COMPREHENSIVE ANNUAL FINANCIAL REPORT

City of Austin

Employees' Retirement System

For the Year Ended December 31, 2006

Austin, Texas

City of Austin
Employees' Retirement System
2006 Annual Report

Comprehensive Annual Financial Report
for the Year ended December 31, 2006

Prepared by: City of Austin Employees' Retirement System, 418 E. Highland Mall Blvd., Austin, Texas 78752-3720

Our Mission

**The mission of the
City of Austin Employees' Retirement System
is to provide reliable retirement benefits.**

We Value:

Accessibility
Accountability
Cooperation
Ethical Behavior
Fairness
Innovation
Integrity
Open Communication
Respect
Responsiveness

TABLE OF CONTENTS

Introductory Section

Financial Section

Investment Section

Actuarial Section

Statistical Section

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Introductory Section

City of Austin Employees' Retirement System

June 30, 2007

Board of Trustees
City of Austin Employees' Retirement System
Austin, Texas

Ladies and Gentlemen:

It is our pleasure to submit to you the Comprehensive Annual Financial Report of the City of Austin Employees' Retirement System (COA ERS or System) for the year ended December 31, 2006. The content of this report is designed to provide a complete and accurate review of operations during the year and is the responsibility of COA ERS management. It has been prepared in accordance with generally accepted principles for accounting and reporting as established by the Governmental Accounting Standards Board (GASB) for governmental organizations and public employee retirement systems.

Structure of the Report

This report is divided in five sections:

- **Introductory Section** includes this letter, a listing of professional service providers and investment managers, describes COA ERS management and organizational structure, and provides a summary and history of plan benefits.
- **Financial Section** contains the opinion of the independent auditor, KPMG LLP, Management's Discussion and Analysis, the financial statements and footnotes of COA ERS, and various supplemental schedules.
- **Investment Section** contains a report from the independent investment consultant, Summit Strategies Group, information on COA ERS' asset allocation, performance, and other schedules.
- **Actuarial Section** includes an actuarial valuation by the independent actuary, Gabriel, Roeder, Smith, & Company.
- **Statistical Section** contains general statistical information regarding System participants and financial data. GASB 44 was implemented in 2006 to effect consistency in reporting and enable comparability of data presented.

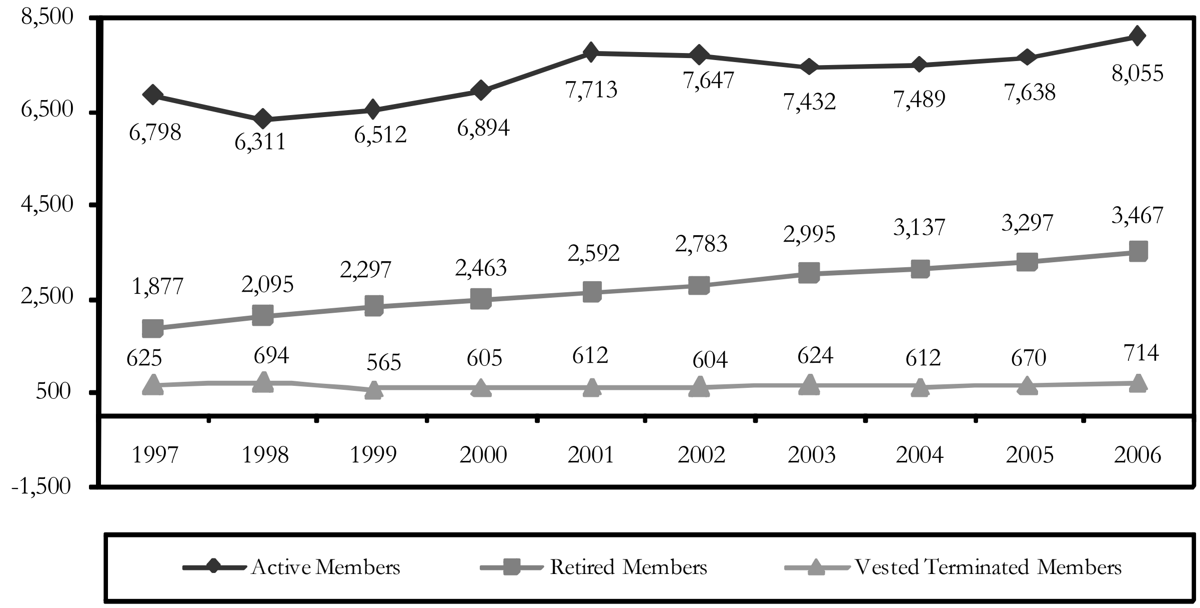
Plan Profile and Demographic Highlights

COA ERS was established in 1941 and has provided retirement benefits to eligible City of Austin employees since that time. Though originally created by city ordinance, the System is now governed by state law and administered by an eleven-member board of trustees.

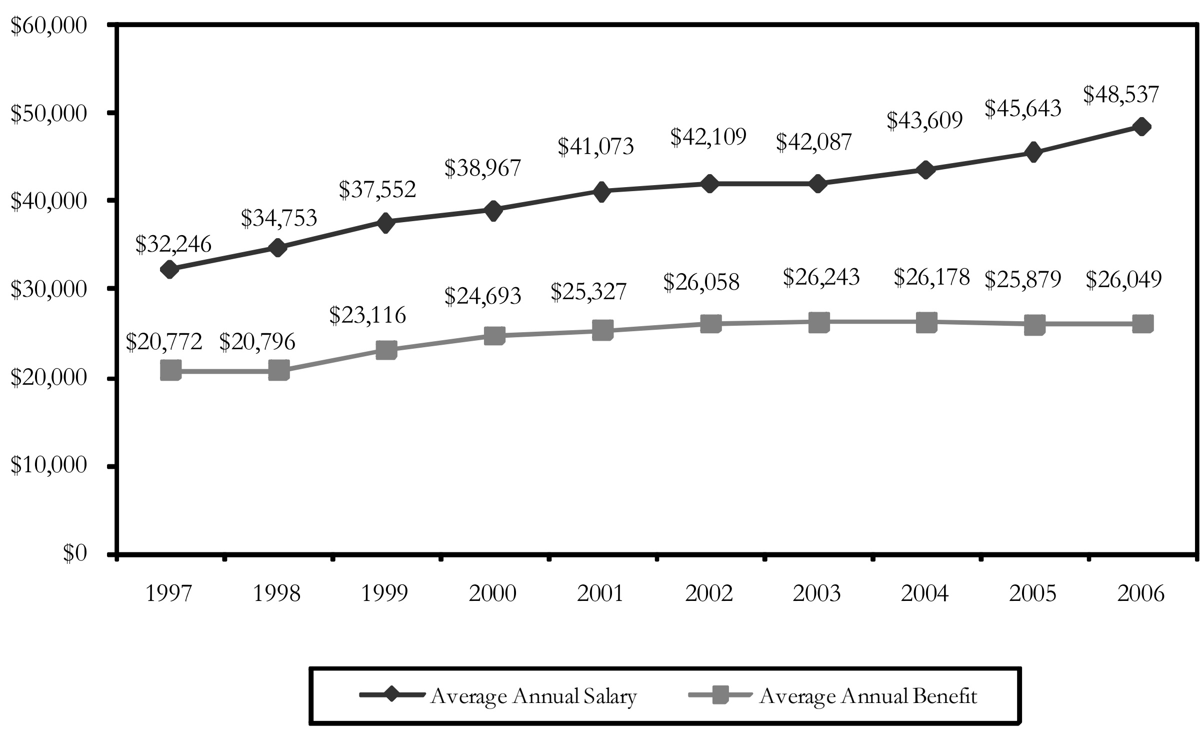
The Plan provides retirement, disability and death benefits to eligible employees of the City of Austin. Both employees and the City of Austin make contributions to the System. Members qualify for normal retirement benefits at age 62; age 55 with 20 years of creditable service; or any age with 23 years of creditable service. Vesting occurs at five years of creditable service. Generally, benefits are determined at 3% of the final average earnings, as defined, multiplied by the number of years of creditable service. Disability retirement is also available pursuant to specific criteria established by statute. Additional information concerning COA ERS plan provisions is contained in the Summary of Plan Provisions later in this section of the report.

The following charts depict the growth in the System membership and the changes in average salaries and benefits. The number of active and retired members has increased for the past four years. Both the average salary of active members and the average retirement benefit have increased over the past year.

Membership Profile



Average Salary and Average Benefit



Financial Summary

Internal controls have been established by COA ERS management to provide reasonable assurance that the assets are properly safeguarded, the financial records are fairly and accurately maintained, and the governing statute and policies are correctly followed. The governing statute requires an annual audit of the System's accounts by a Certified Public Accountant. The Board of Trustees has retained KPMG LLP as independent external auditor since 1997. KPMG's 2006 financial audit was conducted in accordance with generally accepted auditing standards and resulted in an unqualified opinion on the financial statements. The Financial Section contains KPMG's audit opinion letter and additional information including Management's Discussion and Analysis (MD&A) that provides a narrative introduction, overview, and analysis of the basic financial statements. The MD&A complements this letter of transmittal and should be read in conjunction with it.

The ***Additions to Plan Net Assets*** consist of employer and employee contributions, investment income, and realized and unrealized gain or loss on investments. For 2006, employer and employee contributions totaled $66.4 million; investment, securities lending, and other income was $42.4 million; and net appreciation in plan investments net of investment expenses totaled $137.6 million, resulting in net additions to Plan Net Assets of $246.4 million. The ***Deductions from Plan Net Assets,*** totaling $98.2 million, consist of $88.5 million in annuity payments, refunds of $4.2 million, Deferred Retirement Option Program (DROP) disbursements of $1.5 million, retiree lump-sum annuity disbursements of $0.7 million, death benefits of $1.6 million, and administrative expenses of $1.7 million. The net increase of $148.2 million results in total assets held in trust of $1.6 billion.

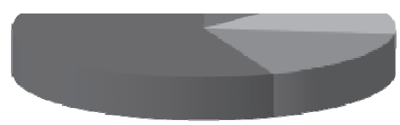
Employer Contributions

Employee Contributions

Interest / Dividends / Other Income

Appreciation in Plan Investments
(net of investment expenses)

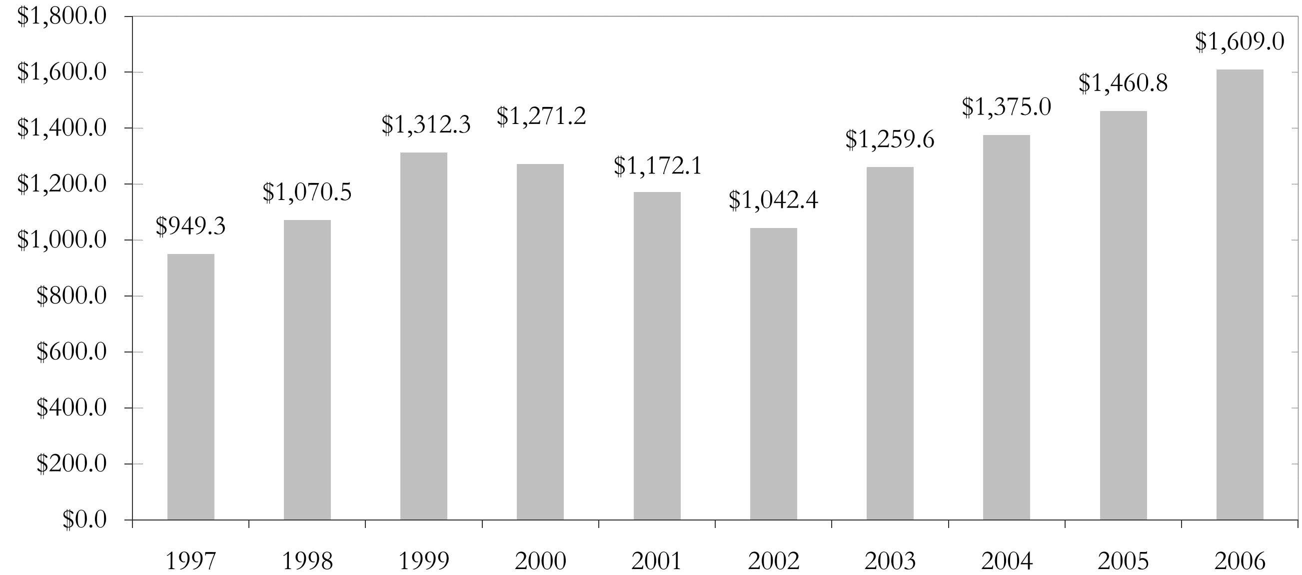
Total Additions



Annuity Payments	$	88,
Refunds		4,
DROP Disbursements		1,
Retiree Lump-Sum Payments		
Death Benefits		1,
General & Administrative Expenses		1,
Total Deductions	**$**	**98,**

The following chart shows the ***Total Plan Net Assets*** at the end of each year since 1997. Net Assets increased by $148.2 million during 2006, resulting in Total Plan Net Assets of $1,608,958,244 at December 31, 2006. Despite three years of net asset loss (2000-2002), Total Plan Net Assets have increased significantly over a ten-year period.

Total Plan Net Assets (in millions)



Investments

Essential to the COA ERS' mission is the responsibility to ensure long-term assets will meet long-term liabilities. This ensures retirement and other benefits will be available for both current and future members. Investments are made with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. Funds of COA ERS are invested solely in the interest of the membership and their beneficiaries, and for the exclusive purpose of providing benefits to such membership and their beneficiaries and defraying reasonable expenses of administering COA ERS. The Board of Trustees has established an investment policy and guidelines which provide for the delegation of investment authority to professional investment advisors.

COA ERS assets are strategically allocated to maximize income and reduce risk by using diverse and complementary portfolio structures. The COA ERS Board has consistently followed a long-range, conservative investment philosophy. The Board employs Summit Strategies Group for independent investment consulting and long-range asset liability analysis.

At December 31, 2006, the investment portfolio of COA ERS was managed by 11 investment managers. The Board has directed an asset allocation strategy as follows: Domestic Fixed Income (30%), International Equities (16.25%), US Equities - Large Cap (32.5%), US Equities - Non-Large Cap (16.25%), and Real Estate (5%). An asset liability study was conducted in late 2006 and modifications in the target asset mix are anticipated in 2007 as a result of the study.

Investment performance for the year ending December 31, 2006 was 12.5%, net of fees, compared to a Policy Benchmark of 14.1%. For the three-year period, COA ERS' portfolio returned 11.0%, net of fees, compared to 10.7% for the Policy Benchmark. For the five-year period, COA ERS' portfolio returned 8.9%, net of fees, compared to 8.9% for the Policy Benchmark. For actuarial purposes, the System's annual investment performance is measured over a five-year period, thereby smoothing annual variations in return. COA ERS is a long-term investor with a permanent fund, so performance over longer periods of time is the most important.

Funding and Actuarial Overview

In addition to investment income, the System is funded by regular contributions equal to eight percent of basic compensation by the City of Austin employees and eight percent of basic compensation by the City of Austin. The City of Austin currently also provides a funding subsidy. State law requires that any change to the plan of benefits adopted by the System be approved by a qualified actuary. The actuary certifies whether or not the contribution commitment by the participants and the City provides an adequate financing arrangement. Using the entry age actuarial cost method, the System's normal cost is determined as a percentage of payroll. The excess of the total contribution rate over the normal cost rate is used to amortize the System's unfunded actuarial accrued liability (UAAL), if any, and the number of years needed to amortize the System's UAAL is determined using a level percentage of payroll method.

As certified in this report by Gabriel, Roeder, Smith & Company, due to the significant asset losses that occurred in recent years, COA ERS contributions are not currently sufficient to amortize the unfunded liability of the System. In the absence of significant actuarial gains, the current contribution rates are not sufficient to support the current benefit structure of the Plan. The overall funded position of the System is 75.9%, down from 78.0% in 2005. The actuarial accrued liability and the actuarial value of assets of COA ERS as of December 31, 2006, amounted to $1.974 billion and $1.498 billion, respectively. A detailed discussion of funding is provided in the Actuarial Section of this report.

The supplemental funding plan adopted by the Austin City Council in 2005 is expected to eventually accomplish a 30-year amortization of the unfunded liability of the System. The initial funding subsidy under the plan started in October 2006 at one percent of covered payroll. Subject to certain conditions, the subsidy will increase by one percent each year up to a total subsidy of four percent. If in any year the investment earnings are 12 percent or greater, the increase in the subsidy will be delayed by a year. Because of this provision, the subsidy will not increase in October 2007. The subsidy (up to four percent) will stay in effect as long as it is needed to attain or keep a 30-year amortization period. As part of the plan, the City Manager and City Council will become part of the process for consideration of future benefit enhancements, including cost-of-living increases.

Certificate of Achievement

For the eighth consecutive year, COA ERS was awarded a Certificate of Achievement for Excellence in Financial Reporting for its Comprehensive Annual Financial Report for the fiscal year ended December 31, 2005 by the Government Finance Officers' Association of the United States and Canada (GFOA). COA ERS is pleased to have achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized Comprehensive Annual Financial Report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current Comprehensive Annual Financial Report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgments

This report reflects the combined effort of the COA ERS staff under the leadership of the Board of Trustees. We would like to express our gratitude to the staff, advisors, and members of the Board who have contributed to the preparation of this report and to the continued successful operation of the City of Austin Employees' Retirement System.

Respectfully Submitted,

Mark Monteith	Stephen C. Edmonds	Donna Durow Boykin, CPA
Board Chair	Executive Director	Finance Manager

Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Austin

Employees' Retirement System

Texas

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
December 31, 2005

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

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

President

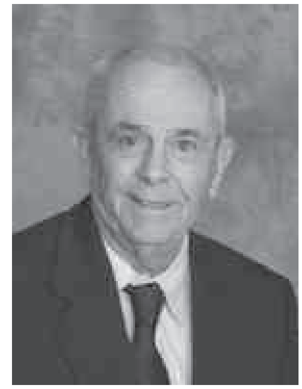
Executive Director

COA ERS 2006 BOARD OF TRUSTEES

Reagan David
Board Chair

Mark Monteith
Board Vice Chair

Janet Bartles
Trustee

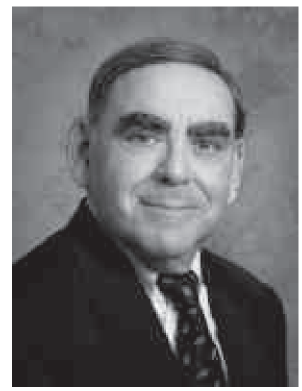


Francis E. Benoit
Trustee

Leslie Browder
Trustee

Eyna Canales-Zarate
Trustee

Betty Dunkerley
Trustee



Ed Golden
Trustee

Elizabeth S. Gonzales
Trustee

Cathy Rodgers
Trustee

Anthony B. Ross, Sr.
Trustee

COA ERS STAFF

Stephen C. Edmonds
Executive Director

Rhonda Helm
Operations Manager

Donna Durow Boykin
Finance Manager

Jesse Ortega
Administrative Supervisor

Melissa Adams
IT Coordinator

Lori Bateman
Member Services Coordinator

Johne Behner
Member Services Specialist

Teresa Cantu
Member Services Specialist

Bertie Corsentino
Financial Analyst

Craig Finkelstein
Member Services Coordinator

Laura L. Fugate
Member Services Specialist

Errin Garcia
Executive Assistant

Korrie Hoskins
Accounting Technician





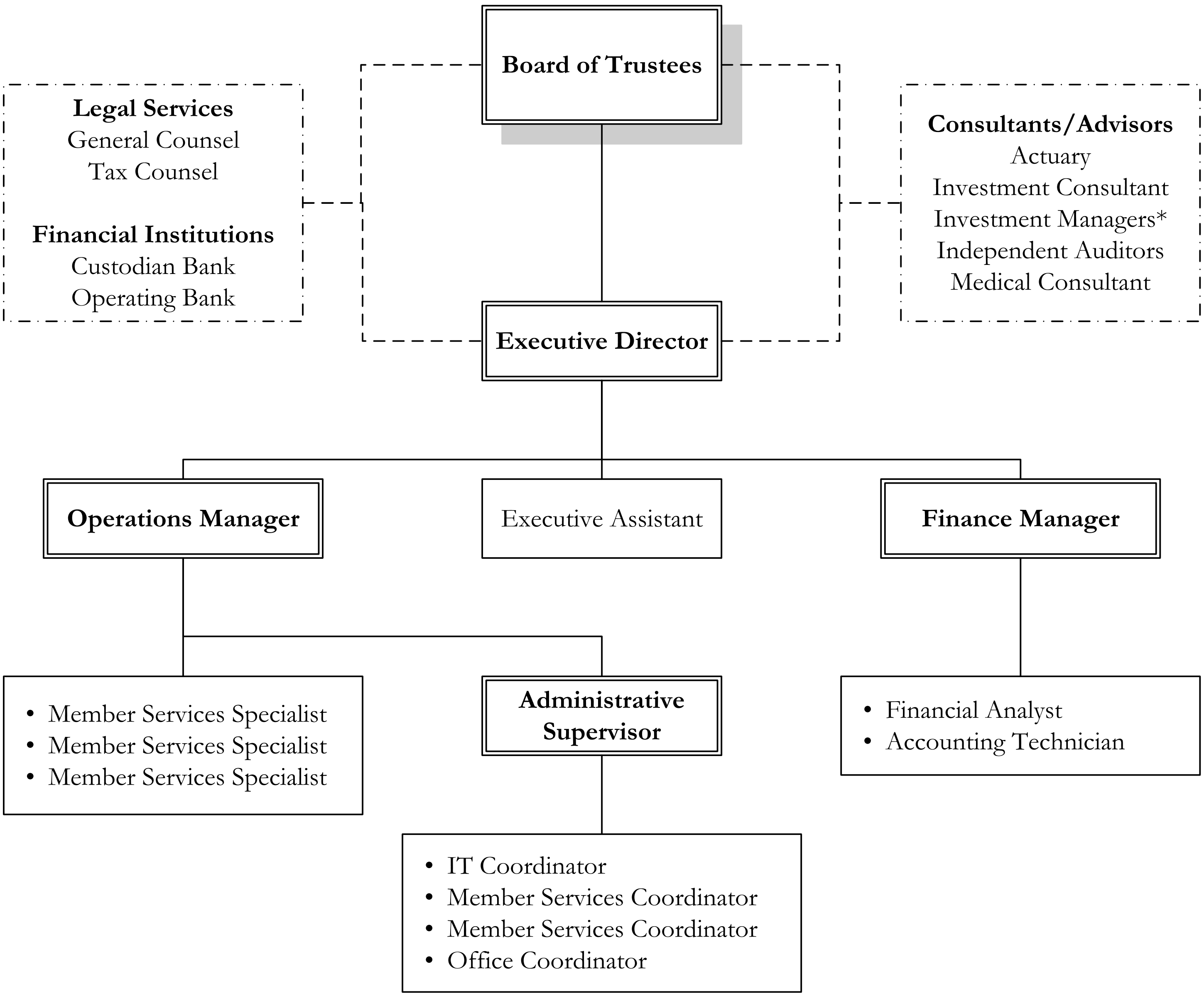








ORGANIZATIONAL CHART



***** For more information on Investment Managers, refer to Asset Allocation Table on page 56.*

PROFESSIONAL SERVICE PROVIDERS

Investment Consultant
Summit Strategies Group

Custodial Bank
Northern Trust

Independent Auditor
KPMG LLP

Actuary
Gabriel Roeder Smith & Company

Legal Counsel
Knight & Partners
Godwin Gruber LLP

Operating Bank
JPMorgan Chase Bank

INVESTMENT MANAGERS

Fixed Income
Agincourt Capital Management LLC
NTGI QM Aggregate Bond Index Fund

International Equity
Sprucegrove Investment Management LTD
Walter Scott & Partners LTD

Real Estate
Principal Global Investors

US Equity
AQR Capital Management
AllianceBernstein
Aronson + Johnson + Ortiz
Driehaus Capital Management LLC
Eubel Brady & Suttman Asset Management
INTECH Enhanced Investment Technologies LLC
Wall Street Associates

SUMMARY OF PLAN PROVISIONS

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM (COA ERS)

Introduction

COA ERS is:
An IRS tax qualified 401(a) defined benefit plan
Governed by State Statute Art. 6243n

COA ERS Board of Trustees:
Provides oversight
Sets policy

COA ERS Staff:
Provides service to all Members
Ensures compliance with policies and procedures

Members of COA ERS:
Are the reason we are here
Are welcome to attend all Board Meetings

Membership Requirements

City of Austin regular employees working 30 or more hours per week become Members of COA ERS on the date of employment as mandated by Statute.

Members do not include:
Temporary employees
Part-time employees working less than 30 hours per week
Civil service employees of the Fire Department and the Police Department
The Mayor and Members of the City Council

Contributions

Employee: Members of COA ERS currently contribute 8% of their base pay, calculated on a 40-hour work week. Contributions are made through payroll deduction each pay period (every two weeks). Overtime and special pay are not included.

