2003 Comprehensive Annual Financial Report

Houston Firefighters' Relief and Retirement Fund

Houston, Texas

A Component Unit of the City of Houston for the Fiscal Year Ended June 30, 2003

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Fiscal Year Ended June 30, 2003

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LETTER OF TRANSMITTAL

Houston Firefighters'
Relief and Retirement Fund

Investing for Firefighters and Their Families®

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October 7, 2003
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, 2003, 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.

The report consists of five sections:

Section 1 — Introduction contains this Letter of Transmittal and identification of the administrative organization and professional services utilized by the Fund;

Section 2 — Financial Information 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;

Section 3 — Investment Information describes investment goals and policies, asset allocation, investment results, and other information; and

Section 4 — Actuarial Information contains the independent consulting actuary's opinion and results of the July 1, 2001, actuarial valuation;

Section 5 — Statistics (unaudited) contains statistical tables of other significant data pertaining to the Fund.

LETTER OF TRANSMITTAL *(continued)*

MILESTONES AND MAJOR INITIATIVES

During fiscal year 2003, the Fund achieved several milestones. Listed below are several milestones from the benefits and investment teams.

Benefits Milestones

During fiscal year 2003, the trustees and staff worked diligently to have Senate Bill 297 passed on June 18, 2003. The benefit enhancements, which will go into effect on September 1, 2003, include:

- Establishment of a minimum and maximum annual DROP interest crediting rates of 5 percent and 10 percent, respectively
- Elimination of the 1 percent administrative fee for Fund maintenance of DROP accounts for retired DROP members
- Ability for a surviving spouse of a deceased member to leave DROP balances with the Fund

This bill also included an increase in firefighter contribution rates from 7.7 percent to 8.35 percent on September 1, 2003, and 9.0 percent on July 1, 2004. The City will contribute twice the firefighters' contribution rate.

During the fiscal year, the Fund implemented an upgraded pension administration system. This system will facilitate additional technological advances such as a Web calculator and a state-of-the-art imaging system.

Investment Milestones

During fiscal year 2003, the investment markets began to show signs of recovery, specifically in October and November 2002 and again in April and May 2003. This was a comforting sign of improvement, considering the poor market environment from March 2000 through September 2002. The major benefactors to the Fund's performance are long-duration corporate bonds as well as high-yield bonds. While international and domestic stocks ended the year flat, there was considerable improvement from how the year started.

The Fund ended the year with a gross rate of return on investments of 6.48 percent, placing it in the top 14th percentile of U.S. public pension funds based on the Trust Universe Comparison Service report produced by Russell/Mellon.

The Board of Trustees made some significant changes during the year to the International Equity asset class. First, the decision was made to convert a passively managed Europe, Australia and Far East (EAFE) account to actively managed, hiring Mercator Asset Management for the mandate. Second, a decision was made to replace an underperforming emerging markets manager and the mandate was awarded to Marvin & Palmer Associates. New alternative and real estate commitments to The Keystone Group, Landmark Partners Fund XI, Springbank LLC and Energy Trust Separate Account were also made during the year. Lastly, the Board of Trustees committed $25 million to Ariel Capital Management to manage mid-capitalization value stocks. This mandate increases our diversification on a capitalization basis to domestic equities and also satisfies the Board's minority-owned manager goal.

ADMINISTRATION, STAFF AND PROFESSIONAL SERVICES

At fiscal year-end, the Fund staff was made up of 22 employees.

The following professionals were employed by the Board of Trustees as of June 30, 2003, 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 5 of this report. Other professionals employed by the Board are listed on page 22.

ACCOUNTING SYSTEMS AND REPORTS

As plan administrator of the Fund, the Board of Trustees maintain 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.

LETTER OF TRANSMITTAL *(continued)*

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 20 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 sufficient investment returns necessary to pay 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, alternative investments and real estate. 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 percent to be able to meet its benefits obligations. The Fund also models an overall goal of 9.25 percent return on investments to cover operational expenditures, money management fees and capital expenditures.

INDEPENDENT AUDIT

An audit was performed by Mir•Fox & Rodriguez, P.C., for the fiscal year ending June 30, 2003, 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, 2002. This was the 20th 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

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ADMINISTRATIVE ORGANIZATION

Executive Director
Maxie L. Patterson

General Counsel
Jonathan W. Needle

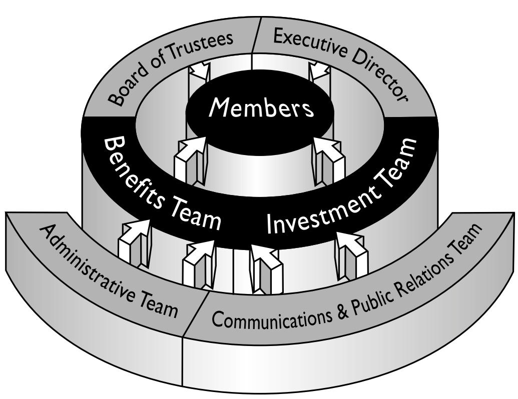
Chief Investment Officer
Christopher E. Gonzales

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 Fund
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
Ariel Capital Management
Blackstone Capital Partners
Brera Capital Partners, LLC
The Centennial Funds
Coller International Partners
Evergreen Investment/Wachovia
Energy Trust LLC
Gulf Investment Management, Inc.
GW Capital, Inc.
Hicks, Muse, Tate & Furst, Inc.
Hyperion Partners
Industrial Growth Partners
The Keystone Group
L&B Real Estate Counsel
Landmark Real Estate Fund
Lexington Capital Partners
Lone Star Opportunity Fund
Loomis Sayles
Marvin & Palmer Associates, Inc.
Mellon Capital
Mercator Asset Management, LP
The Mitchell Group
Sanders Morris Harris, Inc.
Schroder Investment Management
Scudder Kemper
Standish/Mellon Bond
State Street Research
STW Fixed Income Management
TCW Shared Opportunity Fund
Triad Ventures Ltd.

Please see "Fees for Investment Services" on page 30.

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 8, 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 47–48.

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, 2003 and 2002.

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, 2003 and 2002.

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 "An Overview of the Actuarial Valuation" on page 34).

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 6-year trend information provides additional historical information. These charts show the progress 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.

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Section 2
Financial Information

Fiscal Year Ended June 30, 2003

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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, 2003 and 2002, and the related statements of changes in plan net assets for the years then ended. These basic financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these basic 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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial status of the Fund as of June 30, 2003 and 2002, 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 (MD&A) and the required supplemental information (schedules 1 and 2) are not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board (GASB). We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the MD&A and required supplemental information. However, we did not audit such information and do not express an opinion on it.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The additional supplemental information (schedules 3 and 4) is presented for the purpose of additional analysis and is not a required part of the Fund's basic financial statements. This information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Mir Fox & Rodriguez

August 27, 2003

1900 One Riverway
Houston, TX 77056
713 622 1120
713 961 0625 Fax

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Management is pleased to present a discussion and analysis of the Houston Firefighters' Relief and Retirement Fund (HFRRF) financial activity for the fiscal years ended June 30, 2003 and 2002. This discussion is intended to serve as an introduction to the HFRRF basic financial statements which follow.

