2005

COMPREHENSIVE ANNUAL FINANCIAL REPORT

STRENGTH TOGETHER

HOUSTON FIREFIGHTERS' RELIEF AND RETIREMENT FUND

A Component Unit of the City of Houston for the Fiscal Year Ended June 30, 2005

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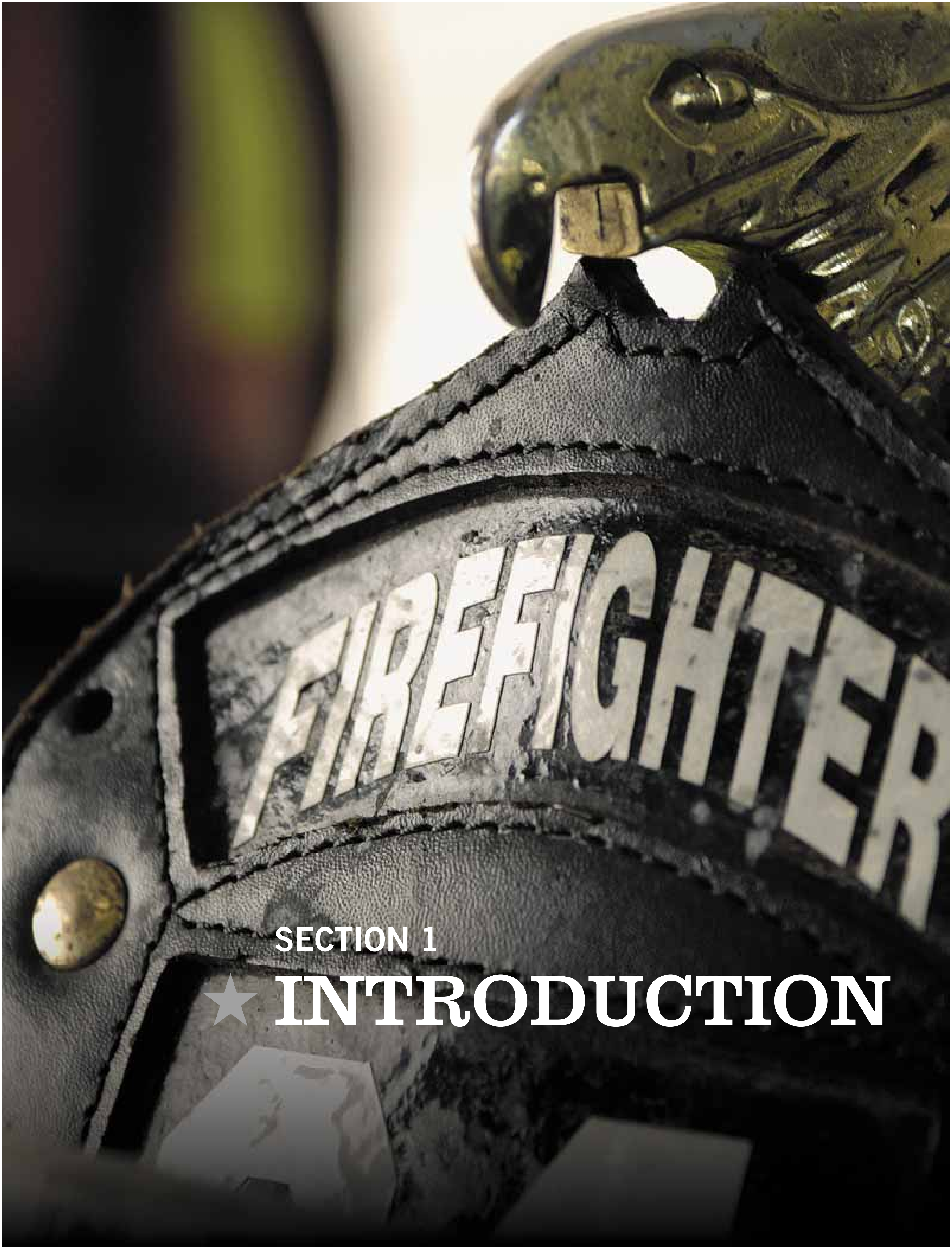

SECTION 1

INTRODUCTION

HOUSTON FIREFIGHTERS' RELIEF AND RETIREMENT FUND

Investing for Firefighters and Their Families®

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★ LETTER OF TRANSMITTAL

October 13, 2005
Philip B. Scheps, Ph.D.
Treasurer
City of Houston
P.O. Box 1562
Houston, Texas 77251-1562

Dear Dr. Scheps:

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, 2005, 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.

It should be noted that, subsequent to the fiscal year-end, June 30, 2005, Chief Investment Officer Christopher Gonzales was appointed Acting Executive Director.

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The report consists of five sections:

Section 1 — Introduction contains this Letter of Transmittal and identifies 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, including the Management's Discussion and Analysis section.

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

Section 4 — Actuarial Information contains the independent consulting actuary's opinion and results of the July 1, 2002, actuarial valuation.

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

MILESTONES AND MAJOR INITIATIVES

The Fund achieved several milestones during fiscal year 2005. Listed below are several accomplishments from the member services, investment and administrative teams.

Member Services Milestones

During fiscal year 2005, the membership services staff continued to enhance the services provided to its members. Among the highlights include:

- **e-Member**

The Fund implemented Web enhancements that expand the financial planning tools available to the members. Together with the Web calculator implemented last year, these tools enable members to access their pension information, perform different types of pension estimates, estimate additional retirement income needs, and avoid possible penalty taxes. Active members now have additional flexibility for obtaining information regarding available pension benefits at any time.

- **Financial Planning Seminar**

The Fund celebrated its fifth anniversary of providing financial planning seminars to its members by expanding its outreach effort to include weekend classes.

- **Retirement Decision Process**

Member Services worked with the Houston Fire Department to enhance the retirement decision process by providing pension options and additional information to anyone considering retirement. This change continues to ensure that members receive the most up-to-date and accurate information before making retirement decisions.

Also effective July 1, 2004, the firefighters' contribution rate increased to 9 percent. The City of Houston contributes at least twice the firefighters' contribution rate (18 percent). Furthermore, after careful review of actuarial information and in-depth discussions with the city, the Board of Trustees adopted the July 1, 2002, actuarial valuation, increasing the city's contribution from 18 to 23.8 percent, effective July 1, 2005. The member rate of 9 percent remains unchanged.

The Fund did not implement any benefit enhancements during fiscal year 2005.

Investment Milestones

Fiscal year 2005 turned out to be an outstanding year for the Fund. The Fund returned 19.1 percent on its investment assets. This return placed the Fund in the first percentile for a one-year period and in the second percentile over a 10-year period of public pension plans as measured by the Trust Universe Comparisons Service (TUCS) Report produced by Russell/Mellon. Once again, the Fund's strong performance can be attributed to its disciplined contrarian investor policy.

Specifically, there were two key contributors to this phenomenal success. The first is the Fund's greater-than-average exposure in international emerging markets, energy sector stocks and alternative investments — all areas that performed extremely well during the past fiscal year. The second is the exceptional performance of our fixed-income portfolio. Paradoxically, in a period marked by slowly rising interest rates, the Fund's fixed-income allocation delivered a double-digit return.

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Among the highlights of the FY 2005 performance returns:

- The three strongest areas for the year were international markets, the energy sector and alternative investments (with the energy sector leading by finishing with an estimated return greater than 40 percent).
- The Fund's extra exposure versus the typical market weights in those three areas enhanced performance.
- Within real estate, the portfolio had a significant distribution from a core portfolio as well as a large valuation increase in a timber/higher-and-better-use portfolio, both boosting the overall Fund performance by 1¼ percent.
- Despite concerns about rising interest rates, the Fund's fixed income portfolio posted a double-digit return.
- Unlike many other years, every asset class in the Fund's portfolio except cash and cash equivalents posted double-digit returns.

Also during the year, the Board of Trustees made significant private equity commitments to the alternative asset class. Capital commitments made include Energy Spectrum Partners IV, Energy Trust Partners II, Lone Star Fund V and TCW Shared Opportunity Fund V.

Finally, a significant portion of the Fund's success can be attributed to a low turnover of investment managers as well as an excellent investment staff and a well-educated and disciplined Board of Trustees operating under effective governance policies.

ADMINISTRATION, STAFF AND PROFESSIONAL SERVICES

At fiscal year-end, the Fund staff was made up of 24 employees. The following professionals were employed by the Board of Trustees as of June 30, 2005, to provide specialty services:

- The custodian bank is Mellon Trust.
- Mir•Fox & Rodriguez, P.C., serves as the auditor.
- Buck Consultants is the actuary.
- Strasburger & Price, LLP, serves as legal counsel.

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 9 of this report. Other professionals employed by the Board are listed on page 35.

ACCOUNTING SYSTEMS AND REPORTS

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

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

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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 30-year rolling period. 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 on 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 global 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 a 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, 2005, and was conducted in accordance with auditing standards generally accepted in the United States of America. The Independent Auditors' Report is included in the financial section of this CAFR. The financial section also contains a management discussion and analysis report that provides a narrative introduction, overview and analysis of the financial statements.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association (GFOA) of the United States and Canada 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, 2004. This was the 22nd year that the Fund has received this prestigious award. In order to be awarded a Certificate of Achievement, a governmental unit 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, to the advisors, and to the many other professionals and participants who have worked so diligently to assure the successful operation of the Fund.

Sincerely,

Christopher E. Gonzales,
Acting Executive Director

Rhonda Scott Smith,
Deputy Director of Finance and Operations

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★ ADMINISTRATIVE ORGANIZATION

Acting Executive Director and Chief Investment Officer
Christopher E. Gonzales

General Counsel
Jonathan W. Needle

Deputy Director of Finance and Operations
Rhonda Scott Smith

Deputy Director of Member Services
Glenna Hicks

Director of Finance and Administration
Claudia McInnis

Director of Technology and Building Services
John D. Moore II

Committees
Budget and Audit
Investment
Legislative
Pension Benefits
Personnel and Procedures

Actuary
Buck Consultants

Auditor
Mir•Fox & Rodriguez, P.C.

Custodian Bank
Mellon Trust

Investment Advisors
AllianceBernstein Institutional Investment Management
Americus Real Estate Investments
Ariel Capital Management
The Blackstone Group
Brera Capital Partners, LLC
Centennial Holdings
Coller Investment Management Limited
Energy Spectrum Capital, LP
Energy Trust, LLC
FX Concepts
Gulf Investment Management
GW Capital, Inc.
Hicks, Muse, Tate & Furst
Industrial Growth Partners
Landmark Equity Partners
Lexington Capital Partners
Lone Star Funds
Loomis Sayles & Company
Marvin & Palmer Associates, Inc.
McKinley Capital Management, Inc.
Mercator Asset Management
The Mitchell Group
PTC — Houston Management, LP
Quantum Energy Management, LP
Ranieri & Co, Inc.
RMK Timberland Group
Standish/Mellon Bond
State Street Global Advisors
State Street Research & Management Co.
STW Fixed Income Mgmt.
TCW
Timberland Investment Resources, LLC
Victory Capital Management

Please see “Fees for Investment Services” on page 45.

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★ 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 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 13, 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 62 – 64.

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 is the end of the fiscal year on June 30, 2005 and 2004.

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 is the years ended June 30, 2005 and 2004.

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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 member 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 48).

