HPOPS

FOR TODAY & TOMORROW

Comprehensive Annual

Financial Report

A Component Unit of

The City of Houston, Texas

July 1, 2009 through

June 30, 2010

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

The mission of the Houston Police Officers' Pension System is to responsibly manage the System in the best interests of the members and beneficiaries so that they may have peace of mind knowing their pension benefits are secure.

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HPOPS

FOR TODAY & TOMORROW

SECTION ONE

INTRODUCTORY SECTION

November 10, 2010

The Membership
Houston Police Officers' Pension System
Houston, Texas

HOUSTON
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PENSION SYSTEM
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The Comprehensive Annual Financial Report (CAFR) of the Houston Police Officers' Pension System (the System) for the fiscal year ended June 30, 2010 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. 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. 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 summary results of the annual actuarial valuation.
- Statistical Section – This section includes historical financial and benefits related data pertaining to the System.

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 guidance provided by applicable statements issued by the Governmental Accounting Standards Board (GASB). The System's independent auditor, BDO, conducted an independent audit of the basic financial statements in accordance with U.S. generally accepted auditing standards. This audit is described in the *Independent Auditors' Report* found in the *Financial Section*. Management has provided the external auditors with full and unrestricted access to the System's staff to discuss their audit and related findings to facilitate independent validation of the integrity of the plan's financial reporting.

The *Financial Section* also contains *Management's Discussion and Analysis*, which serves as an introduction to and overview of the financial statements. The System is considered a component unit of the City of Houston for financial reporting purposes and, as such, the financial statements in this report are also included in the *City of Houston's Comprehensive Annual Financial Report*.

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.

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 $3.0 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.

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 agreement with the City provides for the City's contribution for fiscal year 2010 to be $5 million over the $68 million the City contributed in fiscal year 2009 and increases by $5 million over that amount for fiscal 2011. The number of active members increased in fiscal year 2010 compared to 2009 due to new hires to the Houston Police Department (HPD). Contributions from members increased in fiscal 2010 along with the increase in active members. The System experienced a positive investment return of 13.7% in 2010, which was a increase from the negative investment return of (18.2)% in 2009. This increase is primarily due to strengthening performance in nearly all financial markets during the first three quarters of fiscal year 2010 brought on by government liquidity programs, improving economic conditions and market stability.

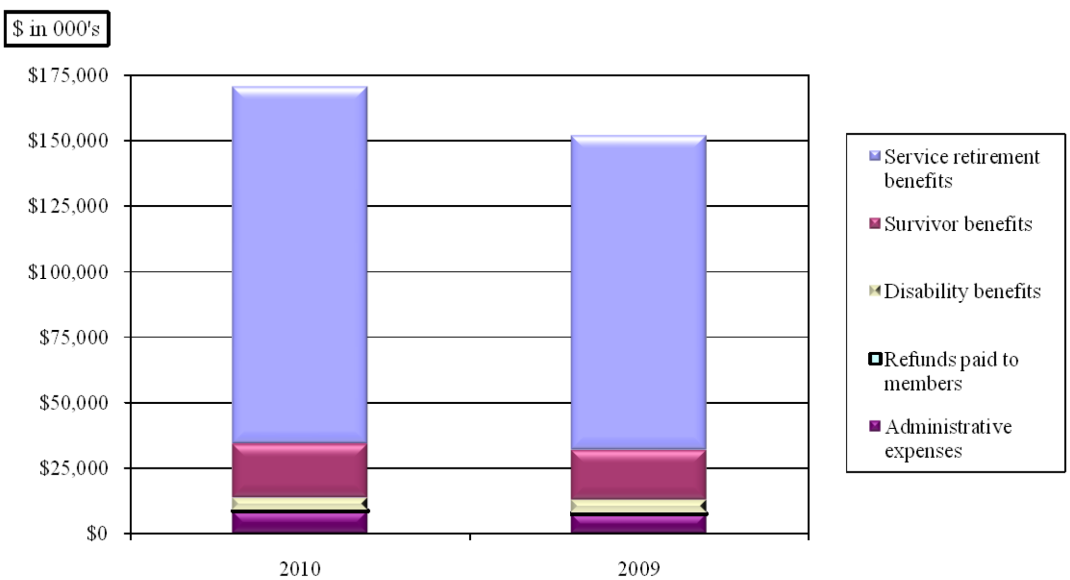
Active members:	2010	2009	Increase (Decrease)
Fully vested	1,745	1,735	10
Nonvested:			
Hired or rehired before October 9, 2004	2,271	2,430	(159)
Hired or rehired after October 9, 2004	1,338	1,086	252
	5,354	5,251	103

	$000's 2010	$000's 2009	Increase Amount	Increase Percentage
Member contributions	$ 34,218	$ 32,519	$ 1,699	5%
Employer contributions	73,192	68,000	5,192	8%
Net investment gain (loss)	364,568	(606,055)	970,623	160%
Total	$ 471,978	$ (505,536)	$ 977,514	193%

Deductions from 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 63 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
	2010	2009		
Service retirement benefits	$ 136,432	$ 120,155	$ 16,277	13.5%
Survivor benefits	20,479	19,006	1,473	7.8%
Disability benefits	4,824	4,951	(127)	(2.6%)
Refunds paid to members	547	618	(71)	(11.5%)
Administrative expenses	8,390	7,311	1,079	14.8%
Total	$ 170,672	$ 152,041	$ 18,631	12.3%

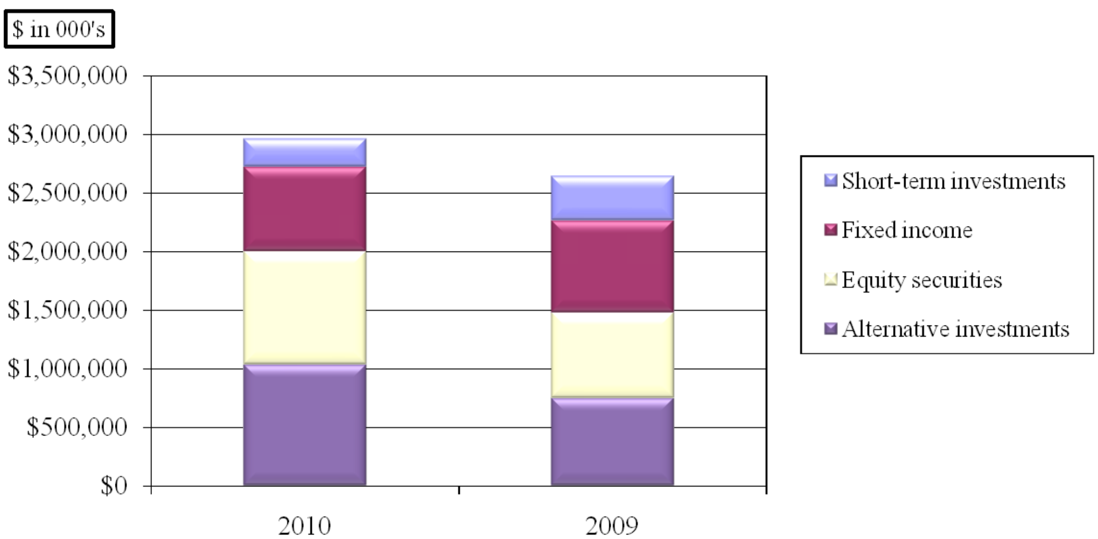


Total benefits paid, which include lump sum payments, increased in 2010 as compared to 2009 due mainly to the cost of living increase and an increase in the number of retirees. Administrative expenses increased mainly due to in the non-recurring costs of both legal expenses arising from a lawsuit the System brought against a former investment manager and development expenses for the System's new enterprise software system. For further information regarding the System's financial condition, refer to Management's Discussion and Analysis in the Financial Section of this report.

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.

	$000's		Increase (Decrease)	Increase (Decrease)
	2010	2009	Amount	Percentage
Short-term investments	$ 240,209	$ 379,182	$ (138,973)	(36.7%)
Fixed income	721,061	786,010	(64,949)	(8.3%)
Equity securities	967,066	732,446	234,620	32.0%
Alternative investments	1,035,288	749,388	285,900	38.2%
Total	$ 2,963,624	$ 2,647,026	$ 316,598	12.0%



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.

During the first half of fiscal year 2010, the market experienced a nearly unprecedented rally that began to stall in January as investors questioned the sustainability of the economic recovery without improving fundamentals. The growing European debt crisis caused volatility to spike sharply higher during the last few months of the fiscal year indicating the prolonged state of the economic downturn. Despite the increased volatility at year end, the System had a very strong return of 13.7% during fiscal year 2010 and out-performed its benchmark rate of return by 1.6%, primarily due to the strong performance of our hedge fund managers and our allocation to risk parity. The System's investments in emerging markets debt and emerging markets equity also contributed to the out-performance as well as the superior performance of one of our active managers, Causeway Capital. The Board firmly believes that by maintaining a disciplined investment approach and with reasonable diversification, the System will meet its long-term investment goals. Further details regarding the System's investments are included in the Investment Section of this report.

Major Initiatives

The System continues to provide a high level of service to our members. The Financial Planning and Estate Planning services allow members to meet one on one with System professional staff to discuss financial issues and work to prepare different legal documents in order to protect the member's estate. These services are free of charge and continue to be highly valued by System members.

The System's staff is still engaged in multiple projects to update and enhance the technology and infrastructure used to administer the System. The new Pension Administration System (PAS) was brought online in May 2009. Since then the staff has installed a new Document Management System with workflow management capabilities that integrates with the new PAS. Fiscal year 2010 changes included updates to the PAS that encompass tracking and reporting for Investments as well as work on HPOPS' new Website. All of these new systems and technology enhancements enable HPOPS to provide a higher level of service to members.

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 USA, LLP, is included on page 17 of this report. The actuarial report, certified by Gabriel Roeder Smith & Company, is included on page 61. Professional service providers who provided services to the System during the year are listed in the following table.

Actuarial

Gabriel Roeder Smith & Company

Consulting

Catapult Systems Inc.
Hammond Associates

Legal Service

Burford & Maney, PC
Gibbs & Bruns, LLP
Klausner & Kaufman
Strasburger & Price, LLP
Accumyn, L.L.C.
Beck, Redden & Secrest, LLP
J. Philip Ferguson
Navigant Consulting, Inc.
Securities Litigation and Consulting Group, Inc.

Legal Service/Lobbyists

HillCo Partners, LLC
Locke Lord Bissell & Liddell LLP

Auditing

BDO USA, LLP
Bickley Prescott & Co.

Custodian

The Northern Trust Company

Money Management

AQR Capital Management LLC
Ashmore Investment Management Limited
Attalus Capital
BlackRock
Brandes Investment Partners
Bridgewater Associates, Inc.
Causeway Capital Management
The Clifton Group
Dimensional Fund Advisors
Driehaus Capital Management, Inc.
First Eagle Investment Mgmt, LLC
First Quadrant LP
MacKay-Shields Financial Corp.
Shenkman Capital Management, Inc.

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, 2009. 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 16 consecutive years (fiscal years 1994-2009). 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's 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 10, 2010

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

The Houston Police Officers' Pension System (HPOPS) is pleased to bring you the fiscal year 2010 Comprehensive Annual Financial Report (CAFR). The CAFR provides a comprehensive picture of HPOPS' finances for the fiscal year ending June 30, 2010, as well as an overview of the year's highlights.

This past fiscal year the System began recovering from the financial crisis of the year before as the United States and the world economies strengthened. However, while this recovery has gotten underway, it is by no means completed. Accordingly, we must continue to diligently work within the system that has served us in the past and to maintain perspective with an ever vigilant eye on the horizon for signs of continued recovery.

We have experienced this before. This decade began with a period of strain and ended with another period of severe financial strain. Just as that previous period of financial market stress was followed by a period of robust market returns, last year's crisis is also being followed up with a strong market recovery. The lessons learned at the beginning of the decade and our stewardship have resulted in a positive investment rate of return for the fiscal year. As the financial markets continue to recover, our investment rate of return for the beginning of the 2011 fiscal year through the end of November 2010 is better than ten percent.

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
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BOARD OF TRUSTEES AND ADMINISTRATIVE STAFF

TRUSTEES ELECTED BY ACTIVE, INACTIVE AND RETIRED POLICE OFFICERS

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JAMES E. MONTERO
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TERRY BRATTON
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JOSEPH GLEZMAN
Trustee

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City Treasurer

Position Vacant
Mayor's Representative

POLICE PENSION OFFICE PERSONNEL

JOHN E. LAWSON
Executive Director

ERIC OLSON
Director of Administration

JUDY G. BAKER
Benefits Manager

CLARK OLINGER
Assistant Benefits Manager

PATRICK S. FRANEY
Chief Investment Officer

ROBERT ARTHUR
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STEPHEN SHALAGAN
Records Manager

BRIAN POER
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CASE WILLS
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Investment Analyst

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STEPHANIE SEGURA
Records Assistant

TONI DEWILLIS
Administrative Assistant

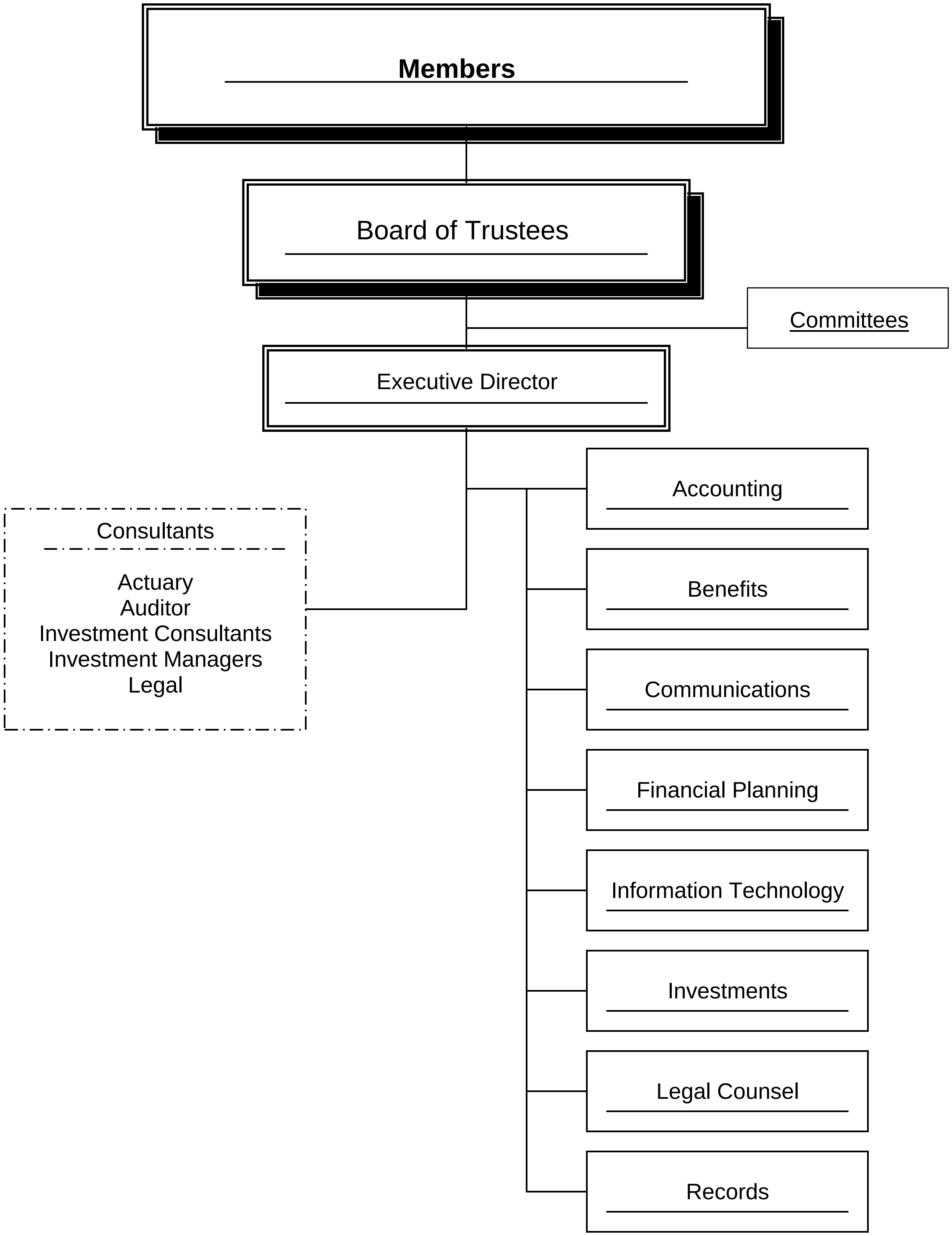
ANGELA CARTWRIGHT
Receptionist

AMELIA WEBER
Benefits Assistant

RICHARD GABLE
Financial Planner

NEAL WALLACH
Investment Analyst/Strategist

ORGANIZATION CHART



See Page 45 – Summary of Investment and Professional Services for a list of Consultants

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, 2009

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

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SECTION TWO

FINANCIAL SECTION

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333 Clay St., Suite 4700
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Independent Auditors' Report

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

We have audited the accompanying statements of plan net assets of the Houston Police Officers' Pension System (the System) as of June 30, 2010 and 2009, 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate, in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, 2010 and 2009, 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 accompanying schedules of "Investment, Professional, and Administrative Expenses" and "Summary of Investments and Professional Services" are 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 are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit this information and express no opinion on it.

BDO USA, LLP

Houston, Texas
October 8, 2010

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, 2010, 2009 and 2008. 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, Schedules, and other unaudited 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 a fixed amount or percentage of the pensionable pay of active members in accordance with Article 6243g-4, Vernon's Texas Civil Statutes, (the Governing Statute) or contracts pursuant to Section 27 thereof, 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):

Years ended June 30:	**2010**	2009	2008
Assets			
Investments at fair value	**$ 2,963,624**	$ 2,647,026	$ 3,315,671
Prepaid management fees	**150**	-	-
Invested securities lending collateral	**196,200**	297,146	368,008
Receivables	**36,195**	27,943	38,189
Cash	**559**	283	123
Total Assets	**3,196,728**	2,972,398	3,721,991
Liabilities			
Foreign currency contracts	**1,002**	382	312
Due to brokers	**25,970**	2,250	23,425
Securities lending collateral	**196,200**	297,146	368,008
Accrued investment and professional fees	**1,036**	1,025	1,506
Other liabilities	**493**	874	442
Total Liabilities	**224,701**	301,677	393,693
Plan net assets held in trust for pension benefits	**$ 2,972,027**	$ 2,670,721	$ 3,328,298

See accompanying independent auditors' report.

The System's net assets increased by approximately $301,306 thousand in fiscal year 2010 over 2009 primarily due to strengthening performance in nearly all financial markets throughout the first three quarters of the fiscal year brought on by government liquidity programs, improving economic conditions and market stability. The domestic and international equity markets and fixed income markets improved steadily, but concerns during the last quarter regarding Euorzone credit woes and their effect on the recovery increased volatility. Alternative investments markets saw gains during the last quarter on somewhat less volatility. The System's net assets decreased by approximately $657,577 thousand in fiscal year 2009 over 2008 primarily due to weakening performance in nearly all financial markets mainly throughout the first two quarters of the prior year brought on by investor concerns over the slowing economy and credit market instability. The domestic and international equity markets and fixed income markets either stabilized or improved during the last quarter of the prior year, but concerns remained that the recovery may be slowing. Alternative investments markets saw weak gains during the last quarter of the prior year on somewhat less volatility. The System experienced a positive investment return of 13.7% in 2010 as opposed to negative (18.2)% in 2009 and a positive return of 0.3% in 2008. These rates of return calculations were prepared using a time-weighted rate of return in accordance with The CFA Institute's Global Investment Performance Standards and, as such, cannot be recalculated from the information provided herein. Changes in receivables are primarily a result of the timing of investment transactions.

