended by SDCERS' actuary. There was no advanced plan sponsor (employer) contribution made by the Airport to SDCERS in FY 2003. The Airport was a newly formed agency effective as of January 1, 2003. As depicted in the audited financial statements in the Financial Section of this CAFR, a portion of the Port's FY 2003 plan sponsor (employer) contribution (made on July 1, 2002), totaling $598,454, was credited to the Airport for the half-year that is was a separate agency from the Port, beginning January 1, 2003, through fiscal year end, June 30, 2003. In addition, plan sponsor (employer) contributions accrued through the second half of FY 2003 were paid by the Airport to SDCERS.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
OTHER REQUIRED SUPPLEMENTARY INFORMATION — SUPPORTING SCHEDULES

SDCERS is an independent entity. The entire expense of SDCERS' administration is charged against the earnings and Plan Assets of SDCERS. Fees for investment management, actuarial services, custodial bank services and travel costs are netted against annual additions to plan assets to arrive at plan net assets at the end of the year as provided for in Sections 24.1501 and 24.1502 of the San Diego Municipal Code.

Budgetary Comparison Schedule
For the Fiscal Years June 30, 2004 and 2003

	FY 2004				FY 2003			
	Proposed Budget	Actual Appropriations	Actual Expenditures	Variance From Appropriations Savings / (Over Expended)	Proposed Budget	Actual Appropriations	Actual Expenditures	Variance From Appropriations Savings / (Over Expended)
Personnel Services	$3,356,876	$3,356,876	$3,265,323	$91,553	$3,262,313	$3,262,313	$3,093,091	$169,222
Fringe Benefits	1,198,122	1,198,122	1,434,021	(235,899)	878,017	976,494	1,181,165	(204,671)
Total Personnel	4,554,998	4,554,998	4,699,344	(144,346)	4,140,330	4,238,807	4,274,256	(204,671)
Supplies and Professional Services	16,938,276	19,675,087	20,443,117	(768,030)	16,169,660	16,197,294	14,684,741	1,512,553
Information Technology	995,191	959,436	991,877	(32,441)	784,638	757,004	1,017,679	(260,675)
Energy/Utilities	69,674	69,674	51,014	18,660	67,842	67,842	109,615	(41,773)
Equipment Outlay	11,174	11,174	10,794	380	11,174	11,174	17,462	(6,288)
Depreciation Expense		-	75,644	(75,644)		-	99,753	(99,753)
Total Non-Personnel	18,014,315	20,715,371	21,572,446	(857,075)	17,033,314	17,033,314	15,929,250	1,203,817
Totals	**$22,569,313**	**$25,270,369**	**$26,271,790**	**($1,001,421)**	**$21,173,644**	**$21,272,121**	**$20,203,506**	**$1,168,368**

	FY 2004	FY 2003
Basis Points as a Percentage of Plan Net Assets	80.15	75.41
Reconciliation		
Administrative Expenses	$10,163,263	$8,155,206
Fees Paid to Investment Professionals	14,859,235	$12,048,300
Litigation Settlement Expense	1,249,292	0
Totals	$26,271,790	$20,203,506
Payments to Consultants (component part of Total Administrative Expenses)	$4,289,911	$2,623,177

Please see additional schedules that follow in Other Required Supplementary Information for a breakdown of each of the three categories identified above.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
OTHER REQUIRED SUPPLEMENTARY INFORMATION — SUPPORTING SCHEDULES (continued)

Schedule of Administrative Expenses
For the Years Ended June 30, 2004 and 2003

	2004	2003
Personnel Services		
Salaries	$3,265,323	$3,023,546
Fringe Benefits	592,825	553,732
CERS Retirement Defined Benefit Contributions	640,869	441,382
Supplemental Pension Savings Plan (SPSP) Contributions	200,327	186,051
Total Personnel Services	4,699,344	4,274,256
Professional Services		
Actuary Services	193,998	163,250
Contracted Services	1,054,461	414,254
Member Benefits System Development Services	451,239	534,006
Legal Fees	1,486,156	277,420
Data Processing/Computer Services	885,697	1,022,326
Accounting Department Charges	218,360	211,921
Total Professional Services	4,289,911	2,623,177
Communication		
Postage	126,105	81,990
Telephone	51,014	100,874
Travel	44,957	55,429
Total Communication	222,075	238,293
Rentals		
Office Space	497,660	494,710
Equipment	49,357	153,659
Total Rentals	547,018	648,369
Office Operations		
Office Supplies & Administration	249,446	202,508
Training, Memberships & Tuition Reimbursement	54,526	51,590
Miscellaneous Fees & Charges	25,299	17,260
Depreciation Expense	75,644	99,753
Total Office Operations	404,915	371,112
Total Administrative Expenses	**$10,163,263**	**$8,155,206**

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
OTHER REQUIRED SUPPLEMENTARY INFORMATION — SUPPORTING SCHEDULES (continued)

Schedule of Payments to Consultants
For the Years Ended June 30, 2004 and 2003

Individual or Firm	2004	2003	Nature of Service
Doctors & Disability Services (see below for full listing)	$335,320	$133,075	Medical Consulting
Gabriel, Roeder, Smith & Company	193,998	163,250	Actuary
Legal Firms & Professional Legal Services (see below for full listing)	1,486,156	277,420	Legal, Arbitration, Mediation, Court Reporting
Levi, Ray & Shoup	451,239	534,006	Member Benefit Systems Development
Linea Solutions	14,655	n/a	Electronic Data Management System (EDMS) Consulting Project
Mellon Consultants (formerly Buck Consultants)	75,074	84,581	Retirement Seminars
Mercer Human Resources Consulting	337,733	2,844	Audit Services/Tax Consulting/Strategic Planning
Nuffer, Tucker, Smith, Inc.	33,881	n/a	Public Relations
San Diego Data Processing Corporation	885,697	1,022,326	Computer/Applications Support
Various Providers	476,158	405,675	Various Contractual Services
Total Payments to Consultants and Professional Service Providers	**$4,289,911**	**$2,623,177**	

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
OTHER REQUIRED SUPPLEMENTARY INFORMATION — SUPPORTING SCHEDULES (continued)

Schedule of Payments to Consultants
For the Years Ended June 30, 2004 and 2003

SDCERS used the following Doctors' services in FY 2004:

California Orthopaedic Institute
Medical Associates, Inc.
- William S. Adsit, M.D.
- Jerome C. Hall, M.D.
- Jeffery Schultz, M.D.
- Wesley R. Smidt, M.D.
- Drew A. Peterson, M.D.
- David G. Levinsohn, M.D.

Children's MRI Center
- Keith Kortman, M.D.

North County Neurology Associates
- Michael A. Lobatz, M.D.

Pacific Spine Clinic, Inc.
- L. Mercer McKinley, M.D.

San Diego Nerve Study Center
- Jonathan Schleimer, M.D.

San Dieguito Orthopaedic Medical Group, Inc.
- David R. Hackley, M.D.

Southern California Cardiology Medical Group, Inc.
- Steven A. Gross, M.D.

Torrey Pines Orthopaedic Medical Group
- Raymond J. Linovitz, M.D.

UCSD Orthopaedic Surgery
- Reid Abrams, M.D.

Other Doctors
- Daniel J. Bressler, M.D.
- William P. Curran, Jr., M.D.
- Calvin A. Colarusso, M.D.
- Richard M. Green, D.P.M
- Richard Greenfield, M.D.
- Roy A. Kaplan, M.D.
- Robert E. Neveln, M.D.
- James S. Sarkisian, M.D.
- Raymond Vance, M.D.

SDCERS paid the following Legal Firms & Professional Legal Services Firms in FY 2004:

Branton & Wilson, APC

Coughlin Semmer & Lipman LLP

Fiduciary Counselors, Inc.

Hanson, Bridgett, Marcus, Vlahos & Rudy, LLP

Hennigan, Bennett & Dorman LLP

Hillyer & Irwin

Ice Miller Legal and Business Advisors

JAMS (Judicial Arbitration Services)

Law Offices of Alton J. Smith & Neil P. Bahan

Law Offices of Michael A. Conger

Office of Administrative Hearings

Peterson & Associates - (Court Reporters)

Pillsbury Winthrop, LLP

Seltzer Caplan McMahon Vitek, APC

Sullivan Hill Lewin Rez & Engel

Information on fees paid to investment professionals is provided on the next page.

SAN DIEGO EMPLOYEES' RETIREMENT SYSTEM
OTHER REQUIRED SUPPLEMENTARY INFORMATION — SUPPORTING SCHEDULES (continued)

Schedule of Fees Paid to Investment Professionals

For the Years Ended June 30, 2004 and 2003

	2004			2003		
	Market Value of Assets Under Management[1]	Total Fees Paid	Basis Points	Market Value of Assets Under Management[1]	Total Fees Paid	Basis Points
Investment Manager Fees						
Domestic Equity Managers	$1,271,464,422	$5,733,157	45.09	$1,102,894,758	$4,187,724	37.97
International Equity Managers	539,343,173	2,439,468	45.23	391,845,286	1,802,496	46.00
Domestic Fixed Income Managers	1,030,002,991	3,800,275	36.90	844,336,681	3,090,590	36.60
International Fixed Income Managers	154,837,163	424,625	27.42	126,443,010	374,863	29.65
Real Estate Managers	282,242,314	1,852,174	65.62	234,212,568	1,950,283	83.27
Cash	3,655,549	n/a	n/a	3,062,243	n/a	n/a
Total Investment Manager Fees	**$3,281,545,612**	**$14,249,699**	**43.42**	**$2,702,794,546**	**$11,405,956**	**42.20**
Other Investment Service Fees						
Custodian Services	n/a	$202,037	0.69[2]	n/a	$204,092	0.79[3]
Investment Consultants	n/a	369,944	1.25[2]	n/a	363,194	1.41[3]
Investment Accounting Application	n/a	37,555	0.13[2]	n/a	75,058	0.29[3]
Total Other Investment Service Fees		**609,536**	**2.07[2]**		**642,344**	**2.49[3]**
Total Fees Paid to Investment Professionals		**$14,859,235**	**50.39[2]**		**$12,048,300**	**46.67[3]**

1 Market Values of Assets Under Management, as of June 30, 2004, and June 30, 2003, for SDCERS' investment managers include total investments at fair value (based on trade date), by investment strategy, as detailed in the actual asset allocation as depicted in the Investment Section of this CAFR. The audited financial statements classify SDCERS' aggregate portfolio by security type, cash, stocks, bonds and real estate, and nets receivables and payables of cash for pending transactions (settlement date based) in each strategy.

2 June 30, 2004 - Basis Points calculation based upon $2,948,646,538, which is the average of FY 2004 Total Net Investments plus Cash and Cash Equivalents equaling $3,240,852,574 and FY 2003 Total Net Investments plus Cash and Cash Equivalents equaling $2,656,058,457.

3 June 30, 2003 - Basis Points calculation based upon $2,581,727,300, which is the average of FY 2003 Total Net Investments plus Cash and Cash Equivalents equaling $2,656,058,457 and FY 2002 Total Net Investments plus Cash and Cash Equivalents equaling $2,507,014,627.

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III. Investment Section

Investment Consultant's Statement

CALLAN ASSOCIATES INC

SAN FRANCISCO
NEW YORK
CHICAGO
ATLANTA
DENVER

October 4, 2004

JAMES A. CALLAHAN, CFA

Mr. Lawrence B. Grissom
Retirement Administrator
San Diego City Employees' Retirement System
401 B Street Suite 400
San Diego, CA 92101

Dear Mr. Grissom:

This letter reviews the investment performance of the San Diego City Employees' Retirement System (SDCERS) for the fiscal years ended June 30, 2004 (FY 2004) as compared to June 30, 2003 (FY 2003).

During fiscal year 2004 and fiscal year 2003, SDCERS' custodian, State Street Bank and Trust Company, independently prepared the information underlying the performance data. The performance calculations were made in compliance with the CFA Institute's (formerly AIMR) Performance Presentation Standards. Callan Associates Inc. serves as SDCERS' independent investment consultant and evaluates SDCERS' performance in relation to market indices, appropriate manager peer groups, and other public pension plans.

SDCERS' primary investment objective is to prudently and expertly invest SDCERS' assets, in accordance with governing law and industry practices, in a manner that will ensure SDCERS' ability to pay promised benefits to its participants. In pursuit of this objective, SDCERS' Board periodically evaluates SDCERS' liabilities, expected contributions and potential earnings. This analysis is used to evaluate alternative investment strategies. The Board then selects a strategic investment plan that balances growth potential and acceptable risk to fund projected liabilities. A policy performance benchmark is constructed that mirrors SDCERS' asset allocation strategy. This policy performance benchmark is a custom total fund index comprised of equity, fixed income and real estate market indices weighted in the same proportions as SDCERS' asset allocation strategy.

Highlights of Fiscal Year 2004

Tremendous monetary and fiscal stimulus, coupled with the easing of geopolitical concerns after the United States led invasion of Iraq, fueled very strong global equity market returns during the first six months of fiscal year 2004 (July through December 2003). While the markets cooled somewhat in the last two quarters of fiscal year 2004 (January through June 2004), returns for the entire fiscal year were attractive across most global equity markets. After several years of investor pessimism, the appetite for risk increased dramatically as the more speculative areas of the markets, including small cap and emerging market stocks, led the way. For the twelve months ended June 30, 2004, the

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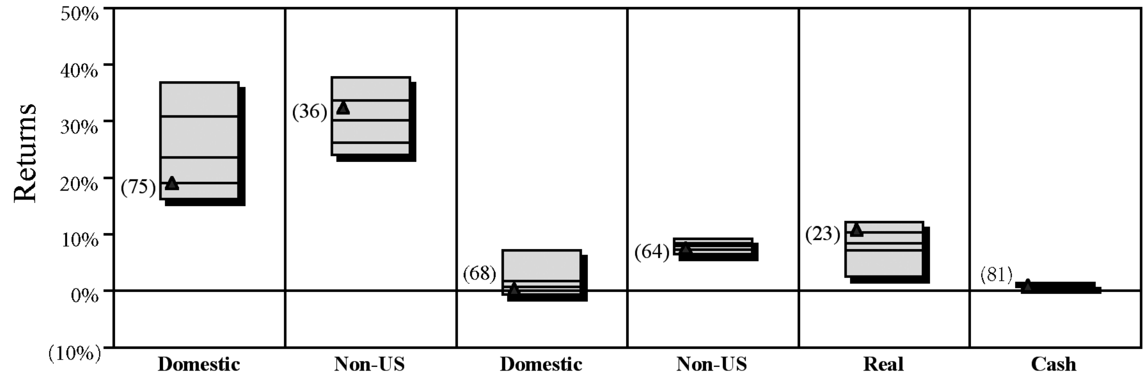
S&P 500 Index returned +19.1%, while the small cap market as measured by the Russell 2000 Index returned +33.4%. On a style basis, value stocks generally outperformed growth stocks across the capitalization spectrum. Traditional value sectors such as Energy and Basic Materials were the best performing sectors within the broad market. The dramatic monetary stimulus and resulting declines in interest rates during fiscal year 2003 led to a sluggish domestic bond market during fiscal year 2004. Improving corporate financial health and robust equity returns triggered a rise in interest rate expectations during the period, leading to falling bond prices and a modestly positive overall return for the bond market. International stocks, led by the strong rally in Japanese equities, enjoyed a banner year and comfortably outperformed their U.S. counterparts. As mentioned previously, emerging market stocks were strong performers for the year overall, despite ending the fiscal year with a sharply negative quarter. The continued weakening of the U.S. dollar in the beginning of the fiscal year generated a meaningful return premium for non-U.S. bonds relative to the U.S. market.

Highlights of Fiscal Year 2003

A strong final quarter in fiscal year 2003 mitigated much of the downward volatility felt throughout the global financial markets for the one-year period ended June 30, 2003. Reigning pessimism surrounding corporate accountability during 2002 gave way to a more optimistic global economic outlook in early calendar year 2003 which resulted in double-digit equity returns across global markets during the fourth quarter of fiscal year 2003 (March through June 2003). Domestic equity returns for the twelve-month fiscal year period were varied, as the S&P 500 Index returned +0.2% and small cap stocks ranged from slightly positive to slightly negative. On a style basis, growth stocks generally outperformed their value counterparts by a moderate margin. Domestic bonds rallied steadily as interest rates fell and uncertainty loomed in the equity markets. On the international front, equities experienced more extremes in terms of volatility, and as a result finished the year ended June 30, 2003, in slightly negative territory. International fixed income performed extremely well during the fiscal year as the dollar continued to weaken and the attractiveness of the U.S. financial markets waned.

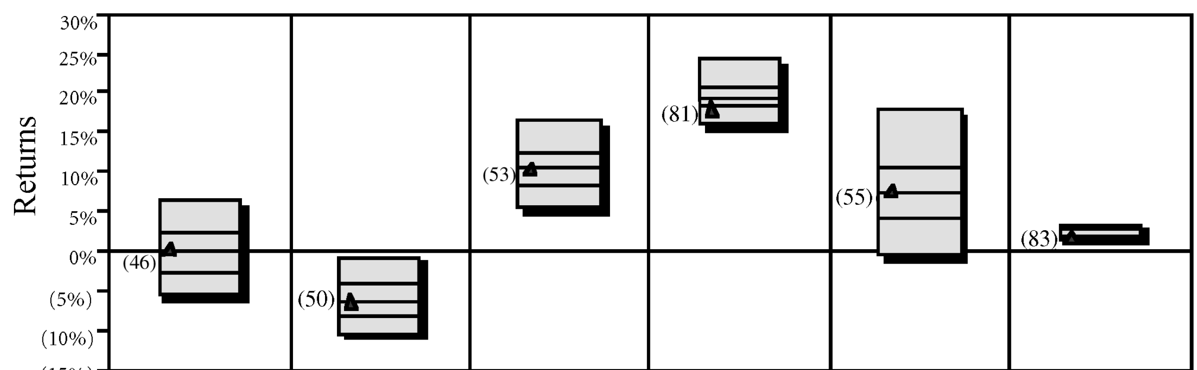
The graphs on the next page depict the performance of Callan's manager database by asset category for the year ended June 30, 2004, and June 30, 2003. The performance of the major market indices is also plotted. A review of the graphs illustrates that in fiscal year 2003, the median performing active manager in all assets classes was in line with performance of the market indices, with the exception of non-U.S. fixed income managers. During fiscal year 2004, active managers had more success in outperforming their respective indices, with the major exception being the non-U.S. equity managers. The widespread underweighting of Japan by active managers, particularly in Japanese financial sector stocks, was the main reason for this under performance. A major difference year-over-year has been the higher absolute global equity returns in fiscal year 2004 as well as the wider range of returns among active managers in that asset class.

Range of Separate Account Manager Returns by Asset Class
One Year Ended June 30, 2004



	Domestic Equity vs S&P 500	Non-US Equity vs MSCI EAFE	Domestic Fixed-Income vs LB Aggr Bd	Non-US Fixed-Income vs Citi Non-US G	Real Estate vs NCREIF Index	Cash Equivalents vs 3 Mon T-Bills
10th Percentile	36.87	37.72	7.18	9.26	12.12	1.47
25th Percentile	30.89	33.72	1.73	8.38	10.41	1.20
Median	23.54	30.15	0.71	8.02	8.47	1.12
75th Percentile	19.11	26.20	0.10	7.27	7.17	1.02
90th Percentile	16.25	24.01	(0.62)	6.51	2.55	0.72
Index ▲	19.11	32.37	0.32	7.60	10.83	0.98

Range of Separate Account Manager Returns by Asset Class
One Year Ended June 30, 2003



	Domestic Equity vs S&P 500	Non-US Equity vs MSCI EAFE	Domestic Fixed-Income vs LB Aggr Bd	Non-US Fixed-Income vs Citi Non-US G	Real Estate vs NCREIF Index	Cash Equivalents vs 3 Mon T-Bills
10th Percentile	5.93	(0.87)	16.37	24.18	11.74	3.46
25th Percentile	2.27	(4.08)	12.29	20.70	9.06	2.55
Median	(0.15)	(6.40)	10.52	19.09	8.04	1.78
75th Percentile	(2.84)	(8.41)	8.56	18.22	4.54	1.60
90th Percentile	(5.73)	(10.34)	5.56	16.43	(0.32)	1.46
Index ▲	0.25	(6.46)	10.40	17.90	7.64	1.53

SDCERS' Fiscal Year 2004 Investment Performance as Compared to Fiscal Year 2003

For the one-year period ended June 30, 2004, SDCERS' total fund, time-weighted return of +20.2% was approximately 420 basis points ahead of SDCERS' custom policy performance benchmark return of +16.0% and well ahead SDCERS' actuarial annual rate of return assumption of +8.0%. SDCERS' fiscal year 2004 total fund return surpassed SDCERS' fiscal year 2003 total fund return of +5.4%, which also exceeded SDCERS' custom policy performance benchmark return of +4.9% over the same time period.

