HPOPS

FOR TODAY & TOMORROW

Comprehensive Annual Financial Report

A Component Unit of

The City of Houston, Texas

July 1, 2002 through

June 30, 2003

HOUSTON POLICE OFFICERS' PENSION SYSTEM
John E. Lawson, Executive Director
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Houston, TX 77007
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SECTION ONE

INTRODUCTORY SECTION

HPOPS

FOR TODAY & TOMORROW

December 5, 2003

The Membership
Houston Police Officers' Pension System
Houston, Texas

The Comprehensive Annual Financial Report (CAFR) of the Houston Police Officers' Pension System (the System) for the fiscal year ended June 30, 2003 is submitted herewith. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, rests with the management of the System. This CAFR is divided into five sections:

- Introductory Section – This section contains the administrative organization, the letter of transmittal and Chairman's report.
- Financial Section – This section contains the report of the Independent Auditor, the financial statements of the System and certain required supplementary information.
- Investment Section – This section contains a report on investment activity, investment policies, investment results, and various investment schedules.
- Actuarial Section – This section contains the Actuary's Certification Letter and the results of the annual actuarial valuation.
- Statistical Section – This section includes significant data pertaining to the System.

We trust that you will find this CAFR helpful in understanding your retirement system, a system that strives to provide responsible stewardship of assets contributed by the members and the City of Houston.

The System was established in 1947, funded by a $100,000 Treasury note, and offered retiring members a pension of $75 per month. Today, the System has investments of $2 billion and offers a variety of pension benefits to members and their beneficiaries. Members have the option to either defer their benefits, take a proportionate retirement benefit, or retire under a regular service retirement. Members also may access a disability retirement, either duty or non-duty connected.

Major Initiatives

The System has been active this year with the Texas legislature to codify our pension benefits. We also participated in the education of our members regarding the Constitutional amendment in Texas which would guarantee their pension benefits could not be reduced. This amendment passed in November, 2003.

This year, as our economy has strengthened, we took time to reassess our investment strategy; to determine the appropriate asset mix, based on productivity and degree of risk, so that when our members are eligible for retirement benefits, the funds we have invested will be available to pay those benefits.

We have continued to put communication with our members as a high priority. Our financial planner has conducted twenty-four seminars, for which 720 of our members have been able to claim continuing education credit through TCLEOSE. In addition, he has met with and personally counseled 425 members during the year. Two hundred fifty members attended our annual retiree seminar, which had presentations on health benefits through the City of Houston, benefits accessible through the Social Security Administration as well as time to talk one on one with System Benefits staff.

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Additionally, due to the retirement of board members and election of new members, we have injected new insights and strengths into our Board of Trustees.

Additions to Plan Net Assets

The System relies on the contributions of members and the City of Houston, as well as income generated from investments, to provide funds needed to finance retirement and disability benefits. The System experienced a positive investment return of 4.15% in 2003 as opposed to a negative 8.83% in 2002, primarily due to the recovery of equity markets. The System's governing statute provides for an annual increase in the City's contribution of $2 million each year through fiscal year 2004 and this accounts for the increase in City contributions. Contributions from members have increased in fiscal 2003 mainly due to active officer pay increases.

	$000's		Increase (Decrease) Amount	Increase (Decrease) Percentage
	2003	2002		
Member contributions	$ 24,008	$ 22,484	$ 1,524	7%
Employer contributions	34,645	32,645	2,000	6%
Net investment loss	81,164	(185,372)	266,536	144%
Total	$ 139,817	$ (130,243)	$ 270,060	207%

Deductions to Plan Net Assets

The System was created to provide retirement benefits to retired Houston Police Officers and their dependents. Although this is still the primary purpose of the System, over the course of 50+ years the System has also added survivor benefits and disability benefits. The cost of these programs includes benefit payments and refunds of contributions to terminated employees. The cost of administering the System is also paid from System assets.

	$000's		Increase (Decrease) Amount	Increase (Decrease) Percentage
	2003	2002		
Benefits paid to members	$ 65,649	$ 59,783	$ 5,866	10%
Refunds paid to members	992	1,194	(202)	-17%
Administrative expenses	3,125	3,311	(186)	-6%
Total	$ 69,766	$ 64,288	$ 5,478	9%

Total benefits paid, which include lump sum payments, increased marginally in 2003 as compared to 2002 due mainly to an increased number of retirees and the annual COLA.

Investments

The System invests funds entrusted to it exclusively for the benefit of its members. It avows an investment rule commonly known as the “prudent expert” rule, whereby from a procedural as well as substantive standpoint, it acts with the care, skill, prudence and diligence that a “prudent expert” acting in a similar capacity would act under similar circumstances.

	2003		2002	
	$000's	%	$000's	%
Short-term investments	$ 144,313	7%	$ 150,851	8%
Fixed income	464,172	23%	474,429	25%
Equity securities	1,227,975	61%	1,151,685	59%
Alternative investments	187,936	9%	158,639	8%
Foreign currency contracts	536	0%	710	0%
Total	$ 2,024,932	100%	$ 1,936,314	100%

The Board of Trustees believes that the System’s assets should be managed in a way that reflects the uniqueness of the System, and that the System’s assets should be diversified over a spectrum of investment vehicles. The determination of the appropriate asset mix is based on capital market assumptions that incorporate historical returns, volatility and the correlation of various asset classes.

Despite economic reports that continue to run hot and cold, equity markets, both domestic and international, have begun to shrug off bad news of the last two years - the recession, slow economic recovery, poor corporate profits, unemployment, fears of war and terrorism, as well as corporate corruption - and seem to have begun a period of recovery. The System’s investment returns generally returned to the black this year after reporting negative returns on investments for the last two years. The Board firmly believes that by maintaining a disciplined investment approach and with reasonable diversification, the System will meet its long-term investment goals.

Funding

It is the System’s intention to have enough money in reserve to provide members with promised benefits upon their retirement. As of July 1, 2002, the System has an unfunded actuarial accrued liability of $256 million. An actuarial accrued liability is the liability for service already rendered by former and present employees. An actuarial accrued surplus is the surplus in excess of the System’s assets over the actuarial accrued liability. Any liability or surplus is amortized using a 30-year constant level percent of payroll method.

Professional Services

The Board of Trustees appoints professional consultants to perform services that are considered essential for the operation of the System. The independent auditor's report, issued by BDO Seidman, LLP, is included on page 9 of this report. The actuarial report, certified by Towers Perrin, is included on page 44.

Acknowledgements

The compilation of this report reflects the combined effort of the System staff under the guidance of the Board of Trustees. Its goal is to provide complete and reliable information as a basis for management decisions and compliance with legal provisions as well as responsible stewardship of funds contributed by its members and the City of Houston.

We would like to take this opportunity to express our gratitude to the staff, System advisors, and to the many other people who have contributed to the successful operation of the System.

Sincerely,

Board of Trustees

Board of Trustees

HPOPS
FOR TODAY & TOMORROW

December 5, 2003

To the Members
Houston Police Officers' Pension System
Houston, Texas

The Houston Police Officers' Pension System is pleased to bring you the 2003 Financial Report. This report provides a comprehensive picture of HPOPS' finances for the year 2002-03, as well as an overview of the year's highlights. As you will see in the report, we have much to be proud of when looking back at the year's accomplishments.

Over the past few years the economy and markets have struggled, but HPOPS has continued to responsibly manage the System. This year, we have entered into a gradual economic recovery. It is the job of the HPOPS Board and Staff to remain visionaries, undaunted by the short-term market changes. At HPOPS we are global thinkers and our decisions are based on what is best for our members.

Being at the helm of a public pension system is much like being at the helm of a ship, a good captain navigates through rough seas and arrives safely at port. As we pull out of the recent rough economic waters, it is important to realize that our focused investing with a long-term vision has brought our System through to calmer waters.

Because of this commitment, our members and their beneficiaries, whether they have just graduated from the Academy or they have been retired for 10 years, will have the calm waters of secure pension benefits at retirement. We at HPOPS continue to plan for the future of all of our current members as well as those members to come. We encourage you to read on to learn more about HPOPS.

Sincerely,

J. Larry Doss
Chairman

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BOARD OF TRUSTEES AND ADMINISTRATIVE STAFF

POLICE PENSION OFFICE PERSONNEL

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Executive Director

PATRICK S. FRANEY
Director of Administration

JUDY G. BAKER
Benefits Manager

TIM NG
Chief Investment Officer

ROBERT ARTHUR
General Counsel

ADA RIDDLE
Accounting Manager

ERIC OLSON
IT Manager

JOSEPH O'BYRNE
Investment Analyst

HAN AU
Investment Analyst

RICHARD GABLE
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STEPHEN SHALAGAN
Records Manager

AMY BEBERNISS
Communications Director

TONI DEWILLIS
Administrative Assistant

FRAN CALDWELL
Benefits Specialist

KELLY DAVIS
Benefits Assistant

LOUISE LE
Benefits Assistant

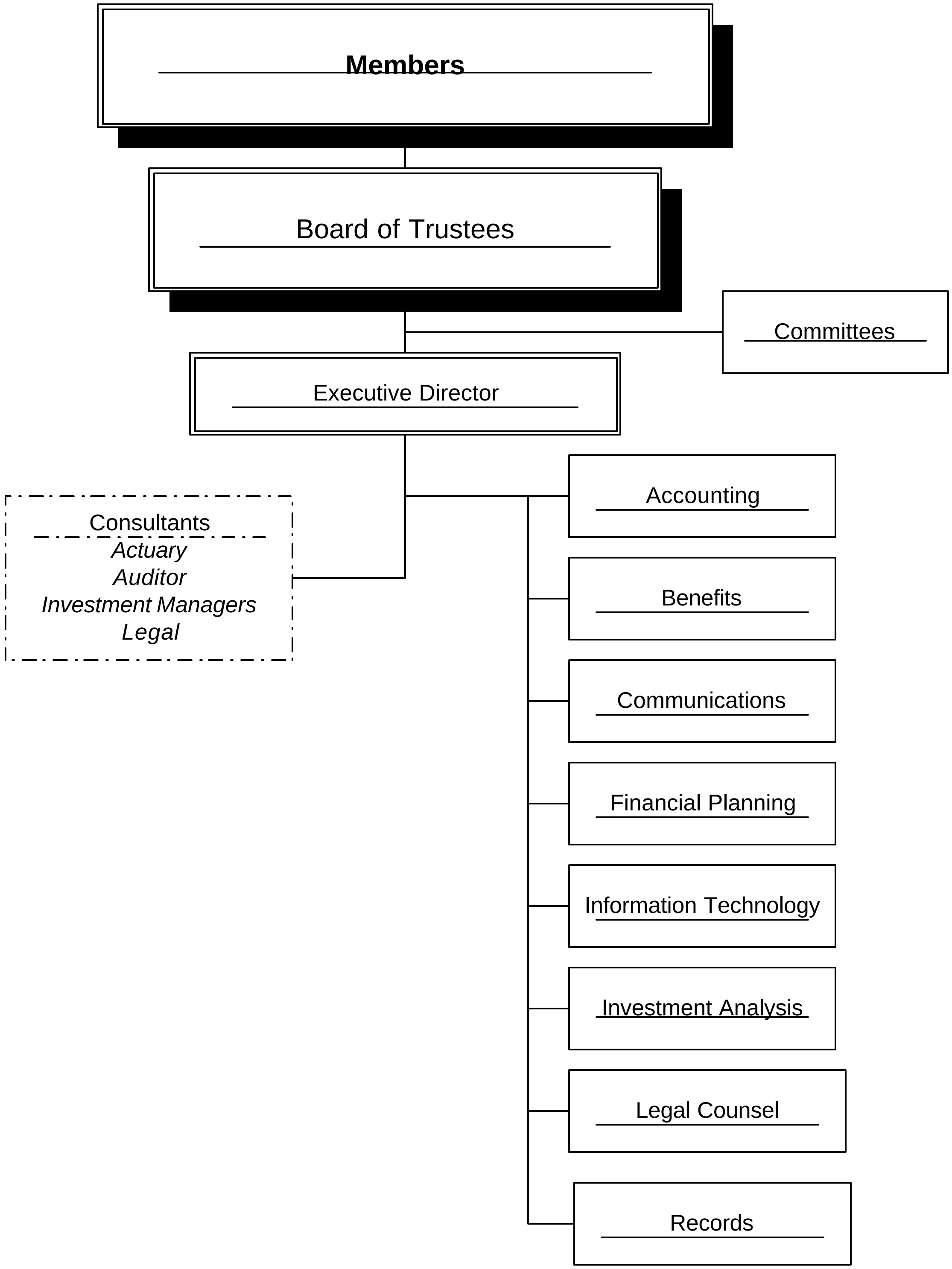
AMELIA MILIAN
Benefits Assistant

CLARK OLINGER
Benefits Assistant

MELISSA SPENCE
Benefits Assistant

REGINA WARD
Benefits Assistant

ANGIE WILLIAMS
Receptionist



See Page 33 – Summary of Investment and Professional Services

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Police Officers Pension System of the City of Houston, Texas

For its Comprehensive Annual Financial Report for the Fiscal Year Ended

June 30, 2002

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

President

Executive Director

SECTION TWO

FINANCIAL SECTION

BDO Seidman, LLP
Accountants and Consultants

333 Clay Street, Suite 4700
Houston, Texas 77002-4180
Telephone: (713) 659-6551
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Independent Auditors' Report

The Board of Trustees
Houston Police Officers' Pension System
Houston, Texas

We have audited the accompanying statements of plan net assets of the Houston Police Officers' Pension System (the System) as of June 30, 2003 and 2002, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the System as of June 30, 2003 and 2002, and its changes in plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits of the basic financial statements were performed for the purposes of forming an opinion on those financial statements taken as a whole. The supplemental information included in Schedules I through III on pages 30 through 34, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

"Management's Discussion and Analysis" and the "Required Supplementary Information" listed on the Table of Contents are not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit this information and express no opinion on it.