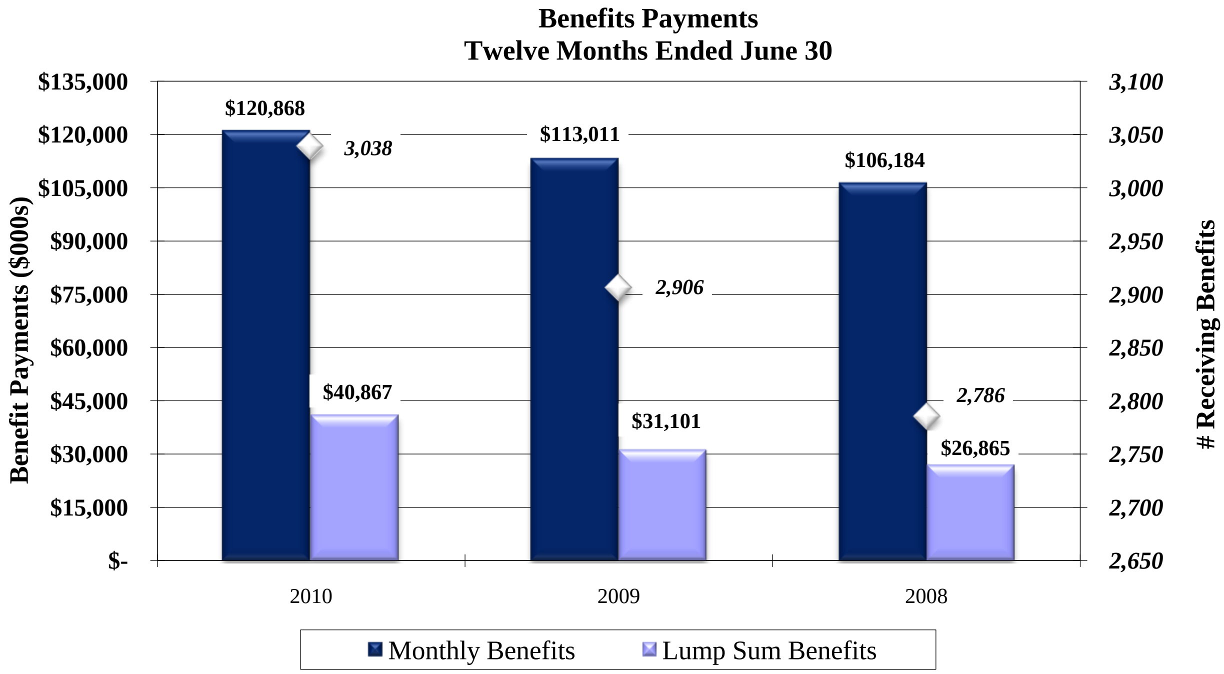
A summary of the Statements of Changes in Plan Net Assets for the System is as follows ($000's):

Years ended June 30:	**2010**	2009	2008
Contributions:			
City	**$ 73,192**	$ 68,000	$ 63,000
Members	**34,218**	32,519	31,003
Total contributions	**107,410**	100,519	94,003
Investment income (loss)	**364,095**	(607,482)	9,350
Net income from securities lending activities	**473**	1,427	2,392
Total additions (deductions)	**471,978**	(505,536)	105,745
Deductions:			
Benefits paid to members	**161,735**	144,112	133,049
Refunds to members	**547**	618	500
Professional and administrative expense	**8,390**	7,311	3,564
Total deductions	**170,672**	152,041	137,113
Net increase (decrease)	**301,306**	(657,577)	(31,368)
Plan net assets held in trust for pension benefits, beginning of year	**2,670,721**	3,328,298	3,359,666
Plan net assets held in trust for pension benefits, end of year	**$ 2,972,027**	$ 2,670,721	$ 3,328,298

See accompanying independent auditors' report.

The October 9, 2004 Agreement with the City requires contribution payments for fiscal year 2010 equal to the amount contributed in 2009 of $68,000 thousand plus $5,000 thousand, resulting in contribution payments of $73,000 thousand. For fiscal year 2009, the City was contractually required to contribute an amount equal to the amount contributed in 2008 of $63,000 thousand plus $5,000 thousand, resulting in contribution payments of $68,000 thousand. These contractual provisions account for the increase in City contributions for the years ended June 30, 2010 and June 30, 2009. As discussed in Note 4, the contributions were partially paid from the proceeds of pension obligation bonds in 2008 and 2009 and from the proceeds of a revenue bond financing facility in 2010.

"Benefits paid to members" consist of both lump sum payments and monthly payments of retirement, disability, and survivor benefits. The System's benefit payment structure provides that members and survivors have the option to receive distributions from their lump sum accounts either on or after the date they begin receiving monthly benefit payments. Due to this ad hoc nature of lump sum distributions the summary results in the accompanying Statements of Changes in Plan Net Assets will not show any distinct trends in the "Benefits paid to members" category. The chart below compares the components of benefits paid to members for the years ended June 30, 2010, 2009, and 2008. Total benefits paid in 2010 increased by approximately $17,623 thousand or 12.2% compared to 2009, mainly due to the annual cost of living adjustment (COLA), a larger number of benefit recipients, and an increase in lump sum benefits. Total benefits paid in 2009 increased by approximately $11,063 thousand or 8.3% compared to 2008, due to the annual cost of living adjustment (COLA), a larger number of benefit recipients, and an increase in lump sum benefits. Average monthly benefit payments increased from approximately $9,418 thousand per month during 2009 to $10,072 thousand per month during 2010, as the number of members and survivors receiving benefits increased by 132 during this time period. Average monthly benefit payments increased from approximately $8,849 thousand per month during 2008 to $9,418 thousand per month during 2009, as the number of members and survivors receiving benefits increased by 120 during this time period.



There was an increase of $1,079 thousand in professional and administrative expenses during 2010 as compared to 2009. This increase is mainly due to an increase in legal expenses arising from a lawsuit the System brought against a former investment manager (see footnote 6) and a decrease in expense for the System's new enterprise software system. This System-wide integrated software project, which began in January 2008, will manage all aspects of benefits administration, investment tracking, accounting and financial reporting. The first phase of the project, software development for benefits administration and data migration was completed in December 2009. Meanwhile, the second phase of the project, investment tracking, has begun. There was an increase of $3,747 thousand in professional and administrative expenses during 2009 as compared to 2008 mainly due to an increase in legal expenses arising from a lawsuit the System brought against a former investment manager (see footnote 6) and expense for the System's new enterprise software system.

System Highlights

The System's funded ratio pursuant to its most recent actuarial valuation dated July 1, 2009 was 79% representing an unfunded actuarial accrued liability of $937,556 thousand. The System's funded ratio as of July 1, 2008 was 82% representing an unfunded actuarial accrued liability of $741,351 thousand. The System's Agreement with the City provides that beginning in 2013, once the System's Funded Ratio reaches 75%, if it should ever be subsequently determined that the Funded Ratio has declined below such 75%, then in the fiscal year next following such determination, the City shall pay such additional amounts to the System as shall be necessary to increase the Funded Ratio to 75%. In addition, beginning in 2013, once the Funded Ratio reaches 80%, this becomes the new floor and if it should ever decline below such 80% level, in the fiscal year next following such determination, the City shall pay such additional amounts to the System as shall be necessary to increase the Funded Ratio to 80%. If this floor provision had been in effect in 2008, and the decline in the System's assets due to the investment market volatility during the 2009 fiscal year had resulted in the System's funded level declining to 60%, this provision of the Agreement would have resulted in a payment due from the City during 2009 of approximately $815,000 thousand. During the 2010 fiscal year, the System changed the Actuarial Cost Method and Amortization Method from the Entry Age Normal Method to the Projected Unit Credit Method to be effective July 1, 2010. It is estimated that this change in method, if implemented as of July 1, 2009, would have increased the System's funded status to 85%.

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.

Houston Police Officers' Pension System

Statements of Plan Net Assets ($000's)

June 30,		**2010**		2009
Assets				
Investments, at fair value (Note 2 and Note 3):				
Short term investments	**$**	**240,209**	$	379,182
Fixed income		**721,061**		786,010
Equity securities		**967,066**		732,446
Alternative investments		**1,035,288**		749,388
Total investments		**2,963,624**		2,647,026
Prepaid management fees		**150**		-
Invested securities lending collateral (Note 3):		**196,200**		297,146
Receivables				
Members		**1,841**		1,651
Investments		**7,848**		8,700
Due from brokers		**26,464**		17,329
Other receivables		**42**		263
Total Receivables		**36,195**		27,943
Cash		**559**		283
Total Assets	**$**	**3,196,728**	$	2,972,398
Liabilities and Plan Net Assets				
Liabilities:				
Foreign currency contracts	**$**	**1,002**	$	382
Due to brokers		**25,970**		2,250
Securities lending collateral (Note 3)		**196,200**		297,146
Accrued investment and professional fees		**1,036**		1,025
Other liabilities		**493**		874
Total Liabilities		**224,701**		301,677
Plan net assets held in trust for pension benefits	**$**	**2,972,027**	$	2,670,721

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,		**2010**		2009
Contributions (Note 1 and Note 4):				
City	**$**	**73,192**	$	68,000
Members		**34,218**		32,519
Total contributions		**107,410**		100,519
Investment income (loss):				
Net appreciation (depreciation) in fair value of investments		**330,724**		(643,053)
Interest:				
Short-term investments		**981**		6,155
Fixed income		**29,048**		25,297
Total interest income		**30,029**		31,452
Dividends		**16,608**		13,170
Other income		**72**		57
Total investment income (loss)		**377,433**		(598,374)
Less investment expense		**(13,338)**		(9,108)
Net income (loss) from investing activities		**364,095**		(607,482)
Securities lending activities (Note 3):				
Securities lending income		**631**		1,903
Securities lending expense		**(158)**		(476)
Net income from securities lending activities		**473**		1,427
Total additions (deductions)	**$**	**471,978**	$	(505,536)
Deductions:				
Benefits paid to members	**$**	**161,735**	$	144,112
Refunds to members (Note 1)		**547**		618
Professional and administrative expense		**8,390**		7,311
Total deductions		**170,672**		152,041
Net increase (decrease)		**301,306**		(657,577)
Plan net assets held in trust for pension benefits, beginning of period		**2,670,721**		3,328,298
Plan net assets held in trust for pension benefits, end of period	**$**	**2,972,027**	$	2,670,721

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 Statute) and contracts pursuant to Section 27 thereof. 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 and their beneficiaries. The System is a local governmental plan and, therefore, is not subject to the Employee Retirement Income Security Act of 1974 (ERISA). 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.

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

June 30,	2010	2009
Retirees and beneficiaries:		
Currently receiving benefits	2,989	2,876
Not yet receiving benefits	20	19
Active members:		
Fully vested	1,745	1,735
Nonvested:		
Hired or rehired before October 9, 2004	2,271	2,430
Hired or rehired after October 9, 2004	1,338	1,086
Total members	8,363	8,146

The following sections describe the benefit structure in effect at June 30, 2010 and 2009. On September 29, 2004 the System and the City entered into an agreement (the October 9, 2004 Agreement) that altered the benefit structure of 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. The benefits described below include those for members hired or rehired on or before October 9, 2004 as well as benefits for members hired or rehired subsequent to October 9, 2004.

Eligibility – Members become eligible to receive a service pension upon retirement with 20 years of service. Members also have the option to select a Delayed Retirement, which allows for vesting after 10 years of service with a pension benefit payable at age 60. Members hired or rehired subsequent to October 9, 2004 are eligible to receive a service pension upon attaining age 55 and 10 years of service.

Benefits – Retirement benefits are equal to 2.75% of the member's pensionable pay for each of the member's first 20 years of service plus 2.00% of pensionable pay for each year in excess of 20 years with no maximum percentage. Members hired or rehired subsequent to October 9, 2004 accrue benefits equal to 2.25% of the member's pensionable pay for each of the member's first 20 years of service plus 2.00% of the member's pensionable pay for each year in excess of 20 years subject to a maximum of 80%. Retired members and surviving spouses are entitled to receive an additional $150 per month in order to defray group medical insurance costs.

Pensionable Pay - Prior to October 9, 2004 pensionable pay, as referred to herein, was referred to as Average Total Direct Pay (ATDP). ATDP was calculated as the annualized highest biweekly pay received by a member in the last 12 months before retirement or entrance into DROP (see below). Biweekly pay was composed of recurring pay types such as for regular hours worked, plus, ad hoc items of pay such as certain types of overtime and certain types of shift pay. As a part of the October 9, 2004 Agreement eligible members of the System retiring after October 7, 2007 will have their retirement or DROP benefit calculated on pensionable pay, which is referred to as Final Average Pay, and is defined as the average of all pay types received by a member over the three years prior to retirement or entrance into DROP exclusive of all categories of overtime.

Deferred Retirement Option Plan – The Deferred Retirement Option Plan (DROP) provides for an optional method of accruing pension benefits. Generally, members with at least 20 years of service are eligible to participate in the DROP. Members hired or rehired subsequent to October 9, 2004 are not eligible to participate in DROP or Back-DROP. 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. Prior to October 9, 2004, 100% of a member’s contributions were credited to his or her notional DROP account. Subsequent to that date, 8.75% of pensionable pay is credited to his or her notional DROP account.

A Back-DROP benefit is also available for all eligible participants. The Back-DROP option allows a DROP member to recalculate his or her DROP notional account by selecting a different entrance date than that originally selected by the member upon entrance into DROP. 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.

Cost of Living Adjustments – Pension benefits and the monthly DROP benefits are adjusted each year equal to 80% of the increase in the Consumer Price Index for all Urban Consumers for the preceding year subject to minimum and maximum increases of 2.4 % and 8.0%, respectively.

Disability Benefits – Duty connected disability benefits are equal to the greater of 55% of pensionable pay or the accrued service pension. Disabled members who qualify for a Catastrophic Disability, as defined, receive a disability benefit equal to 100% of pensionable pay. Members hired or rehired subsequent to October 9, 2004 are eligible for a duty connected disability benefit equal to the greater of 45% of the member’s pensionable pay or the accrued service pension.

Members determined to be eligible for a non duty-connected disability benefit are entitled to a benefit of either 27.5% of pensionable pay, if the member has 10 or fewer credited years of service, or 2.75% per year for credited service in excess of 10 years. Members hired or rehired subsequent to October 9, 2004 are eligible for a non-duty connected disability benefit equal to the greater of 22.5% of the member’s pensionable pay or 2.25% per year for credited service equal to or in excess of 10 years up to 20 years and 2.00% per year for credited service equal to or in excess of 20 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 Houston Police Department (HPD). This refund does not include interest. Members with at least 10 but less than 20 years of credited pension service, who terminate service with the HPD, have the option of a Delayed retirement. Members hired or rehired subsequent to October 9, 2004 are eligible for a refund of contributions until they attain age 55 and 10 years of service.

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 pensionable pay for each year of credited pension service. Members hired or rehired subsequent to October 9, 2004 are not eligible for a Delayed Retirement.

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. Members hired or rehired subsequent to October 9, 2004 are not eligible for this benefit.

Lump Sum Benefit – Members retiring with a service or disability benefit receive a one-time $5,000 lump sum benefit. Members hired or rehired subsequent to October 9, 2004 are not eligible for this benefit.

Reciprocal Retirement Program – Members who have not attained the necessary years of service for retirement are eligible to participate in the System's Reciprocal Retirement Program if they also have pension service with other City departments. This program allows members with the necessary cumulative years of service to combine their service credit with other City retirement systems and 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 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. Surviving spouses can transfer a DROP or PROP balance to a PROP account of their own but are not eligible to credit all or a portion of their survivor benefit to a PROP account. Members hired or rehired subsequent to October 9, 2004 are not eligible for this benefit.

Partial Lump Sum Option Plan – The Partial Lump Sum Option Plan (PLOP) provides for an optional lump sum payment of a portion of a member's retirement benefit. A lump sum payment of not more than 20% of the actuarial value of the member's accrued pension at retirement shall be made available to persons who become active members of HPOPS subsequent to October 9, 2004. The benefit shall be actuarially neutral. Thus, the value of the pension the member receives shall be reduced actuarially to reflect the lump sum payment.

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.

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. 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 average cost method.

Investment Valuation - 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. These statutes stipulate that the governing body of the System is responsible for the management and administration of the funds of the System and shall determine the procedure it finds most efficient and beneficial for the management of the reserve fund of the System. The governing body may directly manage the investments of the System or may choose and contract for professional investment management services. Investments are reported at fair value in accordance with GASB 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools.

In June 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162 (SFAS 168). SFAS 168 establishes the FASB Accounting Standards Codification (ASC or Codification) and supersedes all the existing non-SEC accounting and reporting standards. Under the Codification, ASC 820, Fair Value Measurements and Disclosures (formerly SFAS 157),defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements and is consistent with valuations required by GASB 31. The System elected to include the ASC 820 disclosures as of July 1, 2008.

ASC 820 establishes a hierarchal disclosure framework which prioritizes and ranks the level of market price observability used in measuring investments at fair value. Market price observability is impacted by a number of factors, including the type of investment and the specific characteristics of the investment. Fair value represents the amount at which an investment could be exchanged in a current transaction between willing parties, other than a forced or liquidation sale. Investments with readily available actively quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and lesser degree of judgment used in measuring fair value.

Investments measured and reported at fair value are classified and disclosed in one of the following categories:

> Level I – Securities traded in an active market with available quoted prices for identical assets as of the reporting date.
>
> Level II – Securities not traded on an active market but for which observable market inputs are readily available or Level I securities where there is a contractual restriction as of the reporting date.
>
> Level III – Securities not traded in an active market and for which no significant observable market inputs are available as of the reporting date.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The System's assessment of the significance of a particular input to the fair value measurement requires judgment and considers factors specific to the investment.

Short-term investments include funds held in short-term investment funds of the System's custodian and asset managers.

Fixed income investments include government securities such as Treasury securities, bank loans, US corporate bonds, foreign securities such as dollar denominated and non-dollar denominated issues of non-US governments and private corporations, plus units of commingled fixed income funds of both US and foreign securities.

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 hedge funds, real estate, private equity and structured beta or "risk parity" funds. These investments are in various investment vehicles including limited partnerships and commingled funds.

The System's custodian bank provides security valuations for equity and fixed income securities utilizing vendor supplied pricing. Vendor supplied pricing data for equity securities is based upon the daily closing price from the primary exchange of each security while vendor supplied pricing data for fixed income securities is based upon a combination of market maker quotes, recent trade activity, and observed cash flows. To minimize the potential for inaccurate valuations, multiple price types are obtained from multiple providers and whenever possible prices are put through tolerance checks with exceptions researched and resolved on a same day basis as part of the pricing process. An integral part of the custodian's pricing process is to allow portfolio managers and interested third parties to challenge custodian provided prices which provides additional validation to the custodian's pricing. The evaluation process is handled by the custodian's internal pricing system, which automatically validates substantially all of the System's securities, leaving only exceptions and missing prices for human intervention. The rules this system applies are multi-dimensional and can be applied at a number of different levels, ranging from general to security specific in nature. Consistent with the System's valuation policy, the System's staff maintains and documents an understanding of the custodian's and underlying manager's valuation process and has implemented a program to review and evaluate the reconciliation process and the fair value estimates provided by the custodian and the investment manager. Based upon the procedures described above, and pursuant to ASC 820, equity securities that are valued based on quoted prices in active markets are generally classified as Level I while fixed income securities are generally considered to be Level II or Level III.

The System's custodian values commingled funds at the net asset value provided by the commingled fund's custodian or administrator, as is applicable. The unit values of commingled funds are calculated by the custodian or administrator by dividing the commingled fund's net asset value on the calculation date by the number of units of the commingled fund that are outstanding on the calculation date. The commingled fund's net asset value is calculated by the commingled fund's custodian or administrator by using Level I, Level II or Level III prices, as appropriate, to value each security and/or other asset held by the commingled fund on the calculation date, pursuant to the commingled fund's valuation policy. In short, the net asset value of the commingled fund is calculated based on a compilation of primarily observable market information. The number of units of a commingled fund that are outstanding on the calculation date is derived from observable purchase and redemption activity in the commingled fund. Consistent with the System's valuation policy, the System's staff maintains and documents an understanding of the underlying fund's valuation process and has implemented a program to review and evaluate the fair value estimates provided by the commingled fund. Based upon the procedures described above and pursuant to ASC 820, the unit value for these commingled funds is considered to be a Level II price unless such commingled fund is traded in an active market with available quoted prices, in which case it is considered to be Level I.