SDCERS' custom policy performance benchmark is comprised of the following market indices, in the percentages indicated, as of June 30, 2004:

Domestic Equities
22.8% S&P 500, 7.6% S&P 400 Mid Cap, and 7.6 % Russell 2000

International Equities
10.8% MSCI All Country World ex. U.S. Free, 3.0% EMI World Ex-U.S., and
1.8% MSCI Emerging Markets Free

Domestic Fixed Income
20.5% Lehman Brothers Aggregate, 9.6% Merrill Lynch 1-5 Year Govt/Corp,
and 1.9% First Boston Convertible

International Fixed Income
5.0% Citigroup Non-U.S. World Government Bond

Domestic Real Estate
7.5% NCREIF and 2.5% Wilshire REIT

SDCERS' total fund return significantly outperformed the median public pension plan in the Callan peer universe database for the past two fiscal years. Additionally, long-term results consistently rank SDCERS' performance in the top quartile of the Callan public pension plan peer universe database. Over the last five years, SDCERS' annualized total fund return of +7.2% ranks in the first percentile of the Callan public pension plan peer universe and is a full 2% annualized ahead of SDCERS' custom policy performance benchmark.

SDCERS' Domestic Equity Performance

After enduring a modest fiscal year 2003 return of +2.8%, SDCERS' domestic equity composite returned a remarkable +28.8% during the twelve months ended June 30, 2004. This performance surpassed SDCERS' blended domestic equity performance benchmark return of +23.7% by a healthy margin of +5.1%. During fiscal year 2003, SDCERS' domestic equity composite return ranked in the first percentile in the Callan peer universe. Fiscal year 2004 was comparably impressive, as SDCERS' domestic equity composite return ranked second among Callan's peer universe. During the same fiscal year 2004 time period, the median public pension plan's domestic equity composite in the Callan peer universe returned +21.2%. The strong relative performance in the last year has improved the long-term rankings of SDCERS' domestic equity composite performance in comparison to SDCERS' fiscal year 2003 rankings. SDCERS' domestic equity composite returns exceeded SDCERS' blended domestic equity performance benchmark returns for the trailing three-year and five-year periods by healthy margins and ranked in the first percentile among public pension plans in the Callan peer universe for both periods.

SDCERS' International Equity Performance

SDCERS' international equity composite returned +37.6% for the year ended June 30, 2004, well ahead of the fiscal year 2003 return of –3.0%. The fiscal year 2004 return beat SDCERS' blended international equity performance benchmark return of +34.6% by over 300 basis points. Like SDCERS' domestic equity composite, SDCERS' international equity composite return for fiscal year 2004 ranks in the first percentile versus other public pension plans in the Callan peer universe. During fiscal year 2003, SDCERS' international equity composite return ranked in the 16th percentile of the Callan peer universe. Longer-term performance for SDCERS' international equity composite is equally impressive when measured against

SDCERS' blended international equity performance benchmark and the Callan public pension plan peer universe median return.

SDCERS' Domestic Fixed Income Performance

After lagging the benchmark significantly during fiscal year 2003, SDCERS' domestic fixed income composite performance rebounded in relative terms for the fiscal year ended June 30, 2004. A return of +3.7% for the trailing year ranked SDCERS' performance in the top percentile of public pension plans in the Callan peer universe, and outpaced SDCERS' blended domestic fixed income performance benchmark return of +1.1%. Over the same period last year, SDCERS' fiscal year 2003 domestic fixed income return of +6.1% lagged its SDCERS' blended domestic fixed income performance benchmark return of +9.9%. Despite the strong performance in fiscal year 2004, SDCERS' domestic fixed income composite longer-term cumulative return still trails SDCERS' blended performance benchmark and ranks lower than median within the Callan peer universe.

SDCERS' International Fixed Income Performance

For the twelve months ended June 30, 2004, SDCERS' international fixed income portfolio returned +7.3% which is slightly behind SDCERS' international fixed income performance benchmark return of +7.6% and trails the Callan public pension plan peer universe's median return of +8.0%. Fiscal year 2003 marked the second consecutive year in which SDCERS' international fixed income portfolio was the best performing asset class on an absolute basis. While SDCERS' international fixed income portfolio has performed at a level less than the median public pension plan in the Callan peer universe for the trailing three and five-year periods, SDCERS' since inception (June 1996) return of +6.1% annualized, ranks in the 41st percentile of the Callan peer universe and is 83 basis points ahead of SDCERS' international fixed income performance benchmark.

SDCERS' Real Estate Performance

Fueled by the exceptional performance of the REIT market during the past year, SDCERS' real estate composite provided a very impressive return of +24.3% for the one-year period ending June 30, 2004; this ranked SDCERS' real estate performance in the 10th percentile of the Callan public pension plan peer universe. Over this same time period, SDCERS' blended real estate performance benchmark returned +14.1%. Longer-term results are equally as impressive. For the trailing three and five-year periods ended June 30, 2004, SDCERS' real estate composite return totaled +13.3% and 13.4% annualized respectively, well in excess of SDCERS' blended real estate performance benchmark. This longer term performance ranks SDCERS' returns in the 17th and 16th percentiles, respectively, in the Callan peer universe.

In summary, the fiscal years ended June 30, 2004, and June 30, 2003, proved to be significantly different in terms of absolute returns in the global equity and fixed income markets. SDCERS' disciplined and diversified investment approach over these contrasting two years has led to excellent relative performance, ranking SDCERS' total fund performance in the third percentile for fiscal year 2004 and in the 25th percentile for fiscal year 2003 when compared to the Callan public pension plan peer universe database. As in fiscal year 2003, SDCERS outperformed its custom policy performance benchmark return in fiscal year 2004; in this most recent fiscal year the out performance was by a whopping 420 basis points. On an absolute basis, SDCERS participated significantly in the fiscal year 2004 equity rally while maintaining a prudent exposure to more stable return asset classes like fixed income and real estate. In combination, SDCERS' total investment portfolio produced a fiscal year 2004 return of +20.2%, well ahead of the fiscal year 2003 return of +5.4%. SDCERS' impressive results achieved during this recent period were driven by the superior relative and absolute performance in equities, both domestic and international, and real estate and by strong relative returns in domestic fixed income.

Sincerely,

James A. Callahan, CFA
Senior Vice President

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM ASSET CLASS INVESTMENT RETURNS[1]

Year-to-Year Performance Comparison

For the One-Year Periods Ended June 30, 2004 and June 30, 2003

	2004	2003
SDCERS' Domestic Equity Performance	**28.84%**	**2.81%**
Domestic Equity Benchmark, comprised of:	23.67%	-0.26%
Standard & Poor's 500 (60% weight)	19.11%	0.25%
Standard & Poor's MidCap 400 (20% weight)	27.98%	-0.71%
Russell 2000 (20% weight)	33.37%	-1.64%
SDCERS' International Equity Performance	**37.64%**	**-3.02%**
International Equity Benchmark, comprised of:	34.55%	-3.47%
MSCI AC World Free Ex-US Index (80% weight)	32.50%	-4.19%
EMI World Ex-US Index (20% weight)	44.36%	0.77%
SDCERS' Domestic Fixed Income Performance	**3.69%**	**6.11%**
Domestic Fixed Income Benchmark, comprised of:	1.14%	9.93%
Lehman Aggregate Bond Index (64% weight)	0.32%	10.40%
Merrill Lynch 1-5 Year Gov't/Corp (30% weight)	0.40%	7.77%
First Boston Convertible Index (6% weight)	14.16%	15.46%
SDCERS' International Fixed Income Performance	**7.32%**	**20.74%**
International Fixed Income Benchmark, comprised of:	7.60%	17.90%
Citigroup Non-U.S. Gov't Bond (100% weight)		
SDCERS' Real Estate Performance	**24.29%**	**6.83%**
Real Estate Benchmark, comprised of:	14.08%	5.78%
NCREIF Index (75% weight)	10.83%	7.64%
Wilshire REIT Index (25% weight)	27.17%	3.72%
SDCERS' Total Fund Performance	**20.21%**	**5.44%**
Total Fund Performance Benchmark, comprised of: S&P 500 (22.8%); L/B Aggr (20.5%); MSCI AC World Free ex-US (12.0%); ML 1-5 Gov't Corp (9.6%); Russell 2000 (7.6%); S&P MidCap 400 (7.6%); NCREIF (7.5%); Citigroup Non-U.S. Gov't Bond (5.0%); EMI World ex-US (3.0%); Wilshire REIT (2.5%); and First Boston Convertible Index (2.0%).	16.05%	4.86%

[1] Basis of calculation is time-weighted rates of return.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM ASSET CLASS INVESTMENT RETURNS[1]

Long Term Performance[2]

As of June 30, 2004

	Annualized Performance		
	3-Year	**5-Year**	**10-Year**
SDCERS' Domestic Equity Performance	**4.58%**	**5.13%**	**12.47%**
Domestic Equity Benchmark , comprised of:	2.19%	1.82%	12.18%
Standard & Poor's 500 (60% weight)	-0.70%	-2.20%	11.83%
Standard & Poor's MidCap 400 (20% weight)	6.58%	9.05%	15.47%
Russell 2000 (20% weight)	6.24%	6.63%	10.93%
SDCERS' International Equity Performance	**7.71%**	**6.97%**	**10.99%**[3]
International Equity Benchmark, comprised of:	6.92%	2.09%	4.55%
MSCI AC World Free Ex-US Index (68% weight)	5.25%	0.97%	4.40%
MSCI Emerging Markets Free (12% weight)	13.10%	3.27%	1.20%
EMI World Ex-US Index (20% weight)	12.94%	6.41%	4.93%
SDCERS' Domestic Fixed Income Performance	**5.45%**	**6.12%**	**7.23%**
Domestic Fixed Income Benchmark, comprised of:	5.74%	6.63%	7.57%
Lehman Aggregate Bond Index (70% weight)	6.36%	6.95%	7.39%
Merrill Lynch 1-5 Year Gov't/Corp (20% weight)	5.21%	6.06%	6.38%
First Boston Convertible Index (10% weight)	4.89%	5.75%	10.09%
SDCERS' International Fixed Income Performance	**14.18%**	**6.71%**	**6.73%**[3]
International Fixed Income Benchmark, comprised of:	13.66%	6.84%	6.14%
Citigroup Non-U.S. Gov't Bond (100% weight)			
SDCERS' Real Estate Performance	**13.28%**	**13.40%**	**10.49%**
Real Estate Benchmark, comprised of:	8.95%	10.54%	10.67%
NCREIF Index (75% weight)	7.97%	9.40%	10.36%
Wilshire REIT Index (25% weight)	15.19%	15.11%	12.44%
SDCERS' Total Fund Performance	**7.35%**	**7.18%**	**10.65%**
Total Fund Performance Benchmark, comprised of: S&P 500 (22.8%); L/B Aggr (20.5%); MSCI AC World Free ex-US (10.2%); ML 1-5 Gov't Corp (9.6%); Russell 2000 (7.6%); S&P MidCap 400 (7.6%); NCREIF (7.5%); Citigroup Non-U.S. Gov't Bond (5.0%); Citigroup Non-US EMI World ex-US (3.0%); Wilshire REIT (2.5%); First Boston Convertible Index (1.9%); and, MSCI Emg Mkts Fr (1.8%).	6.04%	5.13%	9.75%

[1] Basis of calculation is time-weighted rates of return.

[2] Long-Term Performance: 3-year, 5-year and 10-year performance benchmarks may have been comprised of different indices and percentage weights due to changes in SDCERS' asset allocation strategy over time.

[3] SDCERS' International Equity and International Fixed Income numbers for 10 years are since inception numbers, (1995 - 1996); 9 years of investment performance.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
INVESTMENT MANAGERS

As of June 30, 2004

Domestic Equity Investment Strategies

Delta Asset Management
Los Angeles, CA

Dimensional Fund Advisors
Santa Monica, CA

Dodge & Cox
San Francisco, CA

Globeflex Capital, L.P.
San Diego, CA

Putnam Investments
Boston, MA

Sector Capital
Memphis, TN

Trust Company of the West (TCW)
Los Angeles, CA
New York, NY

Wall Street Associates
La Jolla, CA

Domestic Fixed Income Investment Strategies

Fidelity Management Trust Company
Boston, MA

Metropolitan West Asset Management
Los Angeles, CA

Nicholas Applegate Capital Management
San Diego, CA

Pacific Investment Management Company (PIMCO)
Newport Beach, CA

Salus Capital Management, Inc.
Los Angeles, CA

SSI Investment Management, Inc.
Beverly Hills, CA

International Equity Strategies

Brandes Investment Partners
San Diego, CA

Grantham, Mayo, Van Otterloo & Co. LLC
Boston, MA

Nicholas Applegate Capital Management
San Diego, CA

Putnam Investments
Boston, MA

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
INVESTMENT MANAGERS (continued)

As of June 30, 2004

International Fixed Income Investment Strategies

Rogge Global Partners
London, England

Real Estate Investment Strategies

Invesco Real Estate
Dallas, TX

RREEF Funds
San Francisco, CA

RREEF Funds (REITs)
Chicago, IL

SSR Realty Advisors
San Francisco, CA

TCW Associates Realty / Westmark
Los Angeles, CA

U.S. Realty Advisors, LLC
New York, NY

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT OBJECTIVES AND POLICIES

Amended by SDCERS' Board, August 15, 2003

Investment Goal

It is the goal of the SDCERS' investment program to ensure that sufficient financial assets are available to provide SDCERS' members and their beneficiaries with all benefits due as specified in SDCERS' Plan. It is the goal of SDCERS' investment program to earn, on a long-term average, a total real rate of return of at least 2.5% above the rate of inflation.

General Limitations

In accordance with the City Charter, SDCERS is structured as a separate Trust Fund. It is neither part of nor combined with the City of San Diego's operational investment pool.

SDCERS' Board establishes an overall asset allocation strategy for the Trust Fund. This strategy identifies the asset classes that are to be utilized in SDCERS' investment portfolio. Allocation percentages are determined for each asset class and are used to assist SDCERS' Board in determining which asset class(es) should receive additional contributions, when available.

Diversification

1. Not more than 5% of the entire equity portfolio shall be invested in the common stock of any one company, nor shall any holding exceed 3% of the outstanding common stock of any one company, at the time of initial commitment;

2. Not more than 10% of the equity portfolio, at market value, shall be invested in preferred stocks. Not more than 2% of the entire equity portfolio shall be invested in the preferred stock of one company, nor shall any holding exceed 5% of the outstanding preferred stocks of any one company, in that particular issue, at market value;

3. Not more than 10% of the entire fixed income portfolio shall be invested in the debt security of any one issue at the time of the initial commitment, except for U.S. Government obligations (or agencies and instruments of the U.S. Government);

4. Pooled investment vehicles and funds for equity, fixed income and cash investments shall be subject to the limitations associated with their primary investment objective. In no case shall an investment in a pool or fund exceed 20% of the market value of said pool or fund, at time of initial commitment;

5. Mortgages must be diversified both by economic region and usage. The combined value of mortgage debt with security interest and other real estate investments shall not exceed 40% of the total Trust Fund, at the time of initial commitment;

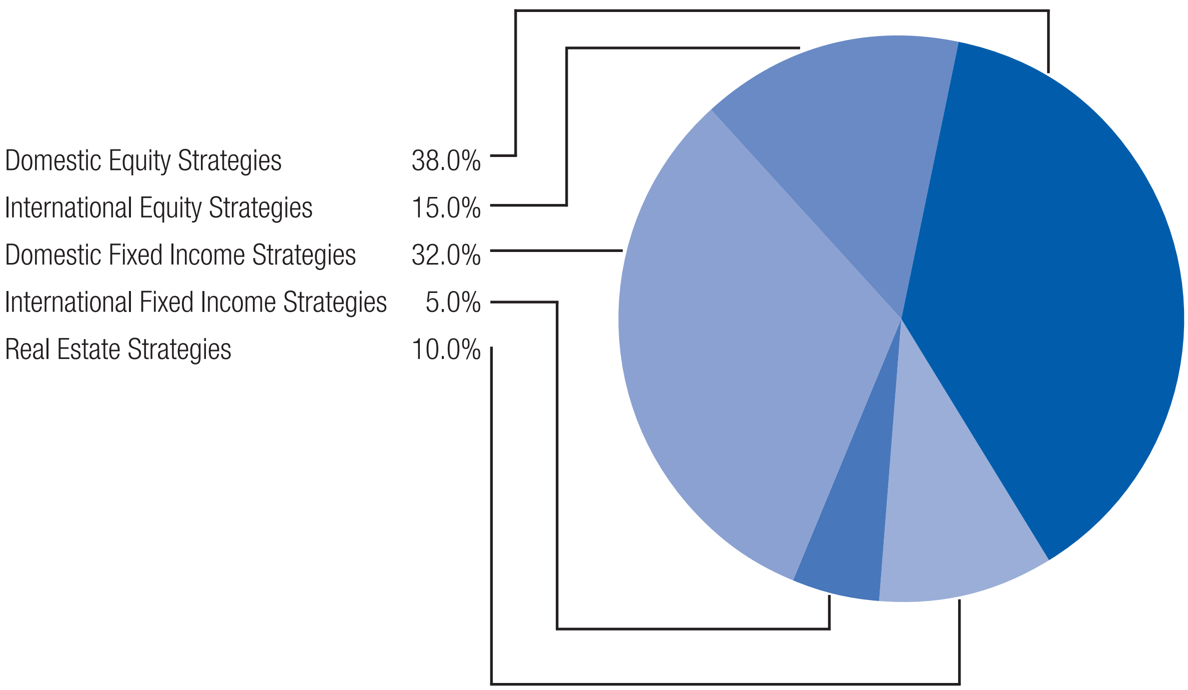
6. Real Estate fee simple, co-investments or commingled fund investments, must be diversified both by economic (geographic) region and property type; and

7. Short-term investments also must be diversified as to issuer and type, except for obligations of the U.S. Government or its agencies.