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 six-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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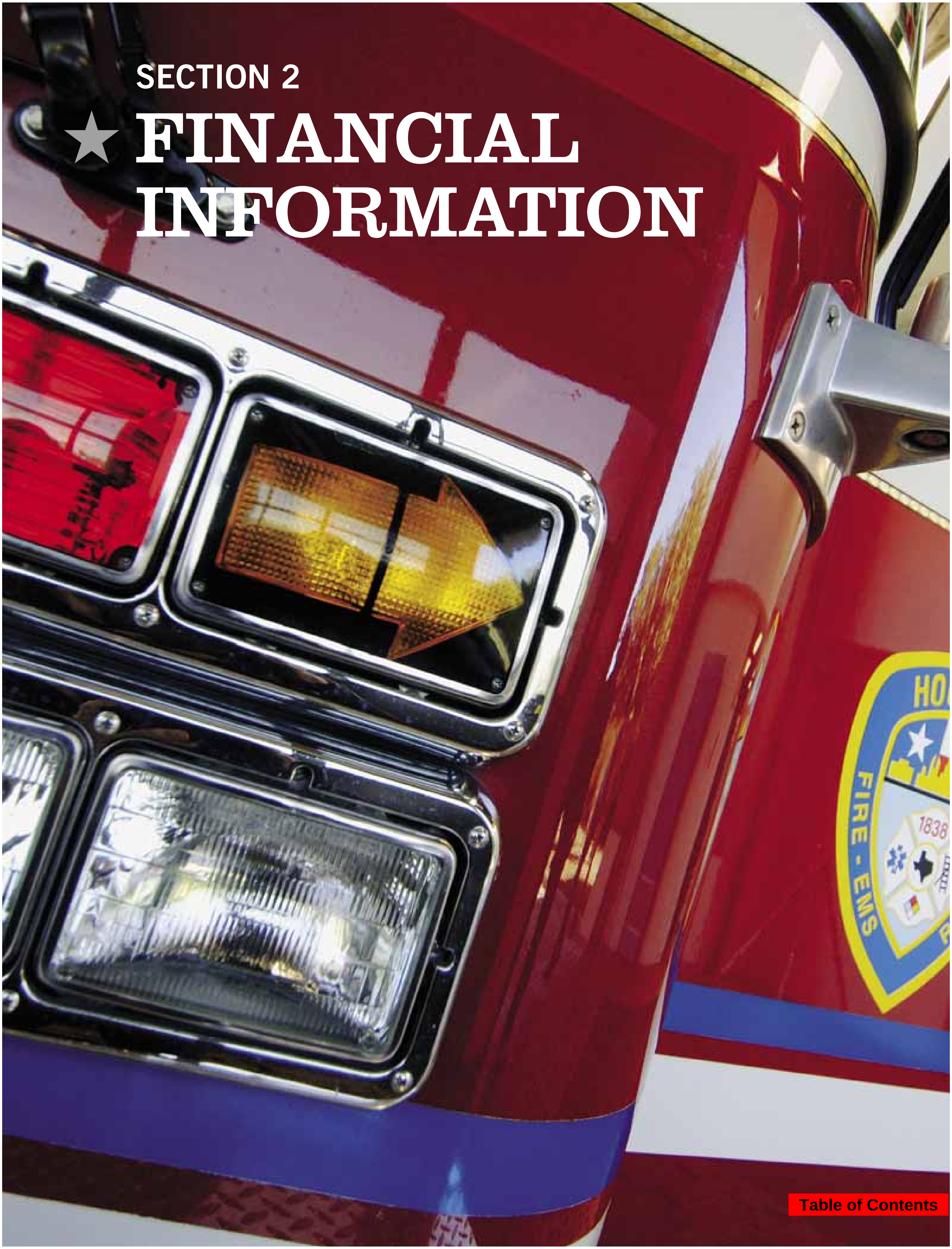
SECTION 2

★ FINANCIAL INFORMATION



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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, 2005 and 2004, 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, 2005 and 2004, and the changes in its financial status 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) are presented for the purpose of additional analysis and are not a required part of the Fund's basic financial statements. This information has been subjected to the auditing procedures applied in our audits 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.

The GASB requires that actuarial information be presented, at a minimum, on a biennial basis. The Fund's Board of Trustees and management have elected not to present the actuarial information on a biennial basis, but rather present the actuarial information in accordance with State of Texas statute, which allows the actuarial valuation to be adopted once every three years. This supplemental information required by the GASB does not affect the basic financial statements presented.

September 21, 2005

Mir Fox & Rodriguez

One Riverway Suite 1900
Houston, Texas 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 (the Fund) financial activity for the fiscal years ended June 30, 2005 and 2004. This discussion is intended to serve as an introduction to the Fund's 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, 2005, 2004 and 2003, and the fiscal year 2005, 2004 and 2003 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 additional supplemental information. These schedules provide additional information to the basic financial statements.

FINANCIAL HIGHLIGHTS

Plan Net Assets

	Fiscal Year 2005	Fiscal Year 2004	Fiscal Year 2003
ASSETS			
Investments	$2,257,555,547	$1,948,167,850	$1,695,741,342
Capital assets (net of depreciation):			
Land and building	$8,324,767	$8,626,341	$8,933,029
Furniture, fixtures and equipment	$1,355,544	$1,416,718	$1,273,883
Other	$636,485,489	$517,253,556	$245,558,145
Total assets	**$2,903,721,347**	**$2,475,464,465**	**$1,951,506,399**
LIABILITIES			
Short-term liabilities	$617,717,330	$494,561,060	$228,262,024
Total net assets	**$2,286,004,017**	**$1,980,903,405**	**$1,723,244,375**

Plan net assets at the end of fiscal year 2005, 2004 and 2003 totaled $2,286,004,017, $1,980,903,405, and $1,723,244,375, respectively. The increase in plan net assets for both fiscal year 2005 and 2004 is due to continued favorable market conditions as evidenced by the Fund's total investment return for fiscal year 2005 of 19.12 percent and fiscal year 2004 of 18.41 percent.

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Changes in Plan Net Assets

	Fiscal Year 2005	Fiscal Year 2004	Fiscal Year 2003
Beginning net assets	$1,980,903,405	$1,723,244,375	$1,660,164,965
Additions to net assets:			
Contributions	$49,044,214	$42,715,409	$41,984,183
Net appreciation in fair value of investments	$281,384,123	$252,764,028	$43,573,461
Interest income	$40,657,595	$38,617,796	$48,917,175
Dividends	$19,360,917	$15,475,695	$10,391,086
Agreed judgment	$9,325,726		
Other net income	($1,818,198)	($2,632,614)	($5,501,473)
Total additions to net assets	**$397,954,377**	**$346,940,314**	**$139,364,432**
Deductions from net assets:			
Benefits	$85,857,122	$83,618,595	$71,385,364
Other	$6,996,643	$5,662,689	$4,899,658
Total deductions from net assets	$92,853,765	$89,281,284	$76,285,022
Ending net assets	**$2,286,004,017**	**$1,980,903,405**	**$1,723,244,375**
Net increase in net assets	$305,100,612	$257,659,030	$63,079,410

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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 amounts contributed by employee members for the last three fiscal years were $16,355,387 (fiscal year 2005), $14,238,463 (fiscal year 2004), and $13,994,725 (fiscal year 2003). Employer contributions for the last three years were $32,688,827 (fiscal year 2005), $28,476,946 (fiscal year 2004), and $27,989,458 (fiscal year 2003).

The fiscal year 2005 contributions increased over fiscal year 2004 due primarily to the increased contribution rate, effective July 1, 2004, from 8.35 to 9 percent for employee members, and from 16.7 to 18 percent for employer contributions. The 2004 contributions increased over 2003 due primarily to the increased contribution rate from 7.7 to 8.35 percent for employee members, and from 15.4 to 16.7 percent for employer contributions, effective September 1, 2003.

In fiscal year 2005, the Fund experienced an exceptional investment performance with an overall return of 19.12 percent. A strong economic environment globally, combined with a precise asset allocation, were the main factors contributing to the superior performance. The Fund had greater market exposures in the areas that performed well compared to the broad market. For example, international emerging markets, energy sector stocks and private equity investments were among the top performers in the market during fiscal year 2005. The Fund's portfolio had higher than average weightings in all of these areas in addition to an excellent selection of investment managers to execute the Fund's strategies in those areas. Also, the Fund's fixed income portfolio composition of increased exposure to high-yield bonds and longer duration bonds helped ensure a double-digit return for the fixed income portfolio during fiscal year 2005. Every asset class in the Fund's portfolio except cash and cash equivalents posted double-digit returns.

In fiscal year 2004, the Fund also experienced significant gains in investment performance resulting in higher plan asset market value and an overall investment return of 18.41 percent. Publicly traded equities, high yield bonds and private equity were the strong performers during fiscal year 2004. The Fund's value-oriented bias in equities contributed to the high performance in fiscal year 2004.

During fiscal year 2005, a lawsuit concerning overtime pay between Emergency Medical Technicians (EMTs), as Plaintiffs, and the City, as Defendant, was settled. This lawsuit affected the Fund in that contributions from both the City and EMTs were due to the Fund on the agreed-upon overtime pay amount. The Final Judgment, dated November 19, 2004, stated that in addition to the statutorily mandated pension fund contributions of $1,825,726 to be withheld from payments to the Plaintiffs, the Defendant must make pension fund contributions (including lost income) to the Fund in the total amount of $7,500,000 on or before July 15, 2005.

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 2005, 2004 and 2003 totaled $92,853,765 (fiscal year 2005), $89,281,284 (fiscal year 2004), and $76,285,022 (fiscal year 2003). This represents an increase of approximately 4 percent between fiscal years 2005 and 2004, and an increase of approximately 16.9 percent between fiscal years 2004 and 2003.

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The 4 percent increase during fiscal year 2005 is primarily due to the 3 percent annual cost-of-living adjustment. The 16.9 percent increase during fiscal year 2004 is due primarily to:

(a) Steadily increasing DROP distributions due to the increasing number of retired members that can access their DROP balances.

(b) Increased benefit recipients: 130 in fiscal year 2004 and 147 in fiscal year 2003.

(c) The annual cost-of-living adjustment.

This growth in benefit payments is normal for a maturing pension fund.

In total, professional and administration deductions increased between fiscal years 2005 and 2004 and increased between fiscal years 2004 and 2003 by 24.4 and 15.6 percent, respectively. The current year's increase is due to additional actuarial services, adjustment for sick/vacation accrual, continuity of staff (reduction in staff attrition) and an increase in insurance and depreciation expenses. During fiscal year 2004, the increase was primarily due to additional consulting/legal expenses and an increase in staffing, insurance and depreciation expenses.

Total additions to the Fund in fiscal year 2005 were $397,954,377, and total deductions were $92,853,765, thereby increasing Fund net assets by $305,100,612. In fiscal year 2004, the Fund's net assets increased by $257,659,030, and in fiscal year 2003, the Fund's net assets increased by $63,079,410.

HISTORICAL TRENDS

Accounting standards require that the statement of plan net assets state assets 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 32). 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 in order to establish the City's contribution rate. In April 2005, the Board of Trustees adopted the finalized July 1, 2002, actuarial valuation, setting the City's contribution rate at 23.8 percent, effective July 1, 2005. The members' contribution rate remains at 9 percent. The July 1, 2002, actuarial report indicates that the Fund is approximately 98 percent funded.