BDO Seidman, LLP

September 24, 2003

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Houston Police Officers' Pension System

Management's Discussion and Analysis
Fiscal Year Ended June 30, 2003

The discussion and analysis of the financial performance of the Houston Police Officers' Pension System (the System), provides an overall review of the System's financial activities for the fiscal years ended June 30, 2003 and 2002. The intent of this discussion and analysis is to look at the System's financial performance as a whole; readers should review the financial statements, notes to the financial statements and required supplementary information, in order to enhance their understanding of the System's financial performance.

Financial Statements

These financial statements consist of the Statements of Plan Net Assets, Statements of Changes in Plan Net Assets, Notes to Financial Statements and other required supplementary information. The System is a single employer contributory defined benefit pension plan. The System is a component unit of the City of Houston, Texas (the City), and as such its reports are included in the Fiduciary Funds of the City as restricted assets.

Financial Highlights

The System presents its financial statements solely on the accounts of the System. The accrual basis of accounting is used by the System, whereby revenues are recognized when they are earned and collection is reasonably assured, and expenses are recognized when the liability has been incurred. Investments are reported at fair value.

A summary of the Statements of Plan Net Assets for the System is as follows ($000's):

June 30,		**2003**		2002
Assets				
Investment at fair value	**$**	**2,024,932**	$	1,936,314
Invested securities lending collateral		**225,531**		221,455
Receivables		**17,093**		37,832
Cash		**63**		65
Total assets		**2,267,619**		2,195,666
Liabilities				
Due to brokers	**$**	**21,823**	$	23,784
Securities lending collateral		**225,531**		221,455
Accrued professional fees		**1,643**		1,676
Other liabilities		**323**		503
Total liabilities		**249,320**		247,418
Plan net assets held in trust for pension benefits	**$**	**2,018,299**	$	1,948,248

See accompanying independent auditors' report.

Management's Discussion and Analysis
Fiscal Year Ended June 30, 2003

The System's net assets increased by approximately $70 million in fiscal year 2003 over 2002 primarily due to recovery in foreign and domestic equity markets. The System experienced a positive investment return of 4.15% in 2003 as opposed to negative 8.83% in 2002. Changes in receivables are primarily a result of the timing of investment transactions.

A summary of the Statements of Changes in Plan Net Assets is as follows ($000's):

Years ended June 30:	**2003**	2002	2001
Contributions:			
City	**$ 34,645**	$ 32,645	$ 30,645
Members	**24,008**	22,484	22,043
Total contributions	**58,653**	55,129	52,688
Investment income (loss)	**80,581**	(186,227)	(80,864)
Net income from securities lending activities	**583**	855	832
Total additions (deductions)	**139,817**	(130,243)	(27,344)
Deductions:			
Benefits paid to members	**65,649**	59,783	60,328
Refunds paid to members	**992**	1,194	884
Professional and administrative expenses	**3,125**	3,311	2,854
Total deductions	**69,766**	64,288	64,066
Net increase (decrease)	**70,051**	(194,531)	(91,410)
Plan net assets held in trust for pension benefits, beginning of year	**1,948,248**	2,142,779	2,234,189
Plan net assets held in trust for pension benefits, end of year	**$ 2,018,299**	$ 1,948,248	$ 2,142,779

The City, in a contract approved in fiscal year 2001, agreed to an annual increase in its contribution of $2 million through fiscal year 2004. The contract also requires the City to make a contribution equal to 16% of pensionable pay for fiscal year 2005 and beginning in fiscal year 2006 and thereafter the City contribution will be actuarially determined. This contractual increase accounts for the increase in total contributions for the years ended June 30, 2003 and 2002.

See accompanying independent auditors' report.

Total benefits paid, which includes lump sum payments, increased marginally in 2003 as compared to 2002 due mainly to an increased number of retirees and the annual COLA.

Total benefits paid remained relatively constant between 2002 and 2001 due to an increase in monthly benefits paid of approximately $600 thousand per month in 2002, which was offset by a decline in the amount of lump sum distributions, caused by a decline in the number of retirements, in 2002.

System Highlights

The System's governing statute was amended by the 78th Legislature and such amendments will be effective September 1, 2003. These amendments codified certain benefit enhancements that were already in effect pursuant to various contracts with the City of Houston.

Contacting the System's Management

This financial report is designed to provide members and other users with a general overview of the System's finances and to show the System's accountability for the funding it receives. If you have questions about this report, you may contact the System's Executive Director at 602 Sawyer, Suite 300, Houston, TX 77007 or by phone at 713-869-8734.

See accompanying independent auditors' report.

Houston Police Officers' Pension System

Statements of Plan Net Assets ($000's)

June 30,		**2003**		2002
Assets				
Investments, at fair value (Notes 1, 2 and 4):				
Short-term investments	**$**	**144,313**	$	150,851
Fixed income		**464,172**		474,429
Equity securities		**1,227,975**		1,151,685
Alternative investments		**187,936**		158,639
Foreign currency contracts		**536**		710
Total investments		**2,024,932**		1,936,314
Invested securities lending collateral (Note 2)		**225,531**		221,455
Receivables:				
Members		**333**		588
Investments		**7,597**		10,895
Due from brokers		**9,081**		26,252
Other receivables		**82**		97
Total receivables		**17,093**		37,832
Cash		**63**		65
Total assets	**$**	**2,267,619**	$	2,195,666

See accompanying independent auditors' report and notes to financial statements.

Statements of Plan Net Assets ($000's)

June 30,		**2003**		2002
Liabilities and Plan Net Assets				
Liabilities:				
Due to brokers	**$**	**21,823**	$	23,784
Securities lending collateral (Note 2)		**225,531**		221,455
Accrued investment and professional fees		**1,643**		1,676
Other liabilities		**323**		503
Total liabilities		**249,320**		247,418
Plan net assets held in trust for pension benefits (see Schedule of Funding Progress)	**$**	**2,018,299**	$	1,948,248

See accompanying independent auditors' report and notes to financial statements.

Houston Police Officers' Pension System

Statements of Changes in Plan Net Assets ($000's)

Years ended June 30,		**2003**		2002
Contributions (Notes 1 and 3):				
City	**$**	**34,645**	$	32,645
Members		**24,008**		22,484
Total contributions		**58,653**		55,129
Investment income (loss):				
Net appreciation (depreciation) in fair value of investments		**37,084**		(232,652)
Interest:				
Short-term investments		**7,248**		2,049
Fixed income		**28,670**		35,629
Total interest income		**35,918**		37,678
Dividends		**12,659**		13,672
Alternative investments		**1,606**		2,361
Other income		**306**		541
Total investment income (loss)		**87,573**		(178,400)
Less – investment expense		**(6,992)**		(7,827)
Net income (loss) from investing activities		**80,581**		(186,227)
Securities lending activities (Note 2):				
Securities lending income		**914**		1,308
Securities lending expense		**(331)**		(453)
Net income from securities lending activities		**583**		855
Total additions (deductions)	**$**	**139,817**	$	(130,243)

Houston Police Officers' Pension System

Statements of Changes in Plan Net Assets ($000's)

Years ended June 30,		**2003**		2002
Deductions:				
Benefits paid to members	**$**	**65,649**	$	59,783
Refunds paid to members		**992**		1,194
Professional and administrative expenses		**3,125**		3,311
Total deductions		**69,766**		64,288
Net increase (decrease)		**70,051**		(194,531)
Plan net assets held in trust for pension benefits, beginning of year		**1,948,248**		2,142,779
Plan net assets held in trust for pension benefits, end of year	**$**	**2,018,299**	$	1,948,248

See accompanying independent auditors' report and notes to financial statements.

1. Plan Description and Contribution Information

General – The Houston Police Officers' Pension System (the System) was created in 1947 by an act of the fiftieth Legislature of the State of Texas, and is governed by Article 6243g-4, Vernon's Texas Civil Statutes (the Governing Statutes). The System is a single employer contributory defined benefit pension plan covering police officers employed full time by the City of Houston (the City) that provides for service, disability and death benefits for eligible members. The System is a local governmental plan and, therefore, is not subject to the Employee Retirement Income Security Act of 1974 (ERISA).

At June 30, 2003, the System's membership consisted of the following:

Description	Number
Retirees and beneficiaries:	
Currently receiving benefits	1,886
Not yet receiving benefits	7
Active members:	
Fully vested	1,745
Nonvested	3,628
Total members	7,266

Eligibility - Members become eligible to receive a service pension upon retirement with twenty years of service. Members also have the option to select a Delayed Retirement, which allows for vesting after ten years of service with a pension benefit payable at age 60.

Benefits - Retirement benefits are equal to 2.75 percent of the member's average total direct pay for each of the member's first twenty years of service plus two percent of average total direct pay for each year in excess of twenty years with no maximum percentage.

Retired members and surviving spouses are entitled to receive an additional $150 per month in order to defray group medical insurance costs.

Deferred Retirement Option Plan - The Deferred Retirement Option Plan (DROP) provides for an optional method of accruing pension benefits. Generally, members with at least twenty years of service are eligible to participate in the DROP and upon termination of employment participating members receive their pension benefit in the form of an annuity and a lump sum benefit. The annuity is the member's pension benefit at the time of enrollment in the DROP plus any subsequent cost of living adjustments. The lump sum benefit is the accumulated balance in the member's notional DROP account which is equal to an amount calculated as if the member's annuity, employee contributions and an interest component had been deposited in a separate account in the member's name during the member's participation in DROP.

A Back-DROP benefit is also available for all eligible participants. The DROP notional account may be recalculated based on a different entrance date selected by the member. The Back-DROP entry date cannot be prior to the latter of October 21, 1995 or the date the member attained 20 years of credited pension service.

DROP and Back DROP participants who terminate service receive the greater of the DROP or Back DROP monthly benefit, as applicable, or a recalculated monthly benefit amount. The recalculated monthly benefit amount is derived by multiplying the member's service percentage as of their DROP or Back DROP entrance date (plus any ad hoc increases in the multiplier) times the average total direct pay as of the member's termination (retirement) date from the Houston Police Department ("HPD").

Cost of Living Adjustments – Pension benefits and the monthly DROP benefits are adjusted each year equal to two-thirds of the percentage increase in the Consumer Price Index for all Urban Consumers for the preceding year subject to minimum and maximum increases of 3.0 percent and 8.0 percent, respectively.

Disability Benefits - Duty connected disability benefits are equal to the greater of fifty-five percent of average total direct pay or the accrued service pension. Disabled members who qualify for a Catastrophic Disability, as defined, receive a disability benefit equal to 100 percent of average total direct pay.

Members determined to be eligible for a non duty-connected disability benefit are entitled to a benefit of either 27.5% of average total direct pay, if the member has ten or fewer credited years of service, or 2.75% per year for credited service in excess of ten but less than twenty years.

Death Benefits - Death benefits are available to a surviving spouse, dependent children or a dependent parent in the event of the death of a member either after disability or service retirement, or prior to retirement.

Refunds of Member Contributions – A member with less than 20 years of credited pension service may elect to obtain a refund of member contributions upon termination of service with the HPD. This refund does not include interest. Members with at least ten but less than 20 years of credited pension service, who terminate service with the HPD, have the option of a Delayed retirement.