Employer: Each pay period, the employer contributes an amount equal to the amount contributed by Member employees. These funds do not become a part of the Member's account. In 2005, the City of Austin adopted the Supplemental Funding Plan (SFP). The SFP will increase the City contribution rate in 1% increments annually over the next several years until the employer contribution rate reaches a maximum of 12%. The rates increase on October 1st of each year; the City contribution rate increased to 9.0% effective October 1, 2006. The increase in the City rate can be delayed by a year if the System earns 12.0% on its assets during the previous calendar year. The increases in the City rate are intended to stay in place until the funding period of the System is less than 30 years. Once the funding period reaches 30 years, the City has the option to reduce the additional contributions to a rate that would produce a 30-year funding period.

RETIREMENT BENEFITS

Retirement Eligibility

Members are eligible for retirement when they meet one of the following age and service requirements:

- Any number of years Creditable Service at age 62*
- 20 years Creditable Service at age 55
- 23 years Creditable Service at any age

*To meet this retirement eligibility, a Member must either be an Active Contributing Member at age 62, a Terminated Vested Member, or a Proportionate Member with five years combined Creditable Service.

Vesting

Members become vested with COA ERS as soon as they have five years of Creditable Service. The Member is not entitled to receive the employer contribution at any time. Instead, vesting means that a Member is entitled to receive a lifetime benefit as long as their contributions are on deposit in the System upon reaching retirement eligibility.

Creditable Service

In order for COA ERS to calculate retirement benefits, it is important to know the total number of years of Creditable Service a Member has with COA ERS. Creditable Service is a combination of Membership service and other types of Creditable Service described below.

Current Active/Vested Members, as of October 1, 1995, were granted service credit for the period between their date of hire and their date of participation, up to six months. All Members hired on or after October 1, 1995 become Members on their date of hire or on their date of regular employment at 30 or more hours per calendar week.

In some cases, Members may purchase Creditable Service. A Member may make such purchases twice each calendar year by lump-sum payment. Purchases must be made prior to retirement. Service credit must be purchased in minimum increments of one month and may be subject to other guidelines. To purchase this service, Members may pay by personal check, cashier's check, or money order, or roll over funds from other qualified plans.

The Board of Trustees adopts policies and guidelines governing the purchase of service credit.

Types of Creditable Service

Membership Service - The employment period during which a Member makes payroll contributions to the System is considered the "Membership Service" period.

Reinstated Membership Service (Prior COA Service) - When Members leave City employment, withdraw their deposits, and later return to City employment or employment with a participating proportionate system, they may purchase and reinstate the earlier time with the City. To purchase this service, they must become a Member of COA ERS or another proportionate system. The cost to purchase prior service credit is based on the amount previously withdrawn plus all interest that would have accrued had the funds remained on deposit.

Non-Contributory Service Credit - Members may purchase service credit for the following non-contributory categories:

- Non-contributory service, such as temporary or part-time service (less than 30 hours per week)
- Approved leave of absence
- Workers' compensation leave due to an injury sustained in the course and scope of employment with the City of Austin

Credit for Federal Active Duty Military Service:

Prior Federal Active Duty Military Service - Members may establish up to 48 months Creditable Service for prior military service. Military service eligible for purchase is full-time active duty service in the armed forces of the United States performed before the first day of the most recent period of active membership in COA ERS. Military service in the reserves, a service academy, or for less than 90 consecutive days is not eligible for purchase. To purchase prior military service, Members must present an original DD214 showing honorable discharge.

Military Leave of Absence - Members may establish Creditable Service for an authorized leave of absence from employment for military service. The Member may establish such Creditable Service during the authorized leave of absence by continuing to make retirement contributions during the period of service. Alternatively, if the Member returns to employment within the applicable period (that varies from 14 days to 90 days depending on the length of service) after the completion of the military service, the Member and the employer may secure such Creditable Service by making a lump-sum payment within five years of the date the Member returns to employment and Active-Member status.

Permissive Time - Members may purchase up to five years of Creditable Service to advance their retirement eligibility date and/or increase the amount of their monthly annuity upon retirement. Only Vested Active or Inactive Members are eligible to purchase Permissive Time. Age, salary, earliest retirement date, and a combination of actuarial data determine the cost. There may be federal limitations on cash purchases.

Sick Leave Conversion - Retiring Members may convert sick leave hours to increase Creditable Service time. Employees eligible to be paid by the City of Austin for up to 720 hours of sick leave upon retirement cannot convert the eligible hours to Creditable Service. Converted sick leave hours cannot be used to reach retirement eligibility. Sick leave must be converted in pay period (80-hour) increments. Both the Member and the City must pay the current contribution rate at the time of retirement to convert hours. Members must begin the conversion process 60 days prior to their retirement date.

Service prior to 1941 - Additional service credit is allowed for Members with service performed before 1941, when the System came into existence. Two percent is applied for the number of years (prior to 1941) times the average salary for the years 1946 through 1950.

Proportionate Service

In 1991 the Texas Legislature established a Proportionate Retirement Program for the benefit of members of participating public retirement systems. A member of two or more of the following participating retirement systems may be eligible for proportionate benefits:

- City of Austin Employees' Retirement System
- The El Paso City Employees' Pension Fund
- El Paso Firemen and Policemen's Pension Fund
- Employees Retirement System of Texas (ERS)
- Judicial Retirement System of Texas I & II
- Texas Municipal Retirement System (TMRS)
- Texas County and District Retirement System (TCDRS)
- Teacher Retirement System of Texas (TRS)
- Other Texas retirement systems covering municipal employees who have qualified plans and have elected to participate in the Proportionate Retirement Program

Participating systems recognize service from other participating systems. A member with service credit in more than one participating retirement system may be eligible to combine that service in order to satisfy the length of service requirements used to determine eligibility for service retirement. Retirement benefits will be paid separately from each system, based only on the service performed in that system. Military service purchases may only be used once in determining the amount of the member's combined service credit.

A member of a participating retirement system who forfeited membership service by withdrawing their deposits may re-establish credit for service earned in another participating proportionate retirement system. Members must contact the system in which they previously had membership in order to determine eligibility requirements to re-establish service credit and/or membership. Members should determine their proportionate retirement benefits before withdrawing member deposits in any of these systems.

Calculation of Retirement Benefits

Factors used to calculate COA ERS retirement benefits:

Total Creditable Service – Total years and months of Creditable Service, including:

- Regular membership service
- Reinstated membership service
- Military service purchased
- Non-contributory service purchased
- Permissive Time purchased
- Converted sick leave
- Up to one six-month probationary period granted at retirement to Active/Vested Members hired before October 1, 1995
- Note: Proportionate service is only used to reach eligibility; it is not used to calculate retirement benefits.

Multiplier – As of January 2002, COA ERS' multiplier is 3.0%.

Final Average Earnings (FAE) – FAE is the average annual salary for the highest 36 months of contributory service during the last 10 years. For most Members, this is the average of the last three years worked. This can be calculated as either a monthly FAE or an annual FAE. Purchases of service credit do not affect FAE.

Retirement Date

The effective date of retirement is always the last working day of the month. For example, if a Member is eligible to retire, completes the application process for retirement, and terminates employment on March 15, the effective date of retirement will be March 31, and the Member will receive the first annuity payment on the last business day of April. If a terminated Vested Member does not withdraw their accumulated deposits on account, the retirement annuity payment may begin the last day of the month after normal retirement eligibility is reached and the Member has completed the application process for retirement from COA ERS.

Retirement Options

COA ERS provides several options for payment of monthly benefits. All payment options are actuarially equivalent to the basic Life Annuity benefit. Members should choose a payment option that best meets their individual needs.

The options that include benefits to a survivor are calculated according to the ages of both the Member and the surviving beneficiary included in the plan. The Member's benefits are reduced if an option is chosen that provides survivor benefits. This reduction is applied to the Member's basic benefit according to the option the Member chooses. Some restrictions may apply to non-spouse survivor benefits.

If the Member is married, spousal consent is required. A Member cannot change options or the survivor beneficiary after retirement. Even if a Retiree and the beneficiary spouse later divorce, the survivor beneficiary cannot be changed. Only the survivor beneficiary named at retirement will receive survivor benefits.

Life Annuity - A basic monthly benefit payable for the life of Retiree. Any balance of Retiree's deposits (including interest) remaining at Retiree's death will be paid in a lump-sum to Retiree's beneficiary.

Option I: 100% Joint and Survivor - A reduced monthly benefit payable throughout Retiree's life. At Retiree's death, survivor beneficiary will continue to receive Retiree's benefit for the remainder of their life.

Option II: 50% Joint and Survivor - A reduced monthly benefit payable throughout Retiree's life. At Retiree's death, survivor beneficiary will continue to receive 50% of Retiree's benefit for the remainder of their life.

Option III: 66 2/3% Joint and Survivor - A reduced monthly benefit payable throughout Retiree's life. At Retiree's death, survivor beneficiary will continue to receive 66 2/3% of Retiree's benefit for the remainder of their life.

Option IV: Joint and 66 2/3% Last Survivor - A reduced monthly benefit payable until the death of either Retiree or survivor beneficiary. After death of Retiree or survivor beneficiary, the last survivor of the two will receive 66 2/3% of Retiree's benefit.

Option V: Fifteen Year Certain and Life Annuity (180 payments) - A monthly benefit payable to Retiree. If Retiree's death occurs before 180 payments are made, Retiree's beneficiary or Retiree's estate will receive remaining monthly payments until all 180 payments have been made. If Retiree is still living after receiving 180 payments, payments will continue until the Retiree's death.

Option VI: Actuarial Equivalent of Life Annuity - This option allows Members to develop their own benefit payment plan with the assistance and approval of the System's actuary. Members have flexibility to design a benefit option that is most appropriate for themselves and their beneficiary's needs after retirement, subject to limitations established in Board Policy. All options are subject to approval by the Board of Trustees.

A "Pop-up" Benefit is provided for Retirees choosing Options I, II, or III as well as Retirees who selected any Joint and Survivor Option other than Joint and Last Survivor Option (e.g. actuarial equivalent of Life Annuity Option with any survivor option including Level Income Survivor options). The "Pop-up" increases the Retiree's benefits to the Life Annuity level if the survivor beneficiary predeceases the Retiree on or after October 1, 1999.

Backward DROP Program

The Deferred Retirement Option Program (DROP) allows Member to receive a lump-sum payment in addition to receiving a monthly annuity based on Final Average Earnings and years of Creditable Service at the beginning of the DROP period.

Members who have already reached retirement eligibility, excluding proportionate service, and who continue to work and contribute to COA ERS, may elect to "DROP-Back" a portion of their Creditable Service time. The amount of time a Member can "DROP-Back" is limited by the most recent of the following events:

- The date of first retirement eligibility
- The date of the last purchase of Creditable Service of any type other than Sick Leave Conversion
- No earlier than 60 months (in one-month increments) prior to the retirement date

The DROP account is credited with 90% of the monthly benefit based on the Life Annuity option. DROP accounts may be rolled over to other qualified plans, paid in one lump-sum to the Member, or a combination of both. DROP payments made directly to the Member are subject to a mandatory 20% federal tax withholding, and if the Member is under age 55 at the time of disbursement, this payment is subject to an additional tax for early withdrawal. The DROP payment is issued at the same time as the first monthly benefit check.

Cost-of-living adjustments (COLA's), interest, and Member or City contributions do not increase the monthly amount credited to the DROP.

IRS Section 415 Restoration of Retirement Income Plan

Certain highly compensated Members may have their retirement annuity limited because of Section 415(b)(1) of the Internal Revenue Code. A plan amendment, effective January 1, 2000, provides for COA ERS to pay a benefit payment that exceeds the limitation imposed by the Internal Revenue Code from a separate, non-qualified and unfunded "Restoration of Retirement Income Plan". Additional details are made available to affected Members during the retirement process.

DISABILITY RETIREMENT BENEFITS

Disability Retirement Requirements

Members may apply for disability retirement benefits if:

- They are mentally or physically incapacitated for the performance of any type of employment duties, AND
- The incapacity is likely to be permanent.

Disability Retirement Eligibility

Active Members with less than five years Creditable Service may only apply for disability retirement if the disability is a result of an on-the-job accident or injury. Active Members with five or more years of Creditable Service may apply for disability retirement even if the disability is not job related. Members who are already eligible to retire may not apply for disability retirement.

Members are considered to remain in the same membership category in effect on the date of termination for 90 days following termination. This allows Members to apply for disability retirement for up to 90 days following termination for inability to perform all employment duties.

Disability Retirees are periodically required to provide proof of continued disability and are annually required to provide employment and income documentation to the Board of Trustees.

Disability Retirement Options

A Member approved for disability retirement may choose a Life Annuity benefit or a benefit described in Options I, II, III, or IV. Disability Retirees are not eligible for any type of lump-sum payment.

DEATH AND SURVIVOR BENEFITS

Retired Members

At the death of a Retiree**,** a death benefit of $10,000 is paid by COA ERS to the designated beneficiary(ies) of the deceased. This $10,000 death benefit is paid to the beneficiary(ies) in addition to any of the following benefits that are applicable:

- If the Retired Member chose the Life Annuity Option, the monthly benefit stops the month following the death of the Retiree. However, if death occurs before the Retiree's accumulated deposits have been paid out, the Retiree's remaining deposits will be paid in a lump-sum to the Retiree's designated beneficiary(ies) or estate.
- If the Retired Member chose an option providing benefits to a survivor beneficiary, at the Retiree's death, such benefits will be paid to the designated survivor. If the survivor beneficiary does not survive the Retiree, monthly benefits cease. However, if the survivor beneficiary does not survive the Retiree, and the Retiree's deposits have not been paid out, the Retiree's remaining deposits will be paid in a lump-sum to the Retiree's designated beneficiary(ies) or estate.

Active Members

At the death of an Active Member who was not yet eligible for retirement, the designated beneficiary(ies) is entitled to a lump-sum payment of the Member's accumulated deposits (contributions and interest) matched by a death benefit from COA ERS equal to the Member's deposits. If the Active Member also had un-matched contributions, e.g. purchases for non-contributory time, prior military service purchases, or Permissive Time purchases, these purchases will be refunded but will not be matched by the System.

If the Active Member was eligible for retirement prior to death and had not yet retired, a surviving spouse may choose any retirement option that would have been available to the Member, except for Life Annuity. Alternatively, a surviving spouse may choose to receive a lump-sum payment of the Member's accumulated deposits and a death benefit from COA ERS equal to the deposits.

If there is no spouse, the deceased Member's designated beneficiary may elect to receive payments under Option V, Fifteen Year Certain and Life Annuity, or receive a lump-sum payment as described above.

Whether a spouse or non-spouse, the survivor beneficiary selecting a retirement option will also receive the $10,000 death benefit. This benefit is not paid to the beneficiaries electing a one-time lump-sum payment.

Inactive Vested Members

Beneficiaries of inactive Vested Members receive the same death benefits as beneficiaries of Active Members as described above.

OTHER INFORMATION

Compliance with Applicable Law

State Statute Art. 6243n., the Internal Revenue Code, and other state and federal laws are applicable to the operation and management of, and the benefits provided by, the System. Such laws place restrictions and limitations on retirement systems, including COA ERS, and directly or indirectly affect Member benefits and options. Such requirements and limitations protect the Members and their benefits. The retirement benefit options available to Members are established by Statute and may provide for beneficiaries and survivors. Deposits or retirement benefits may not be transferred or assigned except pursuant to a Qualified Domestic Relations Order (QDRO). All QDRO's are subject to approval and must meet all statutory requirements. In addition, funds actually due and payable to a Member, beneficiary, or alternate payee may be subject to IRS seizure.

This document is a general overview of System membership and benefits. In the event of any inconsistency between this general overview and state or federal law as modified, interpreted and applied from time to time, the state or federal law will govern and control.

Determining Interest on Members' Contributions

The Board of Trustees annually determines the amount of interest paid on Members' accumulated deposits, taking into consideration the current yield of the most recently issued 10-year U.S. Treasury notes and recommendations of the System's actuary. The actuary considers what funds are necessary to pay all the benefits to which Retirees and their surviving beneficiaries are entitled, as well as the expected liability for current employees who will someday retire.

Retirement interest is accrued on the last day of the calendar year based on the amount that each Member had in the System on the first day of the calendar year. The money must remain on deposit for the entire calendar year in order to accrue interest.

Because COA ERS is a defined benefit, and not a defined contribution plan, interest is set conservatively based on typical fixed-income returns, not on actual returns of the Fund or more aggressive investment vehicles.

Retirement Fund Investments

COA ERS' funds are invested according to the requirement of state law and the COA ERS Board of Trustees' Investment Policy. The investments provide returns that help fund the monthly retirement annuity and other benefits paid by the System to its Members and beneficiaries.

Prohibition on COA ERS Loans and Withdrawals

State and federal law does not allow Active Members to make a partial withdrawal of deposits or to receive loans from their retirement funds.

HISTORY OF BENEFIT ENHANCEMENTS

January 1, 1941

City Council established the City of Austin Employees' Retirement System.

Original City Ordinance provided a maximum annuity of $100 per month at age 65.

Contributions to retirement system set at 4.0%.

No survivor options, no early retirement eligibility, no vesting, no disability benefits, and no death benefits.

1951

Established two options for survivor benefits:

Option I – 100% Joint and Survivor

Option II – 66 2/3% Joint and Survivor

Established eligibility for early retirement.

Established for vested benefits after 15 years of Creditable Service.

Established disability retirement benefits.

Increased contribution rate to 5.0%.

1962

Established additional options for survivor benefits:

Option III – 50% Joint and Survivor

Option IV – 66 2/3% Joint and Last Survivor

1967

Set multiplier at 1.25%.

Set Active Member death benefits at $2,000.

1969

Established provisions for cost-of-living adjustment (COLA).

Set Retired Member death benefits at $2,000.

1971

Increased multiplier from 1.25% to 1.5%.

Established for unreduced retirement benefits at age 62 (lowered from age 65) with any number of years of service.

Provided free health insurance benefits, ages 62 – 65.

Increased contribution rate to 6.0%.

1972

Established for vested benefits after 10 years of Creditable Service.

Established for employees working 30 or more hours per week to make retirement contributions.

Established for Members eligible for early retirement benefits to choose Option I to provide survivor benefits.

1973

Increased multiplier from 1.5% to 1.75%.

Established for Final Average Earnings based on highest 60 months of contributing service.

Allowed for Members eligible for retirement to select option to provide survivor benefit before actually retiring.

Established disability retirement for line-of-duty disabilities regardless of Creditable Service. Disability retirement available for any disability after 10 years of service. Disability retirement benefits based on age and years of service at time of disability retirement; no penalty based on age.

December 1977

Elimination of $2,000 death benefit for Active Members; continued for Retirees.

Established for Active Members' designated beneficiaries to receive contributions and interest plus an equal amount from the System if Member dies prior to retirement eligibility.

September 1978

Established additional retirement options.

December 1979

Discontinued medical insurance payment for retirees who were ages 62 - 65.

July 1981

Established for contributions to be required after age 62 until retirement. Members older than age 62 have option to make up missed contributions to benefit from higher salary averaging for retirement benefits.

Reduced Final Average Earnings period from 60 to 36 months.

October 1982

Increased contribution rate to 6.6%, matched by City.

November 1982

Established retirement benefits for Members age 55 or older with 20 years service.

March 1984

Adopted unisex option factors. The sex of the Member and the beneficiary no longer considered in the determination of any System benefits.

December 1984

Increased Member contribution rate from 6.6% to 7.0%, matched by the City.

Increased multiplier from 1.75% to 1.85%.

Granted special increase to Retirees based on the number of years retired. The increase recognized actual increases in the cost-of-living above cost-of-living adjustments (COLA's) granted previously.

Established for surviving spouse to select an optional benefit if Active Member dies who was already eligible to retire and had not yet selected a benefit option.

Qualified Plan with Internal Revenue Service under IRS Code Section 401(a). Member contributions after January 1, 1985 not taxed until time when benefits are paid to the Member.

Limited "Prior Service" Purchase – Former Members who forfeited membership service by taking a refund when they left City employment may purchase their prior Creditable Service. Current Members allowed six months to reinstate former credit by repaying withdrawn deposits plus interest. Only former Members who had been reemployed by the City before December 20, 1984 are eligible.

Established that the 36 months of salary used to calculate monthly benefits need not be consecutive. Highest 36 months of salary during last 10 years of Creditable Service would be averaged to determine Final Average Earnings.

October 1985

Increased multiplier from 1.85% to 2.0%.

February 1986

Change in composition of Board of Trustees; replaced Council Member position with Retired Member Trustee to be appointed by the City Council.

May 1987

Established that Members laid-off during the period from September 30, 1986 through October 1, 1989, and who were eligible for retirement would receive an unreduced current service annuity.

October 1987

Reduced Member and City contribution rates to the System temporarily from 7.0% to 6.2% of basic compensation for the period from October 1, 1987 to September 30, 1988.

March 1988

Established survivor benefit options for Disability Retirees effective March 13, 1988.

August 1988

Established for vested benefits with five years of Creditable Service.

Extension of "Prior Service Purchases" – Former Members who forfeited membership service by taking a refund of their retirement contributions when they left City employment and have returned to City employment, may purchase and reinstate their prior Creditable Service.

Provided that for purposes of calculating benefits and determining eligibility, three years were added to both age and service for all Members retiring between September 1, 1988 and December 31, 1988.

September 1988

Restored Member and Employer contribution rates to 7.0% from 6.2% of basic earnings effective September 30, 1988.

December 1989

Amended ordinance for Retiree Member Trustee position of the Board to be elected by Retired Members to a four-year term, instead of appointment by the City Council.

January 1990

Granted a special one-time benefit increase ranging from 0.5% to 15% based on date of retirement.

February 1990

Established unreduced retirement benefits for Members at any age with 30 years Creditable Service.

Increased multiplier from 2.0% to 2.1%.

October 1990

Adopted limits on income of Social Security disability benefits for System Disability Retirees.

August 1991

Established System governance by Article 6243n. of Texas State Law effective August 26, 1991. All changes to the System made by the Texas State Legislature.

Became a member of Proportionate Retirement Program with five other statewide retirement systems. Membership service may be combined with other participating systems for meeting service requirements for retirement eligibility.

July 1993

Increased multiplier from 2.1% to 2.2%, with commensurate increase for previous Retirees.

Established for unreduced retirement benefits for Members at any age with 25 years of service.

Allowed purchases for up to 24 months of former active duty U.S. military service.

October 1995

Increased multiplier from 2.2% to 2.3%, with commensurate increase for previous Retirees.

Established that new City of Austin employees become Members of COA ERS at date of employment and that current employees be given retirement service credit for up to one six-month probationary period at time of retirement.

Change in composition of Board of Trustees; Director of Finance Designee replaced with additional Retired Member Trustee to be elected by Retired Members.

Increased death benefit for Retirees from $2,000 to $10,000.

October 1997

Increased multiplier from 2.3% to 2.6%, with commensurate increase for previous Retirees.

Established for unreduced retirement benefits for Members at age 55 with 20 years service.

Increased purchases of former active duty U.S. military service from 24 to 48 months.

Allowed new purchase option of Creditable Service for non-contributory time including time spent on workers' compensation, leaves of absence, part-time and temporary service.

Allowed for the City of Austin to purchase service credit for Members.

October 1999

Increased multiplier from 2.6% to 2.7%, with commensurate increase for previous Retirees.

Increased Member contribution rate from 7.0% to 8.0% following vote by Active Members.

Established for unreduced retirement benefits for Members at any age with 23 years of service.

Set new limits on Retirees returning to work for the City.

Added "pop-up" benefit for Retirees choosing Options I, II, or III (Joint and Survivor Annuities) to increase Retiree benefits if the survivor beneficiary predeceased the Retiree on, or after, October 1, 1999.

Granted Board authority to authorize certain benefit improvements subject to Statute guidelines.

Gave Board the ability to grant an additional payment to Members receiving monthly annuity payments in the form of an additional lump-sum benefit payment. The additional payment would be a percentage of the current monthly payment with a maximum percentage of 100%.

Established for Disability retirement benefits for off-the-job injury/illness after five years Creditable Service (previously 10 years).

January 2000

Established IRS Section 415 Restoration of Retirement Income Plan.

April 2000

Increased multiplier from 2.7% to 2.98%, with commensurate increase for previous Retirees.

Increased employer contribution rate from 7.0% to 8.0%, matching Member contribution rate.

July 2000

Extended "pop-up" benefit to Retirees who selected the actuarial equivalent of Life Annuity Option with underlying options of I, II, or III.

January 2002

Increased multiplier from 2.98% to 3.0%, with commensurate increase for previous Retirees.

Established for purchases of Permissive Time to Active/Inactive Vested Members, based on EGTRRA federal law with a minimum purchase of one month and a maximum of 60 months (five years) or the number of months needed to reach first eligibility for retirement, whichever is less.

Amended Proportionate Retirement Program provided by Texas Government Code 803 to allow former members of participating proportionate systems to re-establish Creditable Service previously forfeited in that system without returning to membership in that system.