The financial statement section consists of:

(a) Basic 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, 2003 and 2002, and the fiscal year 2003 and 2002 additions to and deductions from the Fund.

(b) Notes to the basic financial statements, which are an integral part of the basic 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 supplemental information and other supplemental schedules. These schedules provide additional information to the basic financial statements.

FINANCIAL HIGHLIGHTS

Plan Net Assets

	Fiscal year 2003	Fiscal year 2002	Percent increase (decrease)
Assets:			
Investments	$1,695,741,342	$1,637,191,153	3.6%
Capital assets (net of depreciation):			
Land and building	8,933,029	9,228,589	(3.2)
Furniture, fixtures and equipment	1,273,883	775,310	64.3
Other	245,558,145	133,634,490	83.8
Total assets	1,951,506,399	1,780,829,542	9.6
Liabilities:			
Short-term liabilities	228,262,024	120,664,577	89.2
Total net assets	$1,723,244,375	$1,660,164,965	3.8

Plan net assets at the end of fiscal year 2003 and 2002 totaled $1,723,244,375 and $1,660,164,965, respectively. The increase of approximately 3.8 percent is due to improved market conditions.

Changes in Plan Net Assets

	Fiscal year 2003	Fiscal year 2002	Percent increase (decrease)
Beginning net assets	$1,660,164,965	$1,726,488,181	(3.8)%
Additions to plan assets:			
Contributions	41,984,183	42,669,386	(1.6)
Net appreciation FV of investments	43,573,461	(101,151,952)	143.1
Interest income	48,917,175	53,151,937	(8.0)
Dividends	10,391,086	7,565,826	37.3
Other net income	(5,501,473)	(5,250,731)	(4.8)
Total additions (reductions)	139,364,432	(3,015,534)	4,721.6
Deductions from plan assets:			
Benefits	71,385,364	57,819,590	23.5
Other	4,899,658	5,488,092	(10.7)
Total deductions	76,285,022	63,307,682	20.5
Ending net assets	1,723,244,375	1,660,164,965	3.8
Net increase (decrease)	63,079,410	(66,323,216)	

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MANAGEMENT'S DISCUSSION AND ANALYSIS *(continued)*

In fiscal year 2003, the Fund experienced gains in investment performance, resulting in a higher plan asset market value. Although the public and private equity markets continued to have a difficult year, fixed income investments, specifically high-yield and long-term corporate bonds, had a banner year, returning 39 percent and 23 percent, respectively. The Fund has increased exposure to these two fixed income styles versus the market and benefited from that style set. Overall, the Fund's equity value tilt, combined with the outstanding performance in fixed income, produced a 6.48 percent return.

Plan net assets at the end of fiscal year 2003, 2002 and 2001 totaled $1,723,244,375, $1,660,164,965 and $1,726,488,181, respectively. The increase between fiscal year 2003 and fiscal year 2002 of approximately 3.8 percent is mainly due to improved market conditions. The decrease of 3.8 percent between fiscal year 2002 and fiscal year 2001 was due to a loss in investment performance.

The funds 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 for the last three fiscal years was $13,994,725 (fiscal year 2003), $14,218,663 (fiscal year 2002) and $12,019,123 (fiscal year 2001). Employer contributions for the last three years were $27,989,458 (fiscal year 2003), $28,450,723 (fiscal year 2002) and $24,032,828 (fiscal year 2001). The increase between fiscal year 2002 and fiscal year 2001 was primarily due to an increase in overtime pay. Although overtime pay decreased between fiscal year 2003 and fiscal year 2002, it is still substantial. Since July 1, 1996, by resolution of the Board of Trustees, the employee contribution rate has been 7.7 percent and the employer contribution rate 15.4 percent. Effective September 1, 2003, employee and employer contribution rates will increase to 8.35 percent and 16.7 percent, respectively.

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 comprise the total deductions.

Deductions for fiscal year 2003, 2002 and 2001 totaled $76,285,022, $63,307,682 and $52,276,640, respectively. This represents an increase of approximately 20.5 percent between fiscal year 2003 and fiscal year 2002 and 21.1 percent between fiscal year 2002 and fiscal year 2001. The 20.5 percent increase in fiscal year 2003 is due primarily to:

(1) Higher DROP distributions (which almost doubled in fiscal year 2003)

(2) Increased benefit recipients (147) in fiscal year 2003 compared to fiscal year 2002

(3) A Cost of Living Adjustment awarded in fiscal year 2003

The 21.1 percent increase in fiscal year 2002 is due primarily to:

(1) Higher DROP distributions (which almost doubled in fiscal year 2002)

(2) 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 percent of original benefits amount for each full year in DROP

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

This growth in benefit payments is normal for a maturing pension fund. In total, professional and administrative deductions decreased between fiscal year 2003 and fiscal year 2002 and increased between fiscal year 2002 and fiscal year 2001. The current year's decrease is due to lower consulting/legal expenses and office expenses related to the production of printed material. Last year's increase was due to additional operating expenses related to the Fund's move into its own building, as well as additional staff.

Total additions to the Fund in fiscal year 2003 were $139,364,432 and total deductions were $76,285,022, thereby increasing Fund net assets by $63,079,410. In fiscal year 2002, the Fund's net assets decreased by $66,323,216.

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MANAGEMENT'S DISCUSSION AND ANALYSIS *(continued)*

HISTORICAL TRENDS

Accounting standards require that the statement of plan net assets state asset 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 is provided in the Schedule of Funding Progress (on page 20). 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 Fund, by statute, may adopt an actuarial valuation once every three years. Based on the last actuarial valuation adopted, July 1, 2001, it shows that the funding position of the Fund continues to provide more than adequate assets to meet benefit obligations. While the excess funded actuarial value of assets shows a positive trend over the seven years displayed, the last Asset/Liability Forecast study, produced on July 22, 2002, indicates that the Fund may require increased funding to remain fully funded.

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 20). This schedule indicates that the employer is generally meeting their responsibility to provide resources to the Fund.

