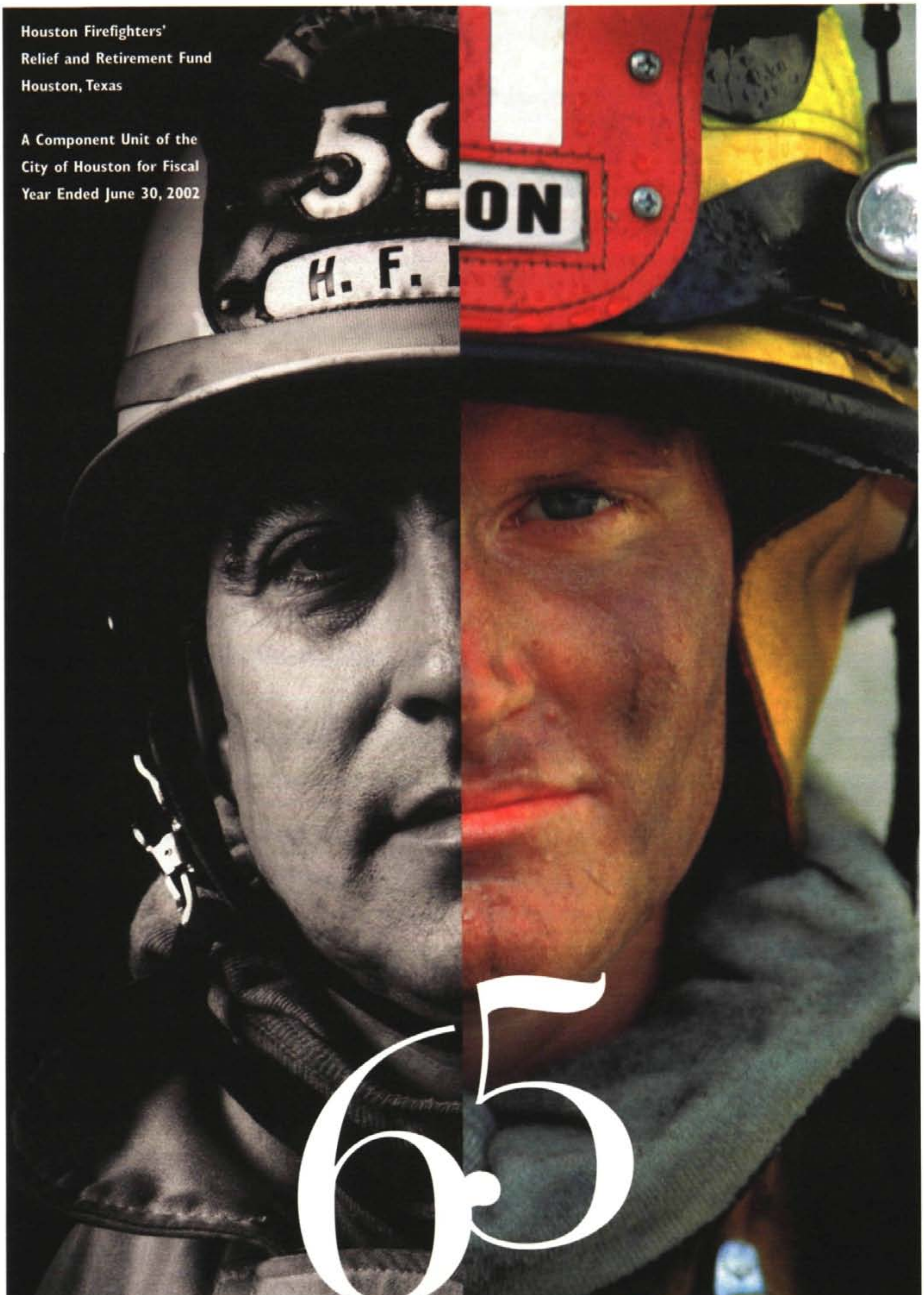
2002 Comprehensive Annual Financial Report

Houston Firefighters' Relief and Retirement Fund
Houston, Texas

A Component Unit of the City of Houston for Fiscal Year Ended June 30, 2002



Years of Solid Performance

Our Vision

Working together as a team, with one mission and one focus to meet our members' retirement needs beyond their expectations.

A Profile of Your Fund

Dedication. Honor. Commitment. Trust. For the past 65 years, the Houston Firefighters' Relief and Retirement Fund has called upon these founding principles to serve its members with the same allegiance they have shown the Houston community. In 1937, the Fund was created to provide steadfast financial futures for firefighters and their families; 51 years later, in 1988, the Fund became the first of three city pension funds to take control of its own management, and, since that time, it has grown in personnel, function, and financial success. Through almost seven decades of change and challenge, one thing has remained constant: the Fund has delivered reliable financial protection for Houston's firefighters, retirees, and their families.

As the Fund celebrates its 65th anniversary, we stop to reflect on the world around us that has evolved so greatly since its inception. At the Fund, advancements in technology have led to innovations in benefit administration that have revolutionized member communications. But though daily office operations are quite different from the way they were back in 1937, the driving force behind them remains steadfast: commitment to the long-term financial security of the Fund's members and their families.

It's taken forward-thinking leadership and solid planning to grow the Fund to its fully funded status over the years. Building from a mere $3,223 in assets in 1937, the Fund's market value totaled $1.6 billion as of June 30, 2002. At this time, the Fund consists of 3,368 active firefighters and 1,774 retirees and beneficiaries. According to state law, each active firefighter contributes 7.7 percent of his or her annual salary to the Fund, with the city matching at least twice that amount, or 15.4 percent.

At the heart of Fund operations through the years has been the Board of Trustees, made up of five active firefighters, one retired firefighter, two citizen members who are Houston residents, the mayor or an appointed representative, and the city treasurer. This experienced team today builds on its rich history of guiding the administrative and investment strategies that govern the Fund's daily operations, as well as overseeing the skilled staff that's been assembled to manage the Fund.

Board of Trustees Report

Members of the Houston Firefighters' Relief and Retirement Fund, Houston, Texas:

Over the past 65 years, the Fund has successfully provided for its members. But perhaps never in its history have events so powerfully impacted the investment market as those of last September. Isn't it all the more remarkable, then, to note that even the volatile economic conditions of the last year have not shaken the rock-solid security of the Fund.

Thanks to the Fund's ongoing pledge to always stay one step ahead of issues affecting pension funds, as well as to take strategic advantage of investment opportunities as they arise, the Fund is able to ensure that its members don't have to worry about the market. Instead, members can enjoy the peace of mind of a fully funded, defined benefit pension plan that promises a sound financial future for members and their families.

Such a commitment can only be based on the following fundamental beliefs that reflect the vision behind the Fund's continuing success:

Our Core Values

People are the foundation of our success and the key to achieving our vision. We are committed to an environment in which all individuals have the opportunity and responsibility to achieve a high degree of personal and professional satisfaction and growth. We will recognize, reward and promote those who live our value.

We encourage open communication — among employees and between employees and management — to resolve problems, express views on related work issues and, in doing so, accept the communication at its face value. We share information that is helpful to one another in order to help the Fund accomplish its mission.

We treat each other with respect. We engage people with different perspectives. We fully utilize people's abilities and promote workforce diversity. We conduct business in an ethical manner by owning up to our own mistakes. We value integrity foremost and will be fair and honest in our dealings with each other. We honor our commitments and are responsible for our actions.

We focus on results in everything we do. We act when we have all the facts. Together, we are accountable for fostering a positive work environment where employees are encouraged to promote teamwork across departmental lines. We define our success by our capacity to learn and continuously improve. We have no limits.

We are a team. We achieve success when we each do all we can to harness our collective knowledge, creativity and expertise to provide enhanced benefit solutions for our members.

Together, we make our vision a reality.

Thank you for your unending support. Enjoy this year's annual report.

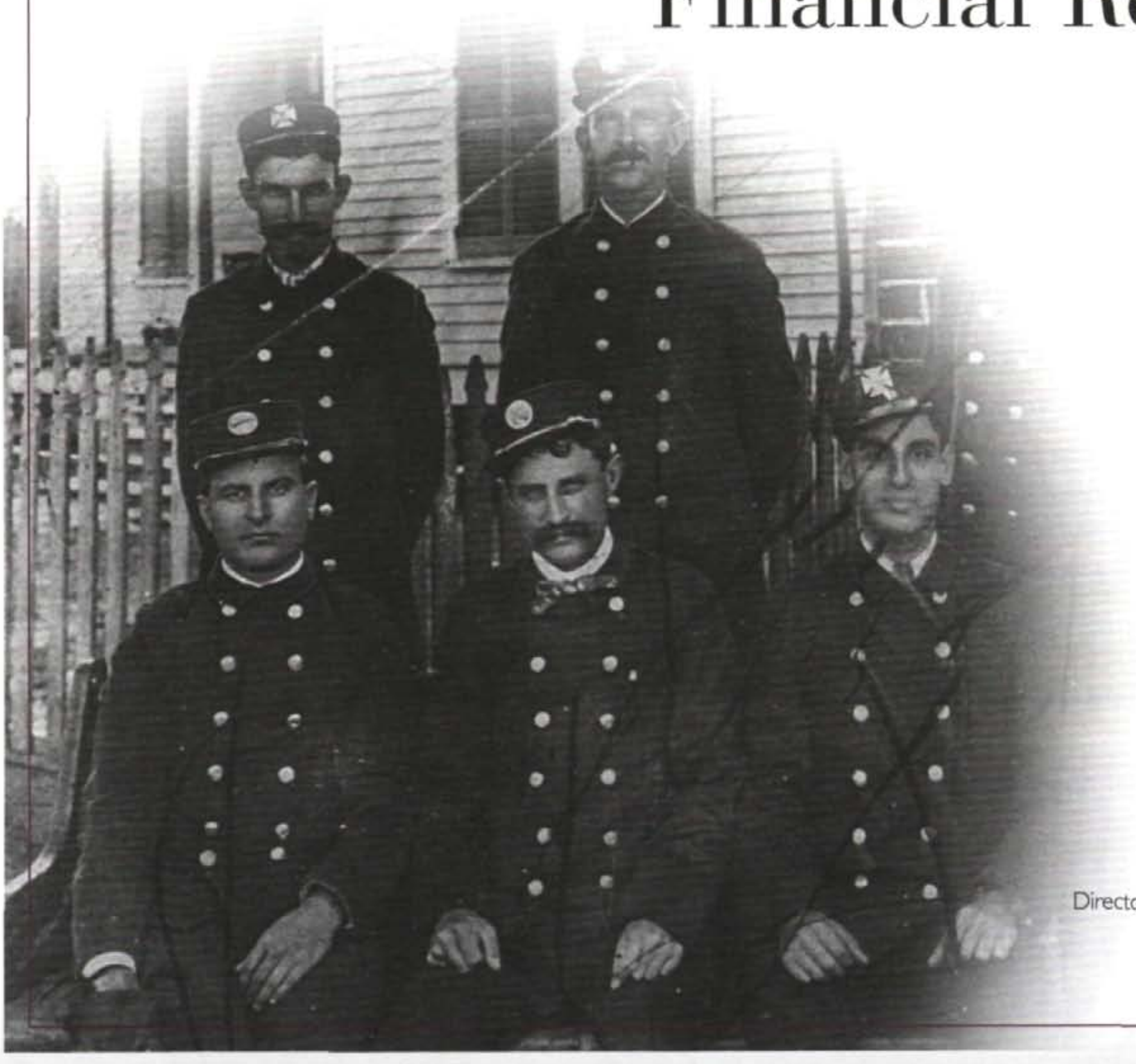
Respectfully,

Board of Trustees

Board of Trustees

A Component Unit of the City of Houston
for Fiscal Year Ended June 30, 2002

2002 Comprehensive Annual Financial Report



Prepared by
Marianne Gooch,
Director of Communications
and Public Relations,
and the HFRRF Staff

Section 1

Introductory Section

Section 2

Financial Section

Section 3

Investment Section

Section 4

Actuarial Section

Section 5

Statistical Section (unaudited)

Section 1 Introductory Section

Investments

If there's anything that 65 years of solid investment experience has taught those managing the Fund, it's to always keep their eyes on the future when they're making decisions today. It's a long-term strategy driven by a genuine commitment to serve and protect the well-being of the Fund's members — just as they've always served and protected the well-being of the citizens of Houston.

It's also a dedication to a knowledge-based, proactive approach to investing that always puts members' needs first. The Fund's team of investors strategically balances caution with calculated risk measurement and innovation with education, utilizing a wealth of resources to remain fully informed as to the latest financial trends and opportunities. The team then works closely with the Board of Trustees to make prudent investment decisions that maximize returns over the long run — minimizing concerns over short-term market instability.

The investment team safeguards the Fund's investment portfolio through a process of asset allocation and diversification. Aided by cutting-edge technology, the team analyzes the latest market activities available to make wise investment recommendations, thus keeping them up to date.

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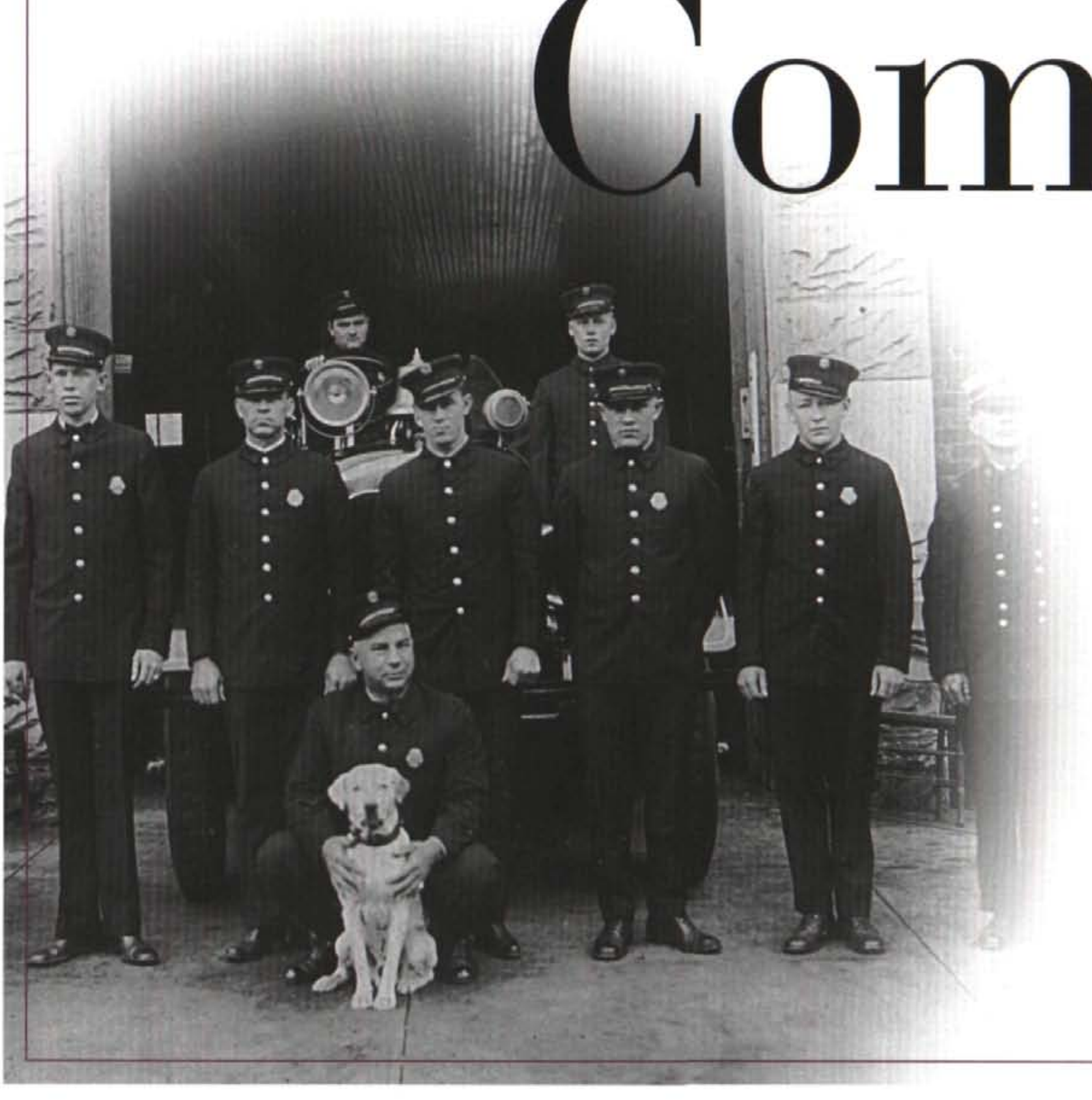
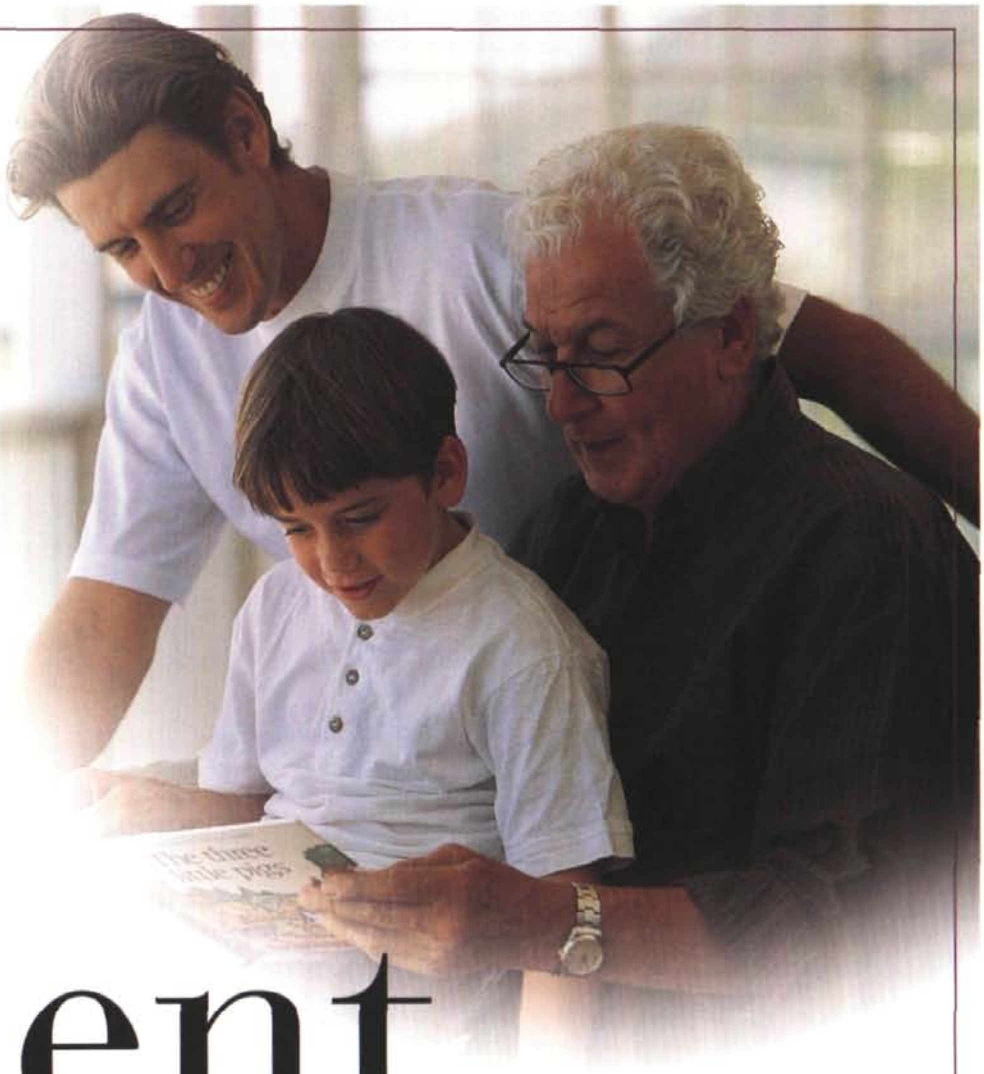


Investment Goals:
Continuously improve our administration, trustee education, and oversight of the Fund monies.

Administration Goals:
Improve internal support in the areas of personnel management, advanced technology applications, employment issues, internal communications, facilities management, continuing education and financial oversight.



itment

An example of one such decision was the Fund's recent investment in Energy Trust LLC, an energy investment management group with which the Fund has worked since 1994. In January 2001, the Fund became a partial owner of the firm, which manages approximately $1 billion in assets for major corporate pension clients across the country. Already, this valuable investment has been rewarded with a stable income stream with a high rate of return.