April 2002

Established Sick Leave Conversion benefit. Allow Members to convert sick leave balances to Creditable Service at time of retirement with purchase paid by Member and City of Austin.

Established Backward DROP (Deferred Retirement Option Program) benefit up to five years for Members working beyond retirement eligibility.

January 2003

Extended "pop-up" benefit to any Joint and Survivor option other than Joint and Last Survivor.

Amended Permissive Time resolution removing provision which restricted Members from purchasing Permissive Time in excess of the amount needed to reach first eligibility for retirement.

Financial Section

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Independent Auditors' Report

The Board of Trustees of
The City of Austin Employees' Retirement System:

We have audited the accompanying statements of plan net assets of the City of Austin Employees' Retirement System (the System) as of December 31, 2006 and 2005, and the related statements of changes in plan net assets for the years then ended which comprise the basic financial statements of the System. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the City of Austin Employees' Retirement System as of December 31, 2006 and 2005, and the changes in plan assets for the years then ended in conformity with United States generally accepted accounting principles.

The management's discussion and analysis on pages 24 through 27 and the schedules of funding progress and employer contributions on pages 49 through 51 are not a required part of the basic financial statements of the System, but are supplementary information required by United States generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of the system. The introductory section on pages 1 through 22, supplementary information on page 52, investment section on pages 53 through 62, actuarial section on pages 63 through 106, and statistical section on page 107 through 115 are presented for purposes of additional analysis and are not a required part of the basic financial statements. The other supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as whole. The introductory, investment, actuarial, and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly we express no opinion on them.

June 7, 2007

KPMG LLP

KPMG LLP, a U.S. limited liability partnership, is the U.S. member firm of KPMG International, a Swiss cooperative.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis

December 31, 2006 and 2005

This section of the City of Austin Employees' Retirement System's (COA ERS or the System) financial report presents our discussion and analysis of the System's financial performance during calendar years 2006 and 2005. We encourage readers to consider the information presented here in conjunction with our financial statements that follow.

Financial Highlights

- Plan net assets held in trust by the System increased by $148.2 million, or 10.1%, in 2006 and increased by $85.7 million, or 6.2%, in 2005. The increases in 2006 and 2005 were due to positive investment returns.

- Contributions increased by $5.9 million, or 9.7% in 2006 and increased by $1.2 million, or 2.1% in 2005. The 2006 increase was due primarily to an approximate $4.9 million increase in employee and City contributions based on payroll, and $1.0 million from the 1% supplemental funding. The 2005 increase was due primarily to an approximate $0.9 million increase in employee creditable service purchases.

- The amount of benefits paid to retired members and beneficiaries, and refunded to terminating employees increased approximately $5.1 million, or 5.5%, during 2006, and $3.5 million, or 4%, during 2005. This is the result of the increase in the number of System retirees and in the average annuity payment. Benefit payments exceeded employee and City contributions by $30.1 million in 2006 and by $30.9 million in 2005.

- The System's rate of return on investments for the year ended December 31, 2006, was 12.8% gross of fees, and 12.5% net of fees, on a market value basis which was greater than the return of 9.1% gross of fees, and 8.8% net of fees, for the year ended December 31, 2005. The actuarial assumed rate of return is 7.75%.

- The funding objective of COA ERS is to meet long-term benefit obligations through contributions and investment income. As of December 31, 2006, the date of the most recent actuarial valuation, the System's funding ratio of actuarial assets as a percentage of actuarial liabilities is 75.9%, which is down from the 78.0% level at December 31, 2005, primarily due to higher than expected salary increases for City employees. See further discussion at footnote 4.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the COA ERS' financial statements, which are comprised of the following:

- Statement of Plan Net Assets
- Statement of Changes in Plan Net Assets
- Notes to the Financial Statements

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis

December 31, 2006 and 2005

Collectively, this information presents the net assets held in trust for pension benefits as of the end of each year, and summarizes the changes in net assets held in trust for pension benefits for the year. The information available in each of these components is briefly summarized below:

- **Financial Statements**

  The *Statement of Plan Net Assets* presents the System's assets and liabilities and the resulting net assets, which are held in trust for pension benefits. This statement reflects a year-end snapshot of the Plan's investments, at fair value, along with cash and short-term investments, receivables and other assets and liabilities.

  The *Statement of Changes in Plan Net Assets*, on the other hand, provides a view of current year additions to and deductions from the plan.

  These two statements report the System's net assets held in trust for pension benefits (net assets) – the difference between assets and liabilities – as one way to measure the COA ERS' financial position. Over time, increases and decreases in net assets are one indicator of whether its financial health is improving or deteriorating.

- **Notes to the Financial Statements** provide additional information that is essential to a full understanding of the data provided in the financial statements.

Financial Analysis

Summary of Plan Net Assets
December 31, 2006, 2005 and 2004

Assets	2006	2005	2004
Cash, receivables and prepaids	$ 9,981,192	8,711,486	8,886,396
Investments	1,600,703,760	1,454,399,446	1,367,901,934
Invested securities lending collateral	183,981,546	165,721,413	156,774,590
Capital assets, net	1,181,333	1,236,529	1,288,925
Total assets	1,795,847,831	1,630,068,874	1,534,851,845
Liabilities			
Total liabilities	186,889,587	169,302,271	159,820,188
Net assets held in trust for pension benefits	$ 1,608,958,244	1,460,766,603	1,375,031,657

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis

December 31, 2006 and 2005

Assets. As shown in the table, COA ERS' net assets increased by $148.2 million in 2006, and $85.7 million in 2005. The 2006 and 2005 increases primarily reflect investment returns in the financial markets. The increase in cash, receivables, and prepaids of approximately $1.3 million in 2006, and decrease of $0.2 million in 2005, were primarily due to fluctuations in the amount of cash held in the System's operating bank account and in the trades pending settlement as well as the interest/dividends receivable. The increase in invested securities lending collateral of $18.3 million in 2006, and $8.9 million in 2005, is relative to the net change in the number of securities on loan at each fiscal year end. There were minimal additions to and no retirements of capital assets in 2006 and 2005, so the decrease reflects depreciation.

Liabilities. Liabilities increased $17.6 million in 2006 and $9.5 million in 2005. These increases are primarily due to increases in securities lending collateral.

Summary of Changes in Plan Net Assets
Years Ended December 31, 2006, 2005 and 2004

		2006	2005	2004
Additions:				
Contributions	$	66,400,877	60,502,121	59,279,793
Investment income		184,039,268	121,766,026	149,649,746
Investment expenses		4,089,091	3,613,695	4,020,717
Net investment income		179,950,177	118,152,331	145,629,029
Other income		1,654	1,960	2,376
Total additions		246,352,708	178,656,412	204,911,198
Deductions:				
Benefit payments and contribution refunds		96,490,275	91,424,005	87,880,845
General and administrative expenses		1,670,792	1,497,461	1,554,864
Total deductions		98,161,067	92,921,466	89,435,709
Net increase		148,191,641	85,734,946	115,475,489
Net assets held in trust for pension benefits, beginning of year		1,460,766,603	1,375,031,657	1,259,556,168
Net assets held in trust for pension benefits, end of year	$	1,608,958,244	1,460,766,603	1,375,031,657

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis

December 31, 2006 and 2005

Additions Additions needed to fund benefits are accumulated through contributions and returns on invested funds. Member and City of Austin contributions for 2006 and 2005 totaled $66.4 million and $60.5 million, respectively. The 2006 contributions represent an increase of $5.9 million, or approximately 9.7% above 2005. The 2006 increase was primarily due to increased annual payroll and implementation of the Supplemental Funding Plan in October 2006. In 2005, contributions based on payroll were $1.2 million above the 2004 level, attributable to an increase in employee creditable service purchases. The amount of Creditable Service Purchases in 2006 was not significantly changed from that of 2005.

COA ERS incurred a positive return on the market value of its investments during 2006. Net investment income of $180.0 million was due to performance of the equity markets, an increase of $61.8 million over 2005. Interest, dividends and net securities lending income generated 2006 income of $42.3 million, an increase from the $36.0 million received in 2005. The total rate of return for the System's investment portfolio in 2006 was 12.5% (net of fees) as compared to 8.8% for 2005.

Deductions. The expenses paid by COA ERS include benefit payments, refunds of member contributions, and administrative expenses. Benefits paid to retirees in 2006 were $92.3 million, an increase of $4.6 million from payments made in 2005, consistent with the increase in the number of retirees to 3,467 in 2006 from 3,297 in 2005. Refunds to terminating employees increased by $0.4 million. Administrative expenses in 2006 were $1.7 million, an increase of $0.2 million from those of 2005.

Benefits paid to retirees in 2005 were $87.6 million, an increase of $4.9 million from payments made in 2004, consistent with the increase in the number of retirees to 3,297 in 2005 from 3,137 in 2004. Refunds to terminating employees decreased by $1.3 million. Administrative expenses in 2005 were $1.5 million, 3.7% less than the amount incurred in 2004.

Investment managers are paid based on their performance. Accordingly, in 2006, as returns were higher, so were the amounts of investment manager fees paid including securities lending fees, an increase of $0.5 million compared to 2005.

Overall Analysis. Overall, as of December 31, 2006, net assets increased by $148.2 million or 10.1% from the prior year, and over the five-year period ending December 31, 2006, net assets increased by 54.4%. Since 2003, the Plan has experienced positive market returns that have exceeded its 7.75% actuarial assumed rate of return.

Request for Information

This financial report is designed to provide a general overview of the finances of the City of Austin Employees' Retirement System for all parties with an interest. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Finance Manager, City of Austin Employees' Retirement System, 418 E. Highland Mall Blvd., Austin, Texas 78752.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Statement of Plan Net Assets

December 31, 2006

	Retirement Plan	Restoration Plan	Total
Assets:			
Cash and cash equivalents (note 3)	$ 4,867,709	15,000	4,882,709
Interest and dividends receivable	3,661,685		3,661,685
Trades pending settlement	113,516		113,516
Employer contributions receivable	608,049		608,049
Employee contributions receivable	715,233		715,233
Investments, at fair value (note 3):			
United States government securities	354,547,289		354,547,289
Corporate bonds	68,093,704		68,093,704
Real Estate Commingled Fund	85,450,667		85,450,667
Corporate stocks	783,609,262		783,609,262
Municipal bonds	532,465		532,465
International stocks and bonds	285,573,543		285,573,543
Short-term investment funds	22,896,830		22,896,830
Total investments	1,600,703,760	—	1,600,703,760
Invested securities lending cash collateral (note 3)	183,981,546		183,981,546
Capital assets, net (note 5)	1,181,333		1,181,333
Total assets	1,795,832,831	15,000	1,795,847,831
Liabilities:			
Accrued expenses	839,756		839,756
Trades pending settlement	1,076,592		1,076,592
Securities lending collateral (note 3)	183,981,546		183,981,546
Refunds and death benefits payable	991,693		991,693
Total liabilities	186,889,587	—	186,889,587
Net assets held in trust for pension benefits (a schedule of funding progress is presented on page 49)	$ 1,608,943,244	15,000	1,608,958,244

See accompanying notes to financial statements.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Statement of Plan Net Assets

December 31, 2005

	Retirement Plan	Restoration Plan	Total
Assets:			
Cash and cash equivalents (note 3)	$ 2,866,111	15,000	2,881,111
Interest and dividends receivable	2,652,884	—	2,652,884
Trades pending settlement	2,081,639	—	2,081,639
Employer contributions receivable	547,926	—	547,926
Employee contributions receivable	547,926	—	547,926
Investments, at fair value (note 3):			
United States government securities	362,467,392	—	362,467,392
Corporate bonds	59,916,345	—	59,916,345
Real Estate Commingled Fund	78,507,966	—	78,507,966
Corporate stocks	691,883,229	—	691,883,229
Municipal bonds	758,348	—	758,348
International stocks and bonds	235,613,344	—	235,613,344
Short-term investment funds	25,252,822	—	25,252,822
Total investments	1,454,399,446	—	1,454,399,446
Invested securities lending cash collateral (note 3)	165,721,413	—	165,721,413
Capital assets, net (note 5)	1,236,529	—	1,236,529
Total assets	1,630,053,874	15,000	1,630,068,874
Liabilities:			
Accrued expenses	963,294	—	963,294
Trades pending settlement	1,620,242	—	1,620,242
Securities lending collateral (note 3)	165,721,413	—	165,721,413
Refunds and death benefits payable	997,322	—	997,322
Total liabilities	169,302,271	—	169,302,271
Net assets held in trust for pension benefits (a schedule of funding progress is presented on page 49)	$ 1,460,751,603	15,000	1,460,766,603

See accompanying notes to financial statements.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Statement of Changes in Plan Net Assets

Year ended December 31, 2006

	Retirement Plan	Restoration Plan	Total
Additions:			
Contributions:			
Employer contributions (note 4)	$ 30,545,197	64,475	30,609,672
Employee contributions (note 4)	35,791,205		35,791,205
	66,336,402	64,475	66,400,877
Investment income:			
Net appreciation in plan investments	141,495,061		141,495,061
Interest	23,983,873		23,983,873
Dividends	17,772,875		17,772,875
Investment income before expenses and securities lending	183,251,809	—	183,251,809
Securities lending income	787,459		787,459
Securities lending fees	(236,105)		(236,105)
Net securities lending income	551,354	—	551,354
Investment expenses	(3,852,986)		(3,852,986)
Net investment income	179,950,177	—	179,950,177
Other income	1,654		1,654
Total additions	246,288,233	64,475	246,352,708
Deductions:			
Retirement annuities/ Benefit payments	88,449,021	64,475	88,513,496
Contributions refunded to terminating employees	4,196,331		4,196,331
DROP disbursements	1,529,839		1,529,839
Retiree lump-sum annuity	648,086		648,086
Death benefits	1,602,523		1,602,523
General and administrative expenses	1,670,792		1,670,792
Total deductions	98,096,592	64,475	98,161,067
Net increase	148,191,641	—	148,191,641
Net assets held in trust for pension benefits, beginning of year	1,460,751,603	15,000	1,460,766,603
Net assets held in trust for pension benefits, end of year	$ 1,608,943,244	15,000	1,608,958,244

See accompanying notes to financial statements.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Statement of Changes in Plan Net Assets

Year ended December 31, 2005

	Retirement Plan	Restoration Plan	Total
Additions:			
Contributions:			
Employer contributions (note 4)	$ 27,129,892	38,263	27,168,155
Employee contributions (note 4)	33,333,966	—	33,333,966
	60,463,858	38,263	60,502,121
Investment income:			
Net appreciation in plan investments	85,564,874	—	85,564,874
Interest	19,398,813	—	19,398,813
Dividends	16,279,651	—	16,279,651
Investment income before expenses and securities lending	121,243,338	—	121,243,338
Securities lending income	522,688	—	522,688
Securities lending fees	(164,035)	—	(164,035)
Net securities lending income	358,653	—	358,653
Investment expenses	(3,449,660)	—	(3,449,660)
Net investment income	118,152,331	—	118,152,331
Other income	1,960	—	1,960
Total additions	178,618,149	38,263	178,656,412
Deductions:			
Retirement annuities/ Benefit payments	83,964,260	38,263	84,002,523
Contributions refunded to terminating employees	3,775,042	—	3,775,042
DROP disbursements	1,650,223	—	1,650,223
Retiree lump-sum annuity	147,838	—	147,838
Death benefits	1,848,379	—	1,848,379
General and administrative expenses	1,497,461	—	1,497,461
Total deductions	92,883,203	38,263	92,921,466
Net increase	85,734,946	—	85,734,946
Net assets held in trust for pension benefits, beginning of year	1,375,016,657	15,000	1,375,031,657
Net assets held in trust for pension benefits, end of year	$ 1,460,751,603	15,000	1,460,766,603

See accompanying notes to financial statements.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

(1) Plan Description

Retirement Plan

The Board of Trustees of the City of Austin Employees' Retirement System (the System) is the administrator of a single-employer defined benefit pension plan (the Plan). Participating employees include all regular, full time employees, except for civil service firefighters and civil service police officers, who work at least 30 hours per week. At December 31, 2006 and 2005, membership consisted of the following:

	2006	2005
Retirees and beneficiaries currently receiving benefits	3,467	3,297
Terminated members entitled to but not yet receiving benefits	714	670
Current employees	8,055	7,638
Total	12,236	11,605

The System provides service retirement, death, disability, and withdrawal benefits. Benefits vest with five years of credited service. Participants may retire with 23 years of service regardless of age, or at age 62. Prior to October 1, 1999, active member contributions to the Plan were 7%. Effective October 1, 1999, active member contributions increased to 8%. Prior to October 1, 1999, the monthly benefit was equal to 2.6% of the highest 36-month average annual salary of the last ten years multiplied by years and months of service. Effective October 1, 1999, the monthly benefit multiplier was increased to 2.7%. Effective April 1, 2000, the monthly benefit multiplier was increased to 2.98%. Effective January 1, 2002, the monthly benefit multiplier was increased to 3.0%. Effective January 1, 2001, the System approved a 3.5% ad hoc retiree increase and a 2.5% increase effective January 1, 2002.

Effective in 2002, a member may elect to retroactively participate in the System's DROP (Deferred Retirement Option Program). DROP programs benefit employees by allowing a lump sum payment in lieu of additional credible service time after reaching retirement eligibility. The member would receive a lump sum payment equal to 90% of the sum of the monthly annuities the participant would have received if the member had retired at the DROP entry date.

The Lump-Sum Death Benefit payable upon the death of a retiree is $10,000.

Participants are required to contribute 8% of their basic compensation to the Plan. The City of Austin (the City) also contributes 8% of basic compensation. The benefit and contribution provisions of this plan are governed by state law. Amendments may be made by the Legislature of the State of Texas. Should the Plan fully terminate at some future time, the retirement allowance of a member would be determined by reference to the member's average final compensation as if the member had attained normal retirement age on that date.

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

Pursuant to the 2005 COA ERS Supplemental Funding Plan and beginning in October 2006, the City will contribute an additional 1% for the City 2007 fiscal year ending September 30, 2007. For subsequent years, contributions will continue to increase by 1%, to a maximum of 4%, if annual fund returns do not exceed 12%, net of fees. For COA ERS' calendar year ended December 31, 2006, returns exceeded the threshold, so supplemental City contributions will remain at 1% for their fiscal year beginning October 1, 2007.

The System is participating in the Proportionate Retirement Program through which a member of the System may combine his membership service with service credit in a participating entity in any of the state-wide retirement systems covering state employees, teachers, county and district employees, and municipal employees, or, any of the El Paso public employee pension funds, for meeting service requirements for service retirement eligibility.

Under the terms of the Plan, the System's employees obtain membership in the Plan on the same basis as City employees. The System contributes to the Plan the same amount of 8% of basic compensation plus 1% supplemental funding, as described above, for its fourteen current employees as the City does for its 8,041 current employees. The System's employees are also required to contribute 8% of their basic compensation to the Plan. Since there is only one Plan, all actuarial calculations are provided on an aggregate basis. The System's annual pension cost for its employees and related contributions made for the past three years are:

		Annual pension cost	Contributions made
2006	$	57,380	57,380
2005		51,970	51,970
2004		49,957	49,957

Restoration Plan

On November 23, 1999, the Board adopted a resolution to establish a "Restoration of Retirement Income Plan for Certain Participants in the City of Austin Employees' Retirement System" (Restoration Plan). This Restoration Plan is effective as of January 1, 2000 and is intended to be a "qualified governmental excess benefit arrangement" within the meaning of Section 415(m) of the Internal Revenue Code, and shall be construed, interpreted and administered in accordance with such provision. The Restoration Plan shall be administered as an unfunded plan which is not intended to meet the qualification requirements of Section 401 of the Internal Revenue Code. Eligible members are those who are members in the Plan whose pension or pension-related benefits under the Plan are limited due to the provision of Section 415 of the Internal Revenue Code.

All benefits payable under this Restoration Plan shall be paid by the City of Austin Employees' Retirement System from contributions provided by the Employer and not from the Fund or any other trust unless such trust is maintained solely for the purpose of providing benefits from this Restoration Plan. No contribution receivable is due for the years ended December 31, 2006 and 2005 for this Restoration Plan. Net assets remaining in this plan as of December 31, 2006 and 2005 were $15,000.

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

The Restoration Plan's annual pension cost and related contributions for the past three years are:

		Annual pension cost	Contributions made
2006	$	64,475	64,475
2005		38,263	38,263
2004		66,674	66,674

At December 31, 2006 and 2005, membership in the Restoration Plan included the following:

	2006	2005
Retirees and beneficiaries currently receiving benefits	8	3
Terminated members entitled to but not yet receiving benefits	—	—
Current employees	—	—
Total	8	3

Other Information

The System is required by statute to maintain three separate funds in its internal accounting records. The first fund, defined in the statute as "Fund 1", shall be maintained to account for all accumulated deposits (contributions and interest) of members who have not withdrawn from the System. The second fund, defined as "Fund 2", shall be maintained to account for all other net assets of the System less the amount held in the third fund, defined as "Fund 3", which shall be maintained to account for accumulated contributions by the employer for the Restoration Plan. At December 31, 2006, the balances of Fund 1, Fund 2, and Fund 3 were $295,166,238, $1,313,777,006, and $15,000, respectively. At December 31, 2005, the balances of Fund 1, Fund 2, and Fund 3 were $280,994,642, $1,179,756,961, and $15,000, respectively.

(2) Summary of Significant Accounting Policies and System Asset Matters

(a) Basis of Accounting

The System's financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting except for the recognition of actuarial liabilities. Contributions are recognized as revenues in the period in which employer reports compensation for their employees. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

The System is not included in any other governmental "reporting entity" as defined by the Governmental Accounting Standards Board (GASB).

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

(b) Cash and Cash Equivalents

Cash and cash equivalents include demand deposit accounts and money market checking accounts. As of December 31, 2006 and 2005, the book balances of the money market checking accounts totaled $4,762,662 and $2,911,152, respectively, and demand deposit accounts totaled $119,747 and ($30,341), respectively.

(c) Investments

The System's equity investments are reported at fair value. Short-term cash investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair value. The System's real estate commingled fund, an open-end investment fund, includes properties that are valued monthly. All properties within this fund are appraised externally by nationally recognized appraisers. The System also has a Northern Trust (Trustee) daily aggregate bond fund that may hold units of participation in any fixed income collective fund established and maintained by the trustee or any of its affiliates. The trustee values its securities at fair value. Any securities for which no current market quotation is readily available are valued at fair value as determined in good faith by Northern Trust Investments, N.A.

Investment income is recognized in the period earned and purchases and sales of investments are recorded on a trade-date basis. Net appreciation/depreciation in Plan investments includes both realized and unrealized gains and losses.

(d) Contributions Receivable

The employee and City contributions for the year ended December 31, 2006 and 2005 that were not deposited with the System by year-end and are shown as contributions receivable.

(e) Capital Assets

Capital assets are recorded at cost. The System capitalizes all computer and electronic equipment purchased as well as any other assets greater than $1,000. Depreciation is computed using the straight-line method over the assets' estimated useful lives of:

Furniture and fixtures	3-12 years
Building	40 years

(f) System Expenses

Substantially all System administrative costs are the responsibility of the System. The administrative costs are funded through the investment income.

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

(g) Use of Estimates

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

(3) Cash, Investments, and Securities Lending

Deposit and investment resources are exposed to risks that have the potential to result in losses that could impact delivery of System services. The Board has adopted a Statement of Investment Policies and Objectives (Investment Policy) to set forth the factors involved in the management of investment assets for the System. This policy is included in every investment management agreement. The document is designed to mitigate risk by requiring that investing be done in compliance with policy guidelines by qualifying the broker and financial institution with whom the System will transact, and by establishing sufficient collateralization, portfolio diversification, and limiting maturity. The System's Board, in accordance with the power and authority conferred under the Texas Statutes, has employed Northern Trust as custodian of the assets of the System.

The following summary of total investments by type as of December 31, 2006 and 2005 confirms that the System has maintained fairly consistent investment mixes.

	2006	2005
Summary of investments by type:		
Asset-backed securities	$ 2,862,005	3,935,247
Commercial mortgage-backed securities	18,450,746	13,031,583
Corporate bonds	68,093,704	59,916,345
Corporate stocks	783,609,262	691,883,229
Government agencies	25,554,107	15,534,284
Government bonds	14,840,799	12,210,129
Government mortgage-backed securities	61,225,087	86,489,874
International stocks and bonds	285,573,543	235,613,344
Municipal bonds	532,465	758,348
Nongovernment backed C.M.O.'s	16,622,040	12,878,282
Other fixed income:		
NTGI Aggregate Bond Fund	214,992,505	218,387,993
Real Estate Commingled Fund	85,450,667	78,507,966
Short-term investment funds	22,896,830	25,252,822
Investments at fair value on balance sheet	1,600,703,760	1,454,399,446
Receivables and pending trades	2,698,609	3,114,281
Total investments (per investment consultant)	$ 1,603,402,369	1,457,513,727

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. While the Board has no formal policy specific to custodial credit risk, operating bank account deposits in excess of Federal Deposit Insurance Corporation (FDIC) insured amounts are covered by pledged securities held as collateral.

