



# HPOPS

FOR TODAY & TOMORROW

Comprehensive Annual

Financial Report

A Component Unit of

The City of Houston, Texas

July 1, 2010 through

June 30, 2011



## **HOUSTON POLICE OFFICERS' PENSION SYSTEM**

John E. Lawson, Executive Director

602 Sawyer, Suite 300

Houston, TX 77007

713.869.8734

713.869.7657 Fax

[www.hpops.org](http://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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TABLE OF CONTENTS

SECTION ONE	PAGE	SECTION FOUR	PAGE
<b>INTRODUCTORY SECTION</b>	<b>3</b>	<b>ACTUARIAL SECTION</b>	<b>59</b>
Letter of Transmittal	4	Actuary's Certification Letter	62
Chairman's Letter	10	Executive Summary	66
Board of Trustees and Administrative Staff	11	Schedule of Funding Progress	67
Administrative Organization	12	Historical Solvency Test	68
Certificate of Achievement for Excellence in Financial Reporting – June 30, 2010	13	Historical Active Participant Data	69
		Retirees, Beneficiaries, and Disabled Participants Added to and Removed from Rolls	70
		Membership Data	71
		Summary of Actuarial Methods and Assumptions	72
		Summary of Plan Provisions	80
<b>SECTION TWO</b>			
<b>FINANCIAL SECTION</b>	<b>15</b>	<b>SECTION FIVE</b>	
Independent Auditor's Report	17	<b>STATISTICAL SECTION</b>	<b>89</b>
Management's Discussion and Analysis	18	Summary	90
Basic Financial Statements:		Changes in Plan Net Assets	91
Statements of Plan Net Assets	22	Contribution Rates	92
Statements of Changes in Plan Net Assets	23	Contributions and Benefits Paid	92
Notes to the Basic Financial Statements	24	Investment Income	93
Required Supplementary Information:		Deductions from Net Assets for Benefits and Refunds by Type	94
Schedule of Funding Progress	42	Total Benefit Payments by Type	95
Schedule of Employer Contributions	42	Valuation of Assets as a Percent of Pension Liabilities	96
Actuarial Data	43	Net Assets Compared to Pension Liability	96
Supplemental Schedules:		Membership	97
Schedule I – Investment, Professional and Administrative Expenses	44	Pensions Awarded and Pensions in Force	98
Schedule II – Summary of Investment and Professional Services	45	Average Monthly Benefit Amounts by Years Credited Service	99
		DROP and PROP Activity	100
<b>SECTION THREE</b>			
<b>INVESTMENT SECTION</b>	<b>47</b>		
Introduction and Commentary	48		
Strategy and Performance Review	49		
Rates of Return	55		
Investment Holdings	56		
Brokerage Commissions	58		



# HPOPS

FOR TODAY & TOMORROW



INTRODUCTORY SECTION

	<u>Page</u>
Letter of Transmittal	4
Chairman's Letter	10
Board of Trustees and Administrative Staff	11
Administrative Organization	12
Certificate of Achievement for Excellence in Financial Reporting – June 30, 2010	13



**HOUSTON POLICE OFFICERS'  
PENSION SYSTEM**



November 10, 2011

The Membership  
Houston Police Officers' Pension System  
Houston, Texas

The Comprehensive Annual Financial Report (CAFR) of the Houston Police Officers' Pension System (the System) for the fiscal year ended June 30, 2011 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 an 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. There are limits to internal control, such as the cost to mitigate some risks may outweigh the risk itself, internal controls may be overridden, or collusion may thwart control design. We believe the System's internal controls are adequate and are working as designed.