Ensuring the efficient day-to-day operation of the investment team is the strength of the Fund's administrative team. This organized group of professionals supports the Fund's investment activities not only by seeing to budget matters and the Fund's compliance with Texas law, but also by facilitating communication among the investment staff and between this team and the Board of Trustees.

Equal support is offered to the investment team by the communications and public relations group, which excels at sharing crucial investment updates and information with Fund members. From the physical and online delivery of the Fund newsletters — *The Red Line* and *The Smoke Reader* — to the almost-weekly updating of the Fund's website, the communications and public relations group is committed to keeping members up to date.

Making intelligent investment recommendations that provide financial security members can count on — this commitment that the Fund's investment team has delivered on a daily for years is the same one that now defines the path into the Fund's future and that of its members.

See page 18 for information regarding investment professionals who provide services to the Fund.

Benefits

While the ultimate purpose of the Fund is to provide the tangible financial benefits that will see members confidently into retirement, the Fund never stops seeking ways to provide other value-added benefits that help them make the most of this financial security. The Fund's benefits team strives to offer resources, tools, and education tailored to members in every phase of the membership cycle.

The Fund accomplishes this through its constant dedication to remaining fully funded. Funding status is determined by adding investment returns to the dollar amounts contributed by members and the city, then subtracting the Fund's fiscal debt and payments of existing member benefits. The remaining money becomes a springboard for the establishment of new member benefits.

These benefits take the shape of one-on-one counseling from the Fund's experienced benefits staff, as well as retirement-planning workshops specifically targeted at multiple groups at various stages in their careers. Whether conducted in confidence in the inviting offices of the Fund's benefits staff or among fellow members in the comfortable surroundings of the Fund's new conference center, these sessions and seminars go beyond the simple distribution of pension funds to provide retirement planning information on how to best put those funds to work for Fund members.

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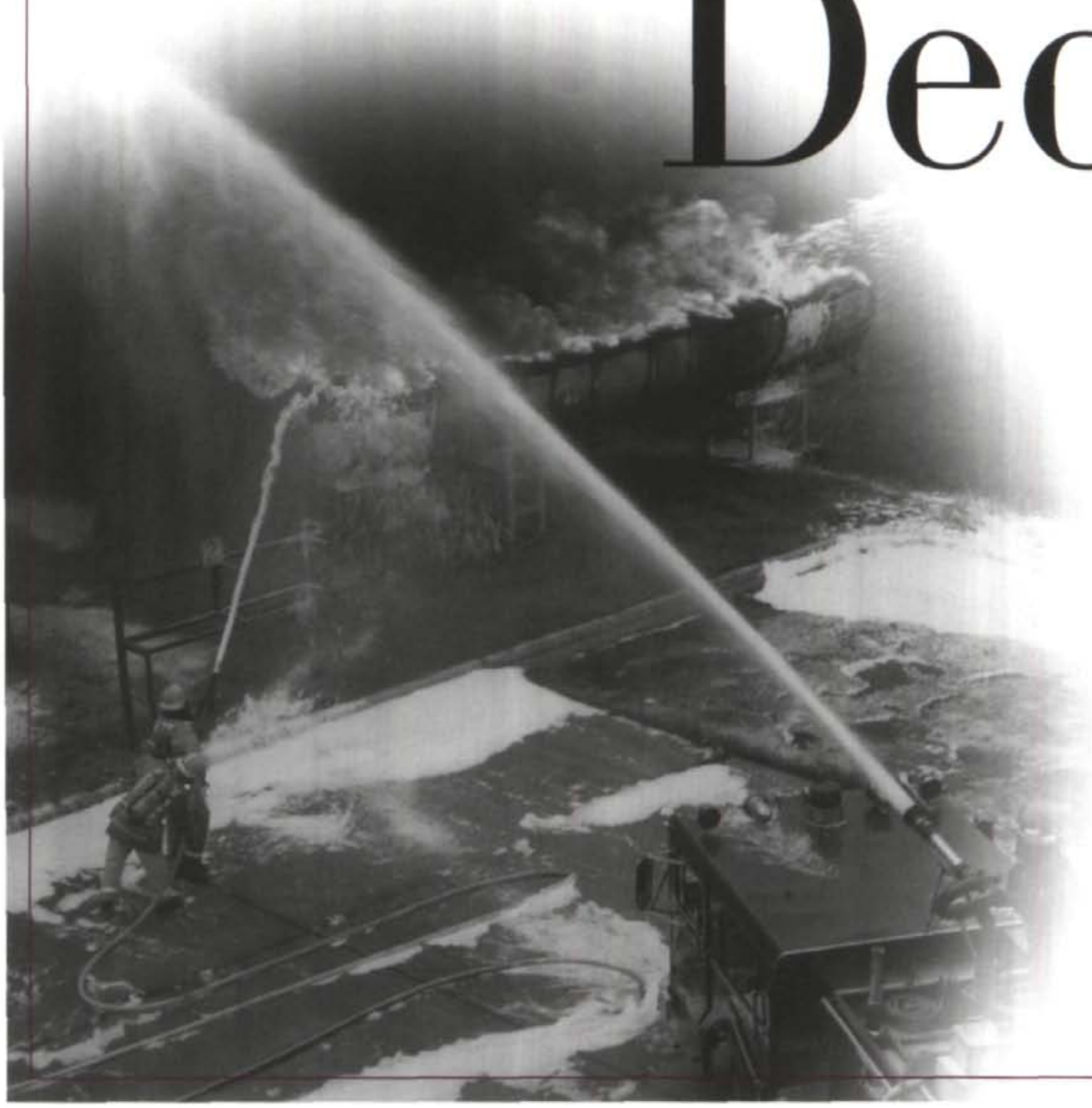
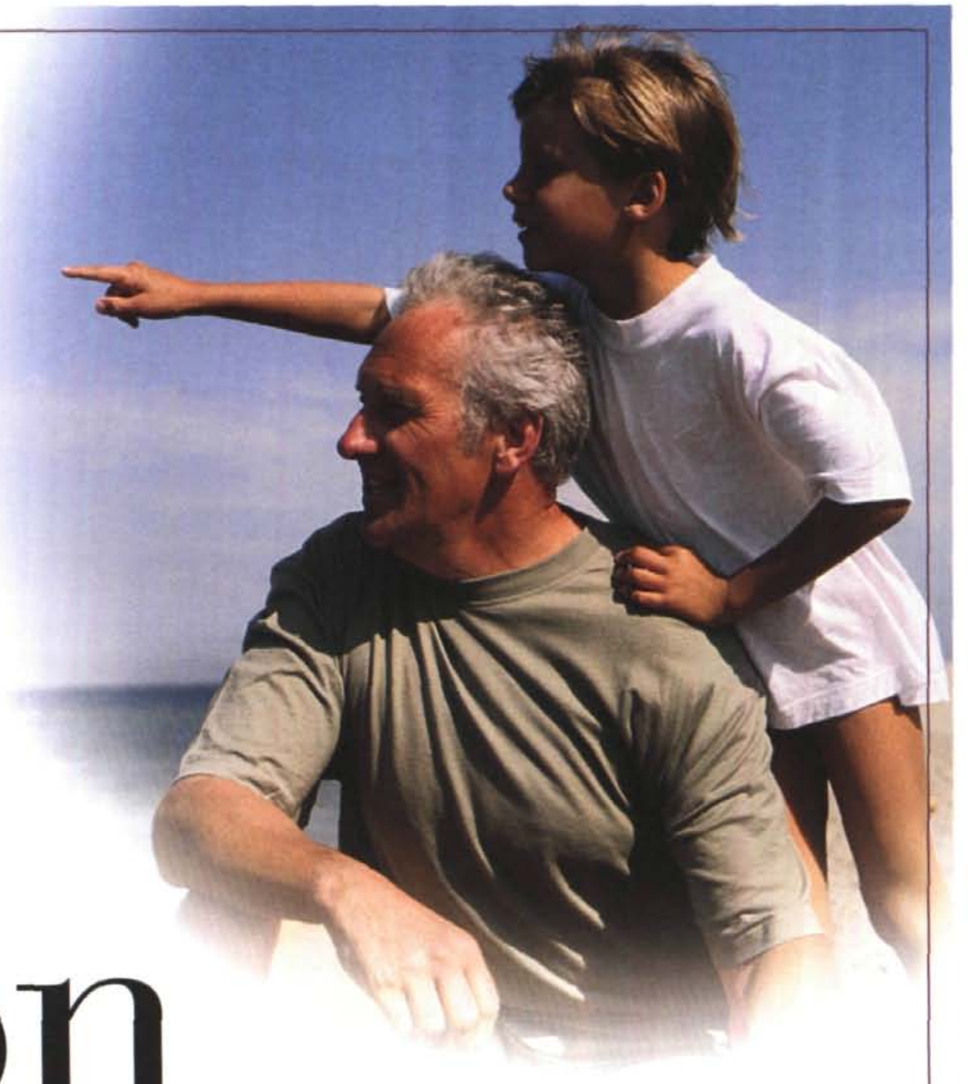


Benefits Goals:

Administer successfully the benefit requirements of the plan with a concerted emphasis on pension administration system development and implementation, maintaining data integrity, financial planning education, and additional services to ensure members maximize their benefits.

Communications and Public Relations Goals:

Communicate benefits and investment information to our members. Communicate information to elected officials.



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The Fund's senior retiree members can further benefit from access to an on-site licensed master social worker. As one of only a few pension funds in the nation to offer this level of service, the Fund employs a social worker who stays in touch with the unique needs of this special member group. Through interviews and home visits with retired firefighters and beneficiaries, this expert determines social and emotional capacity and assists those in need in locating relevant state and local social service agencies.

Supporting the benefits team every step of the way is the Fund's administrative staff, whose diligence in assisting with various benefits issues enables the smooth functioning of benefit operations on a daily basis. In particular, the Fund's in-house attorney provides legal counsel and coordinates contract reviews to best manage the Fund to the benefit of its members. The communications and public relations staff links the benefits team to Fund members by spreading the word on benefit updates and financial and retirement planning tools via newsletters and website announcements.

It's the ongoing aim of the Fund's dedicated benefits group to respond to the feedback and suggestions of its membership as it continues to uncover new and rewarding benefits — benefits that go above and beyond the call of duty, just as its members have in their service to the Houston community.

Energy Trust LLC

A key element of the Houston Firefighters' Relief and Retirement Fund's success lies in making investments that benefit its members to the greatest degree. One such investment is in Energy Trust LLC, which has acted as a manager for the Fund since 1994, where the Fund became a minority owner in 2001. That investment has proven to be a wise one, generating a stable income stream with a high rate of return.

Energy Trust LLC, one of the largest institutional direct oil and gas investment managers in the United States, manages $1 billion in investments for a variety of clients that consist primarily of corporate pension funds.

Investment

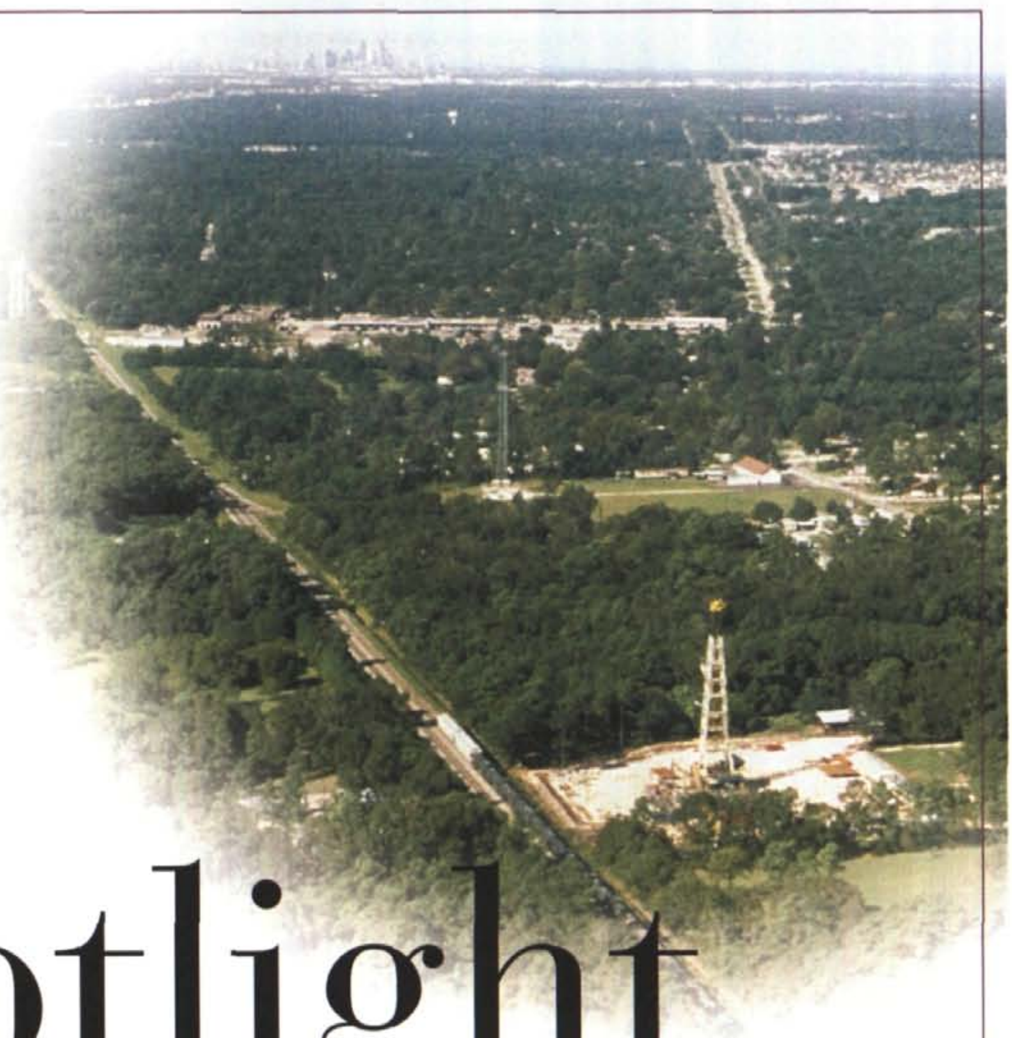
Walter Oil & Gas Corporation, Houston, Texas

Mississippi Canyon, Block 278

Well #1

Gulf of Mexico

Natural Gas Production



Spotlight

Energy Trust LLC manages existing energy investments made for separate account clients, and for more than a decade has delivered competitive rates of return, significant cash flow and intelligent portfolio diversification to its investors. Currently, through affiliated general partner and partnership entities (Energy Trust Partners), investments are being made with targeted returns of greater than 20 percent p.a. in companies that purchase, explore for and develop oil and gas reserves. Experienced Energy Trust professionals work to negotiate advantageous investment terms, and provide ongoing monitoring and analysis to maximize returns to the limited partners.

Ballard Exploration Company, Inc., Houston, Texas

Channelview Unit #1
Discovery Well

Channelview Field
Harris County, Texas

Natural Gas Production

Board of Trustees

Board of Trustees

Staff Members

DIRECTORS
(from left to right)

Marianne Gooch
Director of Communications and Public Relations

Jonathan W. Needle
General Counsel

Maxie L. Patterson
Executive Director

Claudia McInnis
Director of Administration

Glenna Hicks
Director of Benefits

Christopher E. Gonzales
Acting Chief Investment Officer

(from left to right)

Lyn Goldwater
Executive Assistant

Judy Leal
Receptionist/Secretary

Amy Collier
Conference Center Manager

Sarah Harrell
General Accounting Associate

Rosie Torres
Administrative Assistant

Staff Members

(from left to right)

Dwayne M. Pitre
Custodian Leader

Kevin Logan
Building Maintenance Supervisor

Judy Mae S. Sese
Systems/Software Specialist

John D. Moore II
Systems & Facilities Manager

(from left to right)

Van Mary Pham
Investment Analyst

Tony L. Pierce
Benefits Counselor

Marty J. Bredehoft
Investment Analyst

(from left to right)

Michele Word
Benefits Supervisor

Dalia "Dolly" Montoya, CEBS
Senior Benefits Specialist

Elizabeth Carrizal
Benefits Specialist II

Sharon Johnson
Benefits Specialist II

Robin Neyrey
Licensed Master Social Worker

Letter of Transmittal

Houston Firefighters' Relief
and Retirement Fund

Investing for Firefighters and Their Families®

4225 Interwood N. Parkway
Houston, Texas 77032-3866
281.372.5100 Tel
281.372.5101 Fax
1.800.666.9737
www.hfrrf.org

October 31, 2002
Mr. Albertino Mays
Treasurer
City of Houston
P. O. Box 1562
Houston, Texas 77251-1562

Dear Mr. Mays:

The Comprehensive Annual Financial Report (CAFR) of the Houston Firefighters' Relief and Retirement Fund (the Fund), a component of the City of Houston, for the fiscal year ended June 30, 2002, is submitted herewith.

The Houston Firefighters' Relief and Retirement Fund was created in 1937 with the passage of a state law that provided benefits for firefighters in certain cities in Texas. In 1975, Article 6243e.2 was passed in the Texas legislature to create a fund for firefighters in cities with a population not less than 1.2 million. This statute was amended in 1997 into Article 6243e.2(1). Since that time, and currently, Article 6243e.2(1) governs only firefighters employed by the City of Houston. Firefighters in the City of Houston are not covered by Social Security.

Article 6243e.2(1) states that a fund shall be created to provide retirement, disability and death benefits for firefighters and their beneficiaries, and that it shall be governed by a Board of Trustees, which has sole responsibility for its maintenance. In earlier years, the City of Houston provided staff and financing for the daily administration of the Fund. Effective July 1, 1988, the Board of Trustees assumed full responsibility for its administration. Administration of the Fund includes accurately computing and disbursing retirement benefits, receiving and depositing contributions in a timely manner, accounting for investment activity, monitoring the activity of all external investment managers, auditing all financial activities of the Fund on an ongoing basis, and meeting reporting requirements in a timely manner.

Responsibility for the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the Board of Trustees. To the best of the Board's knowledge and belief, the enclosed information is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of Fund operations. All disclosures necessary to enable the reader to gain an understanding of the financial activities of the Fund have been included.

Letter of Transmittal

The report consists of five sections:

THE INTRODUCTORY SECTION contains this Letter of Transmittal and identification of the administrative organization and professional services utilized by the Fund;

THE FINANCIAL SECTION contains the opinion of the independent certified public accountants (auditors) and the financial statements of the Fund, which include the Management's Discussion and Analysis section;

THE ACTUARIAL SECTION contains the independent consulting actuary's opinion and results of the July 1, 2001, actuarial valuation;

THE INVESTMENT SECTION describes investment goals and policies, asset allocation, investment results, and other information; and

THE STATISTICAL SECTION contains statistical tables of other significant data pertaining to the Fund.

MILESTONES AND MAJOR INITIATIVES

During fiscal year 2002, the HFRRF achieved several milestones. Listed below are several milestones from the Benefits and the Investment teams.

Benefits Milestones

A licensed master social worker provides additional services to retirees and beneficiaries, such as individualized communication, referrals to state and local agencies, and support groups. This additional service resulted in an Honorable Mention for a Membership Care Program, awarded by the IFEBP.

The social worker implemented various programs, including support groups and social events for retirees, widows and beneficiaries.

Considerable progress has been made with enhancements in technology with the upgrade of the pension administration system's software that provides faster, more efficient service to our members.

Investment Milestones

During fiscal year 2002, the investment markets continued exhibiting weakness that began in fiscal year 2000. The Dow Jones, the S&P 500, and Nasdaq all traded down to a two-year low in response to the attacks of September 11. During the course of the fiscal year, federal interest rates hit a 40-year low.

The Fund ended the year with a rate of return on investments of (2.39) percent, placing it in the top eleventh percentile in the Russell/Mellon Public Funds universe. Even though the Fund posted a negative return, the loss was minimal because of the style of investing and broad diversification.

The Board of Trustees made new alternative investment commitments to Lexington V, Lone Star IV, Energy Trust Partners, Landmark Real Estate IV, Coller IV, Blackstone IV and Industrial Growth Partners II.

ADMINISTRATION, STAFF, AND PROFESSIONAL SERVICES

At fiscal year-end, the Fund staff was made up of 23 employees.

The following professionals are employed by the Board of Trustees to provide specialty services. The custodian bank is Mellon Trust. Mir•Fox & Rodriguez, P.C. serves as the auditor. Towers Perrin is the actuary. Strasburger & Price, LLP, serves as legal counsel. Pension Consulting Alliance is the investment consultant.