As of December 31, 2006, the System's operating bank balance of $4,882,409 was not exposed to custodial credit risk.

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial risk if the securities are uninsured, are not registered in the name of the System, and are held by the counterparty, its trust or agent, but not in the System's name. The System's investment securities are not exposed to custodial credit risk because all securities are held by the System's custodial bank in the System's name and securities on loan with brokers are fully insured for cash collateral. The cash at Northern Trust is not exposed to custodial credit risk because it is invested in the Short-Term Collective Government STIF (short-term investment fund) composed of short-term high quality money market instruments structured to generate a competitive yield while preserving principal.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the System's investment in a single issuer. The System is authorized to invest in the following as of December 31, 2006:

(a) Domestic Fixed Income Investments

Total fixed income investments may be no less than twenty-seven percent (27%) and no more than thirty-three percent (33%) of the investment portfolio measured at fair value. No single issuer's securities shall represent more than four percent (4%) of portfolio value at purchase cost, or six percent (6%) of the market value of any manager's portfolio. This restriction applies to asset-backed securities, non-agency mortgage-backed securities (including commercial mortgage-backed securities) and taxable municipal securities. The total holdings of an agency-issued mortgage-backed security of the same coupon and maturity series of the same agency shall not exceed twenty percent (20%) of the portfolio at cost (agency-issued mortgage-backed securities include Government National Mortgage Association (GNMA) securities).

Section 144(a) securities shall be limited to no more than five percent (5%) of the portfolio at market value of any manager's portfolio. This does not apply to obligations of the U.S. government (treasury bonds, bills and notes).

The assets of the System are to be invested only in the following fixed income securities:

1. United States Treasury notes, bonds, and bills;
2. United States government agency obligations;

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

3. Investment grade corporate bonds (however, the average rating of all corporate bonds held in any investment portfolio, taken together, may not fall below AA);

4. Preferred stocks;

5. Investment grade foreign bonds payable in United States dollars;

6. Cash equivalents in the form of commercial paper rated as A1 by Moody's or P1 by Standard & Poor's;

7. Other corporate obligations with an equivalent or higher rating than items 1 through 6 above; or

8. Obligations backed by United States government and investment grade municipal funds.

(b) Domestic Equity Investments

While not exposed to concentration of credit risk, total investments in domestic common stock may be no less than thirty-nine percent (39%) and no more than fifty-nine percent (59%) of the total investment portfolio measured at fair value less international equities. No single company's securities shall represent more than four percent (4%) of portfolio value at purchase cost or six percent (6%) of the market value of any manager's portfolio.

The equity assets of the System are invested only in the domestic common stocks listed on the following exchanges:

1. The New York Stock Exchange;

2. The American Stock Exchange; or

3. The National Association of Securities Dealers Automated Quotation (NASDAQ) System.

(c) International Investments

Any international investments must be investment grade and payable in United States dollars. However, such international investments should total no less than eleven percent (11%) and no more than twenty-one percent (21%) of total value of the System's investments at fair value.

(d) Real Estate Open-ended Commingled Fund

While not exposed to concentration of credit risk, total investments in real estate open-ended commingled funds may be up to ten percent (10%) of the total investment portfolio measured at fair value, if, when viewed in conjunction with fixed income, the aggregate does not exceed 38% of the portfolio .

(e) Other Investment Information

As of December 31, 2006 and 2005, respectively, investments in any one organization, other than investments backed by the full faith and credit of the United States Government and the real estate

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

open end commingled fund, did not represent five percent or more of net assets available for benefits.

As of December 31, 2006 and 2005, the following was the composition of the System's portfolio:

	2006	2005
Asset-backed securities	0.2%	0.3%
Commercial mortgage-backed securities	1.2%	0.9%
Corporate bonds	4.3%	4.1%
Corporate stocks	49.0%	47.6%
Government agencies	1.6%	1.1%
Government bonds	0.9%	0.8%
Government mortgage-backed securities	3.8%	5.9%
International stocks and bonds	17.8%	16.2%
Municipal bonds	0.1%	0.1%
Nongovernment backed C.M.O's	1.0%	0.9%
Other fixed income:		
NTGI Aggregate Bond Fund	13.4%	15.0%
Real Estate Commingled Fund	5.3%	5.4%
Short-term investment funds	1.4%	1.7%

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The System's Investment Policy requires fixed income managers to disclose their credit exposure and portfolio duration in their quarterly reports. The System monitors credit exposure using segmented time distribution.

As of December 31, 2006, the System had the following investments and maturities:

Investment type	Fair value	Less than 1 year	1 to 6 years	6 to 10 years	10+ years
Asset-backed securities	$ 2,862,005	—	93,252	1,014,206	1,754,547
Commercial mortgage-backed	18,450,746		—	—	18,450,746
Corporate bonds	68,093,704	1,473,194	27,388,043	26,275,328	12,957,139
Government agencies	25,554,107	—	25,554,107	—	—
Government bonds	14,840,799	—	—	—	14,840,799
Government mortgage-backed securities	61,225,087	—	30,120	—	61,194,967
Municipal/provincial bonds	532,465	—	—	—	532,465
Nongovernment backed C.M.O.'s	16,622,040	—	—	—	16,622,040
Other fixed income:					
NTGI Aggregate Bond Fund	214,992,505	—	—	214,992,505	—
	$ 423,173,458	1,473,194	53,065,522	242,282,039	126,352,703

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

As of December 31, 2005, the System had the following investments and maturities:

Investment type	Fair value	Less than 1 year	1 to 6 years	6 to 10 years	10+ years
Asset-backed securities	$ 3,935,247	—	121,723	—	3,813,524
Commercial mortgage-backed	13,031,583	—	1,652,992	—	11,378,591
Corporate bonds	59,916,345	—	21,501,455	26,083,869	12,331,021
Government agencies	15,534,284	—	5,747,758	9,786,526	—
Government bonds	12,210,129	—	47,701	—	12,162,428
Government mortgage-backed securities	86,489,873	—	—	—	86,489,873
Municipal/provincial bonds	758,348	—	—	—	758,348
Nongovernment backed C.M.O.'s	12,878,282	—	—	—	12,878,282
Other fixed income:					
NTGI Aggregate Bond Fund	218,387,993	—	—	218,387,993	—
	$ 423,142,084	—	29,071,629	254,258,388	139,812,067

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the System. To control credit risk, credit quality guidelines are incorporated into the Investment Policy, as follows:

- Fixed income securities shall not be rated lower than investment grade (Baa3 by Moody's or BBB- by Standard & Poor's or Fitch) by either rating agency unless specific written permission is granted by the Board to a manager. The average rating of all corporate bonds held in any investment portfolio, taken together, may not fall below AA.
- Split-rated securities in which the middle rating is below investment grade shall not comprise more than five percent (5%) of the market value of any manager's portfolio unless specific authority has been granted.
- Unless specific authority has been granted by the Board, in the event of a bond's downgrade below investment grade by Moody's, Standard & Poor's, and Fitch, the Board shall be notified in writing and the manager shall include a recommended course of action in response to the event in the way it deems most prudent for the Fund in the long term.
- The issues of individual entities rated AAA to Aa3 (Moody's) or AA- (Standard & Poor's, and Fitch) may have a five percent (5%) position of portfolio value at purchase cost and a seven percent (7%) position at market value.
- Issues of individual entities rated below Aa3 (Moody's) or AA- (Standard & Poor's and Fitch) may have a two percent (2%) position of portfolio value at purchase cost or three percent (3%) position at market value.
- The ratings issue does not apply to direct obligations of the U.S. government and its agencies, but the securities issued by any one issuer shall not otherwise, in the aggregate, exceed the foregoing limitations.

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

- If specific managers are given international flexibility, the same quality restrictions apply.
- Money market instruments shall have a minimum quality rating comparable to an A3 (Moody's) or A- (Standard & Poor's and Fitch) bond rating and commercial paper shall be rated A1/P1 unless held in a diversified short-term commingled fund.

The quality ratings of investments in fixed income securities as described by nationally recognized statistical rating organizations at December 31, 2006, are as follows:

Standard & Poor's Quality Rating	Total fair value	Asset backed securities	Commercial mortgage-backed	Corporate bonds	Municipal bonds	Non government backed CMO's	NTGI Aggregate Bond Fund
AAA	$ 37,841,539	2,768,753	18,450,746	—	—	16,622,040	—
AA-	5,423,099	—	—	5,423,099	—	—	—
A+	5,738,555	—	—	5,738,555	—	—	—
A	12,839,640	93,252	—	12,746,388	—	—	—
A-	6,695,722	—	—	6,695,722	—	—	—
BBB+	17,284,942	—	—	17,284,942	—	—	—
BBB	14,922,777	—	—	14,390,312	532,465	—	—
BBB-	5,814,686	—	—	5,814,686	—	—	—
AA+/AA **	214,992,505	—	—	—	—	—	214,992,505
Total credit risk of debt securities	321,553,465	$ 2,862,005	18,450,746	68,093,704	532,465	16,622,040	214,992,505
U.S. government and agencies*	101,619,993						
Total	$ 423,173,458						

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

The quality ratings of investments in fixed income securities as described by nationally recognized statistical rating organizations at December 31, 2005, are as follows:

Standard & Poor's Quality Rating	Total fair value	Asset backed securities	Commercial mortgage-backed	Corporate bonds	Municipal bonds	Non government backed CMO's	NTGI Aggregate Bond Fund
AAA	$ 32,542,800	3,813,524	13,031,583	2,819,411	—	12,878,282	—
AA+	524	524	—	—	—	—	—
AA-	1,691,800	—	—	1,691,800	—	—	—
A+	5,953,952	—	—	5,953,952	—	—	—
A	12,953,358	121,199	—	12,832,159	—	—	—
A-	5,578,386	—	—	5,578,386	—	—	—
BBB+	11,022,072	—	—	11,022,072	—	—	—
BBB	14,454,268	—	—	13,695,920	758,348	—	—
BBB-	6,322,645	—	—	6,322,645	—	—	—
AA+/AA **	218,387,993	—	—	—	—	—	218,387,993
Total credit risk of debt securities	308,907,798	$ 3,935,247	13,031,583	59,916,345	758,348	12,878,282	218,387,993
U.S. government and agencies*	114,234,286						
Total	$ 423,142,084						

* Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not have purchase limitations.

* * Weighted average rating

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit.

The System's currency risk exposure, or exchange rate risk, primarily resides within the System's international equity investment holdings. The Systems investment policy is to allow its external managers to decide what action to take regarding their respective portfolio's foreign currency exposures using currency forward contracts.

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

The System's exposure to foreign currency risk includes the following international securities (all equity) as of December 31, 2006, and December 31, 2005:

Currency	2006 Fair value	2005 Fair value
Japanese Yen	$ 86,886,463	74,474,633
British Pound Sterling	55,962,815	46,842,192
EURO Currency	52,597,530	44,288,631
Hong Kong Dollar	26,244,630	21,022,045
Swiss Franc	22,883,847	15,434,021
Australian Dollar	10,896,422	10,152,552
Singapore Dollar	10,182,675	4,567,732
Canadian Dollar	8,387,402	8,515,721
Swedish Krona	5,710,507	2,962,456
Hungarian Forint	1,418,718	499,475
South African Rand	1,387,271	1,028,616
Mexican Peso	1,098,045	854,832
Danish Krone	800,660	3,959,040
Malaysian Ringgit	782,534	812,536
Norwegian Krone	334,024	198,862
Total securities subject to foreign currency risk	$ 285,573,543	235,613,344

Foreign Currency Options

The System periodically invests in foreign currency options in order to hedge the value of a portion of its investments denominated in foreign currencies. Financial options are an agreement that gives one party the right, but not the obligation, to buy or sell a specific amount of an asset for a specified price on or before a specified expiration date. The foreign currency options held by the System entitle the System to convert the value of certain foreign equities into U.S. dollars at an agreed rate. At December 31, 2006, the System held no foreign currency options. At December 31, 2005, the System held a foreign currency option with a fair value of $429,870 (USD) and a book cost of $511,980.

Securities Lending

The System is authorized under its investment policy to participate in securities lending programs through Northern Trust Corporation under which, for an agreed-upon fee, system-owned investments are loaned to a borrowing financial institution. Under this agreement, when the loan closes, the borrowed securities are returned to the System and the collateral is returned to the borrower. The lending agreement requires securities on loan to be collateralized by cash, U.S. government securities, or irrevocable letters of credit with a total market value of at least 102% of the loaned System securities. For global securities pledged as collateral, total market value shall not be less than 105%.

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

The System is not exposed to credit risk at December 31, 2006 and 2005, respectively, as the collateral held exceeded the market value of the securities lent. The System cannot sell or pledge the non-cash collateral unless a default of the securities lending agreement has occurred.

Cash collateral can be invested in a short-term investment pool or in term loans. The term loans can be terminated on demand by either lender or borrower. At December 31, 2006 and 2005, System investments that were in possession of a borrowing financial institution were collateralized by cash and irrevocable letters of credit. The cash collateral was invested in a short-term investment pool with an average weighted maturity less than the maturity of the loaned securities.

There were no significant violations of legal or contractual provisions and no borrower or lending agent default for fiscal years 2006 and 2005.

As of December 31, 2006 and 2005, respectively, the System owned the following investments that were in possession of a borrowing financial institution:

2006		Fair value of loaned securities	Cash/securities collateral value	Cash collateral investment value
Cash collateral:				
U.S. agencies	$	8,842,570	9,063,181	9,063,181
Corporate bonds		9,124,686	9,366,055	9,366,055
Corporate stocks		114,590,369	117,794,412	117,794,412
International stocks		33,272,597	34,913,681	34,913,681
U.S. government securities		12,548,726	12,844,217	12,844,217
		178,378,948	183,981,546	183,981,546
Letters of credit collateral:				
U.S. government securities		1,673,319	1,715,035	—
U.S. agencies		—	—	—
Corporate bonds		2,263,690	2,316,603	—
Corporate stocks		7,259,574	7,434,017	—
		11,196,583	11,465,655	—
Total	$	189,575,531	195,447,201	183,981,546

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

2005		Fair value of loaned securities	Cash/securities collateral value	Cash collateral investment value
Cash collateral:				
U.S. agencies	$	4,637,958	4,755,026	4,755,026
Corporate bonds		9,320,069	9,562,388	9,562,388
Corporate stocks		110,814,901	113,827,115	113,827,115
International stocks		23,931,753	25,355,958	25,355,958
U.S. government securities		11,954,784	12,220,926	12,220,926
		160,659,465	165,721,413	165,721,413
Letters of credit collateral:				
U.S. government securities		402,803	412,777	—
U.S. agencies		9,888,327	10,133,169	—
		10,291,130	10,545,946	—
Total	$	170,950,595	176,267,359	165,721,413

The maturities of the investments made with cash collateral generally match the maturities of their securities loans.

(4) Contributions Required and Contributions Made

As of December 31, 2006 and 2005, the System's funding policy as guided by state law requires contributions equal to 8% of basic compensation, by the participants and by the City.

While the contribution requirements are not actuarially determined, state law requires that each plan of benefits adopted by the System must be approved by a qualified actuary. The actuary certifies that the contribution commitment by the participants and the City provides an adequate financing arrangement. Using the entry age actuarial cost method, the System's normal cost is determined as a percentage of payroll. The excess of the total contribution rate over the normal cost rate is used to amortize the System's unfunded actuarial accrued liability, if any exists, and the number of years needed to amortize the System's unfunded actuarial accrued liability is determined using a level percentage of payroll method.

The funding objective of the System is for contribution rates to be sufficient to cover the normal cost of the Plan and to amortize any unfunded actuarial accrued liabilities over a period not to exceed 30 years. Significant actuarial assumptions used to assess the adequacy of the financing arrangement are the same as those used to compute the unfunded actuarial accrued liability below. The latest actuarial valuation was as of December 31, 2006. In this valuation, the Plan had an unfunded actuarial accrued liability of $476,226,660 as of December 31, 2006. At December 31, 2006 and 2005, employer and employee contributions totaling $66,400,877 and $60,502,121, respectively, were required by the Plan and paid into the System. Due to significant net depreciation in the fair value of the Plan investments during 2000, 2001, and 2002, primarily caused by the unanticipated downturn in the financial markets, the System's Actuary has reported that the Plan's contribution rate is not sufficient to amortize the System's unfunded liabilities as of December 31, 2006; therefore, the System's funding objective is not being met.

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

In 2005, the City of Austin City Council approved a Supplemental Funding Plan (SFP) relating to the System. The basic elements of this plan provide for an initial one percent subsidy from the City beginning in October 2006, and increase one percent each year until it reaches a cap of four percent. A subsidy would continue as long as necessary and in an amount necessary up to four percent to sustain a 30 year funding period. Any incremental increase will be delayed by a year if the System earns twelve percent or more net of fees in any calendar year. Net earnings were 12.5% in 2006, precluding any increase, and the City supplement remaining at 1% for their 2008 fiscal year. The supplemental funding is subject to annual City Council budget approval.

(5) Capital Assets

Capital assets for the years ended December 31, 2006 and 2005 consisted of:

		2006	2005
Land	$	249,964	249,964
Furniture and fixtures		516,109	499,603
Building		1,184,560	1,184,560
Total		1,950,633	1,934,127
Accumulated depreciation		(769,300)	(697,598)
Net capital assets	$	1,181,333	1,236,529

The following summarizes the change in capital assets for the year ended December 31, 2006:

Capital assets, not being depreciated:

		Balance December 31, 2005	Additions	Transfers/ Deletions	Balance December 31, 2006
Land	$	249,964	—	—	249,964
Total	$	249,964	—	—	249,964

Capital assets, being depreciated:

		Balance December 31, 2005	Additions	Transfers/ Deletions	Balance December 31, 2006
Furniture and fixtures	$	499,603	16,506	—	516,109
Building		1,184,560	—	—	1,184,560
Total	$	1,684,163	16,506	—	1,700,669

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

Less accumulated depreciation for:

		Balance December 31, 2005	Additions	Transfers/ Deletions	Balance December 31, 2006
Furniture and fixtures	$	418,574	44,276	—	462,850
Building		279,024	27,426	—	306,450
Total	$	697,598	71,702	—	769,300

The following summarizes the change in capital assets for the year ended December 31, 2005:

Capital assets, not being depreciated:

		Balance December 31, 2004	Additions	Transfers/ Deletions	Balance December 31, 2005
Land	$	249,964	—	—	249,964
Total	$	249,964	—	—	249,964

Capital assets, being depreciated:

		Balance December 31, 2004	Additions	Transfers/ Deletions	Balance December 31, 2005
Furniture and fixtures	$	481,669	17,934	—	499,603
Building		1,184,560	—	—	1,184,560
Total	$	1,666,229	17,934	—	1,684,163

Less accumulated depreciation for:

		Balance December 31, 2004	Additions	Transfers/ Deletions	Balance December 31, 2005
Furniture and fixtures	$	375,672	42,902	—	418,574
Building		251,596	27,428	—	279,024
Total	$	627,268	70,330	—	697,598

(Continued)

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements

December 31, 2006 and 2005

(6) Federal Income Taxes

The Plan is a Public Employee Retirement System and is exempt from Federal income taxes. A favorable determination letter from the Internal Revenue Service was issued in November 1984, with additional letters received December 1999 and March 2003.

(7) Risk Management

The System is exposed to various risks of loss related to torts, errors and omission, violation of civil rights, theft of, damage to, and destruction of assets, and natural disaster. These risks are covered by insurance purchased by the System. This coverage is in compliance with the workers' compensation laws of the State of Texas with no accident or aggregate deductibles. Property physical damage is insured to replacement value with a $1,000 deductible and a building limit of $1,450,000 with contents of $500,000. Automobile limits are set at $1,000,000 per occurrence. Insurance coverage by major category of risk has remained relatively constant as compared to the prior fiscal year. Insurance settlements have not exceeded insurance coverage for any of the past three years. The System obtains Workers Compensation and Employers Liability coverage through Texas Mutual Insurance Company.

The System maintains a pension and welfare fund fiduciary responsibility insurance policy with an aggregate limit of liability of $20,000,000, and officers and directors liability coverage of $5,000,000.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Required Supplementary Information

December 31, 2006 and 2005

The following schedules and the accompanying notes are presented in compliance with the financial reporting standards established by Governmental Accounting standards Board (GASB) Statement No. 25. This actuarially determined information provides information about the funded status of the plan and the progress being made in accumulating sufficient assets to pay benefits when due:

Schedule of Funding Progress (Unaudited) *

Years ended December 31, 1997 through 2006

Actuarial valuation date	Actuarial value of assets (AVA)	Actuarial accrued liability (AAL)	Unfunded actuarial accrued liability (UAAL) (3)-(2)	Funded ratio	Annual covered payroll	UAAL as a percentage of covered payroll (4)/(6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
12/31/1997	$ 856.4	832.1	(24.3)	102.9	219.2	(11.1)
12/31/1998	952.6	877.8	(74.8)	108.5	219.3	(34.1)
12/31/1999	1,105.1	1,044.5	(60.6)	105.8	244.5	(24.8)
12/31/2000	1,231.0	1,212.6	(18.4)	101.5	268.6	(6.8)
12/31/2001	1,311.3	1,360.3	49.0	96.4	316.8	15.5
12/31/2002	1,250.9	1,440.2	189.3	86.9	322.0	58.8
12/31/2003	1,348.8	1,551.8	203.0	86.9	312.8	64.9
12/31/2004	1,356.8	1,678.2	321.4	80.8	326.6	98.4
12/31/2005	1,398.8	1,794.2	395.4	78.0	348.6	113.4
12/31/2006	1,497.8	1,974.0	476.2	75.9	391.0	121.8

Note: Dollar amounts in millions.

* The values provided concur with those presented by the Fund's actuary, Gabriel Roeder Smith & Co, in their 2006 report.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Required Supplementary Information

December 31, 2006 and 2005

Schedule of Employer Contributions (Unaudited) **

Years ended December 31, 1997 through 2006

Fiscal year	Annual required contribution	Employer contributions	Percentage contributed
(1)	(2)	(3)	(2/3)
1997	$ 15,313,819	15,313,819	100.0%
1998	16,126,014	16,126,014	100.0
1999	18,224,558	18,224,558	100.0
2000	21,531,859	21,531,859	100.0
2001	24,831,016	24,831,016	100.0
2002	26,375,274	26,375,274	100.0
2003	30,660,538	24,851,500	81.1
2004	32,733,243	26,940,941	82.3
2005	41,610,470	27,129,892	65.2
2006	49,390,658	30,545,197	61.8

** This schedule discloses the annual contribution required to provide benefits to retirees and their beneficiaries in accordance with the terms of the Plan. The Percentage Contributed is the current contribution rate for the fiscal year (the City's ongoing 8%, plus 1% supplemental funding for quarter beginning October 2006) as a percentage of the Annual Required Contribution (ARC) as determined by the prior year's actuarial valuation. For fiscal year 2006 this percentage is 8.25%/13.34%=61.8%. The current year ARC is calculated by dividing the actual dollar contribution to the Fund by the Percentage Contributed ($30,545,197/61.8%), which produces a 2007 ARC of $49,390,658.

See accompanying independent auditor's report.

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTEM

Notes to Required Supplementary Information (unaudited)

Years ended December 31, 2006 and 2005

(1) Description of Funding Progress

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the actuarial accrued liability as a factor. Isolated analysis of the dollar amounts of actuarial value of assets, actuarial accrued liability and unfunded actuarial accrued liability can be misleading. Expressing the actuarial value of assets as a percentage of the actuarial accrued liability provides an indication of the System's funding status on a going-concern basis. Analysis of this percentage over time indicates whether the System is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the public employee retirement system.

(2) Actuarial Assumptions and Methods

Funding Method – An entry age normal actuarial cost method of valuation is used in determining benefit liabilities and normal cost. Differences between assumed and actual experience (actuarial gains and losses) become part of unfunded actuarial accrued liabilities. The System has a fixed contribution rate greater than the normal cost and the System is currently unfunded. Therefore, the contributions received in excess of the normal cost are used to amortize the unfunded liabilities. Primarily due to the unanticipated significant asset losses caused by the downturn in the 2000-2002 financial markets, the plan's contribution rate is not sufficient to amortize the System's unfunded liabilities; therefore, the funding objective is not being met. In the absence of significant actuarial gains, the current contribution rates will not be sufficient to support the current benefit structure of the Plan. The System negotiated a Supplemental Funding Plan with the City of Austin that was approved by the Austin City Council. This Plan is described in footnote 4 to the financial statements. The supplemental funding is subject to annual City of Austin budget approval. Significant actuarial assumptions employed by the actuary as of December 31, 2006, the date of the latest actuarial study, include:

Amortization method	Level percent of pay, open
Payroll growth rate for amortization	3.5%
Remaining amortization period	30 years *
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rate of return	7.75%
Projected salary increases	5.0% to 6.0%
Includes inflation at	3.25%
Cost-of-living adjustments	None assumed
Post retirement benefit increases	None assumed

* GASB No. 25 prescribes that the Annual Required Contribution (ARC) shall have a funding period of thirty years or less. Since the contributions currently being received by COA ERS are less than the amount necessary to produce a thirty year funding period, the ARC was determined with the maximum thirty year period.