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STATEMENTS OF PLAN NET ASSETS *June 30, 2003 and 2002*

Assets	**2003**	**2002**
Investments, at fair value:		
Short-term investment funds (value at cost)	$ 46,500,526	$ 48,547,970
Commingled domestic equity funds	61,787,446	96,259,809
Commingled international equity funds	53,014,115	170,746,485
Fixed income:		
United States government securities	117,134,741	9,028,597
Corporate bonds — domestic	310,799,601	373,451,503
Other fixed-income securities	158,635,593	154,212,634
Common stocks	573,265,711	437,573,363
Preferred stocks	14,443,712	2,616,028
Alternative investments — partnerships	286,539,243	300,111,037
Real estate	73,620,654	44,643,727
Total investments	1,695,741,342	1,637,191,153
Cash and cash equivalents	2,670,866	3,111,373
Receivables:		
Accrued interest	9,040,928	12,644,942
Due from securities lending	48,374	
Foreign funds contracts	2,475,104	9,159,079
Receivables for investments sold	28,030,597	3,594,081
Accrued dividends	1,014,723	728,335
City of Houston contributions	752,718	538,627
Member contributions	376,359	269,314
Total receivables	41,738,803	26,934,378
Collateral on securities lending arrangements, at fair value	201,148,476	103,588,739
Land	541,232	541,232
Building, net	8,391,797	8,687,357
Furniture, fixtures and equipment, net	1,273,883	775,310
Total assets	1,951,506,399	1,780,829,542
Liabilities		
Accrued expenses	1,893,561	1,683,794
Payables for investments purchased	22,758,139	5,769,680
Foreign taxes payable	22,805	13,244
Foreign funds contracts payable	2,439,043	9,609,120
Collateral on securities lending arrangements, at fair value	201,148,476	103,588,739
Total liabilities	228,262,024	120,664,577
Plan net assets held in trust for pension benefits	$ 1,723,244,375	$ 1,660,164,965

A schedule of funding progress for the plan is presented on page 20.

See accompanying notes to basic financial statements.

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STATEMENTS OF CHANGES IN PLAN NET ASSETS

Years Ended June 30, 2003 and 2002

Additions to plan net assets:	**2003**	**2002**
Contributions:		
City of Houston	$ 27,989,458	$ 28,450,723
Members	13,994,725	14,218,663
	41,984,183	42,669,386
Net investment income:		
Net appreciation (depreciation) in fair value of investments	43,573,461	(101,151,952)
Interest:		
Cash equivalent securities	10,438	89,319
Short-term securities	1,247,112	1,636,963
United States government securities	740,797	866,714
Corporate bonds — domestic	33,315,979	40,981,601
Other fixed-income securities	13,602,849	9,577,340
Total interest	48,917,175	53,151,937
Other	306,605	600,034
Dividends:		
Common stocks	9,443,795	7,311,610
Preferred stocks	913,180	254,216
Commingled equity funds	34,111	—
	10,391,086	7,565,826
Earnings from alternative investments — partnerships	4,661,330	3,629,143
Earnings from real estate	7,322	290,719
Securities lending arrangements:		
Earnings	2,034,529	2,993,651
Rebates and fees	(1,568,259)	(2,527,447)
	466,270	466,204
Gross investment income (loss)	108,323,249	(35,448,089)
Less: investment services expense	10,943,000	10,236,831
Net investment income (loss)	97,380,249	(45,684,920)
Total additions (reductions) to plan net assets	139,364,432	(3,015,534)
Deductions from plan net assets:		
Benefits paid to members	71,385,364	57,819,590
Contribution refunds to members	125,824	179,452
Professional services	410,848	566,118
Administrative expenses	4,362,986	4,742,522
Total deductions from plan net assets	76,285,022	63,307,682
Net increase (decrease) in plan net assets	63,079,410	(66,323,216)
Plan net assets held in trust for pension benefits, beginning of year	1,660,164,965	1,726,488,181
Plan net assets held in trust for pension benefits, end of year	$ 1,723,244,375	$ 1,660,164,965

See accompanying notes to basic financial statements.

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NOTES TO BASIC FINANCIAL STATEMENTS *June 30, 2003 and 2002*

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 6243e.2 (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, 2003 and 2002, the membership of the Fund consisted of the following:

	2003	2002
Retirees and beneficiaries currently receiving benefits	1,921	1,774
Former members entitled to benefits but not yet receiving them	10	12
Active members:		
Vested	2,176	2,243
Nonvested	1,142	1,125
Total members	5,249	5,154

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, 2003 and 2002, covered members were required by statute to contribute 7.7 percent of their salary to the Fund. The City is required to contribute a minimum of twice the members' contributions. The City contributed 15.4 percent of the gross salaries of active members for both years ended June 30, 2003 and 2002.

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 percent of average monthly salary (defined as the monthly average of their highest individual 78 pay periods), plus 3 percent 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 percent 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 percent. Active 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 percent of the member's salary after June 30, 1996, and interest on those amounts, compounded monthly at an interest rate based on the Fund's actual average rate of return 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 percent 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 percent, to be phased in at .5 percent beginning on September 1, 2000, and an additional .5 percent beginning September 1, 2001. The benefit increase was then changed effective September 1, 2001, to be 2 percent 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 percent deducted from the member's salary, the monthly pension allowance and the interest calculation would no longer be credited to the member's account.

Members or beneficiaries of members receiving pension or disability benefits (other than deferred retirees, survivors of deferred retirees, or active members who have elected the DROP) receive an additional monthly benefit payment of $150 along with their standard monthly benefit payment, which began in July 2001.

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 deferred retirees, survivors of deferred retirees, or active members who have elected the DROP) 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 percent 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.

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NOTES TO BASIC FINANCIAL STATEMENTS *(continued)*

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

Disability Benefits

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

Death Benefits

Death benefits are available to a surviving spouse, dependent children or dependent parents. Line-of-duty death benefits are payable at 100 percent of member's average monthly salary. If an active member dies who is eligible for a service, disability or deferred pension, the member's eligible survivors are entitled to death benefits equal to the benefits the member would have been entitled to. 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 percent 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 percent 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 percent, 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.

Basis of Presentation

The accompanying basic 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 basic 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 basic 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. Member and employer contributions are recognized as revenue in the period in which the employer pays compensation to the member. In addition, the Fund records contributions according to Fund requirements and State statute. Benefits paid to members and contributions refunds are recognized when due and payable in accordance with the terms of the Fund. Accrued income, when deemed uncollectable, is charged to operations.

Reporting Entity

The Fund is a component unit of the City and its basic financial statements and required supplemental information are included in the City's comprehensive Annual Financial Report.

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.

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.

Investment Valuation and Income Recognition

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.

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NOTES TO BASIC FINANCIAL STATEMENTS *(continued)*

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. Short-term investments are government and corporate bonds with a maturity of less than 1 year. The fair value of limited partnerships and real estate is based on independent appraisals and recent financial results. 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. Interest and income from other investments are recorded as earned.

Building, Furniture, Fixtures and Equipment

Building, 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 30 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

The cost of administering the Fund is paid by the Fund from current earnings pursuant to an annual fiscal budget adjusted by the Board.

Reclassifications

Certain amounts in 2002 have been reclassified to conform to current year presentation.

Federal Income Tax

The Fund received a favorable letter of determination dated December 29, 1998, from the Internal Revenue Service stating that the Fund qualifies as a tax-exempt plan and trust. 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 percent of covered members' salaries to pay normal costs, reduced by 7.4 percent of covered members' salaries to amortize its funding surplus over 40 years, increased by .5 percent of covered members' salaries for an additional statutory requirement, resulting in a net contribution rate of 15.4 percent. 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.

Historical Trend Information

Historical trend information is provided as supplemental information on pages 20–22. 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.