The System's custodian values the System's investment in limited partnerships at the dollar value provided by the general partners. The fair value of securities held by limited partnerships has been estimated by the general partners in the absence of readily ascertainable fair values. The general partners utilize valuation methods which rely on significant assumptions and inputs of the portfolio company's most recent financial information such as EBITDA and debt and the equity structure of the portfolio company. Valuations may be derived by reference to observable valuation measures for comparable companies and may be adjusted for differences between the investment and the referenced comparables. General partners also utilize relevant information such as discounted cash flow analysis, pending recent transactions and potential initial public offering values in the determination of fair value. Consistent with the System's valuation policy, the System's staff maintains and documents an understanding of the general partner's valuation process and has implemented a program to review and evaluate the fair value estimates provided by each partnership. Based upon the procedures described above and pursuant to ASC 820, these limited partnerships are generally considered to be Level III assets.

The System has established a framework to consistently measure the fair value of the System's assets and liabilities in accordance with applicable accounting, legal, and regulatory guidance. This framework has been provided by establishing valuation policy and procedures that will provide reasonable assurance that assets and liabilities are carried at fair value as described above.

The following table summarizes the valuation of the System's investments in accordance with the above ASC 820 fair value hierarchy levels as of June 30, 2010 and 2009.

($000's)	6/30/2010 Fair Value	6/30/2010 Percent of Net Assets	6/30/2009 Fair Value	6/30/2009 Percent of Net Assets
Level I	$ 454,645	15.4 %	$ 434,788	16.4 %
Level II	2,212,010	74.6	1,893,440	71.5
Level III	296,969	10.0	318,798	12.0
	$ 2,963,624	**100.0 %**	**$ 2,647,026**	**100.0 %**

The following table presents a reconciliation of the beginning and ending balances of the fair value measurements using significant unobservable inputs (Level III).

	Fair Value ($000's)
Balance June 30, 2009	318,798
Purchases	46,541
Sales	(103,650)
Realized Gain/Loss	17,799
Unrealized Gain/Loss Change	17,481
Transfers in/(out) of level III	-
Balance June 30, 2010	296,969

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

Federal Income Tax – A favorable determination that the System is qualified and exempt from Federal income taxes was received May 26, 2007. The Board believes that the System is designed and continues to operate in compliance with the applicable requirements of the Internal Revenue Code.

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

3. Investments

The System's investments have been categorized to address deposit and investment risks related to custodial credit risk, credit risk, concentration of credit risk, interest rate risk, and foreign currency risk.

Custodial Credit Risk – Custodial credit risk for deposits is the risk that in the event of a bank failure, the System's deposits may not be returned to them. The System considers only demand deposits as cash. The System does not have a deposit policy regarding custodial credit risk. As of June 30, 2010 and June 30, 2009, the System had a balance of $559 thousand and $283 thousand, respectively, on deposit at a financial institution. The Federal Depository Insurance Corporation (FDIC) covered cash on deposit up to $250 thousand at this financial institution. As of June 30, 2010, $309 thousand of the System's bank balance of $559 thousand was exposed to custodial credit risk. In addition, at June 30, 2010, the System had approximately $3,850 thousand on deposit with other financial institutions, which is subject to custodial credit risk, as it is not covered by depository insurance and is uncollateralized.

Credit Risk – Credit risk is the risk that the counterparty will not fulfill its obligations. As of June 30, 2010, the System's fixed income assets that are not government guaranteed represented 74.1% of the System's fixed income plus short term investments portfolio. The tables below summarize the System's fixed income portfolio exposure levels and credit qualities.

Average Credit Quality and Exposure Levels of Non-U.S. Government Guaranteed Securities
June 30, 2010

Fixed Income Security Type	Market Value ($000's)	Percent of Total	Weighted Average Credit Quality
Corporate Bonds	$ 136,621	14.2 %	BB
International Government Bonds	98,227	10.2	AA
Mutual Bond Funds	232,804	24.2	Not Rated
Bank Loans	4,556	0.5	B
Short Term Investment Funds	240,209	25.0	Not Rated
Total	$ 712,417	74.1 %	

Ratings Dispersion Detail
June 30, 2010
($000's)

Credit Rating Level	Corporate Bonds	Government Bonds	Mutual Bond Funds	Bank Loans	Short Term Investment Funds
AAA	$ -	$ 30,446	$ -	$ -	$ -
AA	-	54,237	-	-	-
A	698	12,261	-	-	-
BBB	5,005	-	-	-	-
BB	48,420	-	-	1,330	-
B	64,477	-	-	1,984	-
CCC	14,545	-	-	-	-
CC	128	-	-	-	-
D	8	-	-	466	-
Not Rated	3,340	1,283	232,804	776	240,209
Total	$ 136,621	$ 98,227	$ 232,804	$ 4,556	$ 240,209

The System's investment policy allows investment managers full discretion in adopting investment strategies to deal with these risks. Unless otherwise provided in the individual investment manager agreement, the average quality rating of each individual fixed income portfolio on a weighted value basis shall be A-rated or higher, and no issue should have a rating below investment grade (Baa or higher). Certain managers, such as high yield managers, may be exempted from these requirements as provided for in their contracts.

Credit risk for derivative instruments held by the System results from counterparty risk, essentially that the counterparty will be unable to fulfill its obligations, assumed by the System. Information regarding the System's credit risk related to derivatives is found under the derivatives disclosures.

Policies regarding credit risk pertaining to credit risk associated with the System's securities lending program are found under the securities lending disclosures.

Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributable to the magnitude of the System's investment in a single issue. The System's investment policy for each specific portfolio limits investments in any one single domestic equity issue to 15% of each portfolio at market value and for any one single international equity issue to 5% of the System's investments. For fixed income investments, the System's policy limits, by each specific portfolio, investment in any one single fixed income security to 10% of each portfolio at market value. As of June 30, 2010, the System did not have any investments in any one organization which represented greater than 5% of plan net assets.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair values of the System's financial instruments. This risk is managed within the portfolio using the modified duration methodology. It is widely used in the management of fixed income portfolios and estimates the sensitivity of a bond's price to interest rate changes. The System does not have an investment policy specifically regarding interest rate risk. Investment managers have full discretion in adopting investment strategies to deal with these risks, and all of the System's fixed income portfolios are managed in accordance with guidelines that are specific as to the degree of interest rate risk taken. The reporting of modified duration found in the tables below and on the next page quantifies the interest rate risk of the System's fixed income investments. Interest rate risks associated with derivative instruments are found in the derivatives disclosures of these notes.

Modified Duration by Security Type
June 30, 2010

Security Type		Market Value ($000's)	Percent of Total	Weighted Average Modified Duration (years)
US Treasuries	$	248,853	25.9 %	2.8
Corporate Bonds		136,621	14.2	4.5
International Government Bonds		98,227	10.2	7.3
Mutual Bond Funds		232,804	24.2	4.7
Bank Loans		4,556	0.5	3.7
Short Term Investment Funds		240,209	25	0.1
Total	$	961,270	100.0 %	4.7

Modified Duration Analysis by Security Type
June 30, 2010

Corporate Bonds		Market Value ($000's)	Average Modified Duration	Contribution Modifed Duration
Less than 1 year to maturity	$	36	0.0	0.0
1 to 10 years maturities		131,843	4.3	4.2
10 to 20 years maturities		3,580	8.6	0.2
Greater than 20 years maturities		1,162	11.4	0.1
Total	$	136,621		4.5
International Government Bonds				
1 to 10 years maturities		68,617	4.7	3.3
10 to 20 years maturities		14,426	11.2	1.6
Greater than 20 years maturities		15,184	15.4	2.4
Total	$	98,227		7.3
Bank Loans				
1 to 10 years maturities	$	4,556	3.7	3.7
Total	$	4,556		3.7

Foreign Currency Risk – Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. The books and records of the System are maintained in US dollars. Foreign currencies and non-US 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. The System's investment policy requires that no foreign equity securities are permitted unless they are U.S. dollar denominated ADR's trading on the U.S. exchanges. International and global managers shall have the permission to use currency forward and futures contracts to hedge currency against the U.S. dollar. Currency forwards and futures used for the purpose of hedging currency shall be subject to the following guidelines: 1) net forward and futures sales of any currency may not exceed total market value of the assets denominated in that currency. This limitation does not apply to global fixed income managers and currency overlay managers if provided for in their contracts, 2) foreign currency exchange contracts with a maturity exceeding 12 months are not permitted, 3) currency options may be entered into in lieu of or in conjunction with forwards sales of currencies with the same limitations as currency forwards and futures. Cross hedging, the selling of one foreign currency for another foreign currency, which may or may not be the base currency of the portfolio, is permitted. The System's exposure to foreign currency risk in U.S. dollars as of June 30, 2010, is shown in the table on the next page.

Foreign Currency Exposure by Asset Class ($000's)
June 30, 2010

Currency	Short Term Investments	Equities	Fixed Income	Alternative Investments	Options on Foreign Currencies	Total
Australian dollar	$ 20					$ 20
British pound sterling	43	39,775	8,088		(8,094)	39,812
Canadian dollar	16	1,370	2,010		(1,956)	1,440
Danish krone			1,255		(1,194)	61
Euro	4,108	105,341	42,035	$ 20,887	(44,241)	128,130
Hong Kong dollar		3,112				3,112
Japanese yen	34	69,713	45,222		(45,134)	69,835
New Zealand dollar		779				779
Norwegian krone		1,717				1,717
Singapore dollar		1,495				1,495
South Korean won		3,688			(15)	3,673
Swedish krona	4	4,442	650		(642)	4,454
Swiss franc	427	18,209				18,636
Total	$ 4,652	$ 249,641	$ 99,260	$ 20,887	$ (101,276)	$ 273,164

Securities Lending Program –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% of the value of the loaned securities for domestic and international securities, respectively, collateralize all security loan agreements. Whenever the market value of the securities on loan changes, the borrower must adjust the collateral accordingly. 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, 2010 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, 2010 and 2009, was $196,200 thousand and $297,146 thousand, respectively. The System also had non-cash collateral at June 30, 2009, of $47 thousand, consisting of treasury securities and letters of credit. 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, 2010 and 2009 was $190,358 thousand and $290,240 thousand, respectively. At June 30, 2010, the System had no credit risk exposure to borrowers because the amounts the System owes the borrowers, $196,200 thousand, exceeds the amounts the borrowers owe the System, $190,358 thousand.

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 equity, fixed income and short term futures contracts along with foreign currency forward contracts. No derivatives are purchased with borrowed funds.

The fair value balance and notional amounts of derivative instruments outstanding at June 30, 2010, classified by type, and the changes in fair value ($000's) of such derivative instruments for the year then ended is shown in the table below.

	Changes in Fair Value *		Fair Value at June 30, 2010 Classification	Amount		Notional Value	
Investment derivatives:							
Short Term Investments Futures contracts	$	21	Short term investments	$	21	$	10,604
Equity Futures contracts	$	(26)	Equity	$	(26)	$	57,465
Fixed Income Futures contracts	$	(1,257)	Fixed Income	$	(1,257)	$	173,595
Foreign currency forward contracts							
British pound sterling	$	(249)	Foreign currency contracts	$	(249)	£	(5,243)
Canadian dollar	$	24	Foreign currency contracts	$	24	C$	(2,104)
Danish krone	$	(16)	Foreign currency contracts	$	(16)	kr	(7,165)
Euro	$	(91)	Foreign currency contracts	$	(91)	€	(36,043)
Japanese yen	$	(657)	Foreign currency contracts	$	(657)	¥	(3,935,815)
South Korean won	$	-	Foreign currency contracts	$	-	₩	(18,411)
Swedish krona	$	(13)	Foreign currency contracts	$	(13)		(4,902) kr

* All changes in fair value are reported in Net appreciation (depreciation) in fair value of investments in the Statements of Changes in Plan Net Assets.

The Change in Fair Value figures in the preceding table represent amounts due to or due from derivative counterparties as of June 30, 2010. Such amounts are reported as a component of Net appreciation (depreciation) in the Statement of Changes in Net Plan Assets and are reported in the Statement of Plan Net Assets as Due to or Due from brokers for futures contacts and as Foreign currency contracts for currency forward contracts.

Futures on investments are used to obtain market exposure and 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. Foreign currency contracts are used to hedge against the currency risk in the System's investments in foreign equity and fixed income securities. To liquidate the contract prior to expiration an offsetting position in the same contract must be taken. These derivatives are used to enhance yields and provide incremental income.

These derivative instruments are subject to the following risks:

- *Custodial Credit Risk* – Custodial credit risk for derivative instruments is the risk that, in the event of the failure of the counterparty to a transaction, the System will not be able to recover the value of the derivative instruments or collateral securities that are in the possession of an outside party. Consistent with the System's investment policy, the System's derivative instruments were held by the counterparty that was acting as the System's agent.

- *Credit Risk* – The risk that the counterparty will not fulfill its obligations. The System does not have an investment policy specifically regarding credit risk for derivative instruments. The System's investment policy allows investment managers full discretion in adopting investment strategies to deal with this risk. 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 derivative instruments.
- *Foreign Currency Risk* – Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of derivative instruments. The System's derivative instruments exposure to foreign currency risk in U.S. dollars as of June 30, 2010, is shown in the table below.

Currency	Short Term Investments Futures	Equity Futures	Fixed Income Futures	Foreign currency contracts
Australian dollar	$ -	$ -	$ 976	$ -
British pound sterling	-	-	1,268	(8,094)
Canadian dollar	928	5,335	583	(1,956)
Danish krone	-	-	-	(1,194)
Euro	-	-	13,635	(44,241)
Japanese yen	4,223	-	8,482	(45,134)
South Korean won	-	-	-	(15)
Swedish krona	-	-	-	(642)
Total	$ 5,151	$ 5,335	$ 24,944	$ (101,276)

Alternative Investments – As of June 30, 2010 and 2009, the System was invested in various partnerships, separate accounts and commingled funds across various types of alternative investments as detailed in the following chart ($000's).

	Fair Value ($000's)	
Investment Type	**June 30, 2010**	June 30, 2009
Private Equity		
Leveraged Buyouts	$ 120,421	$ 94,847
Special Situations	95,866	85,010
Venture Capital	62,072	61,845
Other Alternatives		
Hedge Funds	286,340	252,895
Real Estate Funds	14,053	7,131
Structured Beta	456,536	247,660
	$ 1,035,288	$ 749,388

Supplemental Information on investment and professional expenses included in Schedule II on page 45 herein does not include the investment management fees and performance fees imbedded in the structure of the private equity and other limited partnership investments listed above. Rather, these fees are a component of the Net appreciation in fair value of investments in the accompanying Statement of Changes in Plan Net Assets.

4. Contributions and Reserves

Contributions – Members were required to contribute 8.75% of their pensionable pay to the System through October 9, 2004. Subsequent to that date members are required to contribute 9.00% of pay and members hired or rehired subsequent to October 9, 2004 contribute 10.25% of pay. Contributions are made on a pre-tax basis pursuant to Governing Statutes.

In the October 9, 2004 Agreement, it was 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 for in such Agreement. This cash payment schedule requires a payment of $73,000 thousand for fiscal 2010. For fiscal years 2011 and 2012 the City has agreed to pay the amount contributed in 2010 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 than the actuarially required contribution, $10,000 thousand per year. Once the System reaches a 100% funded ratio, the City will pay the actuarially required rate, but not less than 16.00% of payroll. Assuming an annual increase in City payments of $10,000 thousand per year beginning in fiscal 2013 the City contribution would be $163,000 thousand in fiscal 2020. City contributions in the Statements of Changes in Plan Net Assets may be greater than the contractually agreed amounts, as members are allowed to contribute accumulated sick and vacation pay to the System upon retirement and such contributions are classified as City contributions.

Pursuant to the terms of the October 9, 2004 Agreement and based on the July 1, 2009 actuarial valuation the City contribution rates and the Actuarial Required Contributions are as shown below for the current year and the ten years ending June 30, 2020.

($000's)

Years Ended June 30,	Actuarial Required Contribution	Cash Payments Required by Agreements	Cash Payments as a Percent of Actuarial Required Contribution	Annual Required Contribution as a Percentage of Pay
2010	$ 116,425	$ 73,000	62.7 %	31.7 %
2011	132,163	78,000	59.0	35.7
2012	150,589	83,000	55.1	40.1
2013	172,766	93,000	53.8	45.1
2014	191,957	103,000	53.7	49.1
2015	200,130	113,000	56.5	50.1
2016	208,343	123,000	59.0	50.8
2017	216,766	133,000	61.4	51.3
2018	225,528	143,000	63.4	51.6
2019	234,368	153,000	65.3	51.9
2020	243,372	163,000	67.0	52.0

The October 9, 2004 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 Agreement provides that the City shall have sole responsibility to obtain approval for issuance of the bonds from the Texas Attorney General, and that HPOPS shall have no involvement or responsibility in such process other than to provide the City with certain documents facilitating the annual transfer of funds. The City has issued pension obligation bonds in each year since 2004 totaling $117,865 thousand in conjunction with its obligations under the Agreement and financed $20,000 thousand of its fiscal 2010 obligations utilizing a revenue bond financing facility.

The October 9, 2004 Agreement was based upon projections wherein the City's annual cash payments would be less than the Actuarial Required Contribution (ARC) in each year through 2017 at which time the payments would begin to exceed the ARC. Subsequent to 2017 the scheduled payments were originally projected to be in excess of the ARC increasing to 200% of the ARC in 2035. Due to actuarial and investment losses and the resulting increase in the ARC, the scheduled payments are not projected to exceed the ARC in 2017 or reach 200% of the ARC in 2035 as originally estimated. In addition, beginning in 2013, once the Funded Ratio reaches 75%, if it should ever be subsequently determined that the Funded Ratio has declined below such 75%, then in the fiscal year next following such determination, the City shall pay such additional amounts to the System as shall be necessary to increase the Funded Ratio to 75%. In addition, beginning in 2013, once the Funded Ratio reaches 80%, this becomes the new floor and if it should ever decline below such 80% level, in the fiscal year next following such determination, the City shall pay such additional amounts to the System as shall be necessary to increase the Funded Ratio to 80%. At the System's current asset level of approximately $2,900 thousand, a 5% decline in the funded ratio below the floor would require the City to pay approximately $145,000 thousand. During the 2010 fiscal year, the System changed the Actuarial Cost Method and Amortization Method from the Entry Age Normal Method to the Projected Unit Credit Method to be effective July 1, 2010. It is estimated that this change in method, if implemented as of July 1, 2009, would have increased the System's funded status to 85% which is in excess of the floor provisions discussed above.

The ARC as a percentage of pay for 2009 is 31.7%. This rate consists of 15.5% to cover Normal Costs and 16.2% to amortize the unfunded actuarial accrued liability over 30 years.

5. Funding Status

The System's actuary conducts periodic valuations to determine the adequacy of the employer contribution rates, to describe the financial condition of the System, and to analyze changes in the System's condition. The System engaged a new actuary to perform the 2008 and 2009 valuations. The System's previous actuary made a business decision to no longer include DROP in their actuarial calculations and thus would no longer be able to value the DROP benefits for which members are eligible. There were no issues or disagreements with the System's previous actuary.