Delayed Retirement – A member with at least 10 but less than 20 years of credited pension service at termination of employment with the HPD has the option of either a refund of member contributions, without interest, or a Delayed retirement benefit. The Delayed benefit is payable at age 60 and is calculated at 2.75% of average total direct pay for each year of credited pension service.

Supplemental Monthly Benefit – In years in which certain investment performance and actuarial funding requirements are met the System issues a supplemental monthly benefit payment to retired members and a supplemental credit to DROP participant's accounts in an amount equal to their normal monthly benefit.

Lump Sum Benefit – Members retiring with a service or disability benefit receive a one-time $5,000 lump sum benefit.

Reciprocal Retirement Program – Members who have less than twenty years of service with the System but who have at least twenty years of cumulative service with the City are eligible to participate in the System's Reciprocal Retirement Program. This program allows members with less than twenty years of credited pension service with the System to combine their service credit with other City retirement systems. If the member has a cumulative twenty years of pension credit then they are eligible to receive a proportionate retirement benefit from the System.

Post Retirement Option Plan - The Post Retirement Option Plan ("PROP") allows retired members to contribute all or a portion of their monthly retirement benefit and DROP lump sum to a notional account maintained by the System which accumulates interest and can be disbursed to the member under certain options as designated by the System. Effective September 1, 2003 surviving spouses will be eligible to participate in PROP only to the extent of retaining the DROP or PROP account of their deceased spouse. Surviving spouses will not be eligible to contribute all or a portion of their survivor benefit to a PROP account.

2. Summary of Significant Accounting Policies

Basis of Presentation –As defined by generally accepted accounting principles established by the Governmental Accounting Standards Board (GASB) the accompanying financial statements include solely the accounts of the System, which include all programs, activities and functions relating to the accumulation and investment of the assets and related income necessary to provide the service, disability and death benefits required under the terms of the Governing Statutes and amendments thereto. The System is a component unit of the City only to the extent the System receives contributions equal to an amount or percentage of the total direct pay of active members in accordance with the Governing Statute.

Basis of Accounting - Basis of accounting is the method by which revenues and expenses are recognized in the accounts and are reported in the financial statements. The accrual basis of accounting is used for the System. Under the accrual basis of accounting, revenues are recognized when they are earned and collection is reasonably assured, and expenses are recognized when the liability is incurred. Member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the Governing Statute.

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

Dividend income is recorded on the ex-dividend date. Income from other investments is recorded when earned. Gains and losses on sales of securities are recognized on the trade date. The cost of investments sold is determined using the first-in, first-out cost flow method.

Statutes of the State of Texas authorize the System to invest surplus funds in a manner provided by the Government Code, Title 8, Subtitle A, Subchapter C. The System's investments have been categorized to indicate the level of risk assumed by the System at year-end.

Category one includes investments that are insured or registered, or for which the System or its agent in the System's name holds the securities. Category two includes investments which are uninsured and unregistered, with securities held by the counter party's trust department or agent in the System's name. Category three includes investments which are uninsured and unregistered, with securities held by the counter party, or by its trust department or agent but not in the System's name. The System's investments in the United States government securities and corporate bonds meet the criteria of Category one. All other investments are in Category three except for commingled funds and alternative investments, which, by their nature, are not required to be so categorized.

Short-term investments include funds held in the Northern Trust Short Term Investment fund (STIF) and commercial paper with maturities not exceeding one year. Fixed income investments include government securities such as Treasury securities, Federally sponsored agency issued discount notes, bonds, agency pass-through securities and collateralized mortgage obligations; US corporate bonds such as term bonds and asset backed securities; and foreign securities such as dollar denominated and non-dollar denominated issues of non-US governments and private corporations. Call options on fixed income securities give the holder the right but not the obligation to purchase US Treasury securities during the term of the option contract. The holder pays a premium for this right, which is carried as an asset of the System, subject to daily mark-to-market adjustments, during the contract term. The issuer of the option has an obligation to the holder to settle the option position in cash at the fair value of the underlying security in exchange for the price specified by the option, until the contract is exercised or expires. Equity securities consist of individual shares of equity securities plus units of commingled stock funds of both US and foreign entities. Alternative investments consist of investments in real estate and venture capital and private equity limited partnerships.

Securities Lending Program –

June 30,	Fair Value ($000's) **2003**	2002
Investments held by System's agent in System's name:		
Cash equivalent securities	**$ 144,313**	$ 150,851
Fixed income	**407,861**	417,902
Equities	**1,073,928**	1,004,228
Alternative investments	**187,936**	158,639
Foreign currency contracts	**536**	710
Securities lending collateral investment pool	**225,531**	221,455
	$ 2,040,105	$ 1,953,785
Investments held by brokers under securities loans with cash collateral:		
Fixed income	**$ 56,311**	$ 56,527
Equities	**154,047**	147,457
	$ 210,358	$ 203,984

The Board of Trustees' policies permit the System to lend securities (domestic and international equities and fixed income) to securities firms on a temporary basis through its custodian bank. The System receives fees for all loans and retains the right to all interest and dividend payments while the securities are on loan. Cash, letters of credit or various government securities having market values equal to or exceeding 102 and 105 percent of the value of the loaned securities for domestic and international securities, respectively, collateralize all security loan agreements. Whenever market value of the securities on loan changes, the borrower must adjust the collateral accordingly. At June 30, 2003, the System had no credit risk exposure to borrowers because the amounts the System owes the borrowers exceed the amounts the borrowers owe the System.

The System's bank pools all collateral received from securities lending transactions and invests any cash collateral. The System holds an undivided share of the collateral provided by the borrowers of the securities. At June 30, 2003 the weighted-average maturity of the collateral pool was 38 days. The relationship between the maturities of the collateral pool and the System's loans has not been determined. Cash collateral invested in the custodian bank collateral pool at June 30, 2003 and 2002, of $218,917 thousand and $210,808 thousand, respectively, is not classified by category of custodial credit risk. The balance of the collateral at June 30, 2003 and 2002, of $6,614 thousand and $10,647 thousand, respectively, consists of treasury securities and letters of credit and is classified in category one.

The System cannot sell or pledge the collateral unless the borrower fails to return the securities borrowed. The market value of securities on loan at June 30, 2003 and 2002 was $216,728 thousand and $214,090 thousand, respectively.

Derivatives – The System's investment managers may invest in derivatives if permitted by the guidelines established by the System's Board of Trustees. The System's staff monitors guidelines and compliance. From time to time the System's investment managers will invest in foreign currency contracts, options, swaps, reverse repurchase agreements, index linked bonds, collateralized mortgage obligations and mortgage-backed securities. No derivatives are purchased with borrowed funds.

The foreign currency contracts are used to hedge against the currency risk in the System's investments in foreign equity securities. The other derivatives are used to enhance yields and provide incremental income.

Futures on investments are used to take advantage of mis-pricing opportunities. When a position is taken in a futures contract, a margin is posted and the contract is subject to daily mark-to-market adjustments. To liquidate the contract prior to expiration an offsetting position in the same contract must be taken. At expiration the holder of the futures contract accepts delivery of the underlying asset at the agreed-upon price.

The average futures balance outstanding during the fiscal years ending June 30, 2003 and 2002 were $107,248 thousand and $28,973 thousand, respectively. Futures outstanding at June 30, 2003 and 2002 were $102,209 thousand and $119,587 thousand, respectively.

These derivative instruments are subject to the following risks:

- *Credit Risk* – The risk that the counterparty will not fulfill its obligations. The System's investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures.

- *Interest Rate Risk* – The risk that changes in interest rates will adversely affect the fair values of the System's financial instruments or cash flows.

- *Basis Risk* – The risk that arises when variable interest rates on a derivative and an associated bond or other interest-paying financial instrument are based on different indexes.
- *Termination Risk* – The risk that a derivative's unscheduled end will adversely affect an investment manager's strategy.
- *Rollover Risk* – The risk that a derivative associated with the System's fixed income investments does not extend to the maturity of those investments.

The contract or notional amounts of these instruments reflect the extent of the System's involvement in each class of financial instrument as of June 30, 2003 as follows ($000's):

Contracts	Description	Notional Value	Exposure
15	Futures on Treasury Bills and Equivalents	$ 5,704	$ –
21	Fixed Income Futures	96,505	–
1	Interest Rate Swap	(643)	(643)
1	Index Linked Government Bond	902	44
5	Reverse Repurchase Agreements	(8,140)	–
4	Fixed Income Options	80	–
96	Long foreign currency contracts	68,029	76
96	Short foreign currency contracts	(67,493)	461
		$ 94,944	$ (62)

Foreign Currency - The books and records of the System are maintained in US dollars. Foreign currencies and non-dollar denominated investments are translated into US dollars at the bid prices of such currencies against US dollars at each balance sheet date. Realized and unrealized gains and losses on investments which result from changes in foreign currency exchange rates have been included in the net depreciation in fair value of investments. Net realized foreign currency gains and losses resulting from changes in exchange rates include foreign currency gains and losses between trade date and settlement date of investment securities transactions, foreign currency transactions and the difference between the amounts of interest and dividends recorded on the books of the System and the amount actually received.

Administrative Costs –All administrative costs of the System are paid from the System's assets.

Cash – The System considers only demand deposits as cash. Short-term investments, classified on the balance sheet as "Investments", are composed of investments in short-term money market funds and commercial paper with maturities not exceeding one year and extended term money market funds with an average maturity not exceeding one year. Short-term investments meet the criteria of category three as described in paragraph one of Investments above.

As of June 30, 2003 and 2002, the System had a balance of $63 thousand and $65 thousand, respectively, on deposit at a financial institution. The Federal Depository Insurance Corporation covered cash on deposit up to $100 thousand at this financial institution. Cash on deposit with the System's custodian bank is collateralized by securities held in the custodian's name.

Federal Income Tax - A favorable determination that the System is qualified and exempt from Federal income taxes was received July 15, 2002. The Board believes that the System is designed and continues to operate in compliance with the applicable requirements of the Internal Revenue Code.

Use of Estimates – The preparation of the System’s financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make significant estimates and assumptions that affect the reported amounts and net plan assets at the date of the financial statements and the actuarial information included in the required supplementary information as of the benefit information date, the changes in the System’s net assets during the reporting period and, when applicable, disclosures of the contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

3. Contributions and Reserves

Contributions – Members are required to contribute 8.75% of their total direct pay to the System. Contributions are made on a pre-tax basis pursuant to Governing Statutes.

Employer contribution rates are established and may be amended by the System's Board of Trustees, based on the results of actuarial valuations. The contribution rates are determined based on the benefit structure established by the Board of Trustees. The contribution rate has been determined to provide for normal cost plus the level percentage of payroll required to amortize the unfunded actuarial accrued liability or surplus over thirty years (constant).

The City contributed $34,645 thousand for fiscal year 2003 as required in an agreement with the City agreement dated May 1, 2001, which was subsequently codified in the Governing Statute effective September 1, 2003. The City's actuarial contribution rate for the year ended June 30, 2003 was 20.5% percent. Pursuant to this agreement the City agrees its contribution rate will be as follows ($000s):

FYE	Amount
2004	$36,645
2005	16% of total direct pay (TDP)
2006 and thereafter	The greater of 16% of TDP or the actuarial determined rate

4. Commitments and Contingencies

As described in Note 1, certain members of the System are entitled to refunds of their accumulated contributions, without interest, upon termination of employment with the City prior to being eligible for pension benefits. At June 30, 2003 and 2002, aggregate contributions from these members of the System were approximately $239,852 thousand and $220,941 thousand, respectively. The portion of these contributions, which are refundable to members who may terminate with less than twenty years of service, has not been determined.

At June 30, 2003 and 2002, the total accumulated lump sum benefit due to DROP members was approximately $378,288 thousand and $309,461 thousand, respectively.

At June 30, 2003 and 2002, the total accumulated lump sum benefit due to PROP participants was $29,012 thousand and $14,793 thousand, respectively.

The System has outstanding commitments to various limited partnerships totaling $169,183 thousand and $186,205 thousand, as of June 30, 2003 and 2002, respectively.

Effective August 1, 1999 the System executed a five-year office lease renewal through July 31, 2004, at a monthly base rental of $15.6 thousand.