* The above is an executive summary of *SDCERS' Goals, Objectives and Policies Relating to Investments as of August 15, 2003*. For a full copy of SDCERS investment policy document, please contact SDCERS' offices at (800) 774-4977 or (619) 525-3600

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
TARGET ASSET ALLOCATION

As of June 30, 2004 and June 30, 2003

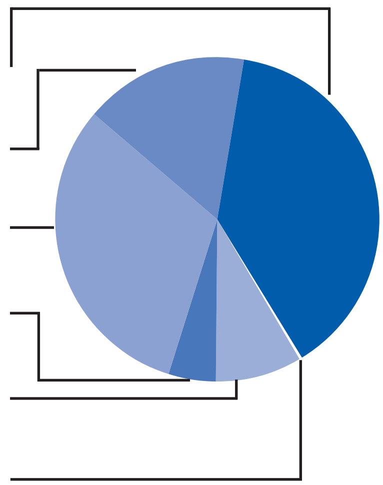


SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
ACTUAL ASSET DIVERSIFICATION – INVESTMENTS, AT FAIR VALUE

As of June 30, 2004 and June 30, 2003

2004

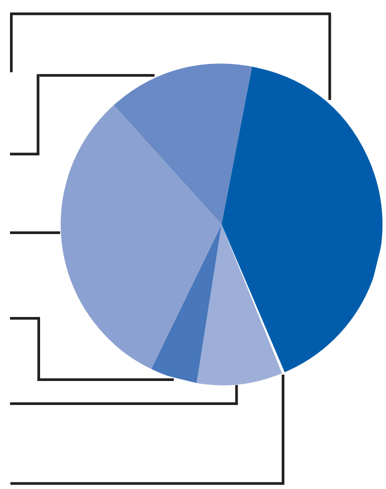
Domestic Equity Strategies	38.7%
International Equity Strategies	16.4%
Domestic Fixed Income Strategies	31.4%
International Fixed Income Strategies	4.7%
Real Estate Strategies	8.6%
Cash	0.1%



Domestic Equity Strategies	$1,271,464,422
International Equity Strategies	539,343,173
Domestic Fixed Income Strategies	1,030,002,991
International Fixed Income Strategies	154,837,163
Real Estate Strategies	282,242,314
Cash	3,655,549
Total Investments, At Fair Value	3,281,545,612
Less Pending Transactions	(40,693,038)
Total Net Investments	$3,240,852,574

2003

Domestic Equity Strategies	40.8%
International Equity Strategies	14.5%
Domestic Fixed Income Strategies	31.2%
International Fixed Income Strategies	4.7%
Real Estate Strategies	8.7%
Cash	0.1%



Domestic Equity Strategies	$1,102,894,758
International Equity Strategies	391,845,286
Domestic Fixed Income Strategies	844,336,681
International Fixed Income Strategies	126,443,010
Real Estate Strategies	234,212,568
Cash	3,062,243
Total Investments, At Fair Value	2,702,794,546
Less Pending Transactions	(46,736,089)
Total Net Investments	$2,656,058,457

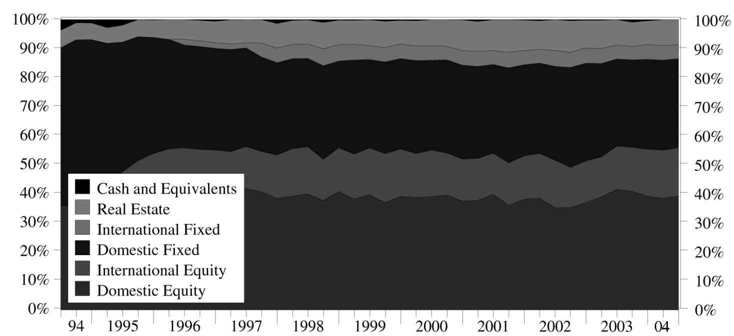
Actual asset allocation values illustrated above are based upon SDCERS' investment managers' specific strategies. Each portfolio, including all securities and cash held by an investment manager, is categorized based upon the strategy that SDCERS hired that manager to execute. SDCERS does not have a target allocation to cash. Investment strategy totals by asset class here will differ from those that appear in the audited financial statements. For GASB reporting purposes, investments in the audited financial statements are stated from a total fund perspective and are then classified by security type: i.e., cash, stocks, bonds and real estate.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
HISTORICAL ASSET ALLOCATION (ACTUAL)
Ten Year History for Fiscal Years 1995 - 2004
(July 1, 1994 - June 30, 2004)

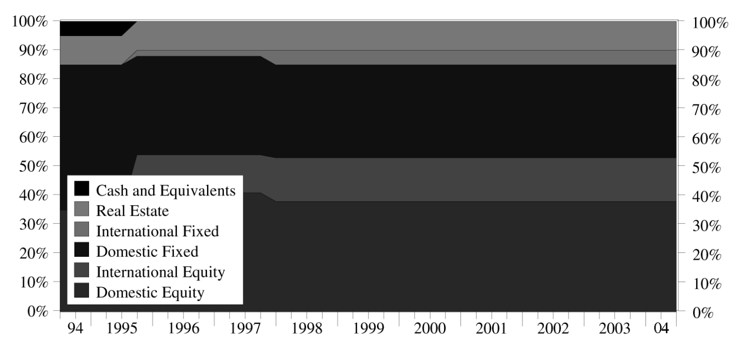
Actual vs Target Historical Asset Allocation

The Historical asset allocation for a fund is by far the largest factor explaining its performance. The charts below show the fund's historical actual asset allocation, the fund's historical target asset allocation, and the historical asset allocation of the average fund in the CAI Public Fund Sponsor Database.

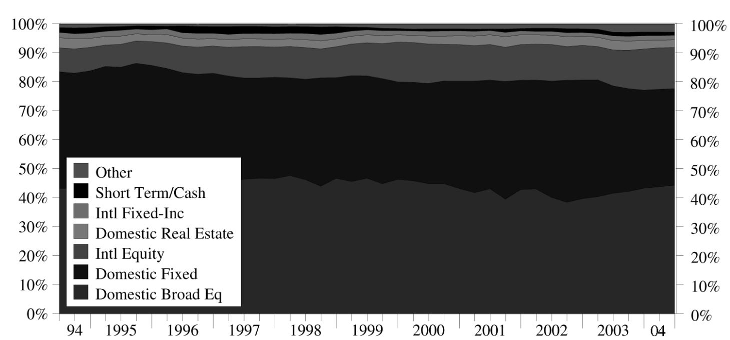
Actual Historical Asset Allocation



Target Historical Asset Allocation



Average CAI Public Fund Sponsor Database Historical Asset Allocation

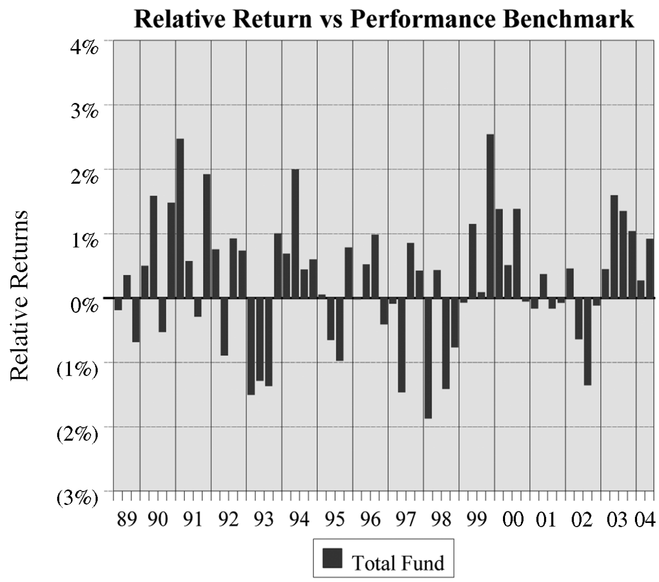


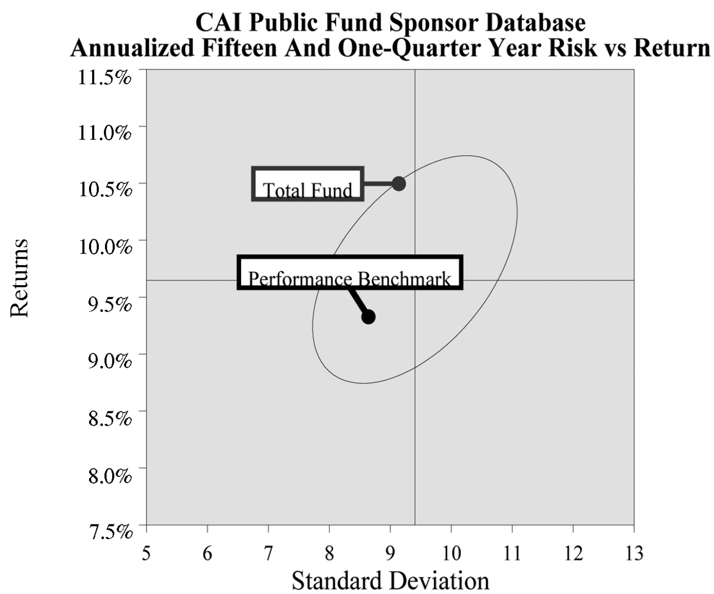
* Current Quarter Target = 22.8% S&P 500, 20.5% L/B Agg, 12.0% MSCI ACW ex US Free, 9.6% ML 1-5 Govt/Corp, 7.6% Russell 2000, 7.6% S&P Mid Cap 400, 7.5% NCREIF Classic Index, 5.0% Non-US Govt World Govt Bd, 3.0% EMI World ex US Index, 2.5% Dow Jones Wilshire REIT and 1.9% FB Convertible Index.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
HISTORICAL RISK VS. RETURN ANALYSIS

Since Inception of Diversified Investment Program

Through June 30, 2004





SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF LARGEST EQUITY HOLDINGS

As of Years Ended June 30

2004

Rank	Shares	Equity Securities (Stocks)	CUSIP	Market Value	Percentage of Total Net Investments
1	646,028	Yahoo! Inc.	984332106	$23,470,197	0.72%
2	273,912	Progressive Corp.	743315103	23,364,694	0.72
3	346,531	Amazon.com Inc.	023135106	18,851,286	0.58
4	193,642	eBay Inc.	278642103	17,805,382	0.55
5	307,632	Genentech, Inc.	368710406	17,288,918	0.53
6	266,896	Maxim Integrated Products, Inc.	57772K101	13,990,688	0.43
7	233,745	Amgen Inc.	031162100	12,755,465	0.39
8	383,041	General Electric Co.	369604103	12,410,528	0.38
9	553,307	Network Appliance, Inc.	64120L104	11,912,700	0.37
10	487,772	Cisco Systems, Inc.	17275R102	11,560,196	0.36
			Totals	**$163,410,055**	**5.04%**

2003

Rank	Shares	Equity Securities (Stocks)	CUSIP	Market Value	Percentage of Total Net Investments
1	243,129	Pfizer, Inc.	717081103	$8,302,855	0.31%
2	321,130	Microsoft Corporation	594918104	8,224,139	0.31
3	378,026	Hewlett Packard Company	428236103	8,051,954	0.30
4	193,150	Simon Property Group Inc	828806109	7,538,645	0.28
5	263,000	Prologis	743410102	7,179,900	0.27
6	166,326	Citigroup Inc.	172967101	7,118,753	0.27
7	320,172	McDonalds Corporation	580135101	7,062,994	0.27
8	126,090	Wal-Mart Stores, Inc.	931142103	6,767,250	0.25
9	209,625	Dow Chemical Company	260543103	6,489,990	0.24
10	251,000	Credit Lyonnais Cap	225386101	6,307,630	0.24
			Totals	**$73,044,110**	**2.75%**

A complete list of portfolio holdings is available upon request.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF LARGEST FIXED INCOME HOLDINGS

As of Years Ended June 30

2004

Rank	Par	Fixed Income (Bonds)	CUSIP	Market Value	Percentage of Total Net Investments
1	27,340,000	FNMA TBA Jul 30 Single Family	01F050676	$26,406,596	0.81%
2	15,473,970	United States Treasury Notes	9128274Y5	17,248,641	0.53
3	12,418,000	United States Treasury Bonds	912810FB9	13,613,233	0.42
4	13,265,000	United States Treasury Notes	912828BH2	12,952,028	0.40
5	10,630,000	United States Treasury Notes	9128277L0	10,980,458	0.34
6	7,909,006	Germany (Fed Rep)	99SRRGII1	9,564,758	0.30
7	8,754,000	United States Treasury Notes	9128275S7	8,892,149	0.27
8	7,896,100	Small Business Admin Partin CTF	831641CX1	8,601,853	0.27
9	8,600,000	FNMA TBA Jul 30 Single Family	01F052672	8,555,657	0.26
10	837,000,000	International Bank For Recon & Dev	541464II6	8,088,098	0.25
			Totals	**$124,903,470**	**3.85%**

2003

Rank	Par	Fixed Income (Bonds)	CUSIP	Market Value	Percentage of Total Net Investments
1	30,710,194	United States Treasury Notes	9128274Y5	$35,163,172	1.32%
2	13,968,561	Small Business Admin Partin CTF	831641CX1	15,753,883	0.59
3	12,652,590	United States Treasury Notes	9128275W8	14,878,655	0.56
4	14,200,000	FNMA TBA Aug 30 Single Family	01F060683	14,743,593	0.56
5	14,400,000	Calpine CDA Energy Fin ULC	13134VAA1	10,998,000	0.41
6	10,300,000	Conseco Financial Securities Corp	20846QHN1	9,495,870	0.36
7	1,130,000,000	Japan (Govt of)	637496II3	9,471,767	0.36
8	50,220,000	Kingdom of Denmark	733534II4	8,415,407	0.32
9	6,790,000	Finland (Republic of)	754818II5	7,863,180	0.30
10	7,950,000	Ford Motor Co DEL	345370CA6	7,344,867	0.28
			Totals	**$134,128,394**	**5.05%**

A complete list of portfolio holdings is available upon request.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF COMMISSIONS
Top 25 Brokerage Firms Used
For the Year Ended June 30

		2004		
Rank	Brokerage Firm	Number of Shares	Total Commissions	Commission Per Share
1	Goldman Sachs & Company	18,173,841	$1,217,364	$0.067
2	Morgan Stanley & Co.	16,119,780	852,664	0.053
3	Citigroup Global Markets, Inc.	20,294,551	769,965	0.038
4	UBS PaineWebber, Inc.	13,656,555	522,326	0.038
5	Merrill Lynch & Co., Inc.	22,675,147	436,983	0.019
6	Investment Technology Group, Inc.	18,109,653	342,577	0.019
7	ABN AMRO	9,823,203	312,020	0.032
8	Bear Stearns & Co., Inc.	8,749,017	296,942	0.034
9	Lehman Brothers, Inc.	7,740,983	271,961	0.035
10	Credit Suisse First Boston Corp.	7,560,475	220,389	0.029
11	Jefferies & Company, Inc.	7,675,409	197,641	0.026
12	Bank of America Securities LLC	4,141,665	193,506	0.047
13	Wells Fargo Securities LLC	5,318,426	183,248	0.034
14	Westminster	2,531,394	148,041	0.058
15	Wachovia Securities, LLC	3,229,586	147,669	0.046
16	Cantor Fitzgerald & Co.	5,168,101	135,404	0.026
17	Charles Schwab & Co. LLC	2,764,803	123,608	0.045
18	BNY Clearing Services LLC	4,415,625	105,986	0.024
19	Deutsche Bank Securities, Inc.	3,568,840	104,208	0.029
20	Standard & Poors Securities, Inc.	1,619,106	87,853	0.054
21	JP Morgan Securities, Inc.	1,732,252	85,822	0.050
22	Keefe Bruyette & Woods, Inc.	1,720,757	85,414	0.050
23	CIBC World Markets Corp.	1,985,447	84,292	0.042
24	Pershing LLC	1,603,991	72,712	0.045
25	Broadcort Capital	1,136,842	64,840	0.057
	All Other Brokers	51,893,463	1,674,951	0.032
	Totals	**243,408,912**	**$8,738,385**	**$0.036**

Year-Over-Year Changes: 9.88% increase in total shares traded; 20.76% increase in total commissions paid; 9.10% increase in commissions per share paid.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF COMMISSIONS (continued)

Top 25 Brokerage Firms Used

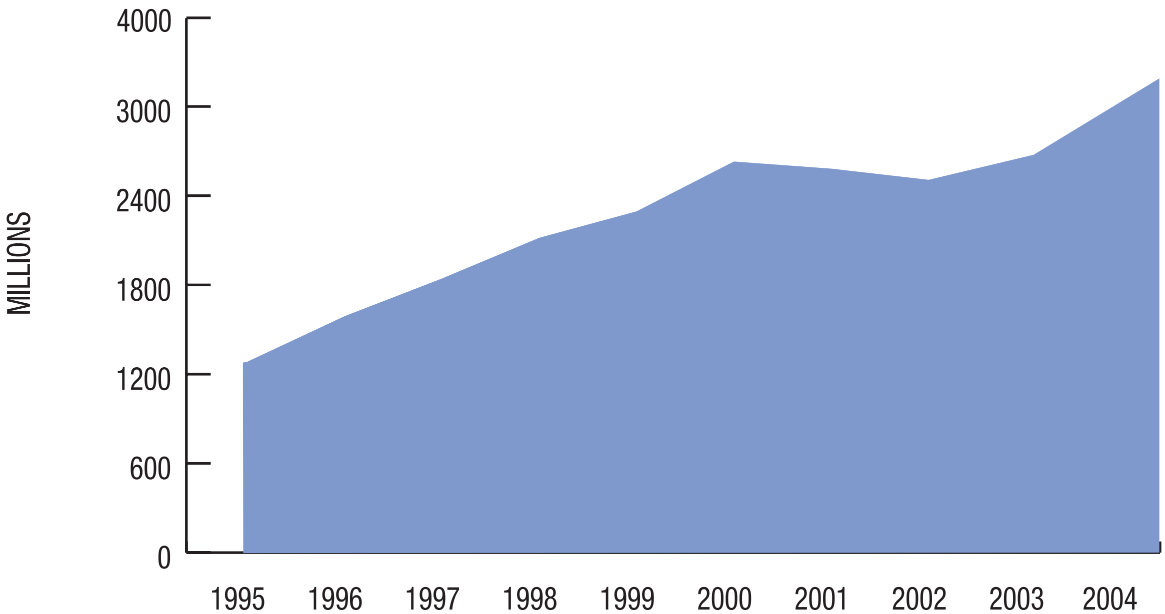
For the Year Ended June 30

2003

Rank	Brokerage Firm	Number of Shares	Total Commissions	Commission Per Share
1	Salomon Smith Barney, Inc.	17,429,322	$692,990	$0.040
2	Goldman Sachs & Company	18,283,737	686,398	0.038
3	State Street Brokerage Services	22,161,788	482,672	0.022
4	UBS Painewebber, Inc.	13,144,037	461,017	0.035
5	ABN AMRO	8,533,325	390,204	0.046
6	Investment Technology Group, Inc.	13,425,713	367,009	0.027
7	Morgan Stanley & Co.	9,828,555	283,968	0.029
8	Lehman Brothers, Inc.	5,657,541	258,712	0.046
9	Merrill Lynch & Co., Inc.	10,397,542	257,515	0.025
10	Citigroup Global Markets, Inc.	5,333,509	241,312	0.045
11	Credit Suisse First Boston Corp.	6,133,516	205,871	0.034
12	Jefferies & Company, Inc.	3,634,399	151,836	0.042
13	Bear Stearns & Co., Inc.	4,883,235	148,867	0.030
14	Instinet	4,705,522	146,157	0.031
15	Cantor Fitzgerald & Co.	2,241,472	115,495	0.052
16	JP Morgan Securities, Inc.	3,283,030	109,146	0.033
17	BNY Clearing Services LLC	4,156,473	105,236	0.025
18	Bank of America Securities LLC	2,159,480	99,043	0.046
19	Prudential Securities Incorporated	2,481,702	93,328	0.038
20	Deutsche Bank Securities, Inc.	10,507,896	93,211	0.009
21	CIBC World Markets Corp.	1,887,790	85,088	0.045
22	Ragen Mackenzie Incorporated	2,376,194	84,102	0.035
23	Wells Fargo Securities LLC	1,987,414	69,985	0.035
24	Robert W. Baird & Co, Incorporated	1,333,950	64,647	0.048
25	Standard & Poors Securities, Inc.	1,039,390	60,740	0.058
	All Other Brokers	44,520,299	1,481,319	0.033
	Totals	**221,526,831**	**$7,235,868**	**$0.033**

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
GROWTH OF INVESTMENTS, AT FAIR VALUE

For Ten Years Ended June 30, 2004

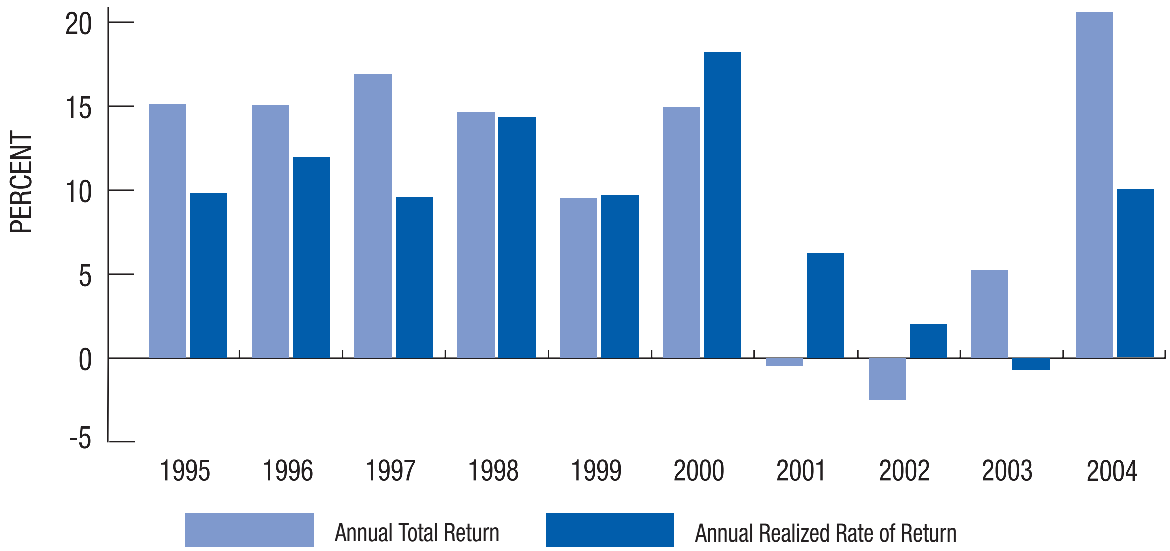


Fiscal Year	Fair Value[1]
1995	$1,282,592,739
1996	1,590,285,263
1997	1,843,391,624
1998	2,116,909,236
1999	2,295,022,045
2000	2,629,874,234
2001	2,582,009,762
2002	2,507,014,627
2003	2,656,058,457
2004	**3,240,852,574**

[1] Fair value includes investments, cash and cash equivalents on deposit, net of pending transactions (receivable for securities sold and liability for securities purchased).