All investment consultants of the Fund acknowledge that they serve in a fiduciary capacity to the Fund. Most of the professional consultants appointed by the Board are listed on page 18 of this report. Other professionals employed by the Board during the year are listed on page 36.

Letter of Transmittal

ACCOUNTING SYSTEMS AND REPORTS

As plan administrator of the Fund, the Board of Trustees maintains the following various internal controls to ensure material accuracy of all data:

- Biweekly control reports are generated by the Fund staff to ensure the accuracy of employee and employer contributions received from the City of Houston;
- Monthly reconciliations are performed on benefit payment information to confirm payment instructions to the custodian bank;
- Monthly reviews are performed on all investment transactions to ensure that dividends and interest on the investments of the Fund are properly credited, all assets are accounted for properly, all market valuations are appropriate, and each investment manager is in compliance with established guidelines;
- The checking account of the Fund, from which administrative payments are made, is reconciled monthly by the staff and wire transfers from the custodian bank are reconciled monthly to the in-house cash account;
- The Budget and Audit Committee of the Board of Trustees, which sets general parameters for spending, meets at least quarterly to review administrative and investment expenditures; and
- The Personnel and Procedures Committee formulates and reviews all procedures of the Fund. The auditor of the Fund reviews these internal controls annually. In turn, the auditor makes a report to the Board. If needed, the Board makes changes in the systems and controls of the Fund.

The financial statements included in this report have been prepared in accordance with generally accepted accounting principles (GAAP) and the principles of governmental accounting and reporting pronounced by the Governmental Accounting Standards Board (GASB). The accrual basis of accounting is used to record assets, liabilities, revenues, and expenses. Revenues for the Fund are taken into account when earned without regard to date of collection. Expenses are recorded when the corresponding liabilities are incurred, regardless of when payment is made. For an overview of the financial position of the fund, please refer to the Management's Discussion and Analysis in the financial section.

Contributions to the Fund are based on the principles of level cost financing, with current services financed on a current basis and prior services amortized over a 40-year period from January 1, 1983, with 21 years remaining. The Fund has ended its fiscal year on June 30 since 1984. The independent auditors' report from a certified public accountant and certification from the actuary of the Fund are included in this report.

INVESTMENTS

The investment portfolio is a major contributor to the Fund. The Board of Trustees created the Investment Committee, consisting of the whole Board, to oversee the investment portfolio, managers, and performance of the Fund. With assistance from the Fund's professional staff, the Investment Committee monitors current investments, as well as potential investment opportunities in light of changing economic conditions, and evaluates the possible impact to the Fund.

The overall goal of the Board's investment program is to provide timely and sufficient benefits to participants and their beneficiaries. Key components of the investment program that enable the Fund to achieve this goal are a diversified investment portfolio, a long-term investment outlook, and prudent risk-taking commensurate with fulfilling the goal of the program. The Fund's assets are invested in short-term instruments ("cash equivalents"), fixed-income securities, domestic and international equity securities, and alternative investments. By investing in different types of assets, the impact that a downturn in one asset class would have on the Fund is minimized and the probability that the Fund will earn an adequate rate of return is improved. The Board maintains an investment outlook that emphasizes stability and long-term planning — because payments to participants and beneficiaries are long-term in nature — and avoids drastic asset shifts and market timing decisions. The Board assumes prudent risk in the investment portfolio to ensure that assets grow at an adequate rate to provide promised benefits to participants and beneficiaries. By adhering to these components, the investment program is characterized by steady growth in ever-changing domestic and international economic environments.

The Fund must earn a return of 8.5% to be able to meet its benefits obligations. The Fund also models an overall goal of 9.25% return on investments to cover operational expenditures, money management fees, and capital expenditures. In fiscal year 2002, operational expenditures were 33.3 basis points; money management fees were 33.58 basis points; and capital expenditures were .14 basis points, a total of 67.02 basis points.

INDEPENDENT AUDIT

An audit was performed by Mir•Fox & Rodriguez, P.C., for the fiscal year ending June 30, 2002, and was conducted in accordance with auditing standards generally accepted in the United States of America. The independent auditors' report is included in this report.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Houston Firefighters' Relief and Retirement Fund, Houston, Texas, for its comprehensive annual financial report for the fiscal year ended June 30, 2001. This was the 19th year that the Fund has received 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 GAAP 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.

ACKNOWLEDGEMENTS

The compilation of this report reflects the combined effort of the Houston Firefighters' Relief and Retirement Fund staff under the leadership of the Board of Trustees. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a means of determining responsible stewardship for the assets contributed by the employee members and the City of Houston.

On behalf of the Board of Trustees, we would like to take this opportunity to express our appreciation to staff members, the advisors, and to the many other professionals and participants who have worked so diligently to assure the successful operation of the Fund.

Sincerely,

Donny R. Myers	Maxie L. Patterson
Chair	Executive Director

Administrative Organization

Executive Director
Maxie L. Patterson

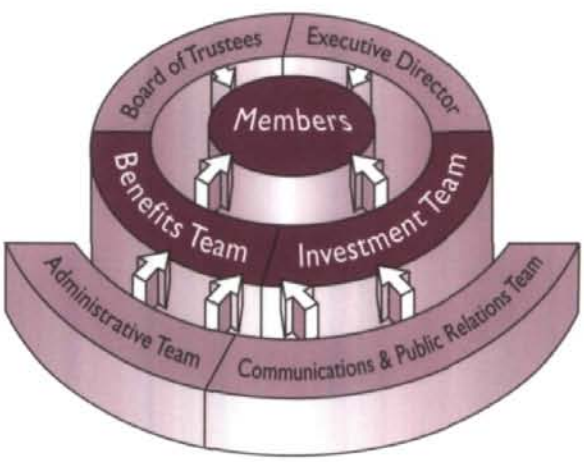
Acting Chief Investment Officer
Christopher E. Gonzales

Director of Administration
Claudia McInnis

Director of Benefits
Glenna Hicks

Director of Communications and Public Relations
Marianne Gooch

Committees
Budget and Audit
Corporate Governance
Investment
Legislative
Memorial
Pension Benefits
Personnel and Procedures



Actuary
Towers Perrin

Attorney
Strasburger & Price, LLP

Auditor
Mir•Fox & Rodriguez, P.C.

Custodian Bank
Mellon Trust

Investment Advisors
AllianceBernstein Institutional Investment Management
Brera Capital Partners, LLC
CB Richard Ellis Investors
The Centennial Funds
Coller Investment Management Limited
Energy Trust LLC
Gulf Investment Management
G.W. Capital, Inc.
Hicks, Muse, Tate & Furst, Inc.
Industrial Growth Partners
L&B Real Estate Counsel
Landmark Partners, Inc.
Lexington Partners
Lone Star Funds
Loomis, Sayles & Company, LP
Mellon Bond Associates
Mellon Capital Management
Ranieri & Company
Schroder Investment Management North America, Inc.
SSR Realty Advisors
State Street Research & Management
STW Fixed Income Management
The Blackstone Group
The TCW Group
Triad Ventures Limited
Evergreen Timberland Investment Management
Deutsche (Zurich Scudder) Investments

Please see Investment Section "Fees for Investment Services," on page 46.

Investment Consultant
Pension Consulting Alliance, Inc.

Financial Statement Preparation

An Overview Of Financial Statement Preparation

At the end of each fiscal year, the Board and staff members prepare financial statements showing the financial activity of the Fund. The financial statements include the statements of plan net assets and changes in plan net assets for the years presented. The notes are essential to the completeness of the information in the financial statements.

After the financial statements are prepared, an independent outside auditor hired by the Board reviews the systems and methods used to arrive at the information in the financial statements. A financial audit is then performed to determine if the financial statements are free of material misstatement. The audit includes examination on a test basis of evidence supporting the amounts and disclosures in the financial statements.

The audit is conducted in accordance with GAAS — generally accepted auditing standards. If the auditor finds the financial statements free of material misstatement, the auditor issues an opinion such as that found on page 22, stating that the statements fairly present the financial position of the Fund in accordance with GAAP — generally accepted accounting principles.

Some of the terms used in this section are defined in the glossary on pages 69-70.

Statements Of Plan Net Assets

The statements of plan net assets are statements of the financial condition of the Fund that show snapshots of Fund assets and liabilities at a specific point in time. In this case, it's the end of the fiscal year at June 30, 2002 and 2001.

The statements show assets, liabilities, and the remaining Fund balance. An asset is anything having commercial, economic, or exchange value. Assets include cash, receivables (interest and dividends earned by the investments of the Fund and employee/member and employer contributions), investments, collateral on securities lending arrangements, and land.

Fund liabilities include money reserved for members who are entitled to benefits and obligations for professional services the Fund has used — but for which payment has not been made.

Statements Of Changes In Plan Net Assets

The statements of changes in plan net assets show the financial impact on the Fund of operations and investments during a period of time. In this case, it's the years ended June 30, 2002 and 2001.

Additions to plan net assets represent cash that came into, or is expected to come into, the Fund from events that take place during a fiscal year.

Additions include employee and employer contributions and investment income. Investment gains are included because the increase (decrease) in market value of investments is shown as revenue since the investments are reported at market value.

Deductions from plan net assets represent the money that the Fund paid out or expects to pay out from events that take place during a fiscal year. Deductions include benefit payments to retirees and beneficiaries, refunds of contributions to firefighters who leave the Fire Department, and professional and administrative expenses.

This statement provides useful information about what happened during a single year. Retirement funds, however, operate with a long-term strategy (see the Overview of the Actuarial Valuation on page 50).

Financial Statement Preparation

Changes in plan net assets at the end of the statement show the previous year's balance, plus revenues after expenses, to total the plan net assets held in trust for pension benefits at fiscal year-end.

Notes To Financial Statements

The notes are an integral part of the financial statements. The notes include any information that might be needed to have an adequate understanding of the overall financial status of the Fund.

In this report, the notes include explanations of the payment and refund features of the governing statute of the Fund, the accounting methods used by the Fund, the funding methods used, the methods and assumptions the actuary uses to determine contribution requirements, and any significant changes that take place after fiscal year-end — but before the audit is complete.

Supplementary Information

The supplementary 10-year trend information provides additional historical information. These charts show the progress during the past 11 fiscal years toward reaching the goal of being totally funded, as well as sources of revenues and types of expenses of the Fund during the fiscal year.

Other supplementary information provides additional information for analysis.

Section 2 Financial Section

INDEPENDENT AUDITORS' REPORT

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

Member of the American Institute of Certified Public Accountants

Board of Trustees
Houston Firefighters' Relief and Retirement Fund:

We have audited the accompanying statements of plan net assets of the Houston Firefighters' Relief and Retirement Fund (the Fund) as of June 30, 2002 and 2001, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the Fund'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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of the Fund as of June 30, 2002 and 2001, and its changes in plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

Mir Fox & Rodriguez

September 6, 2002

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Management is pleased to present a discussion and analysis of the Houston Firefighters' Relief & Retirement Fund (HFRRF) financial activity for the fiscal year ended June 30, 2002. This discussion is intended to serve as an introduction to the HFRRF financial statements which follow.

The financial statement section consists of:

(a) Financial statements, including the Statements of Plan Net Assets and Changes in Plan Net Assets. These statements reflect resources available for the payment of benefits and other expenses as of June 30, 2002, as well as the Fiscal Year 2002 additions to and deductions from the Plan.

(b) Notes to the financial statements which are an integral part of the financial statements. They include additional information that might be needed to have an adequate understanding of the overall financial status of the Fund.

(c) Required supplementary information and other supplementary schedules. These schedules provide additional information to the basic financial statements.

FINANCIAL HIGHLIGHTS

Plan Net Assets

	Fiscal Year 2002	Fiscal Year 2001	Percent increase (Decrease)
Assets:			
Investments	$1,630,392,605	$1,680,649,899	(3.0)%
Land and building	9,228,589	9,524,038	(3.1)%
Other assets	141,208,348	157,286,316	(10.2)%
Total assets	$1,780,829,542	$1,847,460,253	(3.6)%
Liabilities:			
Short-term liabilities	120,664,577	120,972,072	(0.3)%
Total net assets	$1,660,164,965	$1,726,488,181	(3.8)%

Plan net assets at the end of Fiscal Year 2002 totaled $1,660,164,965. Plan net assets decreased approximately 3.8% compared with the amount for Fiscal Year 2001.

CHANGES IN PLAN NET ASSETS

	Fiscal Year 2002	Fiscal Year 2001	Percent increase (Decrease)
Beginning net assets	$1,726,488,181	$1,766,942,115	(2.3)%
Additions to plan net assets:			
Contributions	42,669,386	36,051,951	18.4%
Net depreciation FMV of investments	(90,305,768)	(79,977,341)	(12.9)%
Interest income	53,529,970	40,332,573	32.7%
Dividends	7,565,826	13,321,776	(43.2)%
Other net income	(16,474,948)	2,093,747	(886.9)%
Total (reductions) additions	(3,015,534)	11,822,706	(125.5)%
Deductions from plan net assets:			
Benefits	57,819,590	47,875,474	20.8%
Other	5,488,092	4,401,166	24.7%
Total deductions	63,307,682	52,276,640	21.1%
Ending net assets	$1,660,164,965	$1,726,488,181	(3.8)%
Net increase (decrease)	$(66,323,216)	$(40,453,934)	

MANAGEMENT'S DISCUSSION AND ANALYSIS *(continued)*

In Fiscal Year 2002, the Fund experienced losses in investment performance, resulting in a lower plan asset market value. The current capital market environment continued to be difficult in Fiscal Year 2002, driven by poor investor sentiment, a weak economy, corporate accounting scandals and Middle East tensions. However, the Fund's portfolio defensive strategy reduced the negative market exposure, resulting in minimal year-over-year loss.

The reserves needed to finance retirement benefits are accumulated through the collection of employee and employer contributions and through income on investments. These are offset by Plan deductions. The amount contributed by employee members was $14,218,663. Employer contributions accounted for $28,450,723. Since July 1, 1996, by statute, the employee contribution rate has been 7.7 percent and the employer contribution rate 15.4 percent.

Most deductions from plan net assets in a retirement system relate to the purpose for which it has been created — the payment of benefits. Consequently, recurring benefit payments prescribed by the plan, refunds of contributions to members, the cost of investment services, and the cost of administering the Fund decrease net assets.

Deductions for Fiscal Year 2002 totaled $63,307,682, an increase of approximately 21.1% compared to Fiscal Year 2001. Deductions increased primarily due to:

(1) Higher DROP distributions (which almost doubled in Fiscal Year 2002);

(2) Increased benefit enhancements, which included higher monthly pension benefits, and a guaranteed annual supplement payment; and

(3) Increased benefit recipients (100) in Fiscal Year 2002, compared to Fiscal Year 2001. Most of the additional recipients who exited DROP are receiving an additional 2% of original benefit amount for each full year in DROP.

This growth in benefit payments is normal for a maturing pension fund. Total professional and administrative deductions increased in Fiscal Year 2002, partly due to additional operating expenses related to the Fund's move into its own building, as well as additional staff. Total additions to the plan were $(3,015,534) and total deductions were $63,307,682, thereby decreasing Fund net assets by $66,323,216.

HISTORICAL TRENDS

Accounting standards require that the statement of plan net assets state asset value at fair value, and include only benefits and refunds due plan members and beneficiaries, as well as accrued investment and administrative expenses as of the reporting date. Information regarding the actuarial funding status of the Fund funds is provided in the Schedule of Funding Progress (on page 37). The asset value stated in the Schedule of Funding Progress is the actuarial value of assets, determined by calculating the difference between the expected valuation assets and the actual market value of assets, adjusted for any unrecognized gains or losses and amortized over a five-year period. The actuarial accrued liability is calculated using the entry age normal fund method.

The funding position of the Fund continues to provide more than adequate assets to meet benefit obligations. The excess funded actuarial value of assets show a positive trend over the five-year period displayed.

Annual required contributions of the employer and contributions made by the employer in relation to the required contributions are provided in the Schedule of Employer Contributions (on page 37). This schedule indicates that the employer is generally meeting their responsibility to provide resources to the Fund.

STATEMENTS OF PLAN NET ASSETS *June 30, 2002 and 2001*

Assets	**2002**	**2001**
Investments, at fair value:		
Short-term investment funds (value at cost)	**$ 41,749,422**	$ 36,154,537
Commingled equity funds	**69,579,929**	114,347,979
Commingled international equity funds	**303,803,806**	181,916,413
Fixed-income funds:		
United States government securities	**2,992,381**	10,391,534
Corporate bonds	**412,731,923**	455,764,085
Other fixed-income securities	**63,007,973**	67,074,122
Common stocks	**327,237,969**	422,638,053
Preferred stocks	**2,616,028**	15,737,005
Other investments — partnerships	**406,673,174**	376,626,171
Total investments	**1,630,392,605**	1,680,649,899
Cash and cash equivalents	**9,909,921**	23,598,420
Receivables:		
Accrued interest	**12,644,942**	11,653,313
Foreign funds contracts	**9,159,079**	3,962,140
Receivables for investments sold	**3,594,081**	7,886,316
Accrued dividends	**728,335**	620,820
Employer contributions	**538,627**	—
Member contributions	**269,314**	—
Total receivables	**26,934,378**	24,122,589
Collateral on securities lending arrangements, at fair value	**103,588,739**	108,866,018
Land	**541,232**	541,232
Building, net	**8,687,357**	8,982,806
Furniture, fixtures and equipment	**775,310**	699,289
Total assets	**1,780,829,542**	1,847,460,253
Liabilities		
Accrued expenses	**1,683,794**	1,471,367
Payable for investments purchased	**5,769,680**	6,675,185
Foreign taxes payable	**13,244**	13,937
Foreign funds contracts payable	**9,609,120**	3,945,565
Collateral on securities lending arrangements, at fair value	**103,588,739**	108,866,018
Total liabilities	**120,664,577**	120,972,072
Plan net assets held in trust for pension benefits	**$1,660,164,965**	$1,726,488,181

A schedule of funding progress for the plan is presented on page 37.

See accompanying notes to financial statements.

STATEMENTS OF CHANGES IN PLAN NET ASSETS

Years Ended June 30, 2002 and 2001

	2002	2001
Additions to plan net assets:		
Contributions:		
City of Houston	$ 28,450,723	$ 24,032,828
Members	14,218,663	12,019,123
	42,669,386	36,051,951
Net investment income:		
Net depreciation in fair value of investments	(90,305,768)	(79,977,341)
Interest:		
Cash equivalent securities	1,504,281	2,925,218
United States government securities	866,714	574,688
Corporate bonds	40,981,601	30,767,457
Other fixed income securities	9,577,340	5,260,851
Other	600,034	804,359
	53,529,970	40,332,573
Dividends:		
Common stocks	7,311,610	7,984,735
Preferred stocks	254,216	982,196
Commingled equity funds	—	4,354,845
	7,565,826	13,321,776
Earnings (losses) from other investments — partnerships	(11,060,810)	7,758,950
Securities lending arrangements:		
Earnings	2,993,651	6,055,282
Rebates and fees	(2,527,447)	(5,590,445)
	466,204	464,837
Gross investment loss	(39,804,578)	(18,099,205)
Less: investment services expense	5,880,342	6,130,040
Net investment loss	(45,684,920)	(24,229,245)
Total additions (reductions) to plan net assets	(3,015,534)	11,822,706
Deductions from plan net assets:		
Benefits paid to members	57,819,590	47,875,474
Contribution refunds to members	179,452	298,726
Professional services	566,118	631,725
Administrative expenses	4,742,522	3,470,715
Total deductions from plan net assets	63,307,682	52,276,640
Net decrease in plan net assets	(66,323,216)	(40,453,934)
Plan net assets held in trust for pension benefits, beginning of year	1,726,488,181	1,766,942,115
Plan net assets held in trust for pension benefits, end of year	$1,660,164,965	$1,726,488,181

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS *June 30, 2002 and 2001*

1. DESCRIPTION OF PLAN AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

The Houston Firefighters' Relief and Retirement Fund (the Fund) was created in 1937 by act of the 45th Legislature of the State of Texas (Article 6243e). The current governing statute is Article 6243e2 (1), *Vernon's Texas Civil Statutes* (the Act). The Fund is a single employer-defined benefit pension plan covering all firefighters employed full-time by the City of Houston (the City) and provides for service, disability, and death benefits for eligible members. At June 30, 2002 and 2001, the membership of the Fund consisted of the following:

	2002	2001
Retirees and beneficiaries currently receiving benefits	1,774	1,662
Former members entitled to benefits but not yet receiving them	12	14
Active members:		
Vested	2,243	2,370
Nonvested	1,125	946
Total members	5,154	4,992

The Fund is a local governmental plan, and therefore is not subject to the Employee Retirement Income Security Act of 1974.