Houston Police Officers' Pension System

Required Supplementary Information (Unaudited)

Schedule of Funding Progress *($000's)*

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (Surplus) (UAAL) (b-a)	Funded Ratio (%) (a/b)	Projected Annual Covered Payroll (c)	UAAL as Percentage of Covered Payroll ((b-a)/c)
July 1, 1997	1,329,570	1,258,217	(71,353)	106	187,134	(38)
July 1, 1998	1,518,081	1,549,341	31,260	98	196,364	16
July 1, 1999	1,746,312	1,773,829	27,517	98	246,569	11
July 1, 2000	2,013,491	1,966,404	(47,087)	102	250,691	(19)
July 1, 2001	2,226,307	2,306,427	80,120	97	264,226	30
July 1, 2002	2,337,157	2,593,730	256,673	90	286,150	90

Schedule of Employer Contributions *($000's)*

Years Ended June 30,	Annual Required Contribution	Percentage Contributed	Annual Required Contribution as a Percentage of Pay
1999	30,645	100.0	16.8
2000	30,645	100.0	16.3
2001	30,645	100.0	16.3
2002	32,645	100.0	11. 3
2003	34,645	100.0	20.5
2004	36,645	100.0	24.4

See accompanying independent auditors' report.

Houston Police Officers' Pension System

Required Supplementary Information (Unaudited)

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

Valuation date	July 1, 2002
Actuarial cost method	Entry age
Amortization method	Level percent of payroll Amortization over a constant open period of 30 years
Remaining amortization period	30 years
Asset valuation method	5 year smoothed market
Actuarial assumptions:	
Investment rate of return	8.5%
Payroll growth rate:	
Attributable to inflation	4.0%
Attributable to merit increases	0.0% to 5.0%
Annual cost of living adjustment	3.0% to 8.0%

See accompanying independent auditors' report.

Houston Police Officers' Pension System

Schedule I - Investment, Professional and Administrative Expenses ($000's)

Year ended June 30,	2003	2002
Investment services	$ 6,992	$ 7,827
Professional services:		
Actuarial services	64	202
Auditing services	36	31
Election audit services	1	2
Legal services	28	50
Lobbyist services	97	80
Total professional services	226	365
Administrative expenses:		
Computers and technology	641	628
Education and due diligence	73	128
Fiduciary insurance	65	52
Office rent	198	191
Other office costs	1,922	1,947
Total administrative expenses	2,899	2,946
	$ 10,117	$ 11,138

See accompanying independent auditors' report.

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Year ended June 30, 2003

Type of Investment[1]	Market Value June 30, 2002	Purchases	Sales and Redemptions
Fixed income	$ 474,429	$ 235,655	$ (287,883)
Equity securities	1,151,685	1,418,504	(1,341,082)
Alternative investments	158,639	55,074	(13,973)
Short-term investments	150,851	340,510	(351,677)
	$ 1,935,604	$ 2,049,743	$(1,994,615)

		Sales	Deliveries
Foreign currency contracts	$ 710	$(1,130,582)	$ 1,126,988

[1]*Space and cost restriction make it impractical to print the entire investment portfolio in this report. A portfolio listing is available for review at the System's office.*

Houston Police Officers' Pension System

Schedule II - Summary of Investments (000's)

	Net Appreciation (Depreciation)	*Market Value June 30, 2003*
	$ 41,971	$ 464,172
	(1,132)	1,227,975
	(11,804)	187,936
	4,629	144,313
	$ 33,664	$ 2,024,396
	$ 3,420	536

See accompanying independent auditors' report

Houston Police Officers' Pension System

Schedule III - Summary of Investment and Professional Services ($000's)

Year ended June 30, 2003	Official System Position	Payments	Nature of Services
Abbott Capital Management	Consultant	$ 336	Consulting
The Northern Trust Company	Custodian	183	Custodian
American Express Asset Management	Money manager	387	Money management
Arnhold & S. Bleichroeder	Money manager	790	Money management
Ashmore Investment Management Ltd	Money manager	464	Money management
Barclays Global Investors	Money manager	542	Money management
Brandes Investment Partners	Money manager	985	Money management
Bridgewater Associates, Inc.	Money manager	387	Money management
Credit Suisse Asset Management	Money manager	279	Money management
Driehaus Capital Management, Inc.	Money manager	458	Money management
Gartmore Global Investments	Money manager	508	Money management
Loomis Sayles & Co.	Money manager	119	Money management
MacKay-Shields Financial Corp.	Money manager	250	Money management
The Northern Trust Company	Money manager	41	Money management
NWQ Investment Management Company	Money manager	483	Money management

Houston Police Officers' Pension System

Schedule III - Summary of Investment and Professional Services ($000's)

Year ended June 30, 2003	Official System Position		Payments	Nature of Services
Seneca Capital Management	Money manager	$	26	Money management
Shenkman Capital Management, Inc.	Money manager		285	Money Management
TT International	Money manager		489	Money Management
Towers Perrin	Actuary		64	Actuarial
BDO Seidman, LLP	Auditors		36	Auditing
Lawson, Fields, McCue, Lee & Campbell	Attorneys		28	Legal Service
Locke Liddell Sapp	Attorneys		97	Lobbyists
Bickley Prescott & Co.	Consultant		1	Election Auditing
Other	Other		41	Other
Subtotal			7,279	
Accrued at June 30, 2002			(1,676)	
Accrued at June 30, 2003			1,643	
Total investment and professional services		$	7,246	

See accompanying independent auditors' report.

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SECTION THREE

INVESTMENT SECTION

Responsibilities of the Board of Trustees

The primary fiduciary fiscal responsibility of the Board of Trustees is to insure that the retirement plan assets are responsibly managed in accordance with the actuarial needs of the System, and also with sound, generally accepted financial investment procedures. The determination of the appropriate asset mix is based on capital market assumptions, which incorporate historical and ex ante returns, volatility and correlation of various asset classes.

The Standard of Investment for the System in making investments is to exercise the judgment and care in the circumstances then prevailing which persons of prudence, discretion and intelligence exercise in the management of their own affairs. The Trustees' responsibility is to invest the System's funds solely in the interest of the membership and their beneficiaries, and for the exclusive purpose of providing benefits to the membership and their beneficiaries and defraying reasonable expenses of administering the System.

Investment Philosophy and Objectives

The Board of Trustees believes that the System's assets should be managed in a way that reflects the uniqueness of the System. The System's assets should be diversified over a spectrum of investment vehicles. Specifically, the Board recognizes and adheres to the following philosophical positions:

- Over the long term, the risk of owning equities has been, and should continue to be, rewarded with a somewhat greater return than that available from fixed income investments.
- Fixed income investments provide the System with an investment vehicle that contributes diversification, liquidity and a predictable stream of income, and that dampens volatility in investment returns.
- Diversification into alternative investments provides the System with an opportunity to enhance returns and to achieve broader diversification of the System's assets.

The long-term objectives established by the Board of Trustees are to achieve a real rate of return of 7.3 percent and a nominal rate of return of 9.5 percent.

Investment Strategy and Performance

Terrorism and the slow economy depressed the financial markets for the most part of the fiscal year 2003. Through March 31, 2003, the S & P 500 lost 13.13% and the MSCI EAFE tumbled 21.41%. However, the war with Iraq propelled the stock markets to higher ground since March 2003. The S & P 500 gained 15.39% in the June quarter while the EAFE rose 19.57%.

The System took advantage of the investment opportunities during the fiscal year. The S & P 500, representing the stock market reached a low in July 2002 since the second quarter of 1997, the System shifted $29.5 million from fixed income investment to domestic equity. Then in November 2002, the System moved $22 million from high yield investment to international equity as high yield investment exceeded the upper bound of the target range and the international equity touched a low since mid-1993.

The System's total investments posted a gain of 4.15% for the fiscal year, underperforming the composite benchmark return of 4.34% by 19 basis points or .19%. The poor relative performance was the result of underperformance in the high yield and alternative investment classes.

Domestic Equity

The equity markets posted heavy losses during the first nine months of the fiscal year. The markets finally started to rally in the last quarter; the Russell 3000 and the S & P 500 ended the year in positive territory with gains of .77% and .25% respectively. The System's domestic equity investments generated a return of 3.35%, well above the return on the benchmark. The outperformance was attributable to the superior performance of the majority of our managers. The fiscal year 2003 performance marked the fourth consecutive year the System's equity investment outperformed its benchmark.

International Equity

International equity markets experienced heavy losses during the first nine months of the fiscal year, and even a strong gain in the final quarter of 19.57% failed to erase the decline, thus resulting in a drop of 6.06% for the whole year. With the System's two international equity managers outperforming the benchmark, the System's international equity investments outperformed the EAFE with a negative return of 5.28% compared to a negative return of 6.06% on the EAFE.

High Yield

The high yield markets generated the highest return among all asset classes in the fiscal year ended June 30, 2003. The Citigroup High Yield Market Index rose 26.36%, however, the System's high yield investments generated a gain of only 17.71%. The majority of our high yield investments were in the higher quality securities among this asset class, which did not perform as well as the lower quality issues.

Fixed Income

Fixed income was another bright spot producing healthy returns during the 2003 fiscal year. The Lehman Brothers Aggregate Bond Index generated a return of 10.40%. Seneca Capital Management, a core plus fixed income manager, was terminated during the year and the account was converted to an enhanced fixed income index fund at Barclays Global Investors. Loomis Sayles & Co., another core plus fixed income manager, was also terminated. Funds raised from the liquidation of Loomis Sayles' account were directed to domestic equity for asset rebalancing purposes. The System's fixed income investments had a return of 15.07% for the fiscal year, thus outperforming the benchmark by 4.67%. Asset allocation within the fixed income investments and selection of managers accounted for the superior performance.

Alternative Investments

Alternative investments did not recover in value as fast as the public securities. The System's alternative investments posted a negative return of 3.74%, underperforming the benchmark return of 5.25%. The benchmark return is the sum of 5% and the return on the S & P 500.

Investment Summary

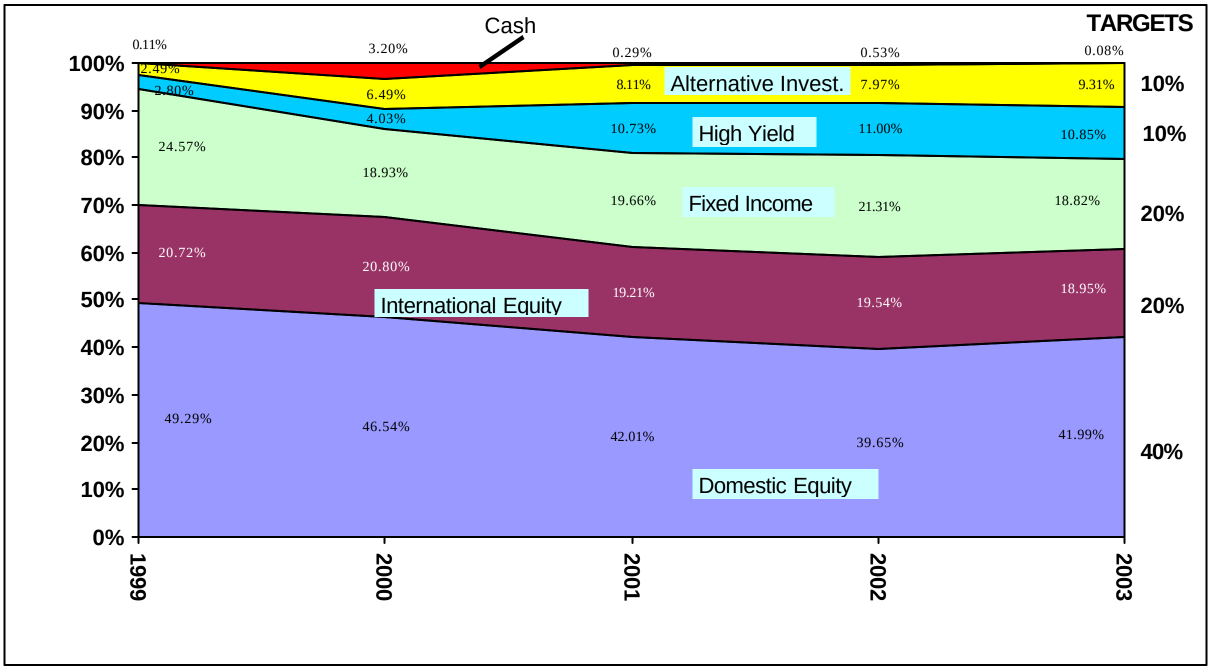
Type of Investment	$000's 2003	$000's 2002	Increase (Decrease) Amount	Increase (Decrease) Percentage
Fixed income	$ 464,172	$ 474,429	$ (10,257)	-2%
Equity securities	1,227,975	1,151,685	76,290	7%
Alternative investments	187,936	158,639	29,297	18%
Short-term investments	144,313	150,851	(6,538)	-4%
Subtotal	2,024,396	1,935,604	88,792	5%
Foreign currency contracts	536	710	710	-25%
Total	$ 2,024,932	$ 1,936,314	$ 89,502	5%

Space and cost restriction make it impractical to print the entire investment portfolio in this report. A portfolio listing is available for review at the System's office.