ACTUARIALLY DETERMINED CONTRIBUTION REQUIREMENTS

	July 1, 2003*	Percentage of covered payroll	July 1, 2002	Percentage of covered payroll
Employer normal cost	$ 40,530,187	22.3%	$ 41,196,124	22.3%
Member normal cost	13,994,725	7.7	14,218,663	7.7
Total normal cost	54,524,912	30.0	55,414,787	30.0
Additional statutory requirement	908,749	.5	923,580	.5
Less: Amortization of surplus actuarial accrued liability	(13,449,478)	(7.4)	(13,668,981)	(7.4)
Net contributions required	$ 41,984,183	23.1	$ 42,669,386	23.1
Employer contributions actually made	$ 27,989,458	15.4	$ 28,450,723	15.4
Member contributions actually made, less contribution refunds	13,994,725	7.7	14,218,663	7.7
Net contributions actually made	$ 41,984,183	23.1	$ 42,669,386	23.1

** Contribution rates based on July 1, 2001, actuarial study*

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NOTES TO BASIC FINANCIAL STATEMENTS *(continued)*

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.

The following table presents a summary of the Fund's investments at fair value and related category of custodial credit risk as of June 30, 2003.

	Category 1	Category 3	Not categorized	Total
Short-term investment funds	$ 46,500,526	$ —	$ —	$ 46,500,526
Commingled domestic equity funds	—	—	61,787,446	61,787,446
Commingled international equity funds	—	—	53,014,115	53,014,115
Fixed income funds:				
United States government securities	117,134,741	—	—	117,134,741
Corporate bonds — domestic	310,799,601	—	—	310,799,601
Other fixed-income securities	158,635,593	—	—	158,635,593
Common stocks	573,265,711	—	—	573,265,711
Preferred stocks	14,443,712	—	—	14,443,712
Other investments — partnerships	—	—	286,539,243	286,539,243
Real estate	—	—	73,620,654	73,620,654
Collateral on securities lending arrangements, at fair value	—	201,148,476	—	201,148,476
Total investments	$1,220,779,884	201,148,476	474,961,458	1,896,889,818

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	$ 48,547,970	$ —	$ —	$ 48,547,970
Commingled domestic equity funds	—	—	96,259,809	96,259,809
Commingled international equity funds	—	—	170,746,485	170,746,485
Fixed income funds:				
United States government securities	9,028,597	—	—	9,028,597
Corporate bonds — domestic	373,451,503	—	—	373,451,503
Other fixed-income securities	154,212,634	—	—	154,212,634
Common stocks	437,573,363	—	—	437,573,363
Preferred stocks	2,616,028	—	—	2,616,028
Other investments — partnerships	—	—	300,111,037	300,111,037
Real estate	—	—	44,643,727	44,643,727
Collateral on securities lending arrangements, at fair value	—	103,588,739	—	103,588,739
Total investments	$1,025,430,095	$103,588,739	$611,761,058	$1,740,779,892

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NOTES TO BASIC FINANCIAL STATEMENTS *(continued)*

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

	2003	2002
Loomis, Sayles & Company	$ 266,665,892	$ 300,518,527
STW Fixed Income Management	261,732,117	234,082,153
Schroder Capital Management	123,040,813	139,518,857
Mercator Asset Management	113,200,716	—
Alliance Bernstein Institutional Investment Management	104,848,198	126,527,326
Gulf Investment Management, Inc.	99,671,870	102,293,316

5. LAND AND 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, 2003 and 2002, all capitalized costs associated with the building have been classified as building. The building cost of $9,080,841 and $9,070,087, respectively, is being depreciated over 30 years. The accumulated depreciation for the building as of June 30, 2003 and 2002 amounted to $689,044 and $382,730, respectively.

6. FURNITURE, FIXTURES AND EQUIPMENT

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

	2003	2002
Office furnishings and equipment	$ 683,854	$ 669,930
Computer equipment	1,048,526	291,542
	1,732,380	961,472
Less accumulated depreciation	(458,497)	(186,162)
Furniture, fixtures and equipment, net	$1,273,883	$ 775,310

7. SECURITIES LENDING ARRANGEMENTS

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

	2003		2002	
	Securities lent	Collateral held	Securities lent	Collateral held
United States government securities	$ 98,185,478	$ 100,733,851	$ 16,531,510	$ 16,782,033
Corporate bonds	45,690,147	47,410,280	63,770,387	65,379,337
Other fixed-income securities	3,876,358	4,196,601	2,864,370	3,016,164
Common and preferred stocks	46,311,435	48,807,744	17,400,145	18,411,205
	$194,063,418	$ 201,148,476	$100,566,412	$103,588,739

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 percent to 109 percent, 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, 2003, and 2002. 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 73 days and 83 days for June 30, 2003, and June 30, 2002, respectively. Cash collateral is invested in the lending agent's collateral investment pool, which has a weighted-average maturity of approximately 95 days and 59 days as of June 30, 2003 and 2002, 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, 2003 and 2002, securities lending transactions were collateralized in cash.

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NOTES TO BASIC FINANCIAL STATEMENTS *(continued)*

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, 2003 and 2002, aggregate contributions from active members of the Fund with less than 10 years of service were approximately $14,000,000 and $14,200,000, respectively. Contributions for employees with 10 to 20 years of service has not been determined. As of June 30, 2003 and 2002, 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 $210,668,000 and $165,000,000 as of June 30, 2003 and 2002, 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, 2003 and 2002, 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 2003 and 2002, the Plan utilized the services of an investment management company (in which the Plan also owns an interest) in the amount of $473,000 and $270,000, respectively.

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REQUIRED SUPPLEMENTAL SCHEDULES

SCHEDULE 1 — 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
7-1-95	$ 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 note to required supplemental schedules.

See accompanying independent auditors' report.

SCHEDULE 2 — SCHEDULE OF EMPLOYER CONTRIBUTIONS (UNAUDITED)

(dollars in thousands)

Year ended June 30,	Annual required contribution	Percentage contributed
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
2003	27,989	100

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

See accompanying note to required supplemental schedules.

See accompanying independent auditors' report.

NOTE TO REQUIRED SUPPLEMENTAL SCHEDULES

The information present in the required supplemental schedules 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.

ADDITIONAL SUPPLEMENTAL SCHEDULES

SCHEDULE 3 — INVESTMENT, PROFESSIONAL SERVICES AND ADMINISTRATIVE EXPENSES

Years Ended June 30, 2003 and 2002

	2003	2002
Investment services:		
Custodial services	$ 316,030	$ 263,129
Money management services	10,626,970	9,973,702
Total investment services	$ 10,943,000	$ 10,236,831
Professional services:		
Actuarial services	83,500	136,590
Audit and accounting services	17,500	17,500
Consulting services	246,587	326,448
Legal services	55,824	77,080
Medical examinations	7,437	8,500
Total professional services	$ 410,848	$ 566,118
Administrative expenses:		
Depreciation expense	578,649	457,913
Continuing education	303,658	372,721
Furniture, equipment and supplies	26,200	46,444
Insurance	638,512	636,880
Investment research	66,266	49,229
Office cost	2,457,794	2,903,440
Facility maintenance	130,758	120,436
Utilities	161,149	152,710
Other		2,749
Total administrative expenses	$ 4,362,986	$ 4,742,522

See accompanying independent auditors' report.