The Fund is a component unit of the City. The operation of the Fund is solely for the City of Houston firefighters. The Fund is governed by a Board of Trustees (the Board) and can only be terminated or amended by an act of the Legislature of the State of Texas. One member of the Board is either the City mayor or an appointed representative, five members are elected by active firefighters, one member is elected by retired firefighters, two members are citizen representatives, and one member is the City treasurer.

Contributions

During the years ended June 30, 2002 and 2001, covered members were required by statute to contribute 7.7% of their salary to the Fund. The City is required to contribute a minimum of twice the members' contributions. The City contributed 15.4% of the gross salaries of active members for both years ended June 30, 2002 and 2001.

Pension benefits

Members with 20 or more years of service retiring on or after November 1, 1997, are entitled to a service retirement of 50% of average monthly salary (defined as the monthly average of their highest individual 78 pay periods), plus 3% of average monthly salary for each year of service in excess of 20 years until the member completes 30 years of service, for a total monthly pension not to exceed 80% of the member's average monthly salary for the highest 78 pay periods of the member's participation.

All members who retired prior to November 1, 1997 should consult the Act in effect at the time of retirement to determine pension benefits.

Effective November 1, 1997, pensions are adjusted annually for a fixed annual cost-of-living adjustment of 3.0%.

Members with 20 or more years of service are eligible to elect to establish a Deferred Retirement Option Plan (DROP) account. When the DROP election becomes effective, a DROP account is established for the member and is credited with the following amounts: the monthly pension allowance determined as if the member had retired at the date the election was made, amounts equal to the deductions made from the DROP member's salary under Section 13(c) of the Act, 7.7% of their salary after June 30, 1996, and interest on those amounts, compounded monthly at an interest rate based on the Fund's actual rate of return on average over the preceding five years. A member may participate in the DROP for a maximum of ten years. The participant's monthly benefit at actual retirement would be increased by 2% of original monthly benefit for every full year of DROP participation. (Beginning September 1, 2000, the percentage increase applied to monthly benefits at actual retirement was 1%, to be phased in at .5% beginning on September 1, 2000, and an additional .5% beginning September 1, 2001. The benefit increase was then changed effective September 1, 2001 to be 2% per year.) A member may continue to be employed as a firefighter by the City after 10 years of participation in the DROP; however, the 7.7% deducted from their salary, the monthly pension allowance, and the interest calculation would no longer be credited to their account.

Disability benefits

Service-connected disability benefits are 50% of average monthly salary (occupational), or 75% of average monthly salary (general), or the service retirement, if it is greater and if the member is eligible. Nonservice-connected disability benefits amount to 25% of average monthly salary, plus 2.5% of average monthly salary for each year of service, up to a maximum of 50% of average monthly salary, or the service retirement, if it is greater and if the member is eligible.

NOTES TO FINANCIAL STATEMENTS *(continued)*

Death benefits

Death benefits are available to a surviving spouse, dependent children or dependent parents. In-the-line-of-duty death benefits are 100% of average monthly salaries. Active, on-duty (not-in-the-line-of-duty) related death benefits are the same as benefits for service-connected disability. Active, off-duty related death benefits are the same as benefits for nonservice-connected disability. Post-retirement death benefits are equal to the benefits being paid to the member upon his or her death. If there are no eligible survivors, the Fund will refund to the member's designated beneficiary or estate the amount of the member's contributions, with 5% simple interest, not compounded, for members with at least 10 years but less than 20 years of service and without interest for members with less than 10 years of service.

Vesting

Members who terminate employment with at least 10 years of service, but prior to becoming eligible for the service retirement, are entitled to 1.7% of average monthly salary for each year of service, payable beginning at age 50, or an optional refund of contributions with simple interest at 5%, not compounded. Members who terminate their employment with less than 10 years of service may receive a refund of their contributions to the Fund, without interest. Members who terminated their employment prior to September 1, 1987, and prior to retirement for reasons other than death or disability forfeit their accumulated plan benefits, including their contributions to the Fund.

Members or beneficiaries of members receiving pension or disability benefits (other than a deferred retiree or an active member who has elected the DROP election) shall receive an additional monthly benefit payment of $150 along with their standard monthly benefit payment beginning in July 2002.

In March 1998, a benefit enhancement was enacted under Section 10 of the Act by the Board to allow members or beneficiaries of members receiving pension, disability or death benefits (other than a deferred retiree, survivors of deferred retirees, or an active member who has elected the DROP election) to receive an additional annual benefit payment, not to exceed $4 million in aggregate per year, if the Fund's plan net assets exceed the actuarially accrued liability as of June 30, the Fund's investment return exceeds 9.25% for the year ended June 30, and the distribution would not increase the City's contribution rate. Effective July 1, 2000, the distribution amount of $4 million was increased to $5 million. The Fund did not meet these requirements for the year ended June 30, 2001. Effective September 1, 2001, the Fund has modified this benefit enhancement by eliminating the three requirements. The $5 million aggregate benefit will be distributed each January.

For additional information on plan benefits, see the Houston Firefighters' Relief and Retirement Fund 2002 Summary Plan Description.

Basis of presentation

The accompanying financial statements are presented in accordance with the Governmental Accounting Standards Board (GASB), which designate accounting principles and financial reporting standards applicable to state and local governmental units. The accompanying financial statements include solely the accounts of the Fund, which include all programs, activities and functions relating to the accumulation and investment of the net assets and related income necessary to provide the service, disability and death benefits required under the terms of the governing statutes and amendments thereto.

Basis of accounting

The basis of accounting is the method by which revenues and expenses are recognized in the accounts and reported in the financial statements. The accrual basis of accounting is used by the Fund. Under the accrual basis of accounting, revenues (which include contributions and investment income) are recognized when they are earned and collection is reasonably assured, and expenses are recognized when the liability is incurred. Benefits and contributions refunds are recognized when due and payable in accordance with the terms of the Plan. Accrued income, when deemed uncollectible, is charged to operations.

New accounting pronouncement

In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB 34). In June 2001, the GASB issued Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, which amended certain provisions of GASB 34. The adoption of GASB 34 required the Plan to present Management's Discussion and Analysis (MD&A). The MD&A is considered to be required supplementary information and precedes the financial statements. The adoption of GASB 34 had no impact on the Fund's basic financial statement.

Use of estimates

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

NOTES TO FINANCIAL STATEMENTS *(continued)*

Cash and cash equivalents securities

The Fund considers only demand deposits as cash. Cash equivalent securities, which are composed of all highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents.

Investments

Statutes of the State of Texas authorize the Fund to invest surplus funds in the manner provided by the Government Code, Title 8, Subtitle A, Subchapter C. This subchapter provides for the investment of surplus assets in any investment or investments that are deemed "prudent" by the Board. The investment policy of the Board does not restrict the types of investments authorized to be made on behalf of the Fund; however, the Board seeks to produce a return on investments that is based on prudent and reasonable investment risk and the cash flow requirements of the Fund given prevailing capital market conditions. While the Board recognizes the importance of the preservation of capital, it also adheres to the theory of capital market pricing, which maintains that varying degrees of investment risk should be rewarded with incremental returns. Consequently, prudent risk-taking is justifiable.

Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at their estimated fair values.

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

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

Furniture, fixtures, and equipment

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

Administrative expenses

All administrative expenses are paid by the Fund.

Reclassifications

Certain amounts in 2001 have been reclassified to conform to current year presentation.

Federal income tax

The Fund received a favorable letter of determination from the Internal Revenue Service stating that the Fund qualifies as a tax-exempt plan and trust as of December 29, 1998. The Fund's management and Board believe that the Fund is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code.

2. CONTRIBUTIONS REQUIRED AND CONTRIBUTIONS MADE

Funding policy

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

The required contribution rate of the City, pursuant to an actuarial study effective July 1, 2001, consists of 22.3% of covered members' salaries to pay normal costs reduced by 7.4% of covered members' salaries to amortize its funding surplus over 40 years, increased by .5% of covered members' salaries for an additional statutory requirement, resulting in a net contribution rate of 15.4%. The City is required to contribute at a rate that has been actuarially determined and adopted by the Board, but not less than twice the members' contributions.

NOTES TO FINANCIAL STATEMENTS *(continued)*

ACTUARIALLY DETERMINED CONTRIBUTION REQUIREMENTS

	July 1, 2002	Percentage of covered payroll	July 1, 2001	Percentage of covered payroll
Employer normal cost	$ 41,196,124	22.3%	$ 21,847,861	14.0%
Member normal cost	14,218,663	7.7%	12,019,123	7.7%
Total normal cost	55,414,787	30.0%	33,866,984	21.7%
Additional statutory requirement	923,580	.5%	8,583,798	5.5%
Less: Amortization of surplus actuarial accrued liability	(13,668,981)	(7.4)%	(6,398,831)	(4.1)%
Net contributions required	$ 42,669,386	23.1%	$ 36,051,951	23.1%
Employer contributions actually made	$ 28,450,723	15.4%	$ 24,032,828	15.4%
Member contributions actually made, less contribution refunds	14,218,663	7.7%	12,019,123	7.7%
Net contributions actually made	$ 42,669,386	23.1%	$ 36,051,951	23.1%

Ten-year historical trend information

Historical trend information is provided as supplemental information on pages 34 through 38. This information is intended to demonstrate progress the Fund has made in accumulating sufficient assets to pay benefits when due and the related actuarial assumptions used in determining the actuarially determined amounts.

3. CASH AND CASH EQUIVALENT SECURITIES

The cash balances of the Fund have been categorized to indicate the level of risk assumed by the Fund at year-end. Category 1 includes cash balances insured or collateralized with securities held by the Fund or by its agent in the name of the Fund. Category 2 includes cash balances collateralized with securities held by the pledging financial institutions' trust department or agent in the name of the Fund. Category 3 includes uncollateralized cash balances (including any bank balance collateralized with securities held by the pledging financial institution or by its trust department or agent, but not in the name of the Fund). The cash balances of the Fund meet the criteria of Category 1 in both years. Cash on deposit with the custodian bank of the Fund is covered by securities held in the Fund's name.

4. INVESTMENTS

The investments of the Fund have been categorized to indicate the level of risk assumed by the Fund at year-end. Category 1 includes investments that are insured or registered, or for which the securities are held by the Fund or its agent in the name of the Fund. Category 2 includes investments which are uninsured and unregistered, with securities held by the counterparty's trust department or agent in the name of the Fund. Category 3 includes investments which are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent, but not in the name of the Fund. Commingled funds and other investments are not required to be so categorized as they are not evidenced by securities that exist in physical or book entry form.

NOTES TO FINANCIAL STATEMENTS *(continued)*

The following table presents a summary of the Fund's investments at fair value and the related category of custodial credit risk as of June 30, 2002.

	Category 1	Category 3	Not categorized	Total
Short-term investment funds	$ 41,749,422	$ —	$ —	$ 41,749,422
Commingled equity funds	—	—	69,579,929	69,579,929
Commingled international equity funds	—	—	303,803,806	303,803,806
Fixed income funds:				
United States government securities	2,992,381	—	—	2,992,381
Corporate bonds	412,731,923	—	—	412,731,923
Other fixed-income securities	—	63,007,973	—	63,007,973
Common stocks	—	327,237,969	—	327,237,969
Preferred stocks	—	2,616,028	—	2,616,028
Other investments — partnerships	—	—	406,673,174	406,673,174
Collateral on securities lending arrangements, at fair value	—	100,566,412	—	100,566,412
Total investments	$457,473,726	$493,428,382	$780,056,909	$1,730,959,017

The following table presents a summary of the Fund's investments at fair value and the related category of custodial credit risk as of June 30, 2001.

	Category 1	Category 3	Not categorized	Total
Short-term investment funds	$ 36,154,537	$ —	$ —	$ 36,154,537
Commingled equity funds	—	—	114,347,979	114,347,979
Commingled international equity funds	—	—	181,916,413	181,916,413
Fixed-income funds:				
United States government securities	10,391,534	—	—	10,391,534
Corporate bonds	455,764,085	—	—	455,764,085
Other fixed-income securities	—	67,074,122	—	67,074,122
Common stocks	—	422,638,053	—	422,638,053
Preferred stocks	—	15,737,005	—	15,737,005
Other investments — partnerships	—	—	376,626,171	376,626,171
Collateral on securities lending arrangements, at fair value	—	105,276,630	—	105,276,630
Total investments	$502,310,156	$610,725,810	$672,890,563	$1,785,926,529

The Fund owned the following investments, which exceeded 5% of plan net assets, as of June 30:

	2002	2001
Loomis, Sayles & Company	$300,518,527	—
STW Fixed Income Management	234,082,153	—
Gulf Investment Management, Inc.	102,293,316	—
Alliance Bernstein Institutional Investment Management	126,527,326	—
Schroder Capital Management	139,518,857	—
Mellon Capital Management International — Country Allocation Fund	—	94,045,882
EB Stock Index Fund	—	89,617,979

NOTES TO FINANCIAL STATEMENTS *(continued)*

5. BUILDING

In February 1998, the Fund purchased land for use in the construction of a new office building for its operations and its members. In April of 2001, the construction of the new building was completed. As of June 30, 2002 and 2001, all capitalized costs associated with the building have been classified as building. The building cost of $9,070,087 and $9,059,365, respectively, is being depreciated over 30 years. The accumulated depreciation for the building as of June 30, 2002 and 2001 amounted to $382,730 and $76,559, respectively.

6. FURNITURE, FIXTURES, AND EQUIPMENT

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

	2002	2001
Office furnishings and equipment	$669,930	$642,710
Computer equipment	291,542	90,998
	961,472	733,708
Less accumulated depreciation and amortization	(186,162)	(34,419)
Furniture, fixtures and equipment — net	$775,310	$699,289

7. SECURITIES LENDING ARRANGEMENTS

The Fund had the following securities on loan and held the following related collateral balances, at fair value, as of June 30:

	2002		2001	
	Securities lent	Collateral held	Securities lent	Collateral held
United States government securities	$ 16,531,510	$ 16,782,033	$ 18,860,696	$ 19,236,903
Corporate bonds	63,770,387	65,379,337	57,726,836	59,300,200
Other fixed-income securities	2,864,370	3,016,164	2,908,948	3,054,480
Common and preferred stocks	17,400,145	18,411,205	25,780,150	27,274,435
	$100,566,412	$103,588,739	$105,276,630	$108,866,018

State statutes and Board policies permit the Fund to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The Fund's custodian lends securities of the type on loan for collateral in the form of cash or other securities of 101% to 109%, which varies based on the types of securities lent. The Fund has no credit risk exposure to borrowers because the amounts the Fund owes the borrowers exceed the amounts the borrowers owe the Fund as of June 30, 2002 and 2001. The contract with the Fund's custodian requires it to indemnify the Fund if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the Fund for income distributions by the securities' issuers while the securities are on loan.

All security loans can be terminated on demand by either the Fund or the borrower, although the average term of the loans is approximately 83 days and 108 days for June 30, 2002 and June 30, 2001, respectively. Cash collateral is invested in the lending agent's collateral investment pool, which has a weighted-average maturity of approximately 59 days and 113 days as of June 30, 2002 and 2001, respectively. The relationship between the maturities of the investment pool and the Fund's loans is affected by the maturities of the security loans made by other entities that use the agent's pool, which the Fund cannot determine. The Fund cannot pledge or sell collateral securities received unless the borrower defaults. At June 30, 2002 and 2001, securities lending transactions were collateralized in cash.

8. COMMITMENTS AND CONTINGENCIES

As described in Note 1, certain members of the Fund are entitled to refunds of their accumulated contributions on termination of employment with the City, prior to being eligible for pension benefits. As of June 30, 2002 and June 30, 2001, aggregate contributions from active members of the Fund with less than ten tears of service were approximately $14,200,000 and $11,100,000, respectively. Contributions for employees with 10 to 20 years of service has not been determined. As of June 30, 2002 and 2001, interest payable related to these contributions has not been accrued.

The Fund had outstanding investment commitments to various limited partnerships and international investment advisors of approximately $165,000,000 and $162,000,000 as of June 30, 2002 and 2001, respectively.

Pursuant to the May 23, 1993 revision of Section 2(l), Chapter 432, Acts of the 64th Legislature, 1973 (Article 6243e.2, *Vernon's Texas Civil Statutes*), the Board may, from Fund assets, establish a self-insurance fund to pay certain claims for indemnification. On June 17, 1993, the Board voted to adopt this subsection allowing for the establishment of a self-insurance fund from Fund assets. The self-insurance fund is a designation of plan net assets by the Board. As of June 30, 2002 and 2001, cumulative contributions made to the self-insurance fund by the Fund have been approximately $5,000,000.

The Fund offers its employees a deferred compensation plan (the Plan) created in accordance with Internal Revenue Code 457. The Plan, available to all employees of the Fund, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. The Plan is administered by the Public Employee Benefits Corporation (PEBSCO), a division of Nationwide Retirement Solutions. Amounts deferred are held in trust by PEBSCO and, since the Fund has no fiduciary responsibility for the Plan, these amounts are not reflected in the accompanying financial statements in accordance with GASB Statement No. 32.

The Fund is a party to various claims and legal actions arising in the ordinary course of its business which, in the opinion of management, will not have a material effect on the Fund's financial position.

9. RELATED PARTY

During fiscal year 2002 and 2001, the Plan utilized the services of an investment management company (in which the Plan also owns an interest) in the amounts of $270,198 and $253,249, respectively.

SUPPLEMENTAL SCHEDULES

SCHEDULE I INVESTMENT SUMMARY

Year Ended June 30, 2002

Type of investment	June 30, 2001 fair value	Purchases	Sales and redemptions	Net appreciation (depreciation) in fair value	June 30, 2002 fair value	Percentage of market value
Short-term investment funds (value at cost)	$ 36,154,537	$404,174,196	$(410,036,601)	$ 11,457,290	$ 41,749,422	2.5%
Commingled equity fund	114,347,979	—	—	(44,768,050)	69,579,929	4.3%
Commingled international equity funds	181,916,413	115,369,237	(133,399,146)	139,917,302	303,803,806	18.6%
Fixed income:						
United States government securities	10,391,534	29,849,659	(37,452,043)	203,231	2,992,381	0.2%
Corporate bonds	455,764,085	—	(1,884,694)	(41,147,468)	412,731,923	25.3%
Other fixed-income securities	67,074,122	268,283,859	(248,252,173)	(24,097,835)	63,007,973	3.9%
Total fixed income	533,229,741	298,133,518	(287,588,910)	(65,042,072)	478,732,277	29.4%
Common stocks	422,638,053	109,597,999	(98,302,171)	(106,695,912)	327,237,969	20.1%
Preferred stocks	15,737,005	—	(1,123,747)	(11,997,230)	2,616,028	0.2%
Other investments – partnerships	376,626,171	66,146,355	—	(36,099,352)	406,673,174	24.9%
	$1,680,649,899	$993,421,305	$(930,450,575)	$(113,228,024)	$1,630,392,605	100%

Space and cost restrictions make it impractical to print the entire investment portfolio in this report. A portfolio listing is available for review at the office of the Fund.

Sales and redemptions are presented at cost in the above table.

See accompanying independent auditors' report.

SUPPLEMENTAL SCHEDULES *(continued)*

SCHEDULE 2 INVESTMENT, PROFESSIONAL SERVICES AND ADMINISTRATIVE EXPENSES

Years Ended June 30, 2002 and 2001

	2002	2001
Investment services:		
Custodial services	$ 263,129	$ 292,044
Money management services	5,617,213	5,837,996
Total investment services	$5,880,342	$6,130,040
Professional services:		
Actuarial services	$ 136,590	$ 52,500
Audit and accounting services	17,500	18,500
Consulting services	326,448	305,493
Legal services	77,080	249,435
Medical examinations	8,500	1,450
Other	—	4,347
Total professional services	$ 566,118	$ 631,725
Administrative expenses:		
Depreciation expense	$ 457,913	$ 110,978
Continuing education	372,721	285,218
Furniture, equipment and supplies	46,444	49,604
Insurance	636,880	532,369
Investment research	49,229	53,651
Office cost	2,903,440	2,198,494
Rent	—	135,589
Facility maintenance	120,436	51,533
Utilities	152,710	53,106
Other	2,749	173
Total administrative expenses	$4,742,522	$3,470,715

See accompanying independent auditors' report.