The most recent valuation shows the funded position of the System at July 1, 2009 decreased from the funding level at July 1, 2008. The actuarial accrued liability increased $289,539 thousand and the actuarial value of assets increased $93,334 thousand. As a result, the System's Unfunded Actuarial Accrued Liability increased $196,205 thousand to $937,556 thousand as of July 1, 2009, which equates to a funded ratio of 79%. The increase in the Unfunded Actuarial Accrued Liability is due to a combination of factors including the increase in the actuarial value of assets less than assumed and contributions below the actuarially required amount. The funded status of the System as of July 1, 2009, the most recent actuarial valuation date, is as follows:

Actuarial Funded Status as of Actuarial Valuation Date July 1, 2009 ($000's)

Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (Surplus) (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as Percentage of Covered Payroll ((b-a)/c)
$ 3,430,946	$ 4,368,501	$ 937,556	79 %	$ 366,924	256 %

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AALs for benefits. Actuarial assumptions and methods are set by the Board of Trustees, based upon recommendations made by the plan's actuary. The current assumptions used in the valuation were adopted by the Board based on the recommendations from the prior actuary. The results of the actuarial valuation are dependent upon the actuarial assumptions used. Actual results can and almost certainly will differ, as actual experience deviates from the assumptions. Even seemingly minor changes in the assumptions can materially change the liabilities, calculated contribution rates and funding periods. The actuarial calculations presented in the actuarial valuation and reproduced in these financial statements are intended to provide information for rational decision making. The actuarial assumptions and methods used comply with the parameters for disclosure that appear in Governmental Accounting Standards Board (GASB) Statement Number 25.

Additional information as of the latest actuarial valuation follows:

Valuation date	July 1, 2009	
Actuarial cost method	Entry age normal	
Amortization method	Entry age normal	
	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	8.5% with maximum 5-year average of 7.0%	
Actuarial assumptions:	Investment rate of return:	8.5%
	Attributable to inflation	3.0%
	Attributable to real rate of return	5.5%
	Payroll growth rate:	
	Attributable to inflation	3.5%
	Attributable to merit increases	0.0% to 9.5%
	Annual cost of living adjustment	80% of increase in CPI for All Urban Consumers (CPI-U), minimum of 2.4% and maximum of 8.0%

As discussed in footnote 4, Contributions and Reserves, during the 2010 fiscal year the System changed the Actuarial Cost Method and Amortization Method from the Entry Age Normal Method to the Projected Unit Credit Method to be effective July 1, 2010.

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 increase above the rates outlined above and ultimately there could be insufficient assets to cover all future benefit payments of the System. In addition, actuarial projections indicate that if the System achieves its 8.5% actuarial investment return assumption over the period ending in 2020 that the System's funded ratio will decline to below 50% during that period absent increases in contribution rates or adjustments to the System's benefit structure. Alternatively, these projections indicate that a 12.5% annualized return over this same period of time would result in a funded ratio of approximately 70% in 2020.

The financial condition of the System and its ability to meet future obligations is predicated on the funding provisions in the Governing Statute and the October 9, 2004 Agreement, which provides a revenue stream based on a percentage of active members' pensionable pay. If the funding schedule is maintained and adequate earnings and gains annually are provided on investments, the System is projected to eventually be adequately funded. If the City does not meet its funding obligations or if the System's earnings and gains from investments are not sufficient, the System's unfunded actuarial accrued liability and the City's future funding obligations will continue to increase above the rates outlined above.

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 four years in the actuarial value of assets, the July 1, 2009 actuarial value of $3,430,946 thousand is $760,225 thousand greater than the fair value $2,670,721 thousand. The $760,225 thousand in deferred losses will be recognized over the next five 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 or decreases. In the absence of significant asset gains during the next few years, the contribution rate needed to amortize the UAAL over 30 years will increase due to the recognition of these deferred losses. As can be seen in the table in Footnote 4, Contributions and Reserves, in the absence of significant asset gains the employer contribution rate is expected to increase to almost 55% over the next 10 years while actuarial projections indicate that the System's funded ratio will decline to below 50% during this period of time.

6. Litigation

From June 2006 through December 2007, the System was invested in a fully collateralized commodities strategy which was implemented by hiring a commodities strategy manager through execution of the First Amendment to an Investment Management Agreement ("IMA") with State Street Bank and Trust Co. ("State Street"). Under the IMA, State Street had full and absolute control to invest funds deposited with State Street with respect to the Commodities Strategy. The Commodities Strategy was implemented by State Street entering into commodities swap contracts that did not require expenditure of collateral funds until swap contract settlement. Under the IMA, 25% of the cash collateral was held by the swap provider and 75% of the collateral was held by State Street, which invested all 75% it held plus all earnings from the commodities and interest on the cash (more than $54,000 thousand) in State Street's proprietary Limited Duration Bond Fund (the "LDBF"). The LDBF was represented to be an unleveraged enhanced cash fund with an aspirational investment objective to match or exceed the returns of the US JP Morgan one month dollar Libor Index by 50 basis points. The IMA did not require State Street to invest or keep the cash collateral in the LDBF or any other particular cash management fund.

The LDBF was represented to be the fund of choice for State Street's commingled version of the separately managed Commodities Strategy invested in by the System, and the LDBF's investment objectives were represented to maximize income while preserving capital by investing in a diversified portfolio of highly rated fixed income securities that would provide daily liquidity if needed. The LDBF was described as having better sector diversification than your typical 2A-7 regulated money market portfolio. Although never previously disclosed to the System prior to the difficulties encountered by the sub-prime market described below, the System subsequently discovered that the LDBF was leveraged at least 3.3 times in the midst of the subprime crisis and that virtually all of the LDBF's assets (upwards of 90 plus %) were invested in sub-prime residential mortgage-backed related securities and derivatives.

By the early summer of 2007, the sub-prime securities market was encountering severe, negative market conditions, and as a result, the LDBF's securities became highly illiquid with little or no market and huge losses were experienced by the LDBF on the sale of securities when they could be sold. Without notice to the System, during this time, substantially all of the LDBF participants, including the other proprietary funds managed by State Street that had made up the vast majority of investors in the LDBF, liquidated and redeemed units for cash with the most highly rated securities that could be sold or borrowed against and/or had decided to take in-kind distributions of their investment in the LDBF that were allegedly equal to their percentage ownership interests in the Fund. The System terminated the commodities strategy in November 2007 but received a distribution of partial cash ($14,270 thousand) and securities (allegedly worth $13,315 thousand) approximately a month later. The securities could only be sold for a fraction of the alleged value and the System incurred actual damages in excess of $35,000 thousand and has suffered attorney fees and legal costs in excess of $5,000 thousand. In August 2008, the System filed a lawsuit against State Street seeking to recover its losses plus management and legal fees and expenses. In February, 2010, after much of the civil discovery was conducted in the consolidated related civil cases in Multi-District Litigation consolidated into federal court in New York, State Street settled with the Securities and Exchange Commission under terms requiring payment of $21,600 thousand to the System. A portion of the payment does not offset the System's damages and no release was required to receive the funds. The lawsuit is still in progress and while the System cannot estimate the ultimate outcome of these proceedings at this time, it intends to continue to vigorously prosecute the suit to recover all of its damages.

7. Commitments and Contingencies

As described in Note 1, there are 3,609 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, 2010 and 2009, aggregate contributions from these members of the System were approximately $149,680 thousand and $140,179 thousand, respectively. The portion of these contributions that might be refunded to members who terminate prior to pension eligibility has not been determined.

At June 30, 2010 and 2009, the total accumulated lump sum benefit due to DROP members was approximately $708,161 thousand and $648,969 thousand, respectively.

At June 30, 2010 and 2009, the total accumulated lump sum benefit due to PROP participants was $323,707 thousand and $275,829 thousand, respectively.

The System has outstanding commitments to various limited partnerships totaling $218,992 thousand and $240,856 thousand, as of June 30, 2010 and 2009, respectively.

The System has a lease for the office it occupies through April 30, 2015. The monthly base rental and outstanding lease commitment is as detailed in the following chart ($000's).

Period	Monthly Base Rent
July 2010 - April 2012	$ 16
May 2012 - April 2015	17

Fiscal Year	Total Rent
2011	$ 190
2012	192
2013	203
2014	203
2015	169
Beyond 2015	-
	$ 957

Schedule of Funding Progress ($000's) [1]

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, 2004	$ 2,466,070	$ 3,339,224	$873,154	74 %	$ 329,840	265 %
July 1, 2005	2,508,794	3,392,974	884,180	74	321,057	275
July 1, 2006	2,681,375	3,633,145	951,770	74	327,080	291
July 1, 2007	3,004,927	3,857,680	852,753	78	336,029	254
July 1, 2008	3,337,612	4,078,963	741,351	82	351,525	211
July 1, 2009	3,430,946	4,368,501	937,556	79	366,924	256

(1) The System's actuaries have indicated that these valuation data 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 above could have been developed by selecting different points within the best-estimate ranges for various assumptions.

Schedule of Employer Contributions ($000's)

Years Ended June 30,	Actuarial Required Contribution	Cash Payments Required by Agreements [2]	Cash Payments as a Percent of Actuarial Required Contribution	Annual Required Contribution as a Percentage of Pay
2005	$ 94,004	$ 36,645	14.7 % [3]	28.5 %
2006	100,170	53,000	23.0 [4]	31.2
2007	107,443	58,000	26.1 [5]	34.0
2008	107,865	63,000	26.0 [6]	32.1
2009	108,621	68,000	44.2 [7]	30.9
2010	116,315	73,000	45.6 [8]	31.7

(2) The amounts listed are in accordance with a payment schedule as provided for in the October 9, 2004 Agreement between the System and the City.
(3) The percentage contributed figure for 2005 has been calculated based on $13,780 thousand since the remainder of the fiscal 2005 cash payment was from the proceeds of pension obligation bonds and, as such, must be excluded from such calculations.
(4) The percentage contributed figure for 2006 has been calculated based on $23,000 thousand since the remainder of the fiscal 2006 cash payment was from the proceeds of pension obligation bonds and, as such, must be excluded from such calculations.
(5) The percentage contributed figure for 2007 has been calculated based on $28,000 thousand since the remainder of the fiscal 2007 cash payment was from the proceeds of pension obligation bonds and, as such, must be excluded from such calculations.
(6) The percentage contributed figure for 2008 has been calculated based on $28,000 thousand since the remainder of the fiscal 2008 cash payment was from the proceeds of pension obligation bonds and, as such, must be excluded from such calculations.
(7) The percentage contributed figure for 2009 has been calculated based on $48,000 thousand since the remainder of the fiscal 2009 cash payment was from the proceeds of pension obligation bonds and, as such, must be excluded from such calculations.
(8) The percentage contributed figure for 2010 has been calculated based on $53,000 thousand since the remainder of the fiscal 2010 cash payment was from the proceeds of pension obligation bonds and, as such, must be excluded from such calculations.

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, 2009
Actuarial cost method	Entry age normal
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	8.5% with maximum 5-year average of 7.0%
Actuarial assumptions:	
Investment rate of return	8.5%
Attributable to inflation	3.0%
Attributable to real rate of return	5.5%
Payroll growth rate:	
Attributable to inflation	3.5%
Attributable to merit increases	0.0% to 9.5%
Annual cost of living adjustment	80% of increase in CPI for All Urban Consumers (CPI-U), minimum of 2.4% And maximum of 8.0%

Houston Police Officers' Pension System

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

Year ended June 30,	2010	2009
Investment services:		
Custodial services	$ 226	$ 219
Money management services	11,268	7,642
Consulting services	790	886
Department Operating Expense	1,054	361
Total investment services	13,338	9,108
Professional services:		
Actuarial services	42	99
Auditing services	110	80
Election audit services	1	-
Legal services	5,667	1,984
Lobbyist services	307	316
Total professional services	6,127	2,479
Administrative expenses:		
Computers and technology	346	2,451
Education	43	42
Fiduciary insurance	84	83
Office rent	171	176
Other office costs	1,619	2,080
Total administrative expenses	2,263	4,832
	$ 21,728	$ 16,419

See accompanying independent auditors' report.

Houston Police Officers' Pension System

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

Twelve Months Ended June 30, 2010	Official System Position	Expense	Nature of Services
Hammond Associates	Consultant	790	Consulting
The Northern Trust Company	Custodian	226	Custodian
AQR Capital Management LLC	Money Manager	138	Money Management
Ashmore Investment Management Limited	Money Manager	2,383	Money Management
BlackRock	Money Manager	340	Money Management
Brandes Investment Partners	Money Manager	944	Money Management
Bridgewater Associates, Inc.	Money Manager	4,527	Money Management
Causeway Capital Management	Money Manager	561	Money Management
The Clifton Group	Money Manager	248	Money Management
Dimensional Fund Advisors	Money Manager	382 *	Money Management
Driehaus Capital Management, Inc.	Money Manager	177	Money Management
First Eagle Investment Mgmt, LLC	Money Manager	656	Money Management
First Quadrant LP	Money Manager	44	Money Management
MacKay-Shields Financial Corp.	Money Manager	540	Money Management
Shenkman Capital Management, Inc.	Money Manager	328	Money Management
Gabriel Roeder Smith & Co.	Actuary	42	Actuarial
BDO Seidman, LLP	Auditors	110	Auditing
Burford & Maney, PC	Attorneys	1,526	Legal Service
Gibbs & Bruns, LLP	Attorneys	2,419	Legal Service
Klausner & Kaufman	Attorneys	18	Legal Service
Strasburger & Price, LLP	Attorneys	42	Legal Service
Accumyn, L.L.C.	Consultant	1,096	Legal Service
Beck, Redden & Secrest, LLP	Consultant	3	Legal Service
J. Philip Ferguson	Consultant	158	Legal Service
Navigant Consulting, Inc.	Consultant	289	Legal Service
Securities Litigation and Consulting Group, Inc.	Consultant	90	Legal Service
HillCo Partners, LLC	Attorneys	157	Lobbyists
Locke Lord Bissell & Liddell LLP	Attorneys	150	Lobbyists
Bickley Prescott & Co.	Consultant	1	Election Auditing
Other	Other	26	Other
Total investment and professional services		$ 18,411	

* The System invests in a mutual fund managed by Dimensional Fund Advisors. This figure represents estimated annual fees incurred by the System based upon the System's average monthly balance.

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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 System's 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 as well as the consideration of current and forward-looking market conditions.

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 and that 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, achieve broader diversification of the System's assets, and to dampen volatility in investment returns.

Investment Policy

The Board of the Houston Police Officers' Pension System (HPOPS) has established an Investment policy with the following broad guidelines and objectives.

- Establish overall financial objectives and set investment policy
- Select appropriate investment options
- Select qualified investment manager(s) and consultants
- Select a qualified custodian
- Communicate on a structured and ongoing basis with those responsible for investment results; and
- Monitor performance to assure that objectives are being met and that policy and guidelines are being followed.

This Investment Policy represents the formal document for HPOPS and is to be communicated to the appointed Investment Manager(s) and is their principal source for developing an appropriate investment strategy and, in addition, serves as the basis for these Managers' and the System's future performance evaluation.

Investment Strategy and Performance

The System has an asset allocation strategy in place that was initially designed to meet its overall investment objective of a long-term 8.5% annualized 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 asset allocation and the actual asset allocation of the System at June 30, 2010 are as follows:

	Target % of Fund	Current Actual % of Fund	Dollars Invested (000's)
Domestic Equity	18.0%	17.5%	$ 518,710
International Equity	18.0%	20.3%	604,699
Total Equity	36.0%	37.8%	1,123,409
Fixed Income	21.0%	21.6%	641,494
High Yield	7.5%	5.2%	154,954
Total Fixed Income	28.5%	26.8%	796,448
Private Equity	10.0%	9.4%	278,359
Risk Parity	12.5%	15.0%	446,536
Hedge Funds	8.0%	10.1%	299,840
Real Assets	5.0%	0.5%	14,053
Total Alternatives	35.5%	35.0%	1,038,788
Total Cash	0.0%	0.4%	12,314
Total Fund	100.0%	100.0%	$ 2,970,959

The market rally that began in March 2009 lasted for the first half of fiscal year 2010. In January, the rally began to stall as investors questioned the sustainability of the economic recovery without improving fundamentals. News of the European debt crisis caused volatility to spike sharply higher during the last few months of the fiscal year and forced investors to accept the prolonged state of the economic downturn. Despite the increased volatility at year end, the System had a very strong return of 13.7% during fiscal year 2010.

The System out-performed its benchmark rate of return by 1.6%, primarily due to the strong performance of our hedge fund managers and our allocation to risk parity. The System’s investments in emerging markets debt and emerging markets equity also contributed to the out-performance as well as the superior performance of one of our active managers, Causeway Capital.

Domestic Equity

The System’s domestic equity investments generated a 14.8% return, underperforming the 15.7% return of its benchmark, the Russell 3000. The System’s domestic equity portfolio is structured to closely follow the capitalization and style weightings of the Russell 3000 Index.

First Eagle outperformed their benchmark, the Russell 1000, by approximately 3.1%. In the first half of the year, they underperformed as security selection within the information technology and health care sectors hurt performance. As financial markets declined in the second half of the fiscal year their overweight to the consumer discretionary sector and security selection within the materials and energy sectors protected the portfolio.

Driehaus had significant underperformance in the first half of the year due to the portfolio's underweight to the information technology sector and un-invested cash funds not participating in the market rally. During the second half of the year, superior stock selection in the information technology sector and the un-invested cash served to protect the portfolio, achieving outperformance of 1.2%. For the fiscal year Driehaus underperformed the Russell 1000 Growth Index by 1.4%.

Assets under management, annualized rates of return and fees paid to domestic equity managers for the fiscal year ending June 30, 2010 are as follows (dollars in 000's):

Manager	Style	Assets	% Returns	Fees
First Eagle	Large Cap	$ 133,706	18.3%	$ 656
BlackRock	S&P 500 Index	224,654	11.8%	47
BlackRock	Russell 2000 Index	25,518	21.7%	21
Clifton Group	S&P 500 Futures[1]	84,806	13.7%	114
Driehaus Capital Mgmt	Large Cap Growth	50,026	12.3%	177
		$ 518,710		$ 1,428

[1]Futures are fully funded

	HPOPS	Benchmark
# of holdings	2291	3000
Avg Market Cap	$59.01 Billion	$59.00 Billion
Portfolio P/E	15.73	14.85
Portfolio P/Book	2.27	1.90
Portfolio Beta (3-yr)	1.03	1.00

International Equity

The System's international equity investments returned 11.6%, outperforming the 10.4% return of the MSCI ACWI ex U.S. benchmark for the fiscal year. This overall out-performance was due to a combination of active management and asset allocation, including an overweight to emerging market equity.

Brandes underperformed its benchmark the MSCI EAFE Index by approximately 2.6%. This underperformance was primarily due to an overweight to Japan as Japan lagged other non-US markets. Additionally, Brandes was overweight to the telecom, IT and financial sectors which detracted from performance.

Causeway outperformed the return of its benchmark, the MSCI EAFE Index during fiscal year 2010 by 7.9%. Strong stock selection led to out-performance during the market rally during the first half of the year and during the volatile second half as well.

Assets under management, annualized rates of return and fees paid to international equity managers for the fiscal year ending June 30, 2010 are on the next page (dollars in 000's):

Manager	Style	Assets	% Returns	Fees
BlackRock	EAFE Small Cap	$ 72,019	12.7%	$ 91
BlackRock	Emerging Markets Equity	62,125	22.4%	48
BlackRock	World Equity ex-US	33,947	10.7%	40
Brandes	EAFE	181,439	3.8%	944
Causeway Capital	EAFE	91,723	14.3%	561
Clifton Group	World Equity ex-US Futures[1]	69,288	8.5%	38
DFA	Emerging Markets Equity	94,158	27.3%	382
		$ 604,699		$ 2,104

[1]Futures are fully funded

	HPOPS	Benchmark
# of holdings	7167	1819
Avg Market Cap	$24.38 Billion	$37.32 Billion
Portfolio P/E	13.32	16.06
Portfolio P/Book	1.24	1.51
Portfolio Beta (3-yr)	0.99	1.00

High Yield

High yield investments are segregated by HPOPS as a separate investment category with a target allocation of 7.5% of the System's total assets.

