HPOPS

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Comprehensive Annual Financial Report

A Component Unit of

The City of Houston, Texas

July 1, 2003 through

June 30, 2004

HOUSTON POLICE OFFICERS' PENSION SYSTEM
John E. Lawson, Executive Director
602 Sawyer, Suite 300
Houston, TX 77007
713.869.8734
713.869.7657 Fax
www.hpops.org

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SECTION ONE

INTRODUCTORY SECTION

December 6, 2004

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, 2004 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, Management's Discussion and Analysis, 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 $2.4 billion and offers a variety of pension benefits to members and their beneficiaries. Members have the option to 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 to ensure our pension benefits are secure now and in the future. On June 30, 2004 the System filed suit against the City of Houston seeking to compel the City to adhere to the statutory funding requirements in an agreement with the City dated May 1, 2001, which was subsequently codified in the Governing Statute effective September 1, 2003. This action was prompted by the fact that the City adopted a budget for the City of Houston for fiscal year 2005 that failed to appropriate the statutorily mandated 16% of the member's total direct pay. The System at the same time was negotiating with the City regarding pension benefits, and on September 29, 2004 the System and the City entered into an agreement (the New Agreement) that altered the benefit structure of the System and the statutorily required contributions due from the City to the System. The agreement protects members' benefits while controlling costs for the City, ensuring our benefits will be secure now and in the future.

As a part of our on-going due diligence, we periodically take 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.

HOUSTON POLICE OFFICERS' PENSION SYSTEM
602 Sawyer, Suite 300
Houston, TX 77007
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800.874.0454
713.869.7657 Fax
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We have continued to put communication with our members as a high priority. Our financial planner has conducted twenty-four seminars, for which 300 of our members have been able to claim continuing education credit through TCLEOSE. In addition, he has met with and personally counseled 650 members and answered over 2,000 phone calls 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.

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 21.65% in 2004, which was an increase over the positive return of 4.15% in 2003. This increase is primarily due to the strong performance of foreign and domestic 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 2004 mainly due to active officer pay increases.

	$000's		Increase (Decrease) Amount	Increase (Decrease) Percentage
	2004	2003		
Member contributions	$ 26,393	$ 24,008	$ 2,385	10%
Employer contributions	36,645	34,645	2,000	6%
Net investment gain/(loss)	437,748	80,785	356,963	442%
Total	$ 500,786	$ 139,438	$ 361,348	259%

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
	2004	2003		
Benefits paid to members	$ 92,697	$ 65,649	$ 27,048	41%
Refunds paid to members	852	992	(140)	-14%
Administrative expenses	2,768	2,746	22	1%
Total	$ 96,317	$ 69,387	$ 26,930	39%

Total benefits paid, which include lump sum payments, increased in 2004 as compared to 2003 due mainly to a significant number of new retirees who left service to take advantage of the April 2004 pay raise which resulted in increased monthly benefits of 15 percent or more for many retiring members. In addition, there was a significant increase in distributions from DROP and PROP lump sum accounts by retiring and retired members due to concerns about the System's funded status.

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.

	2004		2003	
	$000's	%	$000's	%
Short-term investments	$ 222,763	9%	$ 144,313	7%
Fixed income	423,282	17%	464,172	23%
Equity securities	1,556,154	64%	1,227,975	61%
Alternative investments	217,644	9%	187,936	9%
Foreign currency contracts	1,253	0%	536	0%
Total	$ 2,421,096	100%	$ 2,024,932	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.

The past year has seen the economy growing steadily, which resulted in strong growth in the equity markets, both domestic and international, during the first half of the year. The System's investment returns grew 17.2% during this period. The second half of the year saw the Federal Reserve begin slowly raising interest rates, which along with other economic factors had a dampening effect on the economy's growth, but the System still saw its investment return grow an additional 4.4%. The Board firmly believes that by maintaining a disciplined investment approach and with reasonable diversification, the System will meet its long-term investment goals.

Accounting System and Internal Controls

The financial statements and related information included in the financial section of this report are the responsibility of the Board of Trustees and management of the System. The financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) and presented in accordance with the Governmental Accounting Standards Board (GASB). The System adopted GASB Statement No. 34, as amended, in 2002. The System's independent auditors have audited the financial statements, and their report is included herein.

In developing and evaluating the System's accounting system, the adequacy of internal accounting controls is a primary concern. The System's controls are designed to provide reasonable assurance regarding the safekeeping of assets and the reliability of financial records. These controls include strategic design of the System's business and accounting systems, the appropriate segregation of duties and responsibilities, sound practices in the performance of those duties, capable personnel, and the structure of the organization.

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, 2004, the System has an unfunded actuarial accrued liability of $535 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 10 of this report. The actuarial report, certified by Towers Perrin, is included on page 48.

Certificate of Achievement

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Houston Police Officers' Pension System for its comprehensive annual financial report for the fiscal year ended June 30, 2003. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. Such a report must also satisfy both GAAP and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The System has received a Certificate of Achievement for the last 10 consecutive years (fiscal years 1994-2003). We believe our current report continues to conform to the Certificate of Achievement program requirements, and we will be submitting it to the GFOA.

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 6, 2004

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

The Houston Police Officers' Pension System is pleased to bring you the 2004 Comprehensive Annual Financial Report. This report provides a comprehensive picture of HPOPS' finances for the year fiscal year ending June 30, 2004, 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.

As the economy and financial markets have continued to improve, HPOPS has continued to responsibly manage the System's assets, resulting in significant improvement in the HPOPS investment returns as compared to the previous year. It is the job of the HPOPS Board and Staff to remain visionaries, undaunted by the short-term market changes. At HPOPS we strive to be 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. Even though we seem to have pulled out of rough economic waters, it is important to realize that our focused investing with a long-term vision is what will continue to steer our System through 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

HOUSTON
POLICE OFFICERS'
PENSION SYSTEM
602 Sawyer, Suite 300
Houston, TX 77007
713.869.8734
800.874.0454
713.869.7657 Fax
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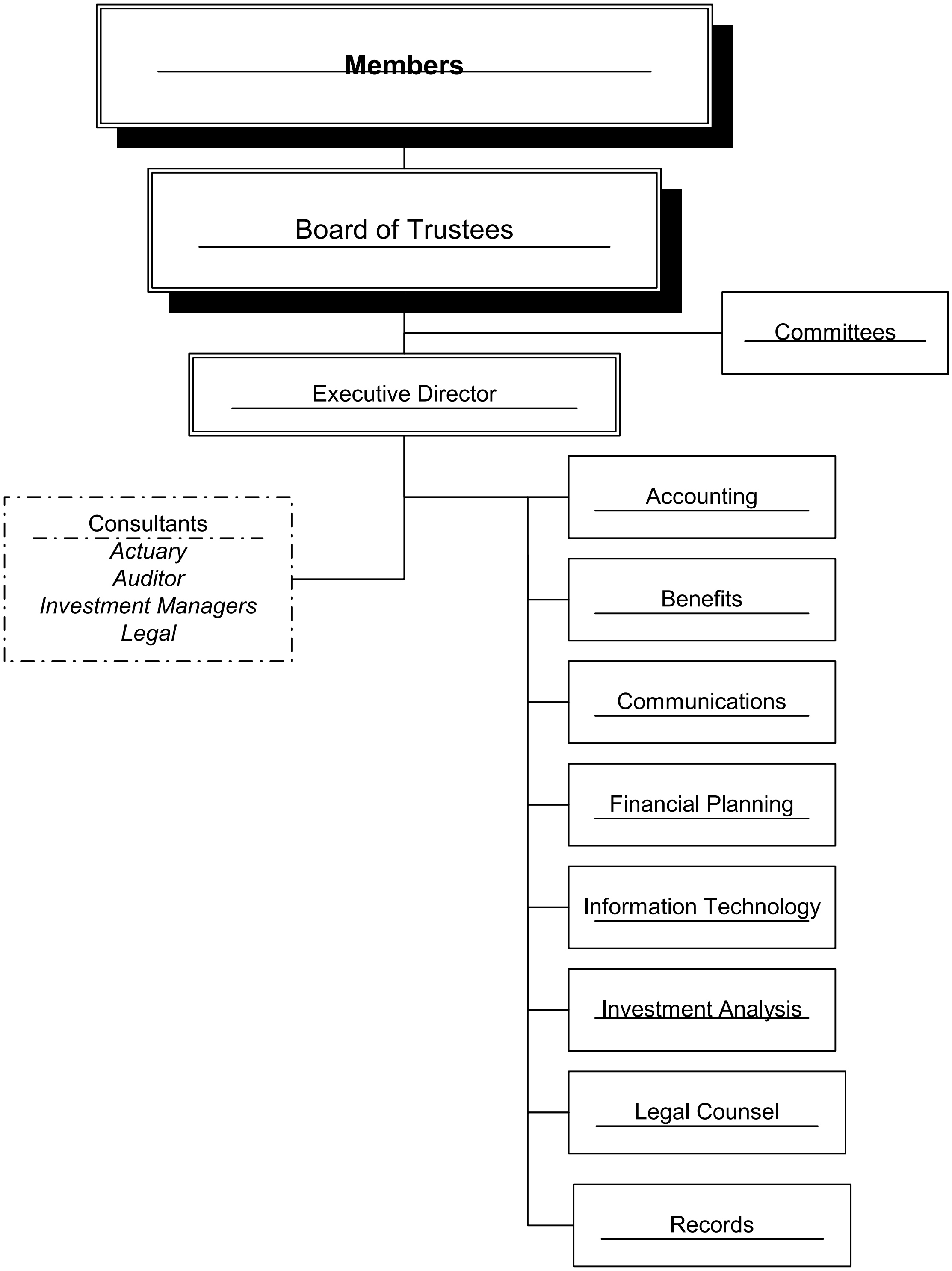
BOARD OF TRUSTEES AND ADMINISTRATIVE STAFF