See accompanying independent auditors' report.

SUPPLEMENTARY INFORMATION

Investment Expenses

		2006	2005
Custodial Fees			
Northern Trust	$	**177,500**	**185,000**
Investment Manager Fees			
Agincourt Capital Management LLC		226,335	290,712
AQR Capital Management		377,268	0
AllianceBernstein		346,521	168,416
Aronson +Johnson + Ortiz		212,244	213,151
Driehaus Capital Management LLC		660,805	802,049
Eubel Brady & Suttman Asset Mgmt		117,440	109,492
INTECH Enhanced Inv Technologies LLC		31,858	0
Northern Trust NTGI QM Funds		107,591	112,880
Sprucegrove Investment Mgmt LTD		621,423	575,018
Sterling Capital Management LLC		0	52,510
Wall Street Associates		132,146	170,392
Walter Scott & Partners LTD		646,486	577,697
Miscellaneous		20,369	17,343
		3,500,486	**3,089,660**
Investment Consulting Fees			
Summit Strategies Group		**175,000**	**175,000**
Total	**$**	**3,852,986**	**3,449,660**

Note: These expenses are presented on an accrual basis.

General & Administrative Expenses

		2006	2005
Actuary	$	58,962	52,199
Attorney		60,470	58,736
Auditing		48,662	47,900
Banking Services		717	9,983
Computer Services		118,627	101,081
Consultants		3,504	6,957
Administrative		1,099,675	1,010,801
Depreciation		71,703	70,329
Insurance		125,502	70,302
Member Communications		22,973	34,308
Continuing Education & Site Visits		59,997	34,865
Total	$	**1,670,792**	**1,497,461**

Consultant Expenses

		2006	2005
Actuary			
Gabriel Roeder Smith & Co	$	**58,962**	**52,199**
Attorney			
Knight & Partners		55,544	52,596
Godwin Gruber LLP		4,926	6,140
		60,470	**58,736**
Auditing			
KPMG LLP		24,500	47,900
Sprouse & Anderson LLP		24,162	0
		48,662	**47,900**
Banking Services			
JPMorgan Chase Bank		0	9,221
National Payment Corporation		717	762
		717	**9,983**
Computer Services			
Austin Web Design		850	6,850
DeRosa Mangold		0	1,075
Levi Ray & Shoup		97,149	77,346
Riata Technologies Inc		16,697	3,246
Other		3,931	12,564
		118,627	**101,081**
Other Consultants			
Robert A. Dennison MD		3,150	3,375
Waters Consulting Group		0	3,150
Other		354	432
		3,504	**6,957**
Total	**$**	**290,942**	**276,856**

Investment Section

Summit **Strategies Group**

January 1, 2007

The Board of Retirement
City of Austin Employees' Retirement System
418 E. Highland Mall Boulevard
Austin, TX 78752-3720

The COA ERS investment portfolio performed well this past year, posting a positive return of 12.8% gross of fees for the fiscal year ending December 31, 2006. The portfolio grew from a beginning value of $1.46 billion to its current value of $1.6 billion thanks to investment gains of $184 million, which were partially offset by net outflows of $38 million. This represents the fourth positive year after a difficult period following the collapse of the technology bubble. All segments of the portfolio produced positive returns, led by strong performance in the international equity and real estate composites.

As detailed earlier, the COA ERS investment portfolio gained 12.8% for the year ending December 31, 2006. This slightly trailed the fund's Passive and Policy Benchmark and the Median Public Fund in the ICC sample. Specifically, the investment portfolio trailed its Passive Benchmark return by 0.6% and its Policy Benchmark return by 1.3%, and the Median Public Fund return by 0.7%, ranking in the 62nd percentile. This is largely attributable to COA ERS' active equity managers failing to keep pace with their benchmarks in strong positive markets. During the fiscal year, all COA ERS investment portfolio asset class composites, with the exception of equities, exceeded their benchmarks. Strong performance by real estate and international equities played a role in the strength at the absolute return level. Longer-term results are good as well and in fact quite impressive. For the 3-year period, the fund returned 11.3% annualized. In this case, the return exceeded the Policy Benchmark and more than 71% of the public funds in our sample. All rates of return were calculated in accordance with CFA Institute performance presentation standards and are gross of fees.

In fiscal year 2006, the funding to AQR small cap value equities was completed in the first quarter. Intech's enhanced S&P 500 index was added in a risk controlled effort to increase returns. Driehaus was terminated as the small cap growth equity manager following organizational changes at the firm. Eubel Brady Suttman underwent significant review as their performance continued to disappoint after such a strong start with the fund. Summit provided Board members an asset/liability study in the fall, which reviewed and recommended several modifications to the current allocation and asset classes or strategies not previously utilized by COA ERS. These investments included value added and opportunistic real estate, portable alpha strategies, private equity, and alternative strategies.

The results for the past year achieved the fund's actuarial assumption for long-term investment results. The investment markets had a strong 2006 and are not expected to reward investors as handsomely for taking risk in the future as they have in the past. We are pleased to see a fourth year of positive returns, but look to the future with a tempered perspective. The long-term results are excellent and the hard work of the Board and staff over the past few years positioned the fund to capitalize on strong markets and are to be commended. We continue to believe that the fund is in a very good position to capture consistent, quality results in the years to come. All of us at Summit Strategies Group have enjoyed our COA ERS experience and look forward to continued service and success. Thank you.

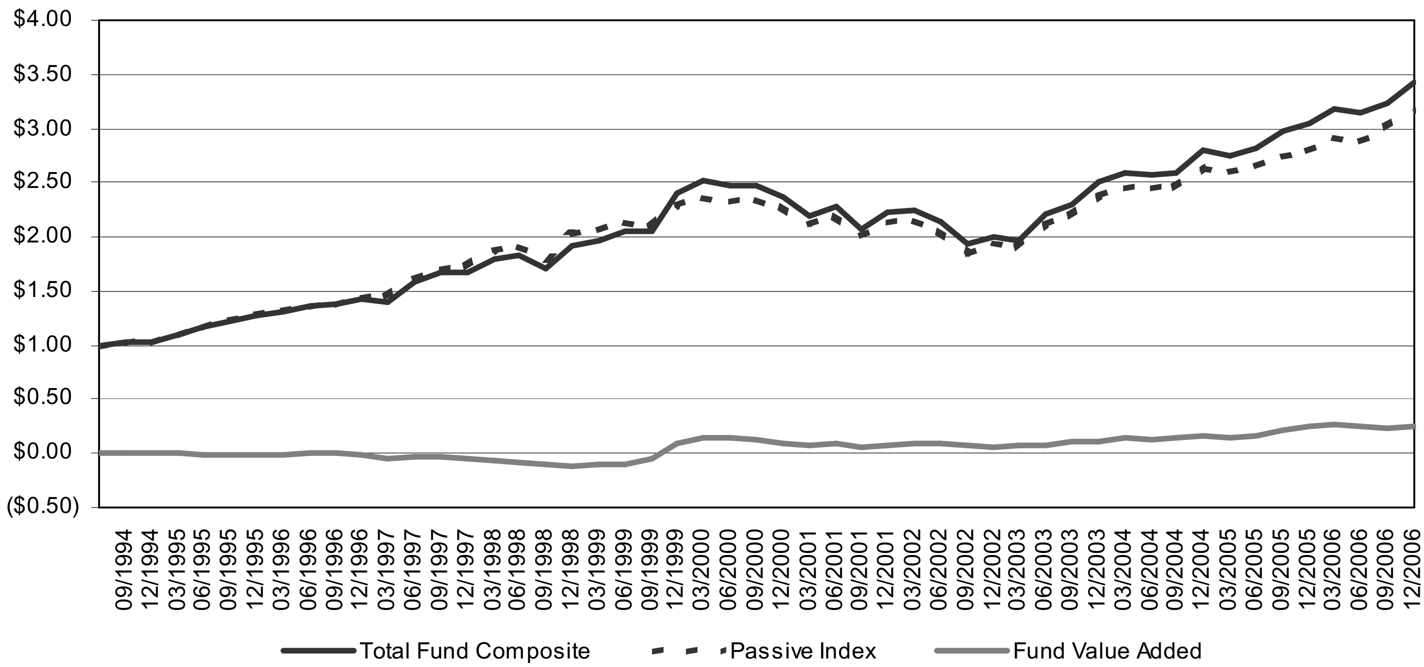
Sincerely,

Eric J. Ralph, CFA
Senior Vice President

TOTAL FUND AND PASSIVE INDEX VS. ICC PUBLIC FUND UNIVERSE

	4Q 2006	1 Year	2 Years	3 Years	5 Years	10 Years
COAERS	5.79%	12.79%	10.91%	11.31%	9.16%	9.15%
Passive Index	5.56%	13.36%	9.71%	10.02%	8.18%	8.18%
5th Percentile	6.49%	16.47%	13.30%	13.33%	10.82%	10.35%
25th Percentile	5.99%	14.66%	11.21%	11.54%	9.27%	9.22%
Median	5.57%	13.47%	10.20%	10.49%	8.53%	8.69%
75th Percentile	4.95%	11.65%	9.02%	9.53%	7.72%	7.82%
95th Percentile	3.59%	8.05%	6.52%	6.91%	6.40%	6.90%
Observations	146	138	137	135	125	112

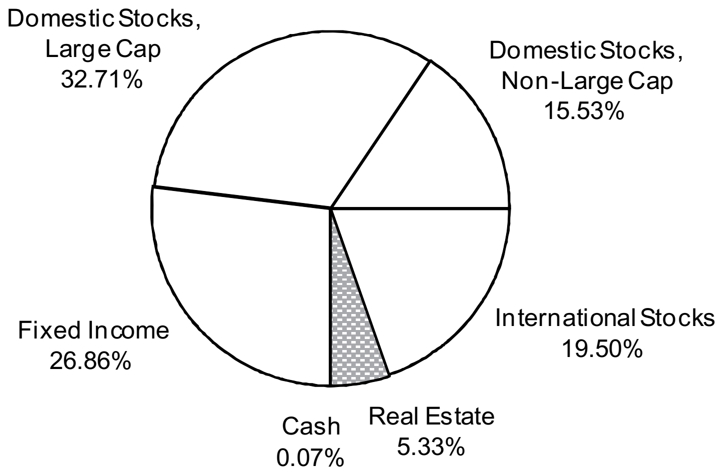
TOTAL GROWTH OF $1.00 VS. PASSIVE INDEX



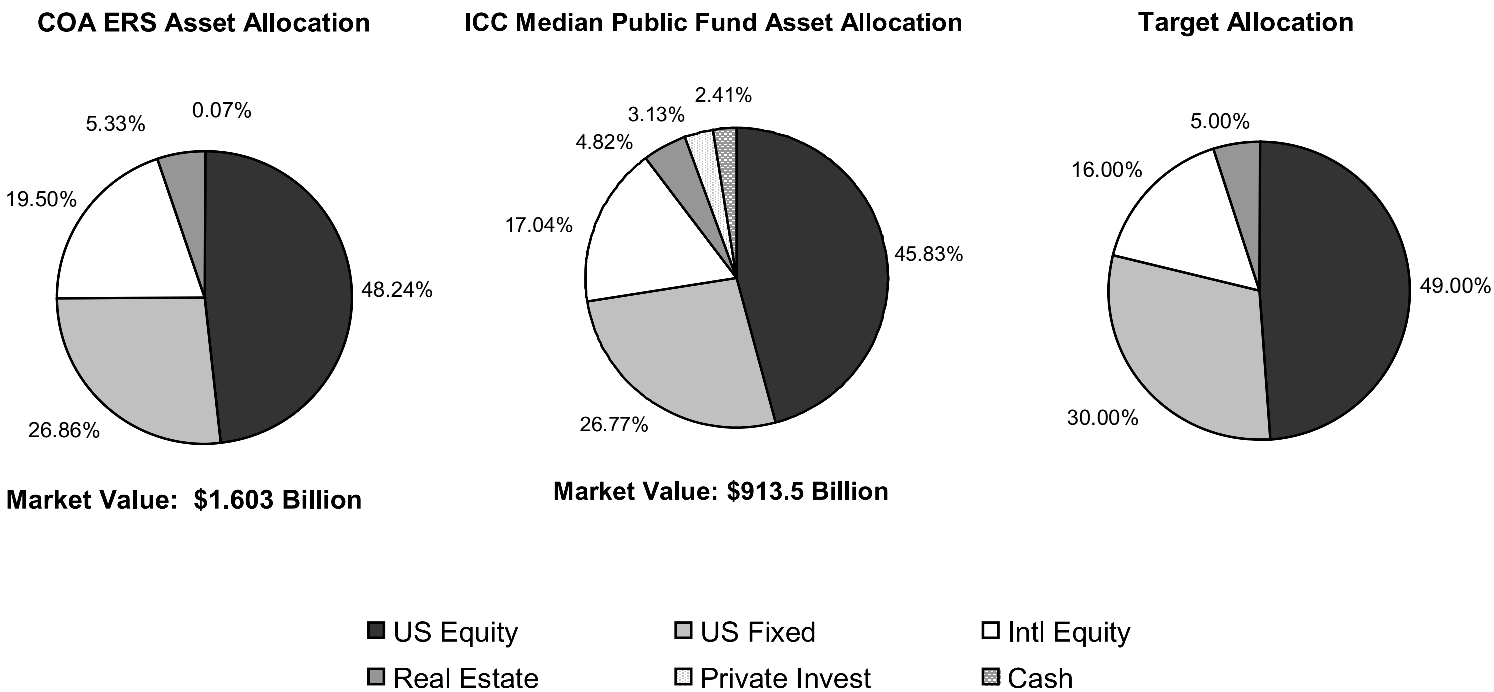
Note: Passive Index is currently comprised of 33% S&P 500, 16% Russell 2500, 16% EAFE, 30% Lehman Aggregate, and 5% NCREIF.

INVESTMENT SUMMARY AT FAIR MARKET VALUE

Asset Class by Fund Manager	Fair Value	Percentage of Total Fair Value
Fixed Income	$430,625,471	26.86%
Domestic Stocks, Large Cap	524,465,699	32.71%
Domestic Stocks, Non-Large Cap	249,093,401	15.53%
International Stocks	312,715,868	19.50%
Real Estate	85,450,667	5.33%
Cash	1,051,263	0.07%
	$1,603,402,369	100.00%



ALLOCATION BY SECTOR



ASSET ALLOCATION

CITY OF AUSTIN EMPLOYEES' RETIREMENT SYSTE
ASSET ALLOCATION
12/31/2006

INVESTMENT POLICY REBALANCING GUIDELINES:	12/31/2006	% OF FUND	ASSET ALLOCATION TARGET %	ASSET ALLOCATION TARGET AMOUNT	VARIANCE FROM TARGET	VARIANCE FROM TARGET %
Stocks	**$ 1,086,274,968**	**67.74%**	**65.00%**	**1,042,211,540**	**44,063,428**	**2.75%**
Domestic Large Cap Equities	524,465,699	32.71%	32.50%	521,105,770	3,359,929	
Domestic Non-Large Cap Equities	249,093,401	15.53%	16.25%	260,552,884	(11,459,483)	
International Equities	312,715,868	19.50%	16.25%	260,552,886	52,162,982	
Subtotal for Rebalancing	**$ 517,127,401**	**32.26%**	**35.00%**	**561,190,829**	**(44,063,428)**	**-2.75%**
Fixed Income	430,625,471	26.86%	30.00%	481,020,710	(50,395,239)	
Real Estate	85,450,667	5.33%	5.00%	80,170,119	5,280,548	
Cash	1,051,263	0.07%	0.00%	-	1,051,263	
	1,603,402,369	**100.00%**	**100.00%**			

ASSET CLASS / MANAGER	12/31/2006	% OF FUND	TARGET %	TARGET AMOUNT	VARIANCE FROM TARGET
	524,465,699			**521,105,770**	**3,359,929**
INTECH Enhanced Investment Technologies (enhanced-index)	266,751,155	16.63%	16.25%	260,552,884	6,198,271
ALLIANCEBERNSTEIN (large cap - growth)	116,976,946	7.30%	8.13%	130,276,443	(13,299,497)
ARONSON+JOHNSON+ORTIZ (large cap - value)	140,737,598	8.78%	8.13%	130,276,443	10,461,155
	249,093,401			**260,552,884**	**(11,459,483)**
DRIEHAUS CAPITAL MGMT LLC(small cap - growth)	20,706	0.01%	0.00%	-	20,706
TRANSITION-NORTHERN (small-cap - growth)	63,658,208	3.97%	4.06%	65,138,221	(1,480,013)
AQR CAPITAL MGMT (small cap - value)	65,548,031	4.08%	4.06%	65,138,221	409,810
WALL STREET ASSOCIATES (mid cap - growth)	58,700,389	3.66%	4.06%	65,138,221	(6,437,832)
EUBEL BRADY & SUTTMAN (mid cap - value)	61,166,067	3.81%	4.06%	65,138,221	(3,972,154)
	312,715,868			**260,552,886**	**52,162,982**
WALTER SCOTT & PARTNERS LTD (intl - growth)	151,740,989	9.46%	8.13%	130,276,443	21,464,546
SPRUCEGROVE INVESTMENT MGMT LTD (intl - value)	160,974,879	10.04%	8.13%	130,276,443	30,698,436
	430,625,471			**481,020,710**	**(50,395,239)**
AGINCOURT CAPITAL MGMT LLC	215,632,966	13.45%	15.00%	240,510,355	(24,877,389)
NTGI QM AGGREGATE BOND FUND	214,992,505	13.41%	15.00%	240,510,355	(25,517,850)
	85,450,667			**80,170,119**	**5,280,548**
PRINCIPAL GLOBAL INVESTORS	85,450,667	5.33%	5.00%	80,170,119	5,280,548
	1,051,263			**0**	**1,051,263**
CASH	1,051,263	0.07%	0.00%	-	**1,051,263**
	$ 1,603,402,369				

Reconciliation to Statement of Plan Net Assets:

Interest and dividends receivable	**3,661,685**
Trades pending settlement - purchases	**113,516**
Total investments	**1,600,703,760**
Trades pending settlement - sales	**(1,076,592)**
	1,603,402,369

TOP TEN EQUITY HOLDINGS

Shares	Stock		Fair Value	% of Fund
160,400	Exxon Mobil Corp	$	12,291,452	0.77%
250,150	General Electric Co		9,381,511	0.59%
165,700	CitiGroup Inc		9,229,490	0.58%
18,300	Google Inc		8,426,784	0.53%
174,000	JP Morgan Chase & Co		8,404,200	0.52%
82,100	Merrill Lynch & Co Inc		7,643,510	0.48%
115,900	Procter & Gamble Co		7,448,893	0.46%
257,100	Pfizer Inc		6,658,890	0.41%
78,050	Apple Computer Inc		6,621,762	0.41%
31,665	Goldman Sachs Group Inc		6,312,418	0.39%
	Top 10 Stock Holdings	$	**82,418,910**	**5.14%**
	Total Investments	$	**1,603,402,369**	**100.00%**

Full listing available upon request.

TOP TEN BOND HOLDINGS

Par	Bond		Fair Value	% of Fund
$ 8,270,000	FHLB Preassign 5.375% 8/19/2011	$	8,411,458	0.53%
6,335,000	Federal NT 6.625% 9/15/2009		6,596,274	0.41%
6,625,783	FHLMC Gold 4.50% 7/1/2019		6,392,887	0.40%
6,210,000	FHLMC 5.75% 3/15/2009		6,305,609	0.39%
5,180,000	US Treasury Bonds 6.00% 2/15/2026		5,874,850	0.37%
4,430,000	US Treasury Bonds 8.75% 5/15/2017		5,860,753	0.37%
5,242,635	FHLMC Multiclass Mtg 5.50% 12/1/2034		5,190,188	0.32%
4,807,976	FNMA Pool #831095 6.005% 10/1/2035		4,841,584	0.30%
9,565,000	US Treasury Sec Stripped Int Pmt 11/15/2020		4,827,752	0.30%
4,886,662	CMO Bear Stearns ARM 10/25/2035		4,799,704	0.30%
	Top 10 Bond Holdings	$	**59,101,059**	**3.69%**
	Total Investments	$	**1,603,402,369**	**100.00%**

BROKER COMMISSIONS OVER $10,000

Broker Name	# of Shares Traded	Commissions Paid	Cost per Share
BROCKHOUSE & COOPER MONTREAL	658,553	$ 11,824	$ 0.018
CITIGROUP GLOBAL MARKETS INC	1,020,505	16,827	0.016
CREDIT SUISSE FIRST BOSTON CORPORATION	509,350	12,384	0.024
DEUTSCHE BANK SECURITIES INC	779,930	18,590	0.024
DRIEHAUS SECURITIES CORP	25,118,409	1,670,531	0.067
GOLDMAN SACHS & COMPANY	1,162,720	17,524	0.015
GUZMAN & COMPANY	795,600	15,873	0.020
IMPERIAL CAPITAL LLC	307,145	15,357	0.050
INVESTMENT TECHNOLOGY GROUP	10,246,702	184,399	0.018
JP MORGAN SECURITIES INC	357,735	14,501	0.041
LEHMAN BROTHERS INC	2,225,885	18,766	0.008
LYNCH JONES & RYAN	347,775	10,493	0.030
MERRILL LYNCH PIERCE FENNER & SMITH INC	731,085	29,168	0.040
MORGAN STANLEY & CO INC	8,682,519	26,800	0.003
PIPER JAFRAY INC	232,800	10,009	0.043
SOCIETE GENERALE LONDON	431,763	30,743	0.071
UBS SECURITIES LLC NEW YORK	455,137	12,762	0.028
Minor Brokers - 124 total	8,799,821	207,010	0.024
Total Broker Commissions	**62,863,434**	**$ 2,323,561**	**$ 0.037**

COMPARISON OF INVESTMENT MANAGER PERFORMANCE

	Balance 12/31/05	Balance 12/31/06	2006 Gross Return (%)	2006 Mgmt Fees (Cash Basis	After-Fees Return (%) 2006	3 Years	5 Years
FIXED INCOME GROUP	**$ 435,153,290**	**$ 430,625,471**	**4.7 %**	**$ 296,020**	**4.6 %**	**3.8 %**	**5.2 %**
Agincourt Capital Mgmt LLC	216,762,467	215,632,966	5.0 %	235,800	4.9 %	3.9 %	5.4 %
Lehman Aggregate			4.3 %		4.3 %	3.7 %	5.1 %
NTGI QM Bond Index Fund	218,390,823	214,992,505	4.4 %	60,220	4.3 %	3.7 %	5.0 %
Lehman Aggregate			4.3 %		4.3 %	3.7 %	5.1 %
INTERNATIONAL	**250,724,541**	**312,715,868**	**25.3 %**	**1,227,877**	**24.8 %**	**20.6 %**	**17.3 %**
Walter Scott & Partners LTD	126,759,948	151,740,989	20.2 %	624,627	19.7 %	18.6 %	15.3 %
EAFE			26.9 %		26.9 %	20.4 %	15.4 %
Sprucegrove Investment Mgmt Inc	123,964,593	160,974,879	30.4 %	603,250	29.9 %	22.5 %	19.2 %
EAFE			26.9 %		26.9 %	20.4 %	15.4 %
DOMESTIC EQUITY	**690,593,323**	**773,559,100**	**12.8 %**	**2,069,797**	**12.4 %**	**11.4 %**	**7.8 %**
US EQUITIES LARGE	**464,704,044**	**524,465,699**	**13.0 %**	**720,840**	**12.9 %**	**11.6 %**	**6.6 %**
NTGI QM S&P 500 Index Fund	231,517,702	N/A	N/A	47,370	N/A	N/A	N/A
S&P 500			15.8 %		15.8 %	10.4 %	6.2 %
INTECH Enhanced Investment Technologies LLC	N/A	266,751,155	N/A	N/A	N/A	N/A	N/A
S&P 500			15.8 %		15.8 %	10.4 %	6.2 %
AllianceBernstein	115,628,723	116,976,946	1.6 %	437,588	1.2 %	8.3 %	N/A
Russell 1000 Growth		0	9.1 %		9.1 %	6.9 %	2.7 %
Aronson+Johnson+Ortiz	117,557,619	140,737,598	19.9 %	235,882	19.7 %	17.1 %	N/A
Russell 1000 Value		0	22.2 %		22.2 %	15.1 %	10.9 %
US EQUITIES NON-LARGE	**225,889,279**	**249,093,401**	**12.2 %**	**1,348,957**	**11.6 %**	**11.1 %**	**10.4 %**
Wall Street Associates	57,121,025	58,700,389	5.6 %	149,622	5.3 %	10.8 %	5.5 %
Russell Mid Cap Growth		0	10.6 %		10.6 %	12.7 %	8.2 %
Eubel Brady & Suttman Asset Mgmt	54,476,273	61,166,067	15.2 %	113,261	15.0 %	8.2 %	11.4 %
Russell Mid Cap Value		0	20.2 %		20.2 %	18.8 %	15.9 %
Driehaus Capital Management LLC	57,212,883	20,706	N/A	791,818	N/A	N/A	N/A
Russell 2000 Growth		0	13.4 %		13.4 %	10.5 %	6.9 %
iShares R2000 Growth	N/A	63,658,208	N/A	N/A	N/A	N/A	N/A
Russell 2000 Growth			13.4 %		13.4 %	10.5 %	6.9 %
Sterling Capital Management LLC	22,466	N/A	N/A	12,681	N/A	N/A	N/A
Russell 2000 Value			23.5 %		23.5 %	16.5 %	15.4 %
AQR Capital Management	57,056,632	65,548,031	N/A	281,575	N/A	N/A	N/A
Russell 2000 Value			23.5 %		23.5 %	16.5 %	15.4 %
REAL ESTATE	**78,507,966**	**85,450,667**	**16.5 %**	**770,755**	**15.4 %**	**N/A**	**N/A**
Principal Global Investors	78,507,966	85,450,667	16.5 %	770,755	15.4 %	N/A	N/A
NCREIF Property		0	16.6 %		16.6 %	17.0 %	13.3 %
CASH	**2,534,607**	**1,051,263**	**5.4 %**		**5.4 %**	**3.9 %**	**3.4 %**
90 Day T-Bills			4.8 %		4.8 %	3.1 %	2.4 %
Total Fund	**$ 1,457,513,727**	**$ 1,603,402,369**	**12.8 %**	**$ 4,364,449**	**12.5 %**	**11.0 %**	**8.9 %**
****Policy Index***			14.1 %		14.1 %	10.7 %	8.9 %

Calculated using time-weighted rate of return based on market rate of return.