The Board adopted the July 1, 2002, actuarial valuation after careful consideration of more recent preliminary actuarial information. It should be noted that the change in funding level is primarily due to the impact of market volatility experienced during fiscal years 2000 through 2003 and not to the benefits liability, which has remained stable and reasonable.

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

CONTACTING THE FUND'S FINANCIAL MANAGEMENT

This financial report is designed to provide our members, business partners and taxpayers with a general overview of the Fund's financial activities. If you have questions about this report or need additional information, contact the Deputy Director of Finance and Operations of the Houston Firefighters' Relief and Retirement Fund at 4225 Interwood North Parkway, Houston, Texas 77032.

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★ STATEMENTS OF PLAN NET ASSETS

Years Ended June 30, 2005 and 2004

ASSETS	Fiscal Year 2005	Fiscal Year 2004
Investments, at fair value:		
Short-term investment funds	$116,398,655	$80,834,015
Fixed income:		
Domestic	$649,317,035	$518,923,963
International	$87,904,314	$98,753,983
Common equity:		
Domestic	$492,322,690	$460,205,938
International	$483,235,585	$378,515,041
Preferred equity:		
Domestic	$518,934	$1,334,125
International	$6,603,488	$784,060
Alternative investments — partnerships	$299,765,798	$300,478,160
Real estate	$121,489,048	$108,338,565
Total investments	**$2,257,555,547**	**$1,948,167,850**
Cash and cash equivalents	$3,055,069	$9,102,265
Receivables:		
Accrued interest	$8,556,880	$8,719,988
Due from broker recapture	$36,298	$12,102
Due from securities lending	$129,821	$86,128
Foreign funds contracts	$63,133,134	$75,880,198
Receivables for investments sold	$6,069,407	$17,371,966
Accrued dividends	$2,084,311	$1,621,272
Agreed judgment	$9,325,726	
City of Houston contributions	$1,198,521	$964,337
Member contributions	$599,254	$482,169
Total receivables	**$91,133,352**	**$105,138,160**
Collateral on securities lending arrangements, at fair value	$542,083,932	$402,958,901
Land	$541,232	$541,232
Building, net	$7,783,535	$8,085,109
Furniture, fixtures and equipment, net	$1,355,544	$1,416,718
Prepaids (operating)	$213,136	$54,230
Total assets	$2,903,721,347	$2,475,464,465
LIABILITIES		
Accounts payable and accrued expenses	$4,285,406	$2,289,361
Payables for investments purchased	$8,625,799	$12,963,933
Foreign taxes payable	$82,766	$43,032
Foreign funds contracts payable	$62,639,427	$76,305,833
Collateral on securities lending arrangements, at fair value	$542,083,932	$402,958,901
Total liabilities	**$617,717,330**	**$494,561,060**
Plan net assets held in trust for pension benefits	**$2,286,004,017**	**$1,980,903,405**

(A schedule of funding progress for the plan is presented on page 32.)
See accompanying notes to basic financial statements.

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★ STATEMENTS OF CHANGES IN PLAN NET ASSETS

Years Ended June 30, 2005 and 2004

	Fiscal Year 2005	Fiscal Year 2004
Additions to plan net assets:		
Contributions:		
City of Houston	$32,688,827	$28,476,946
Members	$16,355,387	$14,238,463
	$49,044,214	$42,715,409
Net investment income:		
Net appreciation in fair value of investments	$281,384,123	$252,764,028
Interest	$40,657,595	$38,617,796
Dividends	$19,360,917	$15,475,695
Earnings from alternative investments — partnerships	$9,085,203	$8,186,731
Other	$494,472	$390,839
Earnings from real estate	$1,788,456	$2,462
Securities lending arrangements:		
Earnings	$10,458,544	$3,510,375
Rebates and fees	($9,319,354)	($2,757,500)
Total securities lending arrangements	**$1,139,190**	**$752,875**
Gross investment income	$353,909,956	$316,190,426
Less investment services expense	($14,325,519)	($11,965,521)
Net investment income	**$339,584,437**	**$304,224,905**
Agreed judgment	$9,325,726	
Total additions to plan net assets	**$397,954,377**	**$346,940,314**
Deductions from plan net assets:		
Benefits paid to members	$85,857,122	$83,618,595
Contribution refunds to members	$73,668	$97,363
Professional services	$964,709	$661,517
Administrative expenses	$5,958,266	$4,903,809
Total deductions from plan net assets	**$92,853,765**	**$89,281,284**
Net increase in plan net assets	$305,100,612	$257,659,030
Plan net assets held in trust for pension benefits, beginning of year	**$1,980,903,405**	**$1,723,244,375**
Plan net assets held in trust for pension benefits, end of year	**$2,286,004,017**	**$1,980,903,405**

See accompanying notes to basic financial statements.

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★ NOTES TO BASIC FINANCIAL STATEMENTS

Years Ended June 30, 2005 and 2004

1. DESCRIPTION OF PLAN

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, 2005 and 2004, the membership of the Fund consisted of the following:

	FY 2005	FY 2004
Retirees and beneficiaries currently receiving benefits	2,131	2,051
Former members entitled to benefits but not yet receiving them	8	9
Active members:		
Vested	2,191	2,109
Nonvested	1,700	1,554
Total members	**6,030**	**5,723**

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.

The following description of the Fund provides only general information. Members should refer to the Summary Plan Description for a more complete description of the Fund's provisions.

Contributions

Active members are required to contribute to the Fund a certain percentage of qualifying salary. The City is required to contribute to the Fund a minimum of twice the members' contributions.

The active members' contribution rate was 7.7 percent and the City's contribution rate was 15.4 percent for the months of July and August 2003. Beginning September 1, 2003, the active members' contribution rate was increased to 8.35 percent and, accordingly, the City's contribution rate was increased to 16.7 percent. Effective July 1, 2004, and for all of fiscal year 2005, the active members' contribution rate was 9 percent and the City's contribution rate was 18 percent. Effective July 1, 2005, the City's contribution rate increased to 23.8 percent.

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.

Pensions are adjusted annually for a fixed annual cost-of-living adjustment of 3.0 percent.

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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, 9 percent of the member's salary after June 30, 2004, 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 0.5 percent beginning on September 1, 2000, and an additional 0.5 percent beginning September 1, 2001. The benefit increase was then changed effective September 1, 2001, to 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 9 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. Effective September 1, 2003, the following three changes to the DROP were implemented: (1) the one percent annual administrative fee for retired members with DROP balances was removed; (2) a 5 percent floor and a 10 percent ceiling on annual DROP interest rates were implemented; and (3) widows of deceased members with DROP account balances may choose to leave the DROP accounts with the Fund.

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) shall receive an additional monthly benefit payment of $150 along with their standard monthly benefit payment.

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 $5 million in aggregate per year and distributed each January.

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. Nonservice-connected disability benefits amount to 25 percent of average monthly salary, plus 2.5 percent of average monthly salary for each 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.

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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. 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying basic financial statements are presented in accordance with generally accepted accounting principles established by the Governmental Accounting Standards Board (GASB), which designates 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.

Adoption of New Accounting Pronouncement

The GASB has issued Statement No. 40, Deposit and Investment Risk Disclosures, which amends GASB Statement No. 3, Deposits with Financial Institutions, Investments (Including Repurchase Agreements), and Reverse Repurchase Agreements. GASB Statement No. 40 requires disclosure information related to common risks inherent in deposit and investment transactions. The statement is effective for financial statements beginning after June 15, 2004, and accordingly, has been implemented by the Fund in fiscal year 2005.

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 compensation is earned. In addition, the Fund records contributions according to Fund requirements and State statute. Benefits paid to members and contribution 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 basic financial statements and the reported amounts of revenues and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents

The Fund considers only demand deposits as cash. Cash equivalent securities, which are composed of

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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

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 one year, and are valued at cost which approximates fair value. 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.

Unrealized gains and losses are presented as net appreciation in fair value of investments on the statements of changes in plan net assets, along with gains and losses realized on sales of investments. 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 the 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. Major outlays for additions and improvements are capitalized if equal to or greater than $5,000. Maintenance and repairs are charged to expense.

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.

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.

Reclassifications

Certain amounts in 2004 have been reclassified to conform to current year presentation.

3. CONTRIBUTIONS REQUIRED AND CONTRIBUTIONS MADE

Funding Policy

Contribution rates are established to remain level over time as a percentage of active members' qualifying 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. During fiscal year 2004, the actuarial amortization period was changed to a rolling 30 years period, and will be considered in the actuarial valuation for fiscal year 2005.

The City's actuarially determined contribution rate was established pursuant to the July 1, 2001, actuarial report and consists of 22.3 percent of covered members' salaries to pay normal costs, reduced by 7.4 percent of covered members' salaries to amortize the funding surplus over 40 years, increased by 0.5 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. The City's contribution rate in effect for August and September 2003 was the actuarially determined rate of 15.4 percent. Effective September

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1, 2003, the active members' contribution rate was increased to 8.35 percent, resulting in an increase in the City's contribution rate to 16.7 percent. Effective July 1, 2004, the active members' contribution rate was increased to 9 percent, resulting in an increase in the City's contribution rate to 18 percent.

Actuarially Determined Contribution Requirements

	June 30, 2005*	June 30, 2004*
Employer normal cost	$47,335,090	$41,236,093
Member normal cost	$16,344,391	$14,238,463
Total normal cost	**$63,679,481**	**$55,474,556**
Additional statutory requirement	$1,061,345	$924,576
Less: Amortization of surplus actuarial accrued liability	($15,707,608)	($13,683,723)
Net contributions required	**$49,033,218**	**$42,715,409**
Employer contributions actually made	$32,688,827	$28,476,946
Member contributions actually made	$16,344,391	$14,238,463
Net contributions actually made	**$49,033,218**	**$42,715,409**
Member buy back contributions		$10,996
Total contributions		**$49,044,214**

** Based on actuarial contribution rates as determined in the July 1, 2001, actuarial study.*

The latest actuarial report on the Fund, which was approved and accepted by the Board in April 2005, is based on the market value of Fund net assets and participant data as of July 1, 2002. The July 1, 2002, actuarial data results in an actuarially determined percentage contribution rate of 23.8 percent, which was adopted by the Board for funding purposes effective July 1, 2005.

Historical Trend Information

Historical trend information is provided as required supplemental information on pages 32 through 36. 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.

4. INVESTMENTS

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

The Board has employed Mellon Trust (Custodian) as Custodian of the assets of the Fund, and in said capacity, the Custodian shall be a fiduciary of the Fund's assets with respect to its discretionary duties including safekeeping the Fund's assets. The Custodian shall establish and maintain a custodial account to hold, or direct its agents to hold, for the account of the Fund all assets that the Board shall from time to

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time deposit with the Custodian. All right, title and interest in and to the Fund's assets shall at all times be vested with the Fund's Board.

In holding all Fund assets, the Custodian shall act with the same care, skill, prudence and diligence under the prevailing circumstances that a prudent person acting in like capacity and familiar with matters of this type would use in the conduct of an enterprise with a like character and with like aims. Further, the Custodian shall hold, manage and administer the Fund's assets for the exclusive purpose of providing the benefits to the members and the qualified survivors of the Fund.

The Board shall manage the investment program of the Fund in compliance with all applicable Federal and State statutes and regulations concerning the investment of pension assets. The Board has adopted Investment Policies and Procedures (Investment Policy) to set forth the factors involved in the management of investment assets for the Fund. The Board has established an Investment Committee to act on all matters related to investments.

