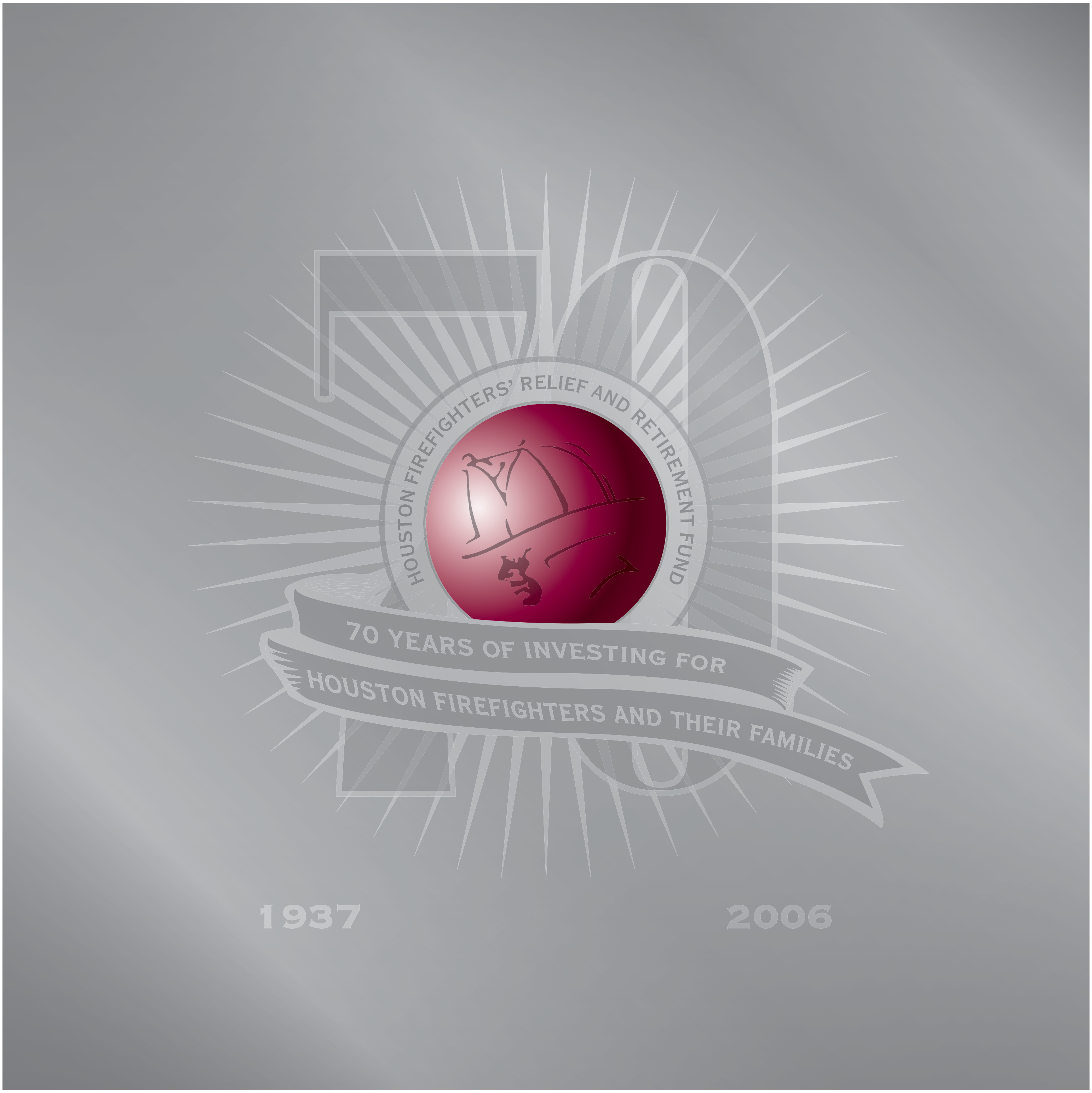


2006 COMPREHENSIVE ANNUAL FINANCIAL REPORT

HOUSTON FIREFIGHTERS' RELIEF AND RETIREMENT FUND

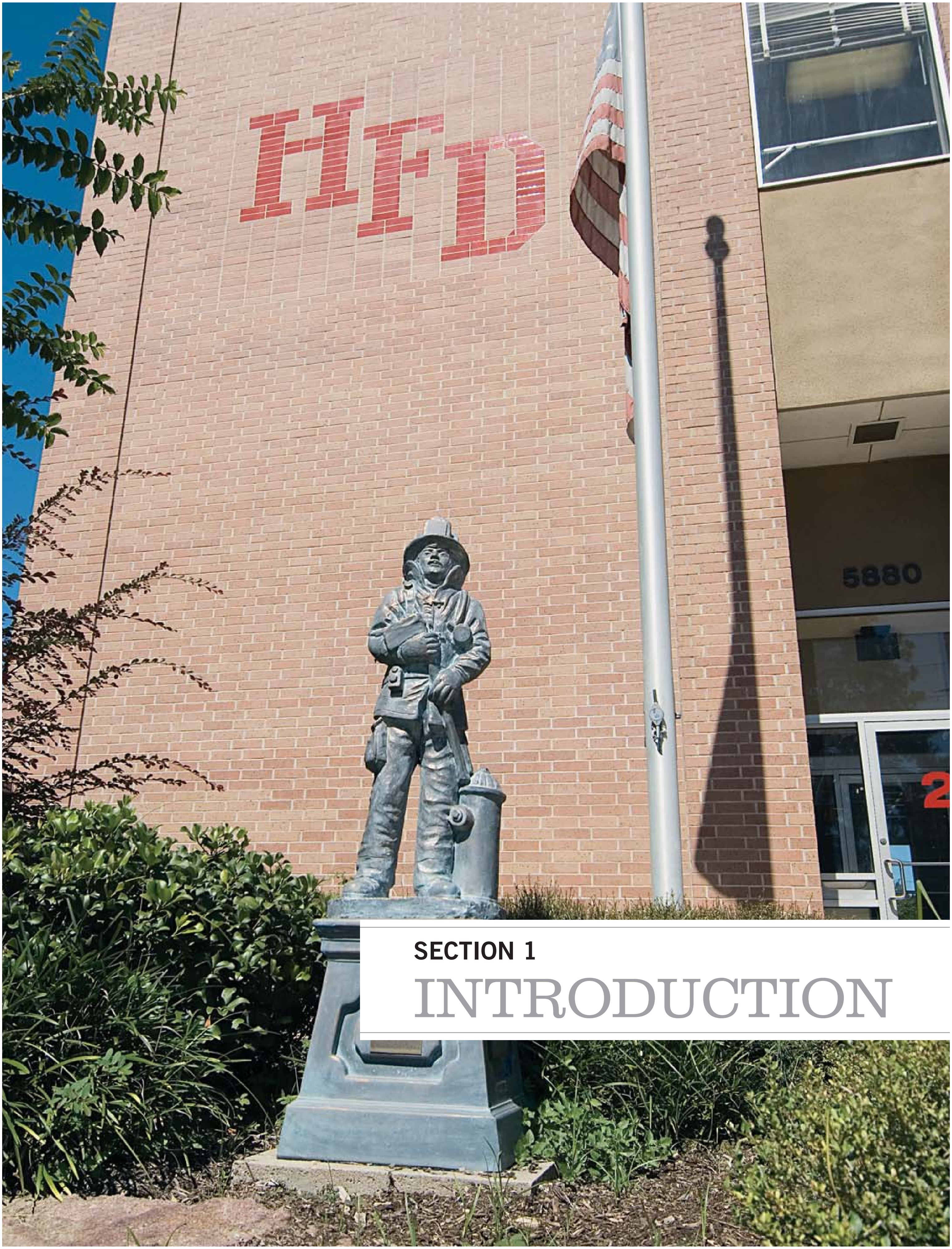
A Component Unit of the City of Houston, Texas, for the
Fiscal Year Ended June 30, 2006

HOUSTON FIREFIGHTERS' RELIEF AND RETIREMENT FUND
A Component Unit of the City of Houston, Texas
Comprehensive Annual Financial Report for the year ending June 30, 2006

Prepared through the combined efforts of
the Houston Firefighters' Relief and Retirement Fund staff under the leadership of the Board of Trustees.

4225 Interwood North Parkway
Houston, TX 77032
281-372-5100
1-800-666-9737
www.hfrrf.org

TABLE OF CONTENTS



SECTION 1

INTRODUCTION

HOUSTON FIREFIGHTERS' RELIEF AND RETIREMENT FUND

Investing for Firefighters and Their Families®

4225 Interwood North Parkway Houston, Texas 77032-3866
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★ LETTER OF TRANSMITTAL

September 25, 2006
Craig T. Mason
Treasurer
City of Houston
P.O. Box 1562
Houston, Texas 77251-1562

Dear Mr. Mason:

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, 2006, is submitted herewith.

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

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

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

The report consists of five sections:

Section 1 — Introduction contains this Letter of Transmittal and 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 (page 14).

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, 2005, 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 2006. Listed below are several accomplishments from the member services, investment and administrative teams.

Our **Investment Team** transformed its traditional investment program into an in-house consultancy, a new approach that we anticipate will have a positive impact on all aspects of the program.

In recognition of their excellent work on our Comprehensive Annual Financial Report, our **Finance and Operations Team** received the Government Finance Officers Association (GFOA) Certificate of Achievement for Excellence in Financial Reporting for the 23rd year in a row.

It's been an especially active year for our **Legal Team,** who worked diligently to obtain support for the Fund's efforts to address the 10 percent penalty imposed on members who retire before age 55 and make lump-sum withdrawals from DROP accounts before age 59½.

Finally, our **Member Services Team** established a "one-stop shop" for classified firefighters who are considering retirement and implemented staff visits to fire stations to discuss benefit issues and Fund news.

ADMINISTRATION, STAFF AND PROFESSIONAL SERVICES

At fiscal year-end, the Fund staff was made up of 29 full-time employees. The following professionals were employed by the Board of Trustees as of June 30, 2006, to provide specialty services:

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

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 pages 36 and 37.

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, a committee of the whole, formulates and reviews all procedures of the Fund. The auditor of the Fund reviews these internal controls annually. In turn, the auditor makes a report to the Board. If needed, the Board makes changes in the systems and controls of the Fund.

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

Contributions to the Fund are based on the principles of level cost financing, with current services financed on a current basis and prior services amortized over a 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 the asset allocation of current investments, as well as reviews potential investment opportunities.

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 market and economic environments.

The performance objective of the Fund is to meet or exceed the actuarial rate, currently 8.5 percent, over a long-term horizon that is defined as 10 years.

The Fund's portfolio produced a total return, gross of fees and expenses, of 14.48 percent for the year ending June 30, 2006. Relative to the policy benchmark return of 10.36 percent, this indicates the Fund's practices resulted in 4.12 percent of value added versus the market for the year. In addition, when compared to other public funds, the Fund's returns for fiscal year 2006 rank in the top fourth percentile. Over the longer term, the Fund has consistently added value over its policy benchmark and exceeded the actuarial nominal rate of return target of 8.5 percent. Additional information regarding the investment results for the year is included in the Investment section of this report.