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ADDITIONAL SUPPLEMENTAL SCHEDULES *(continued)*

SCHEDULE 4 — SUMMARY OF INVESTMENT AND PROFESSIONAL SERVICES

Year Ended June 30, 2003

Individual or firm name	Official plan position	Payment	Nature of services
Mellon Trust	Custodian	$ 316,030	Custodial
Ariel Capital Management	Investment manager	48,870	Money management
Gulf Investment Management, Inc.	Investment manager	453,098	Money management
Mellon EB Index	Investment manager	27,942	Money management
AllianceBernstein	Investment manager	757,403	Money management
State Street Research	Investment manager	190,538	Money management
The Mitchell Group	Investment manager	194,439	Money management
Mercator	Investment manager	400,882	Money management
Marvin & Palmer	Investment manager	260,842	Money management
Schroder Investment Management	Investment manager	729,075	Money management
Scudder Kemper	Investment manager	96,031	Money management
Mellon ICA	Investment manager	52,946	Money management
GW Capital	Investment manager	167,038	Money management
Loomis Sayles	Investment manager	670,701	Money management
Standish/Mellon Bond	Investment manager	229,294	Money management
STW Fixed Income Management	Investment manager	490,408	Money management
Emerging Growth Timberland	Investment manager	165,493	Money management
L&B	Investment manager	13,952	Money management
Lone Star Opportunity Fund	Investment manager	439,370	Money management
Energy Trust	Investment manager	463,898	Money management
Blackstone Capital Partners	Investment manager	237,348	Money management
Brera Capital	Investment manager	233,974	Money management
Hicks, Muse, Tate & Furst Fund	Investment manager	324,292	Money management
Industrial Growth Partners	Investment manager	259,737	Money management
Coller International Partners	Investment manager	445,796	Money management
Landmark Real Estate Fund	Investment manager	961,982	Money management
Lexington Capital Partners	Investment manager	589,990	Money management
Hyperion Partners	Investment manager	145,671	Money management
TCW Shared Opportunity Fund	Investment manager	604,673	Money management
Centennial Fund	Investment manager	750,445	Money management
Triad Ventures Ltd.	Investment manager	20,429	Money management
Blackstone Capital Partners	Investment manager	200,863	Money management
Total investment services		$10,943,000	
Towers Perrin, Inc.	Actuary	83,500	Actuarial
Locke, Lidell and Sapp, LLP	Attorneys	89,669	Consulting
Strasburger and Price, LLP	Attorneys	50,388	Legal
Mir Fox & Rodriguez, PC	Auditors	17,500	Audit and accounting
Pension Consulting Alliance	Consultant	82,500	Consulting
Fred Halperin, HR&C	Consultant	7,125	Consulting
Gene de LaVeaga	Consultant	15,010	Consulting
MDS Research Company, Inc.	Consultant	9,281	Consulting
William & Jenson	Consultant	105,677	Consulting
John Harris Consulting	Consultant	3,420	Consulting
Jeanneret Associates, Inc.	Consultant	4,756	Consulting
Other	Other	(7,243)	Consulting
Other	Other	5,436	Legal
Texas Occupational Medicine	Physicians	7,100	Medical examinations
University of Texas Health Services	Physicians	337	Medical examinations
Total payments		$ 474,456	
Accrued at June 30, 2001		(63,608)	
Total professional services		$ 410,848	

See accompanying independent auditors' report.

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Section 3
Investment Information

Fiscal Year Ended June 30, 2003

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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 sufficient investment returns with appropriate levels of risk necessary to pay 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 2003, the Fund experienced a rate of return of 6.48 percent. Despite increasingly volatile markets, the Fund's investments performed well among its peer group.

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 semiannual 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	11% – 18%	15%
Real Estate	4% – 7%	5%
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.

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OUTLINE OF INVESTMENT POLICIES *(continued)* *and* INVESTMENT HOLDINGS 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 Index
International	24%	MSCI All Country World Ex-US Index
Domestic Fixed Income	35%	Lehman Brothers Universal Index
Alternative Investments	15%	Flat Rate 15%
Real Estate	5%	Flat Rate 9.25%
Cash	1%	Merrill Lynch 90-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.

INVESTMENT HOLDINGS ASSET ALLOCATION *(dollars in millions)*

	Fiscal year ended June 30,									
	1999		2000		2001		2002		2003	
	Market value [1]	Percent	Market value	Percent	Market value	Percent	Market value	Percent	Market value	Percent
Cash Equivalents [2]	$ 9.7	0.6%	$ 9.3	0.5%	$ 24.1	1.4%	$ 9.8	0.6%	$ 49.1	2.9%
Domestic Equity [3]	519.8	32.3	460.6	26.1	395.7	23.0	388.8	23.5	352.4	20.6
Domestic Fixed Income [4]	331.6	20.6	542.7	30.7	586.1	34.1	596.2	36.1	616.6	36.0
High-Yield Securities	202.3	12.6	—	—	—	—	—	—	—	—
International Equities	278.6	17.3	351.2	19.9	337.7	19.7	310.3	18.8	334.8	19.5
Alternative Investments	266.7	16.6	402.5	22.8	374.1	21.8	346.2	21.0	286.5	16.7
Real Estate	—	—	—	—	—	—	—	—	73.6	4.3
	$1,608.7	100.0%	$1,766.3	100.0%	$1,717.7	100.0%	$1,651.3	100.0%	$1,713.2	100.0%

[1] *Includes receivables, payables and foreign currency fluctuations*
[2] *Includes cash residuals from managed accounts*
[3] *Excludes convertible securities*
[4] *Includes convertible securities*

INVESTMENT RESULTS

TOTAL FUND RETURN

	Period ended June 30,					Annualized period ended 6/30/2003		
	1999	2000	2001	2002	2003	3-Year	5-Year	10-Year
HFRRF	**5.5%**	**10.3%**	**1.1%**	**(2.4%)**	**6.48%**	**0.91%**	**3.65%**	**9.05%**

RETURNS BY ASSET CLASS

	Period ended June 30,					Annualized period ended 6/30/2003		
	1999	**2000**	**2001**	**2002**	**2003**	**3-Year**	**5-Year**	**10-Year**
Cash								
HFRRF*	14.8%	9.9%	12.2%	9.3%	1.0%	7.4%	9.3%	7.6%
Merrill Lynch 90-Day T-Bill	4.9	5.5	5.9	2.6	1.5	3.3	4.1	4.6
Domestic Equity								
HFRRF	6.7	(1.4)	11.2	(1.0)	(1.8)	2.6	2.6	10.0
Russell 3000	20.1	9.6	(13.9)	(17.3)	0.8	(10.5)	(1.1)	9.7
Domestic Fixed Income								
HFRRF	2.2	4.8	5.2	1.8	26.8	10.7	7.8	9.7
Lehman Universal Index	2.6	4.8	10.8	7.7	11.5	10.0	7.4	7.3
International Equities								
HFRRF	6.3	22.1	(22.2)	(8.1)	(6.9)	(12.7)	(2.9)	4.5
MSCI All Country World Ex-US Index	7.4	18.8	(23.8)	(9.4)	(5.6)	(13.3)	(3.6)	3.2
Alternative Investments								
HFRRF	7.5	35.3	(2.9)	(6.7)	(7.4)	(5.7)	4.1	15.7
Flat 15%	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
Real Estate Investments								
HFRRF	11.2	5.6	(4.6)	1.5	1.7	(0.5)	3.0	6.4
Flat 9.25%`	9.25	9.25	9.25	9.25	9.25	9.25	9.25	9.25