SUPPLEMENTAL SCHEDULES *(continued)*

SCHEDULE 3 SUMMARY OF INVESTMENT AND PROFESSIONAL SERVICES

Year Ended June 30, 2002

Individual or firm name	Official plan position	Payment	Nature of services
Mellon Trust	Custodian	$ 343,361	Custodial
GW Capital	Investment manager	160,811	Money management
Gulf Investment Management, Inc.	Investment manager	418,611	Money management
Hicks, Muse, Tate & Furst, Inc.	Investment manager	75,000	Money management
Loomis, Sayles & Company, Inc.	Investment manager	693,342	Money management
Mellon Capital Management Corporation	Investment manager	363,174	Money management
Alliance Bernstein Institutional Investment Management	Investment manager	854,715	Money management
Schroder Investment Management North America Inc.	Investment manager	399,868	Money management
State Street Research & Management Company	Investment manager	128,035	Money management
STW Fixed Income Management	Investment manager	449,119	Money management
Scudder Kemper	Investment manager	238,757	Money management
The Mitchell Group	Investment manager	218,618	Money management
Blackstone Domestic Capital	Investment manager	183,740	Money management
Hyperion II Advisors	Investment manager	145,661	Money management
Industrial Growth Partners	Investment manager	29,379	Money management
Mellon Bond Associates	Investment manager	97,809	Money management
Schroder Emerging Markets	Investment manager	489,098	Money management
Energy Trust	Investment manager	270,198	Money management
Total payments		5,559,296	
Accrued at June 30, 2001		(1,212,924)	
Accrued at June 30, 2002		1,533,970	
Total investment services		$5,880,342	
Towers Perrin	Actuary	$ 136,590	Actuarial
Mir•Fox & Rodriguez, P. C.	Auditors	17,500	Audit and accounting
Pension Consulting Alliance	Consultant	48,750	Consulting
Smith Datacom	Computer consultant	2,240	Consulting
Fred Halperin, HR&C	Consultant	11,567	Consulting
Gene de LaVeaga	Consultant	6,150	Consulting
Vitech Systems Group	Consultant	62,331	Consulting
The Dini Partners, Inc.	Consultant	6,500	Consulting
Lloyd Brown Search Consultant, LLC	Consultant	22,995	Consulting
MDS Research Company, Inc.	Consultant	9,000	Consulting
The Burgiss Group	Consultant	21,393	Consulting
HCC Employee Benefits, Inc	Consultant	1,523	Consulting
William & Jenson	Consultant	24,000	Consulting
Locke, Lidell, and Sapp	Attorneys	108,238	Consulting
Other	Other	4,509	Consulting
McAfee & Taff	Attorneys	1,278	Legal
Strasburger and Price, L.L.P.	Attorneys	79,685	Legal
Gilbreth & Associates, P. C.	Attorneys	1,100	Legal
Other	Other	(4,982)	Legal
Texas Occupational Medicine	Physicians	8,500	Medical examinations
Total payments		568,867	
Accrued at June 30, 2001		(2,749)	
Accrued at June 30, 2002		—	
Total professional services		$ 566,118	

See accompanying independent auditors' report.

SCHEDULE 4 SCHEDULE OF FUNDING PROGRESS (UNAUDITED)

(dollars in millions)

Valuation date	Actuarial value of assets (AVA)	Actuarial accrued liability (AAL)	AVA as percentage of AAL	Excess funded AAL	Covered payroll	Excess funded AAL as percentage of covered payroll
7-1-92	$ 694.1	$ 670.1	104%	$ (24.0)	$102.4	(23)%
7-1-93	762.8	758.6	101	(4.2)	119.5	(3)
7-1-94	831.7	793.0	105	(38.7)	120.1	(32)
7-1-95	912.4	852.3	107	(60.1)	127.0	(47)
7-1-96	1,024.5	989.3	104	(35.2)	131.6	(27)
7-1-97	1,183.8	1,128.2	105	(55.6)	142.0	(39)
7-1-98	1,347.4	1,271.4	106	(76.0)	149.0	(51)
7-1-99	1,538.5	1,470.6	105	(67.9)	159.0	(43)
7-1-00	1,726.3	1,589.3	109	(137.0)	163.6	(84)
7-1-01	1,863.1	1,650.8	113	(212.3)	164.3	(129)

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

See accompanying notes to supplemental information.

See accompanying independent auditors' report.

SCHEDULE 5 SCHEDULE OF EMPLOYER CONTRIBUTIONS (UNAUDITED)

(dollars in thousands)

Year ended June 30	Annual required contribution	Percentage contributed
1993	$ 16,716	100%
1994	17,670	100
1995	17,600	100
1996	18,847	100
1997	20,312	100
1998	21,720	100
1999	24,084	100
2000	24,645	100
2001	24,033	100
2002	28,451	100

Contributions were made in accordance with actuarially determined contribution requirements as adopted by the Board of Trustees.

See accompanying notes to supplemental information.

See accompanying independent auditors' report.

REQUIRED SUPPLEMENTAL SCHEDULES

Ten-year historical trend information (continued)

NOTES TO REQUIRED SUPPLEMENTAL SCHEDULES

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

Valuation date	July 1, 2001
Actuarial cost method	Entry age method
Amortization method	Level percent of payroll ending December 31, 2022, closed
Remaining amortization period	21 years
Asset valuation method	Five-year smoothed market
Actuarial assumptions:	
Investment rate of return	8.5%, net of expenses
Salary increases in excess of inflation	0% to 6%, based on seniority and merit
General inflation rate	4% per year
Cost of living adjustment	3% annually

See accompanying independent auditors' report.

Section 3 Investment Section

REPORT OF THE CHIEF INVESTMENT OFFICER and OUTLINE OF INVESTMENT POLICIES

The primary goal of the Houston Firefighters' Relief and Retirement Fund's investment program is to provide both timely and sufficient benefits to plan participants. The Fund's Board of Trustees seeks to produce a return through its investment program that is adequate to maintain the fully funded actuarial status of the Fund, while minimizing risk through portfolio diversification.

In Fiscal Year 2002, the Fund experienced a rate of return of (2.39%). The Fund's investments performed well among its peer group in increasingly volatile markets.

OUTLINE OF INVESTMENT POLICIES

The Board of Trustees of the Houston Firefighters' Relief and Retirement Fund has adopted the following policies. Authority to amend these policies rests solely with the Board of Trustees, which may delegate authority to act on certain matters to the Investment Committee, a committee consisting of the whole Board of Trustees.

INVESTMENT POLICIES

Investment Philosophy

In developing the investment program, the Investment Committee is guided by a set of precepts from which all investment decisions are made, establishing the foundation and direction for all future activity. The Investment Committee applies these precepts knowing the importance of asset allocation and the benefits of diversification. The guiding precepts consist of the following: long-term focused, value-driven, relationship-driven, opportunistic and contrarian.

Asset Allocation

The Investment Committee completed an asset allocation study during the year, which resulted in new asset classes, strategic allocations, ranges, and benchmarks. The Investment Committee has allocated the assets of the Fund to several asset classes with the objective of optimizing the investment return of the Fund within the framework of acceptable risk and diversification. Each asset class is allowed to operate within its specific range established by the Investment Committee. In addition, a strategic allocation has been established for each asset class for the purpose of semi-annual performance evaluation and asset rebalancing. If an asset class allocation reaches an endpoint of its range, the Investment Committee shall rebalance to within the asset class range, as needed, to meet investment return objectives. Current asset classes, asset class ranges, and strategic allocations are as follows:

Asset class	Asset class range	Strategic allocation
Domestic Equities	15% – 25%	20%
International	19% – 29%	24%
Domestic Fixed Income	30% – 40%	35%
Alternative Investments	15% – 25%	20%
Cash	0.5% – 1.5%	1%

Investment Managers

The Board has adopted policies that govern the investment manager selection process, guidelines applicable to the managers, and review and retention procedures for all managers retained by the Fund.

The Fund's Investment Committee uses a systematic process in the selection of investment managers. This process includes rigorous due diligence by the Investment Committee, with assistance from staff and consultants. Manager guidelines include general guidelines applicable to all managers and specific guidelines unique to each manager. Specific guidelines unique to each manager are developed cooperatively by the Board and manager, and incorporated into the Investment Management Services Contract executed by the Board and manager. The Investment Committee, with assistance from staff, continuously monitors each manager's performance and adherence to style, strategy, and manager-specific guidelines. All active managers are required to present before the Committee annually, while passive and alternative managers are reviewed as necessary.

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

OUTLINE OF INVESTMENT POLICIES *(continued)* and ASSET ALLOCATION

Performance Objectives

The performance objective of the Fund is to meet or exceed the actuarial rate plus Fund expenses, currently 8.5% plus 75 basis points, over a long-term horizon which is defined as 10 years. To assess the performance of the overall Fund, the Investment Committee has established a target mix portfolio, which is reflective of the most recently approved asset allocation study. The target mix portfolio will consist of the following index weightings, which are representative of the Fund's current asset allocation:

Asset class	Weight	Index
Domestic Equities	20%	Russell 3000
International	24%	MSCI All Country World Ex-US Index
Domestic Fixed Income	35%	Lehman Universal Index
Alternative Investments	20%	Flat Rate 15%
Cash	1%	Merrill Lynch 91-Day Treasury Bill Index

Each manager is assigned an investment performance benchmark relative to his/her style of management. The performance objective for each manager is to provide a five-year rolling alpha in excess of the manager's fees.

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

Regarding Corporate Governance

The Board of Trustees recognizes its fiduciary obligation to cast its votes in corporate affairs. The Board adopts a written statement of proxy policies and reviews this statement annually. As a part of this policy, the Board has adopted the shareholder's bill of rights, as adopted by the Council of Institutional Investors. All proxies are to be voted in a timely manner in accordance with expressed policies. Voting practices are documented and reviewed by the Board. Shareholder and management proposals are both entitled to due consideration and are given the same degree of attention. At the present time, the Board of Trustees recognizes that voting on international corporate affairs is an extremely specialized and administratively difficult enterprise. The Board of Trustees may, at its discretion and through contractual means, delegate the authority to sign and submit proxy material on behalf of the Fund to international outside managers.

ASSET ALLOCATION *(dollars in millions)*

	Fiscal year ended June 30, 1998		1999		2000		2001		2002	
	Market value	Percent	Market value	Percent	Market value	Percent	Market value	Percent	Market value	Percent
Cash Equivalents	$ 98.8	6.4%	$ 9.7	0.6%	$ 9.3	0.5%	$ 24.1	1.4%	$ 9.8	0.6%
Domestic Equity	509.2	33.1	519.8	32.3	460.6	26.1	395.7	23.0	388.8	23.5
Domestic Fixed Income	322.1	21.0	331.6	20.6	542.7	30.7	586.1	34.1	596.2	36.1
High-Yield Securities	179.4	11.7	202.3	12.6	—	—	—	—	—	—
International Equities	241.9	15.7	278.6	17.3	351.2	19.9	337.7	19.7	310.3	18.8
Alternative Investments	185.9	12.1	266.7	16.6	402.5	22.8	374.1	21.8	346.2	21.0
	$1,537.3	100.0%	$1,608.7	100.0%	$1,766.3	100.0%	$1,717.7	100.0%	$1,651.3	100.0%

INVESTMENT RESULTS

TOTAL FUND RETURN

	Period ended June 30,					Annualized period ended 6/30/02	
	1998	1999	2000	2001	2002	3-Year	5-Year
HFRRF	**13.1%**	**5.5%**	**10.3%**	**1.1%**	**(2.4%)**	**2.1%**	**4.9%**

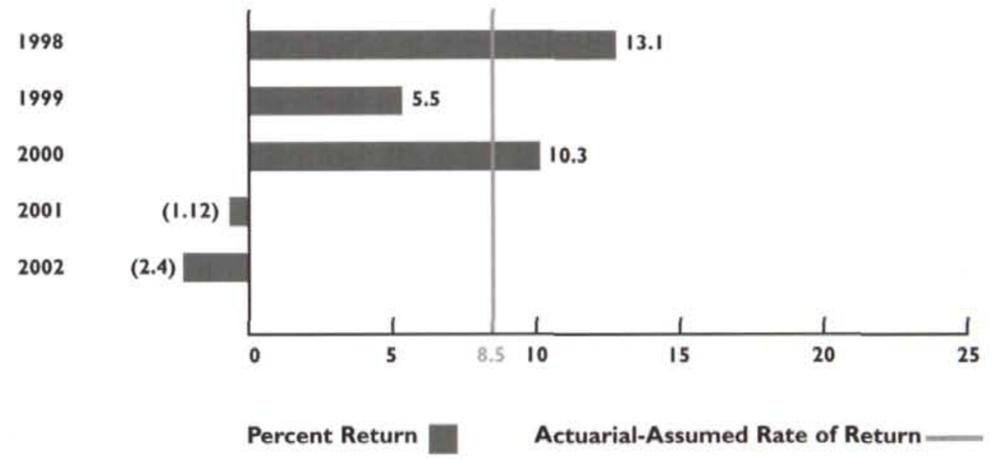
RETURNS BY ASSET CLASS

						Annualized period ended 6/30/02	
	1998	**1999**	**2000**	**2001**	**2002**	**3-Year**	**5-Year**
Cash							
HFRRF*	6.3%	14.8%	9.9%	12.2%	9.3%	10.5%	10.4%
Merrill Lynch 90-Day T-Bill	5.3	4.9	5.5	5.9	2.6	4.7	4.8
Domestic Equity							
HFRRF	14.6	6.7	(1.4)	11.2	(1.0)	2.8	5.8
Russell 3000	28.8	20.1	9.6	(13.9)	(17.3)	(7.9)	3.8
Domestic Fixed Income							
HFRRF	13.2	2.2	4.8	5.2	1.8	3.9	5.3
Lehman Universal Index	10.1	2.6	4.8	10.8	7.7	7.7	7.2
International Equities							
HFRRF	6.1	6.3	22.1	(22.2)	(8.1)	(4.5)	(0.3)
MSCI All Country World Ex-US Index	6.3	7.4	18.8	(23.8)	(9.4)	(6.4)	(1.3)
Alternative Investments							
HFRRF	22.5	8.5	29.8	(3.1)	(5.7)	5.9	9.5
Flat 15%	15.0	15.0	15.0	15.0	15.0	15.0	15.0

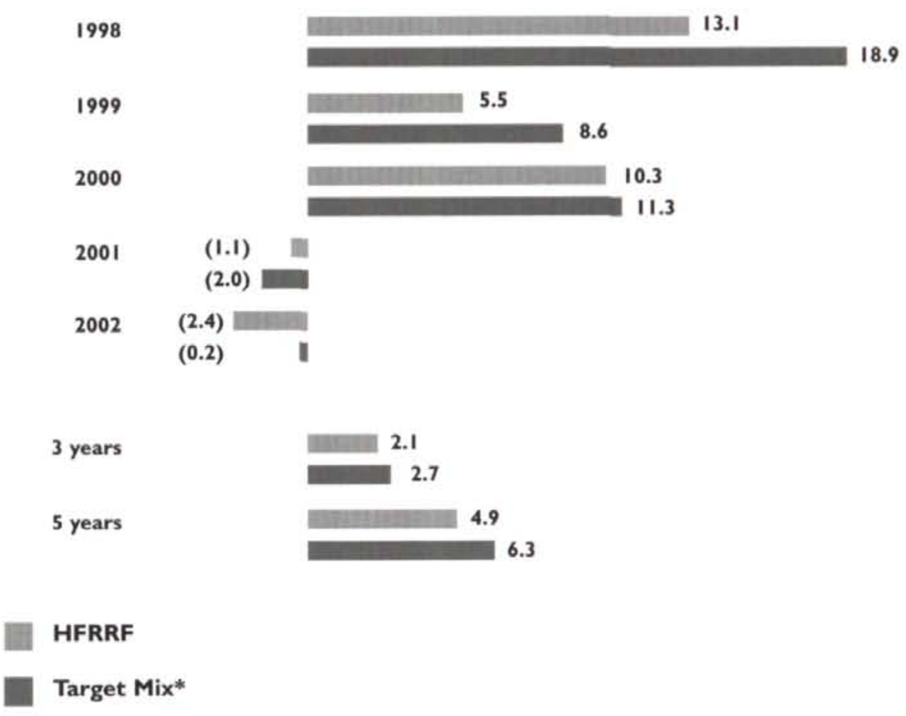
* *Includes results from equity distributions into the cash account*

INVESTMENT RESULTS *(continued)*

TOTAL FUND RETURN vs. ACTUARIAL-ASSUMED RATE OF RETURN



TOTAL FUND RETURN vs. TARGET MIX RETURN



** "Target mix," or target asset mix portfolio, is explained on pages 40-41.*

INVESTMENT RESULTS *(continued)*

COMPARISON OF INVESTMENT RETURNS *Years Ended June 30*

Year	Total Fund	Median Total Fund*	Fund Domestic Equity Investments	Russell 3000 Stock Index	S&P500 Stock Index	Fund Fixed-Income (bond) Investments	Lehman Bros. Universal	Lehman Bros. Gov/Credit	Fund International Equity	MSCI All Country World Ex-US	MSCI EAFE
1978	1.9%	2.1%	3.0%	—%	0.1%	1.2%	—%	1.0%	—%	—%	—%
1979	8.9	10.4	14.7	—	13.6	6.7	—	7.7	—	—	—
1980	11.8	11.4	17.5	18.7	17.3	1.1	—	3.8	—	—	—
1981	11.8	12.1	27.1	23.2	20.6	(11.0)	—	(4.1)	—	—	—
1982	3.4	(1.0)	(7.1)	(13.9)	(11.5)	5.6	—	13.3	—	—	—
1983	36.4	44.1	65.9	66.4	61.2	29.5	—	29.1	—	—	—
1984	(3.9)	(3.7)	(11.7)	(8.5)	(4.7)	(0.2)	—	1.8	—	—	—
1985	27.7	27.3	30.6	31.2	30.9	32.3	—	28.7	—	—	—
1986	21.7	26.1	26.5	35.7	35.8	19.1	—	20.7	—	—	—
1987	13.6	12.5	19.6	19.8	25.1	8.3	—	4.7	—	—	—
1988	3.6	0.6	1.2	(6.1)	(7.1)	11.4	—	7.5	—	—	—
1989	12.8	14.6	16.8	19.7	20.5	10.9	—	12.3	—	—	—
1990	9.3	10.2	14.4	13.5	16.4	4.9	—	7.1	—	—	—
1991	3.7	7.4	2.4	7.2	7.4	11.3	10.7	10.2	(10.6)	—	(11.5)
1992	8.4	13.3	7.5	14.7	13.5	24.6	14.2	14.2	0.8	—	(0.7)
1993	16.7	13.6	19.7	16.0	13.6	20.7	12.0	13.2	12.2	—	20.3
1994	5.7	2.4	2.0	1.0	1.3	2.0	(1.1)	(1.5)	19.7	—	17.0
1995	15.5	16.7	22.1	24.9	26.1	17.5	12.4	12.8	4.1	—	1.7
1996	16.9	17.4	21.5	26.0	26.1	12.2	5.7	4.7	17.9	—	13.3
1997	23.2	20.0	31.5	30.6	34.6	14.3	8.8	7.8	15.5	—	12.8
1998	13.1	17.9	14.6	28.8	30.2	13.2	10.1	11.3	6.1	—	6.1
1999	5.5	11.4	6.7	20.1	22.7	2.2	2.6	2.7	6.3	8.3	7.6
2000	10.3	10.0	(1.4)	9.6	7.3	4.8	4.8	4.3	22.1	16.6	17.2
2001	(1.1)	(4.7)	11.2	(13.9)	(14.8)	5.2	10.8	11.1	(22.2)	(25.4)	(24.8)
2002	**(2.4)**	**(6.0)**	**(1.0)**	**(17.3)**	**(18.0)**	**1.8**	**7.7**	**8.2**	**(8.1)**	**(9.4)**	**(9.5)**

** Trust Universe Comparison Service all master trusts total returns*

COMPOUND ANNUAL RETURN *Years Ended June 30*

	Total Fund	Median Total Fund*	Fund Domestic Equity Investments	Russell 3000 Stock Index	S&P500 Stock Index	Fund Fixed-Income (bond) Investments	Lehman Bros. Universal	Lehman Bros. Gov/Credit
2	(1.8)%	(5.5)%	4.9%	(15.6)%	(16.4)%	3.5%	9.2%	6.5%
3	2.1	(0.3)	2.8	(7.9)	(9.1)	3.9	7.7	6.6
5	4.9	5.7	5.8	3.8	3.7	5.3	7.2	6.6
10	10.1	9.9	12.3	11.3	11.5	9.2	7.3	6.9

** All master trusts total returns*

INVESTMENT HOLDINGS SUMMARY

INVESTMENT HOLDINGS

	Market value at June 30, 2002	Percent of total market value
Cash Equivalents	$ 41,749,422	2.6%
Equities		
Commingled Equity Fund	69,579,929	4.3
Commingled Intl Equity Fund	303,803,806	18.6
Common Stock	327,237,969	20.1
Preferred Stock	2,616,028	0.16
	703,237,732	43.1
Fixed Income		
U.S. Government Securities	2,992,381	0.2
Corporate Bonds	412,731,923	25.3
Other Fixed Income	63,007,973	3.9
	478,732,277	29.4
Other Investments	406,673,174	24.9
Total Market Value	**$1,630,392,605**	**100.0%**

Market value represents the value of the investment holdings only and excludes receivables, payables and foreign currency fluctuations.