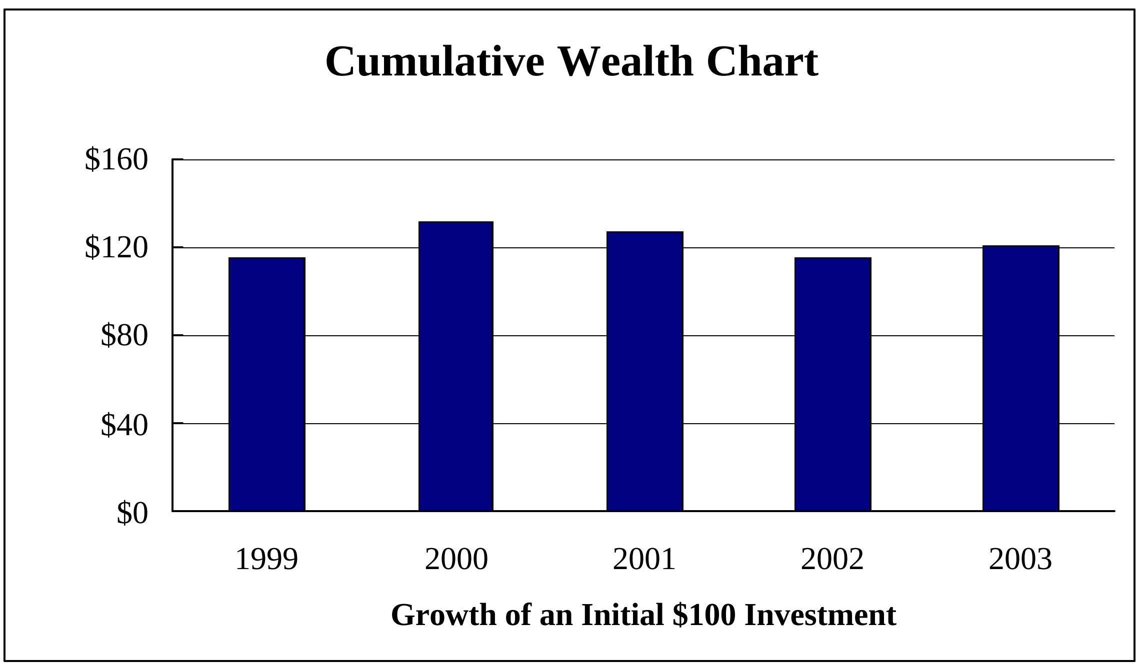
Report Preparation

This report was prepared by the Investment Department of the Houston Police Officers' Pension System.

Asset Allocation as of June 30



Historical Performance



Rates of Return by Year (%)
Years Ended June 30

Year	System Total	Composite Benchmark	Domestic Equity	Russell 3000	International Equity	MSCI EAFE	Fixed Income	Lehman Brothers Aggregate	High Yield	Citi-group HY	Alternative Investment
1999	15.0	13.1	16.4	20.1	25.1	8.0	3.5	3.1	8.9	0.3	7.7
2000	14.8	9.3	11.4	9.6	31.5	17.4	1.1	4.6	5.7	-1.5	54.8
2001	-4.0	-9.1	-3.9	-13.9	-14.1	-23.3	5.3	11.2	2.7	-1.2	-5.9
2002	-8.8	-8.8	-15.4	-17.2	-9.5	-9.2	7.1	8.6	3.0	-4.7	-20.8
2003	4.2	4.3	3.4	0.8	-5.3	-6.1	15.1	10.4	17.7	26.4	-3.7

Compound Annualized Rates of Return by Year (%)
Years Ended June 30, 2003

Years	System Total	Composite Benchmark	Domestic Equity	Russell 3000	International Equity	MSCI EAFE	Fixed Income	Lehman Brothers Aggregate	High Yield	Citi-group HY	Alternative Investment
2	-2.6	-2.6	-6.5	-8.7	-7.4	-7.7	11.0	9.5	10.1	9.8	-11.9
3	-3.0	-4.8	-5.6	-10.5	-9.7	-13.2	9.1	10.1	7.6	6.0	-10.2
5	3.8	1.0	1.7	-1.1	3.9	-3.7	6.3	7.5	7.5	3.3	-1.4
10	8.1	na	10.2	9.7	7.2	3.1	7.7	7.2	na	na	na

These calculations were prepared using a time-weighted rate of return in accordance with AIMR's Global Investment Performance Standards. Though these standards do not apply to plan sponsors per se, we have used them herein for purposes of presenting investment calculate rates of return.

Schedule of Ten Largest Domestic Equity Holdings
As of June 30, 2003

Shares	Description	Market Value ($000's)
409,000	Citigroup Inc	$ 17,505
369,500	Amphenol Corp	17,300
581,100	United Defense Industries	15,074
767,900	Cendant Corp	14,068
312,000	American Express	13,045
598,511	Tyco Intl	11,360
268,475	Interactive Corp	10,624
387,554	Microsoft Corp	9,925
218,647	ViaCom Inc	9,546
302,800	AnnTaylor Stores	8,766

Schedule of Ten Largest Non-U.S. Equity Holdings
As of June 30, 2003

Shares	Description	Market Value ($000's)
44,314	Nestle (Swiss)	$ 9,144
71,333	Zurich Financial (Swiss)	8,505
1,502,500	Hitachi Ltd (Japan)	6,369
381,800	Repsol YPF SA (Spain)	6,191
224,260	Posco (Korea)	5,873
335,210	ING Groep NV (Netherlands)	5,284
910,272	Jardine Matheson (Hong Kong)	5,598
477,970	Telefonica (Spain)	5,549
1,387	Nippon Telephone & Telegraph (Japan)	5,441
426,730	EADS (France)	5,234

A complete list of all individual holdings is available upon request.

Schedule of Ten Largest Domestic Fixed Income Holdings

As of June 30, 2003

Par Value	Description	Market Value ($000's)
1,550,000	Iron Mountain 8.625% due 4-1-2013	$ 1,659
1,500,000	Triad Hospitals 8.75% due 4-27-2005	1,596
1,500,000	Allied Waste Mgmt 10% due 8-1-2009	1,594
1,400,000	Ocean Energy 8.375% due 7-1-2008	1,465
1,250,000	Sinclair Broadcast 8.75% due 12-15-2011	1,372
1,250,000	Stone Container 9.75% due 2-1-2011	1,369
1,250,000	Ches Energy 8.125% due 4-1-2011	1,347
1,250,000	Simmons Co 10.25% due 3-15-2009	1,338
1,250,000	Canandaigua 8.5% due 3-1-2009	1,313
1,311,775	Cedar Brakes 9.875% due 9-1-2013	1,302

Schedule of Ten Largest Non-U.S. Fixed Income Holdings

As of June 30, 2003

Par Value	Description	Market Value ($000's)
12,930,000	Russian Federation Step-Up due 3-13-2030	$ 12,542
4,985,000	Brazil Federal 4% due 4-15-2014	5,361
13,000,000	Venezuela Republic Floating Rate 12-31-2007	4,443
3,485,000	UTD Mexican Sts 8.3% due 8-15-2031	4,013
4,005,000	Brazil Republic 11% due 8-17-2040	3,635
2,335,000	UTD Mexico 11.5% due 5-15-2026	3,500
2,500,000	Belgium Kingdom 7.75% due 10-15-2004	3,077
3,698,176	Uruguay Republic 7.5% due 3-15-2015	2,887
2,160,000	Colombia Republic 11.75% due 2-25-2020	2,675
3,930,000	Ecuador Republic Step-Up 8-15-2030	2,351

A complete list of all individual holdings is available upon request.

Schedule of Brokerage Commissions Paid

Domestic Trades - Ten Largest by Total Commissions Paid

For the year ended June 30, 2003

Brokers	Shares	Commissions	Principal	Commissions Per Share
Nueberger and Berman	23,298,640	$1,397,918	$630,078,208	$0.060
Arnhold & S. Bleichroeder	5,138,000	247,977	166,216,623	0.048
Wachovia Securities	3,880,500	215,849	227,369,047	0.056
Jefferies & Company	2,598,400	126,840	96,992,917	0.049
Smith Barney	2,263,950	114,671	59,991,475	0.051
Credit Suisse First Boston	1,913,287	105,829	55,605,897	0.055
Merrill Lynch	1,887,003	99,000	60,298,916	0.052
Lehman Brothers Inc	1,723,334	90,798	58,603,099	0.053
Morgan Stanley & Co	1,820,040	82,809	54,861,070	0.045
Bernstein, Sanford & Co	1,349,539	76,855	39,724,841	0.057

International Trades - Ten Largest by Total Commissions Paid

For the year ended June 30, 2003

Brokers	Shares	Commissions	Principal	Commissions In Basis Points
Credit Suisse First Boston	880,609	$80,421	$29,980,879	27.75
Merrill Lynch	557,029	68,228	39,403,873	17.32
Goldman Sachs & Co	6,716,907	65,020	36,434,623	17.85
Citigroup Global	342,024	51,479	27,168,822	18.95
Lehman Brothers International	879,932	50,765	26,956,182	18.83
UBS AG	206,690,465	48,851	26,847,628	18.20
Morgan Stanley & Co	353,408	43,490	22,787,580	19.08
JP Morgan	120,335	38,621	18,913,654	20.42
HSBC Investment Bank	306,929	35,450	19,501,213	18.18
Deutsche Bank	2,832,001	33,521	15,779,652	21.24

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SECTION FOUR

ACTUARIAL SECTION

Towers Perrin

Actuarial Certification

This report describes the results of an actuarial valuation of the Houston Police Officers Pension System. The Houston Police Officers Pension System retained Towers Perrin to perform this actuarial valuation for the purposes of determining the funding status for the plan year July 1, 2002 through June 30, 2003.

The consulting actuary is a member of the Society of Actuaries and other professional actuarial organizations and meets their “General Qualification Standard for Prescribed Statements of Actuarial Opinions” relating to pension plans.

In preparing the actuarial results, we have relied upon information provided by the Board of Trustees regarding plan provisions, plan participants, plan assets, and other matters. While the scope of our engagement did not call for us to perform an audit or independent verification of this information, we have reviewed this information for reasonableness but have not audited it. The accuracy of the results presented in this report is dependent upon the accuracy and completeness of the underlying information. Historical information for years prior to 1986 was prepared by the prior actuaries and was not subjected to our actuarial review.

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

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

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

The information contained in this report was prepared for the internal use of the Houston Police Officers Pension System and its auditors in connection with our actuarial valuation of the pension plan. It is neither intended nor necessarily suitable for other purposes.

Towers Perrin

Adam S. Berk

Adam S. Berk
ASA, CFA, EA, MAAA

January, 2004

Historical Unfunded Actuarial Accrued Liability (Surplus) ($000)

Valuation Date	Actuarial Accrued Liability (AAL)	Actuarial Value of Assets (AVA)	AVA as a Percentage of AAL	Unfunded AAL (Surplus)	Covered Payroll	UAAL (Surplus) as a Percentage of Covered Payroll
January 1, 1980	$ 301,585	$ 90,226	30%	$ 211,359	$ 58,169	363%
January 1, 1982	412,298	139,976	34	272,322	89,529	304
July 1, 1984	507,883	230,143	45	277,740	111,489	249
July 1, 1986	454,067	420,487	93	33,580	125,963*	27
July 1, 1987	488,387	505,483	104	(17,096)	126,960	(13)
July 1, 1988	524,894	516,177	98	8,717	121,667	7
July 1, 1989	581,681	585,358	101	(3,677)	122,803	(3)
July 1, 1990	663,278	676,684	102	(13,406)	126,665**	(11)
July 1, 1992	853,975	774,785	91	79,190	143,020	55
July 1, 1993	936,674	857,535	92	79,139	159,321	50
July 1, 1994	984,495	947,456	96	37,039	162,143	23
July 1, 1995	1,000,423	1,038,256	104	(37,833)	174,761	(22)
July 1, 1996	1,199,748	1,168,056	97	31,692	182,251	17
July 1, 1997	1,258,217	1,329,570	106	(71,353)	187,134	(38)
July 1, 1998	1,549,341	1,518,081	98	31,260	196,364	16
July 1, 1999	1,773,829	1,746,312	98	27,517	246,569***	11
July 1, 2000	1,966,404	2,013,491	102	(47,087)	250,691	(19)
July 1, 2001	2,306,427	2,226,307	97	80,120	264,226	30
July 1, 2002	2,593,730	2,337,157	90	256,573	286,150	90

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* Reflects the July 5, 1986 pay decrease.
** Reflects the November 1, 1990 pay increase.
*** Definition of covered payroll changed from base pay to total direct pay less overtime.