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

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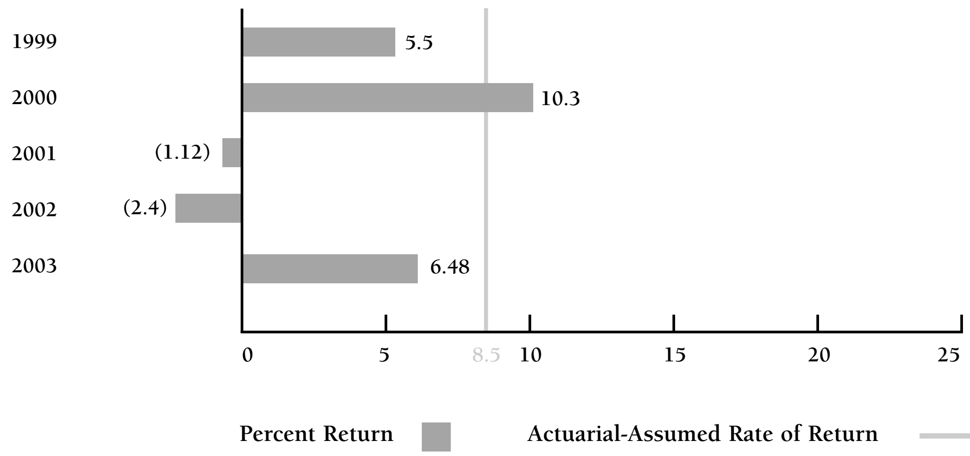
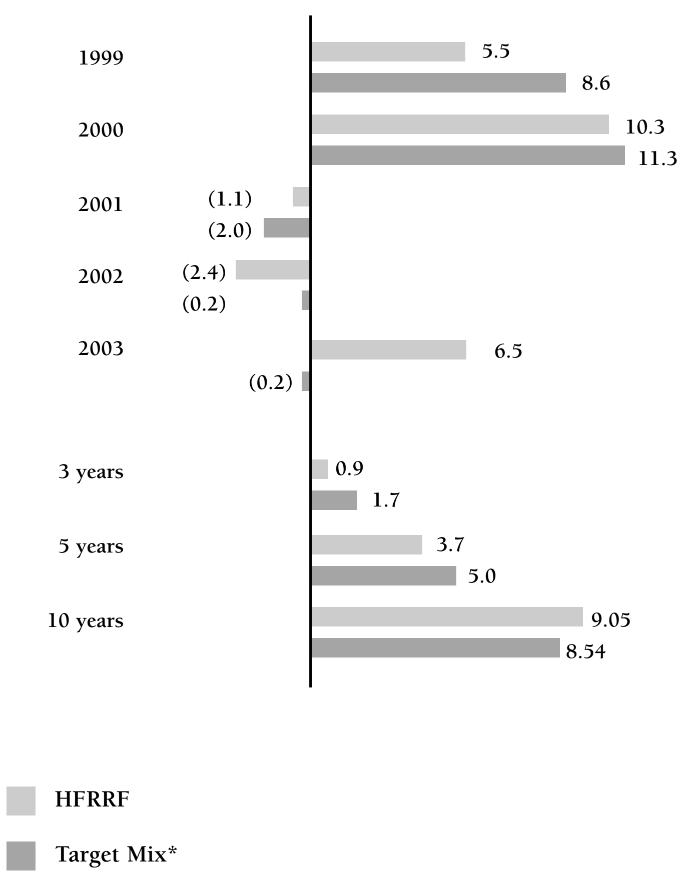
INVESTMENT RESULTS *(continued)*

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 24-25.*

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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
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)
2003	**6.48**	**3.94**	**(1.76)**	**0.77**	**0.26**	**26.84**	**11.51**	**13.14**	**(6.92)**	**(5.58)**	**(6.05)**

** Trust Universe Comparison Service Public Funds 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	1.9%	(1.1)%	(1.4)%	(8.7)%	(9.3)%	13.6%	9.6%	10.7%
3	0.9	(2.4)	2.6	(10.5)	(11.2)	10.7	10.0	10.8
5	3.7	2.6	2.6	(1.1)	(1.6)	7.8	7.4	7.8
10	9.1	8.3	10.0	9.7	10.0	9.7	7.3	7.4

** Trust Universe Comparison Service Public Funds Total Returns*

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INVESTMENT HOLDINGS SUMMARY

INVESTMENT HOLDINGS

	Market value at June 30, 2003	Percent of total market value
Cash and Cash Equivalents	$ 2,670,886	0.2%
Short-term Investment Funds	46,500,526	2.7
Equities		
Commingled Equity Fund	61,787,446	3.6
Commingled Intl. Equity Fund	53,014,115	3.1
Common Stock	573,265,711	33.8
Preferred Stock	14,443,712	0.9
	702,510,984	41.4
Fixed Income		
U.S. Government Securities	117,134,741	6.9
Corporate Bonds	310,799,601	18.3
Other Fixed Income	158,635,593	9.3
	586,569,935	34.5
Alternative Investments	286,539,243	16.9
Real Estate Investments	73,620,654	4.3
Total Market Value	$1,698,412,228	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	$6,020,000	0.35%
VODAFONE GROUP PLC ORD USD0.10	5,537,724	0.32
AMERICAN EXPRESS CO COM	5,518,920	0.32
WELLS FARGO & CO NEW COM	5,292,000	0.31
BANK OF AMERICA CORP	5,215,980	0.30
JOHNSON & JOHNSON COM	5,170,000	0.30
PEARSON ORD 25P	4,869,638	0.28
ING GROEP N.V. CVA EUR0.24	4,825,881	0.28
ALLSTATE CORP COM	4,634,500	0.27
SCHLUMBERGER LTD COM	4,395,468	0.26

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

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

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INVESTMENT HOLDINGS SUMMARY *(continued)*

TEN LARGEST FIXED-INCOME HOLDINGS

Description	Market value	Percent of total market value*
US TREASURY BONDS	$53,432,102	3.12%
US TREASURY BONDS	28,075,634	1.64
US TREASURY BONDS	20,159,875	1.18
CARTESIO SRL BDS	10,909,500	0.64
GENERAL ELEC CAP MTN #TR 00528	9,122,334	0.53
TELEFONICA EUROPE BV US NT	8,504,795	0.50
DRESDNER FDG SILENT PRTNR 144A	8,269,875	0.48
VODAFONE AIRTOUCH PLC NT	8,212,785	0.48
GEORGIA PAC CORP DEB	7,045,425	0.41
FED HOME LOAN MTG NTS EUR	6,338,662	0.37