FINANCIAL HIGHLIGHTS

Additions to assets received by the Fund are used to fund current and future benefits for members and their beneficiaries. The primary sources of additions are contributions from active members and the City of Houston, and investment income. Deductions from assets consist of benefits paid to retired members and their beneficiaries, fees for professional services, and operations costs.

The following table summarizes additions and deductions to the plan's net asset for 2006, 2005 and 2004.

FUNDING STATUS

	2006 (MILLIONS)	2005 (MILLIONS)	2004 (MILLIONS)
Beginning Net Assets	**$2,286**	**$1,981**	**$1,723**
Additions	388	397	347
Deductions	101	92	89
Net Change	287	305	258
Ending Net Assets	**$2,573**	**$2,286**	**$1,981**

The funding objective of the Fund is to establish contributions which, when combined with present assets and future investment returns, will be sufficient to meet the financial obligations to present and future retirees and beneficiaries. Additionally, the Fund's goal is to establish contributions that are an approximately level percentage of payroll for each generation of active members. Annual actuarial valuations measure the progress toward these goals, as well as test the adequacy of the contribution rate.

The Fund's actuary uses a five-year smoothed market-related value to determine the actuarial value of assets. The smoothing prevents extreme volatility in employer contribution rates due to short-term fluctuations in the investment markets. The Entry Age Actuarial Cost method is used to calculate the Fund's long-term funding needs. Under this method, the actuarial value of the anticipated benefit of each plan member is allocated on a level basis over the member's career.

For the July 1, 2005 valuation, the actuarial value of assets was $2.28 billion; the aggregate actuarial liability for the Fund's members was $2.46 billion. The funding ratio is currently 86.1 — that is, current assets cover 86.1 percent of the benefits accrued to date by active and retired members and beneficiaries. This is lower than the 88.2 percent in the July 2004 valuation, primarily due to recognition of earlier investment losses of the Fund.

Additional information regarding the financial condition of the Fund can be found in the Actuarial section of this report.

INDEPENDENT AUDIT

An audit was performed by Mir•Fox & Rodriguez, P.C., for the fiscal year ending June 30, 2006, 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, 2005. This was the 23nd 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.

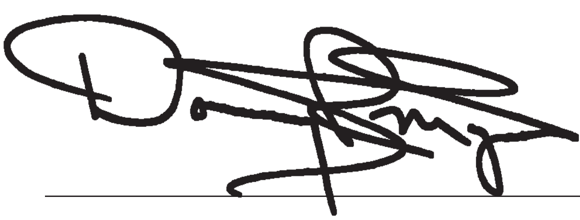
A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

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,



Donny R. Myers,
Executive Director

Rhonda Scott Smith,
Deputy Director of Finance and Operations

★ ADMINISTRATIVE ORGANIZATION

Executive Director
Donny R. Myers

Chief Investment Officer
Christopher Gonzales

Chief Legal Officer
Jonathan W. Needle

Deputy Director of Finance and Operations
Rhonda Scott Smith

Deputy Director of Member Services
Glenna Hicks

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

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.
HM Capital
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
Ranieri & Co, Inc.
RMK Timberland Group
Standish/Mellon Bond Associates
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 46.

★ 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 67 to 69.

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, 2006 and 2005.

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, 2006 and 2005.

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 49).

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

Notes to Financial Statements

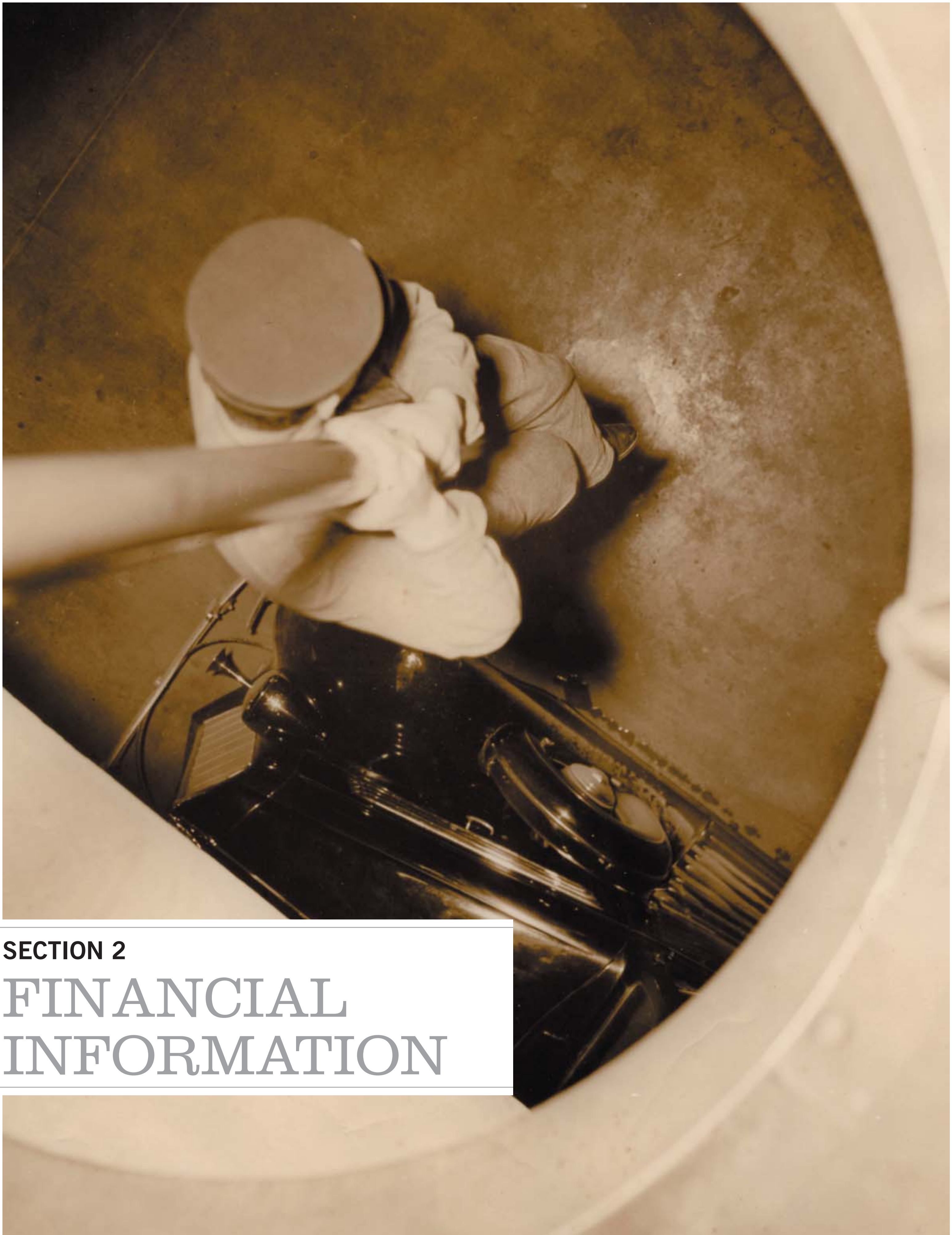
The notes are an integral part of the financial statements. The notes include any information that might be needed to have an adequate understanding of the overall financial status of the Fund.

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

Supplementary Information

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

Other supplementary information provides additional information for analysis.



SECTION 2

FINANCIAL INFORMATION

★ 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, 2006 and 2005, 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 audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements, 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, 2006 and 2005, 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 express no opinion on it.

Our audit was conducted 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.

September 22, 2006

Mir Fox & Rodriguez

One Riverway Suite 1900
Houston, Texas 77056
713.622.1120
713.961.0625 Fax

★ MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

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, 2006, 2005 and 2004. This discussion is intended to serve as an introduction to the Fund's basic financial statements which reflect Fund resources available for payment of benefits and other expenses. The basic financial statements consist of:

The **Statements of Plan Net Assets** which reflect a snapshot of the Fund's financial position and reflect resources available for the payment of benefits and other expenses at fiscal year-end. The statements show the Fund's assets, liabilities and plan net assets (where Assets - Liabilities = Net Assets) available at the end of the fiscal year.

The **Statements of Changes in Plan Net Assets** which reflect the results of all transactions that occurred during the fiscal year and show the fiscal year-end additions to and deductions from the Fund (Additions - Deductions = Net Change in Net Assets). Essentially, this statement shows what has happened to the plan assets during the fiscal year. If net assets increased, then additions were more than the deductions. If net assets decreased, then additions to the Fund were less than the deductions from the Fund.

Notes to the Basic Financial Statements are an integral part of the basic financial statements and include additional information that might be needed to have an adequate understanding of the overall financial status of the Fund.

Required supplemental information and **additional supplemental information** follow the **Notes to the Basic Financial Statements** and provide historical and additional information considered useful in reviewing the basic financial statements.

FINANCIAL HIGHLIGHTS

SUMMARY COMPARATIVE STATEMENTS OF PLAN NET ASSETS			
	FISCAL YEAR 2006	FISCAL YEAR 2005	FISCAL YEAR 2004
ASSETS			
Investments	$2,554,928,572	$2,257,555,547	$1,948,167,850
Capital assets (net of depreciation):			
Land and building	$7,971,016	$8,324,767	$8,626,341
Furniture, fixtures and equipment	$972,448	$1,355,544	$1,416,718
Other	$662,387,701	$636,485,489	$517,253,556
TOTAL ASSETS	**$3,226,259,737**	**$2,903,721,347**	**$2,475,464,465**
LIABILITIES			
Short-term liabilities	$652,375,391	$617,717,330	$494,561,060
TOTAL NET ASSETS	**$2,573,884,346**	**$2,286,004,017**	**$1,980,903,405**

Plan net assets at the end of fiscal year 2006, 2005 and 2004 totaled $2,573,884,346, $2,286,004,017 and $1,980,903,405, respectively. The increase in plan net assets for both fiscal year 2006 and 2005 is due to continued favorable market conditions as evidenced by the Fund's total investment return for fiscal year 2006 of 14.48 percent and fiscal year 2005 of 19.12 percent.