TEN LARGEST EQUITY INVESTMENT HOLDINGS *(excluding commingled funds)*

Description	Market value	Percent of total market value*
SOUTHWEST AIRLS CO COM	$5,656,000	0.34%
JOHNSON & JOHNSON COM	5,644,080	0.34
WELLS FARGO & CO NEW COM	5,256,300	0.32
CHEVRONTEXACO CORP COM	5,095,122	0.31
ALLSTATE CORP COM	4,807,400	0.29
BAXTER INTL INC COM	4,800,600	0.29
AMERICAN EXPRESS CO COM	4,794,240	0.29
BANK OF AMERICA CORP	4,643,760	0.28
CHUBB CORP COM	4,602,000	0.28
J P MORGAN CHASE & CO COM	3,900,800	0.24

**Total market value represents the value of the investment holdings only and excludes receivables, payables and foreign currency fluctuations.*

Please contact the investment staff of HFRRF for a complete list of holdings.

INVESTMENT HOLDINGS SUMMARY *(continued)*

TEN LARGEST FIXED-INCOME HOLDINGS

Description	Market value	Percent of total market value*
GENERAL ELEC CAP MTN TR 00521	$18,301,706	1.11%
DRESDNER FDG SILENT PRTNR 144A	16,465,120	1.00
VODAFONE AIRTOUCH PLC NT	11,970,695	0.72
CALIFORNIA INFRAC 1997-1 A7	10,074,638	0.61
TELEFONICA EUROPE BV US NT	9,462,000	0.57
FORD MTR CO DEL DEBS	8,972,499	0.54
FRANCE TELECOM SA NT	8,075,285	0.49
BANGKOK BK PUB LTD NT 144A	7,892,500	0.48
VERIZON GLOBAL FDG CORP NT	7,460,330	0.45
BANC ONE CORP 7.750% 7/15/2025	7,336,760	0.44

** Total market value represents the value of the investment holdings only and excludes receivables, payables, and foreign currency fluctuations.*

FEES FOR INVESTMENT SERVICES

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	Fiscal Year 2002			Fiscal Year 2001		
	Assets under management	Fees	Basis points*	Assets under management	Fees	Basis points*
Investment Management Fees						
Cash Equivalents Manager [1]	$ 51,138,368	$ 97,809	17	$ 49,244,038	$ 76,470	16
Domestic Equity Managers	387,851,912	1,619,980	41	417,277,313	1,713,136	41
International Equity Managers	310,265,477	1,490,896	49	576,722,405	2,043,863	60
Fixed-Income Managers [2]	596,176,770	1,303,273	22	339,135,105	1,274,329	22
Alternative Investments [3]	—	698,383	—	—	848,918	—
Other Investment Services						
Custodial	—	343,361	—	—	300,492	—
Consultant	—	48,750	—	—	31,146	—
Total Fees for Investment Services	—	$ 5,602,451	—	—	$ 6,288,354	—

** Calculated using average quarterly assets under management*
[1] *Includes cash from managers' accounts*
[2] *High-Yield Manager also included*
[3] *Fees presented are only those fees paid directly by the Fund.*

2002 BROKERAGE COMMISSIONS

(in order of commissions received)

Broker name	Base commissions	Shares	Per share
LYNCH, JONES & RYAN INC, HOUSTON*	$169,581	3,313,559	0.05
MERRILL LYNCH INTL (MEIT), LONDON	63,950	4,102,133	0.02
LEHMAN BROS, LONDON	35,281	1,308,449	0.05
CREDIT SUISSE FIRST BOSTON (EUROPE)	31,859	784,377	0.01
MORGAN GRENFELL, LONDON	28,182	2,315,966	0.04
UBS EQUITIES, LONDON	25,794	2,172,557	0.04
MORGAN STANLEY INTL, LONDON	21,744	1,099,268	0.02
GOLDMAN SACHS INTL, LONDON	20,625	2,605,264	0.03
KLEINWORT BENSON SECS LTD, LONDON	19,830	465,900	0.02
JAMES CAPEL, LONDON	19,028	1,099,632	0.02
WARBURG SECS, HONG KONG	14,313	161,734	0.02
SALOMON BROS INC, NEW YORK	13,755	624,260	0.01
CREDIT SUISSE FIRST BOSTON CORP, N Y	13,741	234,066	0.04
MORGAN STANLEY & CO INC, NY	12,612	518,579	0.02
SMITH BARNEY INC, NEW YORK	11,406	206,888	0.05
MORGAN J P SECS INC, NEW YORK	9,450	182,196	0.05
FOX-PITT KELTON INC	8,766	182,830	0.05
MERRILL LYNCH PIERCE FENNER & SMITH, LON	8,377	438,100	0.05
COMMERZBANK, LONDON	8,371	125,641	0.08
UBS BUNTING WARBURG INC, TOR (T015,BWIT)	8,192	256,390	0.03
GOLDMAN SACHS & CO, NY	6,750	125,000	0.05
DEUTSCHE BANC ALEX BROWN INC, NEW YORK	6,730	134,600	0.05
MONTGOMERY SECURITIES, SAN FRANCISCO	6,408	106,800	0.06
HOWARD WEIL LABOUISSE FRIEDRICHS, NEW OR	5,224	92,670	0.06
DAIN RAUSCHER INC, MINN	4,559	76,114	0.06
CHEVREUX DE VIRIEU SA, PARIS	4,477	107,666	0.02
PRECURSOR GROUP INC, JERSEY CITY	4,467	85,925	0.05
LEHMAN BROS INC, NEW YORK	4,326	84,600	0.05
LEGG MASON WOOD WALKER INC, BALTIMORE	4,055	81,100	0.05
JONES & ASSOC, WESTLAKE VILLAGE	3,925	78,500	0.05
RAYMOND JAMES & ASSOC INC, ST PETERSBURG	3,776	74,500	0.05
J & E DAVY, DUBLIN	3,746	167,106	0.02
SALOMON BROS ASIA LTD, HONG KONG	3,576	178,000	0.02
WEISS PECK & GREER, NEW YORK	3,545	59,075	0.06
KIM ENG SEC LTD, HONG KONG	3,515	70,300	0.05
UBS, STAMFORD	3,355	29,266	0.06
YORKTON SECS INC, TORONTO	3,294	121,700	0.03
UBS (AUSTRALIA) LTD, SYDNEY	3,242	148,600	0.03
FECHTOR DETWILER & CO INC, BOSTON	3,185	63,700	0.05
SG COWEN SECS CORP, NEW YORK	3,138	59,000	0.05
SIMMONS & CO INTL, HOUSTON	2,880	48,000	0.06
BANK OF AMERICA, LONDON	2,705	44,376	0.12
J B WERE & SON LTD, LONDON	2,608	122,500	0.02
COUNTY NATWEST SECS, SYDNEY	2,163	89,100	0.02
BUNTING (ALFRED) & CO, TORONTO	2,111	83,700	0.02
STANDARD & POORS SEC INC, NEW YORK	2,110	42,200	0.05
OTHER BROKERS	34,272	1,097,043	0.04
	$678,995	**25,668,930**	**0.04**

Totals may include slight variances due to rounding. ** Commission recapture broker*

COMMISSION RECAPTURE PROGRAM

Houston Firefighters' Relief and Retirement Fund began a brokerage commission recapture program in 1993. Currently, the brokerage firms of Lynch, Jones & Ryan Inc. and Smith Barney Inc. participate in the program. A portion of any commission generated by trading activity conducted by the Fund's investment managers with these firms is returned or recaptured by the Fund. The amount of the commissions recaptured is defined via contracts with the individual brokerage firms and varies with the type of trading activity. Any commissions recaptured are deposited in the investment manager's account from whom the trading activity originated. The Fund's investment managers are not required to participate in the program, but the Board feels it has provided ample financial incentive for solid participation. During Fiscal Year 2002, approximately 52% of all trading activity was directed toward the commission recapture program.

Section 4 Actuarial Section

AN OVERVIEW OF THE ACTUARIAL VALUATION

There are several types of retirement plans, each designed to provide income security after retirement. How each type of plan is funded varies depending on the type of plan. The Houston Firefighters' Relief and Retirement Fund is a single-employer defined benefit plan, which requires an actuarial valuation to determine the amount of funding required to pay benefits. Another type of plan, a defined contribution plan, does not require an actuarial valuation.

TYPES OF RETIREMENT PLANS

Defined contribution plans accumulate contributions (employee only, or employee and employer). The plan then provides a benefit based on the actual investment growth (or decline) of those contributions. A specific benefit is not promised. Adequate funding is accomplished simply by making the required contributions.

The Houston Firefighters' Relief and Retirement Fund is a defined benefit plan. Defined benefit plans represent a promise to pay specific benefits to employees. The benefit to employees and their survivors is usually much more than the combined contributions of the employee (if specified) and the employer. Determining adequate funding requires making a variety of assumptions to assure full payments can be made from the plan.

FUNDING FOR A DEFINED BENEFIT PLAN

Adequate funding of a defined benefit plan is necessary because employees are promised a specific benefit at retirement (based on the plan formula). Therefore, there must be enough money in the plan to pay the benefits that have been promised.

The exact amount of money required to provide future benefits cannot be determined without making some assumptions. It is necessary for an actuary (a person trained to calculate these types of risks) to make specific assumptions. The actuary must then determine a cost method to assure adequate funding so the Fund can provide promised benefits.

ACTUARIAL COST METHOD

Using an actuarial cost method involves estimating the ultimate cost of the plan, then establishing a systematic way to cover a proportionate part of the estimated cost each year through advance funding. The ultimate cost of a plan includes all specific benefits that are promised to be paid, plus all administrative expenses, less any investment earnings realized over the total life of the plan. Since the exact ultimate cost of the plan cannot be determined until the last retired member of a plan dies, it must be actuarially estimated by forecasting the plan's expenses and investment return. The necessary funding, or contribution amount, is established from these estimates.

Estimating the total amount of benefits that will be paid to members requires the use of statistical methods, because the estimate depends on assumptions about the actual number of people who will receive benefits and the amount of the benefits. Therefore, assumptions must be made about the number of active members and beneficiaries who will receive benefits or become disabled, the duration of retirement and disability payments, amounts paid at different ages, mortality rates, pay raises, terminations, and layoffs — for all the years the plan is in existence.

Administrative expenses must also be estimated. This requires specific accounting and managerial expertise. Investment analysis and forecasting are also required to estimate earnings on plan assets.

ACTUARY'S REPORT

The information that follows was determined using specific actuarial methods, which have been generally described above. The methods were applied to census data about active firefighters, retirees and beneficiaries of the Fund as of July 1, 2001.

ACTUARY'S CERTIFICATION

Towers Perrin

1 Houston Center
1221 McKinney, Suite 2600
Houston, TX 77010-1006
713 754-5400
Fax: 713 754-5462

October 22, 2002

Board of Trustees
Houston Firefighters' Relief and Retirement Fund

DEAR BOARD MEMBERS:

We certify that the information contained in our July 1, 2001 Actuarial Report for the Houston Firefighters' Relief and Retirement Fund and reproduced in the Fund's 2002 Comprehensive Annual Financial Report (CAFR) has been prepared in accordance with generally accepted actuarial principles and practices. To the best of our knowledge, the information is accurate and fairly presents the actuarial position of the Fund as of July 1, 2001. Actuarial valuations are conducted annually.

All of the tables shown in the Actuarial Section of the CAFR were prepared by the staff of the Houston Firefighters' Relief and Retirement Fund (including the trend data schedules on pages 34-38) based on the information provided in the Towers Perrin July 1, 2001 Actuarial Report. In preparing the July 1, 2001 Actuarial Report, we have relied upon information provided by the Board of Trustees regarding plan provisions, plan participants, plan assets and other matters. Historical information for years prior to 1984 was prepared by the prior actuaries and was not subjected to our actuarial review.

FINANCING OBJECTIVE OF THE FUND

Contribution rates are established that, over time, will remain level as a percentage of payroll. The total contribution rate has been determined to provide for normal cost plus the level percentage of payroll required to amortize the unfunded actuarial accrued liability (or surplus), including the effects of actuarial gains and losses, over 40 years from January 1, 1983. The employee contribution rate is 7.7% of pay. The City contribution rate is the total contribution rate offset by the employee contribution rate, but not less than the statutory minimum of twice the employee contribution rate.

PROGRESS TOWARD REALIZATION OF FINANCING OBJECTIVE

The summary of accrued and unfunded accrued liabilities shown in Section II of the Actuarial Report illustrates the progress toward realization of the financing objective. Certain trend data is also contained in Section II.

DISCLOSURE OF PENSION INFORMATION

Effective for the fiscal year beginning July 1, 1996, the Board of Trustees has adopted compliance with the requirements of Governmental Accounting Standards Board (GASB) Statement No. 25. The information required to be disclosed by GASB No. 25 in the notes to the Fund's financial statements is shown in Sections II and III of the Actuarial Report.

DATA

In preparing the July 1, 2001 actuarial valuation, we relied upon data provided by the Board. As part of this valuation, we tested the data for reasonableness. We did not, however, subject this data to any auditing procedures. The data is reviewed annually by the Fund's auditor.

ACTUARIAL METHODS AND ASSUMPTIONS

The actuarial methods and assumptions described in Section VI of the Actuarial Report were selected by the Board of Trustees. The actuarial cost method is the entry age method, with liabilities allocated from date of entry to 40 years of service. The unfunded actuarial accrued liability (surplus), including the effects of actuarial gains and losses, is amortized as a level percentage of payroll ending December 31, 2022. The contribution is increased for interest for one-half of a year to reflect timing of payment. The actuarial value of assets recognizes gains and losses in the market value of assets, based on the difference between the actual rate of return and the assumed rate of return, over five years.

The Board has sole authority to determine the actuarial assumptions. Changes in the actuarial methods and assumptions since the prior valuation are described in Section VI of the report. A study of actuarial experience was last conducted for the years 1983 through 1999. In our opinion, the actuarial assumptions used are appropriate for purposes of the valuation and, in the aggregate, are reasonably related to the experience of the Fund and to reasonable expectations.

PLAN PROVISIONS

The plan provisions used in the actuarial valuation are described in Section VI of the Actuarial Report. Changes in the plan provisions since the prior valuation are also described in Section VI.

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

Sincerely,

Adam S. Berk

Adam S. Berk, ASA, EA, MAAA, CFA
Principal

Wesley A. Pieper, ASA, EA, MAAA
Consultant

SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS *July 1, 2001*

INVESTMENT RETURN

Eight-and-a-half percent per year, net of expenses.

PAYROLL GROWTH RATE

Five percent per year.

INFLATION

Four percent per year.

INDIVIDUAL SALARY INCREASES

Age	Annual salary increase rate
20	10.0%
25	7.5
30	6.0
35	5.0
40	4.5
45	4.0
50	3.5
55 and over	3.0

MORTALITY RATES (non-disabled)

1994 Group Annuity Mortality Table

	Probability of death within one year after attaining age shown	
Age	Male	Female
20	0.05%	0.03%
25	0.07	0.03
30	0.08	0.04
35	0.09	0.05
40	0.11	0.07
45	0.16	0.10
50	0.26	0.14
55	0.44	0.23
60	0.80	0.44

The 1994 Group Annuity Mortality Table is used to determine the mortality assumptions of the plan, including the probability of withdrawal from active service due to death.

TERMINATION RATES

Age	Probability of terminating service (for reasons other than death, disability or retirement) within one year after attaining age shown
20	1.3%
25	1.3
30	1.2
35	0.7
40	0.6
45	0.2
50	0.0

The liability for the optional refund of contributions for participants who terminate with at least 10 but less than 20 years of service was determined by assuming that 50% of such participants elect a refund and 50% elect a deferred monthly benefit.

DISABILITY RATES

Age	Probability of becoming totally disabled within one year after attaining age shown
20	0.75%
25	0.75
30	0.75
35	1.50
40	1.50
45	1.50
50	1.50
55	1.50
60	3.00

The actuarial assumptions and methods were adopted by the Board of Trustees on October 15, 2002, for use in the July 1, 2001, valuation of the Fund.

SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS

July 1, 2001 (continued)

DISABLED MORTALITY RATES

	After becoming disabled, probability of death within one year after attaining age shown	
Age	Male	Female
25	2.6%	1.3%
35	2.8	2.2
45	3.5	2.3
55	5.3	3.0

PERCENTAGE OF DEATH AND DISABILITY IN LINE OF DUTY

Age	Death	Disability
25	100%	60%
35	100	60
45	42	34
55	20	25

One percent of firefighters who become disabled in the line of duty are assumed to be incapable of performing any substantial gainful activity.

RETIREMENT RATES

Service	Probability of retiring within one year
20	2.0%
21 – 22	3.0
23 – 25	4.0
26 – 28	5.0
29	10.0
30	20.0

DROP DURATION

Duration at retirement	Percentage of participants electing the duration
0	10%
3	10
5	10
8	30
10	40

PERCENTAGE MARRIED

Ninety percent married, with husbands assumed to be three years older than wives. No beneficiaries other than spouse assumed.

ACTUARIAL VALUE OF ASSETS

Gains and losses in the market value of assets, based on the difference between the actual rate of return and the assumed rate of return, are recognized in the actuarial value over five years.

ACTUARIAL COST METHOD

Entry Age Method, with liabilities allocated from date of entry to 30 years of service. The Unfunded Actuarial Accrued Liability (Surplus), including the effects of actuarial gains and losses, is amortized as a level percentage of payroll ending December 31, 2022. The contribution is increased for interest for one-half of a year to reflect timing of payment.

CHANGES IN ACTUARIAL METHODS AND ASSUMPTIONS SINCE THE PRIOR YEAR

The actuarial methods and assumptions used in this valuation are the same as those used in prior valuations except for changes in the individual pay increase rates, retirement rates and DROP duration.