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

FEES FOR INVESTMENT SERVICES

	Fiscal year 2003			Fiscal year 2002		
	Assets under management	Fees	Basis points*	Assets under management	Fees	Basis points
Investment Management Fees						
Cash Equivalents Manager [1]	$49,171,392	$ 229,294	47	$ 51,138,368	$ 97,809	17
Domestic Equity Managers	352,449,040	1,671,840	47	387,851,912	1,619,980	41
International Equity Managers	334,827,867	1,539,776	46	310,265,477	1,490,896	49
Fixed-Income Managers	616,634,734	1,328,147	22	596,176,770	1,303,273	22
Alternative Investments	286,539,243	5,678,468	198	—	698,383	—
Real Estate Investments	73,620,654	179,445	24	—	—	—
Other Investment Services						
Custodial	1,713,242,929	316,030	1.8	—	343,361	—
Consultant	1,713,242,929	82,500	0.5	—	48,750	—
Total Fees for Investment Services	—	$11,025,500	64	—	$ 5,602,451	—

** Calculated using average quarterly assets under management*

[1] *Includes cash from managers' accounts*

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2003 BROKERAGE COMMISSIONS

(in order of commissions received)

Broker name	Base commissions	Shares	Per share
LYNCH JONES & RYAN INC, HOUSTON*	$115,943	2,619,600	0.044
DEUTSCHE BANC ALEX BROWN INC, NEW YORK	100,048	13,650,802	0.007
MERRILL LYNCH PIERCE FENNER SMITH INC NY	62,920	1,906,225	0.033
UBS, STAMFORD	59,068	8,310,870	0.007
MERRILL LYNCH INTL LTD, NEW YORK	55,961	65,654,700	0.001
GOLDMAN SACHS & CO, NY	55,796	12,701,400	0.004
MORGAN STANLEY & CO INC, NY	26,043	3,445,035	0.008
JEFFERIES & CO INC, NEW YORK	26,012	570,800	0.046
BEAR STEARNS SEC CORP, BROOKLYN	20,184	593,400	0.034
MERRILL LYNCH INTL LONDON EQUITIES	18,878	224,200	0.084
FOX PITT KELTON INC, NEW YORK	17,963	370,810	0.048
CREDIT SUISSE FIRST BOSTON CORP, NY	17,012	1,239,135	0.047
CITIGROUP GLOBAL MARKETS INC, NEW YORK	15,841	373,200	0.062
CREDIT SUISSE FIRST BOSTON (EUROPE), LON	14,779	757,151	0.014
FRIEDMAN BILLINGS, WASHINGTON DC	14,356	319,735	0.045
MORGAN STANLEY & CO INTL, LONDON	12,876	745,690	0.017
BHF SEC CORP, NEW YORK	12,819	894,600	0.014
SALOMON BROS INTL LTD, LONDON	12,370	1,022,398	0.012
MORGAN J P SECS INC, NEW YORK	12,249	1,073,899	0.011
GOLDMAN SACHS INTL, LONDON	12,212	1,448,332	0.009
J P MORGAN SECS LTD, LONDON	11,653	644,386	0.018
UBS WARBURG ASIA LTD, HONG KONG	10,404	5,141,730	0.002
UBS SECURITIES LLC, NEW YORK	9,400	301,300	0.031
BAIRD, ROBERT W & CO INC, MILWAUKEE	9,147	298,400	0.031
MORGAN GRENFELL, LONDON	9,060	460,344	0.020
BEAR STEARNS & CO INC, NY	8,438	2,887,300	0.003
CITIGROUP GBL MKTS/SALOMON, NEW YORK	8,296	2,817,194	0.042
DRESDNER KLEINWORT BENSON, NEW YORK	7,928	200,298	0.040
UNION BANK SWITZERLAND SECS, LONDON	7,896	1,236,200	0.006
SSANGYONG INVESTMENT SECS, SEOUL	7,647	53,886	0.142
MERRILL LYNCH INTL (MEIT), LONDON	7,503	449,421	0.017
MERRILL LYNCH INTL (3L GLOSS), LONDON	7,341	666,532	0.011
CREDIT LYONNAIS SECS, NEW YORK	6,889	717,460	0.050
DEUTSCHE SEC ASIA LTD, HONG KONG	6,620	668,805	0.010
LEHMAN BROS, LONDON	6,555	366,476	0.057
KLEINWORT BENSON SECS LTD, LONDON	6,097	543,703	0.011
SG COWEN SECS CORP, NEW YORK	5,953	135,100	0.044
UBS SECURITIES CANADA, TOR (T015,BWIT)	5,599	177,100	0.032
INTERMONTE SEC CIM, MILAN	5,246	151,915	0.035
LEHMAN BROS INC, NEW YORK	5,129	349,800	0.015
MCDONALD & CO, NEW YORK	4,380	87,600	0.050
HSBC SECS INC, NEW YORK	4,338	3,784,900	0.001
WACHOVIA SECURITIES LLC, NEW YORK	4,325	86,500	0.050
DEUTSCHE BANK AG (INTL EQUITIES), LONDON	4,312	150,726	0.029
J B WERE & SON LTD, LONDON	4,204	492,586	0.009
INVESTMENT TECHNOLOGY GROUPS, NEW YORK	4,153	1,462,554	0.003
OPPENHEIMER & CO INC, NEW YORK	4,117	84,300	0.049
ADVEST CO, HARTFORD	4,039	119,100	0.034
NOMURA SECS INTL INC, NEW YORK	4,010	1,272,600	0.003
SIMMONS & CO INTL, HOUSTON	3,864	79,400	0.049
UBS EQUITIES, LONDON	$3,777	160,364	0.024
BHC SECS INC, PHILADELPHIA	3,708	61,800	0.060
CSFB & DONALDSON LUFKIN, NEW YORK	3,674	75,600	0.050
KEEFE BRUYETTE AND WOODS, JERSEY CITY	3,565	71,300	0.050
J B WERE & CO, NEW YORK	3,428	46,595	0.074
ABEL NOSER CORP, NEW YORK	3,342	222,100	0.015
SCOTT STRINGFELLOW INC, RICHMOND	3,270	65,400	0.050
SANDLER O'NEILL & PARTNERS, NEW YORK	3,145	62,900	0.050
MERRILL LYNCH, NY	3,133	252,900	0.012
HOARE GOVETT SECS LTD, LONDON	3,114	253,982	0.012
CSFB (HK) LIMITED, HONG KONG	2,955	130,000	0.048
DEUTSCHE MORGAN GRENFELL/CJ LAWRENCE, NY	2,902	39,700	0.073
HOWARD WEIL LABOUISSE FRIEDRICHS, NEW OR	2,846	49,200	0.058
BANC OF AMERICA SEC LTD, LONDON	2,729	465,979	0.006
GRIFFITHS MCBURNEY & PARTNERS, TORONTO	2,620	218,500	0.012
BANQUE PICTET AND CIE, GENEVA	2,596	8,600	0.302
CHEVREUX DE VIRIEU SA, PARIS	2,545	39,989	0.014
BANC OF AMERICA SECS LLC, CHARLOTTE	2,502	41,700	0.060
FIRST ASSOCIATES INVTS, TORONTO (T011)	2,386	94,600	0.025
BNP PARIBAS, LONDON	2,264	23,260	0.097
LEGG MASON WOOD WALKER INC, BALTIMORE	2,065	41,300	0.050
JOHNSON RICE & CO, NEW ORLEANS	2,045	41,500	0.049
FIRST ALBANY CORP, ALBANY	2,015	40,300	0.050
CREDIT SUISSE, NEW YORK	1,976	41,700	0.023
ROCHDALE SECURITIES CORP	1,940	38,800	0.050
CREDIT LYONNAIS SECURITIES INC, NEW YORK	1,900	38,000	0.020
HSBC INVESTMENT BANK, LONDON	1,884	224,841	0.008
BERNSTEIN SANFORD C & CO, NEW YORK	1,825	36,500	0.050
JONES & ASSOCIATES INC, WESTLAKE VILLAGE	1,815	36,300	0.050
SPROTT SEC LTD, TORONTO	1,800	45,000	0.040
NOMURA SECURITIES INTL LON	1,789	47,850	0.037
FIRST UNION CAP MKTS, CHARLOTTE	1,778	36,200	0.049
LEHMAN BROS SECS ASIA LTD, HONG KONG	1,777	2,082,000	0.001
KING (CL) & ASSOCIATES, ALBANY	1,710	35,600	0.048
RBC DOMINION SECS INC (T002,DOMA)	1,685	48,500	0.035
DAIN RAUSCHER INC, MINN	1,580	31,600	0.050
FIRST MARATHON SEC LTD, TORONTO	1,523	47,500	0.032
LASKER STONE & STERN, NEW YORK	1,500	30,000	0.050
SANDERS MORRIS MUNDY, HOUSTON	1,452	24,200	0.060
SAMSUNG SECS, SEOUL	1,417	12,250	0.116
BANCO BILBAO VIZCAYA, NEW YORK	1,300	26,000	0.050
NBCN CLEARING INC TORONTO (T080,NBCS)	1,246	62,300	0.020
JONES & ASSOC, WESTLAKE VILLAGE	1,196	29,900	0.040
INVESTEC ERNST & CO, NEW YORK	1,176	19,600	0.060
T D WATERHOUSE, CANADA	1,159	34,000	0.034
KNIGHT SEC BROADCORT, JERSEY CITY	1,115	33,900	0.033
J & E DAVY, DUBLIN	1,110	45,131	0.025
KIM ENG SEC LTD, HONG KONG	1,100	22,000	0.050
PRIME EXECUTIONS INC, DALLAS	990	19,800	0.050
OTHER BROKERS	182,691	15,001,401	0.043
	$1,166,930	164,468,040	0.038