Beginning in November 2009, the System implemented a tactical underweight of 2.5% to the high yield asset class due to significant tightening of credit spreads. This allocation was still in place as of the fiscal year-end. Assets under management, annualized rates of return and fees paid to high yield managers for the fiscal year ending June 30, 2010 are as follows (dollars in 000's):

Manager	Style	Assets	% Returns	Fees
MacKay Shields	High Yield	$ 93,307	20.4%	$ 417
Shenkman Capital Mgmt	High Yield	61,647	15.0%	328
		$ 154,954		$ 745

	HPOPS	Benchmark
# of securities	477	1,454
Yield to Maturity	8.18	7.70
Effective Duration	3.30	4.17
Quality Rating S&P	B+	B+

Fixed Income

The System's fixed income strategy consists of a separate allocation to a global fixed income mandate, inflation indexed bonds, an emerging market sovereign debt mandate, an emerging markets local currency strategy and an emerging markets corporate high yield bond fund. The System's fixed income portfolio outperformed its benchmark with a fiscal year return of 11.6% versus the 9.5% return on the Barclay's

Aggregate Bond Index for the same time period. Assets under management, annualized rates of return and fees paid to fixed income managers for the fiscal year ending June 30, 2010 are as follows (dollars in 000's):

Manager	Style	Assets	% Returns	Base Fee
Clifton	TIPS	$ 228,587	9.4%	68
Ashmore	Emerging Markets Fixed Income	124,928	23.7%	1,091
Ashmore	Local Currency Debt	87,876	4.7%	1,292
Ashmore	Emerging Markets High Yield[1]	20,000	0.0%	-
Bridgewater[2]	Global Fixed Income, Hedged	180,103	6.7%	-
		$ 641,494		$ 2,451

[1] Funded on 6/30/2010

2 Fees for this strategy are commingled with the fee struture for the Bridgewater hedge fund strategy disclosed elsewhere in this document

Alternative Investments

The System's alternative investment program consists of allocations to private equity, hedge funds, risk parity strategies and real assets. The private equity program was managed by Abbott Capital from 1997 – 2008. Hammond Associates has been overseeing our private equity mandate since the departure of Abbott Capital. The private equity program is a relatively mature strategy in that the System has reached its investment target of approximately 10% of total assets while still having $175 million of outstanding commitments. The System had investments in or commitments to 71 individual private equity partnerships with 40 general partners at June 30, 2010. The current allocation within this strategy is approximately 43% in leveraged buyouts, 34% in special situation funds and 22% in venture capital. This program required $34.9 million of additional funding during fiscal 2010 while at the same time generating distributions of $32.3 million for the same period. This private equity program generated returns for the 2010 fiscal year of 13.9% versus a return of 20.2% of its benchmark, the S&P 500 plus 5%.

The System also has an 8.0% allocation to hedge funds and had $300 million actually invested as of June 30, 2010. These strategies generated fiscal year performance of approximately negative 12.7%.

The System has had a ten percent allocation to risk parity since 2005 and has increased this allocation during fiscal 2010. In addition, un-invested cash allocated to private equity and real estate is generally invested in risk parity until needed. These risk parity strategies are designed to address the issue of the traditional over-allocation of risk to equities and to take full advantage of the powers of diversification. It is a risk-balanced portfolio of asset classes structured to provide equity-like returns with far less risk. Additionally, these strategies are designed to provide more consistent returns across a wide range of economic environments.

Assets under management, annualized rates of return and fees paid to alternative investments managers for the fiscal year ending June 30, 2010 are shown on the next page (dollars in 000's):

Manager	Style	Assets	% Returns	Base Fee
Bridgewater	Risk Parity	$ 217,497	20.2%	601
AQR[1]	Risk Parity	119,608	6.8%	138
First Quadrant[2]	Risk Parity	109,431	-2.3%	44
Bridgewater	Hedge Fund	80,466	29.3%	3,926
Hammond	Hedge Funds	178,347	8.2%	600
Attalus	Hedge Fund	41,027	2.2%	627
Hammond	Real Assets	14,053	N/A	-
Hammond	Private Equity	20,579	N/A	190
Private Equity (Legacy)	Private Equity	257,781	N/A	-
		$ 1,038,789		$ 6,126

[1] Funded on 2/28/2010

[2] Funded on 4/30/2010

Cash

During September 2008 the System switched to a "government only" STIF fund at its custodian bank thereby avoiding many of the liquidity issues experienced by many STIF funds during the credit crisis. The System has a cash securitization program which was initiated in order to more closely track our strategic asset allocation through the securitization of excess cash. During late 2008, the financial markets became extremely volatile resulting in the suspension of the cash securitization program. This program was re-instated at the beginning of fiscal year 2010.

Manager	Style	Assets (000s)	% Returns	Base Fee (000s)
Clifton Group	Cash Securitization	$ 5,061	13.7%	$ 28
		$ 5,061		$ 28

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. In June 2008 the System switched to a "government only" collateral pool thus avoiding exposure to the liquidity issues experienced by many securities lending collateral pools during the credit crisis.

Vendors other than Northern Trust could be used for this program which 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.

Following is a chart of securities lending activity for the most recent three fiscal years (dollars in 000's).

	2010	2009	2008
Avg Securities on Loan	$ 275,442	$ 331,878	$ 492,463
Avg Eligible Securities	$ 952,124	$ 823,736	$ 1,242,246
% on Loan	28.9%	40.3%	39.6%
HPOPS Net Earnings	$ 473	$ 1,427	$ 2,392
Duration of Collateral Pool (days)	34	36	34

Report Preparation

This report was prepared by the Investment Department of the Houston Police Officers' Pension System. All calculations were prepared using a time-weighted rate of return in accordance with The CFA Institute's Global Investment Performance Standards. The System's total rates of return are net of fees. All other rates of return are presented gross of fees. Though these standards do not apply to plan sponsors per se, we have used them herein for purposes of presenting investment rates of return. The Composite Benchmark returns are calculated as if the System's current asset allocation had been in place for all time periods.

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

Year	System Total	Composite Benchmark	Domestic Equity	Russell 3000	Int'l Equity	MSCI ACWI ex U.S.	Fixed Income	Barclays Aggregate	High Yield	Citigroup HY	Alternative Investments
2006	11.2	10.3	12.6	9.6	26.4	28.4	4.5	6.8	6.3	4.2	16.5
2007	17.9	15.9	21.5	20.0	29.3	30.2	9.8	6.1	11.6	11.6	11.8
2008	0.3	-0.3	-10.4	-12.7	-15.2	-6.2	12.9	7.1	-0.6	-2.3	9.5
2009	-18.2	-14.6	-33.8	-26.6	-27.7	-30.9	-1.3	6.1	-0.3	-3.2	-20.3
2010	13.7	12.1	14.8	15.7	11.6	10.4	11.6	9.5	18.5	25.7	15.1

Compound Annualized Rates of Return by Year (%)
Periods Ended June 30, 2010

Year	System Total	Composite Benchmark	Domestic Equity	Russell 3000	Int'l Equity	MSCI ACWI ex U.S.	Fixed Income	Barclays Aggregate	High Yield	Citigroup HY	Alternative Investments
2	-3.5	-1.6	-13.0	-7.8	-10.1	-12.7	4.9	7.8	8.7	10.3	-1.9
3	-2.3	-1.8	-12.1	-9.5	-11.9	-10.7	7.5	7.6	5.5	5.9	1.5
5	4.1	3.9	-1.5	-0.5	2.3	3.4	7.4	5.5	6.8	6.7	5.1
10	4.4	3.9	0.7	-0.9	2.9	2.3	8.7	6.5	7.8	7.2	4.2

These calculations were prepared using a time-weighted rate of return in accordance with The CFA Institute's Global Investment Performance Standards. The System's total rates of return are net of fees. All other rates of return are presented gross of fees. Though these standards do not apply to plan sponsors per se, we have used them herein for purposes of presenting investment rates of return. The Composite Benchmark returns are calculated as if the System's current asset allocation had been in place for all time periods.

Schedule of Ten Largest Domestic Equity Holdings
As of June 30, 2010

Shares	Description	Market Value ($000's)	% of Total Domestic Equity
161,339	Occidental Petroleum	$ 12,515	2.4%
149,430	Colgate-Palmolive	11,769	2.3%
205,913	Kellogg Co.	10,357	2.0%
134,855	Praxair Inc.	10,248	2.0%
142,056	Pioneer Nat Res Co.	8,445	1.6%
118,668	Newmont Mining	7,327	1.4%
289,946	Texas Instruments	6,750	1.3%
345,690	Comcast Corp.	6,005	1.2%
47,958	IBM Corp.	5,922	1.1%
150,465	Amphenol Corp	5,913	1.1%

Schedule of Ten Largest Non-U.S. Equity Holdings
As of June 30, 2010

Shares	Description	Market Value ($000's)	% of Total International Equity
116,242	Sanofi-Aventis	$ 7,052	1.2%
439,700	Deutsche Telekom	5,226	0.9%
107,150	Astrazeneca	5,080	0.8%
118,200	Nippon Telegraph	4,862	0.8%
279,001	Centrais Eletricas	4,840	0.8%
86,651	Akzo Nobel	4,564	0.8%
453,374	Portugal Telecom	4,543	0.8%
239,500	Eni Spa	4,456	0.7%
244,239	Glaxosmithkline	4,231	0.7%
922,100	Mitsubishi	4,220	0.7%

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

Schedule of Ten Largest Domestic Fixed Income Holdings

As of June 30, 2010

Par Value ($000's)	Description	Market Value ($000's)	% of Total U.S. Fixed Income
$ 9,508	US Treas Infl IX Bonds 2.375 Due 01-15-2025 BEO	$ 12,317	3.2%
9,000	US Treas Nts IX Linked 2 Due 1-15-2014 Reg	11,408	3.0%
6,222	US Treas Bds Infl IX 3.875 Due 4-15-2029	11,139	2.9%
8,100	US Treas Nts Infl IX Bond 2.00 Due 07-15-2014 Reg	10,138	2.6%
8,600	US Treas Bds IX 2.00 Due 1-15-2026 Reg	10,074	2.6%
5,696	US Treas Bds Infl IX Due 4-15-2028/12-9-1999 Reg	9,994	2.6%
7,500	US Treas Bds 3.00 IX Nts Due 7-15-2012 Reg	9,798	2.6%
7,350	US Treas Nts IX 2.375 Due 1-15-2017 Reg	8,857	2.3%
7,300	US Treas Nts IX 1.875 Due 7-15-2015 Reg	8,836	2.3%
7,300	US Treas Nts IX 2.00 Due 1-15-2016 Reg	8,723	2.3%

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

As of June 30, 2010

Par Value ($000's)	Description	Market Value ($000's)	% of Total Non-U.S. Fixed Income
850,000	Japan (Govt of) 1.4% Bonds 20/12/13 JPY'256'	$ 10,006	2.4%
530,000	Japan (Govt of) 2.1% Bonds 20/09/24 JPY'72''	6,492	1.6%
400,000	Japan Govt Bond 1.7% 20 SEP 2017	4,885	1.2%
400,000	Japan (Govt of) 1.2% Bds 20/09/11 JPY'60'	4,594	1.1%
350,000	Japan (Govt of) 1.3% Bds 20/12/19 JPY100000	4,059	1.0%
300,000	Japan (Govt of) 1.4% Bds 20/12/11 JPY'235'	3,454	0.8%
1,840	UK (Govt of) 4.75% STK 07/12/38 GBP100	3,031	0.7%
2,100	France (Govt of) 4% OAT 25/04/2013 EUR1	2,799	0.7%
2,000	Italy (Rep of) 6% BTP 1/5/2031 EUR1000	2,776	0.7%
2,000	Italy Rep T-Bond 4.25% 1/8/2014	2,629	0.6%

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

Schedule of Brokerage Commissions Paid

Domestic Equity Trading - Ten Largest by Total Commissions Paid
For the year ended June 30, 2010

Brokers	Shares	Commissions	Principal	Commissions Per Share
Driehaus Securities Corp.	5,927,177	$ 171,134	$ 163,499,410	$ 0.029
Merrill Lynch Pierce Fenner & Smith	2,251,687	82,616	73,651,769	0.037
Goldman Executing & Clearing	2,983,740	35,841	86,988,861	0.012
Cap Institutional Services Inc	846,538	33,862	30,452,736	0.040
Griswold Company	2,234,620	27,933	69,862,126	0.013
J.P. Morgan Securities Inc.	1,304,528	27,575	36,612,763	0.021
Liquidnet Inc.	1,222,412	20,474	34,225,325	0.017
Credit Suisse First Boston Corp.	2,774,000	19,519	71,560,237	0.007
Bernstein, Sanford C. & Co.	460,300	17,934	15,877,783	0.039
Lombardi & Company	1,257,548	15,719	46,556,639	0.012

International Equity Trading - Ten Largest by Total Commissions Paid
For the year ended June 30, 2010

Brokers	Shares	Commissions	Principal	Commissions Per Share
Morgan Stanley	1,029,686	$ 24,194	$ 17,101,397	$ 0.023
Citigroup Global Markets	1,366,288	17,831	12,325,247	0.013
Deutsche Bank Securities	1,927,090	17,132	10,406,750	0.009
Nomura Securities	753,662	14,563	9,548,631	0.019
CSFB	850,034	13,886	10,827,771	0.016
UBS Securities	1,119,560	12,236	10,225,213	0.011
Merrill Lynch	1,073,643	9,570	12,292,626	0.009
Sanford C. Bernstein	441,741	8,105	6,154,234	0.018
JP Morgan Securities	342,564	8,072	5,792,961	0.024
Barclays Capital Inc.	229,663	7,083	4,438,776	0.031

SECTION FOUR

ACTUARIAL SECTION

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Gabriel Roeder Smith & Company
Consultants & Actuaries

HOUSTON POLICE OFFICERS' PENSION SYSTEM

ACTUARIAL VALUATION REPORT
FOR THE YEAR BEGINNING JULY 1, 2009

GRS Gabriel Roeder Smith & Company
Consultants & Actuaries

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January 6, 2010

Board of Trustees
Houston Police Officers' Pension System
602 Sawyer
Suite 300
Houston, TX 77007

Dear Members of the Board:

Subject: Actuarial Valuation as of July 1, 2009

We are pleased to present our Report of the actuarial valuation of the Houston Police Officers' Pension System ("HPOPS" or "the System") for the plan year commencing July 1, 2009. This report describes the current actuarial condition of HPOPS, determines the calculated employer contribution rate (the actuarially required rate), and analyzes changes in this contribution rate. Valuations are prepared annually, as of July 1, the first day of the HPOPS plan year.

Financing objectives and funding policy

Under the HPOPS statute, the employer contribution rate is determined actuarially, based on the Board's funding policy and HPOPS' governing law. The contribution rate determined by a given actuarial valuation and implemented by the Board becomes effective twelve months after the valuation date, i.e., the rates determined by this July 1, 2009 actuarial valuation will be used by the Board when determining the employer contribution rate for the year beginning July 1, 2010 and ending June 30, 2011.

Under the 2004 Meet & Confer Agreement between the Board and the City of Houston, a funding schedule was implemented resulting in a minimum $53 million employer contribution for the fiscal year ending June 30, 2006, increasing by $5 million each year thereafter until HPOPS' funded ratio reaches 100%. In addition, beginning in fiscal year 2013, the City contribution will increase by an additional $5 million per year ($10 million in total) if the contribution levels are still less than the actuarially determined rate. Once the System reaches a 100% funded ratio, the City will pay the actuarially required rate, but not less than 16.00% of payroll.

Given the above schedule, the employer contribution amount for the fiscal year ending June 30, 2011 is not set by this actuarial valuation as of July 1, 2009. Therefore, the actuarially calculated contribution rate from this valuation will not be contributed. Instead, City contributions of $73 million for FY 2010 and $78 million for FY 2011 are to be made under the terms of the above funding schedule.

Houston Police Officers' Pension System
January 6, 2010
Page 2

The amortization period is set by statute, and was modified under the Meet and Confer. The contribution rate and liabilities are computed using the Entry Age Normal (EAN) actuarial cost method. The employer contribution rate is the sum of two pieces: the employer normal cost rate and the amortization rate. The normal cost rate is determined as a percentage of payroll. The employer normal cost is the difference between this and the weighted member contribution rate. The amortization rate is also determined as a level percentage of payroll. It is the amount required to amortize the unfunded actuarial accrued liability (UAAL) over an open period (30 years as of July 1, 2009).

Progress toward realization of financing objectives

The funded ratio (the ratio of the actuarial value of assets to the actuarial accrued liability) is a standard measure of a plan's funded status. In the absence of benefit improvements, it should increase over time, until it reaches 100%. The funded ratio as of July 1, 2009 is 78.54%. In the 2008 valuation the funded ratio was 81.83%.

The calculated employer contribution rate for FY 2011 is 31.73%. This rate is greater than the 30.91% rate calculated in the 2008 valuation. This is due to the significant asset loss in FY 2009. Please see Table 6 under Section III of our Report for a detailed analysis of the change in the calculated employer contribution rate from the prior year to this year.

As you know, the contribution rate is determined using an actuarial value of assets rather than market value. The actuarial value recognizes the difference in actual investment returns relative to the expected return over 5 years rather than reflecting them immediately. There are currently $760.2 million in asset losses being deferred that will be recognized over the next 4 years and further deteriorate the funded status of the System. In the absence of significant asset gains during the next few years, the contribution rate needed to amortize the UAAL over 30 years will increase due to the recognition of these deferred losses. As can be seen in Table 7 of Section III, in the absence of any future gains or losses the employer contribution rate is expected to increase to almost 55% over the next 10 years as the funded ratio decreases below 50%.

It should be noted that other than the City of Houston's agreement to maintain a funded status floor as specified under the 2004 Meet & Confer, the City funding schedule could potentially not be sufficient to cover all future benefit payments of HPOPS. Moreover, the System is currently below the initial funded status floor and it is likely the floor in its current form will not be applicable.

Benefit provisions

The benefit provisions reflected in this valuation are those which were in effect on July 1, 2009. There were no changes in the benefit provisions since the prior valuation.

The benefit provisions are summarized in Appendix B of our Report.

Houston Police Officers' Pension System
January 6, 2010
Page 3

Assumptions and methods

Actuarial assumptions and methods are set by the Board of Trustees, based upon recommendations made by the plan's actuary. The current assumptions used in the valuation were adopted by the Board based on the recommendations from the prior actuary, Towers Perrin.

The results of the actuarial valuation are dependent upon the actuarial assumptions used. Actual results can and almost certainly will differ, as actual experience deviates from the assumptions. Even seemingly minor changes in the assumptions can materially change the liabilities, calculated contribution rates and funding periods. The actuarial calculations presented in our Report are intended to provide information for rational decision making.

The actuarial assumptions and methods used in this report comply with the parameters for disclosure that appear in Governmental Accounting Standards Board (GASB) Statement Number 25.

All assumptions and methods are described in Appendix A of our Report.

Data

Member data for retired, active and inactive members was supplied as of July 1, 2009 by the HPOPS staff. We did not audit this data, but we did apply a number of tests to the data, and we concluded that it was reasonable and consistent with the prior year's data.

Asset and financial information as of July 1, 2009 was supplied to us by the HPOPS staff.

Plan Experience

As part of each valuation, we examine the System's experience relative to the assumptions. The aggregate results of these analyses are disclosed in Tables 5 & 6 under Section III of our Report. This past fiscal year the System had a total liability gain of approximately $1 million.

Actuarial Certification

All of the tables contained in this actuarial valuation report and in the actuarial section of the HPOPS Comprehensive Annual Financial Report (CAFR) were prepared by Gabriel, Roeder, Smith & Company. Historical information for years prior to 2008 was prepared by the prior actuarial firm and was not subjected to our actuarial review. We certify that the information presented herein is accurate and fairly portrays the actuarial position of HPOPS as of July 1, 2009.