The fair values of the Fund's investments as of June 30, by type, are as follows:

	Fiscal Year 2005	**Fiscal Year 2004**
Short-term investment funds	$116,398,655	$80,834,015
Fixed income	$737,221,349	$617,677,946
Common equity	$975,558,275	$838,720,979
Preferred equity	$7,122,422	$2,118,185
Alternative investments - partnerships	$299,765,798	$300,478,160
Real estate	$121,489,048	$108,338,565
Total investments	**$2,257,555,547**	**$1,948,167,850**

Portions of the Fund's investments are classified as security investments. A security is a transferable financial instrument that evidences ownership or creditorship. Investments in partnerships and real estate are investments that are evidenced by contracts rather than securities.

Custodial Credit Risk

For an investment, custodial credit is the risk that, in the event of the failure of the counterparty, the Fund will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the Fund, and are held by either the counterparty or the counterparty's trust department or agent but not in the Fund's name. At June 30, 2005, the Fund's security investments that were not subject to custodial credit risk were the investments in fixed income and equity investments.

Concentration of Credit Risk

The allocation of assets among various asset classes are set by the Board with the objective of optimizing the investment return of the Fund within framework of acceptable risk and diversification. For major asset classes (e.g., domestic equities, international equities, fixed income, alternative investments and real estate), the Fund will further diversify by employing investment managers who implement the strategies selected by the Investment Committee.

Significant guidelines are as follows:

Public Market Investments

1. Specific guidelines will be developed cooperatively by the Fund's investment staff, legal counsel and investment manager and shall be incorporated into the Investment Management Services Contract executed by the Chair of the Investment Committee, Executive Director and the investment manager.

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2. In case of conflict between the specific manager guidelines and the general guidelines, the specific guidelines, as approved by the Investment Committee, shall supersede. The general guidelines are as follows:

- **a.** Manager investment philosophy, style and strategy shall remain consistent and shall not change without the Investment Committee's approval. The manager shall have discretion to manage the portfolio consistent with the style presented to the Investment Committee at the time of selection and further subject to the restrictions established by the policy herein.
- **b.** The following transactions are prohibited: short sales, selling on margin, put and call options, and the use of derivatives for speculation unless authorized by the Investment Committee.
- **c.** Transactions that involve a broker acting as a principal, where such broker is also affiliated with the manager who is making the transaction are prohibited, unless specifically approved by the Investment Committee.
- **d.** Transactions shall be executed at competitive costs, or within the parameters established for directed brokerage transactions by the Investment Committee.
- **e.** Managers shall maintain cash levels consistent with their style as presented to the Investment Committee at the time of selection. Any deviation shall be allowed only after notifying the Chief Investment Officer and Executive Director and should be related to unusual market conditions. The cash level held by each manager will be addressed in the Investment Management Services Contract.

3. The Investment Committee with the assistance from the Fund staff shall monitor each investment manager's performance and adherence to style, strategy, and manager specific guidelines. It is the Investment Committee's discretion to take corrective action by replacing an investment manager if they deem it appropriate at any time.

Alternative and Real Estate Investments

1. The investment specific guidelines for each manager will be incorporated in a Limited Partnership Agreement, Limited Liability Company Agreement or other binding agreement as is appropriate for the investment. The Chair of the Investment Committee and the manager execute this document.

2. In case of conflict between the specific manager guidelines and the general guidelines, the specific guidelines, as approved by the Investment Committee, shall supersede. The general guidelines are as follows:

- **a.** Manager investment philosophy, style and strategy shall remain consistent and shall not change without the Investment Committee's approval. The manager shall have discretion to manage the portfolio consistent with the style presented to the Investment Committee at the time of selection and further subject to the restrictions established by the policy herein.
- **b.** The Chair of the Investment Committee may execute amendments and consents if the resulting changes or allowances are provided for in the governing documents as previously accepted by the Investment Committee. Otherwise, such changes are to be approved by the Investment Committee. The Investment Committee will be notified on a quarterly basis of all executed amendments.

3. The Investment Committee with assistance from the Fund staff shall monitor each Alternative and Real Estate manager's performance and adherence to strategy and manager specific guidelines. It is the Investment Committee's discretion to take corrective action by replacing an investment manager if they deem it feasible and appropriate at any time. Alternative and Real Estate investment manager retention is governed in most cases by Limited Partnership Agreements, Limited Liability Company Agreements or other binding agreements. In these cases, the Investment Committee with assistance from the Fund staff shall identify available options as allowed by the governing documents and determine the impact and consequences of these options.

As of June 30, 2005, the Fund's investments of $119,666,229 in an individual U.S. Treasury Bond exceeded 5 percent of Fund net assets. As of June 30, 2004, the Fund's investment of $146,156,701 in a U.S. Treasury Bond exceeded 5 percent of Fund net assets.

Interest Rate Risk

The Fund invests in fixed income securities including, but not limited to, investments representing instruments with an obligated fixed rate of interest including public and private debentures, mortgages, investments in life insurance general accounts and guaranteed investment contracts with maturities greater than one year, and options/futures. Instruments may have an investment grade or noninvestment grade rating. Purchases and sales, investment selection, and implementation of investment strategies are delegated to the discretion of the investment manager, subject to compliance with its management agreement and the Fund's Investment Policy.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the investment. Interest rate risk is the greatest risk faced by an investor in the fixed income market. The price of a fixed income security typically moves in the opposite direction of the change in interest rates. The weighted average maturity expresses investment time horizons (when the investment comes due and payable) in years, weighted to reflect the dollar size of individual investments within the investment type. The Fund does not have a formal investment policy that limits investment maturities as a means of managing its exposure to potential fair value losses arising from future changes in interest rates, but rather mandates such limits within the Investment Management Services Contract.

At June 30, 2005, the following table shows the Fund's investments by type, with weighted average maturity and fair value:

	Weighted Average Maturity	**Fair Value**
U.S. government issues	10.94	$352,853,759
Corporate debt	9.14	$236,284,791
Non-U.S. government issues	3.44	$38,820,794
Asset backed securities	4.95	$33,662,412
General obligations	17.62	$25,636,309
U.S. private placements	14.84	$18,462,880
FHLMC/FNMA	3.3	$16,174,875
Revenue bonds	19.29	$15,325,529
Total fixed income securities	**10.03**	**$737,221,349**

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Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Fund does not have a formal policy limiting investment credit risk, but rather mandates such limits within the Investment Management Services Contract. The Fund's exposure to investment credit risk in fixed income securities as of June 30, 2005, is as follows:

Quality Rating	Fair Value	Percentage of Holdings
Aaa	$102,629,555	4.55%
Aa1	$20,633,205	0.91%
Aa2	$21,502,751	0.95%
Aa3	$8,916,013	0.39%
A1	$4,677,978	0.21%
A2	$16,076,632	0.71%
A3	$3,438,580	0.15%
Baa1	$12,160,835	0.54%
Baa2	$14,855,742	0.66%
Baa3	$26,495,592	1.17%
Ba1	$16,148,864	0.72%
Ba2	$15,382,990	0.68%
Ba3	$30,060,416	1.33%
B1	$18,876,577	0.84%
B2	$18,996,109	0.84%
B3	$25,265,596	1.12%
Caa1	$5,791,107	0.26%
Caa2	$4,365,818	0.19%
Caa3	$4,913,523	0.22%
Ca	$114,100	0.01%
Rating not available	$13,065,607	0.58%
Total credit risk debt securities*	**$384,367,590**	**17.03%**

** Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and, therefore, have not been included in this disclosure.*

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. International securities investment managers are expected to maintain diversified portfolios by sector and by issuer using the Fund's Investment Policy. The Fund's exposure to foreign currency fluctuation as of June 30, 2005, is as follows:

	Fair Value	Percentage of Holdings
EURO Currency	$111,242,262	4.93%
British Pound Sterling	$93,786,763	4.15%
Japanese Yen	$57,408,173	2.54%
Canadian Dollar	$44,885,887	1.99%
Swiss Franc	$31,252,035	1.38%
Australian Dollar	$27,962,587	1.24%
South Korean Won	$21,283,947	0.94%
Singapore Dollar	$14,553,404	0.64%
Mexican New Peso	$14,316,690	0.63%
Hong Kong Dollar	$13,646,305	0.60%
Norwegian Krone	$13,378,602	0.59%
Brazil Real	$12,777,475	0.57%
New Taiwan Dollar	$11,565,215	0.51%
Thailand Baht	$9,509,435	0.42%
New Zealand Dollar	$8,922,327	0.40%
Swedish Krona	$6,473,212	0.29%
Hungarian Forint	$6,431,204	0.28%
South African Rand	$4,522,012	0.20%
Czech Koruna	$3,258,751	0.14%
Israeli Shekel	$1,410,356	0.06%
Indonesian Rupian	$1,408,732	0.06%
New Turkish Lira	$1,382,067	0.06%
Danish Krone	$10,563	0.00%
Total securities subject to foreign currency risk	**$511,388,004**	**22.62%**

Schedule 4 on page 35 lists the Fund's investment and professional service providers.

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5. CASH AND CASH EQUIVALENTS

For cash deposits and cash equivalents, custodial risk is the risk that in the event of a bank failure, the Fund's deposits may not be returned to it. The Fund's deposits are held by the Custodian bank. As of June 30, 2005 and 2004, the Fund's cash deposits in bank accounts totaled $3,055,069 and $9,102,265, respectively. The Fund does not have a deposit policy for custodial credit risk; however, the Fund's credit risk exposure for amounts not covered by Federal depository insurance is mitigated by the financial strength of the banking institution in which the deposits are held.

6. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

During fiscal years 2005 and 2004, the Fund entered into forward foreign exchange contracts. A currency forward is a contractual agreement between two parties to pay or receive specific amounts of foreign currency at a future date in exchange for another currency at an agreed upon exchange rate. Forward commitments are not standardized and carry credit risk due to the possible nonperformance by one of the counterparties. The maximum potential loss is the aggregate face value in U.S. dollars at the time the contract was opened; however, the likelihood of such loss is remote. Fund management has limited the potential loss by contract when losses accumulate to more than 3 percent of the invested amount. No such losses occurred during fiscal years 2005 or 2004. Forwards are usually traded over-the-counter. These transactions are entered into in order to hedge risks from exposure to foreign currency rate fluctuation and to facilitate trade settlement of foreign security transactions. Forwards carry market risk resulting from adverse fluctuations in foreign exchange rates. Recognition of realized gain or loss depends on whether the currency exchange rate has moved favorable or unfavorable to the contract holder upon termination of the contract. Prior to termination of the contract, the Fund records the unrealized currency translation gain or loss based on the applicable forward exchange rates.