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Historical Solvency Test ($000)

	Actuarial Accrued Liability for:						
Valuation Date	Employee Contributions	Inactive Participants	Active Participants (City-Financed Portion)	Actuarial Value of Assets	Portion of Actuarial Accrued Liability Covered by Assets		
	(1)	(2)	(3)		(1)	(2)	(3)
July 1, 1987	$ 72,603	$ 164,367	$ 251,417	$ 505,483	100%	100%	100%
July 1, 1988	77,404	196,547	250,943	516,177	100	100	97
July 1, 1989	82,919	222,585	276,177	585,358	100	100	100
July 1, 1990	87,430	261,114	314,734	676,684	100	100	100
July 1, 1991	98,099	338,914	416,962	774,785	100	100	81
July 1, 1992	105,464	372,674	458,536	857,535	100	100	83
July 1, 1993	114,279	401,989	468,227	947,456	100	100	92
July 1, 1994	123,471	416,053	460,899	1,038,256	100	100	100
July 1, 1995	91,687	764,518	343,543	1,168,056	100	100	91
July 1, 1996	95,615	812,498	350,104	1,329,570	100	100	100
July 1, 1998	99,298	1,017,723	432,320	1,518,081	100	100	93
July 1, 1999	107,008	1,157,882	508,939	1,746,312	100	100	95
July 1, 2000	111,099	1,324,079	531,225	2,013,491	100	100	100
July 1, 2001	138,248	707,152	1,461,027*	2,226,307	100	100	95
July 1, 2002	145,255	718,779	1,729,696	2,337,157	100	100	85

* Prior to July 1, 2001 the Actuarial Accrued Liability for DROP Participants was included in the Inactive liability.

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Historical Active Participant Data

Valuation Date	Number of Participants	Average Age	Annual Covered Payroll ($000)	Average Annual Covered Payroll	Percentage Increase in Average Covered Payroll
January 1, 1976	2,622	N/A	$ 39,500	$ 15,066	39.9%
January 1, 1978	2,877	N/A	50,040	17,393	15.4
January 1, 1980	3,029	N/A	58,169	19,204	10.4
January 1, 1982	3,243	N/A	89,529	27,607	43.8
July 1, 1984	3,997	N/A	111,489	27,893	1.0
July 1, 1986	4,526	33.5	125,963(1)	27,831	(0.2)
July 1, 1987	4,494	34.4	126,960	28,251	1.5
July 1, 1988	4,239	35.0	121,667	28,702	1.6
July 1, 1989	4,105	35.7	122,803	29,915	4.2
July 1, 1990	4,073	36.2	126,665(2)	31,099	4.0
July 1, 1992	4,120	36.8	143,020	34,714	11.6
July 1, 1993	4,498	36.7	159,321	35,420	2.0
July 1, 1994	4,705	36.8	162,143	34,462	(2.7)
July 1, 1995	4,921	36.9	174,761	35,513	3.0
July 1, 1996(3)	4,395	35.1	150,903	34,335	(3.3)
July 1, 1997	4,282	35.5	149,631	34,944	1.8
July 1, 1998	4,247	35.9	153,479	36,138	3.4
July 1, 1999	4,253	36.3	187,967(4)	44,196(4)	22.3(4)
July 1, 2000	4,137	36.7	179,415	43,368	(1.9)
July 1, 2001(5)	5,325	40.2	264,226(6)	49,620(6)	14.4(6)
July 1, 2002	5,352	40.7	286,150	53,466	7.8

(1) Reflects the July 5, 1986 pay decrease.
(2) Reflects the November 1, 1990 pay increase.
(3) Includes those participants currently accruing benefits from the July 1, 1996 to July 1, 2000 valuation dates (excludes current DROP participants).
(4) Definition of covered payroll changed from base pay to total direct pay less overtime.
(5) Includes active participants eligible for DROP beginning July 1, 2001.
(6) Beginning July 1, 2001 the definition of total direct pay changed from the average of the last 26 pay periods to the highest bi-weekly pay period.

Inactive Participants Added to and Removed from Rolls

	Added to Rolls		Removed from Rolls		Rolls at the End of the Year		Percentage Increase in Annual Benefits	Average Annual Benefit
Period Ended	Number	Annual Benefits ($000)	Number	Annual Benefits ($000)	Number	Annual Benefits ($000)		
December 31, 1977	62	$ 520	18	$ 55	439	$ 2,979	15.1%	$ 6,785
December 31, 1978	66	779	13	80	492	3,653	22.6	7,425
December 31, 1979	68	845	12	126	548	4,370	19.6	7,974
December 31, 1980	73	1,120	19	123	602	5,389	23.3	8,951
December 31, 1981	81	1,191	17	184	666	6,499	20.6	9,759
December 31, 1982	104	1,106	24	240	746	7,842	20.7	10,513
December 31, 1983	82	967	35	362	793	8,931	13.9	11,262
June 30, 1984	53	779	18	150	855	4,760	6.6	11,095
June 30, 1985	83	1,141	42	259	896	10,166	6.8	11,346
June 30, 1986	44	530	37	431	903	10,939	7.6	12,114
June 30, 1987	42	585	36	421	909	11,321	3.5	12,455
June 30, 1988	138	2,668	25	243	1,022	14,069	24.3	13,766
June 30, 1989	89	1,349	46	502	1,065	16,127	14.6	15,142
June 30, 1990	105	1,811	29	457	1,141	18,029	11.8	15,801
June 30, 1992	222	4,662	75	1,127	1,288	22,999	27.6	17,857
June 30, 1993	105	2,012	16	205	1,377	25,474	10.8	18,500
June 30, 1994	106	2,172	64	953	1,419	27,286	7.1	19,229
June 30, 1995	107	2,425	48	847	1,478	29,464	8.0	19,935
June 30, 1996*	893	19,109	36	602	2,335	48,624	65.0	20,824
June 30, 1997	182	3,481	29	618	2,488	52,772	8.5	21,211
June 30, 1998	159	3,483	28	589	2,619	63,957	21.2	24,420
June 30, 1999	150	3,770	46	1,001	2,723	70,432	10.1	25,866
June 30, 2000	233	6,421	36	857	2,920	76,401	8.5	26,165
June 30, 2001**	131	3,755	1,250	33,892	1,801	54,006	(29.3)	29,987
June 30, 2002	104	2,809	46	1,113	1,859	55,013	1.9	29,593

* Includes DROP participants from June 30, 1996 through June 30, 2000

** Beginning July 1, 2001 excludes active participants eligible for DROP.

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Summary of Actuarial Methods and Assumptions

Actuarial Methods

Actuarial Value of Assets	Gains and losses in the market value of assets, based on the difference between the actual and the assumed rate of return, are recognized over five years.
Actuarial Cost Method	Entry Age Method with liabilities allocated from date of entry to assumed retirement age. The Unfunded Actuarial Accrued Liability (Surplus), including effects of actuarial gains and losses, is amortized as a level percentage of pay over 30 years. The contribution is increased for interest for one-half of a year to reflect timing of payments.

Economic Assumptions

Investment Return	8.5% per year, net of expenses
Payroll Growth Rate/Inflation	4.0% per year

Individual Merit Increase Rate

Age	*Increase*
20	5.00%
25	4.30
30	1.80
35	0.55
40	0.25
45	0.25
Over 50	0.00

Individual Pay Increase Rate	Inflation plus merit

Demographic Assumptions

Entry Age	Date sworn.
DROP Participation Rates	100% of active participants are assumed to elect the back DROP. Participants are assumed to elect the maximum duration for the back DROP, up to 20 years.
DROP Antiselection	DROP benefits are loaded by 1% to reflect possible antiselection of back DROP provisions

Retirement Rates

Number of Years of Service	*Probability of Retiring Within One Year*
20	15%
21 – 22	5
23	10
24 – 25	15
26 – 28	30
29 – 40	20
Over 40	100

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Summary of Actuarial Methods and Assumptions (cont.)

Mortality Rates	
< Active participants and nondisabled retirees	1994 Group Annuity Mortality Table (see table below for sample rates).
< Disabled retirees	1987 Commissioners Group Disabled Mortality Table (see table below for sample rates).
Disability Rates	Graduated rates (see table below for sample rates).
Percentage of Deaths and Disabilities in the Line of Duty	100%.
Termination Rates and Terminated Vested Pension Benefit Election	Graduated rates (see table below for sample rates). 50% of members eligible to receive a terminated vested pension are assumed to elect the pension at age 60 instead of a refund of contributions.
Marital Status at Benefit Eligibility	
< Percentage married	90%. (No beneficiaries other than the spouse assumed).
< Age difference	Husbands assumed to be three years older than wives.
Valuation Earnings	Pensionable earnings over the 12 months (26 pay periods) preceding the valuation date, increased for one-half year of assumed pay increases.

Sample Rates

Sample Rates per 100 Participants

	Nondisabled Mortality		Disabled Mortality (Ultimate)	Termination	Disability	
Age	**Male**	**Female**	**All**	**All**	**Male**	**Female**
20	0.05	0.03	0.00	4.44	0.00	0.00
25	0.07	0.03	0.00	3.99	0.00	0.00
30	0.08	0.04	2.82	3.02	0.08	0.12
35	0.09	0.05	2.82	1.92	0.10	0.16
40	0.11	0.07	2.82	0.92	0.14	0.22
45	0.16	0.10	2.82	0.21	0.21	0.30
50	0.26	0.14	2.82	0.00	0.37	0.54
55	0.44	0.23	2.82	0.00	0.79	1.08
60	0.80	0.44	3.14	0.00	2.15	2.86

Summary of Actuarial Methods and Assumptions (cont.)

Changes in Methods and Assumptions from July 1, 2000 to July 1, 2001

Investment return was assumed to be 9% per year (rather than 8.5%), net of expenses, to reflect minimum DROP crediting rates.

The Unfunded Actuarial Accrued Liability (Surplus) is amortized over 30 years, rather than to December 31, 2022.

The Entry Age Method allocating liabilities from date of entry to assumed DROP date was changed to allocate to date of actual retirement to reflect back DROP provisions.

The DROP participation was changed to assume all participants would elect back DROP for up to ten years to better reflect anticipated experience.

Changes in Methods and Assumptions from July 1, 2001 to July 1, 2002

Nondisabled mortality was changed from the 1983 GAM Mortality Table to the 1994 GAM Mortality Table to better reflect anticipated future experience.

DROP retirement benefits were loaded by 1% to reflect possible antiselection under back DROP provisions.

The assumed DROP duration was increased from 10 to 20 years to better reflect anticipated experience.

Summary of Plan Provisions

Covered Members	All police officers sworn before September 1, 1975 are covered under Plan 1, except those who elected by December 31, 1981 to participate in Plan 3. All police officers sworn on or after September 1, 1975, but before September 1, 1981 are covered under Plan 2, except those who elected by December 31, 1981 to participate in Plan 3 and those from Police Cadet Classes 70 and 71 who elected to transfer to Plan 1. All other police officers are covered by Plan 3, except those from Police Cadet Classes 70 and 71 who elected to pay additional contributions and transfer to Plan 1.
Final Compensation	
Prior to November 28, 1998	Monthly base salary paid to the participant in his/her last month of service. For any participant from a position held for less than 3 years, final compensation is the average monthly base salary for the 3 years prior to retirement.
After November 28, 1998 but prior to July 1, 2001	Monthly total direct pay less overtime paid to the participant in his/her last month of service. For any participant from a position held for less than 3 years, final compensation is the average monthly base pay for the 3 years prior to retirement plus the other current components of total direct pay.
After July 1, 2001	Highest biweekly pay period (excluding overtime) during the last 26 pay periods annualized. Amounts not paid on a biweekly basis are deducted from period paid. Annual amounts are divided by 26 and added to the highest pay period, including motorcycle allowances.
Service Retirement	
Eligibility	20 years of service.
Benefit:	
< Prior to November 1, 1955	\$75 per month plus \$2 per month for each year of service in excess of 25 years.
< After November 1, 1955 but prior to January 13, 1968	30% of final compensation plus 1% of final compensation for each year of service in excess of 20 years.