ORGANIZATION CHART



See Page 36 – 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, 2003

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
Fax: (713) 659-3238

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, 2004 and 2003, 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, 2004 and 2003, 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 and II on pages 35 through 37, 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.

As discussed in Note 7, Subsequent Events, to the financial statements, on September 29, 2004 the System and the City of Houston (the City) entered into a new agreement which significantly changed the benefit structure of the System and the required contributions due from the City. Under the new agreement, the City is not funding the system based on actuarially computed contributions. Accordingly, the System may experience a larger unfunded actuarial accrued liability than the amount currently projected. The ability of the City to fund this increased obligation will depend on the various issues as discussed in Note 7, Subsequent Events.

BDO Seidman, LLP

October 27, 2004

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, 2004, 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, required supplementary information and other schedules, 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) 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, 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,		**2004**		2003
Assets				
Investment at fair value	**$**	**2,421,096**	$	2,024,932
Invested securities lending collateral		**348,478**		225,531
Receivables		**37,458**		17,093
Cash		**70**		63
Total assets		**2,807,102**		2,267,619
Liabilities and Plan Net Assets				
Due to brokers	**$**	**33,093**	$	21,823
Securities lending collateral		**348,478**		225,531
Accrued professional fees		**2,483**		1,643
Other liabilities		**280**		323
Total liabilities		**384,334**		249,320
Plan net assets held in trust for pension benefits	**$**	**2,422,768**	$	2,018,299

See accompanying independent auditors' report.

The System's net assets increased by approximately $404,469 thousand in fiscal year 2004 over 2003 primarily due to strong performance in foreign and domestic equity markets. The System experienced a positive investment return of 21.6 % in 2004 as opposed to positive 4.1% in 2003. The first six months of the 2004 fiscal year produced a return of 17.2% and accounted for the majority of the positive 2004 return. These investment returns can be seen in the Investment income (loss) figures in the accompanying chart. 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:	**2004**	2003	2002
Contributions:			
City	**$ 36,645**	$ 34,645	$ 32,645
Members	**26,393**	24,008	22,484
Total contributions	**63,038**	58,653	55,129
Investment income (loss)	**437,007**	80,202	(186,657)
Net income from securities lending activities	**741**	583	855
Total additions (deductions)	**500,786**	139,438	(130,673)
Deductions:			
Benefits paid to members	**92,697**	65,649	59,783
Refunds paid to members	**852**	992	1,194
Professional and administrative expenses	**2,768**	2,746	2,881
Total deductions	**96,317**	69,387	63,858
Net increase (decrease)	**404,469**	70,051	(194,531)
Plan net assets held in trust for pension benefits, beginning of year	**2,018,299**	1,948,248	2,142,779
Plan net assets held in trust for pension benefits, end of year	**$ 2,422,768**	$ 2,018,299	$ 1,948,248

See accompanying independent auditors' report.

The City, in a contract approved in fiscal year 2001, agreed to an annual increase in its contribution of $2,000 thousand 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 City contributions for the years ended June 30, 2004 and 2003.

Total benefits paid, which includes lump sum payments, increased by approximately $27,048 thousand or 41 percent in 2004 as compared to 2003 due to a significant number of new retirees who left service to take advantage of the April 2004 pay raise which resulted in increased monthly benefits of 15 percent or more for many retiring members. In addition, there was a significant increase in distributions from DROP and PROP lump sum accounts by retiring and retired members due to concerns about the System's funded status as discussed in Note 4.

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.

The in-house costs of operating the System's investment department have been classified as a component of Investment income in the accompanying summary of the Statements of Changes in Plan Net Assets. Amounts in 2003 and 2002 have been reclassified to be consistent with this presentation.

System Highlights

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

The System's funded ratio pursuant to its most recent actuarial valuation dated July 1, 2003 was 83% representing an unfunded actuarial accrued liability of $480,327 thousand.

On June 30, 2004 the System filed suit against the City of Houston seeking to compel the City to adhere to the statutory funding requirements as outlined in Note 3. This legal action is based upon the fact that the City adopted a budget for the City of Houston for fiscal year 2005 that fails to appropriate the statutorily mandated 16% of the member's total direct pay. See Notes 4 and 5 for a discussion of the System's funded status and related litigation and see Note 7 for a discussion of an agreement reached by the System and the City subsequent to June 30, 2004 that alters the benefit structure for all members and provides for a series of cash payments to be made to the System in lieu of actuarially required contributions.

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.

Statements of Plan Net Assets ($000's)

June 30,		**2004**		2003
Assets				
Investments, at fair value (Note 2):				
Short-term investments	**$**	**222,763**	$	144,313
Fixed income		**423,282**		464,172
Equity securities		**1,556,154**		1,227,975
Alternative investments		**217,644**		187,936
Foreign currency contracts		**1,253**		536
Total investments		**2,421,096**		2,024,932
Invested securities lending collateral (Note 2)		**348,478**		225,531
Receivables:				
Members		**927**		333
Investments		**8,505**		7,597
Due from brokers		**27,986**		9,081
Other receivables		**40**		82
Total receivables		**37,458**		17,093
Cash		**70**		63
Total assets	**$**	**2,807,102**	$	2,267,619

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

Statements of Plan Net Assets ($000's)

June 30,		**2004**		2003
Liabilities and Plan Net Assets				
Liabilities:				
Due to brokers	**$**	**33,093**	$	21,823
Securities lending collateral (Note 2)		**348,478**		225,531
Accrued investment and professional fees		**2,483**		1,643
Other liabilities		**280**		323
Total liabilities		**384,334**		249,320
Plan net assets held in trust for pension benefits (see Schedule of Funding Progress)	**$**	**2,422,768**	$	2,018,299