7. AGREED JUDGMENT RECEIVABLE

During fiscal year 2005, a lawsuit concerning overtime pay between Emergency Medical Technicians (EMTs), as Plaintiffs, and the City, as Defendant, was settled. This lawsuit affected the Fund in that contributions from both the City and EMTs were due to the Fund on the agreed upon overtime pay amount. The Final Judgment, dated November 19, 2004, stated that in addition to the statutorily mandated pension fund contributions to be withheld from payments to the Plaintiffs, the Defendant must make pension fund contributions to the Fund in the total amount of $7,500,000 on or before July 15, 2005. Such mandated amounts had not been paid as of the 2005 fiscal year-end; therefore, the following is appropriately reflected as a receivable on the statements of plan net assets as of June 30, 2005:

City contribution on overtime earnings plus 6% lost income premium	$7,500,000
Contribution on EMTs' overtime earnings	$1,825,726
	$9,325,726

8. 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 2001, the construction of the new building was completed. All capitalized costs associated with the building have been classified as building in the statements of plan net assets. The building cost is being depreciated over 30 years. The capitalized cost and accumulated depreciation for the building is as follows at June 30:

	FY 2005	FY 2004
Building	$9,086,063	$9,080,841
Less accumulated depreciation	($1,302,528)	($995,732)
	$7,783,535	**$8,085,109**

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9. FURNITURE, FIXTURES AND EQUIPMENT
Furniture, fixtures and equipment are comprised as follows at June 30:

	FY 2005	FY 2004
Office furnishings and equipment	$739,240	$732,778
Computer equipment	$1,966,681	$1,539,547
	$2,705,921	$2,272,325
Less accumulated depreciation	($1,350,377)	($855,607)
Furniture, fixtures and equipment, net	**$1,355,544**	**$1,416,718**

10. 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 (see table below).

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, 2005 and 2004. 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. Cash collateral is invested in the lending agent's collateral investment pool, which has a weighted-average maturity of approximately 31 days and 40 days as of June 30, 2005 and 2004, respectively. The risk associated with the Fund's participation in the securities lending program is investment risk, which affects the yield spread on the investments within the loan investment pool. The Fund cannot pledge or sell collateral securities received unless the borrower defaults. At June 30, 2005 and 2004, securities lending transactions were collateralized in cash.

11. RELATED PARTY
During fiscal years 2005 and 2004, the Plan utilized the services of an investment management company, in which the Plan owns an interest of approximately $282,000 and $426,000 as of June 30, 2005 and 2004, respectively.

12. BENEFIT PLANS
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 Fund also offers its employees a Profit Sharing Plan which is a qualified retirement plan under Section 401(a) of the Internal Revenue Code of 1986, as

	Fiscal Year 2005		Fiscal Year 2004	
	Securities Lent	Collateral Held	Securities Lent	Collateral Held
Fixed income	$466,887,790	$477,737,216	$305,777,502	$312,476,025
Common and preferred stocks	$61,243,760	$64,346,716	$86,333,084	$90,482,876
	$528,131,550	$542,083,932	$392,110,586	$402,958,901

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amended. The Fund maintains the Profit Sharing Plan to provide a tax-deferred way for it to contribute to its employees' savings for retirement, disability, death, and other major life events. The Fund contributes into the Profit Sharing Plan 16 percent of a participating employee's qualified yearly salary. During fiscal years 2005 and 2004, the Fund contributed $309,436 and $250,019, respectively, to the Profit Sharing Plan.

Both of the benefit plans are administered by an outside party, with the related amounts held in trust. Accordingly, these benefit plans are not reflected in the accompanying basic financial statements in accordance with GASB Statement No. 32.

13. 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, 2005 and 2004, aggregate contributions from active members of the Fund with less than ten years of service were approximately $17,600,000 and $17,500,000, respectively. Contributions for employees with 10 to 20 years of service has not been determined. As of June 30, 2005 and 2004, 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 $134,540,000 and $155,844,000 as of June 30, 2005 and 2004, 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, 2005 and 2004, cumulative contributions made to the self-insurance fund by the Fund have been approximately $5,000,000.

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.

14. RISK AND UNCERTAINTIES

The Fund invests in various investments securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the value of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statements of plan net assets.

The Fund's contribution rates and the actuarial information included in schedules 1 and 2 are based on certain assumptions pertaining to interest rates, inflation rates and participant demographics, all of which are subject to change. Due to uncertainties inherent in the estimations and assumptions process, it is at least reasonably possible that changes in these estimates and assumptions in the near term could be material to the financial statements.

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★ REQUIRED SUPPLEMENTAL SCHEDULES

SCHEDULE 1 — SCHEDULE OF FUNDING PROGRESS (UNAUDITED) (Dollars in millions)

Actuarial Validation 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
July 1, 1995	$912	$852	107%	($60)	$127	(47%)
July 1, 1996	$1,025	$989	104%	($35)	$132	(27%)
July 1, 1997	$1,184	$1,128	105%	($56)	$142	(39%)
July 1, 1998	$1,347	$1,271	106%	($76)	$149	(51%)
July 1, 1999	$1,539	$1,471	105%	($68)	$159	(43%)
July 1, 2000	$1,726	$1,589	109%	($137)	$164	(84%)
July 1, 2001	$1,863	$1,651	113%	($212)	$164	(129%)
July 1, 2002	$1,922	$1,970	98%	$48	$191	25%

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.

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SCHEDULE 2 — SCHEDULE OF EMPLOYER CONTRIBUTIONS (UNAUDITED)

(Dollars in thousands)

Fiscal Year (Ending 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%
2004	$28,477	100%
2005	$32,689	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 (UNAUDITED)

The information presented 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, 2002
Actuarial cost method	Entry age method
Amortization method	Level percentage of payroll over 30 years
Remaining amortization period	Rolling 30 year
Asset valuation method	Five-year smoothed market
Actuarial assumptions:	
Investment rate of return	8.5% per year, net of expenses
Payroll growth rate	5% per year
Salary increases	3% to 10%, based on seniority and merit
General inflation rate	4% per year
Cost of living adjustment	3% annually
Mortality rates	1994 Group Annuity Mortality Table

See accompanying independent auditors' report.

SCHEDULE 3 — INVESTMENT, PROFESSIONAL SERVICES AND ADMINISTRATIVE EXPENSES

Years Ended June 30, 2005 and 2004

	Fiscal Year 2005	Fiscal Year 2004
Investment services:		
Custodial services	$344,727	$464,580
Money management services	$13,980,792	$11,500,941
Total investment services	$14,325,519	$11,965,521
Professional services:		
Actuarial services	$215,540	$85,099
Audit and accounting services	$24,750	$31,100
Consulting services	$655,493	$459,506
Legal services	$64,576	$75,712
Medical examinations	$4,350	$10,100
Total professional services	$964,709	$661,517
Administrative expenses:		
Depreciation	$801,563	$703,798
Continuing education	$223,285	$206,045
Furniture, equipment and supplies	$56,314	$26,992
Insurance	$858,713	$744,064
Investment research	$63,367	$52,697
Office cost	$3,645,360	$2,832,118
Facility maintenance	$149,557	$168,944
Utilities	$160,107	$169,151
Total administrative expenses	$5,958,266	$4,903,809

See accompanying independent auditors' report.

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SCHEDULE 4 — SUMMARY OF INVESTMENT AND PROFESSIONAL SERVICES
Years Ended June 30, 2005 and 2004

Individual or firm name	Official plan position	Amount	Nature of services
Mellon Trust	Custodian	$344,727	Custodial
Ariel Capital Management	Investment manager	$417,425	Money management
Gulf Investment Management	Investment manager	$470,215	Money management
AllianceBernstein Institutional Investment Management	Investment manager	$777,937	Money management
State Street Research	Investment manager	$402,296	Money management
The Mitchell Group	Investment manager	$353,536	Money management
Mercator	Investment manager	$967,810	Money management
Marvin & Palmer	Investment manager	$947,990	Money management
McKinley Capital	Investment manager	$955,566	Money management
Victory Capital	Investment manager	$341,952	Money management
State Street Global Advisors	Investment manager	$349,926	Money management
FX Concepts	Investment manager	$334,167	Money management
GW Capital	Investment manager	$187,838	Money management
Loomis Sayles	Investment manager	$724,679	Money management
Standish/Mellon Bond	Investment manager	$152,194	Money management
STW Fixed Income Mgmt	Investment manager	$575,272	Money management
Americus Real Estate Investments	Investment manager	$714,262	Money management
Timberland Investment Resources	Investment manager	$898,988	Money management
Lone Star Opportunity Fund	Investment manager	$510,748	Money management
Energy Trust	Investment manager	$281,741	Money management
Energy Spectrum	Investment manager	$184,157	Money management
Blackstone Capital Partners	Investment manager	$49,183	Money management
Brazos Fund	Investment manager	$337	Money management
Brera Capital	Investment manager	$75,047	Money management
Hicks, Muse, Tate & Furst Fund	Investment manager	($195,044)	Money management
Industrial Growth Partners	Investment manager	$273,468	Money management
Coller International Partners	Investment manager	$443,422	Money management
Landmark Equity Partners	Investment manager	$349,875	Money management
Lexington Capital Partners	Investment manager	$507,991	Money management
Ranieri & Co., Inc.	Investment manager	$354,852	Money management
TCW	Investment manager	$421,569	Money management
Centennial Holdings	Investment manager	$767,443	Money management
Triad Ventures Ltd	Investment manager	($948)	Money management
PTC-Houston Investors, LLC	Investment manager	$125,513	Money management
RMK Emerging Growth	Investment manager	$259,385	Money management
Total investment services		**$14,325,519**	

See accompanying independent auditors' report.

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SCHEDULE 4 — SUMMARY OF INVESTMENT AND PROFESSIONAL SERVICES
Years Ended June 30, 2005 and 2004

Individual or firm name	Official plan position	Amount	Nature of services
Towers Perrin	Actuary	$1,607	Actuarial
Buck Consultants, L.L.C.	Actuary	$213,933	Actuarial
Ogletree Deakins, P.C.	Attorneys	$188	Legal
Strasburger and Price, L.L.P.	Attorneys	$56,436	Legal
Locke, Lidell, and Sapp	Attorneys	$7,952	Legal
Joseph Mason, C.P.A.	Auditors	$2,500	Audit
Mir•Fox & Rodriguez, P.C.	Auditors	$22,250	Audit
Other	Communications	$2,988	Professional services
Printmailers, Inc.	Communications	$1,302	Printing and design
GCI Read-Poland	Communications	$90,482	Printing and design
Locke, Lidell, and Sapp	Consultant	$168,010	Consulting
Websoft Publishing Company, Inc.	Consultant	$149	Consulting
DINI Partners	Consultant	$6,056	Consulting
Gray Associates	Consultant	$7,622	Consulting
Chatham Partners, L.L.C.	Consultant	$161,944	Consulting
Pension Consulting Alliance, Inc.	Consultant	$35,000	Consulting
William & Jenson	Consultant	$120,000	Consulting
Adcetera Design Studio, Inc.	Consultant/Communications	$61,940	Consulting, printing and design
Texas Occupational Medicine	Physicians	$4,350	Medical examinations
Total professional services		**$964,709**	

See accompanying independent auditors' report.

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SECTION 3

★ INVESTMENT INFORMATION

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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 2005, the Fund experienced a rate of return of 19.1 percent.

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 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 as 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%	22%
International	15% – 25%	22%
Fixed Income	30% – 40%	36%
Alternative Investments	11% – 18%	12%
Real Estate	4% – 7%	6%
Cash	0.5 – 2.0%	2%

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

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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.

Performance Objectives

The performance objective of the Fund is to meet or exceed the actuarial rate plus Fund expenses, currently 8.5 percent plus 75 basis points, over a long-term horizon that 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
Cash Equivalents	2%	Custom Benchmark*
Domestic Equity	22%	Russell 3000 Index
Fixed Income	36%	Lehman Universal Index
International Equity	22%	MSCI All Country World Ex-US Index
Alternative Investments	12%	Flat Rate 15%
Real Estate Investments	6%	Flat Rate 9.25%

* *Custom Benchmark: Citigroup 3-month T-bill (April 30, 1988, to August 31, 1997); ML 90-day T-bill Index (September 30, 1997, to May 31, 2000); ML 1-Yr T-bill Index (June 1, 2000, to the present).*

Each manager is assigned an investment performance benchmark relative to his or 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.