**PENSION BOARD**

J. Larry Doss  
CHAIRMAN

Ralph D. Marsh  
VICE CHAIRMAN

James E. Montero  
SECRETARY

Terry A. Bratton  
TRUSTEE

Joe Glezman  
TRUSTEE

Craig T. Mason  
CITY TREASURER

Position Vacant  
MAYOR'S  
REPRESENTATIVE

**EXECUTIVE  
DIRECTOR**

John E. Lawson

**HOUSTON  
POLICE OFFICERS'  
PENSION SYSTEM**  
602 Sawyer, Suite 300  
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**TRANSMITTAL LETTER**

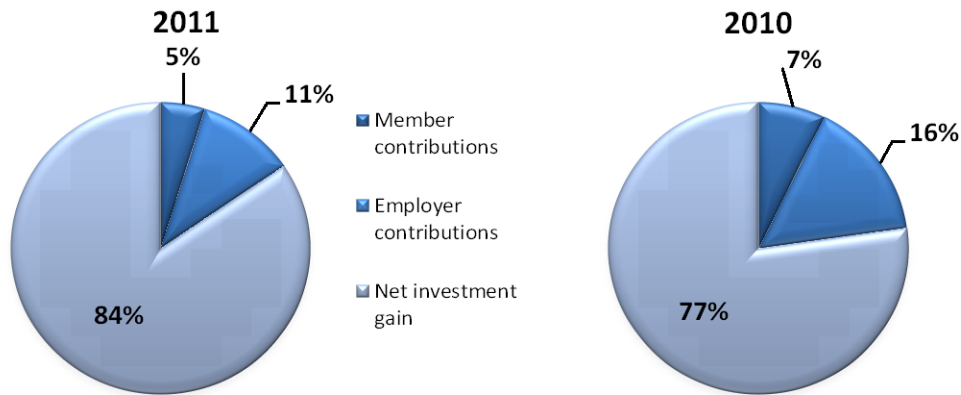
The System was established in 1947, funded by a \$100,000 Treasury note, and offered retiring members a pension of \$75 per month. Today, the System has investments of \$3.5 billion and offers a variety of pension benefits to members and their beneficiaries. Members have the option to defer their benefits, 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 2011 to be \$5 million over the \$73 million the City contributed in fiscal year 2010 and increases by \$5 million over that amount for fiscal 2012. The number of active members decreased in fiscal year 2011 compared to 2010 as the number of retirements outpaced new hires to the Houston Police Department (HPD). Despite this, contributions from members increased in fiscal 2011 as the number of active members hired or rehired after October 9, 2004 increased. These members contribute 10.25% of pay while members hired prior to October 9, 2004 contribute 9.00% of pay. The System experienced a positive investment return of 21.1% in 2011, which was an increase from the positive investment return of 13.7% in 2010. This increase is primarily due to the positive economic environment created by government liquidity programs and the anticipation of improving economic conditions despite significant periods of volatility due to budgetary and debt issues in the U.S. and concerns regarding Eurzone sovereign debt issues.

	2011	2010	Increase (Decrease)
Active members:			
Fully vested	1,733	1,745	(12)
Nonvested:			
Hired or rehired before October 9, 2004	2,135	2,271	(136)
Hired or rehired after October 9, 2004	1,443	1,338	105
	<u>5,311</u>	<u>5,354</u>	<u>(43)</u>