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
HISTORICAL INVESTMENT PERFORMANCE

For Ten Years Ended June 30, 2004

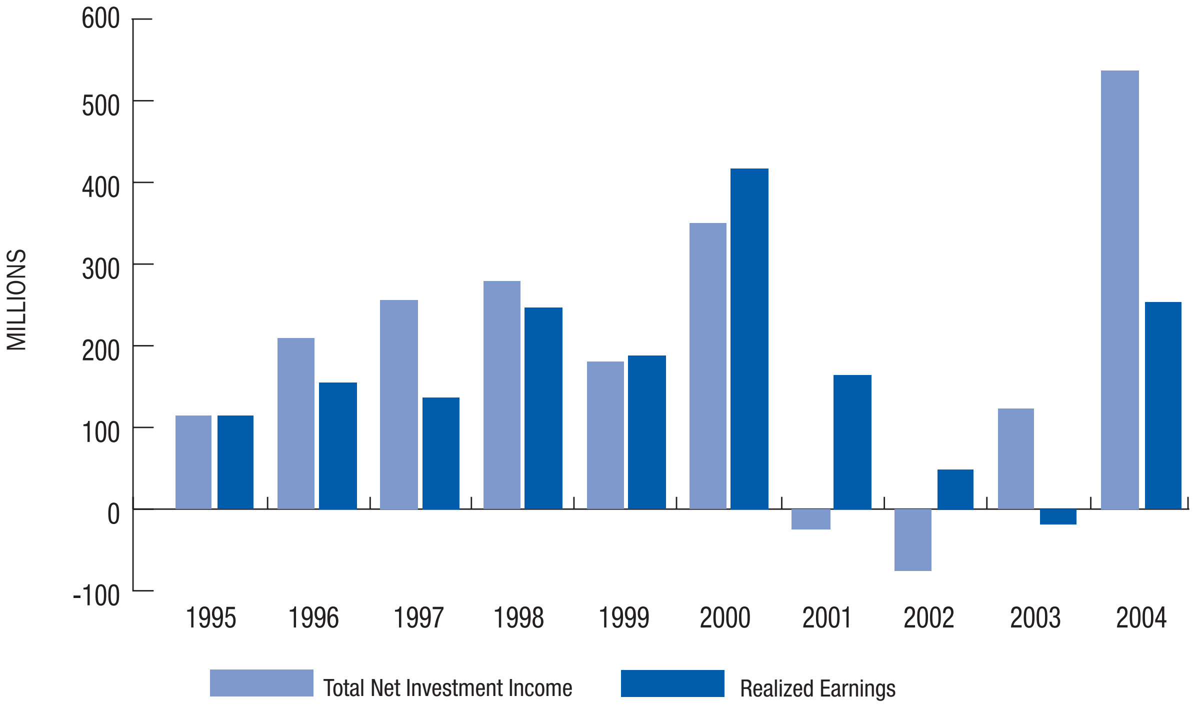


Fiscal Year	Annual Total Return	Annual Realized Rate of Return
1995	15.11%	9.80%
1996	15.08%	11.96%
1997	16.88%	9.57%
1998	14.64%	14.33%
1999	9.59%	9.70%
2000	15.18%	18.24%
2001	(0.75)%	6.26%
2002	(2.40)%	2.02%
2003	5.44%	(0.96)%
2004	**20.21%**	**9.76%**

Annual Total Return measures fund performance in terms of the aggregate change in SDCERS' market value of investments from the beginning of the measurement period to the end of the measurement period. The Annual Realized Rate of Return measures the gains or losses from actual sales of invested assets plus dividends and income earned during the period. The payment of certain SDCERS' contingent retirement benefits is dependent upon the level of annual realized earnings. For further information, please see the Notes to the Financial Statements in the Financial Section of this CAFR.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
HISTORICAL INVESTMENT PERFORMANCE (continued)

For Ten Years Ended June 30, 2004



Net Investment Income
Income earned as of June 30 each year

Fiscal Year	Total Net Investment Income	Realized Earnings[3]
1995	$114,393,608[1]	$114,393,608
1996	209,227,674[2]	155,077,454
1997	255,998,283[2]	136,687,652
1998	278,681,878[2]	246,768,067
1999	180,463,938[2]	187,942,463
2000	349,654,651[2]	417,057,074
2001	(25,126,082)[2]	164,115,281
2002	(75,934,760)[2]	49,082,291
2003	122,729,552[2]	(18,644,596)
2004	**537,196,172**[2]	**260,239,046**

1 Per GASB Statement No. 5, the cost basis of invested assets was reported at year end, thus unrealized income (difference between cost basis and market value) was not recognized as earnings at fiscal year end. The Total Net Investment Income figure for FY 1995 is not stated net of investment manager fees and related investment expenses.

2 Total Net Investment Income includes dividends paid, interest earned, real estate income, and income from securities lending, less investment manager fees and related investment expenses, plus, per GASB Statement No. 25, the net appreciation / depreciation in the fair value of assets.

3 Realized Earnings are depicted in this historical schedule as the payment of certain SDCERS' contingent benefits are dependent upon the level of annual realized earnings generated on invested assets. The calculation of realized gains and losses disclosed is independent of the calculation of net appreciation (depreciation) in the financial statements.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
HISTORICAL ASSET HOLDINGS INFORMATION

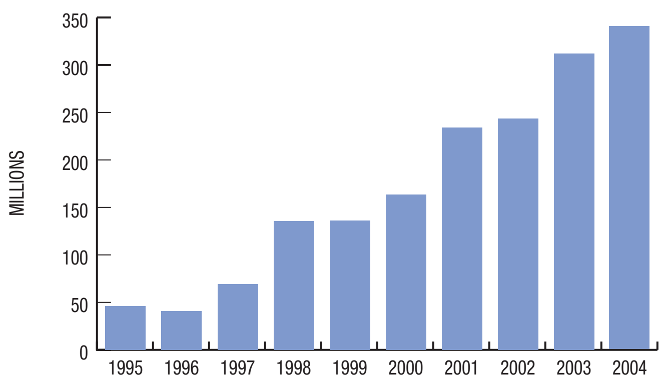
Values Stated on a Trade Date Basis, Gross of Pending Transactions

For Ten Years Ended June 30, 2004

Cash & Cash Equivalent Holdings

Valuation done June 30 each year

Cash and Cash Equivalents are investments with maturities of 90 days or less



Fiscal Year	Market Value of Cash & Equivalents[1]
1995	$46,347,036
1996	40,726,138
1997	69,361,891
1998	135,676,617[2]
1999	135,976,338[2]
2000	163,498,829[2]
2001	234,194,670[2]
2002	243,596,793[2]
2003	312,044,538[2]
2004	**343,851,225**[2]

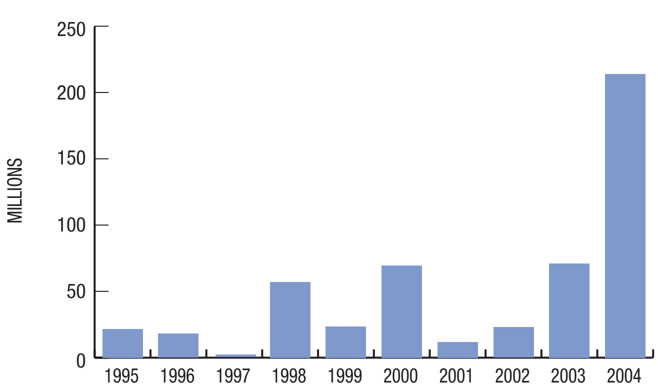
[1] SDCERS does not have a target allocation to cash. In accordance with GASB Statement No. 25, assets are classified by security type; therefore, residual cash held in an investment manager's portfolio is reported here.

[2] Higher cash holdings are due to SDCERS' market neutral strategy that was added to SDCERS' defensive domestic fixed income asset allocation in 1998. The market neutral strategy of long and short domestic equity positions (U.S. stocks) are classified as a net cash position, which is unsecuritized and invested at the Federal Funds Rate less a rebated amount.

Short-Term Investment Holdings

Valuation done June 30 each year

Short Term Investments are investments with maturities greater than 90 days but less than one year



Fiscal Year	Market Value of Short-Term Investments
1995	$21,666,006
1996	18,185,248
1997	609,768
1998	57,018,178
1999	26,318,203
2000	69,460,684
2001	11,864,163
2002	23,004,166
2003	70,934,651
2004	**214,401,018**

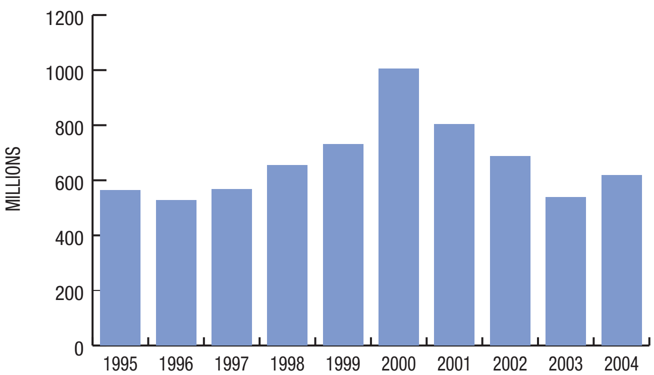
SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM HISTORICAL ASSET HOLDINGS INFORMATION (continued)

Values Stated on a Trade Date Basis, Gross of Pending Transactions

For Ten Years Ended June 30, 2004

Domestic and International Fixed Income (Bond) Holdings

Valuation done June 30 each year

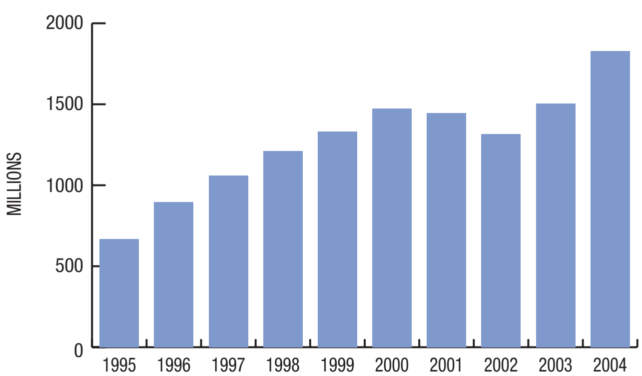


Fiscal Year	Market Value of Bonds
1995	$564,440,812
1996	528,199,836[1]
1997	567,063,982[1]
1998	654,726,238[1]
1999	731,111,193[1]
2000	1,005,154,473[1]
2001	803,756,585[1]
2002	687,237,643[1]
2003	583,984,424[1]
2004	**617,720,971**[1]

[1] International fixed income (bonds) exposure added to holdings in FY 1996.

Domestic and International Equity (Stock) Holdings

Valuation done June 30 each year



Fiscal Year	Market Value of Stocks
1995	$669,385,913
1996	895,631,516
1997	1,059,691,384
1998	1,210,749,732
1999	1,332,344,711
2000	1,473,187,920
2001	1,446,763,240
2002	1,315,658,196
2003	1,505,010,871
2004	**1,827,886,468**

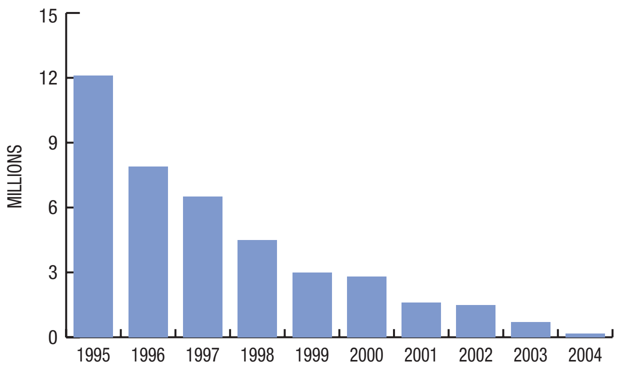
SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
HISTORICAL ASSET HOLDINGS INFORMATION (continued)

Values Stated on a Trade Date Basis, Gross of Pending Transactions

For Ten Years Ended June 30, 2004

Mortgage Holdings

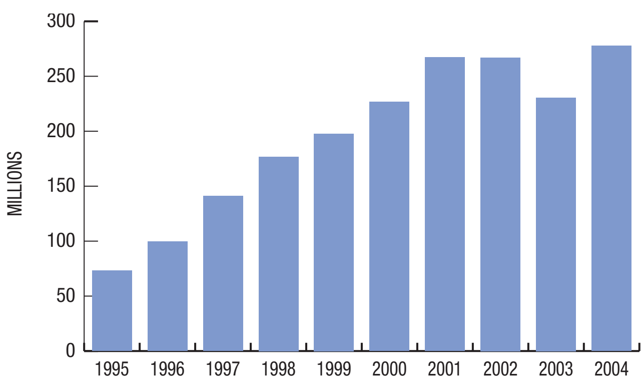
Valuation done June 30 each year



Fiscal Year	Market Value of Mortgages
1995	$12,180,228
1996	7,916,298
1997	6,551,890
1998	4,493,308
1999	3,008,566
2000	2,784,927
2001	1,617,777
2002	1,515,530
2003	668,621
2004	**17,022**

Real Estate Holdings (includes REITs)

Valuation done June 30 each year[1]



Fiscal Year	Market Value of Real Estate
1995	$73,157,993
1996	99,626,227
1997	140,112,709
1998	176,961,020
1999	197,756,091
2000	226,687,071
2001	267,250,573
2002	267,069,355
2003	230,151,441
2004	**277,668,908**

[1] Market value of real estate portfolio is lagged by up to two quarters. Values may be slightly higher or lower than what was experienced on June 30 for FY 1995-2002 due to any appraisal activity. Values for FY 2003 and FY 2004 are correctly stated as of June 30 for each year.

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IV. Actuarial Section

Actuary's Certification Letter

GABRIEL, ROEDER, SMITH & COMPANY
Consultants & Actuaries
9171 Towne Centre Drive • Suite 440 • San Diego, California 92122 • 858-535-1300 • FAX 858-535-1415

September 24, 2004

Members of the Retirement Board
San Diego City Employees' Retirement System
401 B Street, Suite 400
San Diego, CA 92101

Members of the Board:

We are pleased to have provided the actuarial reports from the results of the required annual actuarial valuations of the San Diego City Employees' Retirement System (SDCERS) prepared as of June 30, 2003. The valuation calculations were based on financial statements and financial data provided by SDCERS' executive management team. The data was checked for reasonableness by our staff.

SDCERS' funding objective of the San Diego Unified Port (Port) and the San Diego County Regional Airport Authority (Airport) is to establish and receive contributions, expressed as percents of active member payroll, which will remain approximately level from year to year and will not have to be increased for future generations of citizens. As part of the Gleason settlement agreement, the City of San Diego (City) will be required to make higher than normal contributions through fiscal year 2008. After that time, the City intends to provide level-cost funding, as a percentage of active member payroll that will be approximately equal among different generations of affected taxpayers.

Annual actuarial valuations provide a measure of progress toward this funding objective, as well as test the adequacy of contribution rates. The valuations also provide for a measure of funded status of SDCERS' plan sponsors. As of the last valuation date of June 30, 2003, the funded ratios for the three plan sponsors (employers) participating in SDCERS were as follows:

	2003 Valuations	Previous Valuations
City	67.2%	77.3%
Port	80.3	91.1
Airport	68.4	95.7

The June 30, 2003, valuations reflect benefit enhancements granted by all SDCERS' plan sponsors (employers) and assumption changes for the Port's and the Airport's SDCERS' plan. While the City's previous actuarial valuation was completed as of June 30, 2002, there were two interim actuarial valuations completed on December 31, 2002, for the Port and the Airport due to the creation of the San Diego County Regional Airport Authority by the State of California on January 1, 2003.

The actuarial valuations were calculated based on an inflation assumption rate of 4.25% and an

September 24, 2004

annual real rate of investment return of 3.75%. Thus, the nominal assumed investment rate of return was 8%. The annual salary increase was assumed to be 4.75% with an additional, variable merit increase for an active member's (employee's) first five years of service. The actuarial assumptions used in the plan sponsors' (employers') actuarial valuations are summarized in the attachments to the complete actuarial valuations that are on file at SDCERS' offices. All assumptions were adopted by SDCERS' Board after receiving input from SDCERS' actuary.

The actuarial valuations also compare assumed financial experience to actual financial experience. As of the June 30, 2003, actuarial valuations, there were experience losses as follows, with percents in parentheses representing the experience loss as a percent of valuation liabilities at the beginning of the valuation period:

	Experience Loss (Millions)	
City	$303.7	(9.6%)
Port	10.2	(7.4%)
Airport	2.0	(17.5%)

SDCERS is supported by members' (employees') contributions, plan sponsors' (employers') contributions, and investment income earned on SDCERS' plan assets. The asset value used in determining the plan sponsors' (employers') contribution rates reflects a portion of the unrealized gain or loss in assets. Contributions which satisfy the funding objective are determined by the annual actuarial valuations and are sufficient to: cover the actuarial present value of benefits allocated to the current year by the actuarial cost method (normal cost); and finance over a period of future years the actuarial present value of benefits not covered by valuation assets and anticipated future normal cost (unfunded actuarial accrued liability).

The assumptions and methods used in these actuarial valuations for funding purposes meet the disclosure requirements stated in GASB Statement No. 25, with the exception of calculating for "contingent" Corbett settlement benefits in the City's actuarial valuation.

All schedules in the Actuarial Section were based on information obtained from the June 30, 2003, actuarial valuation reports, as well as information from previous years' actuarial valuations. The following is a list of schedules in the Actuarial Section provided by us.