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 ISS (Institutional Shareholder Services, Inc.) and customized by the HFRRF. All proxies are to be voted in a timely manner in accordance with expressed policies. 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 all outside managers.

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INVESTMENT HOLDINGS ASSET ALLOCATION* (Dollars in millions)

	FY 2005		FY 2004	
	Market Value	**Percent**	**Market Value**	**Percent**
Cash and Cash Equivalents	$69	3.0%	$60	3.1%
Domestic Equity	$550	24.3%	$464	23.7%
Fixed Income	$759	33.6%	$634	32.4%
International Equity	$462	20.4%	$391	20.0%
Alternative Investments	$300	13.3%	$300	15.3%
Real Estate Investments	$121	5.4%	$108	5.5%
	$2,261	**100%**	**$1,957**	**100%**

** Calculated using specific mandates.*

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★ INVESTMENT RESULTS

TOTAL FUND RETURN and RETURNS BY ASSET CLASS

	Period Ending June 30:					Annualized		
	2005	2004	2003	2002	2001	3-Year	5-Year	10-Year
TOTAL FUND								
HFRRF	**19.1**	**18.4**	**6.5**	**(2.4)**	**(1.1)**	**14.5**	**7.7**	**10.6**
Policy Benchmark*	10.7	16.3	7.6	0.2	(2.6)	10.2	5.3	8.8
Actuarial Rate	8.5	8.5	8.5	8.5	8.5	8.5	8.5	8.5
CASH AND CASH EQUIVALENTS								
HFRRF	**4.7**	**3.0**	**1.0**	**9.3**	**12.2**	**2.9**	**6.0**	**7.4**
Custom Benchmark†	1.7	1.0	1.5	2.6	5.9	1.6	3.6	4.4
DOMESTIC EQUITY								
HFRRF	**18.6**	**30.9**	**(1.8)**	**(1.0)**	**11.2**	**15.1**	**10.9**	**12.5**
Russell 3000	8.1	20.5	0.8	(17.3)	(13.9)	9.5	(1.4)	10.1
FIXED INCOME								
HFRRF	**14.3**	**4.7**	**26.8**	**1.8**	**5.2**	**14.9**	**10.2**	**9.7**
Lehman Universal Index	7.4	1.0	11.5	7.7	10.8	6.6	7.6	7.0
INTERNATIONAL EQUITY								
HFRRF	**16.1**	**34.3**	**(6.9)**	**(8.1)**	**(22.2)**	**13.3**	**0.8**	**6.9**
MSCI All Country World Ex-US Index	17.0	32.5	(5.6)	(9.4)	(23.8)	14.1	0.8	5.8
ALTERNATIVE INVESTMENTS								
HFRRF	**28.1**	**20.1**	**(7.4)**	**(6.7)**	**(2.9)**	**12.5**	**5.3**	**15.6**
Flat 15%	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
REAL ESTATE INVESTMENTS								
HFRRF	**24.6**	**4.0**	**1.7**	**1.5**	**(4.6)**	**9.7**	**5.0**	**7.8**
Flat 9.25%	9.3	9.3	9.3	9.3	9.3	9.3	9.3	9.3

ALL RETURNS ARE GROSS OF FEES AND EXPENSES.
NOTE: The Policy Benchmark provides an indication of the returns that could be achieved (excluding transaction costs) by a portfolio invested passively in the broad market with the percentage weights allocated to each asset class in the Fund's policy allocation.

*** Policy Benchmark:** Russell 3000 Index 22%, MSCI All Country Ex-USA Index 22%, Lehman Brothers Universal Bond Index 36%, Alternative Investments flat 15% (12%), Real Estate Investments flat 9.25% (6%), and Cash & Cash Equivalents Custom Benchmark at 2%

† Custom Benchmark: Citigroup 3-month T-bill (April 30, 1988, to August 31, 1997); ML 90-day T-bill Index (September 30, 1997, to May 31, 2000); and ML 1-year T-bill Index (June 1, 2000, to the present).

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COMPARISON OF INVESTMENT RETURNS (Fiscal years end on June 30)

Fiscal Year	Total Fund	Median Total Fund*	Fund Domestic Equity Inv.	Russell 3000 Stock Index	SP500 Stock Index	Fund Fixed-Income (Bond) Inv.	Lehman Bros. Univ.	Lehman Bros. Gov/ Credit	Fund Int'l Equity	MSCI All-Country World Ex-US	MSCI EAFE
1980	11.8	11.4	17.5	18.7	17.3	1.1	—	3.8	—	—	—
1981	11.8	12.1	27.1	23.2	20.6	(11.0)	—	(4.1)	—	—	—
1982	3.4	(1.0)	(7.1)	(13.9)	(11.5)	5.6	—	13.3	—	—	—
1983	36.4	44.1	65.9	66.4	61.2	29.5	—	29.1	—	—	—
1984	(3.9)	(3.7)	(11.7)	(8.5)	(4.7)	(0.2)	—	1.8	—	—	—
1985	27.7	27.3	30.6	31.2	30.9	32.3	—	28.7	—	—	—
1986	21.7	26.1	26.5	35.7	35.8	19.1	—	20.7	—	—	—
1987	13.6	12.5	19.6	19.8	25.1	8.3	—	4.7	—	—	—
1988	3.6	0.6	1.2	(6.1)	(7.1)	11.4	—	7.5	—	—	—
1989	12.8	14.6	16.8	19.7	20.5	10.9	—	12.3	—	—	—
1990	9.3	10.2	14.4	13.5	16.4	4.9	—	7.1	—	—	—
1991	3.7	7.4	2.4	7.2	7.4	11.3	10.7	10.2	(10.6)	—	(11.5)
1992	8.4	13.3	7.5	14.7	13.5	24.6	14.2	14.2	0.8	—	(0.7)
1993	16.7	13.6	19.7	16.0	13.6	20.7	12.0	13.2	12.2	—	20.3
1994	5.7	2.4	2.0	1.0	1.3	2.0	(1.1)	(1.5)	19.7	—	17.0
1995	15.5	16.7	22.1	24.9	26.1	17.5	12.4	12.8	4.1	—	1.7
1996	16.9	17.4	21.5	26.0	26.1	12.2	5.7	4.7	17.9	—	13.3
1997	23.2	20.0	31.5	30.6	34.6	14.3	8.8	7.8	15.5	—	12.8
1998	13.1	17.9	14.6	28.8	30.2	13.2	10.1	11.3	6.1	—	6.1
1999	5.5	11.4	6.7	20.1	22.7	2.2	2.6	2.7	6.3	8.3	7.6
2000	10.3	10.0	(1.4)	9.6	7.3	4.8	4.8	4.3	22.1	16.6	17.2
2001	(1.1)	(4.7)	11.2	(13.9)	(14.8)	5.2	10.8	11.1	(22.2)	(25.4)	(24.8)
2002	(2.4)	(6.0)	(1.0)	(17.3)	(18.0)	1.8	7.7	8.2	(8.1)	(9.4)	(9.5)
2003	6.5	3.9	(1.8)	0.8	0.3	26.8	11.5	13.1	(6.9)	(5.6)	(6.1)
2004	18.4	15.8	30.9	20.5	19.1	4.7	1.0	(0.7)	34.3	32.0	32.4
2005	**19.1**	**9.5**	**19.4**	**8.1**	**6.3**	**14.3**	**7.4**	**7.3**	**16.1**	**14.6**	**13.6**

* *Trust Universe Comparison Service Public Funds Total Returns*

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COMPOUND ANNUAL RETURN (Fiscal years end on June 30)

Period Total	Total Fund	Fund Domestic Equity Inv.	Russell 3000 Stock Index	SP500 Stock Index	Fund Fixed-Income (Bond) Inv.	Lehman Bros. Universal	Lehman Bros. Gov/ Credit	Fund Domestic Equity Inv.
2-year	18.8	12.8	24.6	14.1	12.5	9.4	4.2	3.2
3-year	14.5	9.7	15.1	9.5	8.3	14.9	6.6	6.4
5-year	7.7	3.5	10.9	(1.4)	(2.4)	10.2	7.6	7.7
10-year	10.6	9.5	12.5	10.1	9.9	9.7	7.0	6.9

* *Trust Universe Comparison Service Public Funds Total Returns*

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★ INVESTMENT HOLDINGS SUMMARY

TEN LARGEST EQUITY INVESTMENT HOLDINGS (Excluding commingled funds)

Description	Market Value	Percent of Total Market Value
GLAXOSMITHKLINE ORD GBP0.25	$10,563,019	0.47%
VODAFONE GROUP PLC ORD USD0.10	$10,011,122	0.44%
NESTLE SA CHF1	$9,012,255	0.40%
BAXTER INTL INC COM	$8,792,700	0.39%
SCHLUMBERGER LTD COM	$8,512,874	0.38%
NORDSTROM INC WASH COM	$8,156,400	0.36%
ALLSTATE CORP COM	$7,767,500	0.34%
JOHNSON & JOHNSON COM	$7,410,000	0.33%
AMERICAN EXPRESS CO COM	$7,026,360	0.31%
WELLS FARGO & CO NEW COM	$6,465,900	0.29%

TEN LARGEST FIXED-INCOME HOLDINGS

Description		Market Value	Percent of Total Market Value
U.S. TREASURY BONDS	08.000% 11/15/2021 DD 11/15/91	$118,823,856	5.26%
U.S. TREASURY BONDS	7.250% 05/15/2016 DD 05/15/86	$48,041,655	2.13%
U.S. TREASURY BONDS	5.500% 08/15/2028 DD 08/15/98	$35,499,344	1.57%
U.S. TREASURY BONDS	2.500% 05/31/2006 DD 05/31/04	$30,334,510	1.34%
U.S. TREASURY BONDS	2.250% 04/30/2006 DD 04/30/04	$25,245,000	1.12%
U.S. TREASURY BONDS	4.875% 02/15/2012 DD 02/15/02	$20,516,200	0.91%
U.S. TREASURY BONDS	3.375% 12/15/2008 DD 12/15/03	$12,873,900	0.57%
MEXICO (UTD MEX ST) BDS	9.000% 20-DEC-2012 MXN100	$10,577,344	0.47%
U.S. TREASURY BONDS	2.750% 06/30/2006 DD 06/30/04	$8,620,731	0.38%
U.S. TREASURY BONDS	05.000% 02/15/2011 DD 02/15/01	$7,811,690	0.35%

Note: A list of marketable securities may be available on request.

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INVESTMENT HOLDINGS SUMMARY

(continued)

FEES FOR INVESTMENT SERVICES

	Assets under Management	Fees	Basis Points*
Investment Management Fees			
Cash Equivalents Manager†	$68,570,205	$152,194	0.2220%
Domestic Equity Managers	$550,346,534	$2,763,361	0.5021%
International Equity Managers	$461,594,115	$3,555,459	0.7703%
Fixed Income Managers	$758,844,916	$1,487,788	0.1961%
Alternative Investments	$299,765,798	$4,023,841	1.3423%
Real Estate Investments	$121,489,048	$1,998,148	1.6447%
Other Investment Services			
Custodial	$2,260,610,616	$465,448	0.0206%
Total Fees for Investment Services	**$2,260,610,616**	**$14,446,240**	**0.6390%**

** Calculated using average quarterly assets under management.*

† Includes residual cash from separate accounts, which is swept daily and included in the Super STIF cash management portfolio.