MEMBER DATA *July 1, 2001*

ACTIVE MEMBER AND DROP PARTICIPANT VALUATION DATA

Valuation date	Number	Average age	Annual payroll (millions)	Annual average salary	Percentage increase in average salary
9-1-72	1,930	34.5	$22.5	$11,676	N/A
1-1-76	2,262	33.0	34.6	15,318	31.2%
1-1-78	2,158	33.5	40.2	18,639	21.7
1-1-80	2,543	32.5	49.9	19,646	5.4
1-1-82	2,942	32.5	73.8	25,100	27.8
7-1-84	3,204	34.0	86.1	26,863	7.0
7-1-86	3,167	33.7	99.6	31,455	17.1
7-1-87	3,164	35.3	99.8	31,554	0.3
7-1-88	3,023	36.1	96.1	31,774	0.7
7-1-89	2,967	36.7	98.1	33,061	4.1
7-1-90	2,926	37.1	97.6	33,367	0.9
7-1-91	2,969	37.6	104.4	35,147	5.3
7-1-92	2,913	38.3	102.4	35,139	0.0
7-1-93	2,958	38.6	119.5	40,400	15.0
7-1-94	2,945	39.2	120.1	40,775	0.9
7-1-95	3,084	39.2	127.0	41,173	1.0
7-1-96	3,039	40.1	131.6	43,317	5.2
7-1-97	3,202	40.2	141.9	44,331	2.3
7-1-98	3,229	40.9	149.0	46,158	4.1
7-1-99	3.282	41.4	159.0	48,435	4.9
7-1-00	3,271	42.1	163.6	50,024	3.3
7-1-01	3,318	42.1	164.3	49,522	(1.0)

MEMBER DATA *July 1, 2001 (continued)*

RETIREES AND BENEFICIARIES ADDED TO AND REMOVED FROM ROLLS

	Added to rolls		Removed from rolls		Rolls — end of year		Percentage increase in annual allowances	Average annual allowances
Year ended	No.	Annual allowances	No.	Annual allowances	No.	Annual allowances		
12-31-77	98	$ 788,117	17	$ 39,925	745	$ 3,708,409	27.0%	$ 4,978
12-31-78	72	718,977	23	75,501	794	4,293,999	15.8	5,408
12-31-79	67	719,148	21	83,100	840	5,008,309	16.6	5,962
12-31-80	33	472,890	23	83,846	850	5,497,822	9.8	6,468
12-31-81	61	861,880	38	158,666	873	6,096,636	10.9	6,983
12-31-82	63	643,716	26	170,660	910	6,771,929	11.1	7,442
12-31-83	54	604,566	39	206,704	925	7,402,610	9.3	8,003
6-30-84*	41	619,017	17	98,457	949	3,951,927	6.8	8,328
6-30-85	75	968,380	53	290,481	971	8,431,864	6.7	8,684
6-30-86	54	752,428	38	242,932	987	9,550,326	13.3	9,676
6-30-87	76	1,101,011	33	234,719	1,030	10,521,660	10.2	10,215
6-30-88	121	2,002,328	38	310,920	1,113	12,754,223	21.2	11,459
6-30-89	74	1,306,006	42	299,274	1,145	14,031,647	10.0	12,255
6-30-90	111	1,996,310	37	287,713	1,219	16,428,355	17.1	13,477
6-30-91	129	1,784,000	38	401,000	1,310	17,888,000	8.9	13,655
6-30-92	78	1,588,000	44	401,000	1,344	19,866,000	11.1	14,781
6-30-93	82	1,717,000	48	585,000	1,378	21,516,000	8.3	15,614
6-30-94	112	2,006,000	58	660,000	1,432	23,297,000	8.3	16,269
6-30-95	87	1,728,000	28	353,000	1,491	25,142,000	7.9	16,863
6-30-96	67	1,402,000	56	660,000	1,502	26,379,000	4.9	17,563
6-30-97	56	1,050,000	37	487,000	1,521	27,581,000	4.6	18,133
6-30-98	54	1,064,000	43	477,000	1,532	28,675,000	4.0	18,717
6-30-99	64	1,840,000	28	551,000	1,568	30,233,000	5.4	19,281
6-30-00	95	2,364,000	71	1,167,000	1,592	34,583,000	14.4	21,723
6-31-01	127	3,581,000	47	775,000	1,672	38,347,000	10.9	22,935

** Six-month period*

CONTRIBUTION RATE *July 1, 2001*

ACTUARIALLY DETERMINED vs. ACTUAL CITY CONTRIBUTION RATES AS A PERCENTAGE OF PAYROLL

Valuation date	Actuarially calculated city contribution rate*	Actual city contribution rate
1-1-76	32.8%	18.0%
1-1-78	34.7	18.0
1-1-80	21.7	18.0
1-1-82	16.2	18.0
7-1-84	15.5	16.2
7-1-84	15.7	15.8
7-1-84	15.7	15.7
7-1-86	14.7	15.0
7-1-87	13.0	15.0
7-1-88	13.3	15.0
7-1-89	12.9	15.0
7-1-90	13.2	15.0
7-1-91	15.4	15.0**
7-1-92	15.3	15.3
7-1-93	15.6	15.0
7-1-94	14.9	15.0
7-1-95	13.4***	15.4
7-1-96	14.1***	15.4
7-1-97	14.9***	15.4
7-1-98	11.5	15.4
7-1-99	11.0	15.4
7-1-00	9.9***	15.4
7-1-01	14.9***	15.4

Since 1986, the Board has requested the actuary to perform a valuation annually. These valuations are used, in large part, for management purposes. The authority for adoption of a valuation, for purposes of determining the City's contribution rate, rests with the Board, within the applicable provisions of the governing statutes.

* *Before application of statutory minimum contribution*

** *Excluding additional contribution due to settlement of lawsuit*

*** *Average for the year*

SOLVENCY TEST AND ANALYSIS OF FINANCIAL EXPERIENCE *July 1, 2001*

SOLVENCY TEST *(dollars in thousands)*

Valuation date*	Actuarial accrued liability for: Active member contributions	Retirees, beneficiaries and vested participants	Active participants (city-financed portion)	Actuarial value of assets	Percentage of actuarial accrued liability covered by assets		
		(1)	(2)	(3)	(1)	(2)	(3)
7-1-84	$ 49,367	$ 106,204	$ 93,480	$ 228,032	100%	100%	78%
7-1-86	62,253	133,219	201,137	401,271	100	100	100
7-1-87	68,057	140,330	207,484	453,322	100	100	100
7-1-88	71,001	162,085	206,926	478,460	100	100	100
7-1-89	74,324	176,865	222,242	543,898	100	100	100
7-1-90	77,472	203,190	231,809	598,814	100	100	100
7-1-91	82,301	245,391	293,322	642,499	100	100	100
7-1-92	87,254	270,511	312,358	694,080	100	100	100
7-1-93	92,709	292,558	373,375	762,794	100	100	100
7-1-94	97,583	318,222	377,206	831,741	100	100	100
7-1-95	103,552	342,388	406,387	912,417	100	100	100
7-1-96	131,421	360,055	497,867	1,024,569	100	100	100
7-1-97	156,501	383,605	588,124	1,183,817	100	100	100
7-1-98	261,186	389,700	614,957	1,347,414	100	100	100
7-1-99	324,154	424,990	721,453	1,538,487	100	100	100
7-1-00	376,688	438,303	774,359	1,726,302	100	100	100
7-1-01	374,918	555,332	720,560	1,863,098	100	100	100

** Information for years prior to 1984 is not available.*

ANALYSIS OF FINANCIAL EXPERIENCE *(dollars in thousands)*

	Year ended June 30, 1997	Year ended June 30, 1998	Year ended June 30, 1999	Year ended July 1, 2000	Year ended July 1, 2001
Gain (or Loss) During Year From					
Financial Experience					
From Liability Sources	$ (6,027)	$ (9,126)	$ (30,772)	$ 21,667	$ (9,353)
From Asset Sources	30,894	7,467	(11,189)	3,920	(35,515)
Total	24,867	(1,659)	(41,961)	25,587	(44,868)
Non-Recurring Items*	0	(11,082)	(57,642)	(15,950)	68,166
Composite Gain (or Loss) During Year	$ 24,867	$ (12,741)	$ (99,603)	$ 9,637	$ 23,298

** Non-recurring items reflect changes in actuarial assumptions, methods, and plan provisions.*

SUMMARY OF PLAN PROVISIONS *July 1, 2001*

MEMBERSHIP

Any firefighter who has not reached the age of 36 at the time he or she first enters employment shall automatically become a participant in the Fund upon completing the training period. Before October 1, 1990, the eligibility age was 31. Before 1984, participants entered the Fund on January 1 or July 1.

AVERAGE MONTHLY SALARY

The average of the highest 36 months of salary (or 78 pay periods), including base pay and overtime, before reduction for pre-tax employee contributions and salary deferrals.

SERVICE PENSION

Eligibility — 20 years of service.

Benefit

- For retirement on or after November 1, 1997, 50% of average monthly salary, plus 3% of average monthly salary per year of service in excess of 20 years.
- For retirement on or after November 1, 1996, and prior to November 1, 1997, 48.334% of average monthly salary, plus 2.834% of average monthly salary per year of service in excess of 20 years.
- For retirement on or after November 1, 1995, and prior to November 1, 1996, 46.667% of average monthly salary, plus 2.667% of average monthly salary per year of service in excess of 20 years.
- For retirement on or after September 1, 1991, and prior to November 1, 1995, 45% of average monthly salary, plus 2.5% of average monthly salary per year of service in excess of 20 years, up to 30 years, plus 1.0% of average monthly salary in excess of 30 years.
- For retirement on or after September 1, 1989, and prior to September 1, 1991, 45% of average monthly salary, plus 2.5% of average monthly salary per year of service in excess of 20 years.
- For retirement on or after September 1, 1987, and prior to September 1, 1989, 45% of average monthly salary, plus 2% of average monthly salary per year of service in excess of 20 years.
- For retirement on or after July 1, 1986, and prior to September 1, 1987, 40% of average monthly salary, plus 2% of average monthly salary per year of service in excess of 20 years.
- For retirement on or after January 1, 1970, and prior to July 1, 1986, 35% of average monthly salary, plus 3% of average monthly salary per year of service in excess of 20 years, up to 25 years, plus 1% of average salary in excess of 25 years.

Maximum

- For retirement on or after September 1, 1991, 80% of average monthly salary.
- For retirement on or after September 1, 1989, and prior to September 1, 1991, 70% of average monthly salary.
- For retirement on or after September 1, 1987, and prior to September 1, 1989, 65% of average monthly salary.
- For retirements on or after January 1, 1970, and prior to September 1, 1987, 60% of average monthly salary.

SUPPLEMENTAL BONUS CHECK

Supplemental payments totaling up to $5 million will be payable on a prorated basis determined by the Board of Trustees to eligible retirees and survivors.

DEFERRED RETIREMENT OPTION PLAN (DROP)

Eligibility — 20 years of service.

Benefit — Effective July 1, 2000, eligible participants may elect to participate in the DROP for up to 10 years or until they leave active service. The member's service pension will be calculated based on service and earnings at the time the DROP is elected.

A notional account will be maintained for each DROP participant. This account will be credited with the following amounts while the member is a participant of the DROP:

- The member's monthly retirement pension, including applicable cost-of-living adjustments;
- The member's contribution to the Retirement Fund; and
- Investment earnings/losses at the rate of the Retirement Fund's earnings/losses averaged over a five-year period.

A benefit equal to the DROP account balance would be available at the time the member leaves active service. The payment would be made as a single lump sum or as partial withdrawals.

SUMMARY OF PLAN PROVISIONS *July 1, 2001 (continued)*

Effective on July 1, 2000, a three-year Back-DROP is available for all eligible participants. The DROP account would be recalculated based on what the account balance would have been had the participant elected the DROP up to 3 years earlier than he/she actually did. The initial DROP entry date cannot be backdated prior to September 1, 1995, or prior to 20 years of credited service, and must be on the first of the month selected.

The monthly benefit for a participant at actual retirement will increase 2% for every year of DROP participation (phased in at .5% effective September 1, 2000, and an additional 1.5% effective September 1, 2001).

If a DROP participant suffers an on-duty disability resulting in the inability to perform any gainful activity or dies in the line of duty, the death or disability annuity benefit would be calculated as though the participant had not entered the DROP. In addition, the DROP account would be payable to the participant or beneficiary.

SERVICE-CONNECTED DISABILITY PENSION

Eligibility — No age or service requirements.

Benefit — 50% of average monthly salary (occupational), or service pension if greater and eligible. Firefighters who are not capable of performing any substantial gainful activity will receive 75% of average monthly salary (general), or service pension if greater and eligible.

NONSERVICE-CONNECTED DISABILITY PENSION

Eligibility — No age or service requirements.

Benefit — 25% of average monthly salary, plus 2.5% of average monthly salary per year of service.

Maximum — 50% of average monthly salary, or service pension if greater and eligible.

DEFERRED VESTED PENSION

Eligibility — At least 10 but less than 20 years of service.

Benefit — 1.7% of average monthly salary per year of service, payable beginning at age 50, or optional refund of contributions with interest at a flat rate of 5% not compounded.

DEATH BENEFITS

Payable as specified below if survived by a spouse, dependent children or dependent parents. Effective November 1, 1997, dependent children can continue to receive benefits from the age of 18 through 22 if they are in college, unmarried, and if an election is made by the firefighter.

- **Nonservice-connected** — Monthly benefit that would have been payable had the participant retired for nonservice-connected disability on the date of his or her death, or service pension if greater.

- **Service-connected** — 100% of average monthly salary.

- **Pre-retirement** — Refund of contributions made if no eligible survivors. If death occurs after 10 years of service, interest is credited on the contributions at the flat rate of 5%, not compounded. If death occurs before 10 years of service, no interest is credited.

- **Post-retirement** — Monthly benefit that was payable to the participant prior to his or her death. Effective July 1, 1998, a "graded" post-retirement death benefit is payable to a surviving spouse *if the retiree was not married at the time of retirement.* This "graded" benefit is equal to 20% of the post-retirement death benefit for each year of marriage to a maximum of 100% after five years of marriage.

- **Lump sum** — A one-time $5,000 lump-sum death benefit for any active or retired firefighter. This benefit applies to active members, current retirees, and disabled participants.

SUMMARY OF PLAN PROVISIONS *July 1, 2001 (continued)*

ADDITIONAL BENEFIT

Effective on or after July 1, 2001, an extra monthly benefit of $150 is payable for life to any retired or disabled member or to an eligible survivor of a deceased member. This benefit is not subject to the post-retirement adjustment.

POST-RETIREMENT ADJUSTMENTS

- On or after October 1, 1990, and prior to November 1, 1997 — Pensions adjusted each year based on changes in the Consumer Price Index for All Urban Consumers (CPI-U). The adjustment is based on the amount of benefits payable at the time of adjustment. The maximum annual increase shall be 3% of the benefits payable at the time of adjustment.

  Pension adjustments begin immediately for participants whose benefits become payable on or after July 1, 1986, and are based upon 30 or more years of service.

  On or after November 1, 1997 — Pensions adjusted each year at a fixed rate of 3%. The adjustment is based on the amount of benefits payable at the time of adjustment.

  Pension adjustments for participants who retire with a vested benefit begin at age 48, effective October 1, 2000. Pension adjustments begin immediately for participants who become disabled and cannot perform any substantial gainful activity (current and future) and who qualify for general on-duty disability benefits.

- Prior to October 1, 1990 — Pensions adjusted each year based on changes in the CPI-U, but not below original amount or above original amount, increased 3% each year, not compounded.

  Pension adjustments for participants who retire after March 1, 1982, begin at age 55.

  Pension adjustments begin immediately for participants whose benefits become payable on or after July 1, 1986, and are based upon 30 or more years of service.

CONTRIBUTION RATES

Members — 7.7% of salary. Refund of contributions without interest in the event of termination before 10 years of service.

City — Beginning in 1983, the rate required to fund the Retirement Fund on an actuarial reserve basis. However, a minimum contribution of twice the employee contribution rate is required by the governing statute.

CONTRIBUTION REFUNDS

Members are entitled to a refund of their contributions upon separation from the Fire Department.

- Members with less than 10 years of service are entitled to a full refund of their contributions to the Fund with no interest.
- Members with at least 10 but less than 20 years of service are entitled to a full refund of their contributions, with interest at 5%, not compounded.

FORM OF PAYMENT

Normal form of payment is a single life annuity for unmarried members and an unreduced joint and survivor annuity for married members.

A more detailed description of plan provisions is available at the Houston Firefighters' Relief and Retirement Fund office.

CHANGES IN PLAN PROVISIONS SINCE THE PRIOR VALUATION

Plan provisions reflected in the July 1, 2001, valuation are the same as those in the prior valuation except for the following changes:

- The additional benefit paid to all retirees and beneficiaries increased from $125 to $150 per month. This benefit does not increase with COLA (effective July 1, 2001).
- The participant's monthly benefit at actual retirement is increased from 1% to 2% for every year of DROP participation. The additional benefit accrual is applied to his or her original annuity upon actual retirement, but not added to payments into the DROP account (effective September 1, 2001).

Section 5 Statistical Section (unaudited)

STATISTICS

REVENUES BY SOURCE *(dollars in thousands)* — **ACCRUAL BASIS**

Fiscal year ended June 30,	Employee contributions	Employer contributions	Employer contributions as a percentage of annual covered payroll	Investment income (loss)*	Total
1989	$ 7,215	$ 14,418	15.0%	$ 43,481	$ 65,114
1990	7,492	14,942	15.0	43,736	66,170
1991	7,707	15,335	15.0	19,168	42,210
1992	8,733	17,549	15.0	40,595	66,877
1993	8,410	16,716	15.0	48,959	74,085
1994	8,715	17,670	15.3	105,088	131,473
1995	8,811	17,600	15.0	46,991	73,402
1996	9,418	18,847	15.0	95,985	124,250
1997	10,156	20,312	15.4	253,901	284,369
1998	10,875	21,720	15.4	173,807	206,403
1999	12,043	24,084	15.4	76,916	113,043
2000	12,317	24,645	15.4	159,214	196,176
2001	12,019	24,032	15.4	(24,229)	11,822
2002	**14,219**	**28,451**	**15.4**	**(45,685)**	**(3,015)**

Contributions were made in accordance with actuarially determined contribution requirements as adopted by the Board of Trustees.

** Investment income amounts since 1997 are net amounts based on market value. Amounts for 1989 through 1996 were calculated on a cost basis.*

EXPENSES BY TYPE *(dollars in thousands)* — **ACCRUAL BASIS**

Fiscal year ended June 30,	Benefit payments*	Professional and administrative expenses	Contribution refunds	Total
1989	$ 13,693	$ 889	$916	$15,498
1990	15,361	878	665	16,904
1991	17,598	1,074	451	19,123
1992	20,169	1,220	206	21,595
1993	21,318	1,197	296	22,811
1994	22,935	1,456	293	24,684
1995	24,883	1,455	100	26,438
1996	26,200	1,833	494	28,527
1997	27,377	2,178	658	30,213
1998	43,453	2,461	462	46,376
1999	30,899	2,966	317	34,181
2000	35,502	3,168	187	38,857
2001	47,875	4,102	299	52,277
2002	**57,820**	**5,309**	**179**	**63,308**

Contributions were made in accordance with actuarially determined contribution requirements as adopted by the Board of Trustees.

** The amount of benefit payments for the fiscal year ended 1998 includes $8 million accrued for two supplemental payments to retirees and $7.1 million for the one-time, lump-sum benefit paid in November 1997 to retirees and beneficiaries.*

STATISTICS *(continued)*

BENEFIT EXPENSES BY TYPE *(cash basis)*

Year ending	DROP distributions	Annual supplemental benefit pmt.	Monthly pension benefits: Service retirees	Deferred retirees*	On-duty disabilities	Off-duty disabilities	Survivors	Refunds of contributions due to: Death	Termination	Total
1992	$ —	—	$12,720,546	$ —	$ 2,275,767	$ 1,454,999	$ 3,353,414	$ 0	$ 206,000	$ 20,010,726
1993	—	—	13,906,130	—	2,365,789	1,512,554	3,694,521	0	296,000	21,774,994
1994	—	—	15,092,014	—	2,398,959	1,533,760	4,027,048	55,816	237,000	23,344,597
1995	—	—	16,904,825	—	2,606,972	1,666,753	4,391,192	0	100,000	25,669,742
1996	49,457	—	17,198,964	—	2,642,861	1,674,072	4,838,834	36,238	458,000	26,898,426
1997	385,952	—	17,519,638	—	2,686,301	1,709,433	5,201,535	0	291,000	27,793,859
1998	362,355	—	18,657,516	—	2,801,769	1,645,250	5,521,731	0	83,896	29,072,517
1999	788,368	8,000,000	17,424,507	—	2,776,862	1,605,351	5,661,787	0	316,157	36,573,032
2000	1,887,631	—	21,939,996	333,084	3,215,798	1,741,724	7,243,920	14,305	186,054	36,562,512
2001	5,426,224	4,965,820	25,398,338	367,503	3,236,816	1,623,357	7,702,694	0	152,013	48,872,765
2002	**10,299,394**	**4,951,779**	**30,699,073**	**388,025**	**3,843,253**	**1,634,500**	**8,551,235**	**0**	**179,451**	**60,546,710**

** Reporting of deferred retirees began in 2000.*

RETIRED MEMBERS BY TYPE OF BENEFIT *Year Ended June 30, 2002*

Monthly Benefit Amount		Total number of benefit recipients	Service	Disability	Widows	Children	Deferred (receiving benefits)	Deferred–inactive* (not yet receiving benefits)
$ 1 – 200		4	0	0	0	3	1	0
201 – 400		58	0	0	8	10	40	0
401 – 600		36	0	3	7	6	20	7
601 – 800		42	0	1	21	7	13	5
801 – 1,000		62	18	6	28	10	0	0
1,001 – 1,200		85	20	11	52	1	1	0
1,201 – 1,400		135	53	35	43	4	0	0
1,401 – 1,600		172	74	49	49	0	0	0
1,601 – 1,800		170	88	47	34	1	0	0
1,801 – 2,000		205	130	40	35	0	0	0
Over 2,000		805	638	55	110	2	0	0
	Total:	**1,774**	**1021**	**247**	**387**	**44**	**75**	**12**