* Policy Allocation: 33% S&P 500, 14% Russell 2500 Growth, 15% FTAWI Ex-US, 38% Lehman Aggregate, thru 8/00.
33% S&P 500, 14% Russell 2500 Growth, 15% EAFE, 38% Lehman Aggregate, 9/00 thru 9/01.
33% S&P 500, 14% Russell 2500, 15% EAFE, 38% Lehman Aggregate, 10/01 thru 12/02.
33% S&P 500, 16% Russell 2500, 16% EAFE, 35% Lehman Aggregate, 1/03 thru 305.
33% S&P 500, 16% Russell 2500, 16% EAFE, 30% Lehman Aggregate, 5% NCREIF, 4/05 to present.

SUMMARY OF INVESTMENT POLICY

The City of Austin Employees' Retirement System Board of Trustees, which has the fiduciary duty of overseeing the pension fund investments, has adopted a Statement of Investment Policy and Objectives. This summary includes the major elements of this annually reviewed document. A copy, in its entirety, is available upon request.

INVESTMENT GOALS

The purpose of the Fund is to accumulate the financial reserves necessary to provide for the retirement and pensioning of eligible Members of the City of Austin Employees' Retirement System and their beneficiaries. Given this purpose, the System's liquidity requirement, and the source and predictability of contributions, the Board elects to assume normal pension fund risk in pursuing an investment program. A primary objective of the investment management of the Fund is to emphasize consistency of growth in a manner that protects the Fund from excessive volatility in market value from year to year.

The Board, with consultation, advice, and assistance from the investment consultant, will use the Fund's asset allocation as the primary tool to achieve this goal. As this is a long-term projection and investments are subject to short-term volatility, the main investment review focus of the Board will be to emphasize total return of the Fund versus its absolute and relative targets, each asset segment's composite performance versus appropriate market benchmarks, and each money manager's performance versus a specified asset class style benchmark and style peer comparison over relevant time periods. Each manager is expected to maintain a consistent philosophy and style, perform well versus others utilizing the same style, add incremental value after costs and provide investment management in compliance with this document and the manager's contract with the System.

INVESTMENT PHILOSOPHY

The Fund is a permanent one.

The benefit obligations of the System must be met on a timely and regular basis.

There is currently no expectation of a need for significant liquidity from the Fund's portfolio.

The Fund shall be considered a total return fund, with appropriate recognition given to both current income and capital appreciation. Taxes shall not be a consideration. As such, market value will be the only relevant basis for investment value.

In the long run, ownership (equity investment) is a prudent investment vehicle for preservation of real values. The purpose of fixed income investments is to protect principal and provide a measure of stability to the portfolio.

As a long-term fund with a commitment to funding the full benefits of the participants, cash flow considerations shall take precedence over the liability stream when considering overall asset allocation of Fund assets.

IDENTIFICATION OF DUTIES

There are several parties acting as fiduciaries regarding the investment program for the Fund. This document will set out specific duties and responsibilities for the investment-related parties as they carry out their specific roles towards achieving the objectives of the Fund.

PERMISSIBLE INVESTMENTS

Listed below are the investment vehicles specifically permitted under the current Statement of Investment Policies and Objectives. They are categorized as equity or fixed income to indicate how they are classified for purposes of the asset-mix guidelines in a subsequent section. Unless given authorization in writing, managers are allowed to invest only in the security types listed below for the asset class for which they have been hired.

Equities	***Fixed Income***	***Real Estate***
Common Stocks	Domestic and Yankee Bonds	Open-ended Commingled Funds
Convertible Bonds	Mortgages and Mortgage-Backed Securities	
Preferred Stocks	Asset-Backed Securities	
	Cash-Equivalent Securities	
	Money Market Funds, Bank STIF and STEP Funds	

1. The above assets can be held in commingled (mutual) funds as well as privately managed separate accounts. If held in a commingled account or mutual fund, the prospectus or Declaration of Trust takes precedence over this document.

2. Private placement bonds are not permitted. Section 144(a) fixed income securities are allowable.

3. Investments may not be made in any investment that is prohibited by the Internal Revenue Service, the Department of Labor or statutory restriction.

4. For purposes of definition, cash equivalent securities are any fixed income investment with less than one year to maturity or reset date.

5. The securities representing equity of any one company shall not exceed 4% of the cost basis or 6% of the market value of any manager's portfolio. Fixed income securities of any one corporation shall be limited to 4% at cost of a portfolio and may not exceed 6% at market. This restriction also applies to asset-backed securities, non-agency mortgage-backed securities (including commercial mortgage-backed securities) and taxable municipals. The total holdings of an agency-issued mortgage-backed security of the same coupon and maturity series of the same agency shall not exceed 20% of the portfolio at cost (agency-issued mortgage-backed securities to include GNMA's). The direct debt of the federal government (treasury bonds, bills and notes) shall not be restricted as a percentage of the portfolio.

6. Formulaic investment styles that are index based may deviate from the above position limits provided they are following a pre-established investment process and relative position limitation (i.e. index weight plus 1%) and they will monitor the account and promptly inform COA ERS if the diversification restriction noted above in the Policy is exceeded.

7. Derivatives are permissible for the purpose of equitizing cash (e.g. an overlay program, reducing cash exposure, or in portfolio transition).

8. International equity managers may invest in depository receipts as long as the underlying security is permissible within these guidelines and the investment does not expose the Fund to any greater risk than the risk from holding the underlying security.

9. Domestic equity managers are allowed to invest in dollar-denominated, SEC registered stock of foreign domiciled companies traded on the NYSE, AMEX or OTC markets. Concentration restrictions for the above securities are the same as for any other security.

TOTAL PENSION FUND INVESTMENT OBJECTIVES

Both relative and absolute results will be considered in the evaluation of the total Fund's performance. The following are the performance expectations for the Fund:

- The Fund's total return after fees should exceed the total return of an index composed of a mix of asset class benchmarks in proportions set out in the Statement of Investment Policies and Objectives.
- The time period for this objective is on the market cycle or five years, whichever is shorter.

ASSET CLASS DIVERSIFICATION

Within the broad definition of equities and fixed income for allocation purposes, the Board with advice from the consultant, believe it is prudent to diversify within asset classes. The intra-asset class categories and their proportion of the total asset class allocation shall be:

Equities:	**65%**
Large Cap Domestic	50%
Non-Large Cap Domestic	25%
International	25%

Fixed Income:	**30%**
Core Fixed Income	100%
Cash	0%

Real Estate:	**5%**
Real Estate	100%

While the Board with advice from the consultant believes that diversification is prudent, they also believe that over-diversification is detrimental to the System. Therefore, the Board shall not consider an asset segment for inclusion in the portfolio that does not warrant a 5% allocation of the total fund.

Rebalancing will take place when the broad asset class trigger percentages have been reached.

Actuarial Section

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May 22, 2007

Mr. Stephen Edmonds
Executive Director
City of Austin Employees' Retirement System
418 E. Highland Mall Blvd.
Austin, TX 78752

Dear Mr. Edmonds:

Subject: Actuarial Valuation as of December 31, 2006

We are pleased to present our report on the actuarial valuation of the City of Austin Employees' Retirement System. Based upon this actuarial valuation as of December 31, 2006, it is our opinion that these results reasonably reflect the funded status of the System.

As you know, the employee and employer contribution rates are set by statute. It is expected that these contribution rates will remain level as a percentage of payroll. The funding objective of the plan is for the contribution rates to be sufficient to cover the normal cost of the plan and to amortize any unfunded actuarial accrued liabilities over a period not to exceed 30 years. Due to continued recognition of the significant asset losses from 2000, 2001 and 2002, the plan's contribution rate is not sufficient to amortize the System's unfunded liabilities. Therefore, the funding objective is not currently being met.

In 2005 the City of Austin adopted the Supplemental Funding Plan (SFP). The SFP will increase the City contribution rate in 1% increments annually over the next several years until the rate reaches a maximum of 12.0%. The rates increase on October 1st of each year, therefore the City contribution rate increased to 9.0% effective October 1, 2006. The increase in the City rate can be delayed by a year if the System earns 12.0% on its assets during the previous calendar year. In fact, the System earned more than 12.0% in calendar year 2006, and therefore the City rate will not increase on October 1, 2007. The increases in the City rate are intended to stay in place until the funding period of the System is less than 30 years. Once the funding period reaches 30 years, the City has the option to reduce the additional contributions to a rate that would produce a 30-year funding period.

In addition to the actuarial valuation results, various accounting and statistical tables are also included which should help you compare the results of this plan year with prior years. The information presented in the trend data schedules of this report has been prepared by Gabriel, Roeder, Smith & Company. The information for years 1993 through 2000 was prepared by Watson Wyatt & Company. Information in these schedules prior to 1993 was determined by another actuarial firm.

Mr. Stephen Edmonds
May 22, 2007
Page 2

Actuarial assumptions and methods are set by the Board of Trustees, based upon recommendations made by the plan's actuary. An experience investigation was performed for the five year period ending December 31, 2006. As a result of this study, revised assumptions were adopted by the Board to be effective with this valuation. We believe the assumptions are internally consistent, reasonable, and where appropriate based on the actual experience of COA ERS.

The results of the actuarial valuation are dependent on the actuarial assumptions used. Actual results can and almost certainly will differ, as actual experience deviates from the assumptions. Even seemingly minor changes in the assumptions can materially change the liabilities, calculated contribution rates and funding periods. The actuarial calculations are intended to provide information for rational decision making.

Member data for retired, active and inactive participants was supplied as of December 31, 2006, by the City of Austin Employees' Retirement System staff. We have not subjected this data to any auditing procedures, but have examined the data for reasonableness and consistency with the prior year's data. Asset information was also supplied by the City of Austin Employees' Retirement System staff.

The undersigned are independent actuaries and consultants. Mr. Carter is an Enrolled Actuary and a Member of the American Academy of Actuaries and he meets the Qualification Standards of the American Academy of Actuaries, and both are experienced in performing valuations for large public retirement systems.

We would like to thank you and your staff for their assistance in providing all necessary information to complete this valuation. Their courteous help is very much appreciated. We look forward to discussing this actuarial valuation report with you at your convenience. Please do not hesitate to let us know if you have any questions or need additional information.

Sincerely,

Lewis Ward

Lewis Ward
Consultant

W Michael Carter

W. Michael Carter, F.S.A.
Senior Consultant

klb

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TABLE OF CONTENTS

EXECUTIVE SUMMARY

The key results from the valuation of the City of Austin Employees' Retirement System as of December 31, 2006, may be summarized as follows:

	December 31, 2006 (1)	December 31, 2005 (2)
• Members		
— Actives	8,055	7,638
— Retirees and beneficiaries	3,467	3,297
— Vested - terminated	714	670
— Total	12,236	11,605
• Covered payroll	$ 390,963,991	$ 348,619,141
• Normal cost	$ 58,561,801	$ 52,387,124
— As % of payroll	14.57%	14.56%
• Actuarial accrued liability	$ 1,974,010,618	$ 1,794,181,675
• Present actuarial value of assets	$ 1,497,783,958	$ 1,398,798,722
• Unfunded actuarial accrued liability (UAAL)	$ 476,226,660	$ 395,382,953
• Estimated yield on assets		
— Actuarial value basis	9.33%	5.44%
— Market value basis	12.33%	8.58%
• Contribution rate		
— Employee	8.00%	8.00%
— Employer	9.00% *	8.00%
• Benefit and refund payments	$ 96,425,800	$ 91,385,741
• Amortization period of unfunded actuarial accrued liability	Infinite	Infinite
• GASB No. 25 disclosure		
— UAAL as a % of Payroll	121.8%	113.4%
— GASB funded ratio	75.9%	78.0%
— GASB Annual Required Contribution (ARC)	13.85%	13.34%

* Employer rate increased to 9.0% effective October 1, 2006.

INTRODUCTION

This December 31, 2006, actuarial valuation of the City of Austin Employees' Retirement System has been prepared by Gabriel, Roeder, Smith & Company. The primary purpose of the valuation is to value the liabilities of the System as of December 31, 2006, determine the funding period of any unfunded liability for the plan year beginning January 1, 2007, and to provide certain required disclosure information. We are pleased to have the privilege of working for the Board, and look forward to discussing the results with you at your convenience.

The last actuarial valuation of the City of Austin Employees' Retirement System was prepared as of December 31, 2005 by Gabriel, Roeder, Smith & Company. Valuations are prepared annually as of December 31st.

This valuation reflects the assumption changes adopted by the Board in March of 2007, as a result of the December 31, 2006 Experience Study.

Section C of this report provides the current funded status of the plan and reviews the valuation results. Assets are discussed in Section D, while Section E contains an analysis of the actuarial gains and losses during the past year.

Section F discusses some of the historical comparisons and statistical summaries for the plan. Governmental Accounting Standards Board Statement No. 25 (GASB No. 25) information in the report is discussed in Section G, and Section H provides a summary of the valuation results along with other comments.

Various tables supporting the report are contained in Sections I and J, including any change in benefit provisions since the last valuation.

FUNDED STATUS OF THE PLAN

The funded status of the plan is shown in Table 1, Table 2, and Table 3. Table 1 summarizes the various cost items from the current year's and prior year's actuarial valuations, while Table 2 provides an allocation of the normal cost by its various components. Table 3 shows the components of the actuarial liability.

Reviewing the composition of normal cost of the System, Table 2 indicates that the employer normal cost as of December 31, 2006, is 14.57% of pay. This compares with 14.56% of pay as of the last valuation of December 31, 2005. This normal cost is developed based on the entry-age-normal (EAN) actuarial cost method. As may be seen in Item 1, the normal cost for the retirement benefits is 10.24% of pay. The normal cost for the vested termination benefits is 1.68% and 2.01% for refunds of nonvested terminated employees. The normal cost for disability benefits is 0.24%, and the normal cost for death benefits is 0.40%.

Table 1 illustrates a number of the key actuarial items for the 2006 valuation. As mentioned above, the employer normal cost rate is 14.57% of covered payroll. The actuarial accrued liability is $1,974.0 million as shown in Item 5 and as detailed in Table 3. The actuarial value of assets equals $1,497.8 million, as shown in Item 6. Item 7 of Table 1 shows that the plan has a $476.2 million unfunded liability (i.e. liabilities exceed plan assets) as of the valuation date. As of the last valuation (December 31, 2005), the System was underfunded by $395.4 million.

Currently, the City is contributing 9.00% of payroll and the employees are contributing 8% of payroll. Combining the employees' contributions with the City contribution, the System has 17% of payroll to fund benefits. The current normal cost of the plan is 14.57%, which means that the System is currently receiving contributions in excess of the normal cost equal to 2.43% of pay (17.00% less 14.57%). These excess contributions are available to amortize any unfunded actuarial accrued liability. Based on these contribution rates, if all assumptions are exactly met then the current unfunded liability will never be fully amortized.

FUNDED STATUS OF THE PLAN
(Continued)

Effective October 1, 2006, the City contribution rate increased to 9.0% as part of the Supplemental Funding Plan (SFP). Under the SFP it is anticipated that the City contribution rate will gradually increase to 12.0%. Each calendar year in which the System earns at least 12.0%, on the market value of assets will delay the scheduled increase by one year. These additional contributions will help to reduce the unfunded liability of the System over time. The GASB annual required contribution (ARC) is also shown on Table 1. The ARC for the 2007 plan year, as determined by the 2006 valuation, is 13.85%.

CHANGE IN ASSETS

Table 4 and Table 5 show the development of the actuarial value of assets. Item 6 of Table 4, shows that the actuarial value of assets as of December 31, 2006, is $1,497.8 million.

Table 4 develops the actuarial value of assets under the actuarial asset valuation method adopted by the Board in conjunction with the change to reporting the System's disclosure information under GASB No. 25. This method begins with the market value of assets and is modified by the "Excess (Shortfall)" between expected investment return and actual income. Only 20% of this Excess (Shortfall) is recognized in the valuation immediately following the year in which the Excess (Shortfall) occurs. The remaining 80% of the Excess (Shortfall) is deferred until future years, with an additional 20% recognized in each subsequent year until 100% of the difference is recognized in the fifth year.

The total deferral of all Excess (Shortfall) investment income for the year (shown in Item 2f) is $111.2 million. Table 5 shows the development of the Excess (Shortfall) of investment income for the past four years.

An analysis of the change in the System's market value of assets for the last two plan years and an estimate of the return on assets for the System are included in Table 6. The estimated average annual rate of return for the year ending December 31, 2006, assuming that income, revenue, and expenditures are evenly distributed throughout the year is 12.33% on a market value of assets basis. The rate of return for the year ending December 31, 2006, on an actuarial value basis was 9.33%. This compares with the actuarial assumed investment return of 7.75%.

Table 7 shows the development of the gain/(loss) on the actuarial value of assets for the prior plan year. As may be seen in Item 9, the System had a gain on an actuarial asset basis of $22 million in 2006. This compares to the ($31) million loss in 2005.

ACTUARIAL GAINS AND LOSSES

An important part of the change in unfunded actuarial accrued liability from year to year is due to the impact of actuarial gains and losses of the System. This section summarizes the combined asset and liability experience changes since the prior valuation on December 31, 2005.

As can be seen in Item 7 of Table 8, the expected value of the unfunded actuarial accrued liability as of December 31, 2006, is an underfunded position of $413.1 million. This expected value reflects an assumed investment return assumption of 7.75% on the beginning of year unfunded actuarial accrued liability, normal cost, and contributions during 2006.

Since the actual unfunded actuarial accrued liability as of December 31, 2006 is $476.2 million, it represents a total net loss for the period of $63.1 million, as shown in Item 9 of Table 8. That is, the funded status is less than expected. The net actuarial loss includes an asset gain of $21.5 million as shown in Table 7 and a loss on the liability side equal to $84.6 million. The liability loss can be separated into the loss due to the change in the actuarial assumptions of ($22.5) million and a liability experience loss of ($62.1) million. The liability loss is broken out by source in Items 16-23 of Table 8. As can be seen on Table 8, the largest portion of the liability loss was due to higher than expected salary increases and lower than expected turnover.

There have been no changes to the plan provisions since the prior year. Please see Table 15 for a more detailed description of the plan provisions.

The actuarial assumptions used in this valuation have been modified since the prior year. Revised assumptions were adopted by the Board in March 2007 based on the recommendations from the December 31, 2006 experience investigation. These assumptions are detailed in Table 14.

HISTORICAL COMPARISONS AND STATISTICAL SUMMARIES

Various statistical data on the System is shown in the tables contained in Section J. In addition, Tables 9 through 12 of Section I contain certain actuarial trend information which may be of interest.

Table 9 relates the size of the unfunded actuarial accrued liability (UAAL) to three different measurements. In Columns 3 and 4 the UAAL is related to the covered payroll of the System. Columns 5 and 6 relate the UAAL to the actuarial value of assets, while Columns 7 and 8 relate the UAAL to the total actuarial liabilities of the System.

Tables 10 through 12 provide information which should be included in your annual report. Table 10 provides a schedule of active member valuation data. Table 11 provides a schedule of retirants and beneficiaries added to and removed from payments rolls. Solvency test results are presented in Table 12.

GASB NO. 25 DISCLOSURE

The Governmental Accounting Standards Board (GASB) has issued Statement No. 25 which provides the manner in which the actuarial condition of a public sector retirement plan is to be disclosed. COA ERS was required to comply with GASB No. 25 beginning January 1, 1997.

The required schedule of funding progress is shown in Table 13a. Table 13b is the schedule of annual required contributions required by GASB No. 25. Table 13c provides notes to the required supplementary information.

Assets used for GASB No. 25 disclosure are based on the actuarial value used for this valuation. Plan liabilities are based on the Entry Age Normal (EAN) funding method which is the same method used for determining plan liabilities for valuation purposes, as required by GASB No. 25.

SUMMARY AND CLOSING COMMENTS

It is our opinion that the results of this valuation provide a reasonable reflection of the funded status of the System. Due to the significant asset losses that occurred in 2000-2002, the System's contributions are not currently sufficient to amortize the unfunded liability of the System. In the absence of significant actuarial gains, the current contribution rates will not be sufficient to support the current benefit structure of the Plan.

As previously mentioned, in 2005 the City of Austin adopted a Supplemental Funding Plan (SFP) which will gradually increase the City's contribution rate to the System to 12.0%. This additional contribution is intended to remain in place until the funding period of the System is reduced to below 30 years. Once this occurs, the City, at its discretion, may reduce the SFP contribution rate to a rate that produces a 30-year funding period.

The overall funded position of the System decreased from 78.0% at the prior valuation to 75.9% at this valuation.

It should also be noted that while the System's funded position declined since the prior valuation, the large asset losses (on a market value basis) from 2000, 2001 and 2002 have been fully recognized and the asset gains from the last four years have generated a net deferred investment gain. In the absence of any other actuarial losses or another turn-around in the financial markets, and with the addition of the SFP, the funded position of the System will most probably increase gradually in the future.

In the absence of significant actuarial losses, the SFP should enable the System to return to a position in the not too distant future where the contributions to the System produce a funding period over which the unfunded liabilities can be amortized. Based on deterministic projections it is expected that the System may be able to reduce its funding period to 30 years by the December 31, 2013 valuation.