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★ 2005 BROKERAGE COMMISSIONS

Top 25 Broker Names	Base Commission
MERRILL LYNCH & CO	$346,256
SG AMERICAS SECURITIES LLC, NEW YORK	$155,192
UBS SECURITIES LLC, STAMFORD	$145,800
LYNCH JONES & RYAN INC*	$135,762
BEAR STEARNS & CO INC, NY	$77,177
CREDIT SUISSE	$73,713
GOLDMAN SACHS & CO, NY	$66,361
S G WARBURG, SEOUL	$64,595
MORGAN STANLEY & CO INC, NY	$53,422
CREDIT LYONNAIS SEC, SEOUL	$49,172
PERSHING	$47,661
DAIWA SECS AMER INC, NEW YORK	$45,226
DEUTSCHE BANC ALEX BROWN INC, NEW YORK	$45,214

Top 25 Broker Names	Base Commission
MORGAN J P SECS INC, NEW YORK	$38,203
INSTINET CORP, NEW YORK	$37,103
SAMSUNG SECS, SEOUL	$29,260
MIZUHO SECURITIES USA INC. NEW YORK	$27,899
LEHMAN BROS INC, NEW YORK	$26,973
CHEVREUX DE VIRIEU SA, PARIS	$24,032
SALOMON BROS INTL LTD, LONDON	$20,700
CITIGROUP GBL MKTS INC, NEW YORK	$19,174
NOMURA SECS INTL INC, NEW YORK	$17,313
KNIGHT SEC BROADCORT, JERSEY CITY	$16,027
CREDIT AGRICOLE SECS, INC, NEW YORK	$15,703
OTHER	$313,978
TOTAL	**$1,891,916**

★ COMMISSION RECAPTURE PROGRAM

Houston Firefighters' Relief and Retirement Fund began a brokerage commission recapture program in 1993. Currently, the brokerage firm of Lynch, Jones & Ryan Inc. participates 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 2005, slightly more than 7 percent of all trading activity was directed toward the commission recapture program.

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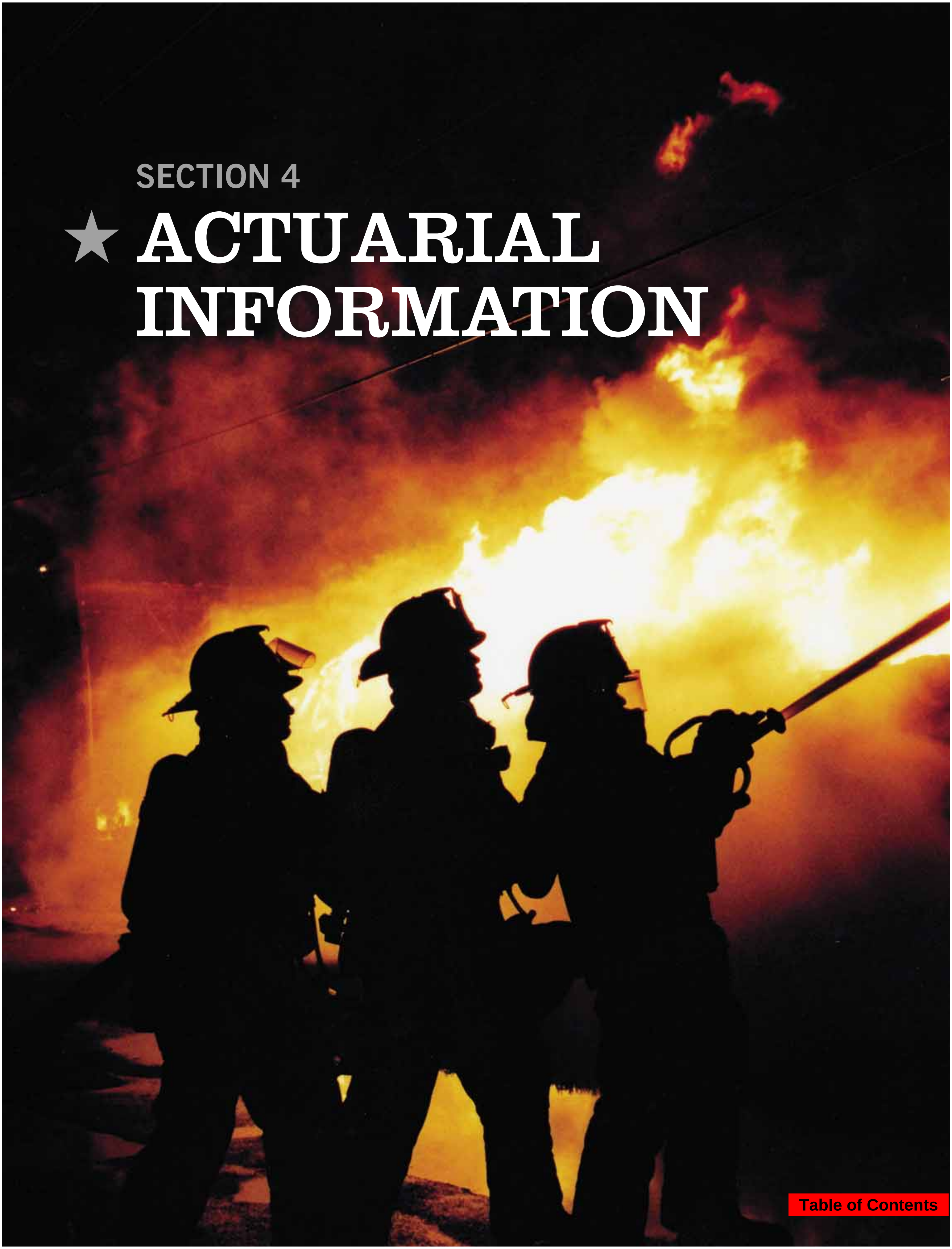
SECTION 4

★ ACTUARIAL INFORMATION



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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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★ ACTUARIAL CERTIFICATION

Towers Perrin

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

January 2003

Board of Trustees
Houston Firefighters' Relief and Retirement Fund

DEAR BOARD MEMBERS:
This report describes the results of an actuarial valuation of the Houston Firefighters' Relief and Retirement Fund. The Houston Firefighters' Relief and Retirement Fund retained Towers Perrin to perform this actuarial valuation for the purposes of determining the funding status for the plan year July 1, 2002, through June 30, 2003.

The consulting actuaries are members of the Society of Actuaries and other professional actuarial organizations and meet their "General Qualification Standard for Prescribed Statements of Actuarial Opinions" relating to pension plans.

In preparing the actuarial results, we have relied upon information provided by the Board of Trustees regarding plan provisions, plan participants, plan assets and other matters. While the scope of our engagement did not call for us to perform an audit or independent verification of this information, we have reviewed this information for reasonableness but have not audited it. The accuracy of the results presented in this report is dependent upon the accuracy and completeness of the underlying information. Historical information for years prior to 1984 was prepared by the prior actuaries and was not subjected to our actuarial review.

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

The funding determination portion of this actuarial valuation has been conducted in accordance with principles of practice prescribed by the Actuarial Standards Board and the requirements of the Texas Government Code. Section 802.101 of the Texas Government Code requires the use of actuarial "assumptions and methods that are reasonable in the aggregate, considering the experience of the program and reasonable expectations, and that, in combination, offer the actuary's best estimate of anticipated experience under the program."

The results shown in this report are reasonable actuarial results. However, a different set of results could also be considered reasonable actuarial results, since the Actuarial Standards of Practice describe a "best-estimate range" for each assumption, rather than a single best-estimate value. Thus, reasonable results differing from those presented in this report could have been developed by selecting different points within the best-estimate ranges for various assumptions.

The information contained in this report was prepared for the internal use of the Houston Firefighters' Relief and Retirement Fund and its auditors in connection with our actuarial valuation of the pension plan. It is not intended nor necessarily suitable for other purposes.

Towers Perrin

Adam S. Berk

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

Wesley A. Pieper

Wesley A. Pieper, ASA, EA, MAAA
Consultant

★ SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS

July 1, 2002

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

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DISABLED MORTALITY RATES

	After Becoming Disabled, Probability of Death Within One Year After Attaining Age Shown	
Age	Male	Female
25	2.6%	1.3%
35	2.8	2.2
45	3.5	2.3
55	5.3	3.0

PERCENTAGE OF DEATH AND DISABILITY IN LINE OF DUTY

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

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

RETIREMENT RATES

Service	Probability of Retiring Within One Year
20	2.0%
21 – 22	3.0
23 – 25	4.0
26 – 28	5.0
29	10.0
30	20.0

DROP DURATION

Duration at Retirement	Percentage of Participants Electing the Duration
0	10%
3	10
5	10
8	30
10	40

PERCENTAGE MARRIED

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

ACTUARIAL VALUE OF ASSETS

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

ACTUARIAL COST METHOD

Entry Age Method with liabilities allocated from date of entry to 30 years of service. The Unfunded Actuarial Accrued Liability (Surplus), including the effects of actuarial gains and losses, is amortized as a level percentage of payroll over 30 years. 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 actuarial report (July 2001), the assumptions used in this valuation are the same as those used in prior valuations except for the change in the amortization period of the unfunded actuarial accrual liability from a level percentage of payroll ending December 31, 2022, to a level percentage of payroll over 30 years (constant).

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★ MEMBER DATA

July 1, 2002

ACTIVE MEMBER AND DROP PARTICIPANT VALUATION DATA

Valuation Date	Number	Average Age	Annual Payroll (dollars in 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)
7-1-02	3,375	41.8	190.5	56,468	14.0

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
6-30-02	172	5,493,000	61	998,000	1,783	44,300,000	15.5	24,846

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★ SOLVENCY TEST AND ANALYSIS OF FINANCIAL EXPERIENCE

July 1, 2002

SOLVENCY TEST (dollars in thousands)

		Actuarial Accrued Liability for					
Valuation Date	Active Member Contributions	Retirees, Beneficiaries and Vested Participants	Active Participants (City-Financed Portion)	Actuarial Value of Assets	Percentage of Actuarial Accrued Liability Covered by Assets		
		(1)	(2)	(3)	(1)	(2)	(3)
7-1-96	$ 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
7-1-02	406,522	698,964	864,668	1,922,405	100	100	94

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	Year Ended July 1, 2002
Gain (or Loss) During Year From Financial Experience:						
From Liability Sources	$ (6,027)	$ (9,126)	$ (30,772)	$ 21,667	$(9,353)	$(163,358)
From Asset Sources	30,894	7,467	(11,189)	3,920	(35,515)	(39,336)
Total	24,867	(1,659)	(41,961)	25,587	(44,868)	(202,694)
Non-Recurring Items*	0	(11,082)	(57,642)	(15,950)	68,166	0
Composite Gain (or Loss) During Year	$ 24,867	$ (12,741)	$ (99,603)	$ 9,637	$ 23,298	(202,694)

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

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★ SUMMARY OF PLAN PROVISIONS

July 1, 2002

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 age 31. Before 1984, participants entered the Fund on January 1 or July 1.

AVERAGE 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.

STANDARD 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 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.