1. Schedule of Retirants and Beneficiaries Added To and Removed From Rolls
2. Solvency Test

While we did not specifically assemble any of the schedules in the Financial and Statistical Sections, we understand that specific data from the June 30, 2003, actuarial valuations and data from prior years' actuarial valuations was used by SDCERS' staff in the presentation of select schedules.

Sincerely,

Rick Roeder

Rick A. Roeder, EA, FSA, MAAA

GABRIEL, ROEDER, SMITH & COMPANY

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS

Used for the June 30, 2003 Valuations

- The **actuarial assumptions and methods** shown in the supporting schedules were recommended and calculated by the actuary and adopted by SDCERS' Board. These assumptions and methods are reviewed and approved annually by SDCERS' Board for each actuarial valuation report. The various economic assumptions currently being used in the actuarial valuations for all three plan sponsors have been in effect since July 1, 1997.

- The **investment rate of return** used in calculating the actuarial valuations was 8.0% per year, compounded annually.

- The **real rate of return** used is the difference between the investment rate of return and the inflation rate. The assumed inflation rate was 4.25%.

Investment Return	8.00%
minus Inflation	4.25%
Real Rate of Return	3.75%

- The **actuarial value of assets** is determined using the net market value and net book value (cost) of plan assets. Taking the gross values and deducting liabilities and reserves as indicated in the financial statements arrives at net values available for benefits. The percentage differences between net market value and net book value over the most recent five-year period were calculated. The resulting percentages were averaged for the five-year period and applied to the current year's net book value of plan assets to arrive at the actuarial value of assets.

- The **probabilities of withdrawal** from active employment, before member is age and service retirement eligible, are shown in Schedule 1.

- The **probabilities of retirement** with an age and service allowance are shown in Schedule 2.

- Total **active member payroll** was assumed to increase as follows:

Inflation	4.25%
plus Merit & Longevity	0.50%
Total	4.75%

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS (continued)

Used for the June 30, 2003 Valuations

- The **mortality table** used in evaluating allowances to be paid was the 1994 Uninsured Pension Mortality table. These assumptions are used to measure the probabilities of members dying after retirement and the probabilities of each benefit payment being made after retirement. The City's SDCERS' Plan assumes the data is set back two years for retirees and set forward five years for disability retirees. The Port's and Airport's SDCERS' Plans assume the data is set back two years for retirees, set forward five years for General disabilitants and set forward two years for Safety disabilitants. Related values are shown below:

Future Life Expectancy (Years)

	Retirants		
Sample Ages	Men	Women	Disabilitants
45	36.07	40.44	30.01
50	31.37	35.64	25.49
55	26.78	30.90	21.20
60	22.38	26.27	17.26
65	18.28	21.86	13.77
70	14.61	17.80	10.66
75	11.35	14.03	7.97
80	8.48	10.61	5.86

- **Salary increase rates** do not vary by age, but do reflect an additional merit component for those members with zero to four years of service at the valuation date.

Years of Service at Valuation Date	City, Port & Airport General	City Safety	Port Safety
0	4.5%	6.5%	7.5%
1	3.5%	5.5%	6.5%
2	2.5%	4.5%	5.5%
3	1.5%	3.0%	3.0%
4	0.5%	1.5%	1.5%

- The assumed, annual **cost-of-living adjustment** is generally 2% per annum, compounded. There is a closed group of 115 special City safety officers whose annual adjustment is equal to inflation (4.25% per year).

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS (continued)

Used for the June 30, 2003 Valuations

- The projected unit credit **actuarial cost method** (adopted as of July 1, 1991) was used in determining age and service allowance actuarial liabilities at normal cost. Actuarial gains and losses reduce or increase the unfunded liability. The City and Port are amortizing any unfunded liabilities over a 30-year, closed amortization period that began on July 1, 1991 (18 years remaining as of the June 30, 2003, actuarial valuation). The Airport is amortizing any unfunded liabilities over an 18.5-year, closed amortization period that began on January 1, 2003 (18 years remaining as of the June 30, 2003, actuarial valuation).

- The report findings of SDCERS' **last study of actuarial experience** were presented to SDCERS' Board in January 2003. Any adopted assumption changes were considered for SDCERS' plan sponsors in their June 30, 2003, actuarial valuations. The experience investigation analyzed statistical data from the annual actuarial valuations for the period July 1, 1997, through June 30, 2001. The June 30, 2003, City actuarial valuation did not incorporate any of the recommended assumption changes from the experience study. The June 30, 2003, Port and Airport actuarial valuations incorporated recommended adjustments related to: rates of withdrawal, disability, service retirement, mortality, and salary increases.

- The **member statistical data** on which the valuations were based was furnished by SDCERS' executive management team, together with pertinent data on financial operations. Data was reviewed for reasonableness, but was not audited by the actuary.

- The **actuarial valuation computations** were made by or under the supervision of a Member of the American Academy of Actuaries (MAAA).

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS (continued)

Used for the June 30, 2003 Valuations

SCHEDULE 1
Withdrawal From Active Employment Before Age & Service Retirement
Percent of Active Members Separating Within Next Year

The rates of separation from active membership in this table measure the probabilities of members leaving employment. These rates do not include separation due to retirement or death.

		City of San Diego					Unified Port of San Diego and San Diego County Regional Airport Authority			
		Disability[1]		Other[2]			Disability[3]		Other[2]	
				General						
Sample Ages	Years of Service	General	Safety	Men	Women	Safety	General	Safety[4]	General	Safety[4]
All	0			4.30%	7.30%	4.40%			5.60%	2.20%
	1			4.30	7.20	4.40			5.50	2.20
	2			4.30	7.00	4.30			4.30	2.20
	3			4.30	6.90	4.10			4.30	2.10
	4			4.20	6.30	4.00			4.20	2.00
20	5 & Over	0.06%	0.54%	4.00	5.60	3.20	0.06%	0.54%	4.60	2.10
25		0.08	0.60	4.00	5.60	3.20	0.08	0.60	4.60	2.10
30		0.10	0.65	3.70	4.20	2.20	0.10	0.65	3.10	1.50
35		0.16	0.71	3.20	2.60	1.40	0.16	0.71	2.30	0.90
40		0.22	0.90	2.10	2.00	0.60	0.22	0.90	1.60	0.40
45		0.33	1.15	1.70	1.60	0.30	0.33	1.15	1.30	0.20
50		0.50	1.25	1.30	1.30	0.10	0.50	1.25	1.00	0.10
55		0.75	1.50	0.90	1.00	0.00	0.75	1.50	0.80	0.00
60		0.97	0.00	0.00	0.00	0.00	0.97	0.00	0.00	0.00

[1] 70% of the General Disabilities and 100% of the Safety Disabilities are assumed to be Industrial. Non-industrial disability is subject to service requirement.

[2] 20% of terminating employees, with 10+ years of service (with the City) or 5+ years of service (with the Port or Airport) at termination, are assumed to subsequently work for a reciprocal employer and receive 4.75% pay increases per year.

[3] 70% of the General Disabilities and 85% of the Safety Disabilities are assumed to be Industrial. Non-industrial disability is subject to service requirement.

[4] The Safety information is only applicable to the Port as the Airport does not have any Safety members.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS (continued)

Used for the June 30, 2003 Valuations

SCHEDULE 2

Percent of Active Members Retiring Within Next Year

The rates of retirement in this table are used to measure the probability of eligible active members retiring during the next year.

Retirement Ages	Safety Members[1]	General Members	Elected Officers[2]	
			Men	Women
50	10.00%	---	---	---
51	10.00	---	---	---
52	10.00	---	---	---
53	10.00	---	15.00%	15.00%
54	20.00	---	1.00	1.00
55	40.00	20.00%	5.00	6.00
56	40.00	10.00	3.00	3.00
57	40.00	10.00	4.00	4.00
58	50.00	15.00	5.00	4.00
59	80.00	15.00	6.00	5.00
60	85.00	20.00	60.00	60.00
61	90.00	25.00	25.00	25.00
62	100.00	50.00	39.00	29.00
63	100.00	40.00	23.00	25.00
64	100.00	25.00	34.00	35.00
65	100.00	50.00	70.00	60.00
66	100.00	40.00	70.00	65.00
67	100.00	40.00	75.00	70.00
68	100.00	40.00	80.00	80.00
69	100.00	40.00	90.00	90.00
70	100.00	100.00	100.00	100.00

[1] Applies only to City and Port. [2] Applies only to City.

- City deferred vested Members were assumed to retire provided they have 10 years of service (or 4 years for an Elected Officer) on the later of attained age or:
- Port and Airport deferred vested Members were assumed to retire provided they have 5 years of service on the later of attained age or:

General Members: Earlier of age 62 or age 55 with 20+ years of service

Safety Members[1]: Earlier of age 55 or age 50 with 20+ years of service

Elected Officers[2]: Earlier of age 55 with 4+ years of service or at an age less than 55 with 8+ years of service with a 2% reduction for each year less than age 55

If the inactive member is not vested for a service retirement, the liability for that member is the return of the member's (employee's) contributions with interest.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
EXECUTIVE SUMMARY OF 2004 ACTUARIAL AUDIT

At the request of SDCERS' Board, Mercer Human Resource Consulting (Mercer) was retained to audit the June 30, 2003, actuarial valuations and experience investigation report for the period 1997 through 2001 performed by Gabriel, Roeder, Smith & Company (GRS) and to evaluate various other actuarial calculations pertaining to SDCERS. The purpose of an actuarial audit is to have an independent actuary review the work of SDCERS' retained actuary to ensure that it was performed and reported in conformance with applicable actuarial standards of practice, to confirm that the calculations were accurate, and to identify any changes in assumptions, methods or communications that would improve the quality of the actuarial valuation and its understanding to the intended audience.

As a result of the actuarial audit, Mercer had findings and/or comments regarding SDCERS' actuarial assumptions, the actuarial valuation methods & results, the analysis of SDCERS' unfunded liability, the analysis involving the projection of the unfunded actuarial accrued liability (UAAL), and the *2002 Contribution Agreement*. The following discusses each of these areas and identifies Mercer's concerns and recommendations.

Actuarial Assumptions

Mercer concluded that the methods and assumptions used by GRS are reasonable and conform to accepted actuarial practices. Mercer has identified several significant areas that they recommend SDCERS and its actuary consider to better represent its funded status utilizing alternative methods.

- That GRS consider recognizing longer life spans either by updating mortality assumptions every few years or by using a generational mortality table that will automatically update mortality rates.
- Because the factors used for purchases of service credit do not reflect the age of the member, consider adopting an age assumption in the actuarial valuation in conjunction with the cost of purchased service.
- Consider using higher long-term merit and seniority increase assumptions for both general and safety members.
- Consider lowering the inflation assumption to 3% from 4.25%.
- Because of the 4.25% inflation assumption there is no reflection of productivity increases or wage growth over inflation. Therefore, consider lowering the inflation assumption to 3% in conjunction with adopting a productivity assumption of 1.25% to develop anticipated salary increases.
- Because administrative expenses are paid from the returns on SDCERS' assets, explicitly recognize these expenses in the return assumption.
- SDCERS pays certain benefits out of realized gains that exceed the actuarial investment return. GRS has recommended a reduction in the investment return assumption of 25 basis points to 7.75% to reflect the funding of these benefits. Mercer concurs with this recommendation.

Actuarial Valuation Methods and Results

The actuarial valuation methods being used by GRS are within generally accepted actuarial practice and are considered acceptable by actuarial standards. In order to improve the stability of contribution rates, Mercer recommends that SDCERS consider the use of the entry age normal cost method. Mercer also recommends the consideration of an alternative method of calculating the actuarial value of assets.

Analysis of Current Unfunded Liability

As of June 30, 1996, SDCERS had a UAAL of $139 million. The UAAL would have grown to $149 million as of June 30, 2003 if all actuarial assumptions had been met. In actuality, the UAAL at June 30, 2003 was $1,157 million, an increase of $1,008 million.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
EXECUTIVE SUMMARY OF 2004 ACTUARIAL AUDIT (continued)

Mercer evaluated the causes of this increased unfunded liability that accrued during the period June 30, 1996 through June 30, 2003. They identified several factors as having a significant contribution to this unfunded liability. The following table summarizes Mercer's dollar estimates of the various factors that contributed to the current $1,008 million increase in the UAAL (in millions):

Factor	Increase in UAAL	Percentage of Total UAAL Evaluated
Changes in Benefit Levels	$261	25.9%
Employer Contributions at a Level Less than Recommended by the Actuary	$185	18.3%
Investment Performance less than the Actuarial Assumed Rate of Return	$75	7.5%
Use of Reserves for Additional Benefits (Health, Supplemental Benefits and Benefit Payments per Legal Settlements)	$300	29.8%
Actuarial Assumption Changes Other Factors Particular to SDCERS'	$48	4.8%
Experience	$139	13.7%
Total Unexpected Increase in UAAL	$1,008	100.0%

Analysis of the Projection of the Unfunded Actuarial Accrued Liability (UAAL)

Mercer concluded that it is reasonable to rely on the UAAL projections performed by GRS for the purposes for which they were developed. However, they recommend using more detailed methods to perform UAAL projections to provide more theoretically accurate results. The determination Mercer made using more detailed projections showed slightly higher funded ratios and lower contribution rates. However, the uncertain nature of actuarial projections makes the differences insignificant.

2002 Contribution Agreement

Currently, the City contributions and the valuation assumptions used to determine the funded status of SDCERS are based on the *2002 Contribution Agreement*. The actuarial assumptions used under the *2002 Contribution Agreement* are more aggressive than the best estimates recommended by GRS. In addition, The *2002 Contribution Agreement* also sets the City contribution rates below the actuarial calculated rates. Mercer believes that it is a best practice to use the actuary's best estimate of actuarial assumptions and to calculate full actuarially determined contributions in order to present the most accurate picture of SDCERS' financial status.

Allocation of Assets to Port and Airport

The assets of SDCERS are allocated to the Port and Airport based on the actuarial value of assets. Mercer believes that the best practice would be to allocate assets based on market value of assets.

The above is an executive summary of Mercer's findings reported in the 2004 Actuarial Audit. A full copy of this audit is available upon request by contacting SDCERS at (619) 525-3600 or (800) 774-4977.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF ACTIVE MEMBER VALUATION DATA

For the Years Ended June 30

City of San Diego

Valuation Date	Active Members	Annual Payroll	Average Annual Payroll	% Increases In Average Annual Pay
6/30/2003	**10,100**	**$533,595,405**	**$52,831**	**2.76%**
6/30/2002	10,409	535,156,545	51,413	5.54
6/30/2001	9,892	481,863,319	48,712	7.67
6/30/2000	9,913	448,501,827	45,244	2.89
6/30/1999	9,654	424,515,969	43,973	3.13
6/30/1998	9,359	399,035,094	42,637	3.74

Unified Port of San Diego

Valuation Date	Active Members	Annual Payroll	Average Annual Payroll	% Increases In Average Annual Pay
6/30/2003	**609**	**$34,163,647**	**$56,098**	**0.00%**
12/31/2002[1]	606	33,995,335	56,098	5.70
6/30/2002	736	39,063,314	53,075	6.95
6/30/2001	734	36,425,136	49,626	5.99
6/30/2000	654	30,621,242	46,821	3.04
6/30/1999	661	30,034,900	45,439	4.94
6/30/1998	616	26,672,111	43,299	0.27

San Diego County Regional Airport Authority

Valuation Date	Active Members	Annual Payroll	Average Annual Payroll	% Increases In Average Annual Pay
6/30/2003	**208**	**$11,577,127**	**$55,659**	**8.54%**
12/31/2002[1]	173	8,871,283	51,279	N/A

[1] The San Diego County Regional Airport Authority was established as a separate agency (plan sponsor - employer), effective January 1, 2003, from the Unified Port of San Diego. As a result, interim actuarial valuations were prepared for the Unified Port of San Diego and the San Diego County Regional Airport Authority as of December 31, 2002.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF RETIREES AND BENEFICIARIES ADDED TO AND REMOVED FROM ROLLS

For the Years Ended June 30

City of San Diego

	Added		Removed		Total		% Increase	Average
Valuation Date	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowances	In Annual Allowances	Annual Allowance
6/30/03	**470**	**$22,966,042**	**146**	**$2,035,123**	**5,467**	**$144,916,588**	**19.22%**	**$26,508**
6/30/02	168	6,924,718	37	479,153	5,143	121,554,577	7.92	23,635
6/30/01	386	15,610,998	163	1,918,967	5,012	112,637,558	18.13	22,474
6/30/00	251	8,798,554	119	1,273,240	4,789	95,348,751	8.57	19,910
6/30/99	319	11,506,968	81	1,720,856	4,657	87,823,437	14.79	18,858
6/30/98	241	8,107,722	Data	Revision[1]	4,419	76,507,181	22.08	17,313

[1] Reflects data revision due to retroactive DROP retirees; no annual allowances removed in 1998.

Unified Port of San Diego

	Added		Removed		Total		% Increase	Average
Valuation Date	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowances	In Annual Allowances	Annual Allowance
6/30/03	**15**	**$520,260**	**19**	**$454,851**	**274**	**$5,892,202**	**3.15%**	**$21,504**
12/31/02	26	901,784	11	449,156	278	5,712,542	8.61	20,549
6/30/02[1]	18	532,224	1	16,552	263	5,259,914	21.00	20,000
6/30/01	9	241,083	5	121,845	246	4,346,932	4.88	17,670
6/30/00	11	302,123	1	10,818	242	4,144,798	9.71	17,127
6/30/99	7	114,675	2	19,293	232	3,777,935	4.64	16,284
6/30/98	24	743,928	6	62,433	227	3,610,346	25.73	15,905

[1] Benefits include the 7% Andrecht Increase and the 2% COLA.

San Diego County Regional Airport Authority

	Added		Removed		Total		% Increase	Average
Valuation Date	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowances	In Annual Allowances	Annual Allowance
6/30/03	**1**	**$25,112**	**0**	**$0**	**1**	**$25,112**	**n/a**	**$25,112**
12/31/02			No valuation activity to report					

NOTE: DROP recipients (for all plan sponsors) are treated as retirees in the above three tables. DROP was instituted in 1997. Due to cost of living adjustments (COLA), the rolls at end of the year will not "sum" to additions and removals of new and deceased benefit recipients.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SOLVENCY TEST

For the Years Ended June 30

City of San Diego

	Aggregate Accrued Liabilities For ($ In Thousands)				Portion of Accrued Liabilities Covered by Reported Assets		
Valuation Date	(1) Active Member Contributions	(2) Retirants And Beneficiaries	(3) Active Member Service Credit	Reported Assets[1]	(1)	(2)	(3)
6/30/03[4]	**$379,284**	**$1,741,490**	**$1,411,852**	**$2,375,431**	**100.00%**	**100.00%**	**18.04%**
6/30/02	353,686	1,440,392	1,374,842	2,448,208	100.00	100.00	47.58
6/30/01	296,851	1,337,799	1,174,888	2,525,645	100.00	100.00	75.84
6/30/00[3]	276,352	1,170,075	1,082,347	2,459,815	100.00	100.00	93.63
6/30/99	238,278	1,026,395	916,874	2,033,153	100.00	100.00	83.82
6/30/98[2]	220,415	885,586	873,667	1,852,151	100.00	100.00	85.40

[1] Actuarial Value of Assets [2] Reflects revised actuarial and economic assumptions [3] Reflects non-contingent Corbett benefit increases [4] Reflects General benefit increases

Unified Port of San Diego

	Aggregate Accrued Liabilities For ($ In Thousands)				Portion of Accrued Liabilities Covered by Reported Assets		
Valuation Date	(1) Active Member Contributions	(2) Retirants And Beneficiaries	(3) Active Member Service Credit	Reported Assets[1]	(1)	(2)	(3)
6/30/03[4]	**$13,264**	**$65,581**	**$75,455**	**$123,884**	**100.00%**	**100.00%**	**59.69%**
12/31/02[3]	11,578	63,843	62,403	125,619	100.00	100.00	80.44
6/30/02	12,317	57,650	70,230	140,613	100.00	100.00	100.00
6/30/01	10,754	52,025	60,347	145,278	100.00	100.00	100.00
6/30/00	9,609	44,774	42,777	133,183	100.00	100.00	100.00
6/30/99	8,792	40,725	40,292	110,310	100.00	100.00	100.00
6/30/98[2]	7,325	39,282	35,026	98,007	100.00	100.00	100.00

[1] Actuarial Value of Assets [2] Reflects revised actuarial and economic assumptions
[3] Interim (mid year) actuarial valuation performed due to split of San Diego County Regional Airport Authority from Unified Port of San Diego [4] Reflects General benefit increases

San Diego County Regional Airport Authority

	Aggregate Accrued Liabilities For ($ In Thousands)				Portion of Accrued Liabilities Covered by Reported Assets		
Valuation Date	(1) Active Member Contributions	(2) Retirants And Beneficiaries	(3) Active Member Service Credit	Reported Assets[1]	(1)	(2)	(3)
6/30/03	**$1,877**	**$295**	**$14,107**	**$11,142**	**100.00%**	**100.00%**	**63.59%**
12/31/02[2]	1,509	0	10,018	11,028	100.00	100.00	95.00

[1] Actuarial Value of Assets [2] The San Diego County Regional Airport Authority was established as a separate agency (plan sponsor - employer), effective January 1, 2003, from the Unified Port of San Diego; interim fiscal year actuarial valuations were prepared for the Unified Port of San Diego and the San Diego County Regional Airport Authority as of December 31, 2002.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
ANALYSIS OF FINANCIAL EXPERIENCE

For the Years Ended June 30

Actuarial gains or losses realized in the operation of retirement systems provide an experience test. Gains and losses are expected to cancel each other out over a period of years (in the absence of double-digit inflation). Sizable year-to-year fluctuations are common.