SUMMARY COMPARATIVE STATEMENTS OF CHANGES IN PLAN NET ASSETS			
	FISCAL YEAR 2006	FISCAL YEAR 2005	FISCAL YEAR 2004
Beginning net assets	$2,286,004,017	$1,980,903,405	$1,723,244,375
Additions to net assets:			
Contributions	$67,250,954	$49,044,214	$42,715,409
Net appreciation in fair value of investments	$250,059,653	$275,802,362	$252,764,028
Interest income	$48,722,319	$40,657,595	$38,617,796
Dividends	$20,577,585	$19,360,917	$15,475,695
Net proceeds from securities lending	$1,440,398	$1,139,190	$752,875
Earnings from alternative and real estate investments	$10,417,063	$10,873,659	$8,189,193
Other income	$511,678	$494,472	$390,839
Less cost of investment services	($10,094,588)	($8,743,758)	($11,965,521)
Net investment and other income	$321,634,108	$339,584,437	$304,224,905
Agreed judgment	–	$9,325,726	–
TOTAL ADDITIONS TO NET ASSETS	$388,885,062	$397,954,377	$346,940,314
Deductions from net assets:			
Benefits	$93,842,906	$86,042,122	$83,803,595
Other	$7,161,827	$6,811,643	$5,477,689
TOTAL DEDUCTIONS FROM NET ASSETS	$101,004,733	$92,853,765	$89,281,284
NET INCREASE IN NET ASSETS	$287,880,329	$305,100,612	$257,659,030
ENDING NET ASSETS	$2,573,884,346	$2,286,004,017	$1,980,903,405

ADDITIONS

Contributions

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 $18,470,660 (fiscal year 2006), $16,355,387 (fiscal year 2005) and $14,238,463 (fiscal year 2004). Employer contributions for the last three years were $48,780,294 (fiscal year 2006) $32,688,827 (fiscal year 2005) and $28,476,946 (fiscal year 2004).

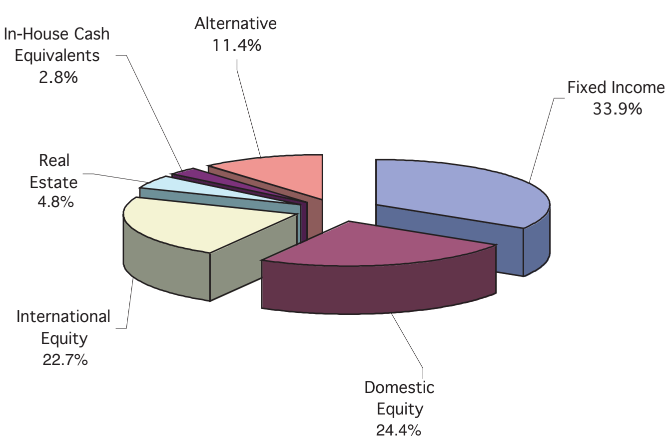
The fiscal year 2006 employer contributions increased when compared to fiscal year 2005 primarily because of the increase in the contribution rate, effective July 1, 2005, from 18 percent to 23.8 percent. The increase in the employee contributions is mainly due to salary increases negotiated during the collective bargaining process and an increase in overtime pay which is due to the additional manpower requirements needed to effectively respond to the Hurricane Katrina and Hurricane Rita disasters.

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

Net Investment and Other Income

The Fund's overall financial position continued to grow during fiscal year 2006 with an overall investment return of 14.48 percent. This strong result enhanced the portfolio's market value to more than $2.5 billion by contributing a net of $322 million to the Fund. The Fund's portfolio experienced double-digit returns from the international equity, private equity, real estate and domestic equity asset classes. The performance in the Fund's bond market was only slightly positive primarily due to rising interest rates. The Fund's higher than market exposures to the energy sector and international emerging markets were the drivers behind the strong return. The positive gain for the fiscal year strengthened our long-term performance. Annually compounded over the past 10 years, the Fund's investment portfolio returned 10.41 percent through June 30, 2006.

ASSET ALLOCATION as of june 30, 2006



At the year end, U.S. and international stocks represented approximately 47.1 percent of the Fund's investments, U.S. and international bond investments represented 33.9 percent, alternative private equity investments represented 11.4 percent and real estate 4.8 percent. The remaining 2.8 percent represents cash equivalents.

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.

Agreed Judgment

During fiscal year 2005, a lawsuit concerning overtime pay between Emergency Medical Technical 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. This amount was accrued for in fiscal year 2005. The agreed upon contributions (including lost income) were distributed to the Fund by the City during the first quarter of fiscal year 2006.

DEDUCTIONS

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, and the cost of administering the Fund comprise the total deductions.

Deductions for fiscal year 2006, 2005 and 2004 totaled $101,004,733, $92,853,765 and $89,281,284. This represents a net increase of approximately 8.8 percent between fiscal years 2006 and 2005 and an increase of approximately 4 percent between fiscal years 2005 and 2004.

Benefits Paid to Members

The 9 percent increase of benefits paid to members during fiscal year 2006 is mainly due to the annual cost-of-living adjustment of three percent and an increase in the number of retirees from 92 to 152. This increase in retirements occurred primarily because the first major group of 10-year Deferred Retirement Option Plan (DROP) participants retired during the first half of the fiscal year. The Fund allows members to participate in DROP for a maximum of 10 years. Although a member may continue to be employed as a firefighter by the City after 10 years of participation in the DROP, no monies will be credited to the member's DROP account. Approximately 94 of the 152 members (61.84 percent) that retired during the fiscal year were 10-year DROP participants.

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

Professional and Administrative Expenses

In total, professional and administration deductions increased between fiscal years 2006 and 2005 and increased between fiscal years 2005 and 2004 by 2.4 percent and 21.1 percent, respectively. The Fund's current professional and administrative expense reflects only a slight net increase. This is primarily due to a stabilization in personnel expenses including staff healthcare costs along with a decrease in consultation/legal fees associated with contract negotiations. During fiscal year 2005, 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 2006 were $388,885,062 and total deductions were $101,004,733, thereby increasing Fund net assets by $287,880,329. In fiscal year 2005, the Fund's net assets increased by $305,100,612 and in fiscal year 2004, the Fund's net assets increased by $257,659,030.

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 33). The asset value stated in the Schedule of Funding Progress is the actuarial value of assets, determined by calculating the difference between the expected valuations of 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 City's current contribution rate will remain in effect until July 1, 2008.

The Board adopted the July 1, 2002 actuarial valuation after careful consideration of more recent preliminary actuarial information. It should be noted that the Actuarial Value of Assets is based on the difference between the actual rate of return and the 8.5 percent assumed rate of return recognized in the actuarial value over five years. Because the gains and losses are smoothed over a five-year period, the change in funding level in the 2002 actuarial valuation is primarily due to the impact of market volatility experienced during fiscal years 2000 through 2003 and not the accrued benefits liability, which remains 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 34). This schedule indicates that the employer is generally meeting its responsibility to provide resources to the Fund. It should be noted that in March 2006, the Board of Trustees adopted the 2005 actuary valuation for financial reporting purposes only. The 2005 report indicates that the Fund has a funding ratio of 86 percent.

ADDITIONAL INFORMATION

The Governmental Accounting Standards Board (GASB) has issued Statement No. 44 which amends the portions of the National Council on Governmental Accounting (NCGA) Statement 1, *Governmental Accounting and Financial Reporting Principles,* that guides the preparation of the required statistical section of the Fund's comprehensive annual financial report (CAFR). This provision adds new information that has been identified as important and eliminates certain previous requirements.

The statistical section of the CAFR presents detailed information, typically in ten-year trends, that assists users in utilizing the basic financial statements, notes to basic financial statements, and required supplementary information to assess economic conditions. The Fund's statistical section, which is a part of the CAFR, will now include trend information on fund balances, ten-year trend information about net assets and changes in net assets.

The provisions of GASB Statement No. 44 are effective for statistical sections prepared for periods beginning after June 15, 2005 and will only impact the Fund's CAFR presentation.

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.

★ STATEMENTS OF PLAN NET ASSETS

Years Ended June 30, 2006 and 2005

	FY 2006	FY 2005
Assets		
Investments, at fair value:		
Short-term investment funds	$136,945,184	$116,398,655
Fixed income:		
Domestic	$687,896,997	$649,317,035
International	$151,310,574	$87,904,314
Common equity:		
Domestic	$538,045,787	$492,322,690
International	$619,277,281	$483,235,585
Preferred equity:		
Domestic	$192,500	$518,934
International	$7,759,723	$6,603,488
Alternative investments — partnerships	$290,559,272	$299,765,798
Real estate	$122,941,254	$121,489,048
TOTAL INVESTMENTS	**$2,554,928,572**	**$2,257,555,547**
Cash and cash equivalents	$2,769,451	$3,055,069
Receivables:		
Accrued interest	$11,813,690	$8,556,880
Due from broker recapture	$20,787	$36,298
Due from securities lending	$134,172	$129,821
Foreign funds contracts	$60,255,931	$63,133,134
Receivables for investments sold	$5,017,861	$6,069,407
Accrued dividends	$1,872,570	$2,084,311
Agreed judgment		$9,325,726
City of Houston contributions	$1,952,613	$1,198,521
Member contributions	$736,383	$599,254
TOTAL RECEIVABLES	**$81,804,007**	**$91,133,352**
Collateral on securities lending arrangements, at fair value	$577,293,406	$542,083,932
Land	$483,325	$541,232
Building, net	$7,487,691	$7,783,535
Furniture, fixtures and equipment, net	$972,448	$1,355,544
Prepaids (operating)	$520,837	$213,136
TOTAL ASSETS	**$3,226,259,737**	**$2,903,721,347**
Liabilities		
Accounts payable and accrued expenses	$3,548,647	$4,285,406
Payables for investments purchased	$9,988,859	$8,625,799
Foreign taxes payable	$66,622	$82,766
Foreign funds contracts payable	$61,477,857	$62,639,427
Collateral on securities lending arrangements, at fair value	$577,293,406	$542,083,932
TOTAL LIABILITIES	$652,375,391	$617,717,330
Plan net assets held in trust for pension benefits	**$2,573,884,346**	**$2,286,004,017**

(A schedule of funding progress for the plan is presented on page 33.)

See accompanying notes to basic financial statements.

★ STATEMENTS OF CHANGES IN PLAN NET ASSETS

Years Ended June 30, 2006 and 2005

	FY 2006	FY 2005
Additions to plan net assets:		
Contributions:		
City of Houston	$48,780,294	$32,688,827
Members	$18,470,660	$16,355,387
TOTAL CONTRIBUTIONS	**$67,250,954**	**$49,044,214**
Net investment income:		
Net appreciation in fair value of investments	$250,059,653	$275,802,362
Interest	$48,722,319	$40,657,595
Dividends	$20,577,585	$19,360,917
Earnings from alternative investments — partnerships	$8,231,059	$9,085,203
Earnings from real estate	$2,186,004	$1,788,456
Other	$511,678	$494,472
Securities lending arrangements:		
Earnings	$23,779,889	$10,458,544
Rebates and fees	($22,339,491)	($9,319,354)
TOTAL SECURITIES LENDING ARRANGEMENTS	**$1,440,398**	**$1,139,190**
Gross investment income	$331,728,696	$348,328,195
Less investment services expense	($10,094,588)	($8,743,758)
NET INVESTMENT INCOME	**$321,634,108**	**$339,584,437**
Agreed judgment		$9,325,726
TOTAL ADDITIONS TO PLAN NET ASSETS	**$388,885,062**	**$397,954,377**
Deductions from plan net assets:		
Benefits paid to members	$93,842,906	$86,042,122
Contribution refunds to members	$264,965	$73,668
Professional services	$741,222	$964,709
Administrative expenses	$6,155,640	$5,773,266
TOTAL DEDUCTIONS FROM PLAN NET ASSETS	**$101,004,733**	**$92,853,765**
Net increase in plan net assets	$287,880,329	$305,100,612
Plan net assets held in trust for pension benefits, beginning of year	**$2,286,004,017**	**$1,980,903,405**
Plan net assets held in trust for pension benefits, end of year	**$2,573,884,346**	**$2,286,004,017**

★ NOTES TO BASIC FINANCIAL STATEMENTS Years Ended June 30, 2006 and 2005

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, 2006 and 2005, the membership of the Fund consisted of the following:

	FY 2006	FY 2005
Retirees and beneficiaries currently receiving benefits	2,243	2,131
Former members entitled to benefits but not yet receiving them	9	8
Active members:		
Vested	2,040	2,191
Nonvested	1,756	1,700
TOTAL MEMBERS	**6,048**	**6,030**

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.