ACTUARIAL TABLES

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 1

SUMMARY OF COST ITEMS

	December 31, 2006		December 31, 2005	
	Cost Item	Cost as % of Pay	Cost Item	Cost as % of Pay
	(1)	(2)	(3)	(4)
1. Participants				
a. Active	8,055		7,638	
b. Terminated vested	714		670	
c. Retired participants and beneficiaries	3,402		3,233	
d. Disabled	65		64	
e. Total	12,236		11,605	
2. Covered Payroll	$ 390,963,991		$ 348,619,141	
3. Averages for Active Participants				
a. Average age	43.5		43.5	
b. Average years of service	8.9		9.1	
c. Average pay	$ 48,537		$ 45,643	
4. Employer Normal Cost	$ 58,561,801	14.57% *	$ 52,387,124	14.56% *
5. Actuarial Accrued Liability				
a. Active participants	$ 1,023,110,623		$ 899,281,397	
b. Terminated vested participants	39,696,189		39,547,196	
c. Refunds of terminated nonvested participants	7,037,727		7,167,430	
d. Retired participants and beneficiaries	896,205,243		839,612,626	
e. Disabled participants	7,960,836		8,573,026	
f. Total	$ 1,974,010,618	504.91%	$ 1,794,181,675	514.65%
6. Present Actuarial Assets	$ 1,497,783,958	383.10%	$ 1,398,798,722	401.24%
7. Unfunded Actuarial Accrued Liability (UAAL)	$ 476,226,660	121.81%	$ 395,382,953	113.41%
8. Relative Size of UAAL				
a. As percent of actuarial assets	31.80%		28.27%	
b. As percent of covered payroll	121.81%		113.41%	
9. GASB Annual Required Contribution (ARC)	13.85%		13.34%	

* as % of expected payroll

GABRIEL ROEDER SMITH & COMPANY

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 2

ANALYSIS OF NORMAL COST BY COMPONENT

	Cost as % of Pay	
Benefit Component	December 31, 2006	December 31, 2005
(1)	(2)	(3)
1. Retirement Benefits	10.24%	10.19%
2. Termination - Deferred Benefits	1.68%	1.75%
3. Terminations - Refund Benefits	2.01%	1.96%
4. Disability Benefits	0.24%	0.30%
5. Death Benefits	0.40%	0.36%
6. Normal Cost	14.57%	14.56%

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 3

ACTUARIAL PRESENT VALUE OF FUTURE BENEFITS AND CALCULATION OF ACTUARIAL ACCRUED LIABILITY

	December 31, 2006 (1)	December 31, 2005 (2)
A. Present Value of Future Benefits		
1. Active participants		
a. Retirement benefits	$ 1,251,241,155	$ 1,091,723,069
b. Terminations - deferred benefits	114,871,984	104,892,781
c. Terminations - refund benefits	34,764,396	32,722,568
d. Disability benefits	14,357,652	17,189,445
e. Death benefits	30,766,689	23,256,166
f. Total	$ 1,446,001,876	$ 1,269,784,029
2. Retired participants		
a. Service retirements and beneficiaries	$ 896,205,243	$ 839,612,626
b. Disability retirements	7,960,836	8,573,026
c. Total	$ 904,166,079	$ 848,185,652
3. Inactive participants		
a. Vested terminations with deferred benefits	$ 39,696,189	$ 39,547,196
b. Nonvested terminations with refunds payable	7,037,727	7,167,430
c. Total	$ 46,733,916	$ 46,714,626
4. Total actuarial present value of future benefits	$ 2,396,901,871	$ 2,164,684,307
B. Present Value of Future Pay	$ 2,903,695,664	$ 2,549,479,041
C. Normal Cost Rate	14.57%	14.56%
D. Present Value of Future Normal Costs	$ 422,891,253	$ 370,502,632
E. Actuarial Accrued Liability for Active Members		
1. Present value of future benefits (Item A.1.f.)	$ 1,446,001,876	$ 1,269,784,029
2. Less present value of future normal costs (Item D)	422,891,253	370,502,632
3. Actuarial accrued liability	$ 1,023,110,623	$ 899,281,397
F. Total Actuarial Accrued Liability (Item A.2.c + Item A.3.c + Item E.3)	$ 1,974,010,618	$ 1,794,181,675

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 4

DEVELOPMENT OF ACTUARIAL VALUE OF ASSETS

Item	Valuation as of December 31, 2006
(1)	(2)
1. Excess (shortfall) of investment income for current year and previous three years (see Table 5):	
a. Current year	$ 65,927,379
b. Current year - 1	10,996,163
c. Current year - 2	47,286,825
d. Current year - 3	164,524,777
e. Current year - 4	(205,130,274)
2. Deferral of excess (shortfall) of investment income for:	
a. Current year (80% deferral)	$ 52,741,903
b. Current year - 1 (60% deferral)	6,597,698
c. Current year - 2 (40% deferral)	18,914,730
d. Current year - 3 (20% deferral)	32,904,955
e. Current year - 4 (0% deferral)	0
f. Total deferred for year	$ 111,159,286
3. Market value of plan assets, end of year	$ 1,608,943,244
4. Preliminary actuarial value of plan assets, end of year (Item 3 - Item 2.f)	$ 1,497,783,958
5. Actuarial value of assets corridor	
a. 80% of market value of assets, end of year	$ 1,287,154,595
b. 120% of market value of assets, end of year	$ 1,930,731,893
6. Final actuarial value of plan assets, end of year (Item 4, but not less than Item 5.a., or greater than Item 5.b.)	$ 1,497,783,958

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 5

CALCULATION OF EXCESS INVESTMENT INCOME FOR ACTUARIAL VALUE OF ASSETS

Item	Plan Year Ending December 31, 2006	2005	2004	2003	2002
(1)	(2)	(3)	(4)	(5)	(6)
1. Net Investment Income					
a. Interest and Dividends	$ 41,758,402	$ 35,680,424	$ 32,165,731	$ 30,655,364	$ 32,348,029
b. Realized and unrealized gains and losses*	138,193,429	82,473,867	113,465,673	215,414,069	(145,341,052)
c. Administrative expenses	(1,670,792)	(1,497,461)	(1,554,864)	(1,552,770)	(1,641,675)
d. Total	$ 178,281,039	$ 116,656,830	$ 144,076,540	$ 244,516,663	$ (114,634,698)
2. Market value of assets, beginning of year	$ 1,460,751,603	$ 1,375,016,657	$ 1,259,556,169	$ 1,042,376,123	$ 1,172,088,538
3. Contributions during year	$ 66,336,402	$ 60,463,857	$ 59,213,119	$ 55,356,622	$ 60,166,320
4. Benefits and refunds paid during year	$ (96,425,800)	$ (91,385,741)	$ (87,814,171)	$ (82,693,239)	$ (75,244,037)
5. Other	$ -	$ -	$ (15,000)	$ -	$ -
6. Expected net investment income at	7.75%	7.75%	7.75%	7.75%	7.75%
a. Market value of assets, beginning of year	$ 113,208,249	$ 106,563,791	$ 97,615,603	$ 80,784,150	$ 90,836,862
b. Contributions	2,570,536	2,342,974	2,294,508	2,145,069	2,331,445
c. Benefits and refunds	(3,425,125)	(3,246,098)	(3,119,233)	(2,937,333)	(2,672,731)
d. Other	-	-	(1,163)	-	-
e. Total	$ 112,353,660	$ 105,660,667	$ 96,789,715	$ 79,991,886	$ 90,495,576
7. Excess investment income for year (Item 1.d. - Item 6.e.)	$ 65,927,379	$ 10,996,163	$ 47,286,825	$ 164,524,777	$ (205,130,274)

*Includes investment expenses

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 6

CHANGE IN NET ASSETS

		Valuation Period Ending December 31,	
		2006	2005
		(1)	(2)
1.	Assets in plan at beginning of year **(A)**	$ 1,460,751,603	$ 1,375,016,657
2.	Employer contributions	30,545,197	27,129,891
3.	Employee contributions	35,791,205	33,333,966
4.	Benefit payments made*	92,229,469	87,610,699
5.	Refunds of contributions	4,196,331	3,775,042
6.	Expenses paid from trust	1,670,792	1,497,461
7.	Investment return	179,951,831	118,154,291
8.	Other	-	0
9.	Assets in plan at end of year **(B)** (1 + 2 + 3 - 4 - 5 - 6 + 7 + 8)	$ 1,608,943,244	$ 1,460,751,603
10.	Approximate rate of return on average invested assets		
	a. Net investment income (7 - 6 = **I**)	$ 178,281,039	$ 116,656,830
	b. Estimated yield based on **(2I/(A + B - I))**	12.33%	8.58%

*Note: Benefit payments exclude any distributions from the 415 Restoration Plan

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 7

ACTUAL VERSUS EXPECTED ACTUARIAL ASSETS

Item	Plan Year Ending December 31, 2006	Plan Year Ending December 31, 2005
(1)	(2)	(3)
1. Actuarial assets, beginning of year	$ 1,398,798,722	$ 1,356,797,448
2. Contributions during year	$ 66,336,402	$ 60,463,857
3. Benefits paid during year	$ (92,229,469)	$ (87,610,699)
4. Refunds paid during year	$ (4,196,331)	$ (3,775,042)
5. Other	$ 0	$ 0
6. Assumed net investment income at	7.75%	7.75%
a. Beginning of year assets	$ 108,406,901	$ 105,151,802
b. Contributions	2,570,536	2,342,974
c. Benefits	(3,276,068)	(3,112,005)
d. Refunds	(149,057)	(134,093)
e. Other	0	0
f. Total	$ 107,552,312	$ 104,248,678
7. Expected actuarial assets, end of year (Sum of Items 1 through 6)	$ 1,476,261,636	$ 1,430,124,242
8. Actuarial assets, end of year	$ 1,497,783,958	$ 1,398,798,722
9. Asset gain/(loss) (Item 8 - Item 7)	$ 21,522,322	$ (31,325,520)

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 8

ACTUARIAL GAIN OR LOSS AS OF DECEMBER 31, 2006

CALCULATION OF TOTAL ACTUARIAL GAIN OR LOSS	2006	2005
1. Unfunded actuarial accrued liability (UAAL) as of prior year	$ 395,382,953	$ 321,383,795
2. Actual normal cost paid during year	53,907,645	48,799,891
3. Subtotal (1 + 2)	$ 449,290,598	$ 370,183,686
4. Interest at prior valuation's rate of 7.75%	32,731,100	26,798,240
5. Contributions during year	(66,336,402)	(60,463,857)
6. Interest on contributions for one-half year	(2,570,536)	(2,342,974)
7. Expected UAAL as of December 31st, (3 + 4 + 5 + 6)	$ 413,114,760	$ 334,175,095
8. Actual UAAL as of December 31st	476,226,660	395,382,953
9. Actuarial gain/(loss) for the period (7 - 8)	$ (63,111,900)	$ (61,207,858)
SOURCE OF GAINS AND LOSSES		
10. Asset gain/(loss) (See Table 7)	$ 21,522,322	$ (31,325,520)
11. Total liability gain/(loss) for the period (9-10)	(84,634,222)	(29,882,338)
12. Gain/(loss) due to benefit enhancements	0	0
13. Gain/(loss) due to retiree ad hoc increases	0	0
14. Gain/(loss) due to assumption changes	(22,494,462)	0
15. Liability experience gain/(loss) (11 - 12 - 13 - 14)	$ (62,139,760)	$ (29,882,338)
SOURCE OF LIABILITY GAINS AND LOSSES		
16. Salary Increases	$ (42,803,967)	$ (10,557,053)
17. Service Retirement	3,116,296	(1,827,746)
18. Withdrawal	(9,889,569)	(11,211,947)
19. Disability Retirement	(374,341)	(305,147)
20. Active Mortality	(32,757)	195,910
21. Retiree Mortality	1,647,599	4,002,949
22. New Entrants	(6,740,544)	(7,026,336)
23. Other (Data)	(7,062,477)	(3,152,968)
24. Total Liability Experience Gain/(Loss)	$ (62,139,760)	$ (29,882,338)

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 9

RELATIVE SIZE OF UNFUNDED ACTUARIAL ACCRUED LIABILITY

		Relative to Covered Payroll		Relative to Actuarial Value of Present Assets		Relative to Total Actuarial Accrued Liability	
Valuation as of December 31	Unfunded/ (Overfunded) Actuarial Accrued Liability	Covered Payroll	Percent of Covered Payroll	Present Assets	Percent of Present Assets	Actuarial Accrued Liability	Percent of Actuarial Accrued Liability
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1990	(38,568,183)	$ 171,738,189	(22.5%)	$ 410,546,517	(9.6%)	$ 362,978,334	(10.6%)
1991	(66,275,489)	194,588,280	(34.1%)	470,664,195	(14.1%)	404,388,706	(16.4%)
1993	(37,919,161)	235,227,565	(16.1%)	579,092,507	(6.5%)	541,173,346	(7.0%)
1995	(84,343,636)	221,001,903	(38.2%)	707,317,679	(11.9%)	622,974,043	(13.5%)
1997	(24,282,232)	219,207,826	(11.1%)	856,422,516	(2.8%)	832,140,284	(2.9%)
1998	(74,816,812)	219,326,742	(34.1%)	952,634,480	(7.9%)	877,817,668	(8.5%)
1999	(60,632,797)	244,538,110	(24.8%)	1,105,121,657	(5.5%)	1,044,488,860	(5.8%)
2000	(18,353,201)	268,635,564	(6.8%)	1,230,971,746	(1.5%)	1,212,618,545	(1.5%)
2001	48,980,941	316,793,390	15.5%	1,311,288,668	3.7%	1,360,269,609	3.6%
2002	189,347,298	322,007,672	58.8%	1,250,851,348	15.1%	1,440,198,646	13.1%
2003	203,040,300	312,790,966	64.9%	1,348,790,502	15.1%	1,551,830,802	13.1%
2004	321,383,795	326,590,164	98.4%	1,356,797,448	23.7%	1,678,181,243	19.2%
2005	395,382,953	348,619,141	113.4%	1,398,798,722	28.3%	1,794,181,675	22.0%
2006	476,226,660	390,963,991	121.8%	1,497,783,958	31.8%	1,974,010,618	24.1%

GABRIEL ROEDER SMITH & COMPANY

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 10

SCHEDULE OF ACTIVE MEMBER VALUATION DATA

Year Ending December 31	Active Participants	Covered Payroll	Average Salary	Percent Increase
(1)	(2)	(3)	(4)	(5)
1990	6,626	$171,738,189	$25,918	4.9%*
1991	6,968	194,588,280	27,926	7.7%
1993	7,761	235,227,565	30,309	4.2%*
1995	7,190	221,001,903	30,737	0.7%*
1997	6,798	219,207,826	32,246	2.4%*
1998	6,311	219,326,742	34,753	7.8%
1999	6,512	244,538,110	37,552	8.1%
2000	6,894	268,635,564	38,967	3.8%
2001	7,713	316,793,390	41,073	5.4%
2002	7,647	322,007,672	42,109	2.5%
2003	7,432	312,790,966	42,087	-0.1%
2004	7,489	326,590,164	43,609	3.6%
2005	7,638	348,619,141	45,643	4.7%
2006	8,055	390,963,991	48,537	6.3%

* Average annual increase/(decrease) over two-year period.

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 11

SCHEDULE OF RETIRANTS AND BENEFICIARIES ADDED TO AND REMOVED FROM ROLLS

	Added to Rolls		Removed from Rolls		Rolls-End of Year			
Year Ending December 31	Number	Annual Allowances	Number	Annual Allowances	Number	Annual Allowances	% Increase in Annual Allowances	Average Annual Allowances
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1995	279	$ 4,787,640	88	$ 1,214,255	1,654	$ 27,032,976	16.4%*	$ 16,344
1997	328	7,714,560	105	1,192,120	1,877	38,989,044	20.1%*	20,772
1998	243	5,409,180	25	830,604	2,095	43,567,620	11.7%	20,796
1999	259	10,757,697	57	1,152,275	2,297	53,097,238	21.9%	23,116
2000	241	5,552,629	75	1,403,412	2,463	60,817,825	14.5%	24,693
2001	224	5,278,490	95	2,046,233	2,592	65,647,094	7.9%	25,327
2002	309	7,754,803	118	2,534,050	2,783	72,520,159	10.5%	26,058
2003	271	7,706,066	59	1,502,757	2,995	78,596,302	8.4%	26,243
2004	227	5,619,478	85	1,741,624	3,137	82,121,249	4.5%	26,178
2005	258	6,699,023	98	2,438,555	3,297	85,324,686	3.9%	25,879
2006	259	6,788,190	89	1,883,938	3,467	90,312,037	5.8%	26,049

* Average annual increase/(decrease) over two-year period.

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 12

SOLVENCY TEST

	Aggregated Accrued Liabilities for				Portions of Accrued Liabilities Covered by Reported Assets		
Valuation Date	Active and Inactive Members Contributions	Retirees and Beneficiaries	Active and Inactive Members (Employer Financed Portion)	Reported Assets	(5)/(2)	[(5)-(2)]/3	[(5)-(2)-(3)]/(4)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
December 31, 1995	169,715,854	281,857,452	171,400,737	707,317,679	100.0%	100.0%	100.0%
December 31, 1997	157,311,099	385,407,128	289,422,057	856,422,516	100.0%	100.0%	100.0%
December 31, 1998	178,757,374	442,732,833	256,327,461	952,634,480	100.0%	100.0%	100.0%
December 31, 1999	230,542,295	536,835,240	277,111,325	1,105,121,657	100.0%	100.0%	100.0%
December 31, 2000	221,908,346	629,257,941	361,452,258	1,230,971,746	100.0%	100.0%	100.0%
December 31, 2001	248,579,180	654,307,118	457,383,311	1,311,288,668	100.0%	100.0%	89.3%
December 31, 2002	265,812,595	718,187,586	456,198,465	1,250,851,348	100.0%	100.0%	58.5%
December 31, 2003	252,182,701	777,100,825	522,547,276	1,348,790,502	100.0%	100.0%	61.1%
December 31, 2004	261,905,526	812,266,336	604,009,381	1,356,797,448	100.0%	100.0%	46.8%
December 31, 2005	280,994,642	848,185,652	665,001,381	1,398,798,722	100.0%	100.0%	40.5%
December 31, 2006	295,166,238	904,166,079	774,678,301	1,497,783,958	100.0%	100.0%	38.5%

GABRIEL ROEDER SMITH & COMPANY

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 13a

SCHEDULE OF FUNDING PROGRESS
(As required by GASB #25)

Valuation Date	Actuarial Value of Assets (AVA)	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL) (3) - (2)	Funded Ratio (2)/(3)	Annual Covered Payroll	UAAL as % of Payroll (4)/(6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
December 31, 1990	$ 410.5	$ 363.0	$ (38.6)	113.1%	$ 171.7	(22.5%)
December 31, 1991	470.7	404.4	(66.3)	116.4%	194.6	(34.1%)
December 31, 1993	579.1	541.2	(37.9)	107.0%	235.2	(16.1%)
December 31, 1995	707.3	623.0	(84.3)	113.5%	221.0	(38.2%)
December 31, 1997	856.4	832.1	(24.3)	102.9%	219.2	(11.1%)
December 31, 1998	952.6	877.8	(74.8)	108.5%	219.3	(34.1%)
December 31, 1999	1,105.1	1,044.5	(60.6)	105.8%	244.5	(24.8%)
December 31, 2000	1,231.0	1,212.6	(18.4)	101.5%	268.6	(6.8%)
December 31, 2001	1,311.3	1,360.3	49.0	96.4%	316.8	15.5%
December 31, 2002	1,250.9	1,440.2	189.3	86.9%	322.0	58.8%
December 31, 2003	1,348.8	1,551.8	203.0	86.9%	312.8	64.9%
December 31, 2004	1,356.8	1,678.2	321.4	80.8%	326.6	98.4%
December 31, 2005	1,398.8	1,794.2	395.4	78.0%	348.6	113.4%
December 31, 2006	1,497.8	1,974.0	476.2	75.9%	391.0	121.8%

Note: Dollar amount in millions.

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 13b

SCHEDULE OF EMPLOYER CONTRIBUTIONS
(as required by GASB #25)

Fiscal Year (1)	Annual Required Contribution (2)	Percentage Contributed (3)
1992	$14,266,156	100.00%
1993	$15,653,339	100.00%
1994	$17,005,695	100.00%
1995	$16,983,178	100.00%
1996	$15,738,068	100.00%
1997	$15,313,819	100.00%
1998	$16,126,014	100.00%
1999	$18,224,558	100.00%
2000	$21,531,859	100.00%
2001	$24,831,016	100.00%
2002	$26,375,274	100.00%
2003	$30,660,538	81.05%
2004	$32,733,243	82.30%
2005	$41,610,470	65.20%
2006	$49,390,658	61.84%

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006 **TABLE 13c**

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

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

Valuation Date	December 31, 2006
Actuarial cost method	Entry Age Normal
Amortization method	Level Percent of Pay, open
Payroll growth rate for amortization	3.50%
Remaining amortization period	30 years
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rate of return*	7.75%
Projected salary increases	5.00% to 6.00%
*Includes inflation at	3.25%
Cost-of-living adjustments	None assumed

STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS
(Effective as of December 31, 2006)

A. ACTUARIAL ASSUMPTIONS

1. Investment Return Rate (adopted effective December 31, 2002)

   7.75% per annum, compounded annually.

2. Mortality

   a. Nondisabled (adopted effective December 31, 1997)

      Rate of Decrement: 1994 Group Annuity Mortality Table for males and females. No age setbacks.

   b. Disabled (adopted effective December 31, 2002)

      Mortality tables from Revenue Ruling 96-7 for males and females disabled after December 31, 1994. No age setbacks.

	Rates of Mortality					
	Nondisabled					
	Rate of Decrement		Post-Retirement		Disabled	
Age	Male	Female	Male	Female	Male	Female
20	.000507	.000284	.000507	.000284	.024583	.009650
25	.000661	.000291	.000661	.000291	.027457	.011974
30	.000801	.000351	.000801	.000351	.030661	.014843
35	.000851	.000478	.000851	.000478	.034184	.017654
40	.001072	.000709	.001072	.000709	.038373	.020579
45	.001578	.000973	.001578	.000973	.043033	.023988
50	.002579	.001428	.002579	.001428	.048004	.027961
55	.004425	.002294	.004425	.002294	.053120	.032594
60	.007976	.004439	.007976	.004439	.058118	.037993
65	.014535	.008636	.014535	.008636	.063669	.044287
70	.023730	.013730	.023730	.013730	.073284	.051331

STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS
(EFFECTIVE AS OF December 31, 2006)
(Continued)

3. Retirement Rates: (adopted effective December 31, 2006)
   The following rates of retirement are assumed for members eligible to retire.

Age	Rates of Retirement	
	Males	Females
45 & under	35.0%	35.0%
46	35.0%	27.5%
47	35.0%	27.5%
48	40.0%	27.5%
49	40.0%	27.5%
50	40.0%	27.5%
51	40.0%	27.5%
52	35.0%	27.5%
53	35.0%	27.5%
54	35.0%	27.5%
55	35.0%	35.0%
56	27.5%	35.0%
57	27.5%	35.0%
58	27.5%	35.0%
59	27.5%	35.0%
60	27.5%	40.0%
61	27.5%	25.0%
62	30.0%	40.0%
63	25.0%	32.5%
64	25.0%	25.0%
65	40.0%	30.0%
66	25.0%	25.0%
67	25.0%	20.0%
68	20.0%	20.0%
69	20.0%	20.0%
70 & older	100.0%	100.0%

STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS (EFFECTIVE AS OF December 31, 2006) (Continued)

4. Rates of Decrement Due to Withdrawal (adopted effective December 31, 1997)

Males

	Years of Service					
Age	0	1	2	3	4	5+
25	0.2214	0.1936	0.1860	0.1568	0.1402	0.0923
30	0.2013	0.1760	0.1691	0.1425	0.1274	0.0839
35	0.1915	0.1674	0.1491	0.1171	0.1002	0.0680
40	0.1736	0.1518	0.1296	0.1008	0.0883	0.0529
45	0.1570	0.1372	0.1158	0.0925	0.0844	0.0385
50	0.1444	0.1263	0.1100	0.0912	0.0837	0.0268
55	0.1368	0.1196	0.1123	0.0958	0.0835	0.0208
60	0.1406	0.1229	0.1216	0.1053	0.0835	0.0233

Females

	Years of Service					
Age	0	1	2	3	4	5+
25	0.2181	0.2038	0.1956	0.1873	0.1281	0.1256
30	0.2118	0.1980	0.1899	0.1818	0.1233	0.1130
35	0.2105	0.1968	0.1837	0.1567	0.1079	0.0827
40	0.1939	0.1812	0.1649	0.1394	0.0990	0.0649
45	0.1728	0.1615	0.1495	0.1309	0.0990	0.0594
50	0.1454	0.1359	0.1341	0.1251	0.1004	0.0546
55	0.1399	0.1333	0.1269	0.1168	0.1067	0.0560
60	0.1478	0.1408	0.1340	0.1289	0.1238	0.0596

STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS
(EFFECTIVE AS OF December 31, 2006)
(Continued)

5. Disability Rates* (adopted effective December 31, 1997)

Sample rates are shown below:

Age	Rates of Decrement Due to Disability All Participants
20	.00014
25	.00019
30	.00031
35	.00052
40	.00092
45	.00209
50	.00379
55	.00490
60	.00911

* Rates are for disability due to all causes, occupational disability rates are assumed to be 10% of all causes rates.

6. Rates of Salary Increase (adopted effective December 31, 2006)

Years of Service	Promotional Rate of Increase	Total Annual Rate of Increase Including 3.25% Inflation Component and 1.75% Productivity Component
1 – 8	1.00%	6.00%
9	0.75%	5.75%
10	0.50%	5.50%
11 - 19	0.25%	5.25%
20 or more	0.00%	5.00%

STATEMENT OF ACTUARIAL METHODS AND ASSUMPTIONS
(EFFECTIVE AS OF December 31, 2006)
(Continued)

7. DROP Participation: (adopted effective December 31, 2002)

   It was assumed that 20% of retiring active members with at least 20 years of service would elect a "Back-end" DROP.

8. Married Percentage: (adopted effective December 31, 1997)

   100% of the active members are assumed to be married. Spouses are assumed to be the same age as the member.

9. Normal Form of Payment: (adopted effective December 31, 1997)

   It is assumed that all retiring members will elect the Life only form of payment.

10. Interest Crediting Rate on Employee Contributions: (adopted effective December 31, 2002)

    It is assumed that the interest credit rate on employee contributions will be 6.0%.

11. Payroll Growth Rate: (adopted December 31, 2002)

    It is assumed that payroll will grow at 3.50% annually.

B. ACTUARIAL VALUE OF ASSETS

The actuarial value of assets is equal to the market value of assets less a five-year phase in of the Excess (Shortfall) between expected investment return and actual income with the resulting value not being less than 80% or more than 120% of the market value of assets.