City of San Diego

Valuation Date	6/30/03	6/30/02	6/30/01	6/30/00	6/30/99
Estimated Gain (Loss) Attributed to Investment Experience	$(286,400,000)	$(312,953,654)	$(95,647,385)	$290,700,000	$74,892,018
Estimated Gain (Loss) Attributed to Pay Increases	23,100,000	(25,000,000)	(37,000,000)	18,773,910	13,135,392
Estimated Gain (Loss) Attributed to Post-Retirement Mortality Experience of Retirants and Beneficiaries at Beginning of Year and Pay Increases for New Retirees in Year of Retirement	---	---	---	---	---
Estimated Gain (Loss) Attributed to Employee Turnover, Pre-Retirement Mortality, Retirement Incidence, Data Corrections and Miscellaneous Factors	(40,399,305)	(26,861,501)	(60,521,599)	(22,834,750)	(58,277,111)
Total Estimated Experience Gain (Loss)	**$(303,699,305)**	**$(364,815,155)**	**$(193,168,984)**	**$286,639,160**	**$29,750,299**

[1] The San Diego County Regional Airport Authority (Airport) was established as a separate agency by the State of California effective January 1, 2003, from a group of employees formerly employed by the Unified Port of San Diego (Port). The Airport elected to enter into an agreement with SDCERS for the administration of their defined benefit plan. As such, an interim valuation was prepared as of 12/31/2002 for both the Airport and the Port.

[2] Prior to 1998, one actuarial valuation was performed for both the City and the Port together.

Reconciling Differences Between Assumed Experience and Actual Experience

Once actual experience has occurred and been observed, it will not likely coincide exactly with assumed experience regardless of the skill of the actuary and the many calculations made. Most retirement systems, including SDCERS, cope with this difference by having annual actuarial valuations. Each actuarial valuation is a complete recalculation of assumed future experience, taking into account all past differences between assumed and actual experience. The result is a continued adjustment in financial position and funded status.

Unified Port of San Diego						San Diego County Regional Airport Authority[1]	City of San Diego/ Unified Port of San Diego[2]
6/30/03	12/31/02	6/30/02	6/30/01	6/30/00	6/30/99	6/30/03	6/30/98
$(8,150,891)	$(10,838,574)	$(14,923,620)	$1,304,928	$14,962,558	$3,854,203	$(641,718)	$101,000,000
1,771,000	(1,915,000)	(1,708,425)	(2,462,678)	36,100	(288,881)	(247,000)	9,141,984
480,000	(520,130)	(511,278)	1,267,497	(896,871)	(523,992)	---	---
(4,348,544)	2,176,599	(3,145,376)	(3,009,643)	992,586	559,703	(1,124,984)	(79,055,974)
$(10,248,435)	**$(11,097,105)**	**$(20,288,699)**	**$(2,899,896)**	**$15,094,373**	**$3,601,033**	**$(2,013,702)**	**$31,086,010**

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
ANALYSIS OF FINANCIAL EXPERIENCE (continued)
For the Years Ended June 30

	City of San Diego				
Valuation Date	**6/30/03**	**6/30/02**	**6/30/01**	**6/30/00**	**6/30/99**
Experience Gain (Loss)	$(303,699,305)	$(364,815,155)	$(193,168,984)	$286,639,160	$29,750,299
Beginning of Year Accrued Liabilities	3,168,921,175	2,809,537,745	2,528,773,900	2,181,547,453	1,979,668,038
Gain (Loss) Percentage of Liabilities	(9.58)%	(12.98)%	(7.64)%	13.14%	1.50%
Net Increase/Decrease In Liabilities	**$359,383,430**	**$280,763,845**	**$347,226,447**	**$201,879,415**	**$157,236,020**

[1] The San Diego County Regional Airport Authority (Airport) was established as a separate agency by the State of California effective January 1, 2003, from a group of employees formerly employed by the Unified Port of San Diego (Port). The Airport elected to enter into an agreement with SDCERS for the administration of their defined benefit plan. As such, an interim valuation was prepared as of 12/31/2002 for both the Airport and the Port.

[2] Prior to 1998, one actuarial valuation was performed for both the City and the Port together.

Unified Port of San Diego						San Diego County Regional Airport Authority[1]	City of San Diego/ Unified Port of San Diego[2]
6/30/03	12/31/02[1]	6/30/02	6/30/01	6/30/00	6/30/99	6/30/03	6/30/98
$(10,248,435)	$(11,097,105)	$(20,288,699)	$(2,899,896)	$15,094,373	$3,601,033	$(2,013,702)	$31,086,010
137,824,047	140,196,959	123,125,659	97,159,852	89,808,543	81,632,570	11,526,293	1,822,432,018
(7.44)%	(7.92)%	(16.48)%	(2.98)%	16.81%	4.41%	(17.47)%	1.71%
$(2,372,912)	**$17,071,300**	**$25,965,807**	**$7,351,310**	**$8,175,973**	**n/a[2]**	**$(11,526,293)**	**$139,827,486**

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
ANALYSIS OF FINANCIAL EXPERIENCE (continued)

For the Years Ended June 30

Discussion of the Comparative Schedules of Experience Gain/(Loss)

June 30, 2003 (City): The City's net loss of $303.7 million was a result of investments earning less than the actuarial assumed rate of return of 8%, unexpected retirements and additional service credit purchased. In addition, losses accrued to the City's SDCERS' plan due to less than expected active member (employee) turnover and pre-retirement mortality. These losses were offset by savings generated from lower than anticipated active member (employee) pay increases and data refinements on inactive members. This year's net loss further increased the City's SDCERS' liabilities to $359.4 million over SDCERS' prior year liabilities.

June 30, 2003 (Port): The Port's net loss of $10.2 million was a result of investments earning less than the actuarial assumed rate of return of 8%, unexpected retiree data corrections and additional service credit purchased. In addition, losses accrued to the Port's SDCERS' plan due to less than expected active member (employee) turnover and pre-retirement mortality. These losses were offset by savings generated from less than anticipated active member (employee) pay increases and more than expected post-retirement mortality. Although there was a net loss in experience, overall the Port's SDCERS' liabilities decreased by $2.3 million over prior year liabilities (valued as of the 12/31/2002 actuarial valuation), primarily due to the transfer of additional members (and their associated liabilities) to the Airport's SDCERS' plan.

June 30, 2003 (Airport): The Airport's net loss of $2.0 million was a result of earning less than the actuarial assumed rate of return of 8%, greater than expected active member (employee) pay increases, additional service credit purchased and additional members (and their associated liabilities) transferred from the Port to the Airport during fiscal year 2003. Additional losses accrued to the Airport's SDCERS' plan as a result of less than expected active member (employee) turnover, pre-retirement mortality and retirements. This year's loss increased the Airport's SDCERS' liabilities of $11.5 million over the prior year liabilities (valued as of the 12/31/2002 interim actuarial valuation) in which the Airport had no accrued liabilities. The results of the Airport's June 30, 2003, actuarial valuation was the first time a net loss was experienced for the Airport's plan.

December 31, 2002 (interim actuarial valuation for the Port): The net loss of $11.1 million was a result of investments earning less than the actuarial assumed rate of return of 8% and more than expected active member (employee) pay increases, combined with less than expected active member (employee) turnover and pre-retirement mortality. This year's net loss further increased the Port's SDCERS' liabilities to $17.1 million over SDCERS' prior year liabilities. The results of the December 31, 2002, interim actuarial valuation again demonstrated a loss by SDCERS.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
ANALYSIS OF FINANCIAL EXPERIENCE (continued)

For the Years Ended June 30

June 30, 2002: The net losses of $364.8 million (City) and $20.3 million (Port) were a result of investments earning less than the actuarial assumed rate of return of 8% and more than expected active member (employee) pay increases, combined with less than expected active member (employee) turnover and pre-retirement mortality. These losses further increased SDCERS' liabilities to $280.8 million (City) and $26.0 million (Port) over SDCERS' prior year liabilities. The results of the June 30, 2002, actuarial valuations were the second consecutive year that a loss was experienced for this plan.

June 30, 2001: The net losses of $193.2 million (City) and $2.9 million (Port) were a result of investments earning less than the actuarial assumed rate of return of 8% and more than expected active member (employee) pay increases, combined with less than expected active member (employee) turnover and pre-retirement mortality. These losses further increased SDCERS' liabilities to $347.2 million (City) and $7.4 million (Port) over SDCERS' prior year liabilities. The results of the June 30, 2001, actuarial valuations were the first time in recent years that a net loss was experienced by SDCERS.

June 30, 2000: The net gains of $286.6 million (City) and $15.1 million (Port) were a result of investments earning more than the actuarial assumed rate of return of 8% and the savings from expected active member (employee) pay increases exceeding losses due to more than expected pay increases to new retirees, and less than expected active member (employee) turnover and pre- and post-retirement mortality. These gains helped to reduce the overall increases in SDCERS' liabilities to $201.9 million (City) and $8.2 million (Port) over SDCERS' prior year liabilities.

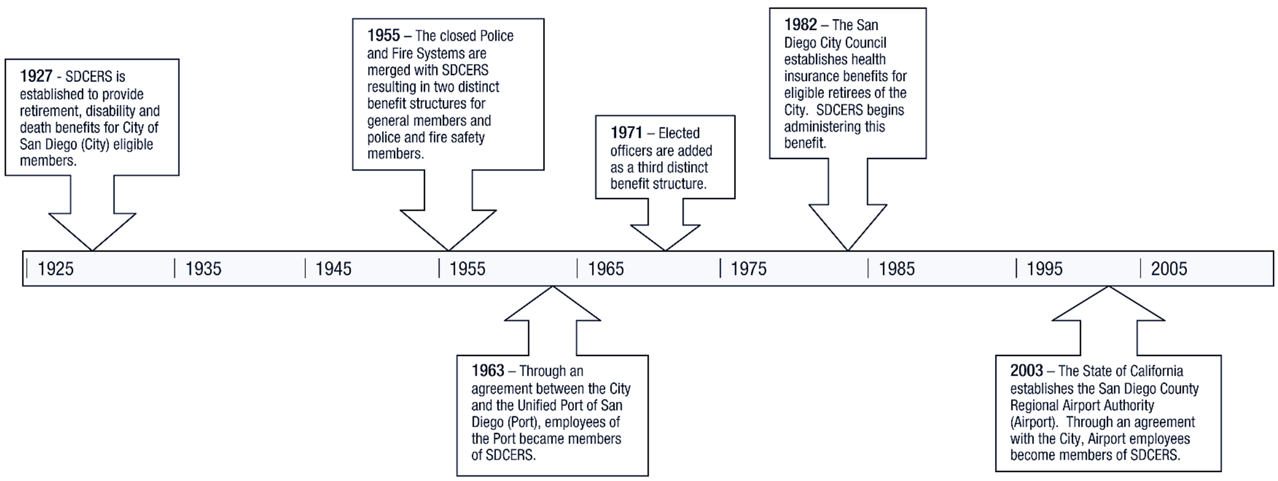
June 30, 1999: The net gains of $29.7 million (City) and $3.6 million (Port) were a result of investments earning more than the actuarial assumed rate of return of 8% and the net savings from expected active member (employee) pay increases exceeding losses due to more than expected pay increases to new retirees, and less than expected active member (employee) turnover, and, pre- and post-retirement mortality. These gains helped to reduce the overall increase in SDCERS' liabilities to $157.2 million (City and Port) over SDCERS' prior year liabilities.

June 30, 1998: The net gain of $31.1 million was a result of investments earning more than the actuarial assumed rate of return of 8% and savings from expected active member (employee) pay increases exceeding losses due to less than expected active member (employee) turnover and pre-retirement mortality. This gain helped to reduce the overall increase in SDCERS' liabilities to $139.8 million over SDCERS' prior year liabilities.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF SDCERS' BENEFIT PROVISIONS

As of June 30, 2004

SDCERS' History and Description



SDCERS, acting as agent of a multi-employer defined benefit plan, provides vested members a specified portion of their annual salaries when they retire. In order to attain the appropriate level of funding for each member, SDCERS' Plan specifies a formula to be used to calculate the amount that would need to be contributed by plan sponsors (employers) and members (employees) each year until retirement. To maintain stable levels of required contributions, SDCERS' Board has established a diversified, long-term investment strategy consisting of investments in the following asset classes: domestic and international fixed income, domestic and international equities, and domestic real estate. Additionally, SDCERS reinvests interest earnings and the profits from the sale of invested assets. Currently, SDCERS' Plan Net Assets for the Defined Benefit Pension Plan are valued at \$3.084 billion as of June 30, 2004, and \$2.520 billion as of June 30, 2003. SDCERS' Post-Employment Healthcare Benefits Plan Net Assets are valued at \$9.084 million as of June 30, 2004, and \$21.812 million as of June 30, 2003.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF SDCERS' BENEFIT PROVISIONS (continued)

As of June 30, 2004

Since its inception, the number of SDCERS' members and retirees has increased. For the fiscal year ended June 30, 2004, there was a total increase of 146 participants. This is comprised of a net decrease of 128 members and a net increase of 274 retirees.

The following pages illustrate the various benefit provisions for the City's, Port's and Airport's SDCERS participants. For a complete description of these benefits, please call SDCERS at (800) 774-4977 or (619) 525-3600 and request a Summary Plan Description for the plan that you are a member of or the member group you are interested in.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF SDCERS' BENEFIT PROVISIONS (continued)

As of June 30, 2004

	City of San Diego
1. Membership Requirements	Membership is mandatory upon employment with the City, for all full, three-quarter, and half-time classified employees and any unclassified employees hired on or after 8/11/93.
2. Monthly Base Salary for Benefits	Highest one-year average, subject to a 10% increase, if the General or Safety Member elects such increase in lieu of an increased benefit formula.
3. Service Retirement	
Eligibility	
General Members	Age 62 with 10 years of service credit, or age 55 with 20 years of service credit.
Safety Members (includes Fire, Lifeguard & Police)	Age 55 with 10 years of service credit, or age 50 with 20 years of service credit.
Elected Officers	Age 55 with 4 years of service. Eligible to retire at any age with 8 years of service, however, benefit is reduced by 2% per year for each year under age 55.
Benefit Formula Per Year of Service	
General Members	Choice of: (1) 2.0% per year of service at age 55, increasing to 2.55% at age 65, with an additional 10% added to Final Compensation; (2) 2.25% per year of service at age 55, and increasing to 2.55% at age 65; or (3) 2.5% per year of service at age 55, and increasing to 2.8% at age 65, not to exceed 90% of Final Compensation.
General Members (Andrecht-Covered) (Applies to Airport only)	n/a
Executive General Members - Port & Airport only (where not specifically identified, treated as part of General Members)	n/a
Safety Members (City - Fire & Police, Port - Harbor Police)	Choice of: (1) 2.5% per year of service at age 50, increasing to 2.9999% at age 55, with an additional 10% added to Final Compensation, not to exceed 90% of Final Compensation; or (2) 3.0% per year of service at age 50 and above, not to exceed 90% of Final Compensation.
Safety Members (City - Lifeguard)	Choice of: (1) 2.2% at age 50, increasing to 2.77% at age 55, with an additional 10% added to Final Compensation, not to exceed 90% of Final Compensation; or (2) 3.0% at age 50 and above, not to exceed 90% of Final Compensation.
Elected Officers	3.5% per year of service. A 2% annual reduction factor applies to benefits for Elected Officers retiring prior to age 55.

Unified Port of San Diego	San Diego County Regional Airport Authority
Membership is mandatory upon employment for all full-time Port employees.	Membership is mandatory upon employment for all full-time Airport employees.
Highest one-year average, subject to a 10% increase, if the General or Safety Member elects such increase in lieu of an increased benefit formula.	Highest one-year average, subject to a 10% increase, if the General or Safety Member elects such increase in lieu of an increased benefit formula.
Age 62 with 5 years of service credit, or age 55 with 20 years of service credit.	Age 62 with 5 years of service, or age 55 with 20 years of service.
Age 55 with 5 years of service credit, or age 50 with 20 years of service credit.	n/a
n/a	n/a
Choice of: (1) 2.0% per year of service at age 55, increasing to 2.55% at age 65, with an additional 10% added to Final Compensation; (2) 2.25% per year of service at age 55, and increasing to 2.55% at age 65; or (3) 2.5% per year of service at age 55, and increasing to 3.0% at age 65, not to exceed 90% of Final Compensation.	Service Retirement calculated at 2.5% at age 55, and increasing to 3.0% at age 60, not to exceed 90% of Final Compensation.
n/a	Choice of: (1) 2.0% per year of service at age 55, increasing to 2.55% at age 65, with an additional 10% added to Final Compensation; (2) 2.25% per year of service at age 55, and increasing to 2.55% at age 65; or (3) 2.5% per year of service at age 55, and increasing to 3.0% at age 65, not to exceed 90% of Final Compensation.
Effective as of 12/21/2002, Service Retirement calculated at 3.0% at age 55 or older.	Effective as of 12/21/2002, Service Retirement calculated at 3.0% at age 55 or older.
Choice of: (1) 2.5 % at age 50, increasing to 2.77% at age 55, with an additional 10% added to Final Compensation; or (2) 3.0% at age 50 and above, not to exceed 90% of Final Compensation.	n/a
n/a	n/a
n/a	n/a

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF SDCERS' BENEFIT PROVISIONS (continued)

As of June 30, 2004

	City of San Diego
Retirement Payment Options	Choice of:
	Maximum Benefit - provides the highest possible monthly allowance to the member for their lifetime and guarantees their spouse a 50% automatic continuance after the member dies for the rest of his or her life. If unmarried, the member may choose to receive a lump sum refund of surviving spouse contributions and interest or treat them as voluntary additional contributions to provide a larger annuity benefit for the member.
	Option 1 - receive a reduced monthly retirement allowance until the member's death. If the member dies before they receive the total amount of their accumulated contributions, SDCERS will pay the balance to their beneficiary or estate. If the member dies after their annuity payments exceed their accumulated contributions, no payments will be made to the member's beneficiary or estate.
	Option 2 - receive a reduced monthly retirement allowance until the member's death. When the member dies, their spouse or beneficiary will receive a continuance equal to 100% of the member's reduced monthly retirement allowance for the rest of his or her life. The amount of the reduction depends upon the age difference between the member and their beneficiary.
	Option 3 - receive a reduced monthly retirement allowance until the member's death. When the member dies, their beneficiary will receive a retirement allowance equal to 50% of the member's reduced monthly benefit for the rest of his or her life. The amount of the reduction depends upon the age difference between the member and their beneficiary.
	Option 4 - receive a reduced monthly retirement allowance until the member's death. When the member dies, their beneficiary will receive a percentage of the member's reduced monthly benefit in an amount selected by the member, for the rest of his or her life. The higher the percentage to the beneficiary and the greater the age difference between the member and their beneficiary, the greater the reduction in the member's monthly retirement allowance.
	Social Security Integrated Option - The member may select this option in addition to one of the other five payment choices only if the member was enrolled as a General Member in SDCERS before January 1, 1982, and are eligible to receive a Social Security benefit. The member would receive an increased monthly allowance from SDCERS based on their estimated Social Security benefit. When the member turns 65, SDCERS will then actuarially reduce their monthly retirement allowance for the remainder of their life. This reduction will be greater than the adjusted amount the member received from the time the member retired to the time the member turned 65. After the member's death, their surviving spouse or beneficiary will receive a continuance based on the non-adjusted benefit amount from the payment option the member selected at retirement.