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.

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 10 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 1 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. Non-service-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.

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.

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 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 private equity and real estate limited partnership investments is based on independent appraisals and recent financial results as reported by the general partner. Investments that do not have an established market may be 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 2005 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-year period, and will be considered in the actuarial valuation for fiscal year 2005.

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. Effective July 1, 2004, the active members' contribution rate was increased to 9 percent, resulting in a City contribution rate of 18 percent. The City's contribution rate was increased from 18 percent to 23.8 percent, effective July 1, 2005, while the active members' contribution rate remained at 9 percent. The City's actuarially determined contribution rate of 23.8 percent was established pursuant to the July 1, 2002 actuarial report and consists of 22.1 percent of covered members' salaries to pay normal costs, increased by 1.7 percent of covered members' salaries to amortize the funding of the unfunded actuarial accrued liability over a rolling 30-year period.

ACTUARIALLY DETERMINED CONTRIBUTION REQUIREMENTS	
JUNE 30, 2006*	
Employer normal cost	$45,291,392
Member normal cost	$18,470,660
TOTAL NORMAL COST	**$63,762,052**
Plus: Amortization of deficit actuarial accrued liability	$3,488,902
NET CONTRIBUTIONS REQUIRED	**$67,250,954**
Employer contributions actually made	$48,780,294
Member contributions actually made	$18,470,660
TOTAL CONTRIBUTIONS	**$67,250,954**

JUNE 30, 2005*	
Employer normal cost	$47,335,090
Member normal cost	$16,344,391
TOTAL NORMAL COST	**$63,679,481**
Additional statutory requirement	$1,061,345
Less: Amortization of surplus actuarial accrued liability	($15,707,608)
NET CONTRIBUTIONS REQUIRED	**$49,033,218**
Employer contributions actually made	$32,688,827
Member contributions actually made	$16,344,391
Net contributions actually made	$49,033,218
Member buy-back contributions	$10,996
TOTAL CONTRIBUTIONS	**$49,044,214**

** Based on actuarial contribution rates as determined in the July 1, 2002 actuarial study.*

The July 1, 2002 actuarial data results in an actuarially determined percentage contribution rate of 23.8 percent, which was adopted by the Board in April 2005 for funding purposes effective July 1, 2005.

Historical Trend Information

Historical trend information is provided as required supplemental information on pages 33 and 34. 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 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:

	FY 2006	FY 2005
Short-term investment funds	$136,945,184	$116,398,655
Fixed income	$839,207,571	$737,221,349
Common equity	$1,157,323,068	$975,558,275
Preferred equity	$7,952,223	$7,122,422
Alternative investments — partnerships	$290,559,272	$299,765,798
Real estate	$122,941,254	$121,489,048
TOTAL INVESTMENTS	**$2,554,928,572**	**$2,257,555,547**

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, 2006 and 2005, the Fund's security investments that were not subject to custodial credit risk were the investments not registered on an exchange.

Concentration of Credit Risk

The allocation of assets among various asset classes is 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 and the investment manager.

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 appropriate staff 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, 2006, the Fund's investments of $139,171,588 in an individual U.S. Treasury Bond exceeded 5 percent of Fund net assets. As of June 30, 2005, the Fund's investment of $119,666,229 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 non-investment-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, 2006, 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	13.51	$337,423,605
U.S. fixed income funds	0.00	$993,867
U.S. private placements	15.05	$33,516,045
U.S. taxable muni bonds	27.94	$1,226,335
Non–U.S. government issues	18.81	$42,950,628
Non–U.S. corporate	5.46	$43,208,814
Non–U.S. FHLM/FNMA	2.15	$6,910,894
Corporate debt	12.24	$315,362,619
Asset-backed securities	3.53	$40,397,658
General obligations	17.11	$11,847,376
Zero-coupons	17.43	$432,245
FHLMC/FNMA	25.44	$385,638
Revenue bonds	18.71	$4,551,847
TOTAL FIXED INCOME SECURITIES	**12.14**	**$839,207,571**

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, 2006, is as follows:

Quality Rating	Fair Value	Percentage of Holdings
Aaa	$138,590,738	5.42%
Aa1	$22,044,230	0.86%
Aa2	$28,519,248	1.12%
Aa3	$11,517,185	0.45%
A1	$11,804,634	0.46%
A2	$32,175,216	1.26%
A3	$19,568,364	0.77%
Baa1	$21,949,061	0.86%
Baa2	$31,294,415	1.22%
Baa3	$30,240,100	1.18%
Ba1	$7,347,294	0.29%
Ba2	$21,015,484	0.82%
Ba3	$15,773,904	0.62%
B1	$21,445,059	0.84%
B2	$34,616,119	1.35%
B3	$12,927,330	0.51%
Caa1	$6,554,939	0.26%
Caa2	$7,292,001	0.29%
Caa3	$4,344,175	0.17%
Ca	$952,725	0.04%
Rating not available	$21,811,745	0.85%
TOTAL CREDIT RISK DEBT SECURITIES*	**$501,783,966**	**19.64%**

** 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, 2006, is as follows:

	Fair Value	Percentage of Holdings
EURO Currency	$195,628,022	7.66%
British Pound Sterling	$94,017,256	3.68%
Japanese Yen	$76,273,139	2.99%
Canadian Dollar	$46,048,682	1.80%
Swiss Franc	$25,481,349	1.00%
South Korean Won	$21,903,999	0.86%
Hong Kong Dollar	$21,437,362	0.84%
Norwegian Krone	$18,846,399	0.74%
Australian Dollar	$18,518,905	0.73%
Brazil Real	$17,483,688	0.68%
Singapore Dollar	$16,617,774	0.65%
Mexican New Peso	$14,068,405	0.55%
New Taiwan Dollar	$12,819,467	0.50%
Swedish Krona	$11,102,044	0.43%
South African Comm Rand	$9,809,621	0.38%
Thailand Baht	$9,503,644	0.37%
New Zealand Dollar	$8,752,593	0.34%
Indonesian Rupian	$4,904,430	0.19%
Czech Koruna	$1,917,996	0.08%
Argentina Peso	$1,049,973	0.04%
New Turkish Lira	$1,010,691	0.04%
Malaysian Ringgit	$225,745	0.01%
Hungarian Froint	$2,159	0.00%
TOTAL SECURITIES SUBJECT TO FOREIGN CURRENCY RISK	**$627,423,343**	**24.56%**

Schedule 4 on pages 36 and 37 lists the Fund's investment and professional service providers

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, 2006 and 2005, the Fund's cash deposits in bank accounts totaled $2,769,451 and $3,055,069, 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 2006 and 2005, 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 2006 or 2005. 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

During the fiscal year 2006, the transaction was completed with the payment of the receivable balance in July 2005.

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 2006	FY 2005
Building	$9,096,912	$9,086,063
Less accumulated depreciation	($1,609,221)	($1,302,528)
BUILDING, NET	$7,487,691	$7,783,535

9. FURNITURE, FIXTURES AND EQUIPMENT

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

	FY 2006	FY 2005
Office furnishings and equipment	$753,909	$739,240
Computer equipment	$2,219,567	$1,966,681
Furniture, fixtures and equipment	**$2,973,476**	**$2,705,921**
Less accumulated depreciation	($2,001,028)	($1,350,377)
FURNITURE, FIXTURES AND EQUIPMENT, NET	**$972,448**	**$1,355,544**

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, 2006 and 2005. 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 47 days and 31 days as of June 30, 2006 and 2005, 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, 2006 and 2005, securities lending transactions were collateralized in cash.

11. RELATED PARTY

During fiscal years 2006 and 2005, the Plan utilized the services of an investment management company, in which the Plan owns an interest of approximately $210,000 and $282,000 as of June 30, 2006 and 2005, respectively.

During fiscal year 2006, the Fund's Board approved the sale of property for $87,120 to the Houston Texas Fire Fighter's Federal Credit Union (HTFFFCU). A member of the Fund's Board is also a board member of HTFFFCU and abstained from any vote pertaining to this transaction. Because of this Board member's relationship with both Boards, this action may be considered a related party transaction. This transaction was completed during the 2006 fiscal year and was paid in full as of June 30, 2006.

	FISCAL YEAR 2006		FISCAL YEAR 2005	
	Securities Lent	Collateral Held	Securities Lent	Collateral Held
Fixed income	$457,303,119	$467,817,821	$466,887,790	$477,737,216
Common and preferred stocks	$104,113,985	$109,475,585	$61,243,760	$64,346,716
	$561,417,104	$577,293,406	$528,131,550	$542,083,932

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 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 2006 and 2005, the Fund contributed $323,573 and $309,436, 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, 2006 and 2005, aggregate contributions from active members of the Fund with less than 10 years of service were approximately $24,558,000 and $17,600,000, respectively. Contributions for employees with 10 to 20 years of service has not been determined. As of June 30, 2006 and 2005, 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 $154,000,000 and $134,540,000 as of June 30, 2006 and 2005, 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, 2006 and 2005, 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 investment 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.

★ 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%
July 1, 2004	$2,000	$2,267	88%	$267	$182	147%
July 1, 2005	$2,119	$2,461	86%	$342	$192	178%

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

See accompanying note to required supplemental schedules.
See accompanying independent auditors' report.

SCHEDULE 2 — SCHEDULE OF EMPLOYER CONTRIBUTIONS (UNAUDITED)

(Dollars in thousands)

FISCAL YEAR (ENDING JUNE 30)	ANNUAL REQUIRED CONTRIBUTION	PERCENTAGE CONTRIBUTED
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%
2006	$48,780	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, 2005
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	3% per year	
Salary increases	3% to 7%, based on seniority and merit	
General inflation rate	3% per year	
Cost-of-living adjustment	3% annually	
Mortality rates	1994 Group Annuity Mortality Table	
Future DROP interest credits	Floor of 5% and a ceiling of 10%. Interest is assumed to be credited at 8% to reflect an expected average 0.5% net gain due to asset performance outside this range.	
DROP duration	Duration of DROP at retirement	Percentage of participants electing retirement at the specified duration
	0	10%
	3	10%
	5	10%
	8	30%
	10	40%

See accompanying independent auditors' report.