All of our work conforms with generally accepted actuarial principles and practices, and with the Actuarial Standards of Practice issued by the Actuarial Standards Board. In our opinion, our calculations also comply with the requirements of state law and, where applicable, the Internal

Houston Police Officers' Pension System
January 6, 2010
Page 4

Revenue Code, ERISA, and the Statements of the Governmental Accounting Standards Board. The undersigned are independent actuaries and consultants. Both Mark and Joseph are Enrolled Actuaries and all are Members of the American Academy of Actuaries, and all meet the Qualification Standards of the American Academy of Actuaries. Finally, all of the undersigned are experienced in performing valuations for large public retirement systems.

Respectfully submitted,
Gabriel, Roeder, Smith & Company

Mark R. Randall, FCA, EA, MAAA
Executive Vice President

Joseph P. Newton, FSA, EA, MAAA
Senior Consultant

Bradley E. Stewart, ASA, MAAA
Consultant

Executive Summary (dollar amounts are in millions)

Item	July 1, 2009	July 1, 2008
Membership		
• Number of:		
- Active members	5,245	5,065
- Retirees and beneficiaries	2,878	2,796
- Inactive members	22	19
- Total	8,145	7,880
• Annualized Payroll supplied by HPOPS	$ 354,516	$ 339,638
Calculated Contribution rates		
• Employer	31.73%	30.91%
• Member[1]	9.18%	9.12%
Assets ($000s)		
• Market value	$ 2,670,721	$ 3,328,298
• Actuarial value	3,430,946	3,337,612
• Estimation of return on market value	-18.6%	0.2%
• Estimation of return on actuarial value	4.1%	12.5%
• Employer contribution	$ 68,000	$ 63,000
• Member contribution	$ 32,519	$ 31,003
• Ratio of actuarial value to market value	128.5%	100.3%
Actuarial Information		
• Employer normal cost %	15.54%	17.54%
• Unfunded actuarial accrued liability (UAAL)	$ 937,556	$ 741,351
• Amortization rate	16.19%	13.37%
• Funding period	30.0 years	30.0 years
• GASB funded ratio	78.5%	81.8%
Projected employer contribution based on calculated rate		
• Fiscal year ending June 30,	2010	2009
• Projected payroll (millions)	$ 366.9	$ 351.5
• Projected employer contribution (millions) (actual contribution rate set by Meet & Confer)	$ 116.4	$ 108.7

[1] Employee contribution rate is 9.00%. Members hired after October 9, 2004 contribute 10.25% of pay.

Schedule of Funding Progress ($000)

Date	Actuarial Value of Assets (AVA)	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL) (3) - (2)	Funded Ratio (2)/(3)	Annual Payroll	UAAL as % of Payroll (4)/(6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
July 1, 1993	$ 947,456	$ 984,495	$ 37,039	96.2%	$ 162,143	22.8%
July 1, 1994	1,038,256	1,000,423	(37,833)	103.8%	174,761	(21.6%)
July 1, 1995	1,168,056	1,199,748	31,692	97.4%	182,251	17.4%
July 1, 1996	1,329,570	1,258,217	(71,353)	105.7%	187,134	(38.1%)
July 1, 1998	1,518,081	1,549,341	31,260	98.0%	196,364	15.9%
July 1, 1999 *	1,746,312	1,773,829	27,517	98.4%	246,569	11.2%
July 1, 2000	2,013,491	1,966,404	(47,087)	102.4%	250,691	(18.8%)
July 1, 2001	2,226,307	2,306,427	80,120	96.5%	264,226	30.3%
July 1, 2002	2,337,157	2,593,730	256,573	90.1%	286,150	89.7%
July 1, 2003	2,394,411	2,874,738	480,327	83.3%	300,405	159.9%
July 1, 2004	2,466,070	3,339,224	873,154	73.9%	329,840	264.7%
July 1, 2005	2,508,794	3,392,974	884,180	73.9%	321,057	275.4%
July 1, 2006	2,681,375	3,633,145	951,770	73.8%	327,080	291.0%
July 1, 2007	3,004,927	3,857,680	852,753	77.9%	336,029	253.8%
July 1, 2008	3,337,612	4,078,963	741,351	81.8%	351,525	210.9%
July 1, 2009	3,430,946	4,368,501	937,556	78.5%	366,924	255.5%

* Definition of covered payroll changed from base pay to total direct pay less overtime

Historical Solvency Test ($000)

	Aggregated Accrued Liabilities for				by Reported Assets		
Valuation Date	Active Members Contributions	Retirees Beneficiaries and Vested Terminations[1]	Members (City Financed Portion)	Actuarial Value of Assets	(5)/(2)	[(5)-(2)]/(3)	[(5)-(2)-(3)]/(4)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
July 1, 1993	$ 114,279	$ 401,989	$ 468,227	$ 947,456	100.0%	100.0%	92%
July 1, 1994	123,471	416,053	460,899	1,038,256	100.0%	100.0%	100%
July 1, 1995	91,687	764,518	343,543	1,168,056	100.0%	100.0%	91%
July 1, 1996	95,615	812,498	350,104	1,329,570	100.0%	100.0%	100%
July 1, 1998	99,298	1,017,723	432,320	1,518,081	100.0%	100.0%	93%
July 1, 1999	107,008	1,157,882	508,939	1,746,312	100.0%	100.0%	95%
July 1, 2000	111,099	1,324,079	531,225	2,013,491	100.0%	100.0%	100%
July 1, 2001	138,248	707,152	1,461,027	2,226,307	100.0%	100.0%	95%
July 1, 2002	145,255	718,779	1,729,696	2,337,157	100.0%	100.0%	85%
July 1, 2003	153,634	838,090	1,883,014	2,394,411	100.0%	100.0%	74%
July 1, 2004	153,088	995,841	2,190,295	2,466,070	100.0%	100.0%	60%
July 1, 2005	249,804	1,259,243	1,883,927	2,508,794	100.0%	100.0%	53%
July 1, 2006	262,514	1,421,330	1,949,301	2,681,375	100.0%	100.0%	51%
July 1, 2007	275,990	1,575,900	2,005,790	3,004,927	100.0%	100.0%	57%
July 1, 2008	294,678	1,726,121	2,058,165	3,337,612	100.0%	100.0%	64%
July 1, 2009	312,489	1,872,226	2,183,786	3,430,946	100.0%	100.0%	57%

Note: Dollar amounts in $000

[1] Column (3) included AAL for DROP participants until 2000, now in Column (4)

Historical Active Participant Data

Valuation Date	Active Count	Average Age	Average Svc	Covered Payroll	Average Salary	Percent Changes
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1988	4,239	35.0	N/A	$121,667	$28,702	1.6%
1989	4,105	35.7	N/A	$122,803	$29,915	4.2%
1990	4,073	36.2	N/A	$126,665[(1)]	$31,099	4.0%
1992	4,120	36.8	N/A	$143,020	$34,714	11.6%
1993	4,498	36.7	N/A	$159,321	$35,420	2.0%
1994	4,705	36.8	N/A	$162,143	$34,462	-2.7%
1995	4,921	36.9	N/A	$174,761	$35,513	3.0%
1996[(2)]	4,395	35.1	N/A	$150,903	$34,335	-3.3%
1997	4,282	35.5	N/A	$149,631	$34,944	1.8%
1998	4,247	35.9	N/A	$153,479	$36,138	3.4%
1999	4,253	36.3	N/A	$187,967[(3)]	$44,196[(3)]	22.3%[(3)]
2000	4,137	36.7	N/A	$179,415	$43,368	-1.9%
2001[(4)]	5,325	40.2	N/A	$264,226[(5)]	$49,620[(5)]	14.4%[(5)]
2002	5,352	40.7	N/A	$286,150	$53,466	7.8%
2003	5,387	41.3	N/A	$300,405	$55,765	4.3%
2004	5,225	41.7	N/A	$329,840	$63,127	13.2%
2005	4,867	42.0	N/A	$321,057[(6)]	$65,966[(6)]	4.5%[(6)]
2006	4,785	42.3	N/A	$327,080	$68,355	3.6%
2007	4,879	42.1	N/A	$336,029	$68,873	0.8%
2008	5,065	42.0	15.7	$351,525	$69,403	0.8%
2009	5,245	41.8	15.4	$366,924	$69,957	0.8%

(1) Reflects the November 1, 1990 pay increase.

(2) For the July 1, 1996 to July 1, 2000 valuations, includes those participants currently accruing benefits (i.e. excludes current DROP

(3) Definition of covered payroll changed from base pay to total direct pay less overtime.

(4) Beginning July 1, 2001, includes active participants eligible for DROP.

(5) 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

(6) Beginning October 9, 2004, pensionable pay is the total of the last 26 pay periods, excluding CMEPP and SOSP.

Retirees, Beneficiaries, and Disabled Participants Added to and Removed from Rolls

	Added to Rolls		Removed from Rolls		Rolls-End of Year			
Valuation July 1,	Number	Annual Allowances	Number	Annual Allowances	Number	Annual Allowances	% Increase in Annual Allowances	Average Annual Allowances
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1993	106	$ 2,172	64	$ 953	1,419	$ 27,286	7.1%	$ 19,229
1994	107	2,425	48	847	1,478	29,464	8.0%	19,935
1995	893	19,109	36	602	2,335	48,624	65.0%	20,824
1996 *	182	3,481	29	618	2,488	52,772	8.5%	21,211
1998	159	3,483	28	589	2,619	63,957	21.2%	24,420
1999	150	3,770	46	1,001	2,723	70,432	10.1%	25,866
2000	233	6,421	36	857	2,920	76,401	8.5%	26,165
2001 **	131	3,755	1,250	33,892	1,801	54,006	(29.3%)	29,987
2002	104	2,809	46	1,113	1,859	55,013	1.9%	29,593
2003	106	2,967	47	1,109	1,918	61,531	11.8%	32,081
2004	220	9,172	33	1,014	2,105	70,307	14.3%	33,400
2005	353	15,962	55	1,776	2,403	86,933	23.6%	36,177
2006	254	10,195	66	2,197	2,549	96,812	11.4%	37,980
2007	175	8,056	49	1,809	2,717	105,481	9.0%	38,823
2008	149	11,889	57	1,995	2,809	115,375	9.4%	41,073
2009	154	9,639	63	2,275	2,900	122,738	6.4%	42,324

* From June 30, 1996 through June 30, 2001 includes DROP participants.
** Beginning July 1, 2001 excludes active participants eligible for DROP.

Note: Dollar amounts in $000

Membership Data ($000)

	July 1, 2009 (1)	July 1, 2008 (2)
1. Active members		
a. Number	5,245	5,065
b. Number in DROP	1,728	1,844
c. Total payroll	$ 366,924	$ 351,525
Payroll in DROP	$ 141,783	$ 148,951
d. Average salary	69,957	69,403
e. Average age	41.8	42.0
f. Average service	15.4	15.7
2. Inactive participants		
a. Vested	22	19
b. Total annual benefits (deferred)	$ 551	$ 463
c. Average annual benefit	25,054	24,344
3. Service retirees		
a. Number	2,200	2,130
b. Total annual benefits	$ 95,152	$ 89,808
c. Average annual benefit	43,251	42,163
d. Average age	62.5	62.2
4. Disabled retirees		
a. Number	131	119
b. Total annual benefits	$ 4,935	$ 4,224
c. Average annual benefit	37,672	35,496
d. Average age	51.9	50.8
5. Beneficiaries and spouses		
a. Number	547	541
b. Total annual benefits	$ 22,100	$ 20,880
c. Average annual benefit	40,402	38,595
d. Average age	67.8	66.9

Summary of Actuarial Assumptions and Methods

The following methods and assumptions were used in preparing the July 1, 2009 actuarial valuation report.

1. Valuation Date

   The valuation date is as of July 1st , the first day of each plan year. This is the date as of which the actuarial present value of future benefits and the actuarial value of assets are determined.

2. Actuarial Cost Method

   The actuarial valuation uses the Entry Age Normal (EAN) actuarial cost method. Under this method, the employer contribution rate is the sum of (i) the employer normal cost rate, and (ii) a rate that will amortize the unfunded actuarial accrued liability (UAAL).

   a. The valuation is prepared on the projected benefit basis, under which the present value, at the investment return rate assumed to be earned in the future (currently 8.50%), of each participant's expected benefit payable at retirement or death is determined, based on his/her age, service, sex and compensation. The calculations take into account the probability of a participant's death or termination of employment prior to becoming eligible for a benefit, as well as the possibility of his/her terminating with a service, disability, or survivor's benefit. Future salary increases are also anticipated. The present value of the expected benefits payable for the active participants is added to the present value of the expected future payments to retired participants and beneficiaries to obtain the present value of all expected benefits payable from the System on account of the present group of participants and beneficiaries.

   b. The employer contributions required to support the benefits of the System are determined using a level funding approach, and consist of a normal cost contribution and an accrued liability contribution.

   c. The normal cost contribution is determined using the "entry age normal" actuarial cost method. Under this method, a calculation is made to determine the average uniform and constant percentage rate of employer contribution which, if applied to the compensation of each new participant during the entire period of his/her anticipated covered service, would be required to meet the cost of all benefits payable on his/her behalf based on the benefits provisions applicable for the individual member.

d. The unfunded actuarial accrued liability contributions are determined by subtracting the actuarial value of assets from the actuarial accrued liability and amortizing the result over 30 years from the valuation date.

The contribution rate determined by this valuation will not be effective until one year later, but the determination of the rate does not reflect this deferral. It is assumed that there will be no change in the employer normal cost rate due to the deferral, and it is assumed that payments are made uniformly throughout the year.

3. Actuarial Value of Assets

The actuarial value of assets is based on the market value of assets with a five-year phase-in of actual investment return in excess of (less than) expected investment income. Expected investment income is determined using the assumed investment return rate and the market value of assets (adjusted for receipts and disbursements during the year). The returns are computed net of administrative and investment expenses.

4. Economic Assumptions

a. Investment return: 8.50% per year, compounded annually, composed of an assumed 3.00% inflation rate and a 5.50% net real rate of return. This rate represents the assumed return, net of all investment and administrative expenses.

b. Salary increase rate: A service-related component, plus a 3.00% inflation component, as follows:

Years of Service	Service-related Component	Total Annual Rate of Increase Including 3.00% Inflation Component
(1)	(2)	(3)
1	7.00%	10.00%
2	0.25%	3.25%
3	0.25%	3.25%
4	5.00%	8.00%
5	9.50%	12.50%
6	8.50%	11.50%
7	0.75%	3.75%
8	0.50%	3.50%
9	7.75%	10.75%
10	1.00%	4.00%
11	9.00%	12.00%
12	0.75%	3.75%
13	1.25%	4.25%
14	1.50%	4.50%
15	0.50%	3.50%
16	5.50%	8.50%
17	0.75%	3.75%
18 and Over	0.00%	3.00%

c. Payroll growth rate: In the amortization of the unfunded actuarial accrued liability, payroll is assumed to increase 3.50% per year. This increase rate is solely due to the effect of inflation on salaries, with no allowance for future membership growth.

5. Demographic Assumptions

a. Retirement Rates

Participants as of October 9, 2004							
	Service						
Age	20-21	22-23	23-24	26-27	28-29	30-39	40 and Over
40-54	5.0%	5.0%	5.0%	10.0%	20.0%	20.0%	100.0%
55-59	5.0%	10.0%	10.0%	30.0%	30.0%	40.0%	100.0%
60-64	10.0%	10.0%	25.0%	50.0%	50.0%	50.0%	100.0%
New Participants after October 9, 2004							
Age	20-21	22-23	23-24	26-27	28-29	30-37	38 and Over
55-59	5.0%	10.0%	10.0%	30.0%	30.0%	40.0%	100.0%
60-64	10.0%	10.0%	25.0%	50.0%	50.0%	50.0%	100.0%

100% of members age 65 and over are expected to retire

b. DROP Participation

100% of eligible active participants are assumed to elect the DROP.

c. DROP Entry Date

Active members (not already in DROP) are assumed to take advantage of the DROP and enter when first eligible. Participants are assumed to elect the maximum duration for the back DROP, up to 20 years.

d. DROP Interest Credit

A minimum of 3.00% interest will be credited to existing DROP accounts with a maximum of 7.00%. If the System's actuary certifies that past service costs are fully funded, the credit may be as high as 10.00%. For this actuarial valuation, the drop interest credit is assumed to be 7.00%

e. Mortality rates (for active and retired members)

- Healthy males – Based on the 1994 Group Annuity Mortality Table for males.
- Healthy females - Based on the 1994 Group Annuity Mortality Table for females.
- Disabled males and females – 1987 Commissioners Group Disabled Mortality Table.

Sample rates are shown below:

Age	Healthy Males	Healthy Females	Disabled Males	Disabled Females
(1)	(2)	(3)	(4)	(5)
25	0.07%	0.03%	2.82%	2.82%
30	0.08%	0.04%	2.82%	2.82%
35	0.09%	0.05%	2.82%	2.82%
40	0.11%	0.07%	2.82%	2.82%
45	0.16%	0.10%	2.82%	2.82%
50	0.26%	0.14%	2.82%	2.82%
55	0.44%	0.23%	2.82%	2.82%
60	0.80%	0.44%	3.14%	3.14%
65	1.45%	0.86%	3.98%	3.98%
70	2.37%	1.37%	5.71%	5.71%
75	3.72%	2.27%	8.19%	8.19%
80	6.20%	3.94%	11.84%	11.84%

f. Termination Rates and Disability Rates

Termination rates (for causes other than death, disability or retirement):

Termination and disability rates are a function of the member's age. Termination rates are not applied after a member becomes eligible for a retirement benefit. Rates at selected ages are shown below.

Age Based Rates of Termination		
Age	Male	Female
20	4.4395%	4.4395%
25	3.9958%	3.9958%
30	3.0221%	3.0221%
35	1.9177%	1.9177%
40	0.9211%	0.9211%
45	0.2166%	0.2166%
50	0.0012%	0.0012%
55	0.0012%	0.0012%
60	0.0012%	0.0012%

Age Based Rates of Disability		
Age	Male	Female
20	0.0800%	0.1000%
25	0.0800%	0.1000%
30	0.0800%	0.1240%
35	0.1040%	0.1640%
40	0.1440%	0.2160%
45	0.2080%	0.3000%
50	0.3660%	0.5400%
55	0.7900%	1.0800%
60	2.1520%	2.8600%

6. Other Assumptions

a. Percent married: 90% of employees are assumed to be married. (No beneficiaries other than the spouse assumed.)

b. Age difference: Male members are assumed to be three years older than their spouses, and female members are assumed to be three years younger than their spouses.

c. Percent electing annuity on death (when eligible): All of the spouses of vested, married participants are assumed to elect an annuity.

d. Percent electing deferred termination benefit: 50% of vested terminating members are assumed to elect a refund rather than take a deferred benefit at age 60.

e. There will be no recoveries once disabled.

f. No surviving spouse will remarry.

g. Assumed age for commencement of deferred benefits: Members electing to receive a deferred benefit are assumed to commence receipt at the first age at which unreduced benefits are available.

h. Administrative expenses: The assumed investment return rate represents the anticipated net return after payment of all investment and administrative expenses.

i. Pay increase timing**:** Beginning of (fiscal) year. This is equivalent to assuming that reported pays represent amounts paid to members during the year ended on the valuation date.

j. Decrement timing: Decrements of all types are assumed to occur mid-year.

k. Eligibility testing: Eligibility for benefits is determined based upon the age nearest birthday and service nearest whole year on the date the decrement is assumed to occur.

l. Decrement relativity: Decrement rates are converted to probabilities in order to account for multiple decrements.

m. Incidence of Contributions**:** Contributions are assumed to be received continuously throughout the year based upon the computed percent of payroll shown in our Report, and the actual payroll payable at the time contributions are made.

n. Benefit Service: All members are assumed to accrue one year of service each year. Exact fractional service is used to determine the amount of benefit payable.

7. Participant Data

Participant data was supplied in electronic files. There were separate files for (i) active members, (ii) inactive members, and (iii) members and beneficiaries receiving benefits.