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,		**2004**		2003
Contributions (Notes 1, 3 and 7):				
City	**$**	**36,645**	$	34,645
Members		**26,393**		24,008
Total contributions		**63,038**		58,653
Investment income:				
Net appreciation in fair value of investments		**401,591**		37,084
Interest:				
Short-term investments		**2,071**		7,248
Fixed income		**27,406**		28,670
Total interest income		**29,477**		35,918
Dividends		**15,897**		12,659
Alternative investments		**1,598**		1,606
Other income		**333**		306
Total investment income		**448,896**		87,573
Less – investment expense		**(11,889)**		(7,371)
Net income from investing activities		**437,007**		80,202
Securities lending activities (Note 2):				
Securities lending income		**1,153**		914
Securities lending expense		**(412)**		(331)
Net income from securities lending activities		**741**		583
Total additions	**$**	**500,786**	$	139,438

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

Years ended June 30,		**2004**		2003
Deductions:				
Benefits paid to members	**$**	**92,697**	$	65,649
Refunds paid to members		**852**		992
Professional and administrative expenses		**2,768**		2,746
Total deductions		**96,317**		69,387
Net increase		**404,469**		70,051
Plan net assets held in trust for pension benefits, beginning of year		**2,018,299**		1,948,248
Plan net assets held in trust for pension benefits, end of year	**$**	**2,422,768**	$	2,018,299

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, 2004, the System's membership consisted of the following:

Description	Number
Retirees and beneficiaries:	
Currently receiving benefits	2,100
Not yet receiving benefits	10
Active members:	
Fully vested	1,907
Nonvested	3,335
Total members	7,352

The following sections describe the benefit structure in effect at June 30, 2004. See Note 7, Subsequent Events, for changes to the System's benefit structure subsequent to that date.

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 later 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 55% 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 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 (13th check) – 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 have all or a portion of their monthly retirement benefit and DROP lump sum credited 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 credit 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 ($000's) 2004	2003
Investments held by System's agent in System's name:		
Short-term investments	**$ 222,763**	$ 144,313
Fixed income	**312,670**	407,861
Equities	**1,369,177**	1,073,928
Alternative investments	**217,644**	187,936
Foreign currency contracts	**1,253**	536
Securities lending collateral investment pool	**348,478**	225,531
	$2,471,985	$ 2,040,105
Investments held by brokers under securities loans with cash collateral:		
Fixed income	**$ 110,612**	$ 56,311
Equities	**186,976**	154,047
	$ 297,588	$ 210,358

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, 2004, 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, 2004 the weighted-average maturity of the collateral pool was 24 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, 2004 and 2003, of $305,144 thousand and $218,917 thousand, respectively, is not classified by category of custodial credit risk. The balance of the collateral at June 30, 2004 and 2003, of $43,334 thousand and $6,614 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, 2004 and 2003 was $338,917 thousand and $216,728 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.

Foreign currency contracts are used to hedge against the currency risk in the System's investments in foreign equity and fixed income securities and also as part of a total return strategy that seeks absolute returns from relative changes in the prices of foreign currencies. The other derivatives are used to enhance yields and provide incremental income.

The System is invested in a second total return strategy utilizing various foreign currency derivative instruments. The strategy is managed by a third party investment management firm in an account managed by a prime broker. The System has $10,000 thousand on deposit with the prime broker, and the System and the prime broker swap cash flows each month equal to the profit or loss in the account. At June 30, 2004 the System had approximately $202,118 thousand in foreign currency exposure pursuant to this strategy. These foreign currency contracts are not reflected in the accompanying schedule of derivative instruments.

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, 2004 and 2003 was $(258,723) thousand and $107,248 thousand, respectively. Futures outstanding at June 30, 2004 and 2003 were $(818,376) thousand and $102,209 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, 2004 as follows ($000's):

Contracts	Description	Notional Value	Exposure
26	Futures on Treasury Bills and Equivalents	$ (433,705)	$ –
40	Fixed Income Futures	(387,913)	–
8	Equity Futures	3,242	–
1	Interest Rate Swap	(218)	(218)
653	Long foreign currency contracts	328,635	1,252
653	Short foreign currency contracts	(327,382)	1
		$ (817,341)	$1,035

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 appreciation 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, 2004 and 2003, the System had a balance of $70 thousand and $63 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.

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. Plan changes discussed in Note 7 have not been submitted to the IRS for a determination review.

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.

Reclassifications – Expenses previously reported for the year ended June 30, 2003, have been reclassified from professional and administrative expenses to investment expenses in the amount of $379 thousand. This reclassification had no effect on net plan assets held in trust for pension benefits.

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 $36,645 thousand for fiscal year 2004 as required in an agreement with the City 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, 2004 was 28.5% percent. Pursuant to the governing statute the City is obligated to contribute 16% of total direct pay in fiscal 2005 and to fund the System at the actuarial determined rate thereafter. See Notes 4 and 5 for a discussion of the System's funded status and related litigation and Note 7 for a discussion of a new agreement between the System and the City that provides for a new schedule of cash payments to be made by the City. This agreement was entered into subsequent to June 30, 2004.

4. Funding Status

The System's actuary conducts an annual valuation to determine the adequacy of the current employer contribution rates, to describe the current financial condition of the System, and to analyze changes in the System's condition. This valuation shows the funded position of the System at July 1, 2003 decreased from the funding level at July 1, 2002. The actuarial accrued liability increased $281,008 thousand and the actuarial value of assets increased $57,254 thousand. As a result, the System's unfunded actuarial accrued liability increased $223,754 thousand to $480,327 thousand as of July 1, 2003. The increase in the unfunded actuarial accrued liability is due to a combination of factors including actuarial losses from both asset and liability sources and recognition of prior asset losses. The July 1, 2003 actuarial valuation was adopted by the Board of Trustees on August 12, 2004.

Based on actual asset and employee data as of July 1, 2003, the July 1, 2003 actuarial valuation and the provisions of the governing statute for determining employer contribution rates, the City contribution rate is projected to increase as follows:

Year Beginning	Actuarial		By Statute	
July 1	Amount	Percent	Amount	Percent
2004	$ 89,040	28.5%	$ 49,987	16.0%
2005	104,949	32.3	104,949	32.3
2006	121,987	36.1	121,987	36.1
2007	132,841	37.8	132,841	37.8
2008	138,886	38.0	138,886	38.0

The City paid $36,645 thousand in contributions for fiscal 2004 and has budgeted $13,600 thousand for City contributions in the year beginning July 1, 2004. The System will experience difficulty in meeting long-term obligations at a point in time if the City does not meet the funding requirements outlined above. See Note 5 for a discussion of pending litigation on the issue and Note 7 for a discussion of a new agreement between the System and the City that provides for a new schedule of cash payments to be made by the City. This agreement was entered into subsequent to June 30, 2004.

The financial condition of the System and its ability to meet future obligations is predicated on the funding provisions in the governing statute, which provides a revenue stream based on a percentage of active members' total direct pay. If the funding schedule is maintained and adequate earnings and gains are provided on investments, the System will eventually be adequately funded. If the City does not meet its funding obligations the System's unfunded actuarial accrued liability and the City's future funding obligations will continue to increase above the rates outlined above and in Note 7.

The figures in the accompanying unaudited Schedule of Funding Progress (the Unfunded Actuarial Accrued Liability (UAAL) and the Funded Ratio) are based on actuarial calculations that make use of the actuarial value of assets, not the fair value. Since asset gains and losses (earnings greater or less than the 8.50% investment return assumption for example) are recognized 20% per year for five years in the actuarial value of assets, the July 1, 2003 actuarial value of $2,394,411 thousand is $376,112 thousand larger than the fair value of $2,018,299 thousand. The $376,112 thousand in deferred losses will be recognized over the next four years and as these losses are recognized, the unfunded liability can be expected to increase by a corresponding amount, over and above other expected increases.

5. Litigation

On June 30, 2004 the System filed suit against the City of Houston seeking to compel the City to adhere to the statutory funding requirements as outlined in Note 3. This legal action is based upon the fact that the City adopted a budget for the City of Houston for fiscal year 2005 that fails to appropriate the statutorily mandated 16% of the member's total direct pay.

On August 3, 2004 the City filed a motion for summary judgment to dismiss the lawsuit claiming that the City has breached no obligations to the System, that the City has made every contribution to which the System is contractually entitled, the System's claims have no merit and that the issue is currently being negotiated and is possibly the subject of an eventual legislative solution.