SCHEDULE 3 — INVESTMENT, PROFESSIONAL SERVICES AND ADMINISTRATIVE EXPENSES

Years Ended June 30, 2006 and 2005

	FY 2006	FY 2005
Investment services:		
Custodial services	$400,165	$344,727
Money management services	$9,694,423	$8,399,031
TOTAL INVESTMENT SERVICES	$10,094,588	$8,743,758
Professional services:		
Actuarial services	$143,297	$215,540
Audit and accounting services	$31,398	$24,750
Consulting services	$485,144	$655,493
Legal services	$71,008	$64,576
Medical examinations	$10,375	$4,350
TOTAL PROFESSIONAL SERVICES	**$741,222**	**$964,709**
Administrative expenses:		
Depreciation	$964,269	$801,563
Continuing education	$268,724	$223,285
Furniture, equipment and supplies	$88,495	$56,314
Insurance	$750,299	$673,713
Investment research	$72,618	$63,367
Office cost	$3,667,567	$3,645,360
Facility maintenance	$173,350	$149,557
Utilities	$170,318	$160,107
TOTAL ADMINISTRATIVE EXPENSES	**$6,155,640**	**$5,773,266**

See accompanying independent auditors' report.

SCHEDULE 4 — SUMMARY OF INVESTMENT AND PROFESSIONAL SERVICES
Year Ended June 30, 2006

INDIVIDUAL OR FIRM NAME	OFFICIAL PLAN POSITION	AMOUNT	NATURE OF SERVICES
Mellon Trust	Custodian	$400,165	Custodial
McKinley Capital	Investment manager	$1,185,440	Money management
Mercator	Investment manager	$1,137,944	Money management
Marvin & Palmer	Investment manager	$1,061,582	Money management
AllianceBernstein	Investment manager	$834,408	Money management
Loomis Sayles "A" and "B"	Investment manager	$778,329	Money management
State Street Research A	Investment manager	$541,092	Money management
Ariel Capital Management	Investment manager	$503,030	Money management
Victory	Investment manager	$485,505	Money management
STW Fixed Income Mgmt "A"	Investment manager	$459,266	Money management
Gulf Investment Management	Investment manager	$446,054	Money management
The Mitchell Group	Investment manager	$401,503	Money management
FX Concepts	Investment manager	$401,125	Money management
State Street Global	Investment manager	$389,303	Money management
STW Fixed Income Mgmt "B"	Investment manager	$259,420	Money management
Texas Forest Partners	Investment manager	$236,011	Money management
Energy Trust	Investment manager	$209,891	Money management
GW Capital	Investment manager	$191,084	Money management
Standish/Mellon Bond "STIF"	Investment manager	$178,462	Money management
Energy Spectrum	Investment manager	($5,026)	Money management
TOTAL INVESTMENT SERVICES		$10,094,588	

See accompanying independent auditors' report.

SCHEDULE 4 — SUMMARY OF INVESTMENT AND PROFESSIONAL SERVICES
Year Ended June 30, 2006

INDIVIDUAL OR FIRM NAME	OFFICIAL PLAN POSITION	AMOUNT	NATURE OF SERVICES
Buck Consultants, L.L.C.	Actuary	$143,297	Actuarial
Strasburger and Price, L.L.P.	Attorneys	$69,259	Legal
Locke, Lidell, and Sapp	Attorneys	$1,749	Legal
Mir•Fox & Rodriguez, P.C.	Auditors	$24,248	Audit
Joseph Mason, C.P.A.	Auditors	$7,150	Other accounting services
Infinity Vision Group	Communications	$18,175	Professional services
Printmailers, Inc.	Communications	$3,789	Printing and design
National Mail Advertising	Communications	$2,317	Printing and design
Other	Communications	$400	Professional services
Locke, Lidell, and Sapp	Consultant	$192,026	Consulting
William & Jenson	Consultant	$120,000	Consulting
Adcetera Design Studio, Inc.	Consultant/Communications	$87,475	Consulting, printing and design
Gray Associates	Consultant	$28,324	Consulting
Procorp Associates, Inc.	Consultant	$20,154	Consulting
Leadingwell Associates	Consultant	$6,740	Consulting
Secure Data Solutions	Consultant	$4,600	Consulting
Pension Consulting Alliance, Inc.	Consultant	$740	Consulting
Websoft Publishing Company, Inc.	Consultant	$404	Consulting
Texas Occupational Medicine	Physicians	$10,375	Medical examinations
TOTAL PROFESSIONAL SERVICES		**$741,222**	

See accompanying independent auditors' report.

SECTION 3

INVESTMENT INFORMATION

★ 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 2006, the Fund experienced a rate of return of 14.48 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 fiscal year 2005, which resulted in new asset classes, strategic allocations, ranges and benchmarks. No changes were made to the allocations in fiscal year 2006. 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 semi-annual performance evaluation and asset rebalancing. If an asset class allocation reaches an endpoint of its range, the Investment Committee shall rebalance to within the asset class range, as needed, to meet investment return objectives. Current asset classes, asset class ranges and strategic allocations are as follows:

Asset Class	Asset Class Range	Strategic Allocation
Domestic Equities	15% – 25%	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 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, 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-Year 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.

INVESTMENT HOLDINGS ASSET ALLOCATION* (Dollars in millions)				
	FISCAL YEAR 2006		FISCAL YEAR 2005	
	Market Value	Percent	Market Value	Percent
Cash and Cash Equivalents	$74	2.9%	$69	3.0%
Domestic Equity	$623	24.3%	$550	24.3%
Fixed Income	$867	33.9%	$759	33.6%
International Equity	$580	22.7%	$462	20.4%
Alternative Investments	$290	11.4%	$300	13.3%
Real Estate Investments	$123	4.8%	$121	5.4%
	$2,557	**100%**	**$2,261**	**100%**

** Calculated using specific mandates.*

★ INVESTMENT RESULTS

TOTAL FUND RETURN AND RETURNS BY ASSET CLASS								
PERIOD ENDING JUNE 30:						ANNUALIZED		
	2006	2005	2004	2003	2002	3-Year	5-Year	10-Year
TOTAL FUND								
HFRRF	14.5	19.1	18.4	6.5	(2.4)	17.3	10.9	10.4
Policy Benchmark*	10.4	10.7	16.3	7.6	0.2	11.6	8.0	8.5
Actuarial Rate	8.5	8.5	8.5	8.5	8.5	8.5	8.5	8.5
CASH AND CASH EQUIVALENTS								
HFRRF	7.0	4.7	3.0	1.0	9.3	4.9	5.0	7.5
Custom Benchmark†	2.9	1.7	1.0	1.5	2.6	1.8	2.6	4.1
DOMESTIC EQUITY								
HFRRF	16.5	18.6	30.9	(1.8)	(1.0)	21.8	12.0	12.0
Russell 3000	9.6	8.1	20.5	0.8	(17.3)	12.6	3.5	8.5
FIXED INCOME								
HFRRF	1.4	14.3	4.7	26.8	1.8	6.7	9.4	8.6
Lehman Universal Index	(0.3)	7.4	1.0	11.5	7.7	2.7	5.4	6.4
INTERNATIONAL EQUITY								
HFRRF	27.8	16.1	34.3	(6.9)	(8.1)	25.9	11.3	7.8
MSCI All Country World Ex-US Index	28.4	17.0	32.5	(5.6)	(9.4)	25.8	11.9	7.2
ALTERNATIVE INVESTMENTS								
HFRRF	31.7	28.1	20.1	(7.4)	(6.7)	26.5	11.9	16.8
Flat 15%	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
REAL ESTATE INVESTMENTS								
HFRRF	15.8	24.6	4.0	1.7	1.5	14.5	9.2	8.6
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)

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	18.6	8.1	6.3	14.3	7.4	7.3	16.1	14.6	13.6
2006	**14.5**	**9.3**	**16.5**	**9.6**	**8.6**	**1.4**	**(0.3)**	**(1.5)**	**27.9**	**26.9**	**26.6**

* *Trust Universe Comparison Service Public Funds Total Returns*

COMPOUND ANNUAL RETURN								
Period Total	Total Fund	Median 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
2-year	16.8	9.1	17.5	8.8	7.5	7.7	3.5	2.8
3-year	17.3	11.0	21.8	12.6	11.2	6.7	2.7	1.6
5-year	10.9	6.1	12.0	3.5	2.5	9.4	5.4	5.1
10-year	10.4	8.4	12.0	8.5	8.4	8.6	6.4	6.3

** Trust Universe Comparison Service Public Funds Total Returns*

★ INVESTMENT HOLDINGS SUMMARY

TEN LARGEST EQUITY INVESTMENT HOLDINGS (Excluding commingled funds)		
DESCRIPTION	MARKET VALUE	PERCENT OF TOTAL MARKET VALUE
GLAXOSMITHKLINE ORD GBP0.25	$14,611,653	0.57%
SCHLUMBERGER LTD COM	$13,584,616	0.53%
MITSUBISHI UFJ FINANCIAL GROUP	$13,296,592	0.52%
UNICREDITO ITALIAN EUR0.50	$11,390,953	0.44%
TAKEDA PHARMACEUTICAL CO LTD	$10,743,996	0.42%
HALLIBURTON CO COM	$10,526,837	0.41%
CATERPILLAR INC	$9,630,264	0.37%
CHEVRON CORPORATION COM	$8,498,062	0.33%
BANK OF AMERICA CORP	$7,758,530	0.30%
ASSURANCES GENERALES DE FRANCE	$7,325,034	0.28%

TEN LARGEST FIXED-INCOME HOLDINGS			
DESCRIPTION		MARKET VALUE	PERCENT OF TOTAL MARKET VALUE
U.S. TREASURY BONDS	8.000% 11/15/2021 DD 11/15/91	$138,068,671	5.36%
U.S. TREASURY NOTES	4.250% 11/15/2014 DD 11/15/04	$53,959,584	2.10%
U.S. TREASURY BONDS	5.375% 02/15/2031 DD 02/15/01	$34,879,900	1.36%
U.S. TREASURY BONDS	8.125% 08/15/2019 DD 08/15/89	$31,472,644	1.22%
ARAB REP EGYPT GTD NT	4.450% 09/15/2015 DD 09/27/05	$14,111,077	0.55%
U.S. TREASURY NOTES	3.375% 10/15/2009 DD 10/15/04	$13,679,228	0.53%
U.S. TREASURY BONDS	4.500% 02/15/2036 DD 02/15/06	$13,654,922	0.53%
U.S. TREASURY NOTES	3.875% 09/15/2010 DD 09/15/05	$13,133,920	0.51%
MEXICO (UTD MEX ST) BONDS	9.000% 20-DEC-2012 MXN100	$9,068,562	0.35%
U.S. TREASURY NOTES	3.500% 12/15/2009 DD 12/15/04	$8,548,200	0.33%