Unified Port of San Diego

Choice of:

Maximum Benefit - provides the highest possible monthly allowance to the member for their lifetime and guarantees their spouse a 50% automatic continuance after the member dies for the rest of his or her life. If unmarried, the member may choose to receive a lump sum refund of surviving spouse contributions and interest or treat them as voluntary additional contributions to provide a larger annuity benefit for the member.

Option 1 - receive a reduced monthly retirement allowance until the member's death. If the member dies before they receive the total amount of their accumulated contributions, SDCERS will pay the balance to their beneficiary or estate. If the member dies after their annuity payments exceed their accumulated contributions, no payments will be made to the member's beneficiary or estate.

Option 2 - receive a reduced monthly retirement allowance until the member's death. When the member dies, their spouse or beneficiary will receive a continuance equal to 100% of the member's reduced monthly retirement allowance for the rest of his or her life. The amount of the reduction depends upon the age difference between the member and their beneficiary.

Option 3 - receive a reduced monthly retirement allowance until the member's death. When the member dies, their beneficiary will receive a retirement allowance equal to 50% of the member's reduced monthly benefit for the rest of his or her life. The amount of the reduction depends upon the age difference between the member and their beneficiary.

Option 4 - receive a reduced monthly retirement allowance until the member's death. When the member dies, their beneficiary will receive a percentage of the member's reduced monthly benefit in an amount selected by the member, for the rest of his or her life. The higher the percentage to the beneficiary and the greater the age difference between the member and their beneficiary, the greater the reduction in the member's monthly retirement allowance.

Social Security Integrated Option - The member may select this option in addition to one of the other five payment choices only if the member was enrolled as a General Member in SDCERS before January 1, 1982, and are eligible to receive a Social Security benefit. The member would receive an increased monthly allowance from SDCERS based on their estimated Social Security benefit. When the member turns 65, SDCERS will then actuarially reduce their monthly retirement allowance for the remainder of their life. This reduction will be greater than the adjusted amount the member received from the time the member retired to the time the member turned 65. After the member's death, their surviving spouse or beneficiary will receive a continuance based on the non-adjusted benefit amount from the payment option the member selected at retirement.

San Diego County
Regional Airport Authority

Choice of:

Maximum Benefit - provides the highest possible monthly allowance to the member for their lifetime and guarantees their spouse a 50% automatic continuance after the member dies for the rest of his or her life. If unmarried, the member may choose to receive a lump sum refund of surviving spouse contributions and interest or treat them as voluntary additional contributions to provide a larger annuity benefit for the member.

Option 1 - receive a reduced monthly retirement allowance until the member's death. If the member dies before they receive the total amount of their accumulated contributions, SDCERS will pay the balance to their beneficiary or estate. If the member dies after their annuity payments exceed their accumulated contributions, no payments will be made to the member's beneficiary or estate.

Option 2 - receive a reduced monthly retirement allowance until the member's death. When the member dies, their spouse or beneficiary will receive a continuance equal to 100% of the member's reduced monthly retirement allowance for the rest of his or her life. The amount of the reduction depends upon the age difference between the member and their beneficiary.

Option 3 - receive a reduced monthly retirement allowance until the member's death. When the member dies, their beneficiary will receive a retirement allowance equal to 50% of the member's reduced monthly benefit for the rest of his or her life. The amount of the reduction depends upon the age difference between the member and their beneficiary.

Option 4 - receive a reduced monthly retirement allowance until the member's death. When the member dies, their beneficiary will receive a percentage of the member's reduced monthly benefit in an amount selected by the member, for the rest of his or her life. The higher the percentage to the beneficiary and the greater the age difference between the member and their beneficiary, the greater the reduction in the member's monthly retirement allowance.

Social Security Integrated Option - The member may select this option in addition to one of the other five payment choices only if the member was enrolled as a General Member in SDCERS before January 1, 1982, and are eligible to receive a Social Security benefit. The member would receive an increased monthly allowance from SDCERS based on their estimated Social Security benefit. When the member turns 65, SDCERS will then actuarially reduce their monthly retirement allowance for the remainder of their life. This reduction will be greater than the adjusted amount the member received from the time the member retired to the time the member turned 65. After the member's death, their surviving spouse or beneficiary will receive a continuance based on the non-adjusted benefit amount from the payment option the member selected at retirement.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF SDCERS' BENEFIT PROVISIONS (continued)

As of June 30, 2004

	City of San Diego
4. Non-Industrial Disability	
Eligibility	
All Members	Ten years of service credit.
Benefit Formula Per Year of Service	
General Members	Choice of: (1) 1.5% per year of service multiplied by Final Compensation; (2) one-third of final compensation; or (3) the earned service retirement benefit, if eligible.
Safety Members	Choice of: (1) 1.8% per year of service; (2) one-third of final compensation; or (3) the earned service retirement benefit, if eligible.
Elected Officers	Earned service retirement benefit.
5. Industrial Disability	
Eligibility	
All Members	No age or service requirement
Benefit Formula Per Year of Service	
General Members	Choice of: (1) 50% of final compensation; or (2) the earned service retirement benefit, if eligible.
Safety Members	Choice of: (1) 50% of final compensation; or (2) the earned service retirement benefit, if eligible.
Elected Officers	Earned service retirement benefit.
6. Non-Industrial Death Before Eligible to Retire	Refund of employee contributions with interest plus 1/12 of Final Compensation, multiplied by years of service credit, up to maximum of 1/2 of Final Compensation.
7. Non-Industrial Death After Eligible to Retire for Service	50% of earned benefit payable to eligible surviving spouse.
8. Industrial Death	
General Members	50% of the final compensation divided into 12 equal payments each year.
Safety Members	50% of the final compensation divided into 12 equal payments each year.
9. Death After Retirement	Continuance to specified beneficiary based upon retirement payment option selected. $2,000 payable in lump sum to the beneficiary or the estate of the retiree.
10. Withdrawal Provisions	1. Less than ten years of service credit - Refund of accumulated member (employee) contributions with interest, or may keep contributions on deposit with SDCERS and earn additional interest. 2. Ten or more years of service credit - If contributions are left on deposit, entitled to earned benefits, commencing anytime after eligible to retire.

Unified Port of San Diego	San Diego County Regional Airport Authority
Ten years of service credit.	Ten years of service credit.
Choice of: (1) 1.5% per year of service multiplied by Final Compensation; (2) one-third of final compensation; or (3) the earned service retirement benefit, if eligible.	Choice of: (1) 1.5% per year of service multiplied by Final Compensation; (2) one-third of final compensation; or (3) the earned service retirement benefit, if eligible.
Choice of: (1) 1.8% per year of service; (2) one-third of final compensation; or (3) the earned service retirement benefit, if eligible.	n/a
n/a	n/a
No age or service requirement.	No age or service requirement.
Choice of: (1) 50% of final compensation; or (2) the earned service retirement benefit, if eligible.	Choice of: (1) 50% of final compensation; or (2) the earned service retirement benefit, if eligible.
Choice of: (1) 50% of final compensation; or (2) the earned service retirement benefit, if eligible.	n/a
n/a	n/a
Refund of employee contributions with interest plus 1/12 of Final Compensation, multiplied by years of service credit, up to maximum of 1/2 of Final Compensation.	Refund of employee contributions with interest plus 1/12 of Final Compensation, multiplied by years of service credit, up to maximum of 1/2 of Final Compensation.
50% of earned benefit payable to eligible surviving spouse.	50% of earned benefit payable to eligible surviving spouse.
50% of the final compensation divided into 12 equal payments each year.	50% of the final compensation divided into 12 equal payments each year.
50% of the final compensation divided into 12 equal payments each year.	n/a
Continuance to specified beneficiary based upon retirement payment option selected. $2,000 payable in lump sum to the beneficiary or the estate of the retiree.	Continuance to specified beneficiary based upon retirement payment option selected. $2,000 payable in lump sum to the beneficiary or the estate of the retiree.
1. Less than five years of service credit - Refund of accumulated member (employee) contributions with interest, or may keep contributions on deposit with SDCERS and earn additional interest. 2. Five or more years of service credit - If contributions are left on deposit, entitled to earned benefits, commencing anytime after eligible to retire.	1. Less than five years of service credit - Refund of accumulated member (employee) contributions with interest, or may keep contributions on deposit with SDCERS and earn additional interest. 2. Five or more years of service credit - If contributions are left on deposit, entitled to earned benefits, commencing anytime after eligible to retire.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF SDCERS' BENEFIT PROVISIONS (continued)
As of June 30, 2004

	City of San Diego
11. Post-Retirement Cost-of-Living Benefits	
General Members	Based on changes in Consumer Price Index, to a maximum of 2% per year.
Safety Members	Based on changes in Consumer Price Index, to a maximum of 2% per year.
12. Computed Plan Sponsor Contribution Rate	Determined by the Projected Unit Credit Funding Method with a 30-year closed amortization of any Unfunded Actuarial Accrued Liability beginning on 7/1/1991.
13. Member Contributions	Vary by age at time of entrance into SDCERS. Any portion of these contributions paid by the plan sponsor (employer) are not directly reflected in either the member (employee) contributions or related refund calculations.
14. Internal Revenue Code Compliance	Benefits provided by SDCERS' Plans are subject to the limitations set forth in Section 415 in accordance with the "grandfather" election in Section 415(b)(10) of the Internal Revenue Code.

Unified Port of San Diego	San Diego County Regional Airport Authority
Based on changes in Consumer Price Index, to a maximum of 2% per year.	Based on changes in Consumer Price Index, to a maximum of 2% per year.
Based on changes in Consumer Price Index, to a maximum of 2% per year.	n/a
Determined by the Projected Unit Credit Funding Method with a 30-year closed amortization of any Unfunded Actuarial Accrued Liability beginning on 7/1/1991.	Determined by the Projected Unit Credit Funding Method with an 18.5-year closed amortization of any Unfunded Actuarial Accrued Liability beginning on 1/1/2003.
Vary by age at time of entrance into SDCERS. Any portion of these contributions paid by the plan sponsor (employer) are not directly reflected in either the member (employee) contributions or related refund calculations.	Vary by age at time of entrance into SDCERS. Any portion of these contributions paid by the plan sponsor (employer) are not directly reflected in either the member (employee) contributions or related refund calculations.
Benefits provided by SDCERS' Plans are subject to the limitations set forth in Section 415 in accordance with the "grandfather" election in Section 415(b)(10) of the Internal Revenue Code.	Benefits provided by SDCERS' Plans are subject to the limitations set forth in Section 415 in accordance with the "grandfather" election in Section 415(b)(10) of the Internal Revenue Code.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF SDCERS' BENEFIT PROVISIONS (continued)

As of June 30, 2004

Deferred Retirement Option Program (DROP)

The Deferred Retirement Option Plan (DROP) is a voluntary program created by SDCERS' plan sponsors (employers) to provide SDCERS' members (employees) with an alternative method to accrue benefits in SDCERS. For actuarial valuation purposes, SDCERS' members entering DROP are considered "retired" the date they enter DROP.

A SDCERS' member's decision to enter DROP is irrevocable. If a SDCERS member participates in DROP, he or she will have access to a lump sum benefit in addition to his or her normal monthly retirement allowance when he or she retires. DROP was initially offered by SDCERS' plan sponsors on a trial basis for a three-year period ending March 31, 2000. It has since become a permanent retirement option. SDCERS' members are eligible to participate in DROP when they are eligible for a service retirement. A DROP participant continues to work for his/her respective employer (plan sponsor) and receives a regular paycheck. Both the plan sponsor (employer) and the DROP participant no longer make retirement contributions to SDCERS, and the DROP participant stops earning creditable service. A DROP participant continues to receive most of the employer-offered benefits available to regular employees.

A SDCERS' member must select a retirement option when he/she enters DROP. If the DROP participant elects to leave a continuance to a beneficiary, the DROP participant must name a beneficiary at that time as well. The selection of a retirement option and the designation of a beneficiary for a continuance are irrevocable and cannot be changed once the first payment is made into a DROP account.

SDCERS' members electing to enter DROP must agree to participate in the program for a specific period of time, up to a maximum of five years; this specific time period cannot be modified once agreed to. A DROP participant must end employment with his or her employer (plan sponsor) on or before the end of the selected DROP participation period.

When a SDCERS member participates in DROP, a DROP account is set up for that individual. The money credited to a DROP account comes from six sources:

1. A DROP participant's contributions – 3.05% of salary each pay period of participation in DROP (no employee contributions are made to SDCERS during this time);
2. The plan sponsor's contributions – 3.05% of salary each pay period of participation in DROP (no employee contributions are made to SDCERS during this time);
3. The DROP participant's monthly retirement allowance, as determined when entering DROP;
4. The COLA (cost of living adjustment) increases to a monthly retirement allowance that occur while participating in DROP;
5. SDCERS' Supplemental Benefit (13th Check) payments made while participating in DROP; and
6. Interest credited to the DROP account each quarter, at the rate determined by SDCERS' Board.

The DROP benefit is the value of a DROP participant's account at the end of the DROP participation period. It is available either in a lump sum or periodic distributions. Once a participant leaves DROP, he/she begins receiving their monthly retirement allowance directly.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF SDCERS' BENEFIT PROVISIONS (continued)

As of June 30, 2004

SDCERS will distribute the funds in a participant's DROP account when he/she leaves employment and begins retirement, unless he/she chooses to delay distribution of these funds. The distribution is made as a single lump sum, periodic payments, in 240 equal monthly payments, or as otherwise allowed by SDCERS' Board, subject to the applicable provisions of the Internal Revenue Code.

For further information on the DROP program, please contact SDCERS' office at (800) 774-4977 or (619) 525-3600, or visit SDCERS' Web site at www.sdcers.org.

Post-Employment Healthcare Benefits

SDCERS administers the single-employer Post-Employment Healthcare Benefits Plan for eligible City of San Diego retirees and/or their beneficiaries. Post-Employment Healthcare Benefits for members retiring from City employment are based on their health eligibility status. City retirees are either health-eligible or non-health-eligible. SDCERS also administers a special healthcare benefit for spouses and dependents of eligible City employees who have died while in the line of duty.

To determine eligibility, a retiree must meet the following conditions: was on the Active Payroll of the City of San Diego on or after October 5, 1980, retired on or after October 6, 1980, and is eligible for and is receiving a pension allowance from SDCERS. SDCERS' health-eligible retirees may obtain health insurance coverage with the company and plan of their choice including any City-sponsored, union-sponsored or privately secured health plan. Medicare eligible retirees may receive reimbursement for their Medicare Part B premium and reimbursement/payment of their health premiums. Non-Medicare eligible retirees may receive reimbursement/payment of health premiums only.

If a retiree does not meet the above conditions, then the retiree may be eligible to receive a non-health-eligible benefit. To receive this benefit, a retiree must meet the following conditions: Retired or terminated employment as a vested member of the City of San Diego prior to October 6, 1980, and is eligible for and is receiving a pension allowance from SDCERS. The health benefit for non-health-eligible retirees is a reimbursement of up to $1,200 per fiscal year for a combination of both Medicare Part B premiums and medical expenses (including co-pays, prescription costs, premiums for health and hospital insurance coverage).

The Death in the Line of Duty Widow/Widower healthcare benefit is paid to eligible spouses. Death in the Line of Duty Widows/Widowers and their dependent children are eligible to be enrolled in a City-sponsored health plan. They receive payment for health insurance premiums and Medicare Part B premiums up to the annual flexible dollar amount for active City SDCERS' members (employees).

The Post-Employment Healthcare Benefits Plan is funded by City of San Diego, the plan sponsor (employer). As of June 30, 2004, and June 30, 2003, there were no annual contributions made to the Plan. Payments for retiree healthcare insurance premiums are made in cash from the City's annual operating budget. Beginning in FY 2005, the City will make specific contributions to SDCERS for this Plan; these contributions are not actuarially based, but rather budgeted as a current year expense of the City.

For further information on the Post-Employment Healthcare Benefits Plan program, please contact SDCERS' office at (800) 774-4977 or (619) 525-3600, or visit SDCERS' Web site at www.sdcers.org.

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V. Statistical Section

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF REVENUES BY SOURCE (ADDITIONS)

For Fiscal Years Ended June 30

	Fiscal Year	Plan Sponsors' (Employers') Contributions	Members' (Employees') Contributions Paid By Plan Sponsors (Employers)	Members' (Employees') Contributions	Members' (Employees') Contributions for Service Purchased	Earned Interest on PSC Installment Contracts[1]	DROP Contributions (plus Pension Allowances)	Net Investment Income[2]	Other Income	Total Revenues
Dollars	**2004**	**$87,861,650**	**$33,951,427**	**$16,299,646**	**$75,419,976**	**$907,814**	**$0[5]**	**$537,196,172**	**$0**	**$751,636,685**
% of total		**11.69%**	**4.52%**	**2.17%**	**10.03%**	**0.12%**	**0.00%**	**71.47%**	**0.00%**	**100.00%**
Dollars	2003	72,558,680[3]	31,606,145	20,917,653	40,016,896	477,758	0[5]	122,729,552	0	288,306,684
% of Total		25.17	10.96	7.26	13.88	0.17	0.00	42.56	0.00	100.00
Dollars	2002	49,962,365	28,794,143	24,192,104	29,353,981	n/a	29,892,770	(75,934,760)	459,087	86,719,690
% of Total		57.61	33.20	27.90	33.85		34.47	-87.56	0.53	100.00
Dollars	2001	44,598,473	25,566,207	35,413,089[4]	n/a	n/a	28,303,009	(25,126,082)	371,123	109,125,819
% of Total		40.87	23.43	32.45			25.94	-23.03	0.34	100.00
Dollars	2000	40,001,210	24,271,821	28,874,726[4]	n/a	n/a	17,334,525	349,654,651	308,302	460,445,235
% of Total		8.69	5.27	6.27			3.76	75.94	0.07	100.00
Dollars	1999	35,901,367	23,439,812	30,081,241[4]	n/a	n/a	11,770,221	180,463,938	290,335	281,946,914
% of Total		12.73	8.31	10.67			4.18	64.01	0.10	100.00

1 Earned Interest on PSC Installment Contracts was called out separately in the Statement of Changes in Plan Net Assets for the Defined Benefit Pension Plan as a result of a restatement suggested by SDCERS' independent auditor. In prior years, Earned Interest on PSC Installment Contracts was included in Members' (Employees') Contributions for Purchased Service in the Statement of Changes in Plan Net Assets.

2 Net Investment Income includes all SDCERS' earnings for both the Defined Benefit Pension Plan and the Post-Employment Healthcare Benefits Plan.