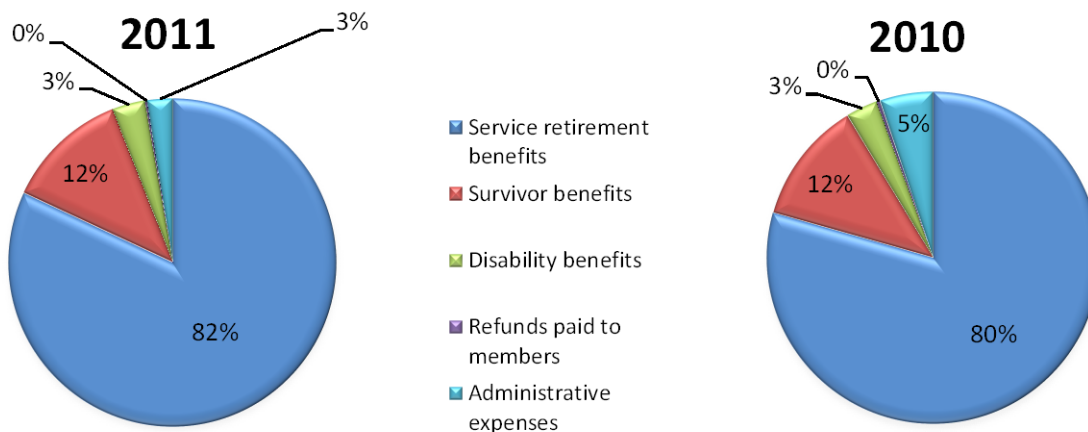
	\$000's		Increase Amount	Increase Percentage
	2011	2010		
Member contributions	\$ 35,122	\$ 34,218	\$ 904	2.6%
Employer contributions	78,287	73,192	5,095	7.0%
Net investment gain	621,557	364,650	256,907	70.5%
Total	<u>\$ 734,966</u>	<u>\$ 472,060</u>	<u>\$ 262,906</u>	<u>55.7%</u>



**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 64 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
	2011	2010		
Service retirement benefits	\$ 144,920	\$ 135,915	\$ 9,005	6.6%
Survivor benefits	21,385	20,480	905	4.4%
Disability benefits	5,736	5,340	396	7.4%
Refunds paid to members	420	547	(127)	(23.2%)
Administrative expenses	4,364	8,945	(4,581)	(51.2%)
<b>Total</b>	<b>\$ 176,825</b>	<b>\$ 171,227</b>	<b>\$ 5,598</b>	<b>3.3%</b>



Total benefits paid, which include lump sum payments, increased in 2011 as compared to 2010 due mainly to the cost of living increase, an increase in the number of retirees, and an increase in lump sum benefits. Administrative expenses decreased mainly due to 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.

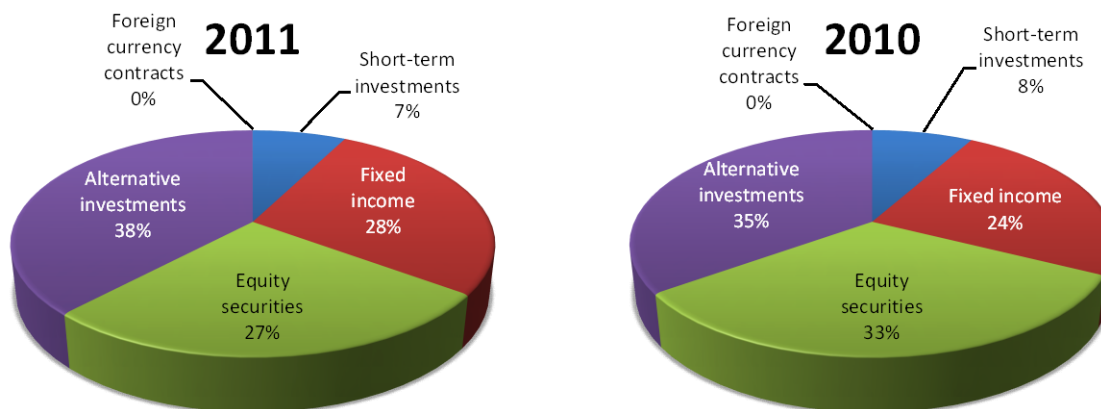
The Board of Trustees believes that the System’s assets should be managed in a way that reflects the uniqueness of the System, and that the System’s assets should be diversified over a spectrum of investment vehicles. The



## TRANSMITTAL LETTER

determination of the appropriate asset mix is based on capital market assumptions that incorporate historical returns, volatility and the correlation of various asset classes.