The data for active members included birth date, sex, most recent hire date, salary paid during last fiscal year, hours worked by the employee, and employee contribution amounts. For retired members and beneficiaries, the data included date of birth, sex, amount of monthly benefit, and date of retirement. Also included was the member's Group and for members participating in DROP, their account balances and monthly DROP income.

All healthy and disabled retirees are assumed to have 100% joint and survivor annuities, prorated by the 90% marriage assumption and reflecting the three year spousal age differential described above. All beneficiaries are assumed to have life annuity only benefits.

Salary supplied for the current year was based on the earnings for the year preceding the valuation date. This salary was adjusted by the salary increase rate for one year.

In fiscal years when a 27^{th} pay period occurs the individual pays for employees who were employed throughout the year will be adjusted by multiplying their reported pay by the ratio of 26/27. In years that have only 26 pay periods no adjustment would be needed.

Assumptions were made to correct for missing, bad, or inconsistent data. These had no material impact on the results presented.

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 but prior to October 9, 2004	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.
After October 9, 2004	Average of the last three years of compensation (excluding exempt time, overtime and strategic officer staffing pay). This average will be phased in beginning with the pay period ending after October 9, 2004 until the new definition is fully phased in after 78 pay periods.
Service Retirement	
Eligibility	
‣ Sworn prior to October 9, 2004	20 years of service.
‣ Sworn on or after October 9, 2004	Age 55 with 10 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.
▸ 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 but prior to October 9, 2004	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.

‣ After October 9, 2004	Participants sworn prior to October 9, 2004 will receive the highest of the following alternatives using Final Average Compensation effective after October 9, 2004, from October 9, 2004 through October 7, 2007: 1) 2.25% of Final Average Compensation for each of the first 20 years of service plus 2% of Final Average Compensation for each year of service in excess of 20 years, with a maximum of 80% of Final Average Compensation. 2) Benefit participant would have received had participant retired or entered the DROP immediately before October 9, 2004 3) Benefit calculated using a sliding average of the pay received for the pay periods elapsed since October 9, 2004. New participants after October 9, 2004: 2.25% of Final Average Compensation for each of the first 20 years of service plus 2% of Final Average Compensation for each year of service in excess of 20 years, with a maximum of 80% of Final Average Compensation.
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 for members sworn prior to October 9, 2004.

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.

Deferred Retirement Option Plan (DROP)

Eligibility	20 years of service and sworn in prior to October 9, 2004.
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.
- After July 1, 2001 but prior to October 9, 2004 — 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.
- After October 9, 2004 — A minimum of 3.00% interest will be credited to existing DROP accounts with a maximum of 7.00%. If the actuary certifies that past service costs are fully funded, the credit may be as high as 10.00%.

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 and sworn in prior to October 9, 2004.
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%.

Partial Lump Sum Optional Payment (PLOP)

Eligibility	Participant on or after October 9, 2004.
Benefit	
‣ After October 9, 2004	Up to 20% of the actuarial value of the accrued pension at retirement.

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	For participants before October 9, 2004, 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	
▸ 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. 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 who was sworn in prior to October 9, 2004.
	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	
▸ Prior to October 9, 2004	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.
▸ After October 9, 2004	Monthly benefits for participants receiving payments are increased each April 1 by 80% of the increase in the Consumer Price Index for All Urban Consumers (CPI-U) for the preceding year, with a minimum of 2.4% and a maximum of 8%.
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. – Effective October 9, 2004, the funded ratio of the plan must be at least 120% for the 13th check to be paid out.

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 but before October 9, 2004 — Each participant contributes 8.75% of average total direct pay less overtime.
- After October 9, 2004
  - – Members sworn in prior to October 9, 2004 — Each participant contributes 9.00% of pay. The additional 0.25% will be credited to the Plan's general fund.
  - – Others — Each participant contributes 10.25% of pay, which will be credited to the Plan's general fund.

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.

Employer Contribution — The City of Houston will follow the following contribution schedule:

Fiscal Year Ending (June 30th)	City Contribution Amount
2001	$ 30,645,000
2002	32,645,000
2003	34,645,000
2004	36,645,000
2005	36,645,000
2006	16% of total compensation, with a minimum of $53,000,000
2007-2012	$5,000,000 above the prior year's payment

Beginning in Fiscal Year 2013 and continuing until the System's funded ratio is 100%, payments will increase each year by $5,000,000 or, if the scheduled payment is less than the actuarial rate, $10,000,000. In addition, once the System's funded ratio is 100%, the City will pay the actuarially required rate, but not less than 16% of covered pay.

Additionally, beginning in Fiscal Year 2013 and once the funded ratio reaches 75%, if the funded ratio drops below 75%, the City will pay additional amounts in the following fiscal year to return the System to 75% funded. Once the fund ratio reaches 80%, the City will contribute additional amounts to return the System to 80% funded.

Changes in Plan Provisions from Since the Prior Valuation

There were no changes to the plan provisions from the prior actuarial valuation.

SECTION FIVE

STATISTICAL SECTION

Summary

This part of the System's comprehensive annual financial report presents detailed information as a context for understanding what the information in the financial statements, note disclosures, and required supplementary information says about the System's overall financial health. All information presented was derived from the comprehensive annual financial reports for the relevant year and/or the Systems benefits administration system.

Financial Trends

The **Changes in Plan Net Assets** schedule on page 91 shows the additions and deductions from plan net assets and the resulting changes in plan net assets for the ten years ending June 30, 2010. Contributions from members and the City have grown slowly and steadily during this time. However, it is the System's investment income, even with losses at the beginning and end of the decade, that have provided the most impact on additions to plan net assets. Deductions to plan net assets are primarily for benefits paid to members.

City and member contributions to the System are external sources of the additions to plan net assets. **Contribution Rates** on page 92 show what percent the City's and the members' contributions are of payroll for the ten years ending June 30, 2010. The accompanying chart of **Contributions and Benefits Paid** compares the total contributions made and the benefits paid for the ten years ending June 30, 2010. While the growth in benefits paid exceeds the growth in contributions in recent years, the City's contributions under the October 9, 2004 agreement are scheduled to continue to increase over the coming years.

Contributions are not the only source from which benefits are paid. Earnings from the System's investments are the fund's internal sources of and, in most years, the largest component of additions to plan net assets. The **Investment Income** schedule on page 93 provides details of the System's net investment gain/loss for the ten years ending June 30, 2010.

Deductions from Net Assets for Benefits and Refunds by Type on page 94 presents a detailed view of the benefits paid to members and refunds for the ten years ending June 30, 2010, and the chart on page 95 graphically represents this data. Service retirements account for the majority of benefit payments, growing over the last several years as the number of retirees has increased. Lump sum benefits are payments members and survivors receive at their discretion from their lump sum accounts either on or after the date they begin receiving monthly benefit payments, and therefore vary from year to year.

On page 96, **Valuation of Assets as a Percent of Pension Liabilities** shows the percentage of the pension liability that is funded and **Net Assets Compared to Pension Liability** compares the actuarial value of the System's assets to the actuarial accrued liability. These charts graphically represent the funding progress of the System for the ten years ending June 30, 2010. The existence of an unfunded actuarial liability does not necessarily indicate financial problems. The System and the City entered into an agreement on October 9, 2004, which if maintained and adequate earnings and gains are provided on investments, the System is projected to eventually be adequately funded.

Participant Information

The **Membership** schedule on page 97 provides a breakdown of the plan membership for the ten years ending June 30, 2010. For fiscal year 2010, active members increased by 103, retired members and their beneficiaries increased by 113, and terminated vested members increased by one.

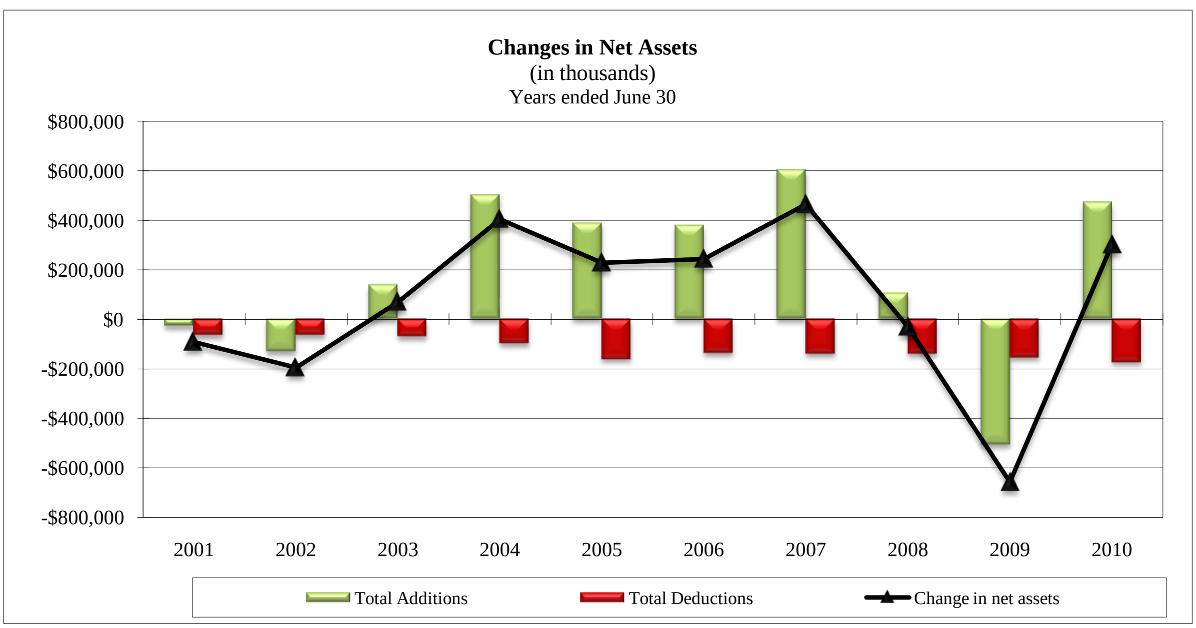
Operating Information

The **Pensions in Force** and **Pensions Awarded** schedules on page 98 provide the number of pensions by type, age and payment amount. The **Average Monthly Benefit Amounts by Years Credited Service** on page 99 presents the average final average salary and the number of retired members, in five-year increments of credited service, for the seven years ended June 30, 2010. The **DROP and PROP Activity** schedules on page 100 provide information about the total amount in DROP and PROP accounts and the total number of participants as well as the changes to those totals for the ten years ending June 30, 2010.

Changes in Plan Net Assets
Previous Ten Fiscal Years
($000's)

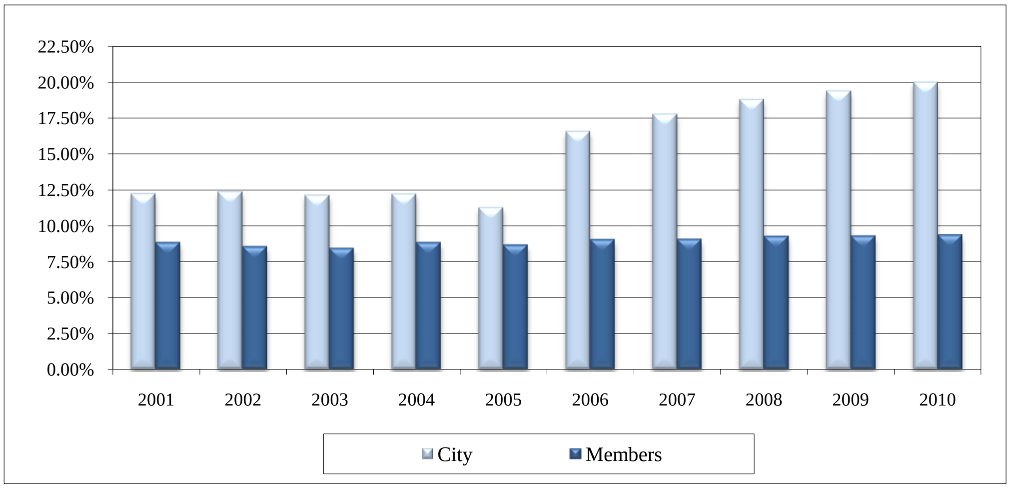
Fiscal Year	2001	2002	2003	2004	2005
Additions					
City contributions	$ 30,645	$ 32,645	$ 34,645	$ 36,645	$ 37,125
Members contributions	22,043	22,484	24,008	26,393	28,410
Investment income (net of expenses)	(80,864)	(186,227)	80,202	437,007	320,561
Securities lending income (net of expenses)	832	855	583	741	876
Total additions to plan net assets	(27,344)	(130,673)	139,438	500,786	386,972
Deductions:					
Benefits paid to members	60,328	59,783	65,649	92,697	153,861
Refunds to members	884	1,194	992	852	1,198
Professional and administrative expense	2,854	2,881	2,746	2,768	3,473
Total deductions from plan net assets	64,066	63,858	69,387	96,317	158,532
Change in net assets	$ (91,410)	$ (194,531)	$ 70,051	$ 404,469	$ 228,440

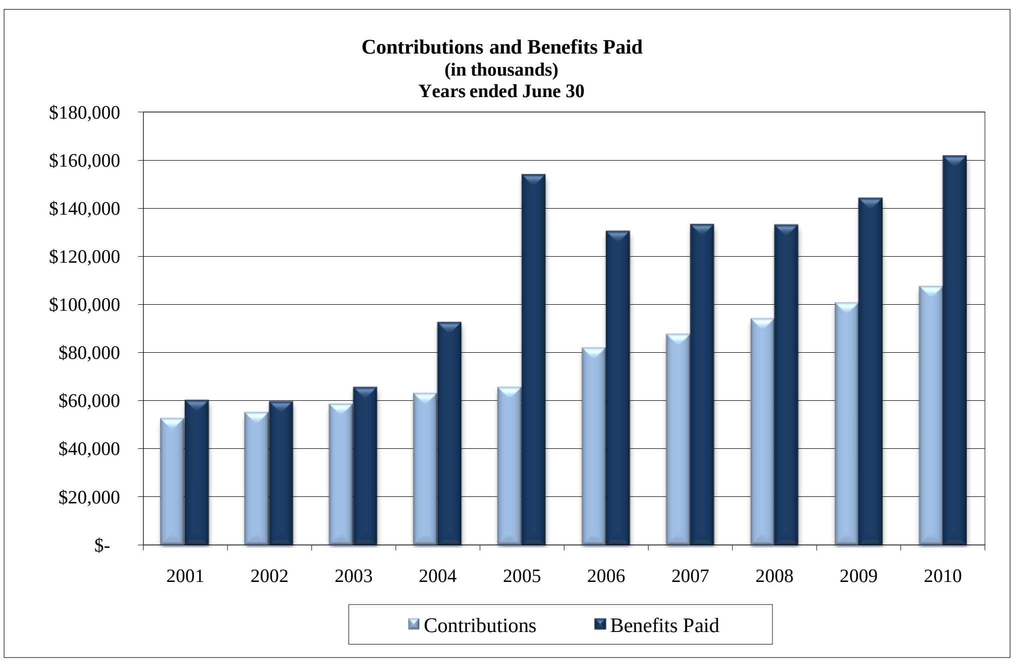
Fiscal Year	2006	2007	2008	2009	2010
Additions					
City contributions	$ 53,068	$ 58,000	$ 63,000	$ 68,000	$ 73,192
Members contributions	28,863	29,489	31,003	32,519	34,218
Investment income (net of expenses)	294,966	512,873	9,350	(607,482)	364,095
Securities lending income (net of expenses)	1,101	1,239	2,392	1,427	473
Total additions to plan net assets	377,998	601,601	105,745	(505,536)	471,978
Deductions:					
Benefits paid to members	130,443	133,351	133,049	144,112	161,735
Refunds to members	700	739	500	618	547
Professional and administrative expense	2,958	2,950	3,564	7,311	8,390
Total deductions from plan net assets	134,101	137,040	137,113	152,041	170,672
Change in net assets	$ 243,897	$ 464,561	$ (31,368)	$ (657,577)	$ 301,306



Contribution Rates
Previous Ten Fiscal Years

	Percent of Payroll	
Fiscal Year	City	Members
2001	12.22%	8.79%
2002	12.35%	8.51%
2003	12.11%	8.39%
2004	12.20%	8.79%
2005	11.26%	8.61%
2006	16.53%	8.99%
2007	17.73%	9.02%
2008	18.75%	9.23%
2009	19.34%	9.25%
2010	19.95%	9.33%





Investment Income
Previous Ten Fiscal Years
($000's)

Fiscal Year	2001	2002	2003	2004	2005
Investing activities					
Net appreciation (depreciation) in fair value of investments	$ (130,063)	$ (232,652)	$ 37,084	$ 401,591	$ 275,205
Interest	41,312	37,678	35,918	29,477	35,006
Dividends	14,293	13,672	12,659	15,897	26,314
Alternative investments [(1)]	1,107	2,361	1,606	1,598	
Other income	326	541	306	333	282
Total	(73,025)	(178,400)	87,573	448,896	336,807
Less investment expense	(7,839)	(7,827)	(7,371)	(11,889)	(16,246)
Net income (loss) from investing activities	(80,864)	(186,227)	80,202	437,007	320,561
Securities lending activities					
Securities lending income	1,283	1,308	914	1,153	1,332
Securities lending expense	(451)	(453)	(331)	(412)	(456)
Net income from securities lending activities	832	855	583	741	876
Total investment income (loss)	(80,032)	(185,372)	80,785	437,748	321,437

Fiscal Year	2006	2007	2008	2009	2010
Investing activities					
Net appreciation (depreciation) in fair value of investments	$ 256,825	$ 459,957	$ (26,749)	$ (643,053)	$ 330,724
Interest	30,201	38,304	34,603	31,452	30,029
Dividends	21,926	27,581	19,540	13,170	16,608
Other income	157	147	142	57	72
Total	309,109	525,989	27,536	(598,374)	377,433
Less investment expense	(14,143)	(13,116)	(18,186)	(9,108)	(13,338)
Net income (loss) from investing activities	294,966	512,873	9,350	(607,482)	364,095
Securities lending activities					
Securities lending income	1,478	1,652	3,189	1,903	631
Securities lending expense	(377)	(413)	(797)	(476)	(158)
Net income from securities lending activities	1,101	1,239	2,392	1,427	473
Total investment income (loss)	$ 296,067	$ 514,112	$ 11,742	$ (606,055)	$ 364,568

(1) Income reported under alternative investments for 2001 - 2004 consists of distributions from private equity partnership investments of the System. These private equity partnerships use various methods to invest in private companies, usually loans or an equity investment. Distributions from these partnerships represent interest earned on loans, stock distributions or returns on equity investments. Prior to fiscal year 2005, the income portion of these distributions were recorded as income from alternative investments. Starting in fiscal year 2005, this income was reclassified to interest or dividends according to the nature of the underlying investment.