See Note 7 for a resolution of this litigation subsequent to June 30, 2004.

6. Commitments and Contingencies

As described in Note 1, there are 3,335 non-vested active members of the System 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, 2004 and 2003, aggregate contributions from these members of the System were approximately $113,549 thousand and $116,952 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, 2004 and 2003, the total accumulated lump sum benefit due to DROP members was approximately $404,172 thousand and $378,288 thousand, respectively.

At June 30, 2004 and 2003, the total accumulated lump sum benefit due to PROP participants was $65,804 thousand and $29,012 thousand, respectively.

The System has outstanding commitments to various limited partnerships totaling $131,030 thousand and $169,183 thousand, as of June 30, 2004 and 2003, respectively.

Effective August 1, 2004 the System executed an eleven-year office lease renewal through April 30, 2015, with the first 9 months rent-free and monthly base rentals thereafter ranging from $14.8 thousand to $16.9 thousand.

7. Subsequent Events

On September 29, 2004 the System and the City entered into an agreement (the New Agreement) that altered the benefit structure of the System and the statutorily required contributions due from the City to the System. The contract has a term beginning on October 9, 2004 extending through June 30, 2017 and thereafter renews for one-year terms through June 30, 2034 unless either party terminates the agreement.

For administrative purposes, benefits available to members pursuant to the New Agreement have been classified as either New Plan benefits or as Old Plan benefits and are summarized as follows:

Old Plan - Active members as of October 9, 2004:

- Monthly DROP and retirement benefits are based on a three-year average of pensionable pay (as re-defined in the New Agreement) subject to certain "grandfather" provisions.
- Benefit accrual rate of 2.75% per year of service for the first 20 years of service and 2.0% per year thereafter with no maximum rate.
- No minimum retirement age.
- Employee contribution rate of 9.0%.
- Annual cost of living adjustments equal to 80% of CPI with a minimum of 2.4% and a maximum of 8.0%.
- The DROP and PROP interest credit will have a floor of 3.0% and a maximum of 7.0%. If the System has a 100% funded ratio then the maximum rate will be 10%.
- No Supplemental monthly benefit (13th check) will be paid unless the System's funded ratio equals or exceeds 120%.
- $5,000 lump sum at retirement.
- Additional disability benefit of up to four years.

New Plan - Members hired subsequent to October 9, 2004:

- Monthly retirement benefits are based on a three-year average of pensionable pay (as defined in the New Agreement).
- Benefit accrual rate of 2.25% per year of service for the first 20 years of service and 2.0% per year thereafter with a maximum rate of 80%.
- Employee contribution rate of 10.25%.
- Minimum retirement eligibility requirement of age 55 and 10 years of service.
- No DROP or PROP benefit.
- No Supplemental monthly benefit (13th check).
- No $5,000 lump sum at retirement.
- No additional disability benefit.
- Partial lump sum option.

Retired members and survivors are effectively members of the Old Plan. There have been no changes for this group from pension benefits effective prior to the New Agreement except for the following:

- Annual cost of living adjustments equal to 80% of CPI with a minimum of 2.4% and a maximum of 8.0%.
- The DROP and PROP interest credit will have a floor of 3.0% and a maximum of 7.0%. If the System has a 100% funded ratio then the maximum rate will be 10%.
- No Supplemental monthly benefit (13th check) will be paid unless the System's funded ratio equals or exceeds 120%.

Cash Payments by the City to the System

In the New Agreement the City has agreed that in lieu of contributions to the System made pursuant to actuarial valuations the City will make cash payments to the System in accordance with a payment schedule as provided in the New Agreement. This cash payment schedule requires a payment of $36,645 thousand for fiscal year 2005 and then 16.0% of member compensation but not less than $53,000 thousand for fiscal 2006. For fiscal years 2007 through 2012 the City has agreed to pay the amount contributed in 2006 plus an amount increasing by $5,000 thousand each year. Beginning in fiscal year 2013 and until the System's Funded Ratio reaches 100%, the City payments shall increase each fiscal year by the greater of $5,000 thousand or if the scheduled City payment is less that the actuarially required contribution, $10,000 thousand per year.

The New Agreement provides that the City may make these cash payments from any source, including pension obligation bonds. Senate Bill 1696 became law on September 1, 2003 and authorized municipalities to issue obligations to fund all or any part of an unfunded liability. This law requires the City to enter into a written agreement with the System that states the date or dates that the System will accept the net proceeds of the obligations to be issued in payment of all or a portion of the unfunded liability.

The payments pursuant to the New Agreement are projected to be less than the Actuarial Required Contribution (ARC) in each year through 2017 at which time the payments will begin to exceed the ARC. The scheduled payment amount for fiscal 2005 represents 24.1% of the ARC. Scheduled payment amounts in fiscal 2006 represent 58.4% of the ARC with the payment amount as a percent of the ARC increasing gradually each year thereafter until approximately 2017 when the scheduled payment amount will equal the ARC. Subsequent to 2017 the scheduled payments are projected to be in excess of the ARC increasing to 200% of the ARC in fiscal 2035.

Unfunded Actuarial Accrued Liability

Assuming the benefit adjustments outlined above were effective July 1, 2004 the provisions of the New Agreement would have reduced the System's unfunded actuarial liability from $685,000 thousand to $534,804 thousand. Pursuant to the previously described schedule of cash payments the System's Unfunded Actuarial Accrued Liability is projected to increase from approximately $534,804 thousand as of June 30, 2004 to $1,258,000 thousand in 2021. These projected Unfunded Actuarial Accrued Liabilities equate to funded ratios of 81.8% and 85.6% respectively. Subsequent to fiscal year 2022 the Unfunded Actuarial Accrued Liability is projected to begin decreasing pursuant to the effects of the payment schedule described above.

In accordance with the terms of the New Agreement, the City is obligated to make certain cash payments to the System but is no longer obligated to make payments to the System in amounts that have been actuarially determined to be sufficient to cover all future benefit payments of the System. If, however, the System achieves a funded ratio of 75% or 80% in any year subsequent to 2013 then the City will be required to annually contribute amounts to the System which are sufficient to maintain such funded ratios.

If the City is unable to meet its funding obligations due to a shortfall of tax revenues, an inability to obtain or raise funds through the issuance of pension obligation bonds or from other sources, or if the System does not achieve the actuarial assumptions inherent in these projections then the System's unfunded actuarial accrued liability and the City's funding obligations will continue to increase above the rates outlined above and ultimately there could be insufficient assets to cover all future benefit payments of the System.

Litigation

Pursuant to the New Agreement the System has agreed to nonsuit its lawsuit against the City without prejudice. The System reserves the right to reinstate the lawsuit if the City does not meet its payment obligations under the New Agreement.

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, 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	256,573	90	286,150	90
July 1, 2003	2,394,411	2,874,738	480,327	83	300,405	160
July 1, 2004(1)	2,464,987	2,999,791	534,804	82	336,000	160

(1) See Note 7, Subsequent Events. The July 1, 2004 amounts represent an actuarial projection used as a basis for the New Agreement.

Schedule of Employer Contributions ($000's)

Years Ended June 30,	Actuarial Required Contribution	Cash Payments Required by Agreements(4)	Cash Payments as a Percent of Actuarial Required Contribution	Actuarial Required Contribution as a Percentage of Pay
1999	35,820	30,645	85.6	16.2
2000	40,538	30,645	75.6	16.3
2001	28,467	30,645	107.7	11.3
2002	52,677	32,645	62.0	20.5
2003	66,948	34,645	51.7	24.4
2004	85,966	36,645	42.6	28.5
2005(2)	95,760	36,645	24.1(3)	28.5
2006(2)	90,765	53,000	58.4(3)	26.1
2007(2)	101,861	58,000	56.9(3)	28.3
2008(2)	108,779	63,000	57.9(3)	29.2
2009(2)	110,658	68,000	61.5(3)	28.7

See accompanying independent auditors' report.