Summary of Plan Provisions (cont.)

< After January 13, 1968 but prior to July 1, 1986	Plans 1 and 2: 30% of final compensation plus 2% of final compensation for each year of service in excess of 20 years. Plan 3: 2% of final compensation for each year of service up to 40 years, reduced 0.42% for each month benefit commencement precedes age 55.
< After July 1, 1986 but prior to July 1, 1988	2% of final compensation for each year of service up to 40 years.
< After July 1, 1988 but prior to September 1, 1997	45% of final compensation plus 2% of final compensation for each year of service in excess of 20 years; maximum 80% of final compensation. Benefit based on prior formula is payable until July 1, 1991 and recomputed benefit is payable thereafter.
< After September 1, 1997 but prior to July 1, 2001	50% of final compensation plus 2% of final compensation for each year of service in excess of 20 years; maximum 80% of final compensation.
< After July 1, 2001	55% of final compensation plus 2% of final compensation for service in excess of 20 years. The Pension System recomputed the benefit of each person who retired before July 1, 2001. The retiree's benefit was increased by the result of multiplying the difference between 55% and the percentage used at the time of retirement in computing the retiree's benefit for the first 20 years of service by the base salary of the retiree at the time of retirement. Retroactive cost-of-living increases were not applied to the increased benefit. This recomputed benefit is effective for all payments on or after July 1, 2001.
Additional Benefits	An extra monthly benefit of $150.00 is payable for life. Effective November 28, 1998, a $5,000 lump sum is payable upon retirement.
Terminated Vested Pension Benefit	
Eligibility	More than 10 but less than 20 years of service. Termination on or after November 28, 1998.
Benefit	2.75% of final compensation times years of service. This benefit commences at age 60 or at termination of service if later.

Summary of Plan Provisions (cont.)

Deferred Retirement Option Plan (DROP)

Eligibility	20 years of service
Benefit:	
< After September 1, 1995 but prior to September 1, 1997	Eligible participants may elect to participate in the DROP until they leave active service. The member's retirement pension will be calculated based on service and earnings at the time the DROP is elected. A notional account will be maintained for each DROP participant. This account will be credited with the following amounts while the member is participant of the DROP: < The member's monthly retirement pension, including applicable cost-of-living adjustments, < The member's contribution to the Pension System, and < Investment earnings/losses at the rate of the Pension System's earnings/losses averaged over a five-year period. Effective July 1, 2001, this rate is subject to a minimum of 0%. A benefit equal to the DROP account balance is paid at the time the member leaves active service. The payment is made as a single lump sum. If a DROP participant suffers an on-duty disability resulting in the inability to perform his/her usual and customary duties as a police officer or dies in the line of duty, he (or his survivors) are allowed to revoke the DROP election and to receive the more generous on-duty disability or death benefits.
< After September 1, 1997 but prior to December 1, 1998	The Pension System recomputed the benefit of each person who entered the DROP before September 1, 1997. The benefit was increased in the same manner as the retiree's benefit.
< After December 1, 1998 but prior to July 1, 2001	The Pension System recomputed the benefit of each person who entered the DROP before December 1, 1998. The benefit was recalculated based on Total Direct Pay less overtime upon entry to the DROP. This recomputed benefit is effective for all payments on or after December 1, 1998.

Summary of Plan Provisions (cont.)

< After July 1, 2001	The Pension System recomputed the benefit of each person who entered the DROP before July 1, 2001. The member's benefit was increased by the result of multiplying the difference between 55% and the percentage used at the time of DROP entry in computing the member's benefit for the first 20 years of service by the base salary of the member at the time of DROP entry. Retroactive cost-of-living increases were applied to the increased benefit. The account balance for each participant was recomputed as if this new benefit had been effective since DROP entry.
Benefit Recalculation	Effective July 1, 2001, monthly benefit at retirement will be recalculated to be the greater of (i) current monthly benefit, or (ii) monthly benefit based on service at DROP entry and Final Compensation at retirement date.
Back DROP Option	Effective on July 1, 2001, a back DROP option is available for all eligible participants. The DROP account is recalculated under the option based on what the account balance would have been had the participant elected the DROP 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.
Postretirement Option Plan (PROP)	
Eligibility	Retired from DROP
Benefit:	
< After November 28, 1998 but prior to July 1, 2001	A retired member is allowed to leave all or a portion of their DROP account in the System. These accounts are credited every calendar year with the 30-year Treasury bond rate as of June of the preceding year.
< After July 1, 2001	The interest rate earned on PROP accounts will be the same as the interest rate credited to DROP accounts, including a minimum credited rate of 0%.

Summary of Plan Provisions (cont.)

Disability Retirement

Eligibility	Effective July 1, 2001, participant partially or totally disabled is eligible for Disability Retirement as defined below: < Total: Disability is defined as “unable to perform his/her usual and customary duties as a police officer”. < Partial: Disability is an impairment which renders the participant unable to work as a police officer and which is expected to last 12 months.
Benefit:	
< Duty-connected	Total: The service retirement benefit accrued to date of disability (or 20 years, if greater). Partial: 35% of final compensation is payable for life or as long as he remains incapacitated.
< Not duty-connected	Total or partial: The disability benefit is 2.75% of final compensation times years of service up to 20, minimum 27.5% of final compensation.
Additional benefits	An education allowance equal to 100% of final compensation less disability benefit is payable for up to four years for off-duty or duty-related disability. Proportionate members injured while on-duty as a municipal worker will receive immediate off-duty benefit upon Board approval.

Survivor Benefits

Eligibility	Surviving spouses and dependent children and parents of participants, including surviving spouses of retired or disabled participants who were not married at the time of retirement or disability, provided the spouse was married to the participant for at least 5 years at the time of death:
Benefit	Spouse’s benefit upon death before retirement:
< Prior to September 1, 1997	If duty-connected: Monthly lifetime benefit equal to 100% of final compensation at date of death. If not duty-connected: Monthly lifetime benefit equal to 100% of the service retirement benefit the participant had accrued at the time of death. Spouse’s benefit upon death after retirement monthly lifetime benefit equal to actual benefit payable at time of death.

Summary of Plan Provisions (cont.)

Dependent children's benefit if no surviving spouse, the benefit that would have been payable to the spouse is divided equally among the dependent children.

If there is a surviving spouse, the dependent children of Plan 1 and Plan 2 participants receive $25 per month. Dependent children include unmarried children who are under age 18, and for Plan 3, full-time students under age 22, or permanently disabled children.

Dependent parent's income if no surviving spouse or children, but there is a dependent parent, the benefit that would have been payable to the spouse will be paid to the dependent parent.

< After September 1, 1997 but prior to July 1, 2001

The Pension System recomputed the benefit of each survivor whose original benefit was computed prior to September 1, 1997. The benefit was increased in the same manner as the retiree's benefit.

< After July 1, 2001

The Pension System recomputed the benefit of each survivor whose original benefit was computed prior to July 1, 2001. The benefit was increased in the same manner as the retiree's benefit.

Additional benefits

Effective December 1, 1998, a $5,000 lump sum is paid upon the death of an active member.

Effective July 1, 2001, an extra monthly benefit of $150.00 is payable for life. Children receiving equivalent of the spouse's benefit do not receive this additional benefit.

Benefit Adjustments

Cost-of-living

Monthly benefits for participants receiving payments are increased each April 1 by 2/3 of the increase in the Consumer Price Index for All Urban Consumers (CPI-U) for the preceding calendar year. Effective September 1, 1997 this increase is subject to a minimum of 3.0% per year compounded and a maximum increase of 8.0% per year compounded.

Summary of Plan Provisions (cont.)

13th benefit check

Effective November 28, 1998, a 13th benefit check is paid to current retirees and DROP members when:

- The assets on the fund equal or exceed the liabilities after the 13th benefit check is paid.
- The return on investments for the preceding fiscal year exceeds 9.25%.
- The payment of the benefit will not cause the City of Houston's contribution to the System to increase.

Service Adjustments

Effective November 28, 1998, participants with previous service with the City in non-classified positions may use that service to satisfy the service requirement of 20 years for retirement purposes only.

Effective July 1, 2001, participants who have service credit in more than one City of Houston Pension Plan may use their combined service to qualify for DROP participation.

Effective July 1, 2001, participants involuntarily transferred to the System from the Houston Municipal Employees System will receive service under this plan for years worked while serving as a City Marshall, Airport Police or Park Police.

Contributions

Employee Contributions

Prior to December 1, 1998, each participant contributes 8.75% of base salary. After December 1, 1998, each participant contributes 8.75% of average total direct pay less overtime.

Refunds

Refunds of contributions are made if

(i) The participant dies before 10 years of service and the death is not duty-connected,

(ii) The participant dies with no eligible survivor,

(iii) A Plan 1 or 2 participant leaves service before eligibility for retirement after completing 5 years of service, or

(iv) A Plan 3 participant leaves service with less than 20 years of service.

Contributions are refunded without interest.

Summary of Plan Provisions (cont.)

Employer Contribution

The city will follow the following contribution schedule:

Fiscal Year Ending (June 30)	City Contribution Amount
2001	$ 30,645,000
2002	32,645,000
2003	34,645,000
2004	36,645,000
2005	16% of pay

For fiscal years ending after June 30, 2005 the City will contribute the greater of:

(i) 16% of pay

(ii) The actuarially determined rate.

Changes in Plan Provisions from July 1, 2000 to July 1, 2001 Valuation Dates

Eliminated service eligibility requirement for off-duty and survivor benefits.

Increased off-duty disability and survivor benefit to 2.75% of final compensation times service up to 20 years (minimum 27.5%).

Proportionate members injured while on duty as a municipal worker will receive immediate off-duty benefit upon Board approval.

Added an education allowance for up to four years for off-duty and duty-related disability retirement equal to 100% of final compensation less the disability benefit payable.

Added a “back DROP” option for current active and DROP members.

Increased monthly retiree insurance stipend from $88.05 to $150.00 per month.

Increased benefit accruals for service less than or equal to 20 years from 50% of final compensation to 55% of final compensation. Benefit increases to retirees exclude COLA adjustment.

Reset city contribution schedule.

The monthly benefit for DROP members will be recalculated at retirement to be the greater of

(i) The current monthly benefit or

(ii) Recalculated benefit based on service at DROP entry and Total Direct Pay at retirement.

Changed the interest rate earned on PROP accounts from the 30-year treasury rate to the 5-year average return earned by the Pension System. The credit rate for both DROP and PROP will be greater than or equal 0.0%.

Members who have service credit in more than one City of Houston Pension Plan may use their combined service to qualify for DROP participation.

Summary of Plan Provisions (cont.)

Members involuntarily transferred to the System from the Houston Municipal Employees System will receive service under this plan for years worked while serving as a City Marshall, Airport Police or Park Police.

Changed the definition of Total Direct Pay from the average of the last 26 pay periods to the highest bi-weekly pay period during the last 26 pay periods, annualized. Also, include motorcycle allowance in definition of Total Direct Pay.

Changes in Plan Provisions from July 1, 2001 to July 1, 2002

The plan provisions were not changed.