	\$000's		Increase (Decrease) Amount	Increase (Decrease) Percentage
	2011	2010		
Short-term investments	\$ 268,819	\$ 240,209	\$ 28,610	11.9%
Fixed income	988,908	721,061	267,847	37.1%
Equity securities	962,752	967,066	(4,314)	(0.4%)
Alternative investments	1,359,950	1,035,288	324,662	31.4%
Foreign currency contracts	516	-	516	
<b>Total</b>	<b>\$ 3,580,945</b>	<b>\$ 2,963,624</b>	<b>\$ 617,321</b>	<b>20.8%</b>



During the first half of fiscal year 2011, the market experienced a rally based on improving economic reports and speculation of government fiscal action and possible tax reform, including the extension of the Bush tax cuts. However, the growing European debt crisis and reports of deteriorating global economic conditions helped bring the market rally to a halt. Despite this, the System had a very strong return of 21.1% during fiscal year 2011, outperforming its benchmark rate of return by 0.9% primarily due to the strong performance of our hedge fund managers and our fixed income allocation. The System's investments in emerging markets debt also contributed to the outperformance as well as the superior performance from two of our active managers, Causeway Capital and First Eagle.

The Board firmly believes that by maintaining a disciplined investment approach and with reasonable diversification, the System will enhance the likelihood of meeting its long-term investment goals. Further details regarding the System's investments are included in the Investment Section of this report.

## Funding

It is the System's intention to have enough money in reserve to provide members with promised benefits upon their retirement. The System's actuary conducts a periodic valuation to determine the adequacy of the current employer contribution rates, to describe the current financial condition of the System, and to analyze changes in the System's condition. An actuarial accrued liability is the liability for service already rendered by former and present employees. An actuarial accrued surplus is the excess of the System's actuarial value of assets over the actuarial accrued liability. Any liability or surplus is amortized using a 30-year constant level percent of payroll method.

The most recent actuarial valuation shows the funded position of the System at July 1, 2010 of 83% increased from the funding level at July 1, 2009 of 79%. The actuarial accrued liability decreased \$136 million and the actuarial value of assets increased \$96 million. As a result, the System's Unfunded Actuarial Accrued Liability decreased \$232 million to \$706 million as of July 1, 2010. The decrease in the Unfunded Actuarial Accrued Liability is due to

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## TRANSMITTAL LETTER

a combination of offsetting factors including contributions below the actuarially required amount, changes in the actuarial value of assets, and changes in actuarial assumptions as more fully described in the footnotes and schedules to the financial statements. Further details regarding the System's actuarial liability are included in the Actuarial 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 2011 brought the launch of the new Member Website which gives members more information on their benefits as well as providing a self-service environment for things like address, direct deposit and tax withholding changes. All of these 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 62. Professional service providers who provided services to the System during the year are listed below.

<b>Actuarial</b>	Gabriel Roeder Smith & Company	<b>Legal Service/Lobbyists</b>	HillCo Partners, LLC Locke Lord Bissell & Liddell LLP
<b>Auditing</b>	BDO USA, LLP Bickley Prescott & Co.	<b>Money Management</b>	AQR Capital Management LLC Ashmore Investment Management Limited Attalus Capital BlackRock Institutional Trust Company 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. PanAgora Asset Management, Inc. Shenkman Capital Management, Inc.
<b>Consulting</b>	Mercer Investment Consulting Inc. Franklin Park Associates, LLC		
<b>Custodian</b>	The Northern Trust Company		
<b>Legal Service</b>	Burford & Maney, PC Burford, Hawash, Meade & Gaston LLP Gibbs & Bruns, LLP Strasburger & Price, LLP Accumyn, L.L.C. The Advocates J. Philip Ferguson Navigant Consulting, 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, 2010. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of state and local government financial reports.

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**TRANSMITTAL LETTER**

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 17 consecutive years (fiscal years 1994-2010). 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



# HPOPS

FOR TODAY & TOMORROW

November 10, 2011

**PENSION BOARD**

*J. Larry Doss*  
CHAIRMAN

*Ralph D. Marsh*  
VICE CHAIRMAN

*James E. Montero*  
SECRETARY

*Terry A. Bratton*  
TRUSTEE

*Joe Glezman*  
TRUSTEE

*Craig T. Mason*  
CITY TREASURER

*Position Vacant*  
MAYOR'S  
REPRESENTATIVE

**EXECUTIVE  
DIRECTOR**

*John E. Lawson*

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 2011 Comprehensive Annual Financial Report (CAFR). The CAFR provides a comprehensive picture of HPOPS' finances for the fiscal year ending June 30, 2011, as well as an overview of the year's highlights.