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

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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 2003, approximately 10 percent of all trading activity was directed toward the commission recapture program.

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Section 4
Actuarial Information

Fiscal Year Ended June 30, 2003

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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.

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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 20–22) 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 percent 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

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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

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

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.

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SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS *July 1, 2001* ***(continued)***

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.

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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
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)

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		
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
6-30-01	127	3,581,000	47	775,000	1,672	38,347,000	10.9	22,935

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

SOLVENCY TEST *(dollars in thousands)*

	Actuarial accrued liability for				Percentage of actuarial accrued liability covered by assets		
Valuation date	Active member contributions	Retirees, beneficiaries and vested participants	Active participants (city-financed portion)	Actuarial value of assets			
		(1)	(2)	(3)	(1)	(2)	(3)
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

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.*

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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.

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.

ANNUAL SUPPLEMENTAL BENEFIT

Supplemental benefit payments totaling $5 million will be payable each January to eligible retirees and survivors in accordance with guidelines determined by the Board of Trustees.

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. 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 Fund; and
- Investment earnings/losses at the rate of the 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.

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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% to be 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.

NON-SERVICE-CONNECTED DISABILITY PENSION

Eligibility — No age or service requirements.

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

ADDITIONAL BENEFIT

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

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

POST-RETIREMENT ADJUSTMENTS

- 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.

- 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.

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 plan 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 (to be effective September 1, 2001).

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Section 5
Statistical Information
(unaudited)

Fiscal Year Ended June 30, 2003

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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) based on market value	Total
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)
2003	**13,995**	**27,990**	**15.4**	**97,380**	**139,364**

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

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

Fiscal year ended June 30,	Benefit payments*	Professional and administrative expenses	Contribution refunds	Total
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
2003	**71,385**	**4,774**	**126**	**76,286**

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.*

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STATISTICS *(continued)*

BENEFIT EXPENSES BY TYPE *(cash basis)*

		Annual	Monthly pension benefits					Refunds of contributions due to		
Year ending	DROP distributions	supplemental benefit pmt.	Service retirees	Deferred retirees*	On-duty disabilities	Off-duty disabilities	Survivors	Death	Termination	Total
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
2003	**17,587,240**	**4,971,066**	**36,227,547**	**425,491**	**4,170,940**	**1,528,181**	**9,250,844**	**0**	**125,824**	**74,287,133**

** Reporting of deferred retirees began in 2000.*

RETIRED MEMBERS BY TYPE OF BENEFIT *Year Ended June 30, 2003*

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	57	0	0	8	10	39	0
401 – 600	37	0	0	8	4	25	3
601 – 800	34	0	3	16	4	11	5
801 – 1,000	57	13	6	29	9	0	2
1,001 – 1,200	73	18	9	41	4	1	0
1,201 – 1,400	125	46	33	42	4	0	0
1,401 – 1,600	154	62	40	52	0	0	0
1,601 – 1,800	184	90	50	42	2	0	0
1,801 – 2,000	188	117	33	37	1	0	0
Over 2,000	1,008	808	73	125	2	0	0
Total:	**1,921**	**1,154**	**247**	**400**	**43**	**77**	**10**

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

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STATISTICS *(continued)*

AVERAGE MONTHLY BENEFIT PAYMENTS FOR SERVICE RETIREMENTS

Retirement effective dates	Years of credited service		
July 1, 1997 through June 30, 2003	**20 – 25**	**26 – 30**	**Over 30**
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
Period 7-1-02 through 6-30-03			
Number of Service Retirements	40	43	65
Average Monthly Benefit (based on averages)	2,438	2,527	3,556
Summary			
Period 7-1-97 through 6-30-03			
Number of Service Retirements	**115**	**140**	**185**
Average Monthly Benefit (based on averages)	**$2,092**	**$2,596**	**$3,311**

* *Reflects amended numbers*

GLOSSARY

Some of these terms are used in the Investment Section, beginning on page 24. 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.

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.

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GLOSSARY *(continued)*

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.

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Houston Firefighters'
Relief and Retirement Fund

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