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

FEES FOR INVESTMENT SERVICES			
DESCRIPTION	**ASSETS UNDER MANAGEMENT**	**FEES**	**BASIS POINTS***
Cash Equivalents Manager†	$73,882,059	$178,462	0.2415%
Domestic Equity Managers	$622,591,448	$3,211,593	0.5158%
International Equity Managers	$580,537,920	$4,175,393	0.7192%
Fixed Income Managers	$866,921,938	$1,688,099	0.1947%
Alternative Investments	$290,559,301	$204,865	0.0705%
Real Estate Investments	$122,941,256	$236,011	0.1920%
OTHER INVESTMENT SERVICES			
CUSTODIAL	$2,557,433,922	$400,165	0.0156%
TOTAL FEES FOR INVESTMENT SERVICES	**$2,557,433,922**	**$10,094,588**	**0.3947%**

** 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.

★ 2006 BROKERAGE COMMISSIONS

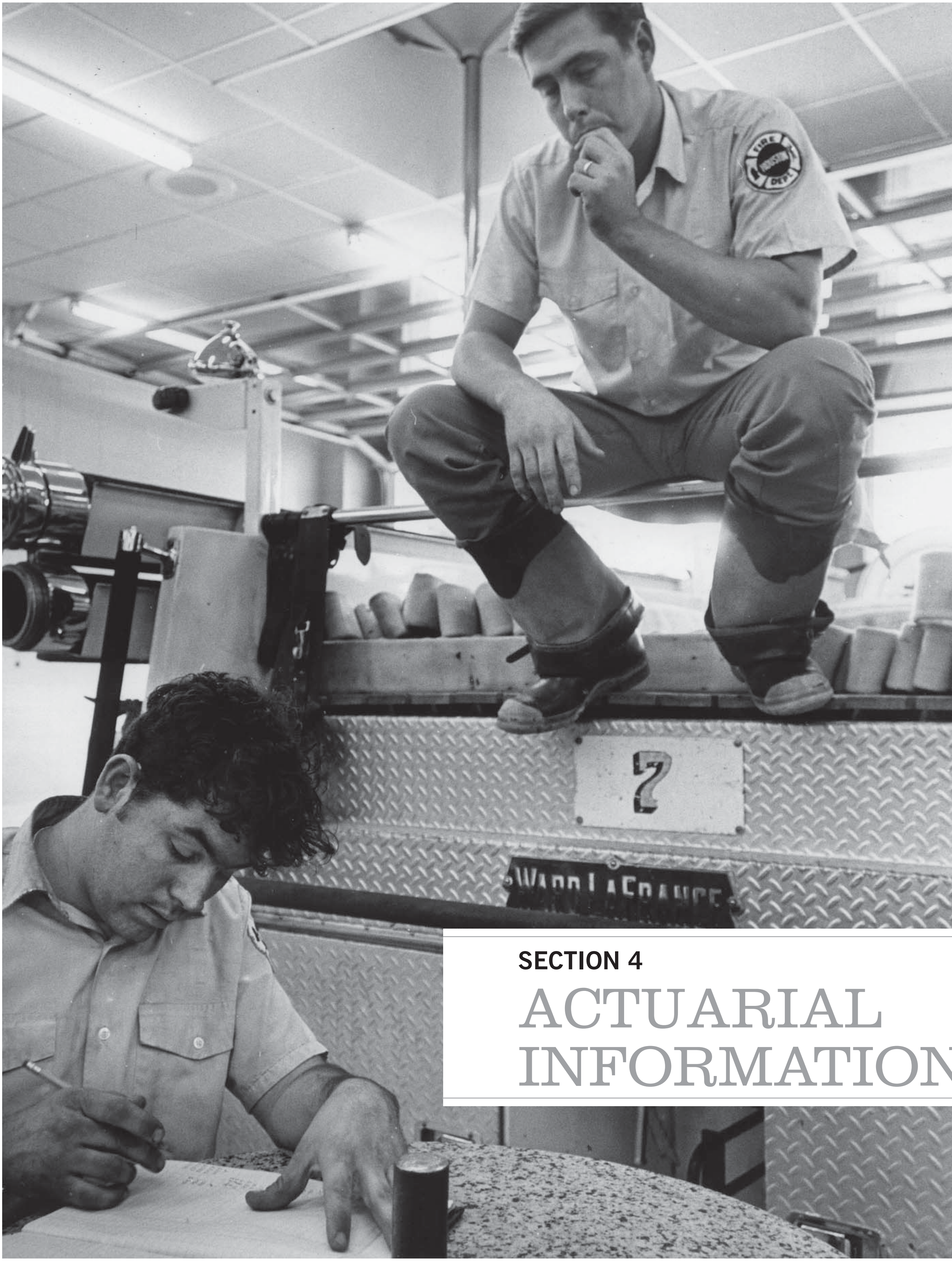
TOP 25 BROKER COMMISSION PAID	
BROKER NAME	**BASE COMMISSION**
LYNCH JONES & RYAN INC, HOUSTON*	$169,956
PERSHING DIVISION OF DLJ, NY	$119,413
MERRILL LYNCH PIERCE FENNER, WILMINGTON	$91,389
GOLDMAN SACHS & CO, NY	$79,444
MERRILL LYNCH INTL LONDON EQUITIES	$78,946
BEAR STEARNS & CO INC, NY	$48,224
UBS SECURITIES LLC, STAMFORD	$41,610
MERRILL LYNCH PIERCE FENNER SMITH INC NY	$40,349
MORGAN STANLEY & CO INC, NY	$38,656
CREDIT SUISSE, NEW YORK (CSFBUS33XXX)	$36,399
SG SEC (LONDON) LTD, LONDON	$35,283
S G WARBURG, SEOUL	$31,120
MIZUHO SECURITIES USA INC. NEW YORK	$28,133
CITIGROUP GBL MKTS INC, NEW YORK	$27,195
SAMSUNG SECS, SEOUL	$26,483
J P MORGAN SEC LTD/STOCK LENDING, LONDON	$25,436
ABG SECS, OSLO	$23,669
MORGAN J P SECS INC, NEW YORK	$23,441
DRESDNER KLEINWORT SECS LTD (KBENGB22)	$22,032
CREDIT LYONNAIS SEC, SEOUL	$21,522
DEUTSCHE BK SECS INC, NY (NWSCUS33)	$20,074
LIQUIDNET INC, BROOKLYN	$19,118
PERSHING SECURITIES LTD, LONDON	$19,089
LEHMAN BROS INC, NEW YORK	$17,637
UBS WARBURG ASIA LTD, HONG KONG	$16,908
TOTAL	**$1,101,526**

** Commission recapture broker*

Total broker commissions paid in fiscal year 2006 are $1,684,830.

★ 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 2006, slightly more than 10 percent of all trading activity was directed toward the commission recapture program.



SECTION 4

ACTUARIAL INFORMATION

★ 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, 2005.

★ ACTUARIAL CERTIFICATION

buckconsultants
an ACS company

Wells Fargo Plaza
1000 Louisiana Street,
Suite 4900
Houston, TX 77002

November 29, 2006

Board of Trustees
Houston Firefighters' Relief and Retirement Fund
4225 Interwood North Parkway
Houston, TX 77032-3866

Dear Board Members:

The Actuarial Valuation Report dated May 15, 2006 describes the results of the actuarial valuation of the Houston Firefighters' Relief and Retirement Fund (HFRRF) as of July 1, 2005. The Fund retained Buck Consultants to perform this actuarial valuation for the purposes of determining the funding status for the plan year July 1, 2005 through June 30, 2006.

HFRRF's goal is to establish contributions which, when combined with present assets and future investment return, will be sufficient to meet the financial obligations of HFRRF to present and future retirees and beneficiaries. An additional goal is to establish contributions which are an approximately level percentage of payroll for each generation of active members.

Actuarial valuations are performed annually, with the most recent valuation as of July 1, 2005. According to this valuation, the plan is 86.1% funded – that is, current assets cover 86.1% of the benefits accrued to date by active and retired members and beneficiaries. This is lower than the 88.2% in the January 1, 2004 valuation, primarily due to the recognition of earlier investment losses of the Fund.

The actuarial assumptions and methods 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 and methods 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 and meet the parameters of Governmental Accounting Standards Board Statement No. 25.

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 2004 was prepared by the prior actuaries and was not subjected to our actuarial review.

HFRRF staff prepared the supporting schedules in the actuarial section of the Comprehensive Annual Financial Report, and the trend tables in the financial section are based on information supplied in prior actuarial reports, as well as our July 1, 2004 actuarial valuation report.

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.

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.

Carly A. Nichols

Carly A. Nichols, ASA, EA

Lee James

Lee A. James, FSA, EA, MAAA, FCA

★ SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS

July 1, 2005

INVESTMENT RETURN

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

PAYROLL GROWTH RATE

Three percent per year.

INFLATION

Three percent per year.

INDIVIDUAL SALARY INCREASES

Age	Annual Salary Increase Rate
20	7.00%
25	6.25
30	5.50
35	5.00
40	4.00
45	3.70
50	3.40
55 and over	3.00

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 ceasing active service due to death.

TERMINATION RATES

Age	Probability of Terminating Service (for Reasons Other Than Death, Disability or Retirement) Within One Year After Attaining Age Shown
20	1.3%
25	1.3
30	1.2
35	0.7
40	0.6
45	0.2
50	0.0

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

DISABILITY RATES

Age	Probability of Becoming Totally Disabled Within One Year After Attaining Age Shown
20	0.75%
25	0.75
30	0.75
35	1.50
40	1.50
45	1.50
50	1.50
55	1.50
60	3.00

The actuarial assumptions and methods were adopted by the Board of Trustees on June 16, 2005, for use in the July 1, 2005 valuation of the Fund.

DISABLED MORTALITY RATES

Age	After Becoming Disabled, Probability of Death Within One Year After Attaining Age Shown — Male	Female
20	2.3	0.7
25	2.6	1.3
30	2.9	1.9
35	2.8	2.2
40	3.1	2.3
45	3.5	2.3
50	4.1	2.6
55	5.3	3.0
60	6.5	3.4

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

Number of Years of Service	Probability of Retiring Within One Year
20	8.0%
21 – 22	6.0
23 – 24	5.0
25	6.0
26	10.0
27 – 29	12.0
30 – 31	25.0
32 – 34	40.0
35 – 36	50.0
37	60.0
38 – 39	80.0
40+	100.0

DROP DURATION

Duration of DROP at Retirement	Percentage of Participants Electing Retirement at the Specified 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 2004), the assumptions used in this valuation are the same.