This past fiscal year the United States and the world economies have been perplexing. The first half of the year showed improvement with economic reports turning more positive as markets reacted favorably to government stimulus and concerns over the threat of a double-dip recession eased. However, the second half of the year saw geopolitical unrest in North Africa and the Middle East and a natural disaster in Japan followed by renewed debt concerns in Europe. Despite this volatility, the System had a very strong return of 21.1%, which is an improvement over last fiscal year's return of 13.7%.

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. The lessons learned over the past few years and our stewardship allow us to fulfill our mission 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.

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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Houston, TX 77007  
713.869.8734  
800.874.0454  
713.869.7657 Fax  
www.hpops.org

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**BOARD OF TRUSTEES AND ADMINISTRATIVE STAFF**

**TRUSTEES ELECTED BY ACTIVE, INACTIVE AND RETIRED POLICE OFFICERS**

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**J. LARRY DOSS**  
*Chairman*



**RALPH D. MARSH**  
*Vice-Chairman*



**JAMES E. MONTERO**  
*Secretary*



**TERRY BRATTON**  
*Trustee*



**JOSEPH GLEZMAN**  
*Trustee*

**TRUSTEES BY STATE STATUTE**

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**CRAIG T. MASON**  
*City Treasurer*

**Position Vacant**  
*Mayor's Representative*

**POLICE PENSION OFFICE PERSONNEL**

---

**JOHN E. LAWSON**  
*Executive Director*

**BRIAN POER**  
*IT Manager*

**TONI DEWILLIS**  
*Administrative Assistant*

**ERIC OLSON**  
*Director of Administration*

**CASE WILLS**  
*Developer*

**ANGELA CARTWRIGHT**  
*Receptionist*

**JUDY G. BAKER**  
*Benefits Manager*

**SHERYL BAINES**  
*Benefits Assistant*

**AMELIA WEBER**  
*Benefits Assistant*

**CLARK OLINGER**  
*Assistant Benefits Manager*