Deductions from Net Assets for Benefits and Refunds by Type
Previous Ten Fiscal Years
($000's)

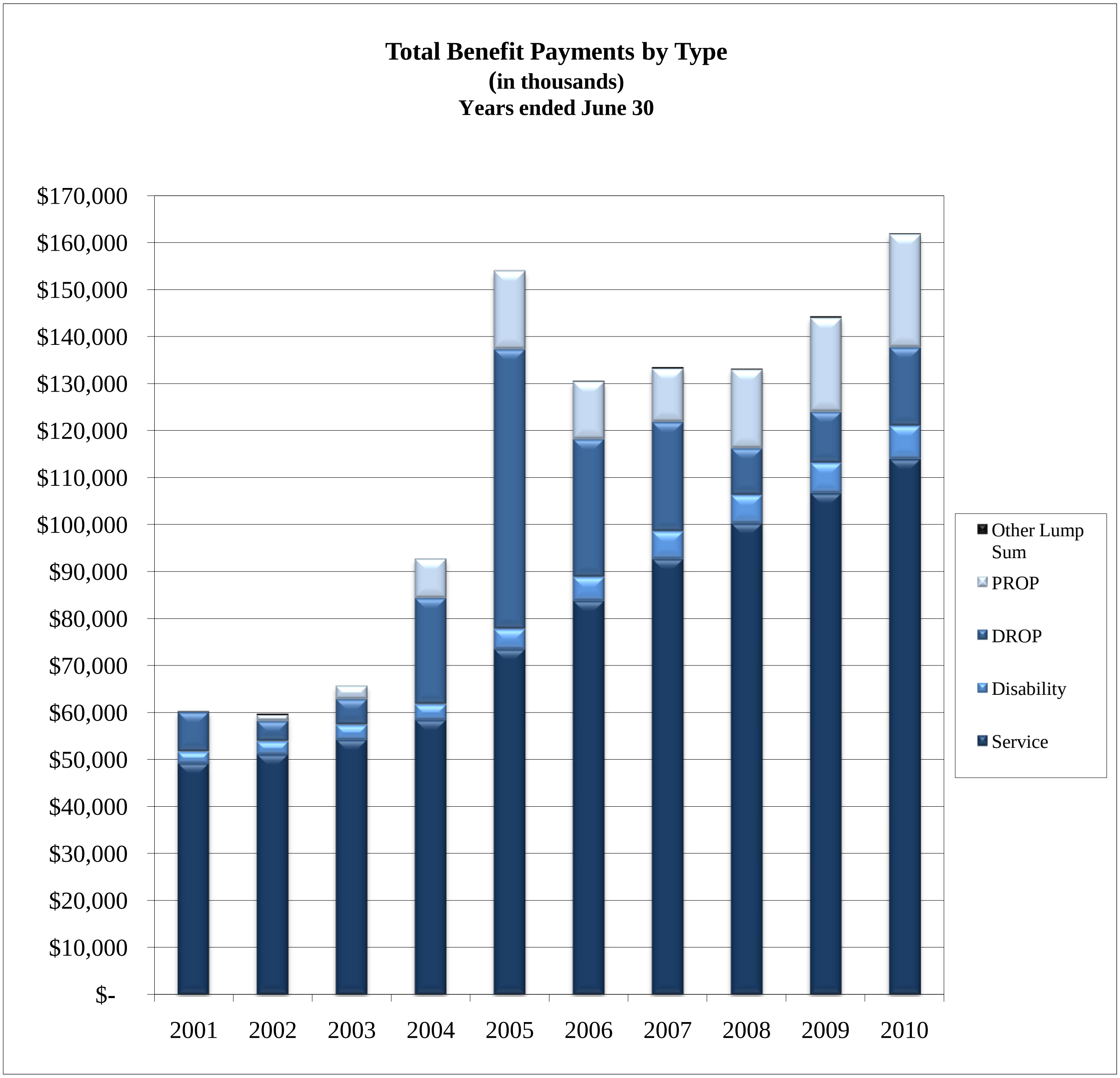
Fiscal Year	2001	2002	2003	2004	2005
Type of Benefit					
Service					
Retirees	$ 38,557	$ 40,126	$ 42,566	$ 45,912	$ 59,709
Survivors	10,641	10,934	11,640	12,466	13,733
Disability					
Retirees - duty	1,337	1,572	1,646	1,787	2,604
Retirees - nonduty	304	310	323	313	358
Survivors	836	941	1,178	1,238	1,310
Lump Sum					
DROP distributions	8,381	4,263	5,441	22,603	59,493
PROP distributions (1)	97	1,348	2,815	8,352	16,649
Other (2)	175	288	40	25	5
Total benefits	$ 60,328	$ 59,783	$ 65,649	$ 92,697	$ 153,861
Type of Refund					
Death	$ 49	$ -	$ 20	$ -	$ -
Separation	835	1,194	972	852	1,198
Total refunds	$ 884	$ 1,194	$ 992	$ 852	$ 1,198

Fiscal Year	2006	2007	2008	2009	2010
Type of Benefit					
Service					
Retirees	$ 69,074	$ 77,639	$ 83,925	$ 89,226	$ 95,197
Survivors	14,612	14,965	16,203	17,291	18,612
Disability					
Retirees - duty	3,378	4,003	4,154	4,334	4,675
Retirees - nonduty	347	313	371	444	516
Survivors	1,364	1,517	1,531	1,715	1,868
Lump Sum					
DROP distributions	29,272	23,315	9,937	10,889	16,682
PROP distributions (1)	12,233	11,303	16,680	19,922	24,035
Other (2)	163	296	248	291	149
Total benefits	$ 130,443	$ 133,351	$ 133,049	$ 144,112	$ 161,734
Type of Refund					
Death	$ -	$ -	$ -	$ 3	$ -
Separation	700	739	500	615	547
Total refunds	$ 700	$ 739	$ 500	$ 618	$ 547

(1) PROP was established as a benefit option in 1998 with the first distributions made in 2001.

(2) Lump Sum, Other: Under the provisions of Article 6243g-4, Vernon's Annotated Texas Statutes (VATS), Sec. 12(b) and Sec. 15(c) a member who retires, including a member who was a DROP participant, and begins to receive a monthly service pension shall receive a one-time lump sum payment of $5,000. This benefit became effective November 23, 1998 with the first payments in 1999. From 2003 through May, 2005, the amount reported represents those payments to members who were not DROP participants. Payments to DROP participants are reported with the DROP distributions, because they are processed and recorded together for administrative purposes. Starting in June 2006, all one-time lump sum payments of $5,000 are reported with the DROP distributions.

Article 6243g-4, Vernon's Annotated Texas Statutes (VATS), Sec. 15(h) provides for the payment of an additional monthly disability benefit to assist members retired due to disability with the costs of an education or training program. Effective January 1, 2006, payment of the additional monthly disability benefit occurs only after the member successfully completes each semester in the form of a lump sum. The first payments totaling $118 thousand were made in June 2006.


Total Benefit Payments by Type
(in thousands)
Years ended June 30
$170,000
$160,000
$150,000
$140,000
$130,000
$120,000
$110,000
$100,000
$90,000
$80,000
$70,000
$60,000
$50,000
$40,000
$30,000
$20,000
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2001
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2005
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2010
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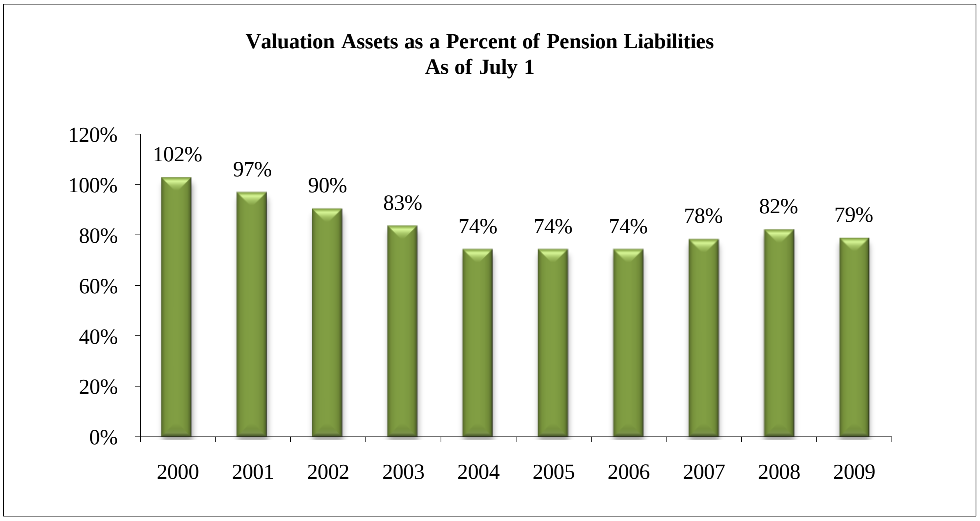
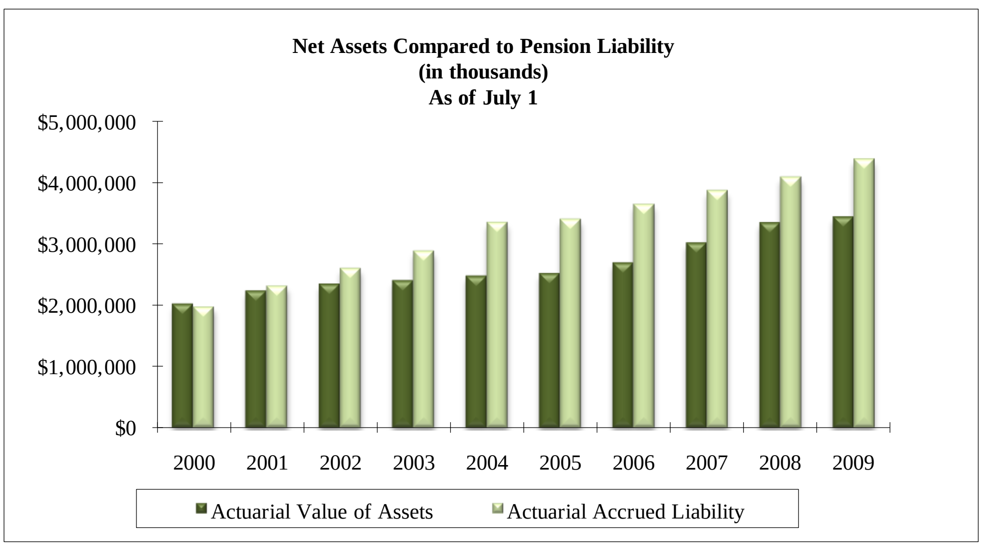
PROP
DROP
Disability
Service



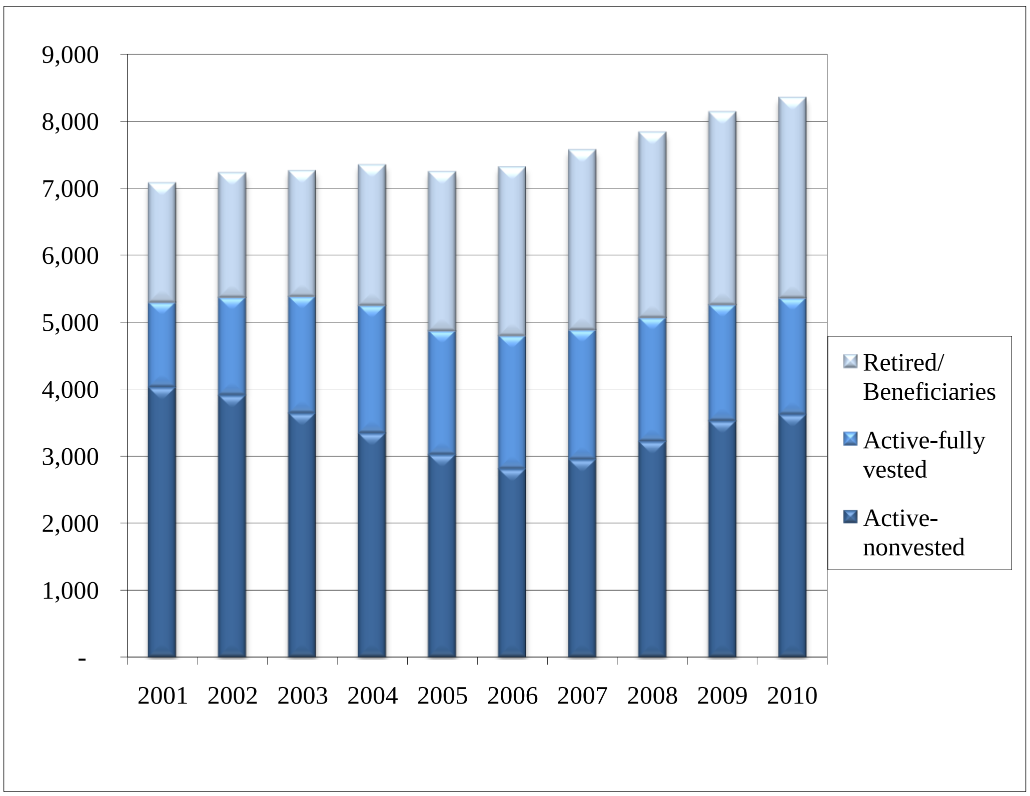


Charts through most recent actuarial valuation dated July 1, 2009.

Membership
Last Ten Fiscal Years

Fiscal Year	Active Nonvested	Active Fully Vested	Retired/ Beneficiaries	Terminated Vested *	Totals
2001	4,015	1,275	1,786		7,076
2002	3,895	1,466	1,864	5	7,230
2003	3,628	1,745	1,886	7	7,266
2004	3,335	1,907	2,100	10	7,352
2005	3,016	1,851	2,376	3	7,246
2006	2,802	1,992	2,517	15	7,326
2007	2,942	1,940	2,683	15	7,580
2008	3,211	1,849	2,768	16	7,844
2009	3,516	1,735	2,876	19	8,146
2010	3,609	1,745	2,989	20	8,363

* Terminated Vested members were not separately reported until fiscal year 2002.



Total Pensions in Force by Type and by Age
Year Ended June 30, 2010

Age on June 30,	Total	Type of Pension Service	Type of Pension Disability	Survivor
Under 40	32	-	10	22
40-44	38	5	23	10
45-49	176	119	35	22
50-54	328	283	18	27
55-59	583	506	24	53
60-64	697	613	17	67
65-69	369	288	4	77
70-74	298	211	8	79
75-79	238	173	-	65
80-84	168	85	-	83
85 and over	62	15	2	45
Total	2,989	2,298	141	550

Pensions Awarded in Current Year by Type and by Age
Year Ended June 30, 2010

Age on June 30,	Total	Type of Pension Service	Type of Pension Disability	Survivor
Under 40	7	-	-	7
40-44	6	2	4	-
45-49	19	15	2	2
50-54	47	44	1	2
55-59	45	42	2	1
60-64	19	17	1	1
65-69	6	-	-	6
70-74	4	-	-	4
75-79	3	-	-	3
80-85	3	-	-	3
85 and over	-	-	-	-
Total	159	120	10	29

Pensions Awarded in Current Year by Type and by Monthly Amount
Year Ended June 30, 2010

Monthly Amount	Total	Type of Pension Service	Type of Pension Disability	Survivor
Under $1000	-	-	-	-
$1000-$2000	4	-	-	4
$2000-$3000	12	1	2	9
$3000-$4000	99	82	5	12
$4000-$5000	37	33	1	3
$5000-$6000	4	3	1	-
$6000 and over	3	1	1	1
Total	159	120	10	29

Average Monthly Benefit Amounts
Previous Seven Fiscal Years

		Years Credited Service							
Member Retiring During Fiscal Years		**<5**	**5-10**	**10-15**	**15-20**	**20-25**	**25-30**	**30+**	**All Members**
2004	Average monthly benefit	$ -	$ 1,892	$ 1,875	$ 2,402	$ 3,096	$ 3,369	$ 4,023	$ 3,456
	Average final average salary	$ -	$ 3,970	$ 4,024	$ 4,577	$ 5,661	$ 6,043	$ 6,006	$ 5,820
	Average DROP Balance	$ -	$ 5,000	$ 5,000	$ 5,000	$ 88,499	$ 391,141	$ 536,444	$ 340,555
	Number of retirees	-	4	4	3	52	61	70	194
2005	Average monthly benefit	$ 3,582	$ 1,367	$ 2,213	$ 2,970	$ 3,278	$ 3,558	$ 4,134	$ 3,668
	Average final average salary	$ 3,582	$ 3,468	$ 4,779	$ 5,322	$ 5,970	$ 6,428	$ 6,293	$ 6,152
	Average DROP Balance	$ 5,000	$ 5,026	$ 5,000	$ 41,719	$ 103,644	$ 395,811	$ 583,494	$ 378,705
	Number of retirees	1	5	3	7	84	81	134	315
2006	Average monthly benefit	$ -	$ 2,432	$ 2,666	$ 2,809	$ 3,289	$ 3,455	$ 3,897	$ 3,510
	Average final average salary	$ -	$ 4,250	$ 4,848	$ 5,112	$ 5,952	$ 6,306	$ 6,190	$ 6,027
	Average DROP Balance	$ -	$ 5,000	$ 5,000	$ 5,000	$ 79,836	$ 382,006	$ 620,961	$ 355,204
	Number of retirees	-	7	3	4	55	44	71	184
2007	Average monthly benefit	$ -	$ 2,463	$ 2,742	$ -	$ 3,272	$ 3,472	$ 3,693	$ 3,447
	Average final average salary	$ -	$ 4,478	$ 4,930	$ -	$ 5,841	$ 6,284	$ 6,097	$ 6,004
	Average DROP Balance	$ -	$ 5,000	$ 5,000	$ -	$ 131,167	$ 379,358	$ 631,452	$ 367,727
	Number of retirees	-	1	7	-	58	46	61	173
2008	Average monthly benefit	$ -	$ 1,665	$ 2,502	$ 3,803	$ 3,498	$ 3,359	$ 3,918	$ 3,520
	Average final average salary	$ -	$ 4,405	$ 5,037	$ 6,914	$ 5,910	$ 3,021	$ 6,439	$ 6,052
	Average DROP Balance	$ -	$ 5,000	$ 5,000	$ 5,000	$ 144,905	$ 399,403	$ 704,850	$ 381,261
	Number of retirees	-	3	3	1	39	29	35	110
2009	Average monthly benefit	$ -	$ -	$ -	$ 3,064	$ 3,698	$ 3,560	$ 3,872	$ 3,669
	Average final average salary	$ -	$ -	$ -	$ 6,415	$ 2,559	$ 5,531	$ 6,548	$ 5,150
	Average DROP Balance	$ -	$ -	$ -	$ 5,000	$ 221,852	$ 414,500	$ 828,194	$ 477,574
	Number of retirees	-	-	-	2	29	62	35	128
2010	Average monthly benefit	$ -	$ -	$ 2,832	$ 3,909	$ 3,474	$ 3,779	$ 3,942	$ 3,770
	Average final average salary	$ -	$ -	$ 5,149	$ 5,888	$ 6,016	$ 6,382	$ 6,857	$ 6,457
	Average DROP Balance	$ -	$ -	$ 5,000	$ 5,000	$ 194,752	$ 382,059	$ 836,142	$ 501,842
	Number of retirees	-	-	2	4	26	48	50	130
Seven Years Ended June 30, 2010									
	Average Monthly Benefit	$ 3,582	$ 1,944	$ 2,477	$ 3,086	$ 3,326	$ 3,517	$ 3,963	$ 3,578
	Average Final Average Salary	$ 3,582	$ 4,033	$ 4,768	$ 5,463	$ 5,607	$ 5,910	$ 6,299	$ 5,980
	Average DROP Balance	$ 5,000	$ 5,006	$ 5,000	$ 17,240	$ 123,776	$ 392,991	$ 644,319	$ 391,120
	Number of Retirees	1	20	22	21	343	371	456	1,234

The above chart includes all Service, Proportionate and Disability retirements. It does not include Delayed Retirements or Survivor benefits due to Active member deaths. The DROP Balance includes $5,000 lump sum benefit.

DROP Activity
(dollars in thousands)
Years ended June 30

	DROP Accounts			DROP Participants		
Fiscal Year	Accumulations	Distributions	Total	Entrants	Withdrawals	Total
2001	$ 104,768	$ (8,381)	$ 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
2005	46,126	(59,493)	390,805	372	(298)	1,845
2006	73,581	(29,272)	435,114	296	(168)	1,973
2007	80,863	(23,315)	492,662	120	(157)	1,936
2008	95,543	(9,937)	578,268	15	(100)	1,851
2009	81,590	(10,889)	648,969	13	(126)	1,738
2010	75,874	(16,682)	708,161	106	(117)	1,727

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		
Fiscal Year	Accumulations	Distributions	Total	Entrants	Withdrawals	Total
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
2005	66,659	(16,649)	115,814	159	(32)	384
2006	43,037	(12,233)	146,618	88	(24)	448
2007	56,938	(11,303)	192,253	115	(16)	547
2008	44,696	(16,680)	220,269	73	(19)	601
2009	75,482	(19,922)	275,829	113	(14)	700
2010	71,913	(24,035)	323,707	95	(22)	773

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