(2) See Note 7, Subsequent Events. The years 2005 through 2009 represent actuarial projections used as a basis for the New Agreement.
(3) See Note 7, Subsequent Events. The percentage contributed figure for 2005 has been calculated based on $13,600 thousand since the remainder of the fiscal 2005 cash payment is anticipated to be from the proceeds of pension obligation bonds and, as such, must be excluded from such calculations. The years 2006 through 2009 assume that none of the cash payments will be made with the anticipated proceeds of pension obligation bonds although actual amounts will subsequently need to be adjusted for such payments consistent with the treatment of pension obligation bond proceeds in 2005.
(4) Amounts for 1999 through 2004 represent amounts paid pursuant to various agreements between the System and the City. Amounts subsequent to 2004 represents estimated cash payments pursuant to the New Agreement discussed in Note 7, Subsequent Events.

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, 2003
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
DROP interest credit rate	9.0% [(1)]
Actuarial assumptions:	
Investment rate of return	8.5%
Payroll growth rate:	
Attributable to inflation	4.0% [(2)]
Attributable to merit increases	0.0% to 5.0% [(3)]
Annual cost of living adjustment	3.0% [(4)]

See accompanying independent auditors' report.

(1) Pursuant to the provisions of the New Agreement discussed in Note 7, this assumption has been changed to 7.0%.
(2) Pursuant to a 2004 actuarial experience study this assumption has been changed to 3.5% and adopted for purposes of the actuarial projection used for the New Agreement discussed in Note 7.
(3) Pursuant to a 2004 actuarial experience study this assumption has been changed to a range of 0.0% to 9.0% and adopted for purposes of the actuarial projection used for the New Agreement discussed in Note 7, Subsequent Events.
(4) Pursuant to the provisions of the New Agreement discussed in Note 7, Subsequent Events, this rate has been changed to 2.8%.

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

Year ended June 30,		2004		2003
Investment services:				
Custodial services	$	146	$	185
Money management services		10,960		6,459
Consulting services		350		348
Department operating expenses		433		379
Total investment services		11,889		7,371
Professional services:				
Actuarial services		199		64
Auditing services		37		36
Election audit services		1		1
Legal services		61		28
Lobbyist services		87		97
Total professional services		385		226
Administrative expenses:				
Computers and technology		244		546
Education		38		69
Fiduciary insurance		64		52
Office rent		178		167
Other office costs		1,885		1,686
Total administrative expenses		2,409		2,520
	$	14,683	$	10,117

See accompanying independent auditors' report.

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

Year ended June 30, 2004	Official System Position	Expense	Nature of Services
Abbott Capital Management	Consultant	$ 350	Consulting
The Northern Trust Company	Custodian	146	Custodian
American Express Asset Management	Money manager	469	Money Management
Arnhold & S. Bleichroeder	Money manager	1,049	Money Management
Ashmore Investment Management Ltd	Money manager	243	Money Management
Barclays Global Investors	Money manager	1,092	Money Management
Brandes Investment Partners	Money manager	1,418	Money Management
Bridgewater Associates, Inc.	Money manager	2,942	Money Management
Credit Suisse Asset Management	Money manager	450	Money Management
Driehaus Capital Management, Inc.	Money manager	510	Money Management
Gartmore Global Investments	Money manager	645	Money Management
MacKay-Shields Financial Corp.	Money manager	406	Money Management
The Northern Trust Company	Money manager	10	Money Management
NWQ Investment Management Company	Money manager	706	Money Management
Shenkman Capital Management, Inc.	Money manager	468	Money Management

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

Year ended June 30, 2003	Official System Position	Expense	Nature of Services
TT International	Money manager	552	Money Management
Towers Perrin	Actuary	199	Actuarial
BDO Seidman, LLP	Auditors	37	Auditing
Gibbs & Bruns LLP	Attorneys	18	Legal Service
Lawson, Fields, McCue, Lee & Campbell	Attorneys	28	Legal Service
Locke Liddell Sapp	Attorneys	87	Lobbyists
Bickley Prescott & Co.	Consultant	1	Election Auditing
Other	Other	15	Other
Total investment and professional services		$ 11,841	

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 that incorporate historical 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.

Investment Strategy and Performance

The System has an asset allocation strategy in place that was designed to meet its overall investment objective of an 8.5% annual rate of return. This allocation strategy is reviewed periodically by the Board and is changed in anticipation of or in response to changing market conditions. The current target asset allocation and the actual asset allocation of the System at June 30, 2004 is as follows:

	Target % of Fund	Current % of Fund	Dollars Invested (000's)
Domestic Equity	40.00%	42.87%	$ 1,039,182
International Equity	18.00%	21.77%	527,822
Total Equity	58.00%	64.64%	1,567,004
Fixed Income	16.00%	9.69%	234,783
High Yield	10.00%	14.58%	353,489
Total Fixed Income	26.00%	24.27%	588,272
Private Equity	10.00%	8.94%	216,709
Hedge Funds	5.00%	1.10%	26,656
Currency	1.00%	0.40%	9,712
Real Estate	0.00%	0.04%	935
Total Alternative	16.00%	10.48%	254,012
Total Cash	0.00%	0.61%	14,767
Total Fund	100.00%	100.00%	$ 2,424,055

Fiscal 2004 was divided into a period of strong gains in the first six months of the year and a second period of basically just holding our ground in the final six months of the year. The U.S. stock market turned decisively bullish in 2003, breaking its three-year streak of negative returns. The heightened enthusiasm for stocks was generated by compelling valuations early in the year, increases in earnings, and confidence in the strength and sustainability of the current economic expansion. All of the major market indices posted 25% plus gains for calendar year 2003 with small capitalization stocks significantly outperforming large capitalization stocks for the year. This trend held true in the international equity markets with broad international equity indices increasing approximately 29% in the twelve months ending in June 2004.

After a strong start to calendar year 2004, the impending end to a period of extraordinarily low interest rates resulted in substantial volatility for both bonds and equities for the second half of our fiscal year. After trading sharply lower in April and May, the equity markets recovered somewhat in May and June to finish the second quarter with a modest gain. The concern is not when the Federal Reserve would raise rates, but rather for how long and by how much. Historically, the stock market has been able to rise in the early stages of Fed tightening. It is only later in the tightening cycle that stocks have been more negatively impacted. While stocks managed to record modest gains, bonds fell sharply recording their worst quarter since 1994 in the quarter ending in June dragging returns into negative territory for the last six months.

HPOPS was able to outperform the markets in most areas during our fiscal year. The System has a current asset mix that includes 40% in US equities and our total return in the US equity markets was approximately 23%. The System's relative out performance in the international equity markets was even more pronounced with a total return of approximately 41%. Fixed income markets did not perform well relative to equities during the fiscal year but even so the HPOPS fixed income investments produced returns in excess of 3%, which is better than the fixed income returns provided by the market in general.