★ MEMBER DATA

July 1, 2005

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
7-1-99	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
7-1-04	3,656	40.4	181.5	48,206	(14.6)
7-1-05	3,894	39.4	192.1	49,353	2.4

RETIREES AND BENEFICIARIES ADDED TO AND REMOVED FROM ROLLS								
	ADDED TO ROLLS		REMOVED FROM ROLLS		ROLLS—END OF YEAR			
Year Ended	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowances	Percentage Increase in Annual Allowances	Average Annual Allowances
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
6-30-04*	377	N/A	109	N/A	2,051	57,676,000	30.2	28,121
6-30-05	135	4,353,000	53	1,107,000	2,133	62,882,000	9.0	29,481

* *Two-year period*

★ SOLVENCY TEST AND ANALYSIS OF FINANCIAL EXPERIENCE

July 1, 2005

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)
7-1-99	$ 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
7-1-04	307,036	909,085	1,050,702	2,000,302	100	100	75
7-1-05	351,112	997,506	1,112,524	2,119,203	100	100	69

ANALYSIS OF FINANCIAL EXPERIENCE (dollars in thousands)

Gain (or Loss) During Year From Financial Experience:	Year Ended June 30, 1999	Year Ended July 1, 2000	Year Ended July 1, 2001	Year Ended July 1, 2002	Year Ended July 1, 2004	Year Ended July 1, 2005
From Liability Sources	$ (30,772)	$ 21,667	$(9,353)	$(163,358)	$(8,019)	$(10,841)
From Asset Sources	(11,189)	3,920	(35,515)	(39,336)	(175,458)	(21,995)
Total	(41,961)	25,587	(44,868)	(202,694)	(183,477)	(32,836)
Non-Recurring Items*	(57,642)	(15,950)	68,166	0	5,142	(15,038)
Composite Gain (or Loss) During Year	$ (99,603)	$ 9,637	$ 23,298	$(202,694)	$(178,335)	$(47,874)

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

★ SUMMARY OF PLAN PROVISIONS

July 1, 2005

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.

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.

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

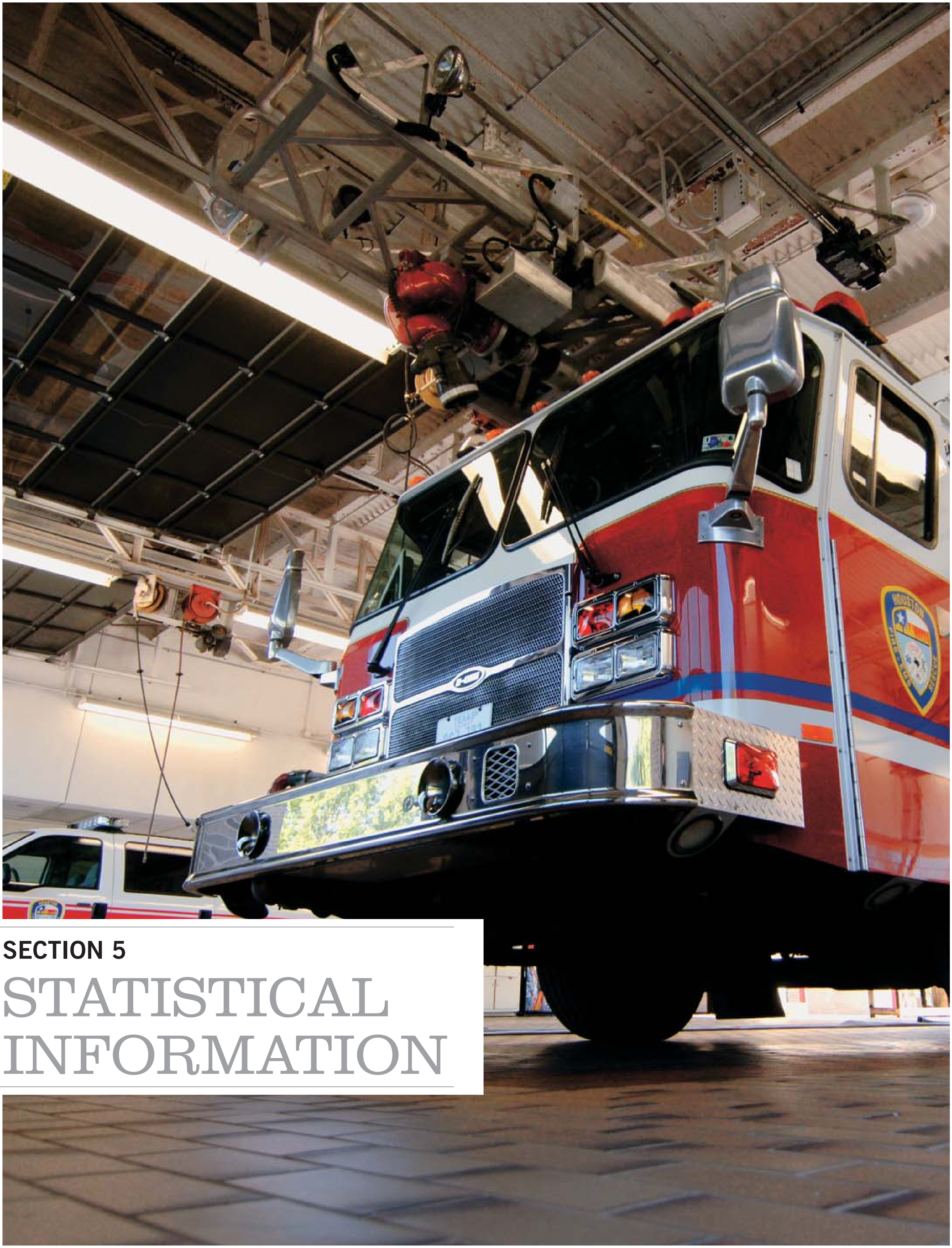
Pensions adjusted each year at a fixed rate of 3%. The adjustment is based on the amount of benefits payable at the time of adjustment.

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.

CONTRIBUTION RATES

Members: 9% 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. For 2005 – 2008, the City contributes 23.8% of payroll. This rate is based on the 2002 actuarial valuation and will be effective until fiscal year ending June 30, 2008.



SECTION 5

STATISTICAL INFORMATION

★ STATISTICS

INTRODUCTION

The Statistical section of the Houston Firefighters' Relief & Retirement Fund's Comprehensive Annual Financial Report presents detailed information related to the financial statements. The schedules within the Statistical section are classified into the following three categories: Financial Trends, Revenue Capacity and Operating Information. All information was derived from Audited Annual Financials and/or our member services database system.

Financial Trends

The **Revenue by Source** presents the member and employer contributions, as well as the net investment income/loss for the 10 years ending June 30, 2006. The Fund's investment returns have the most significant impact on the additions to the plan net assets.

The **Expenses by Type** presents the benefits, refunds of contributions and administrative expenses for the 10 years ending June 30, 2006. The Fund's benefits payments have the most significant impact on the total deductions from plan net assets.

The **Benefits Expenses by Type** presents the amount of benefit payments and refunds by type for the 10 years ended June 30, 2006. Most benefit types are monthly retirement benefits.

The **Statement of Changes in Plan Net Assets** is a schedule combining the additions to and deductions from plan net assets from the schedule of Revenue by Source and schedule of Expenses by Type to arrive at net increase/decrease to changes in plan net assets for the 10 years ended June 30, 2006.

Revenue Capacity

The **Schedule of Investment Income** presents the details of the total net investment gain/loss for the 10 years ended June 30, 2006. The Fund has two outside sources of revenue and one own-source (internal) of revenue. Employer contributions and member contributions, provided in the schedule of Revenue by Source, are the two outside sources of revenue, and investment income is the Fund's own-source revenue. Since investment income is the largest source of revenue to the Fund, this schedule provides more detail on the major components of the investment income, which is also disclosed in total on the schedule of Revenue by Source.

Operating Information

The schedule of **Retired Members by Type of Benefit** presents, for given benefit ranges, the total number of retirees, total monthly benefits and total number of retirees by retirement type as of June 30, 2006.

The schedule of **Average Monthly Benefit Payments and Average Final Average Salary of Retired Members** presents, in five-year increments of credited service, the average monthly benefit, the average final average salary and the number of retired members for the 10 years ended June 30, 2006.

The schedule of **Participating Employers and Active Members** provides the number of covered employees and the corresponding percentage of participation who work within the City of Houston for the 10 years ended June 30, 2006.

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
2006	$18,471	$48,780	23.80%	$321,634	—	$388,885
2005	$16,355	$32,689	18.00%	$339,584	$9,325†	$397,953
2004	$14,238	$28,477	*	$304,225	—	$346,940
2003	$13,995	$27,990	15.40%	$97,380	—	$139,365
2002	$14,219	$28,451	15.40%	($45,685)	—	($3,015)
2001	$12,019	$24,032	15.40%	($24,229)	—	$11,822
2000	$12,317	$24,645	15.40%	$159,214	—	$196,176
1999	$12,043	$24,084	15.40%	$76,916	—	$113,043
1998	$10,875	$21,720	15.40%	$173,807	—	$206,402
1997	$10,156	$20,312	15.40%	$253,901	—	$284,369

* *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 (excludes contribution refunds)	Professional and Administrative Expenses	Contribution Refunds	Total
2006	$93,843	$6,897	$265	$101,005
2005	$86,042	$6,738	$74	$92,854
2004	$83,619	$5,565	$97	$89,281
2003	$71,385	$4,774	$126	$76,285
2002	$57,820	$5,309	$179	$63,308
2001	$47,875	$4,102	$299	$52,276
2000	$35,502	$3,168	$187	$38,857
1999	$30,899	$2,966	$317	$34,182
1998	$43,453	$2,461	$462	$46,376
1997	$27,377	$2,178	$658	$30,213

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

BENEFIT EXPENSES BY TYPE

	2006	2005	2004	2003	2002
Refunds of Contributions	$264,965	$73,668	$97,363	$125,824	$179,452
Death Benefits	$240,000	$185,000	—	—	—
Deferred Retirees	$466,763	$454,197	$438,383	$413,387	$388,025
Off-Duty Disabilities	$1,433,514	$1,494,307	$1,506,122	$1,443,059	$1,634,500
Annual Supplemental Benefit Payments	$4,975,774	$4,973,854	$4,956,121	$4,971,066	$4,951,779
On-Duty Disabilities	$5,762,572	$5,393,720	$4,606,603	$3,718,092	$3,114,594
Survivors	$11,927,149	$10,756,585	$9,959,839	$8,572,203	$7,759,610
DROP Distributions	$19,707,773	$18,920,316	$22,931,233	$17,587,240	$10,299,394
Service Retirees	$49,329,361	$43,864,143	$39,220,294	$34,680,317	$29,671,688
TOTAL	**$94,107,871**	**$86,115,790**	**$83,715,958**	**$71,511,188**	**$57,999,042**