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SECTION FIVE

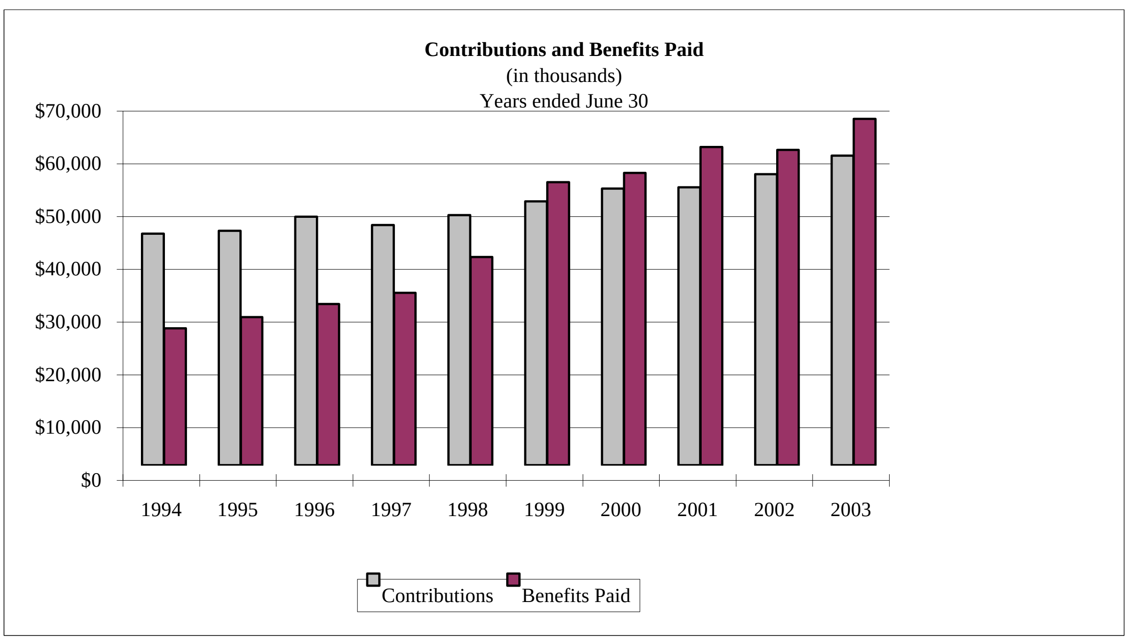
STATISTICAL SECTION

Schedule of Revenue by Source and Expenses by Type

(000's)

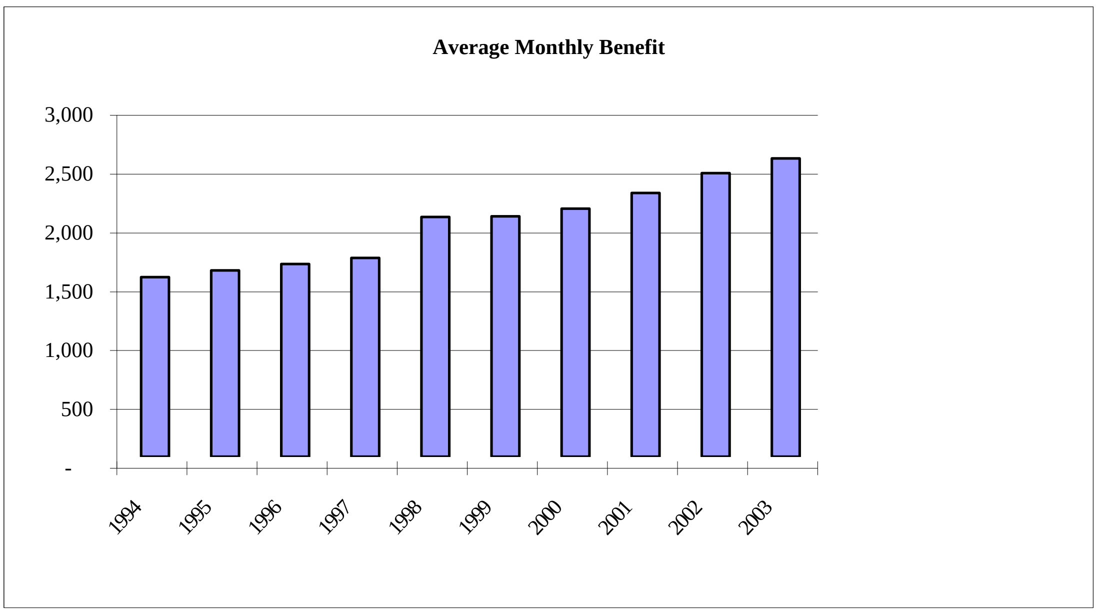
For years ended June 30

Fiscal Year	Member Contributions	City Contributions	Investment Income (Loss)	Total Additions (Deductions)	Benefits Paid	Administrative Expenses	Refunds	Total Deductions	Net Increase (Decrease)
1994	$ 13,895	$ 29,980	$ 12,362	$ 56,237	$ 25,961	$ 619	$ 629	$ 27,209	$ 29,028
1995	14,498	29,929	111,194	155,621	28,061	885	744	29,690	125,931
1996	15,533	31,562	186,111	233,206	30,552	886	829	32,267	200,939
1997	16,012	29,503	216,567	262,082	32,676	1,272	946	34,894	227,188
1998	16,832	30,564	214,448	261,844	39,440	1,166	986	41,592	220,252
1999	19,347	30,645	251,412	301,404	53,626	1,678	1,127	56,431	244,973
2000	21,761	30,645	292,603	345,009	55,421	2,216	1,545	59,182	285,827
2001	22,043	30,645	(80,232)	(27,344)	60,328	2,854	884	64,066	(91,410)
2002	22,484	32,645	(185,372)	(130,243)	59,783	3,311	1,194	64,288	(194,531)
2003	24,008	34,645	81,164	139,817	65,649	3,125	992	69,766	70,051

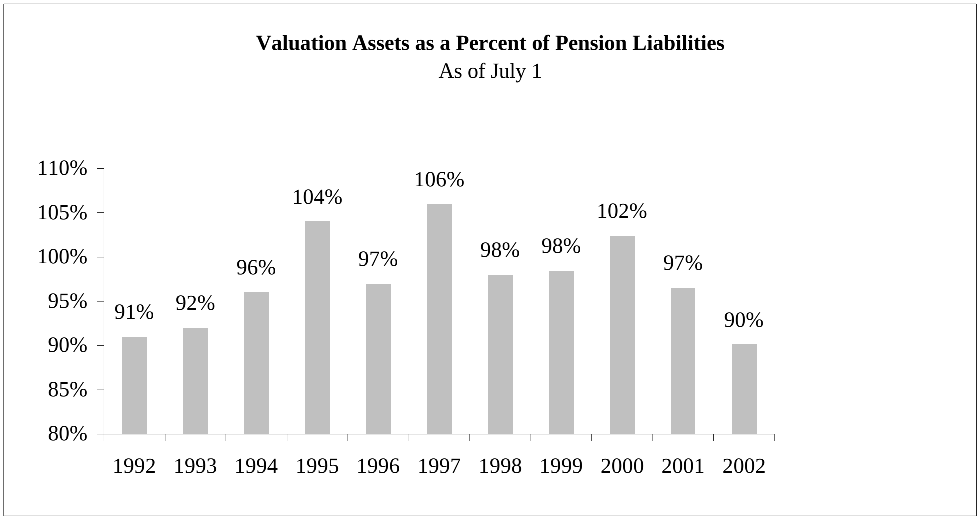


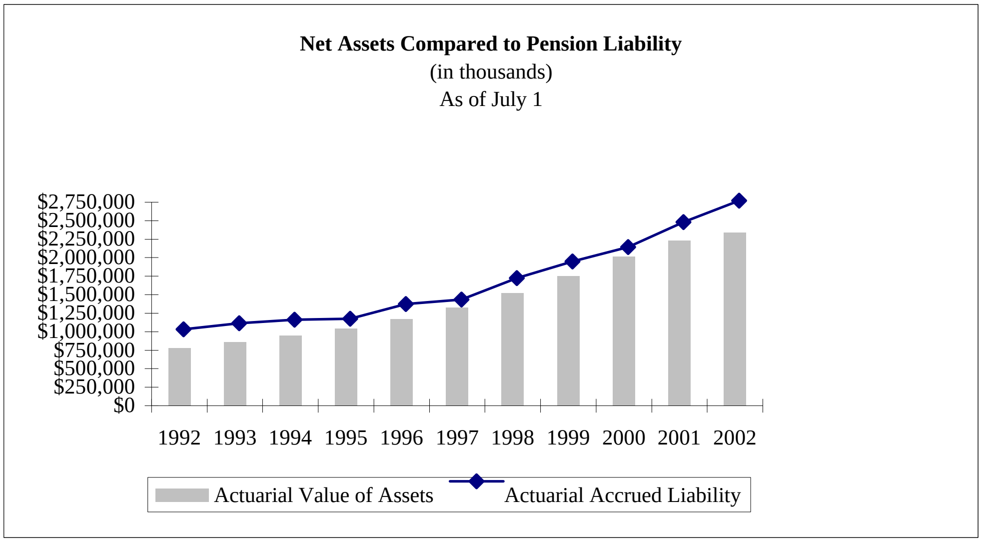
Average Monthly Benefit
Years Ended June 30,

Year	Retirees and Beneficiaries at Year End	Total Benefits Paid	DROP Distributions	PROP Distributions	Average Monthly Benefit	
1994	1,419	25,960,618	-		1,525	
1995	1,478	28,061,493	-		1,582	
1996	1,548	30,415,628	136,791		1,637	
1997	1,582	32,042,856	633,520		1,688	
1998	1,614	39,440,091	1,801,464		2,036	
1999	1,658	48,676,297	4,948,733		2,043	*
2000	1,723	47,401,683	8,019,553		2,108	*
2001	1,786	51,864,507	8,366,211	97,000	2,242	*
2002	1,864	54,172,009	4,262,647	1,348,270	2,410	*
2003	1,886	57,393,030	5,441,178	2,814,643	2,534	*



* The Average Monthly Benefit has been computed by deducting, from Total Benefits Paid, the amounts attributable to the $5,000 lump sum payments and the "13th" check, where applicable.


Valuation Assets as a Percent of Pension Liabilities
As of July 1
110%
105%
100%
95%
90%
85%
80%
91%
92%
96%
104%
97%
106%
98%
98%
102%
97%
90%
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002


Net Assets Compared to Pension Liability
(in thousands)
As of July 1
$2,750,000
$2,500,000
$2,250,000
$2,000,000
$1,750,000
$1,500,000
$1,250,000
$1,000,000
$750,000
$500,000
$250,000
$0
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
Actuarial Value of Assets
Actuarial Accrued Liability

STATISTICAL SECTION

Pensions Awarded by Type and by Age

Year Ended June 30, 2003

		Type of Pension		
Age on June 30,	Total	Service	Disability	Survivor
Under 40	3	1	-	2
40-44	7	6	1	-
45-49	21	17	-	3
50-54	14	14	-	1
55-59	16	13	3	-
60-64	7	7	-	-
65-69	2	2	-	-
70-74	-	-	-	-
75 and over	-	-	-	-
Total	70	60	4	6

Pensions in Force by Type and by Age

June 30, 2003

		Type of Pension		
Age on June 30,	Total	Service	Disability	Survivor
Under 40	34	9	1	24
40-44	123	99	10	14
45-49	282	254	4	24
50-54	374	343	-	31
55-59	347	273	29	45
60-64	209	160	4	45
65-69	179	112	5	62
70-74	136	73	11	52
75-79	107	41	1	65
80-84	63	15	-	48
85 and over	32	2	-	30
Total	1,886	1,381	65	440

Pensions Awarded by Type and by Monthly Amount

Year Ended June 30, 2003

		Type of Pension		
Monthly Amount	Total	Service	Disability	Survivor
Under $1000	2	-	-	2
$1,000-1,500	1	-	1	-
$1,500-2,000	1	-	1	-
$2,000-2,500	25	22	2	1
$2,500-3,000	16	16	-	-
$3,000 and over	25	22	-	3
Total	70	60	4	6

Benefit Expenses by Type
(dollars in thousands)
Years ended June 30,

Year	Service Retirement	Disability	Survivor	Children	DROP Distributions	PROP Distributions	Total Benefits Paid
1999	$ 39,057	$ 997	$ 8,555	$ 68	$ 4,949	$ -	$ 53,626
2000	36,984	1,179	9,149	89	8,020	0	55,421
2001	38,078	1,608	12,077	102	8,366	97	60,328
2002	40,510	1,869	11,695	98	4,263	1,348	59,783
2003	42,608	1,968	12,730	87	5,441	2,815	65,649

DROP Activity
(dollars in thousands)
Years ended June 30

	DROP Accounts			DROP Participants		
Year	Accumulations	Distributions	Total	Entrants	Withdrawals	Total
1999	$ 40,262	$ (4,949)	$ 100,938	115	(56)	1,066
2000	51,892	(8,020)	144,810	179	(56)	1,189
2001	104,753	(8,366)	241,197	155	(52)	1,292
2002	72,527	(4,263)	309,461	210	(73)	1,429
2003	74,343	(5,441)	378,363	277	(10)	1,696

Note: DROP Activity data for 2001 has been restated for the effect of the recalculation of DROP accounts pursuant to the 2001 Meet and Confer Agreement with the City of Houston.

PROP Activity
(dollars in thousands)
Years ended June 30

	PROP Accounts			PROP Participants		
Year	Accumulations	Distributions	Total	Entrants	Withdrawals	Total
1999	-	-	-	-	-	-
2000	385	-	385	7	-	7
2001	918	(97)	1,206	7	-	14
2002	14,935	(1,348)	14,793	94	(1)	107
2003	17,034	(2,815)	29,012	48	(2)	153

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