Domestic Equity

The System's domestic equity investments participated in the 2003 bull market with a 22.87% return, exceeding the 20.39% return on its benchmark, the Russell 3000. The superior performance of the System's value managers and one of its small cap growth managers more than offset the below-benchmark performance of other active managers. Assets under management, annualized rates of return and fees paid to domestic equity managers for the fiscal year ending June 30, 2004 are as follows (dollars in 000's):

Manager	Style	Assets	Returns	Fees
American Express	Small/MidCap Growth	$ 69,602	18.67	$ 469
Arnhold & S Bleichroeder	Large Cap Value	223,629	27.17	1,049
Barclays Alpha Tilt	Enhanced S&P 500 Index	329,761	18.11	861
Driehaus Capital Mgmt	Small/MidCap Growth	117,072	37.31	510
Gartmore Asset Mgmt	Large Cap Growth	170,636	17.77	645
NWQ Investment Mgmt	Mid Cap Value	128,482	36.77	706
		$ 1,039,182		$ 4,240

International Equity

International equity markets also had a very good year in fiscal 2003. The System's international equity investments returned 41.00%, significantly outperforming the 32.64% return on the MSCI EAFE benchmark for the year. The System allows managers to increase or decrease their exposure to emerging markets in response to their views on the market as opposed to having a dedicated emerging markets manager. During June of 2004 the EAFE index strategy managed by Barclay's Global Investors was converted to an enhanced index strategy with Barclays so the rate of return figures in the following table are for approximately 11 ½ months for the EAFE index product and ½ month for the enhanced indexed strategy. In June of 2004 TT International was terminated as an international equity manager for the System, the account was substantially liquidated and invested in an enhanced international equity index at

Barclays Global Investors. The System intends to invest the funds formerly under management by TT International (approximately $95 million) with another active manager during 2005. Assets under management, annualized rates of return and fees paid to international equity managers for the fiscal year ending June 30, 2004 are as follows (dollars in 000's):

Manager	Style	Assets	Returns	Fees
Brandes International	International Equity	$ 350,512	49.13	$ 1,418
TT International	International Equity	10,837	23.88	552
BarclaysEAFE Index	International Equity	-	29.81	40
Barclays International Alpha Tilt	International Equity	166,473	0.83	-
		$ 527,822		$ 2,010

High Yield

High yield investment is segregated as a separate asset class as the result of a 1998 asset allocation study with a target allocation of 10% of the System's total investments. The System implemented a high yield strategy in July 2000 that utilizes three separate high yield managers whose styles should complement each other in order to dampen some of the volatility in this asset class. Performance for this program since its inception is as follows:

	Fiscal 2004	Fiscal 2003	Fiscal 2002	7/31/2000 Through 6/30/2004
Credit Suisse	11.07	17.68	-1.56	7.64
MacKay Shields	16.84	26.43	2.95	10.72
Shenkman	7.49	12.45	7.58	8.44
Total Fund	11.61	17.72	3.03	8.58
Benchmark	10.32	26.36	-4.67	6.91

In October 2003 the System made a tactical allocation decision to reallocate $100 million from fixed income into high yield. This tactical decision resulted in a gain to the System of approximately $13.7 million through June 30, 2004. This portion of the System's investments had a return of 11.61% for the year versus the benchmark Salomon Brothers High Yield Market Index return of 10.32%. Assets under management, annualized rates of return and fees paid high yield managers for the fiscal year ending June 30, 2004 are as follows (dollars in 000's):

Manager	Style	Assets	Returns	Fees
Credit Suisse	**High Yield**	$ 110,503	11.07	$ 450
MacKay Shields	**High Yield**	117,326	16.84	406
Shenkman	**High Yield**	125,660	7.49	468
		$ 353,489		$ 1,324

Fixed Income

The System's fixed income strategy consists of a passive allocation to the Lehman Brothers Aggregate through an index strategy managed by Barclay's Global Investors (BGI) in combination with separate allocations to a global fixed income mandate and an emerging markets mandate. As discussed above in the section on high yield, a tactical re-allocation is in place that has substantially reduced the System's exposure to the BGI strategy at June 30, 2004. The total fixed income investment generated a 4.57% return for fiscal 2004, versus the .32% return on the Lehman Brothers Aggregate Bond Index for the same time period. Assets under management, annualized rates of return and fees paid to high yield managers for the fiscal year ending June 30, 2004 are as follows (dollars in 000's):

Manager	Style	Assets	Returns	Fees
Ashmore	**Emerging Markets**	$ 87,129	11.61	$ 243
Barclay's Global Investors	**Core Bond Index**	3,003	0.40	189
Bridgewater	**Global Fixed Income**	144,650	2.74	446
		$ 234,782		$ 878

Alternative Investments

The System's alternative investment program consists of allocations to private equity, hedge funds and currency. The private equity strategy is managed by Abbott Capital Management and is a relatively mature strategy in that the System has reached is investment target of 10% of total assets while still having $131 million of outstanding commitments. The current allocation within this strategy is approximately 42% in leveraged buyouts, 42% in special situations funds and 16% in venture capital. This program required $49.5 million in additional funding during fiscal 2004 while at the same time generating distributions of $47.7 million for the same period. This private equity program generated returns for the 2004 fiscal year of 28.69% versus its benchmark return of 24.05%.

The System also has a 5% allocation to hedge funds (approximately $121 million) but only has $26.7 million actually invested as of June 30, 2004. There is an additional 1% allocation to currency strategies with a $20 million risk limit. This currency strategy was not fully implemented as of June 30, 2004. Assets under management, annualized rates of return and fees paid to for the fiscal year ending June 30, 2004 are as follows (dollars in 000's):

Manager	Style	Assets	Returns	Fees
Abbott Capital	**Private Equity**	$ 204,714	28.69	$ 350
Bridgewater	**Hedge Fund**	26,639	45.32	$ 2,496
FX Concepts	**Currency**	9,711	-2.62	-
Real Estate	**Various**	935	8.02	-
Other	**Various**	12,013	-5.20	-
		$ 254,012		$ 2,846

Securities Lending

The System's master custodian Northern Trust operates the Securities Lending program on behalf of HPOPS. Securities are loaned on a short-term basis to brokers in exchange for (generally) cash collateral. Northern Trust then invests this collateral and the investment income is divided between HPOPS and Northern Trust in accordance with agreed-upon percentages.

This program generates incremental income for HPOPS but is subject to certain risks. These risks include (1) the possibility that the borrower cannot return the securities and (2) that the investments in which Northern invests the collateral lose money. This first risk is controlled by strict guidelines on which borrowers will be approved to participate in the program and daily adjustment of the collateral for changes in the market value of the securities that are out on loan. The second risk is controlled by strict quality and duration guidelines on the securities that the collateral can be invested in.

Vendors other than Northern Trust could be used for this program who could generate additional income but this is not likely without what has been determined to be an unacceptable increase in risk. Northern's participation in the Securities Lending program also allows for a reduction in custody fees.

Northern has never experienced a loss due to borrower default or collateral reinvestment in a collateral fund. Following is a chart of securities lending activity for the most recent three fiscal years (dollars in 000's).

	2004	2003	2002
Securities on Loan at year end	$ 338,917	$ 216,728	$ 221,455
Eligible Securities at year end	$ 1,979,436	$ 1,692,147	$ 1,626,114
Income	$ 741	$ 583	$ 855
% on Loan	17.1%	12.8%	13.6%
Duration of Collateral Pool	24	38	30

Report Preparation

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

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 Investments
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
2004	21.6	19.0	22.9	20.5	41.0	32.9	4.6	0.3	11.6	10.4	28.7

Compound Annualized Rates of Return by Year (%)
Years Ended June 30, 2004

Year	System Total	Composite Benchmark	Domestic Equity	Russell 3000	International Equity	MSCI EAFE	Fixed Income	Lehman Brothers Aggregate	High Yield	Citi-group HY	Alternative Investments
2	12.6	11.1	12.7	10.2	15.6	11.7	9.7	5.2	14.6	18.1	4.5
3	4.9	3.5	2.4	0.2	6.5	4.3	8.8	6.4	10.6	10.0	-0.5
5	5.0	1.7	2.8	-1.1	6.4	0.4	6.5	7.0	8.0	5.3	3.6
10	10.0	10.1	12.5	11.7	na	4.4	8.4	7.4	na	7.6	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 calculated rates of return.