ALTERNATE SERVICE PENSION

Eligibility: Firefighters who became participants prior to September 1, 1987, and who attain age 50 with 20 years of service, will receive the greater of the standard or alternate pension.

Benefit: 50% of average monthly salary plus 1% of average monthly salary per year of service after becoming eligible to retire on an alternate pension.

Maximum: 65% of average monthly salary.

SUPPLEMENTAL BONUS CHECK

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

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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 ten years or until they leave active service. The member's standard or alternate service pension (whichever is greater) will be calculated based on service and earnings at the time the DROP is elected.

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

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

A benefit equal to the DROP account balance will be paid at the time the member leaves active service. The payment will be made as a single lump sum or as three annual installments, if the member chooses.

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 1% effective September 1, 2000, and 1% 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 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, 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 year of service.

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

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 between the ages of 18 and 22 if they are in college.

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Non-service-connected: Monthly benefit that would have been payable had the participant retired for non-service-connected disability on the date of his or her death (or service pension if greater).

Service-connected: 100% of average monthly salary.

Postretirement: Monthly benefit which was payable to the participant prior to his or her death. Effective July 1, 1998, a "graded" postretirement 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 postretirement death benefit for each year of marriage to a maximum 100% after five years of marriage.

Preretirement: 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.

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 retired or disabled member or to an eligible survivor of a deceased member. This benefit is not subject to the postretirement adjustment.

EXCESS BENEFIT

Benefit equal to the excess of any members' standard service pension benefit over the limit imposed by Section 415 of the code.

POSTRETIREMENT ADJUSTMENT

Prior to October 1, 1990

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

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

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

On or after October 1, 1990, and prior to November 1, 1997

Pensions adjusted each year based on changes in the 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 adjustment for participants who retire or terminate with a vested benefit after March 1, 1982, begin at age 48. Pension adjustments begin immediately for participants who become disabled and cannot perform any substantial gainful activity (current and future) and qualify for general on-duty disability benefits. Participants whose benefits become payable on or after July 1, 1986, and are based upon 30 or more years of service are also eligible for pension adjustments to begin immediately.

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CONTRIBUTION RATES

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

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

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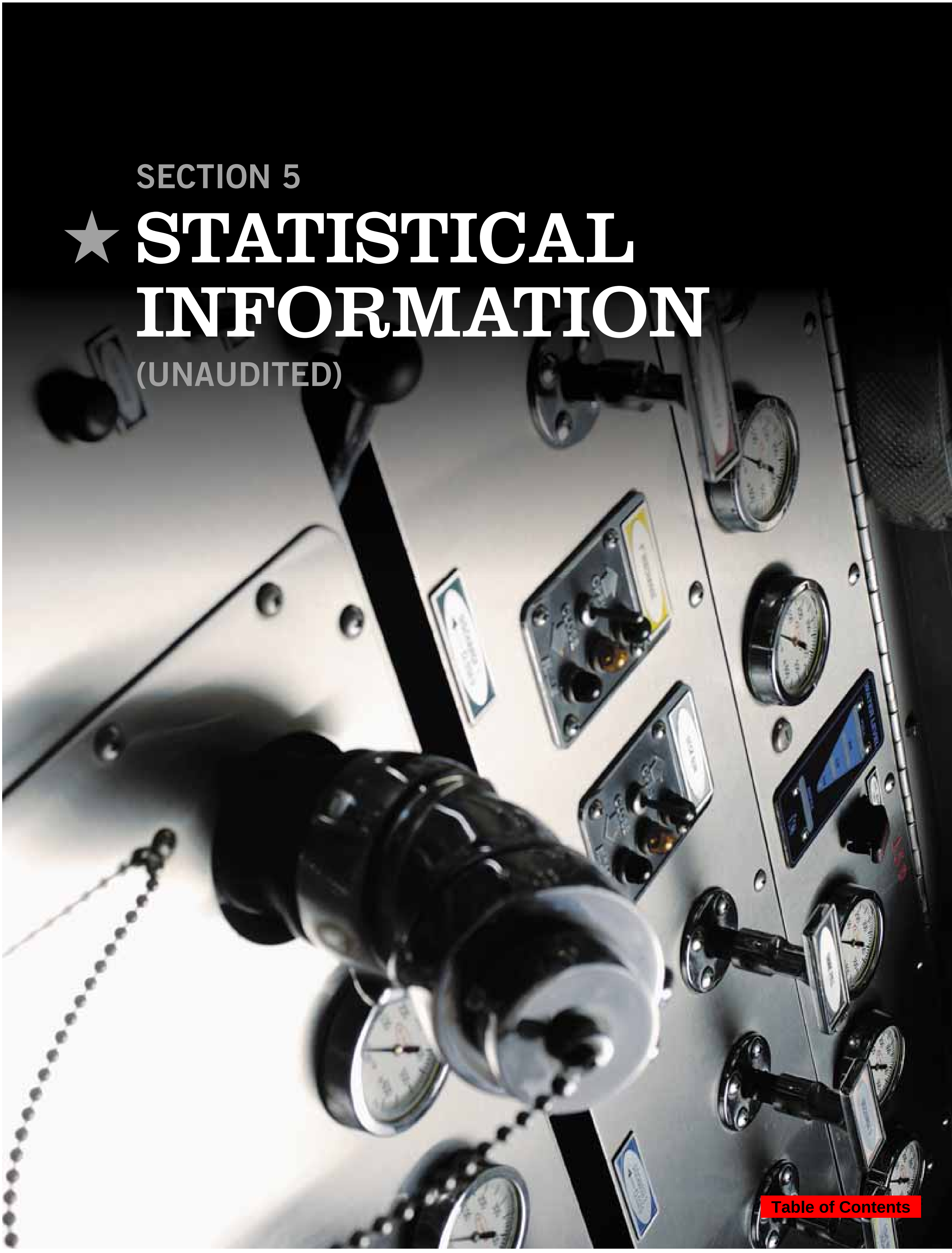
SECTION 5

STATISTICAL INFORMATION

(UNAUDITED)



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★ STATISTICS

REVENUES BY SOURCE — ACCRUAL BASIS
Dollars in thousands

Fiscal Year (Ending June 30)	Employee Contributions	Employer Contributions	Employer Contributions as a Percentage of Annual Covered Payroll	Investment Income (or Loss) Based on Market Value	Other	Total
1999	$12,043	$24,084	15.40%	$76,916	—	$113,043
2000	$12,317	$24,645	15.40%	$159,214	—	$196,176
2001	$12,019	$24,032	15.40%	($24,229)	—	$11,822
2002	$14,219	$28,451	15.40%	($45,685)	—	($3,015)
2003	$13,995	$27,990	15.40%	$97,380	—	$139,364
2004	$14,238	$28,477	*	$304,225	—	$346,940
2005	$16,355	$32,689	18.0%	$339,584	$9,325†	$397,954

** The employer contributed 15.4 percent of the firefighters' salaries during July and August 2003. Beginning September 1, 2003, the employer contributed 16.7 percent of firefighters' salaries.*

† Represents proceeds from agreed judgment regarding lawsuit concerning overtime pay between Emergency Medical Technical Technicians, as Plaintiffs, and the City of Houston, as Defendant.

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

EXPENSES BY TYPE — ACCRUAL BASIS
Dollars in thousands

Fiscal Year (Ending June 30)	Benefit Payments	Professional and Administrative Expenses	Contribution Refunds	Total
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
2004	$83,619	$5,565	$97	$89,281
2005	$85,857	$6,922	$93	$92,872

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

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STATISTICS
(continued)

BENEFIT EXPENSES BY TYPE (Fiscal years end on June 30)

	2005	2004	2003	2002	2001
Refunds due to Pre-Retirement Deaths	$0	$0	$0	$0	$0
Refunds due to Terminations	$73,668	$97,363	$125,824	$179,451	$152,013
Deferred Retirees	$454,197	$438,383	$425,491	$388,025	$367,503
Off-Duty Disabilities	$1,469,531	$1,506,122	$1,528,181	$1,634,500	$1,623,357
Annual Supplemental Benefit Payments	$4,973,854	$4,956,121	$4,971,066	$4,951,779	$4,965,820
On-Duty Disabilities	$5,257,337	$4,606,603	$4,170,940	$3,843,253	$3,236,816
Survivors	$10,751,691	$9,959,839	$9,250,844	$8,551,235	$7,702,694
DROP Distributions	$18,920,316	$22,931,233	$17,587,240	$10,299,394	$5,426,224
Service Retirees	$43,770,023	$39,242,440	$36,227,547	$30,699,073	$25,398,338
Total	**$85,670,617**	**$83,738,104**	**$74,287,133**	**$60,546,710**	**$48,872,765**

RETIRED MEMBERS BY TYPE OF BENEFIT

Total Monthly Benefit Amount	Number of Benefit Recipients	Service	Disability	Widows	Children	Deferred (Receiving Benefits)	Deferred Inactive*
$1 – $200	4	1	0	0	3	0	0
$201 – $400	50	0	0	8	8	34	0
$401 – $600	44	0	0	8	6	30	1
$601 – $800	34	1	1	12	8	12	5
$801 – $1,000	45	9	6	20	6	4	2
$1,001 – $1,200	57	16	4	31	5	1	0
$1,201 – $1,400	98	32	27	36	3	0	0
$1,401 – $1,600	127	51	25	50	1	0	0
$1,601 – $1,800	181	75	54	50	2	0	0
$1,801 – $2,000	167	93	33	38	3	0	0
Over $2,000	1,324	1,044	102	175	3	0	0
Total Recipients	**2,131**	**1,322**	**252**	**428**	**48**	**81**	**8**

** "Deferred inactive" are not included in total columns since they are not yet receiving benefits.*

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AVERAGE MONTHLY BENEFIT PAYMENTS FOR SERVICE RETIREMENTS (Fiscal years end on June 30)

Effective Retirement Date	Years of Credited Service		
	20 – 25	**26 – 30**	**Over 30**
July 2004 – June 2005			
Number of Service Retirements	24	26	36
Average Monthly Benefit	$2,665	$2,802	$3,733
July 2003 – June 2004			
Number of Service Retirements	35	28	71
Average Monthly Benefit	$2,611	$2,667	$3,664
July 2002 – June 2003			
Number of Service Retirements	40	43	65
Average Monthly Benefit	$2,438	$2,527	$3,556
July 2001 – June 2002			
Number of Service Retirements	17	33	64
Average Monthly Benefit	$2,304	$2,577	$3,584
July 2000 – June 2001			
Number of Service Retirements	22	32	36
Average Monthly Benefit	$1,999	$2,295	$3,159
July 1999 – June 2000			
Number of Service Retirements	18	15	11
Average Monthly Benefit	$2,000	$3,016	$3,549
July 1998 – June 1999			
Number of Service Retirements	6	11	7
Average Monthly Benefit	$1,808	$2,647	$3,308
SUMMARY, July 1998 – June 2005			
Number of Service Retirements	162	188	290
Average Monthly Benefit	$2,261	$2,647	$3,508

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★ GLOSSARY

Some of these terms are used in the Investment Section, beginning on page 38. 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 percent 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 percent and 70 percent 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, nonconvertible, dollar-denominated securities issued under Rule 144-A. The Eurodollar Index encompasses non-SEC registered, as well as global

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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.

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 Stock Index
Measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 8 percent of the investable U.S. equity market. The Russell 3000 Stock Index is comprised of stocks within the Russell 1000 and the Russell 2000 indices.

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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, multiemployer 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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