3 Amount includes an additional plan sponsor (employer) contribution made by the City of San Diego for a portion of their net pension obligation applicable to fiscal years 1997 - 2002, totaling $9,923,538. For further details concerning this additional plan sponsor (employer) contribution, please see the Schedules of Plan Sponsors' (Employers') Contributions and the Notes to Schedules of Plan Sponsors' (Employers') Contributions in the Required Supplementary Information located in the Financial Section of this CAFR.

4 Prior to 2002, Members' (Employees') Contributions included Contributions for Purchased Service.

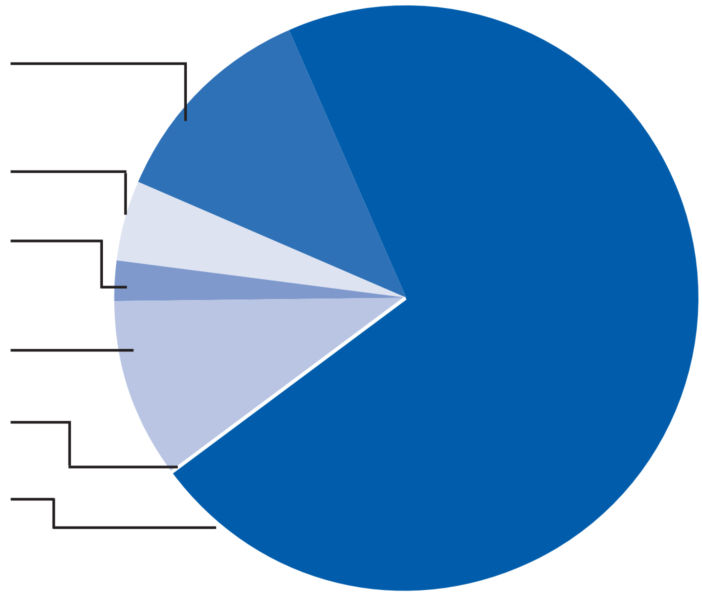
5 Reflects restatement of DROP as a plan liability effective June 30, 2004 with June 30, 2003 restated.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF REVENUES BY SOURCE (ADDITIONS) (continued)

For Fiscal Years Ended June 30

FY 2004 Revenues

Plan Sponsors' (Employers') Contributions	11.69%
Members' (Employees') Contributions Paid by Plan Sponsors (Employers)	4.52%
Members' (Employees') Contributions	2.17%
Members' (Employees') Contributions for Purchased Service	10.03%
Earned Interest on PSC Installment Contracts	0.12%
Net Investment Income	71.47%
TOTAL	100.00%



SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF EXPENSES BY TYPE (DEDUCTIONS)

For Fiscal Years Ended June 30

	Fiscal Year	Retirement, Death and Disability Benefits	Health Insurance Payments	Administrative Expenses	Allowance for Uncollectable Purchased Service Payments[1]	Litigation Settlement Expense[2]	Refund of Members' (Employees') Contributions	Total Expenses
Dollars	**2004**	**$174,393,789**	**$12,829,903**	**$10,163,263**	**$244,704**	**$1,249,292**	**$2,108,909**	**$200,989,860**
% of Total		**86.77%**	**6.38%**	**5.06%**	**0.12%**	**0.62%**	**1.05%**	**100.00%**
Dollars	2003	155,614,422	11,450,200	8,155,205	68,693	n/a	1,378,787	176,667,307
% of Total		88.08	6.48	4.62	0.04		0.78	100.00
Dollars	2002	141,037,774	8,882,138	7,866,835	147,913	n/a	994,740	158,929,400
% of Total		88.74	5.59	4.95	0.09		0.63	100.00
Dollars	2001	145,991,812	7,207,618	6,279,578	n/a	n/a	1,462,746	160,941,754
% of Total		90.71	4.48	3.90			0.91	100.00
Dollars	2000	105,179,379	5,413,222	5,835,241	n/a	n/a	1,250,997	117,678,839
% of Total		89.38	4.60	4.96			1.06	100.00
Dollars	1999	92,902,634	5,400,264	3,235,667	n/a	n/a	1,643,187	103,181,752
% of Total		90.04	5.23	3.14			1.59	100.00

[1] Allowance for Uncollectable Purchased Service Payments was called out separately in the Statement of Changes in Plan Net Assets for the Defined Benefit Pension Plan as a result of a restatement suggested by SDCERS' independent auditor. In prior years, an allowance was not included as an offset to the Receivable of Members' (Employees') Contributions for Purchased Service in the Statement of Changes in Plan Net Assets.

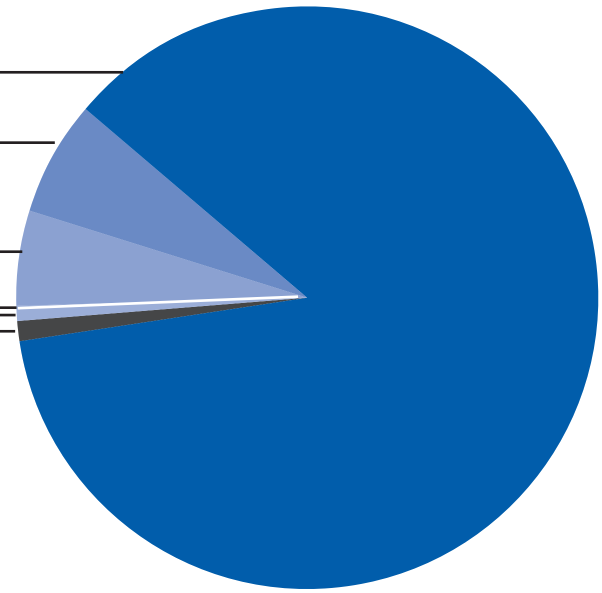
[2] Litigation Settlement Expense is SDCERS' portion of the plaintiff's attorney fee awarded as a result of the Gleason settlement reached in July 2004. For additional information on this expense and the Gleason settlement, refer to *Note 11. Legal Action* in the Notes to the Financial Statements in the Financial Section of the CAFR.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF EXPENSES BY TYPE (DEDUCTIONS) (continued)

For Fiscal Years Ended June 30

FY 2004 Expenses

Retirement, Death and Disability Benefits	86.77%
Health Insurance Payments	6.38%
Administrative Expenses	5.06%
Allowance for Uncollectible Purchased Service Payments	0.12%
Litigation Settlement Expense	0.62%
Refund of Members' (Employees') Contributions	1.05%
TOTAL	100.00%



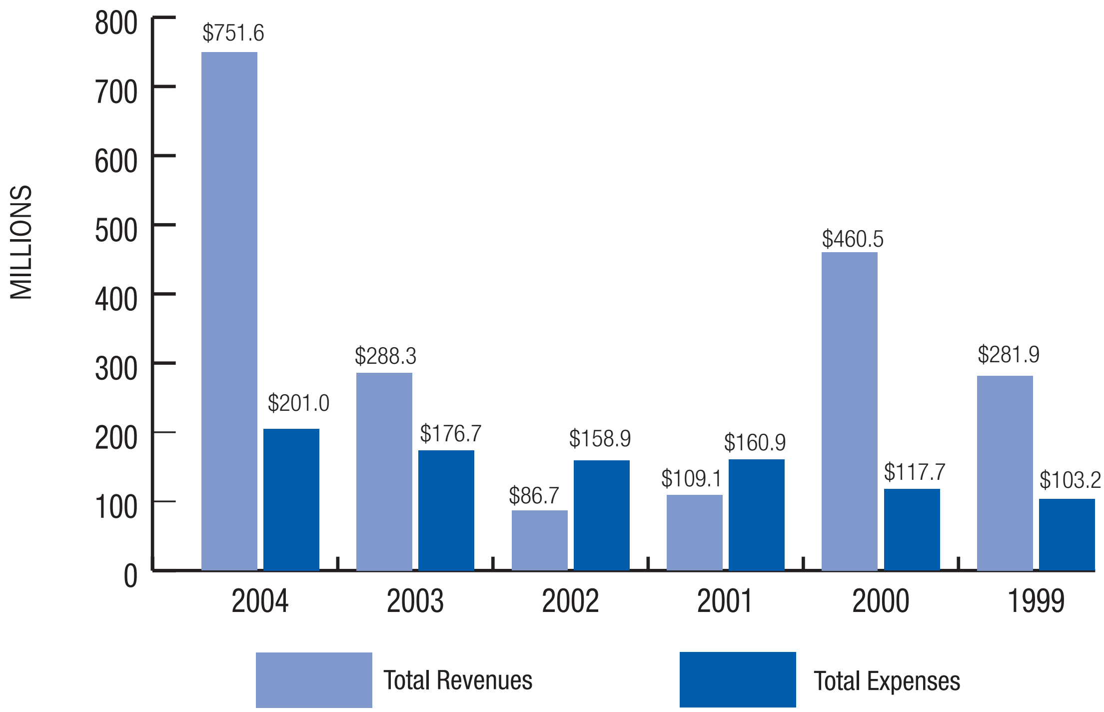
SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
COMPARISON OF REVENUES BY SOURCE (ADDITIONS) AND EXPENSES BY TYPE (DEDUCTIONS)

For The Years Ended June 30

Fiscal Year	Total Net Plan Assets All Plans	Revenues All Plans	Revenue as a % of Total Plan Net Assets	Expenses All Plans	Expenses as a % of Total Plan Net Assets	Revenues as a % of Expenses
2004	**$3,092,746,478**	**$751,636,685**	**24.30%**	**$200,989,860**	**6.50%**	**373.97%**
2003	2,542,099,653	288,306,684	11.34	176,667,307	6.95	163.19
2002	2,527,890,311	86,719,690	3.43	158,929,400	6.29	100.55
2001	2,599,281,332	109,125,819	4.20	160,941,754	6.19	67.80
2000	2,652,492,234	460,445,235	17.36	117,678,839	4.44	391.27
1999	2,309,725,838	281,946,914	12.21	103,181,752	4.47	273.25

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
COMPARISON OF REVENUES BY SOURCE (ADDITIONS) AND EXPENSES BY TYPE (DEDUCTIONS) (continued)

For The Years Ended June 30



SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF ALLOWANCES BEING PAID
SERVICE AND DISABILITY RETIREES AND BENEFICIARIES

As of Years Ended June 30

	City of San Diego			
As of Years Ended	**6/30/2003**		**6/30/2002**	
Type of Allowance	Annual No.	Annual Allowances	Annual No.	Annual Allowances
Total Service Retirements	3,260	$109,471,010	3,043	$89,330,198
Total Disability Retirements	1,239	27,164,406	1,247	25,716,957
Total Deaths Before Retirement[2]	30	509,400	42	599,081
Total Deaths After Retirement	938	7,771,772	811	5,908,340
Total Allowances Being Paid	**5,467**	**$144,916,588**	**5,143**	**$121,554,576**

[1] The San Diego County Regional Airport Authority (Airport) was established effective as of January 1, 2003, from the Unified Port of San Diego (Port); interim actuarial valuations as of December 31, 2002, were performed to reflect the two separate agencies (plan sponsors). All retirees remained with the Port as of December 21, 2002; therefore, no allowances were paid on behalf of the Airport.

[2] Total deaths before retirement represents one-time payments to members' (employees') beneficiaries and refund of members' (employees') contributions, plus interest.

06/30/2003		Unified Port of San Diego 12/31/2002[1]		6/30/2002		San Diego County Regional Airport Authority 6/30/2003[1]	
Annual No.	Annual Allowances	Annual No.	Annual Allowances	Annual No.	Annual Allowances	Annual No.	Annual Allowances
162	$4,343,496	167	$4,242,311	158	$3,892,413	1	$25,112
60	1,022,188	62	1,021,125	60	988,565	0	0
1	28,160	1	9,337	2	19,653	0	0
51	498,358	48	439,769	43	359,284	0	0
274	**$5,892,202**	**278**	**$5,712,542**	**263**	**$5,259,915**	**1**	**$25,112**

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF AVERAGE BENEFIT PAYMENT AMOUNTS

As of Years Ended June 30

	City of San Diego					
As of Years Ended	**6/30/03**	**6/30/02**	**6/30/01**	**6/30/00**	**6/30/99**	**6/30/98**
Totals						
Number of Allowances	5,467	5,143	5,012	4,789	4,657	4,419
Annual Allowances Paid	$144,916,588	$121,554,576	$112,637,558	$95,348,751	$87,823,437	$76,507,181
Averages						
Annual Allowance	$26,508	$23,635	$22,474	$19,910	$18,858	$17,313
Percentage Increase Over Prior Year	12.16%	5.17%	12.88%	5.66%	8.92%	13.89%
Attained Age	67.2	67.7	67.5	68.1	68.0	68.3
Age At Retirement	54.2	54.2	54.2	54.4	54.5	54.5
Service Years At Retirement	22.7	21.7	21.2	20.9	20.9	21.0
New Retirees[2]						
Number of Allowances	470	168	386	251	319	241
Average Age	56.9	55.7	56.1	56.3	55.6	56.2
Average Allowance	$48,864	$41,219	$40,443	$35,054	$36,072	$33,642
Percent Increase Over Prior Year	18.55%	1.92%	15.37%	-2.82%	7.22%	10.00%

[1] San Diego County Regional Airport Authority (Airport) was established effective as of January 1, 2003, from the Unified Port of San Diego (Port); interim actuarial valuations were performed as of December 31, 2002, to reflect the two separate agencies. As of December 31, 2002, the Airport had no retirees or beneficiaries receiving benefits; all retirees and beneficiaries are counted as retiring from the Port as of the date of this actuarial valaution.

[2] Retirees only (including DROP participants); beneficiaries excluded.

[3] Prior to "Andrecht"; $18,907 average annual allowance after 7% "Andrecht" increase.

Unified Port of San Diego							San Diego County Regional Airport Authority
6/30/03	12/31/02[1]	6/30/02	6/30/01	6/30/00	6/30/99	6/30/98	6/30/03[1]
274	278	263	246	242	232	227	1
$5,892,202	$5,712,542	$5,259,914	$4,346,932	$4,144,798	$3,776,524	$3,610,346	$25,112
$21,504	$20,549	$20,000	$17,670[3]	$17,127	$16,278	$15,905	$25,112
4.65%	2.75%	13.19%	3.17%	5.22%	23.45%	15.77%	n/a
68.2	68.6	68.4	68.3	68.5	68.5	68.7	66.1
57.3	57.4	57.4	57.4	57.7	58.0	58.6	65.0
16.7	16.6	16.5	15.8	16.1	16.0	16.7	10.2
15	26	18	9	11	7	24	1
59.0	59.0	60.0	56.6	59.2	55.4	60.8	66.1
$34,684	$34,684	$29,568	$26,787	$25,920	$16,382	$30,997	$25,112
17.30%	n/a	10.38%	3.34%	58.22%	-47.15%	90.00%	n/a

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF ACTIVE MEMBERS

As of Years Ended June 30

	City of San Diego					
As of Years Ended	**6/30/03**	**6/30/02**	**6/30/01**	**6/30/00**	**6/30/99**	**6/30/98**
Totals						
Number of Members	10,100	10,409	9,892	9,913	9,654	9,359
Salaries	$533,595,405	$535,156,545	$481,863,319	$448,501,827	$424,515,969	$399,035,094
Averages						
Annual Salary	$52,831	$51,413	$48,712	$45,244	$43,973	$42,637
Percentage Increase Over Prior Year	2.76%	5.54%	7.67%	2.89%	3.13%	3.74%
Current Age	42.4	42.4	42.1	42.2	41.9	41.8
Years Service Credit[2]	11.5	11.3	10.7	10.7	10.7	10.8

1 The San Diego County Regional Airport Authority (Airport) was established effective as of January 1, 2003, from the Unified Port of San Diego (Port); interim actuarial valuations were performed as of December 31, 2002, to reflect the two separate agencies.

2 6/30/03, 12/31/02 and 6/30/2002 actuarial valuations include purchased service credit.

Unified Port of San Diego							San Diego County Regional Airport Authority	
6/30/03	12/31/02[1]	6/30/02	6/30/01	6/30/00	6/30/99	6/30/98	6/30/03	12/31/02[1]
609	606	736	734	654	661	616	208	173
$34,163,647	$33,995,335	$39,063,314	$36,425,136	$30,621,242	$30,034,900	$26,672,111	$11,577,127	$8,871,283
$56,098	$56,098	$53,075	$49,626	$46,821	$45,439	$43,299	$55,659	$51,279
5.70%	n/a	6.95%	5.99%	3.04%	4.94%	0.27%	8.54%	n/a
44.7	44.6	44.4	43.8	43.9	43.7	43.5	43.5	42.9
8.2	8.2	8.2	7.7	7.8	7.5	7.4	6.0	6.5

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF INACTIVE MEMBERS[1]

As of Years Ended June 30

	City of San Diego					
As of Years Ended	**6/30/03**	**6/30/02**	**6/30/01**	**6/30/00**	**6/30/99**	**6/30/98**
Totals						
Number of Inactive Members	1,723	1,499	1,438	1,016	800	791
Other Members[3]	0	0	0	0	0	344
Total Members	1,723	1,499	1,438	1,016	800	1,135
Member Contribution Balances						
Inactive Members	$31,484,749	$25,808,549	$23,501,628	$18,620,827	$12,244,598	$12,281,289
Other Members[3]						$19,829,472
Total Contribution Balances	$31,484,749	$25,808,549	$23,501,628	$18,620,827	$12,244,598	$32,110,761
Member Averages						
Member Age	43.7	43.1	42.9	44.3	43.1	42.6
Service Years Earned[4]	6.4	6.6	6.8	7.5	6.6	7.4
Contribution Balance	$18,273	$17,217	$16,343	$18,328	$15,306	$15,526

[1] Inactive members are former active members of SDCERS who have left employment of the plan sponsor (employer) and have contributions still on deposit with SDCERS. Inactive SDCERS' members may or may not be vested to receive a retirement benefit in the future.

[2] San Diego County Regional Airport Authority was established effective as of January 1, 2003, from the Unified Port of San Diego (Port); interim actuarial valuations were performed to reflect the two separate employers (plan sponsors). All inactive SDCERS members remained with the Port as of December 31, 2002; therefore, all contributions for inactive Port SDCERS members remained with the Port.

[3] Other Members may include withdrawals (refunds), deaths, disabilities, and service retirements which are in transition.

[4] City's 6/30/02 actuarial valuation includes years of purchased service.

Unified Port of San Diego							San Diego County Regional Airport Authority
6/30/03	12/31/02[2]	6/30/02	6/30/01	6/30/00	6/30/99	6/30/98	6/30/03[2]
194	186	196	163	142	99	91	7
0	0	0	0	0	0	37	0
194	186	196	163	142	99	128	7
$1,348,216	$1,235,981	$1,276,922	$1,135,633	$938,416	$631,050	$567,632	$9,808
						1,372,784	0
1,348,216	$1,235,981	$1,276,922	$1,135,633	$938,416	$631,050	$1,940,416	$9,808
44.7	43.9	43.4	44.2	41.6	42.6	41.5	45.9
3.9	4.1	4.1	4.3	3.7	3.6	4.1	0.9
$6,950	$6,645	$6,515	$6,967	$6,609	$6,374	$6,238	$1,401

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF PARTICIPATING PLAN SPONSORS (EMPLOYERS)

As of June 30, 2004

City of San Diego (City)
202 C Street
San Diego, CA 92101-3860
(619) 236-5555
www.sandiego.gov

Unified Port of San Diego (Port)
3165 Pacific Highway
San Diego, CA 92101-1128
(619) 686-6200
www.portofsandiego.org

San Diego County Regional Airport Authority (Airport)
3225 North Harbor Drive
San Diego, CA 92101-1022
(619) 400-2400
www.san.org

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San Diego City Employees' Retirement System

401 B Street, Suite 400, San Diego, CA 92101-4298
Toll Free (800) 774-4977 Local Dialing (619) 525-3600
Web site: www.sdcers.org

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