** Deferred–inactive members are not yet included in the total columns, as they are not yet receiving benefits.*

STATISTICS *(continued)*

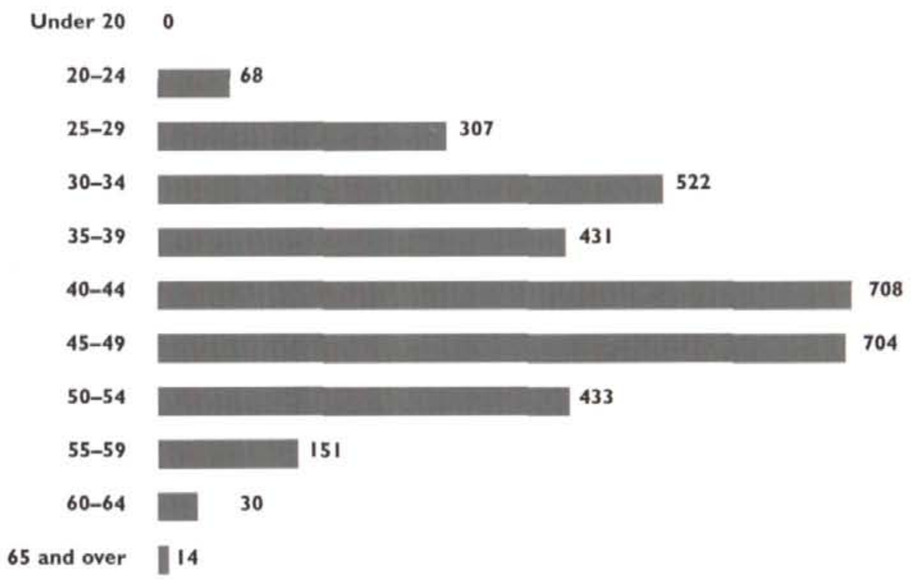
AVERAGE MONTHLY BENEFIT PAYMENTS FOR SERVICE RETIREMENTS

Retirement effective dates July 1, 1992 through June 30, 2002	Years of credited service 20 – 25	 26 – 30	 Over 30
Period 7-1-92 through 6-30-93			
Number of Service Retirements	21	7	12
Average Monthly Benefit (based on averages)	$1,639	$2,166	$2,938
Period 7-1-93 through 6-30-94			
Number of Service Retirements	21	10	11
Average Monthly Benefit	1,893	2,428	2,841
Period 7-1-94 through 6-30-95			
Number of Service Retirements	19	7	11
Average Monthly Benefit	1,616	2,535	2,845
Period 7-1-95 through 6-30-96			
Number of Service Retirements	11	2	5
Average Monthly Benefit	1,642	4,524	2,730
Period 7-1-96 through 6-30-97			
Number of Service Retirements	10	1	0
Average Monthly Benefit	1,930	3,241	
Period 7-1-97 through 6-30-98			
Number of Service Retirements	12	6	2
Average Monthly Benefit	2,001	2,514	2,709
Period 7-1-98 through 6-30-99*			
Number of Service Retirements	6	11	7
Average Monthly Benefit	1,808	2,647	3,308
Period 7-1-99 through 6-30-00			
Number of Service Retirements	18	15	11
Average Monthly Benefit	2,000	3,016	3,549
Period 7-1-00 through 6-30-01			
Number of Service Retirements	22	32	36
Average Monthly Benefit	1,999	2,295	3,159
Period 7-1-01 through 6-30-02			
Number of Service Retirements	17	33	64
Average Monthly Benefit	2,304	2,577	3,584
Summary			
Period 7-1-92 through 6-30-02			
Number of Service Retirements	**157**	**124**	**159**
Average Monthly Benefit (based on averages)	**$1,883**	**$2,794**	**$3,074**

** Reflects amended numbers*

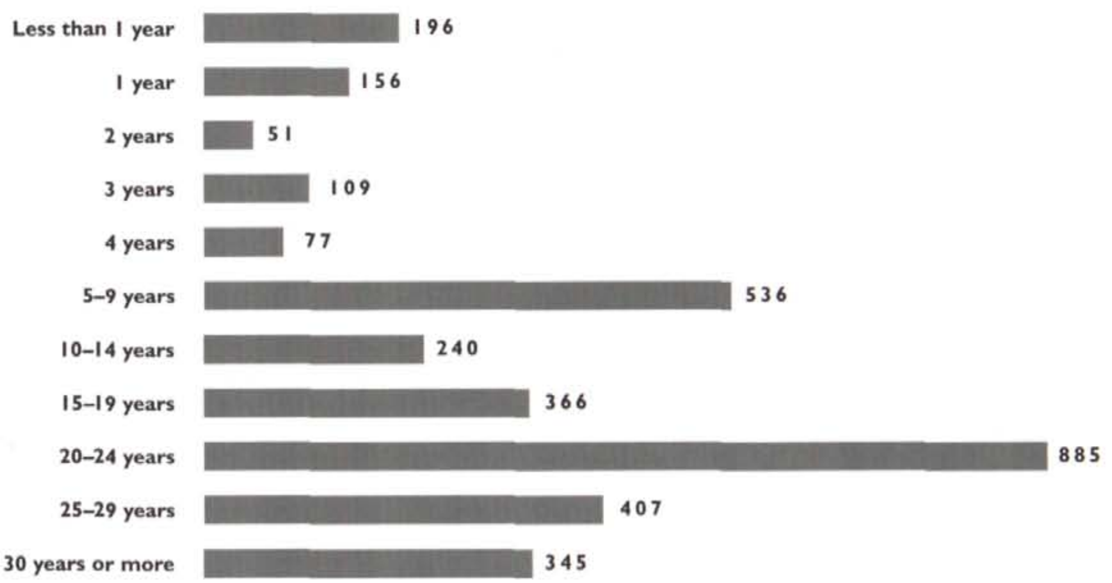
STATISTICS *(continued)*

AGE DISTRIBUTION OF ACTIVE FIREFIGHTERS *June 30, 2002*



Total Firefighters 3,368

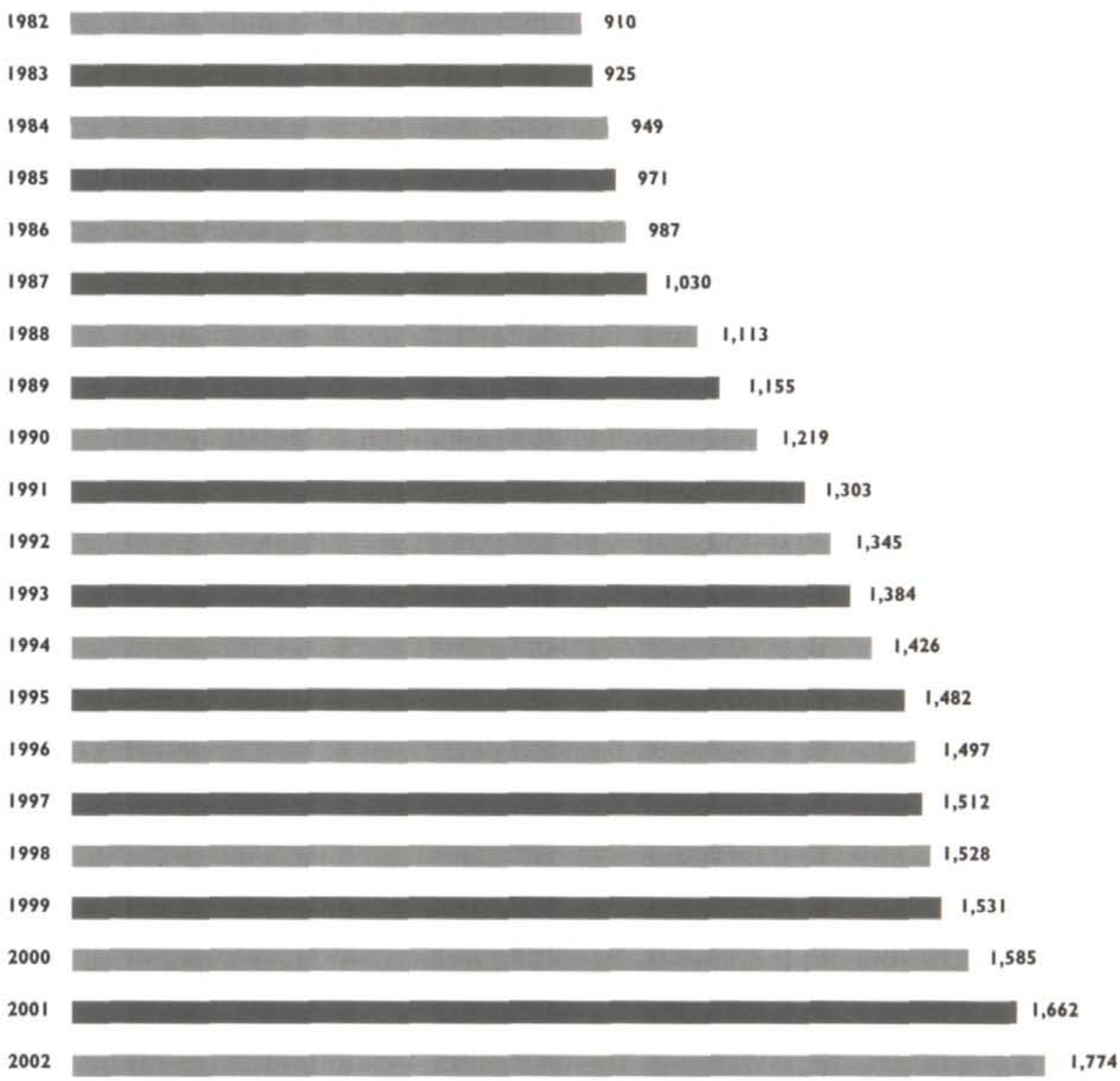
YEARS OF SERVICE FOR ACTIVE FIREFIGHTERS *June 30, 2002*



Total Firefighters 3,368

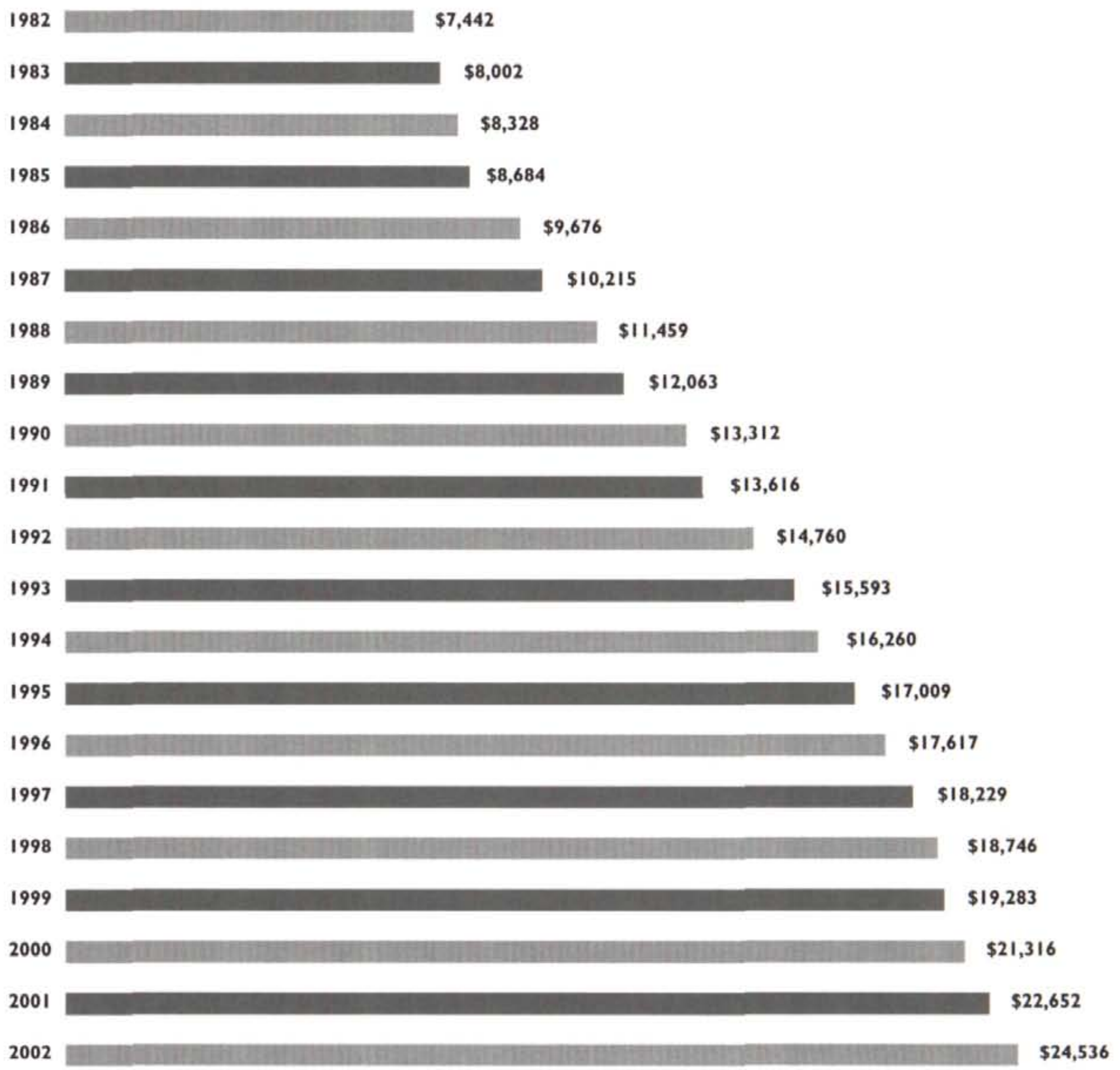
STATISTICS *(continued)*

NUMBER OF RETIREES AND BENEFICIARIES RECEIVING MONTHLY BENEFIT PAYMENTS *June 30, 2002*



STATISTICS *(continued)*

AVERAGE ANNUAL BENEFIT PAID TO RETIREES AND BENEFICIARIES* *June 30, 2002*



** Does not include annual supplemental benefit*

STATISTICS *(continued)*

BREAKDOWN OF DROP PARTICIPANTS *June 30, 2002*

		Years of service		
		20–25	**26–30**	**Over 30**
1996	Number of DROP Participants	31	51	68
	Average Monthly Benefit	$1,924	$2,487	$3,233
	Exited	0	1	1
1997	Number of DROP Participants	45	89	4
	Average Monthly Benefit	$2,047	$2,751	$3,261
	Exited	10	3	1
1998	Number of DROP Participants	200	186	5
	Average Monthly Benefit	$2,308	$2,909	$3,271
	Exited	5	9	3
1999	Number of DROP Participants	172	69	5
	Average Monthly Benefit	$2,219	$3,011	$3,557
	Exited	5	12	7
2000	Number of DROP Participants	263	37	1
	Average Monthly Benefit	$2,268	$3,235	$4,531
	Exited	15	12	14
2001	Number of DROP Participants	239	21	1
	Average Monthly Benefit	$2,279	$3,396	$7,800
	Exited	22	35	40
2002	Number of DROP Participants	81	10	0
	Average Monthly Benefit	$2,434	$4,014	
	Exited	16	38	68
Total	Number of DROP Participants	1031	463	84
	Average Monthly Benefit	$2,211	$3,115	$4,276
	Exited	73	110	134

Number of DROP participants for each year includes amended numbers.

GLOSSARY

Some of these terms are used in the Investment Section, beginning on page 39. Others are used throughout this report. Definitions are provided as they relate to the Houston Firefighters' Relief and Retirement Fund.

Accrual Basis of Accounting
Accounting method in which income and expense transactions are recognized when they are earned or incurred rather than when they are settled. The Fund uses this method of accounting.

Asset
Anything having commercial or exchange value that is owned by the Fund.

Book Value
The value (cost) at which an asset is carried on a balance sheet.

Cash Basis of Accounting
Accounting method in which revenue and expense transactions are recognized when they are paid for (settled), rather than when they are incurred.

Compound or Compounding
The process of calculating and adding current interest to the principal and interest of a previous period(s). For example, compound interest is the interest earned on the principal plus interest earned earlier. If $100 is deposited in a bank account that earns 10% interest, the account will have $110 at the end of the first year and $121 at the end of the second year. The extra $1, earned on the $10 interest from the first year, is the compound interest. This example assumes interest is compounded annually. Interest can also be compounded on a daily, quarterly, or other-time basis.

Compound Return
Profit on an investment, usually expressed as an annual percentage rate.

Diversification
Spreading of risk by putting assets in several different categories of investments, such as stocks, bonds, cash, high yield and alternatives. Further diversification is accomplished by using different investment managers with different management styles within each category.

Fund Equity (Stock) Investments
The portion of the total Fund that is invested in ownership interest in corporations, usually in common stock.

Fund Fixed-Income (Bond) Investments
The portion of the total Fund that is invested in debt instruments that usually pay a fixed rate of interest or dividends over a specified period of time — for example, corporate or government bonds.

Institutional Investor Organization
An organization that invests and trades large volumes of securities (stocks and bonds). Some examples are retirement funds, insurance companies, banks, mutual funds and college endowment funds. Typically, between 50% and 70% of the daily trading at the New York Stock Exchange is on behalf of institutional investors across the country. The Fund is an institutional investor.

The Lehman Universal Index
The union of the Lehman Aggregate Index, the Lehman U.S. High Yield Index, the Lehman 144-A Index, the Lehman Eurodollar Index and the Lehman Emerging Markets Index. The Aggregate Index covers the U.S. investment-grade, fixed-rate market and includes government and corporate bonds, agency mortgage pass-through securities and asset-backed issues. The High Yield Index covers the universe of dollar-denominated, fixed-rate noninvestment-grade debt. The 144-A Index includes fixed-rate, investment-grade, non-convertible, dollar-denominated securities issued under Rule 144-A. The Eurodollar Index encompasses non-SEC registered, as well as global investment-grade, fixed-rate U.S. dollar-denominated issues. The Emerging Markets index includes dollar-denominated local, corporate, sovereign and Brady bonds of emerging-market countries.

Liability
Any debt of the Fund giving a creditor a claim on the assets of the Fund (i.e., the money has not yet been paid, but the event causing the obligation has already occurred).

Market Value
Estimated selling price of an asset on the open market at a specified point in time.

Mean Return
The average return.

Median Return
The midpoint return when all returns are ranked from highest to lowest — and there is an equal number of returns above and below.

GLOSSARY *(continued)*

Median Total Fund Return
The midpoint return for all assets in all plans in a universe of plans.

Merrill Lynch 90-Day Treasury Bill Index
Generally accepted as a proxy for the return on a risk-free asset, this index links the monthly returns for 90-day U.S. Treasury Bills.

MSCI All Country World Ex-US Index
MSCI (Morgan Stanley Capital International) has 51 country indices and several regional indices, which are formed by aggregating the country indices. MSCI All Country World Ex-US Index includes all countries excluding the United States. MSCI equity indices are constructed in a consistent manner across all countries, encompassing a total of 23 developed markets and 28 emerging markets. The consistent approach to index construction ensures the proper representation of the countries' underlying industry distribution and market capitalization, and allows investors to accurately compare equity performance across the markets, regions and sectors. MSCI calculates indices by applying full market capitalization weights (price multiplied by the number of shares outstanding) for the constituent securities. MSCI calculates regional indices using GDP weightings for countries.

Portfolio
Combined holding of more than one stock, bond or other asset by an individual or institutional investor.

Portfolio Management
The process of selecting, monitoring and changing assets within a portfolio or account to meet defined investment objectives. For the Fund, this management approach describes a universe of assets, determines how assets are to be distributed among security types such as stocks and bonds, and determines a risk/return relationship for investments.

Receivables
Assets to which the Fund is entitled — but has not received.

Russell 3000 Index
Measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market. The Russell 3000 index is comprised of stocks within the Russell 1000 and the Russell 2000 indices.

SEI
A service used by the Fund from Fiscal Year 1978 to 1988 to measure total Fund investment return against a universe of other funds that maintains similar investment portfolios. SEI maintains a database of investment portfolio returns for corporate, public, multi-employer and foundation investment portfolios.

Standard Deviation
A statistical measure of the degree to which an individual value in a probability distribution tends to vary from the mean of the distribution. Standard deviation quantifies the relationship between risk and return, and is often applied in modern portfolio management.

Total Fund
All the investments of the Fund, including stocks, bonds, cash equivalents, high-yield bonds and alternative investments.

Trust Universe Comparison Service (TUCS)
A service used by the Fund starting in Fiscal Year 1989 to measure the total Fund investment return against a universe of other funds with similar investment portfolios. TUCS maintains a database of investment portfolio returns for hundreds of corporate, public, multi-employer and foundation investment portfolios.

Universe
A total number of facts or events to which a specific fact or event is compared. For example, a database of investment portfolio returns of organizations, like the Fund, can be used to compare investment performance.

Houston Firefighters'
Relief and Retirement Fund

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