Schedule of Ten Largest Domestic Equity Holdings
As of June 30, 2004

Shares	Description	Market Value ($000's)
945,820	General Electric	$ 30,644
782,100	Amphenol Corp	26,059
310,910	ITT INDS	25,805
778,700	Microsoft Corp	22,239
182511	MFC SPDR TR Unit Series 1 Std. & Poors	20,902
589,563	Tyco Intl	19,538
330,200	Anadarko	19,349
381,606	Target Corp	16,206
137,500	General Dynamics	13,653
216,286	Wachovia Corp	9,624

Schedule of Ten Largest Non-U.S. Equity Holdings
As of June 30, 2004

Shares	Description	Market Value ($000's)
40,300	Nestle (Swiss)	$10,747
586	Millea Holdings (Japan)	8,700
892,300	Abbey Natl (UK)	8,305
1,262,328	Marks & Spencer (UK)	8,304
2,111,452	BCA Intesa (Italy)	8,246
120,400	Unilever (Netherlands)	8,217
138,000	Schering AG (Germany)	8,131
605,866	BBVA (Spain)	8,093
1,166,500	Hitachi (Japan)	8,028
687,063	Jardine Matheson (Hong Kong)	7,557

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

Schedule of Ten Largest Domestic Fixed Income Holdings
As of June 30, 2004

Par Value	Description	Market Value ($000's)
1,950,000	Nextel Communications 7.375% due 8/1/2015	$ 1,969
1,800,000	Iron Mountain 8.625% due 4/1/2013	1,908
1,755,000	Georgia Pacific 7.75% due 11/15/2029	1,684
1,765,000	El Paso Production 7.75% due 6/1/2013	1,619
1,500,000	Ellis Perry 8.875% due 9/15/2013	1,548
1,500,000	Liberty Group 9.375% due 2/1/2008	1,492
1,385,000	AES Corp. 9% due 5/15/2015	1,483
1,450,000	Corrections Corp. 7.5% due 5/1/2011	1,464
1,400,000	Waste Services, Inc. 9.5% due 4/15/2014	1,435
1,450,000	Cablevision Systems 8% due 4/15/2012	1,428

Schedule of Ten Largest Non-U.S. Fixed Income Holdings
As of June 30, 2004

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, 2004

Brokers	Shares	Commissions	Principal	Commissions Per Share
Neuberger and Berman	32,321,214	$1,935,249	$966,731,528	$0.060
Merrill Lynch	6,931,990	345,948	298,132,886	0.050
Wachovia Securities	2,564,300	128,497	100,167,289	0.050
Lehman Brothers Inc.	2,196,752	108,790	96,633,623	0.050
UBS Securities	2,908,878	134,237	81,751,294	0.046
Cantor Fitzgerald & Co.	2,178,814	106,044	80,163,955	0.049
Jefferies & Company	2,385,800	101,552	79,506,686	0.043
Bear Stearns	2,192,399	100,424	75,812,166	0.046
Berstein, Sanford C. & Co.	1,998,764	99,876	82,591,752	0.050
Smith Barney Inc.	1,928,871	95,626	66,857,526	0.050

International Trades - Ten Largest by Total Commissions Paid

For the year ended June 30, 2004

Brokers	Shares	Commissions	Principal	Commissions In Basis Points
Citigroup Global	16,264,014	$229,516	$157,808,846	14.54
Merrill Lynch	5,569,880	107,991	57,165,208	18.89
Deutsch Bank	4694.758	92,701	52,923,374	17.52
Goldman Sachs	5,248,200	77,488	42,161,323	18.38
Lehman Brothers	5,261,501	63,872	43,928,087	14.54
CSFB	4,033,327	61,613	38,303,531	16.09
USB Warburg	678,841,206	56,930	39,809,044	14.30
Morgan Stanley	1,526,033	42,096	27,391,645	15.37
JP Morgan	1,819,437	34,940	24,913,194	14.02
Societe Generale	524,008	17,666	11,806,498	14.96

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, 2003 through June 30, 2004.

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 as of the valuation date.

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, 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
July 1, 2003	2,874,738	2,394,411	83	480,327	300,405	160

* 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.

Prepared by Towers Perrin

Historical Solvency Test ($000)

Valuation Date	Actuarial Accrued Liability for: 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, 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
July 1, 2003	153,634	838,090	1,883,014	2,394,411	100	100	74

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

Prepared by Towers Perrin

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, 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
July 1, 2003	5,387	41.3	300,405	55,765	4.3

(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

Period Ended	Added to Rolls: Number	Added to Rolls: Annual Benefits ($000)	Removed from Rolls: Number	Removed from Rolls: Annual Benefits ($000)	Rolls at the End of the Year: Number	Rolls at the End of the Year: Annual Benefits ($000)	Percentage Increase in Annual Benefits	Average Annual Benefit
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
June 30, 2003	106	2,967	47	1,109	1,918	61,531	11.8	32,081

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

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

Prepared by Towers Perrin

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
DROP Crediting Rate	9.0% per year

Demographic Assumptions

Entry Age	Date sworn.
DROP Participation Rates	100% of active participants are assumed to elect the 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
PROP Antiselection	PROP benefits are loaded by 1% to reflect possible antiselection of PROP provisions

Summary of Actuarial Methods and Assumptions (cont.)

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

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	Highest pay in the last 26 pay periods preceding the valuation date, annualized and increased for one-half year of assumed pay increases.

Summary of Actuarial Methods and Assumptions (cont.)

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

Changes in Methods and Assumptions Since the Prior Valuation

The actuarial methods and assumptions used in this valuation are the same as those used in the prior valuation.

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.

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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 Since the Prior Valuation

There have been no changes to the plan provisions since the prior valuation.

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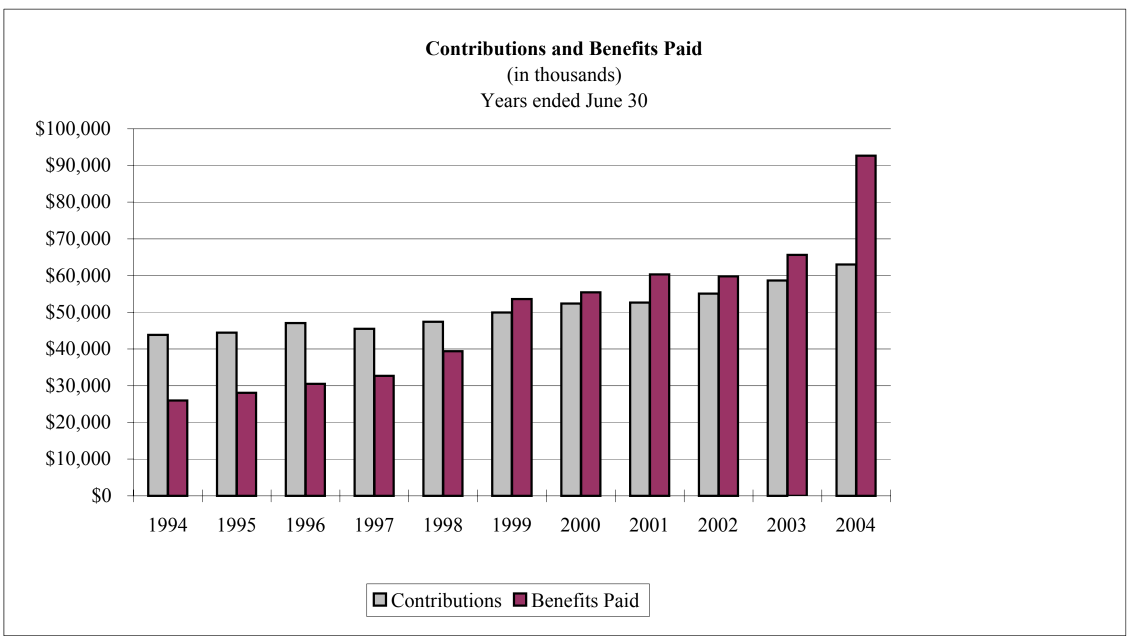
SECTION FIVE