	2001	2000	1999	1998	1997
Refunds of Contributions	$298,726	$186,168	$316,765	$461,865	$658,552
Other Lump Sums	—	—	—	$7,130,000*	—
Death Benefits	—	—	—	—	—
Deferred Retirees	$367,503	$333,084	$286,766	$233,486	$133,378
Off-Duty Disabilities	$1,712,337	$1,741,724	$1,605,351	$1,645,250	$1,709,433
Annual Supplemental Benefit Payments	$4,965,820	—	—	8,000,000	—
On-Duty Disabilities	$2,793,819	$2,815,798	$2,776,862	$2,801,769	$2,686,301
Survivors	$5,927,926	$6,643,817	$5,661,787	$5,521,731	$5,201,535
DROP Distributions	$5,426,224	$1,887,631	$788,368	$362,355	$385,952
Service Retirees	$26,681,845	$22,079,996	$19,779,900	$17,758,197	$17,260,226
TOTAL	**$48,174,200**	**$35,688,218**	**$31,215,799**	**$43,914,653**	**$28,035,377**

** Represents one-time lump-sum benefit paid in November 1997 to retirees and beneficiaries*

STATEMENT OF CHANGES IN PLAN NET ASSETS Last 10 Fiscal Years

	2006	2005	2004	2003	2002
Additions					
Employer Contributions	$48,780,294	$32,688,827	$28,476,946	$27,989,458	$28,450,723
Member Contributions	$18,470,660	$16,355,387	$14,238,463	$13,994,725	$14,218,663
Net Investment Income (net of expenses)	$321,634,108	$339,584,437	$304,224,905	$97,380,249	($45,684,920)
Other*		$9,325,726			
TOTAL ADDITIONS	**$388,885,062**	**$397,954,377**	**$346,940,314**	**$139,364,432**	**($3,015,534)**
Deductions					
Total Benefit Expenses (see Benefit Expenses by Type)	$94,107,871	$86,115,790	$83,715,958	$71,511,188	$57,999,042
Administrative & Professional Expense	$6,896,862	$6,737,975	$5,565,326	$4,773,834	$5,308,640
TOTAL DEDUCTIONS	**$101,004,733**	**$92,853,765**	**$89,281,284**	**$76,285,022**	**$63,307,682**
Change in Plan Net Assets	**$287,880,329**	**$305,100,612**	**$257,659,030**	**$63,079,410**	**($66,323,216)**
Net Assets Held in Trust, Beginning of Year	$2,286,004,017	$1,980,903,405	$1,723,244,375	$1,660,164,965	$1,726,488,181
Net Assets Held in Trust, End of Year	$2,573,884,346	$2,286,004,017	$1,980,903,405	$1,723,244,375	$1,660,164,965

	2001	2000	1999	1998	1997
Additions					
Employer Contributions	$24,032,828	$24,644,897	$24,084,115	$21,720,131	$20,312,418
Member Contributions	$12,019,123	$12,316,994	$12,043,106	$10,875,611	$10,156,225
Net Investment Income (net of expenses)	($24,229,245)	$159,213,891	$76,915,830	$173,807,157	$253,901,182
Other*					
TOTAL ADDITIONS	**$11,822,706**	**$196,175,782**	**$113,043,051**	**$206,402,899**	**$284,369,825**
Deductions					
Total Benefit Expenses (see Benefit Expenses by Type)	$48,174,200	$35,688,218	$31,215,799	$43,914,653	$28,035,377
Administrative & Professional Expense	$4,102,440	$3,168,364	$2,965,586	$2,461,253	$2,177,837
TOTAL DEDUCTIONS	**$52,276,640**	**$38,856,582**	**$34,181,385**	**$46,375,906**	**$30,213,214**
Change in Plan Net Assets	**($40,453,934)**	**$157,319,200**	**$78,861,666**	**$160,026,993**	**$254,156,611**
Net Assets Held in Trust, Beginning of Year	$1,766,942,115	$1,609,622,915	$1,530,761,249	$1,370,734,256	$1,116,577,645
Net Assets Held in Trust, End of Year	$1,726,488,181	$1,766,942,115	$1,609,622,915	$1,530,761,249	$1,370,734,256

* *Agreed judgment income*

SCHEDULE OF INVESTMENT INCOME Last 10 Fiscal Years	2006	2005	2004	2003	2002
Investment Gain (Loss)					
Net Appreciation/(Depreciation) in Fair Value of Investments	$250,059,653	$275,802,362	$252,764,028	$43,573,461	($101,151,952)
Interest	$48,722,319	$40,657,595	$38,617,796	$48,917,175	$53,151,937
Dividends	$20,577,585	$19,360,917	$15,475,695	$10,391,086	$7,565,826
Earnings from Alternative Investments — Partnerships	$8,231,059	$9,085,203	$8,186,731	$4,661,330	$3,629,143
Earnings from Real Estate	$2,186,004	$1,788,456	$2,462	$7,322	$290,719
Miscellaneous	$511,678	$494,472	$390,839	$306,605	$600,034
	$330,288,298	**$347,189,005**	**$315,437,551**	**$107,856,979**	**($35,914,293)**
Investment Expenses	($10,094,588)	($8,743,758)	($11,965,521)	($10,943,000)	($10,236,831)
Net Gain (Loss) from Investing Activities	$320,193,710	$338,445,247	$303,472,030	$96,913,979	($46,151,124)
From Securities Lending Arrangements:					
Earnings	$23,779,889	$10,458,544	$3,510,375	$2,034,529	$2,993,651
Rebates and Fees	($22,339,491)	($9,319,354)	($2,757,500)	($1,568,259)	($2,527,447)
Net Income from Securities Lending Activities	$1,440,398	$1,139,190	$752,875	$466,270	$466,204
TOTAL NET INVESTMENT GAIN (LOSS)	**$321,634,108**	**$339,584,437**	**$304,224,905**	**$97,380,249**	**($45,684,920)**

	2001	2000	1999	1998	1997
Investment Gain (Loss)					
Net Appreciation/(Depreciation) in Fair Value of Investments	($79,977,341)	$112,220,793	$29,540,200	$124,718,447	$201,902,076
Interest	$40,332,573	$35,667,500	$38,065,585	$38,357,510	$28,351,541
Dividends	$13,321,776	$14,057,088	$13,466,064	$13,284,395	$14,081,079
Earnings from Alternative Investments — Partnerships	$7,758,950	$2,776,589	$1,588,309	$2,956,118	$13,999,430
Earnings from Real Estate	—	—	—	—	—
Miscellaneous	—	—	—	—	—
	($18,564,042)	**$164,721,970**	**$82,660,158**	**$179,316,470**	**$258,334,126**
Investment Expenses	($6,130,040)	($5,850,002)	($6,100,337)	($5,885,032)	($4,767,294)
Net Gain (Loss) from Investing Activities	($24,694,082)	$158,871,968	$76,559,821	$173,431,438	$253,566,832
From Securities Lending Arrangements:					
Earnings	$6,055,282	$4,476,149	$6,599,912	$7,558,229	$5,958,499
Rebates and Fees	($5,590,445)	($4,134,226)	($6,243,903)	($7,182,510)	($5,624,149)
Net Income from Securities Lending Activities	$464,837	$341,923	$356,009	$375,719	$334,350
TOTAL NET INVESTMENT GAIN (LOSS)	**($24,229,245)**	**$159,213,891**	**$76,915,830**	**$173,807,157**	**$253,901,182**

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	5	0	0	1	4	0	0
$201 – $400	42	0	0	7	3	32	0
$401 – $600	50	0	0	4	15	31	0
$601 – $800	34	0	2	11	10	11	6
$801 – $1,000	36	5	5	16	4	6	3
$1,001 – $1,200	54	15	2	28	8	1	0
$1,201 – $1,400	86	24	22	37	3	0	0
$1,401 – $1,600	107	37	24	45	1	0	0
$1,601 – $1,800	162	66	44	52	0	0	0
$1,801 – $2,000	161	81	38	39	3	0	0
Over $2,000	1,505	1,181	114	206	4	0	0
TOTAL RECIPIENTS	**2,242**	**1,409**	**251**	**446**	**55**	**81**	**9**

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

AVERAGE MONTHLY BENEFIT PAYMENTS AND AVERAGE FINAL AVERAGE SALARY OF RETIRED MEMBERS			
EFFECTIVE RETIREMENT DATE	YEARS OF CREDITED SERVICE		
	20 – 25	26 – 30	Over 30
JULY 2005 – JUNE 2006			
Number of Service Retirements	11	34	99
Average Monthly Benefit	$2,705	$2,636	$3,653
Average Final Average Salary	$4,381	$3,674	$3,805
JULY 2004 – JUNE 2005			
Number of Service Retirements	24	26	36
Average Monthly Benefit	$2,665	$2,802	$3,733
Average Final Average Salary	$4,254	$3,776	$4,046
JULY 2003 – JUNE 2004			
Number of Service Retirements	35	28	71
Average Monthly Benefit	$2,611	$2,667	$3,664
Average Final Average Salary	$4,470	$3,662	$4,073
JULY 2002 – JUNE 2003			
Number of Service Retirements	40	43	65
Average Monthly Benefit	$2,438	$2,527	$3,556
Average Final Average Salary	$4,378	$3,542	$3,789
JULY 2001 – JUNE 2002*			
Number of Service Retirements	17	34	65
Average Monthly Benefit	$2,304	$2,577	$3,584
Average Final Average Salary	$4,074	$3,580	$3,825
JULY 2000 – JUNE 2001			
Number of Service Retirements	22	32	36
Average Monthly Benefit	$1,999	$2,295	$3,159
Average Final Average Salary	$3,753	$3,563	$3,747
JULY 1999 – JUNE 2000*			
Number of Service Retirements	19	15	11
Average Monthly Benefit	$2,000	$3,016	$3,549
Average Final Average Salary	$3,682	$4,228	$4,203
JULY 1998 – JUNE 1999			
Number of Service Retirements	6	11	7
Average Monthly Benefit	$1,808	$2,647	$3,308
Average Final Average Salary	$3,748	$3,871	$4,135
JULY 1997 – JUNE 1998*			
Number of Service Retirements	10	7	5
Average Monthly Benefit	$2,146	$2,767	$2,825
Average Final Average Salary	$3,606	$3,942	$3,419
JULY 1996 – JUNE 1997*			
Number of Service Retirements	15	6	1
Average Monthly Benefit	$1,988	$2,823	$3,123
Average Final Average Salary	$3,630	$4,063	$3,756

** Reflects revised statistics*

PARTICIPATING EMPLOYERS AND ACTIVE MEMBERS		
CITY OF HOUSTON	ACTIVE MEMBERS	PERCENTAGE OF COVERED EMPLOYEES
2006	3,796	100%
2005	3,891	100%
2004	3,663	100%
2003	3,318	100%
2002	3,368	100%
2001	3,316	100%
2000	3,276	100%
1999	3,281	100%
1998	3,234	100%
1997	3,207	100%

★ 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

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.

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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