C. ACTUARIAL FUNDING METHOD

The funding period required to amortize the unfunded actuarial accrued liability is determined using the entry-age normal actuarial cost method. This method assigns the System's total actuarial present value of future benefits to various periods. The actuarial accrued liability is assigned to years prior to the valuation, the normal cost is assigned to the year following the valuation. The remaining costs are assigned to future years.

The normal cost is determined on an individual basis. The actuarial accrued liability is the difference between the total present value of future benefits and the actuarial present value of future normal costs. The unfunded actuarial accrued liability is the excess of the actuarial accrued liability over the actuarial value of assets.

SUMMARY OF BENEFIT PROVISIONS
OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2006

A. EFFECTIVE DATE

January 1, 1941.

B. ELIGIBILITY AND PARTICIPATION

Any regular and permanent employee of the City of Austin, excluding all civil service commissioned police officers and firefighters, the Mayor and members of the City Council and all part-time employees who work less than 75 percent of a normal work week.

C. MEMBERSHIP SERVICE

The period of time during which an eligible employee pays into and keeps on deposit the contribution prescribed to be paid by the employee into the System.

D. AVERAGE FINAL COMPENSATION

The average of the monthly compensation up to $16,666 ($12,500 for persons who first become members after 1995), for the 36 calendar months of highest compensation during the last 120 months prior to termination.

E. MEMBER AND EMPLOYEE CONTRIBUTION RATES:

The City currently contributes 8.00% of pay for each active member. Each active member contributes 8.00% of pay. These contributions are made under a pre-tax 401(h) pick-up arrangement.

F. RETIREMENT BENEFITS

1. Normal Retirement

    a. Eligibility: A participant may retire upon attaining age 62, or 23 years of service, or attaining age 55 with 20 years of service.

    b. Monthly Benefit: 3.00% of average final compensation times years of service.

    c. Payment Form: Benefits are paid as a monthly life annuity to the participant, with a provision that should the participant die prior to receiving monthly payments whose sum is greater than or equal to the participant's accumulated employee contributions, then the participant's beneficiary shall receive a lump-sum equal to the excess of the participant's accumulated employee contributions with interest over the sum of the monthly payments received.

SUMMARY OF BENEFIT PROVISIONS
OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2006
(Continued)

d. Optional Forms of Payment:

i) Joint and contingent annuity with either 100%, 66 2/3%, or 50% of the reduced retirement income payable for the life of the contingent annuitant upon the death of the retiring participant, with the provision that, should the contingent annuitant predecease the participant, the monthly annuity will revert to the amount that would have been payable under the normal form of payment,

ii) Joint and 66 2/3% last survivor provides a reduced retirement income payable as long as both the member and the joint annuitant are alive, and upon the death of either the member or the joint annuitant, the benefit reduces to 2/3 of such amount for the remainder of the life of the last survivor,

iii) Period certain and life annuity with 15 years of payments guaranteed, or

iv) Life annuity with modified cash refund.

e. Deferred Retirement Option Program (DROP): A member may elect to retroactively participate in the System's DROP (i.e. a Back End DROP). The member would receive a lump-sum payment equal to 90% of the sum of the monthly annuities the participant would have received if the member had retired at the DROP entry date. No COLAs are included but changes in the benefit multiplier are reflected.

2. Early Retirement: Currently there are no reduced retirement benefits under the plan. See Normal Retirement.

G. DISABILITY RETIREMENT

1. Eligibility: If the employee is terminated by reason of a total and permanent disability which prevents the employee from engaging in any substantial gainful employment. If the employee has less than five years of service, the disability must be job related.

2. Monthly Benefit: Same as Normal Retirement benefit using pay and service at date of disability.

3. Form of Payment: The normal form of payment that is available to a member taking normal retirement and the optional forms of payments described in F.1.d.i) and F.1.d.ii) above.

SUMMARY OF BENEFIT PROVISIONS OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2006 (Continued)

H. VESTING OF BENEFITS

1. Vesting

An employee is vested according to the following schedule:

Years of Vesting Service	Vested Percentage
Less than 5	0%
5 or more	100%

2. Benefits Upon Vesting

A vested participant is entitled to the retirement benefit payable at normal retirement earned to the date of participant's termination multiplied by his/her vested percentage, or a refund of the employee's accumulated employee contributions with interest.

I. DEATH IN SERVICE

1. Eligibility: All active members.

2. Benefit: The amount of the benefit payable to the beneficiary is:

a. Employee eligible for retirement at date of death:

The surviving spouse if any may elect to receive an annuity equal to the monthly benefit as if the member had retired under any retirement option that would have been available to the member at the end of the month in which the member died. If there is no surviving spouse, then the beneficiary may elect to receive a 15 years certain and life annuity. The surviving spouse or beneficiary instead of electing the annuity may elect to receive a benefit equal to twice the member's accumulated employee contributions with interest.

b. Employee not eligible for retirement at date of death:

A benefit equal to twice the member's accumulated employee contributions with interest.

SUMMARY OF BENEFIT PROVISIONS OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2006 (Continued)

J. RETIREE LUMP-SUM DEATH BENEFIT

Upon death of a retired member, a $10,000 lump-sum death benefit is payable. This benefit is also payable upon the death of an active member eligible for retirement whose surviving spouse or beneficiary elects to receive an annuity.

K. COST-OF-LIVING ADJUSTMENT (COLA)

On January 1 of each year the Board may approve a cost-of-living increase for those retirees who retired on or before December 31 of the previous year. The maximum increase which can be approved is 6%. The amount of the increase is set by the Board upon recommendation by the System's actuary that such an increase will not make the Fund financially unsound, and the adjustment is not inconsistent with the Code. The increase is prorated for any benefit which has been in effect for less than a year, with the proration being 1/12 for each monthly payment received during the prior year.

L. LUMP-SUM ADDITIONAL BENEFIT PAYMENT

Once each year the Board may approve a lump-sum additional benefit payment to be paid to those members currently in payment status. The additional payment would be equal to a percentage of the member's monthly annuity with a maximum percentage of 100%.

M. LEGISLATED PLAN CHANGES ENACTED BY 1995 LEGISLATURE

1. 2.3% Multiplier

   The benefit multiplier was increased from 2.2% per year of service to 2.3% per year of service effective October 1995.

2. 2.3% Retiree Gross-up

   Effective October 1995, current retirees received an increase in their benefit amount to bring their retirement benefit amount up to what it would be currently if they had retired under the 2.3% multiplier.

SUMMARY OF BENEFIT PROVISIONS OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2006 (Continued)

3. $10,000 Retiree Lump-Sum Death Benefit

   The lump-sum death benefit payable upon the death of a retiree was increased from $2,000 to $10,000.

4. Plan Participation Begins at Date of Hire

   The six-month service requirement for participation was eliminated. Current active members were granted service for the period between their date of hire and their date of participation, up to six months.

N. LEGISLATED PLAN CHANGES ENACTED BY 1997 LEGISLATURE

1. 2.6% Multiplier

   The benefit multiplier was increased from 2.3% per year of service to 2.6% per year of service effective October 1997.

2. 2.6% Retiree Gross-up

   Effective October 1997, current retirees received an increase in their benefit amount to bring their retirement benefit amount up to what it would be currently if they had retired under the 2.6% multiplier.

3. Military Service Purchase

   Increased the number of months of military service that may be purchased from 24 to 48.

4. Noncontributory Service Purchase

   Allowed an employee to purchase noncontributory service for the following periods of time: (1) while employee was on workers' compensation leave, (2) while employee was on an authorized leave of absence, and (3) while employee performed service for the employer in a position for which the service was not otherwise creditable. The employee pays the full actuarial cost of the service purchase.

SUMMARY OF BENEFIT PROVISIONS OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2006 (Continued)

5. Employer Purchase of Unreduced Retirement Eligibility

   Allowed the employer to purchase the amount of service required to qualify an employee for an unreduced retirement benefit at age 55. To be eligible for the purchase, the employee must never have been a highly compensated employee within the meaning of IRC Section 414(q). The cost of the service purchase is the full actuarial cost of both the benefit and the retirement eligibility.

O. LEGISLATED PLAN CHANGES ENACTED BY 1999 LEGISLATURE

1. 2.7% Multiplier

   The benefit multiplier was increased from 2.6% per year of service to 2.7% per year of service effective October 1999.

2. 2.7% Retiree Gross-up

   Effective October 1999, current retirees received an increase in their benefit amount to bring their retirement benefit amount up to what it would be currently if they had retired under the 2.7% multiplier.

3. 23 & Out Provision

   The service requirement at which a participant may retire with an unreduced retirement benefit was decreased from 25 years of creditable service to 23 years of creditable service.

4. Pop-Up Provisions for Certain Joint and Survivor Payment Options

   Certain optional forms of payment which extend coverage to a joint annuitant (Options I, II, and III) were amended so that, should the contingent annuitant predecease the participant, the monthly annuity will revert to the amount that would have been payable under the normal form of payment.

SUMMARY OF BENEFIT PROVISIONS OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2006 (Continued)

5. LUMP-SUM ADDITIONAL BENEFIT PAYMENT

The Board was given the ability to make an additional payment to members in payment status in the form of a lump-sum additional benefit payment. The additional payment would be a percentage of the current monthly payment with a maximum percentage of 100%.

P. BENEFIT ENHANCEMENTS ENACTED BY THE BOARD OF TRUSTEES IN 2000

1. "415 Restoration of Retirement Income Plan"

Certain highly compensated members may have their retirement annuity limited because of Section 415(b)(1) of the Internal Revenue Code. A plan amendment effective January 1, 2000, provides for COA ERS to pay a benefit payment that exceeds the maximum benefit limitation imposed by the Internal Revenue Code from a separate, non-qualified, pay-as-you-go "Restoration of Retirement Income Plan".

2. 2.98% Multiplier

The benefit multiplier was increased from 2.7% per year of service to 2.98% per year of service effective April 2000.

3. 2.98% Retiree Gross-up

Effective April 2000, current retirees received an increase in their benefit amount to bring their retirement benefit amount up to what it would be currently if they had retired under the 2.98% multiplier.

4. "Pop-up" Benefit Amendment

The "pop-up" benefit is extended to retirees who selected the actuarial equivalent of Life Annuity option with underlying options of I, II, or III.

Q. BENEFIT ENHANCEMENTS ENACTED BY THE BOARD OF TRUSTEES IN 2001

None

SUMMARY OF BENEFIT PROVISIONS OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2006 (Continued)

R. BENEFIT ENHANCEMENTS ENACTED BY THE BOARD OF TRUSTEES IN 2002

1. 3.00%Multiplier

   Benefit multiplier was increased from 2.98% per year of service to 3.00% per year of service effective January 2002.

2. 3.00% Retiree Gross-up

   Effective January 2002, current retirees received an increase in their benefit amount to bring their retirement benefit amount up to what it would be currently if they had retired under the 3.00% multiplier.

3. Deferred Retirement Option Program

   A "Back End" DROP was added as an optional form of retirement effective in 2002. The retiring member may elect to retroactively participate in a DROP. The member would receive a lump-sum payment equal to 90% of the sum of the monthly annuities the participant would have received if the member had retired at the DROP entry date. No COLAs are included but changes in the benefit multiplier are reflected.

4. Purchase of Permissive Time

   A member may purchase up to five years of Permissive Time. The purchase price charged to the member is the anticipated actuarial cost to the System for the additional service. Minimum purchase is one month with a maximum of 60 months (5 years) or the number of months needed to reach first eligibility for retirement whichever is less.

5. Conversion of Unused Sick Leave

   At retirement an employee may elect to purchase Creditable Service for unused sick leave. The Board requires payment by the Member, and then by the City of the equivalent amount of retirement contributions that would have been made had the sick hours been exercised as sick hours. An employee must already be eligible for retirement to purchase the service.

SUMMARY OF BENEFIT PROVISIONS OF THE RETIREMENT PLAN AS OF DECEMBER 31, 2006 (Continued)

S. BENEFIT ENHANCEMENTS ENACTED BY THE BOARD OF TRUSTEES IN 2003

1. “Pop-up” Benefit Amendment

   “Pop-up” benefit was extended to any Joint and Survivor option (including level income options), other than Joint and Last Survivor.

2. Permissive Time Amendment

   Permissive Time resolution was amended removing the provision that restricts members from purchasing Permissive Time in excess of the amount needed to reach first retirement eligibility.

T. BENEFIT ENHANCEMENTS ENACTED BY THE BOARD OF TRUSTEES IN 2004

None

U. BENEFIT ENHANCEMENTS ENACTED BY THE BOARD OF TRUSTEES IN 2005

None

V. BENEFIT ENHANCEMENTS ENACTED BY THE BOARD OF TRUSTEES IN 2006

None

DEFINITION OF TERMS

1. ***Actuarial Cost Method***

   A method for determining the actuarial present value of future benefits and allocating such value to time periods in the form of a normal cost and an actuarial accrued liability.

2. ***Present Value of Future Benefits***

   This is computed by projecting the total future benefit cash flow from the System, using actuarial assumptions, and then discounting the cash flow to the valuation date.

3. ***Normal Cost***

   Computed differently under different actuarial cost methods, the normal cost generally represents the value of the portion of the participant's anticipated retirement, termination, and/or death and disability benefits accrued during a year.

4. ***Actuarial Accrued Liability***

   Computed differently under different actuarial cost methods. Generally actuarial accrued liability represents the value of the portion of the participant's anticipated retirement, termination, and/or death and disability benefits accrued as of the valuation date.

5. ***Entry Age Actuarial Cost Method***

   A method under which a participant's actuarial present value of future benefits is allocated on a level basis over the earnings of the participant between his/her entry into the System and his/her assumed exit.

6. ***Unfunded Actuarial Accrued Liability***

   The difference between total actuarial present value of future benefits over the sum of the tangible assets of the System and the actuarial present value of the members' future normal costs. The System is underfunded if the difference is positive and overfunded if the difference is negative.

7. ***Actuarial Value of Assets***

   The value of cash, investments, and other property belonging to the System, as valued by the actuary for purposes of the actuarial valuation.

DEFINITION OF TERMS
(Continued)

8. ***Actuarial Gain or Loss***

From one valuation to the next, if the experience of the plan differs from that anticipated by the actuarial assumptions, an actuarial gain or loss occurs. For example, an actuarial gain would occur if the assets in the trust had a yield of 12% based on actuarial value, while the assumed yield on the actuarial value of assets was 7.75%.

Statistical Section

STATISTICAL TABLES

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 17

DISTRIBUTION OF ALL ACTIVE PARTICIPANTS BY AGE AND LENGTH OF SERVICE AS OF DECEMBER 31, 2006

Attained Age	0	1	2	3	4	5-9	10-14	15-19	20-24	25-29	30-34	35+	Number of Employees	Average Annual Salary
Under 25	114	51	22	10	1	8	0	0	0	0	0	0	206	29,032
25-29	230	136	64	32	45	129	1	0	0	0	0	0	637	34,293
30-34	181	125	88	53	83	307	64	0	0	0	0	0	901	40,454
35-39	142	105	86	56	77	391	200	70	5	0	0	0	1,132	45,577
40-44	105	80	72	47	56	375	258	155	114	2	0	0	1,264	49,918
45-49	102	76	75	45	51	365	260	241	256	24	1	0	1,496	53,382
50-54	87	51	57	28	46	280	194	187	192	61	4	0	1,187	54,384
55-59	48	33	35	16	30	210	153	140	103	36	13	2	819	55,558
60-64	17	11	9	6	13	102	61	58	39	12	5	2	335	53,222
65 & Over	3	4	5	1	0	15	22	16	8	3	1	0	78	54,552
All Ages	1,029	672	513	294	402	2,182	1,213	867	717	138	24	4	8,055	48,537

GABRIEL, ROEDER, SMITH & COMPANY

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 18

DISTRIBUTION OF ALL ACTIVE PARTICIPANTS BY SERVICE AND CURRENT RATE OF PAY AS OF DECEMBER 31, 2006

Completed Years of Service	Number of Employees	Total Average Salary
0	1,029	$ 37,878
1	672	38,986
2	513	40,735
3	294	43,627
4	402	44,810
5-9	2,182	47,604
10-14	1,213	53,633
15-19	867	58,242
20-24	717	61,805
25-29	138	60,554
30-34	24	70,561
35+	4	65,770
All Years	8,055	$ 48,537

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 19

SCHEDULE OF AVERAGE BENEFIT PAYMENTS, LAST TEN YEARS

	Years Creditable Service						
Retirement Effective Dates	0-4	5-9	10-14	15-19	20-24	25-29	30+
Period 01/01/06 to 12/31/06							
Average monthly benefit	$289	$620	$1,413	$1,826	$2,939	$3,720	$4,854
Average final average salary	$46,003	$39,609	$53,356	$49,024	$55,322	$61,669	$64,402
Number of retired memebers	10	41	15	29	101	24	8

Prior year information not available.

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 20

RETIRED MEMBERS BY TYPE OF BENEFIT (AS OF DECEMBER 31, 2006)

Amount of Monthly Benefit	Number of Retired Members	Type of Retirement [a]				Option Selected [b]									
		1	2	3	4	Unmod.	1	2	3	4	5	6	7	8	9
Deferred						714									
$ 1 - $ 250	74	57	7	1	9	40	25	4	2	0	0	0	3	0	0
251 - 500	154	117	22	10	5	66	55	7	8	4	0	1	13	0	0
501 - 750	201	143	32	11	15	94	62	17	11	1	5	0	9	0	2
751 - 1,000	231	175	37	11	8	91	67	21	18	7	6	11	5	0	5
1,001 - 1,250	210	161	37	8	4	67	59	15	13	7	11	10	10	0	18
1,251 - 1,500	301	249	40	10	2	88	101	26	21	3	22	17	10	0	13
1,501 - 1,750	320	286	28	5	1	89	108	27	21	5	21	17	13	2	17
1,751 - 2,000	315	277	33	5	0	83	102	21	25	3	30	21	5	1	24
Over 2,000	1,661	1,577	78	4	2	391	560	119	117	31	141	133	55	8	106
Total	3,467	3,042	314	65	46	1,723	1,139	257	236	61	236	210	123	11	185

Notes:

[a] Type of retirement:
1-Normal retirement for age and service
2-Beneficiary payment, normal retirement or death in service
3-Disability retirement
4-QDRO - alternate payee

[b] Option selected:
Unmodified Plan: life annuity
The following options reduce the retired member's monthly benefit:
Option 1 - Beneficiary receives 100 percent of member's reduced monthly benefit
Option 2 - Beneficiary receives 50 percent of member's reduced monthly benefit
Option 3 - Beneficiary receives 66-2/3 percent of member's reduced monthly benefit
Option 4 - Survivor receives 66-2/3 percent of member's reduced monthly benefit upon first death
Option 5 - Level income option payable for life of retiree
Option 6 - Level income option, beneficiary receives 66-2/3 percent of member's monthly benefit
Option 7 - Life annuity with 15 years guaranteed
Option 8 - Other participant created actuarial equivalent forms of payment
Option 9 - Level income option, beneficiary receives 100 percent of member's monthly benefit

SCHEDULE OF PARTICIPATING EMPLOYERS

The City of Austin and the City of Austin Employees' Retirement System are the only participating employers in the plan.

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 22

CHANGE IN NET ASSETS, LAST TEN FISCAL YEARS

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Additions										
Member Contributions	$ 16,119	$ 17,121	$ 20,052	$ 23,414	$ 26,238	$ 33,794	$ 30,449	$ 32,272	$ 33,334	$ 35,791
Employer Contributions	15,323	16,126	18,225	21,532	24,831	26,375	24,907	27,008	27,168	30,610
Investment Income (net of expenses)	129,814	138,464	259,255	(20,509)	(78,888)	(112,995)	246,069	145,631	118,154	179,952
Total additions to plan net assets	161,256	171,712	297,531	24,437	(27,819)	(52,826)	301,426	204,911	178,656	246,353
Deductions										
Benefit Payments	33,745	42,908	49,825	59,312	66,013	71,023	77,187	81,426	85,851	90,116
Refunds	6,123	6,423	4,867	4,945	3,991	3,958	4,477	5,112	3,775	4,196
Administrative Expenses	936	1,105	1,133	1,220	1,305	1,642	1,553	1,555	1,497	1,671
Lump-sum Payments						266	1,029	1,343	1,798	2,178
Total deductions from plan net assets	40,805	50,436	55,826	65,477	71,310	76,888	84,246	89,436	92,921	98,161
Change in net assets	$120,451	$121,275	$241,706	$ (41,039)	$ (99,129)	$(129,715)	$217,180	$115,475	$ 85,735	$148,192

Notes: Dollar amounts in thousands
Columns may not add due to rounding
Includes contributions to and benefit payments from 415 Restoration Plan

City of Austin Employees' Retirement System
Actuarial Valuation - December 31, 2006

TABLE 23

BENEFIT AND REFUND DEDUCTIONS FROM NET ASSETS BY TYPE, LAST TEN FISCAL YEARS

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Type of Benefit										
Age and service benefits:										
Retirees [a]	$32,515	$42,094	$48,074	$58,128	$64,598	$70,094	$75,527	$80,152	$84,003	$88,513
Beneficiaries [a]										
Lump-sum payments						$266	$1,029	$1,343	$1,798	$2,178
In service death benefits: [b]	$1,230	$814	$1,752	$1,184	$1,416	$929	$1,660	$1,274	$1,848	$1,603
Disability benefits: [c]										
Type of Refund										
Death [b]										
Separation	$6,123	$6,423	$4,867	$4,945	$3,991	$3,958	$4,477	$5,112	$3,775	$4,196
Total refunds	$6,123	$6,423	$4,867	$4,945	$3,991	$3,958	$4,477	$5,112	$3,775	$4,196

Notes: Dollar amounts in thousands

[a] Segregation of age benefits for beneficiaries not currently available

[b] Segregation of death benefits between refunds and in service death benefits not currently available

[c] Segregation of disability benefits from age and service benefits not currently available

Includes benefit payments from 415 Restoration Plan

Excludes administrative expenses

HISTORY OF CONTRIBUTIONS AND BENEFIT RATES

Year	Employer Contribution Rate	Member Contribution Rate	Interest Paid on Member Deposits	Benefits Multiplier Increase	Cost of Living Increase
1941	4.00%	4.00%	-	1.13%	-
1942	5.00%	-	-	-	-
1943	-	-	-	-	-
1944	-	-	-	-	-
1945	-	-	2.00%	-	-
1946	-	-	2.00%	-	-
1947	-	-	2.00%	-	-
1948	-	-	2.00%	-	-
1949	-	-	2.00%	-	-
1950	-	-	2.00%	-	-
1951	5.00%	5.00%	2.00%	-	-
1952	-	-	2.00%	-	-
1953	-	-	1.91%	-	-
1954	-	-	2.46%	-	-
1955	-	-	2.52%	-	-
1956	-	-	2.60%	-	-
1957	-	-	2.00%	-	-
1958	-	-	2.62%	-	-
1959	-	-	2.79%	-	-
1960	-	-	3.27%	-	-
1961	-	-	2.77%	-	-
1962	-	-	3.65%	-	-
1963	-	-	3.76%	-	-
1964	-	-	3.31%	-	-
1965	-	-	3.25%	-	-
1966	-	-	3.56%	-	-
1967	-	-	3.68%	1.25%	-
1968	-	-	4.25%	-	-
1969	-	-	4.66%	-	-
1970	-	-	4.98%	-	-
1971	6.00%	6.00%	5.43%	1.50%	-
1972	-	-	6.04%	-	-
1973	-	-	6.22%	1.75%	-
1974	-	-	6.33%	-	-
1975	-	-	6.82%	-	-
1976	-	-	6.94%	-	-
1977	-	-	6.51%	-	-
1978	-	-	6.66%	-	-
1979	-	-	7.84%	-	-
1980	-	-	8.01%	-	-
1981	-	-	8.14%	-	-
1982	6.60%	6.60%	8.21%	-	-
1983	-	-	8.39%	-	-
1984	7.00%	7.00%	8.29%	1.85%	-
1985	-	-	8.22%	2.00%	-
1986	-	-	8.00%	-	3.00%
1987	6.20%	6.20%	8.00%	-	1.50%
1988	7.00%	7.00%	8.00%	-	3.00%
1989	-	-	8.00%	-	3.00%
1990	-	-	8.00%	2.10%	3.00%
1991	-	-	6.50%	-	3.00%
1992	-	-	6.00%	-	4.00%
1993	-	-	5.00%	2.20%	3.10%
1994	-	-	6.00%		6.00%
1995	-	-	6.75%	2.30%	6.00%
1996	-	-	6.75%	-	6.00%
1997	-	-	6.75%	2.60%	6.00%
1998	-	-	5.00%	-	5.00%
1999	7.00%	8.00%	6.25%	2.70%	3.00%
2000	8.00%	8.00%	5.75%	2.98%	-
2001	-	-	4.25%	-	3.50%
2002	-	-	3.75%	3.00%	2.50%
2003	-	-	3.75%	-	-
2004	-	-	3.75%	-	-
2005	-	-	4.50%	-	-
2006	-	*9.00%	4.50%	-	-

*Includes subsidy payment from City of Austin as part of Supplemental Funding Plan

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