STATISTICAL SECTION

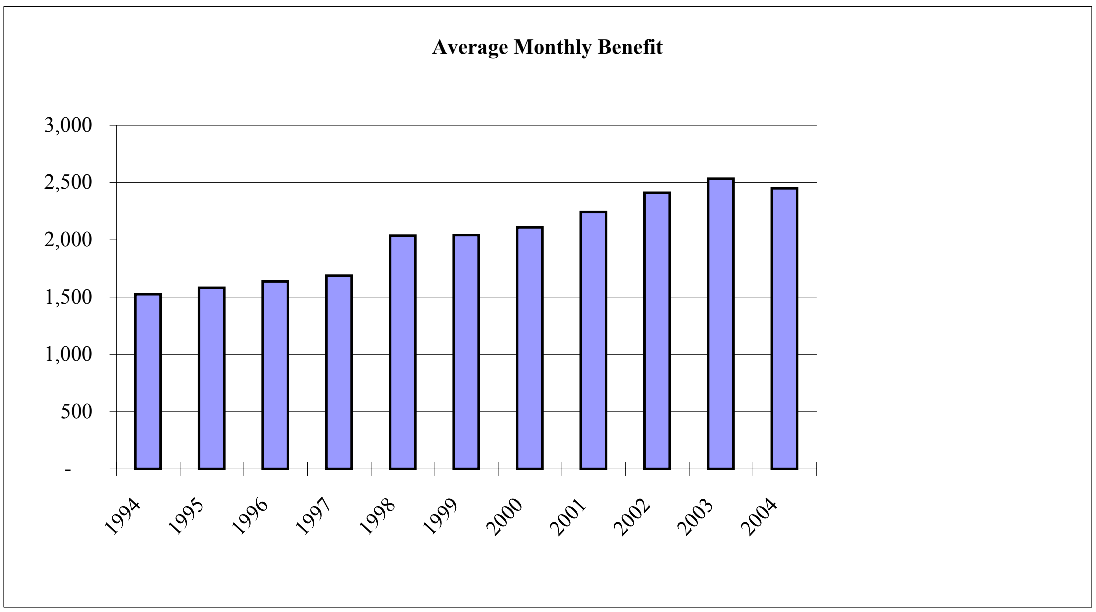
Schedule of Revenue by Source and Expenses by Type
(000's)
For years ended June 30

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	(185,802)	(130,673)	59,783	2,881	1,194	63,858	(194,531)
2003	24,008	34,645	80,785	139,438	65,649	2,746	992	69,387	70,051
2004	26,393	36,645	437,748	500,786	92,697	2,768	852	96,317	404,469

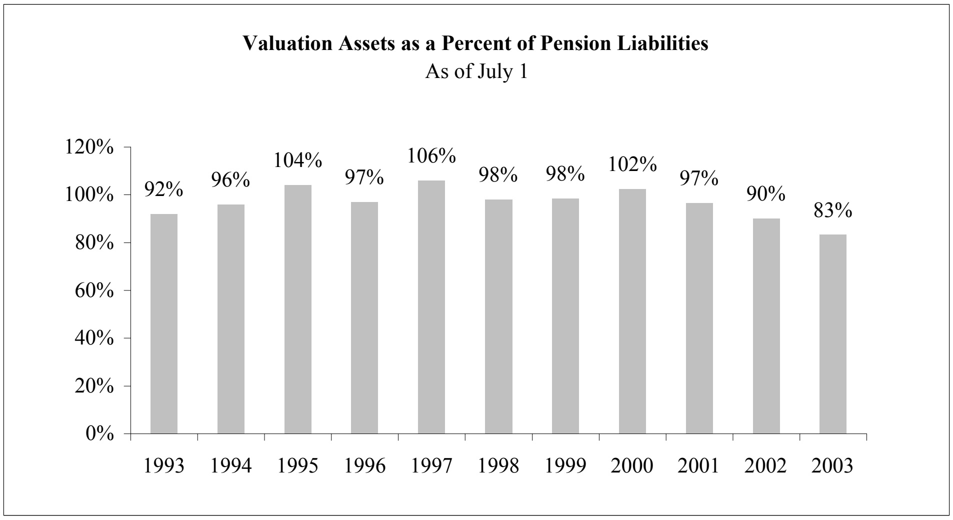


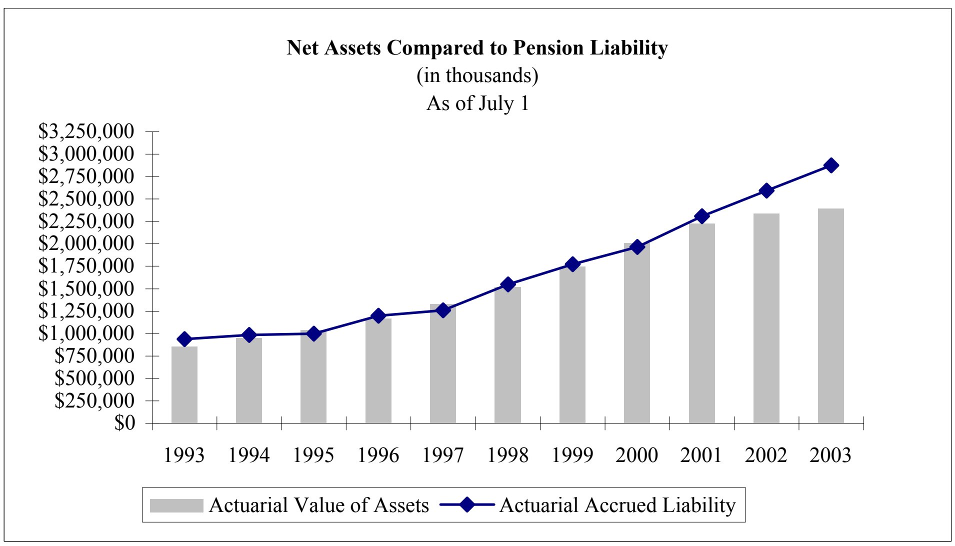
Average Monthly Benefit
Years Ended June 30,

Year	Retirees and Beneficiaries at Year End	Monthly Annuity Payments	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	*
2004	2,100	61,742,419	22,603,155	8,351,758	2,449	*



* 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
120%
100%
80%
60%
40%
20%
0%
92%
96%
104%
97%
106%
98%
98%
102%
97%
90%
83%
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003


Net Assets Compared to Pension Liability
(in thousands)
As of July 1
$3,250,000
$3,000,000
$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
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
Actuarial Value of Assets
Actuarial Accrued Liability

STATISTICAL SECTION

Pensions Awarded by Type and by Age

Year Ended June 30, 2004

		Type of Pension		
Age on June 30,	Total	Service	Disability	Survivor
Under 40	14	-	5	9
40-44	17	14	3	-
45-49	30	28	1	1
50-54	45	44	-	1
55-59	72	69	-	3
60-64	29	23	-	6
65-69	7	4	-	3
70-74	4	1	-	3
75 and over	-	-	-	-
Total	218	183	9	26

Pensions in Force by Type and by Age

Year Ended June 30, 2004

		Type of Pension		
Age on June 30,	Total	Service	Disability	Survivor
Under 40	44	-	11	33
40-44	54	26	16	12
45-49	128	96	9	23
50-54	290	253	12	25
55-59	431	373	10	48
60-64	308	254	4	50
65-69	318	251	7	60
70-74	239	179	2	58
75-79	175	103	-	72
80-84	78	27	2	49
85 and over	35	7	-	28
Total	2,100	1,569	73	458

Pensions Awarded by Type and by Monthly Amount

Year Ended June 30, 2004

		Type of Pension		
Monthly Amount	Total	Service	Disability	Survivor
Under $1000	-	-	-	-
$1,000-1,500	4	1	1	2
$1,500-2,000	8	1	-	7
$2,000-2,500	13	6	2	5
$2,500-3,000	45	37	3	5
$3,000 and over	148	138	3	7
Total	218	183	9	26

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	-	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
2004	46,115	2,100	13,316	211	22,603	8,352	92,697

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)	1,072
2000	51,892	(8,020)	144,810	178	(59)	1,191
2001	104,753	(8,366)	241,197	159	(52)	1,298
2002	72,527	(4,263)	309,461	212	(74)	1,436
2003	74,268	(5,441)	378,288	297	(62)	1,671
2004	48,487	(22,603)	404,172	285	(185)	1,771

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	8	-	8
2001	918	(97)	1,206	8	(1)	15
2002	14,935	(1,348)	14,793	95	(1)	109
2003	17,034	(2,815)	29,012	48	(4)	153
2004	45,144	(8,352)	65,804	119	(15)	257

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