**REGINA WARD**  
*Benefits Assistant*

**RICHARD GABLE**  
*Financial Planner*

**PATRICK S. FRANNEY**  
*Chief Investment Officer*

**STACEY GALO**  
*Investment Analyst*

**NEAL WALLACH**  
*Investment Analyst/Strategist*

**ROBERT ARTHUR**  
*General Counsel*

**NICK DANG**  
*Attorney*

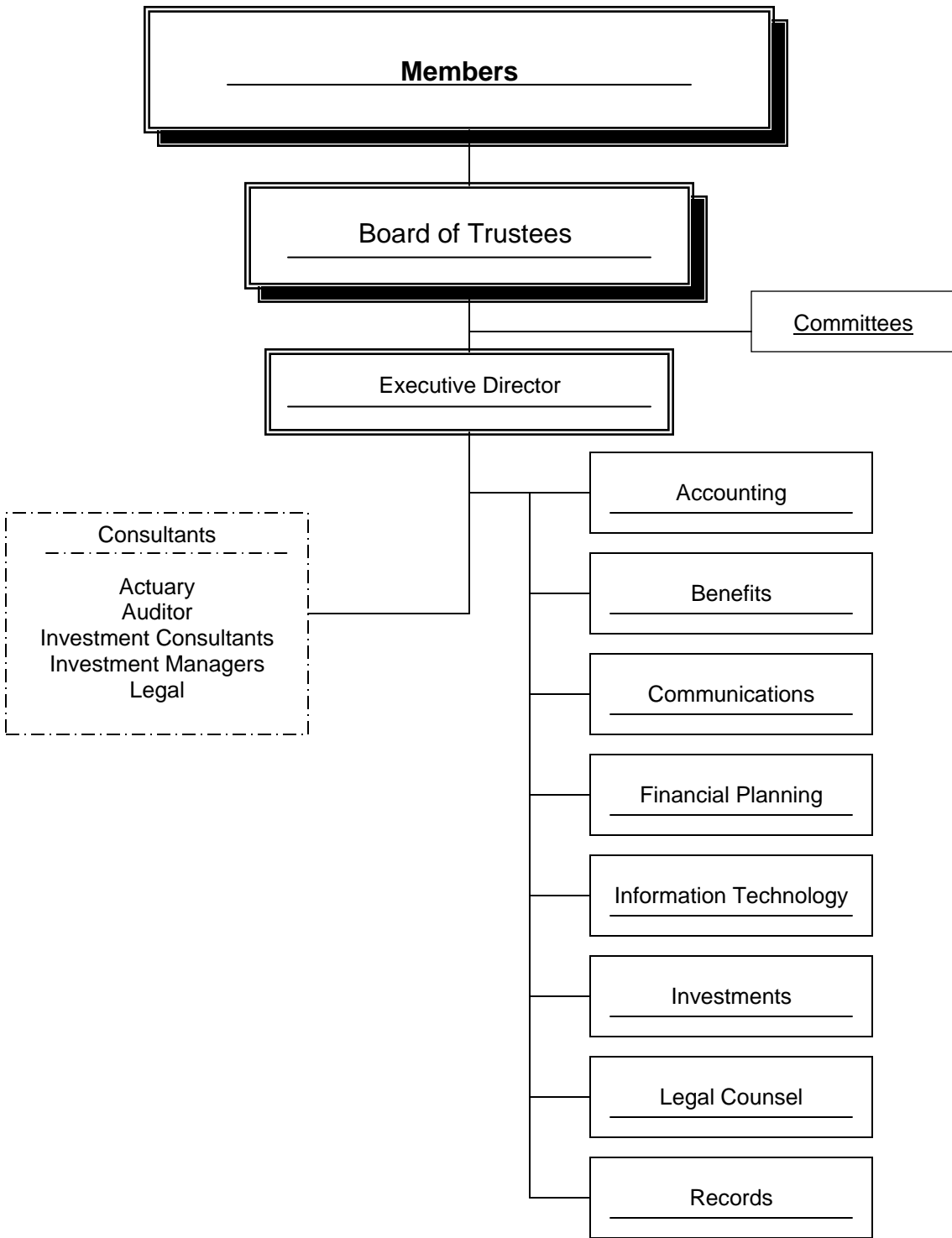
**KEVIN T. O'TOOLE**  
*Accounting Manager*

**LAJUANA SCOTT**  
*Accountant*

**STEPHEN SHALAGAN**  
*Records Manager*

**STEPHANIE SEGURA**  
*Records Assistant*

**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, 2010

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

	<u>Page</u>
Independent Auditor’s Report	17
Management’s Discussion and Analysis	18
Basic Financial Statements:	
Statements of Plan Net Assets	22
Statements of Changes in Plan Net Assets	23
Notes to the Basic Financial Statements	24
Required Supplementary Information:	
Schedule of Funding Progress	42
Schedule of Employer Contributions	42
Actuarial Data	43
Supplemental Schedules:	
Schedule I – Investment, Professional and Administrative Expenses	44
Schedule II – Summary of Investment and Professional Services	45



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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, 2011 and 2010, 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, 2011 and 2010, 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 are 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  
September 6, 2011

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms.

BDO is the brand name for the BDO network and for each of the BDO Member Firms.

# Houston Police Officers' Pension System

## Management's Discussion and Analysis Fiscal Year Ended June 30, 2011

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, 2011, 2010 and 2009. 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:	2011	2010	2009
<b>Assets</b>			
Investments at fair value	\$ 3,580,945	\$ 2,963,624	\$ 2,647,026
Prepaid management fees	150	150	-
Invested securities lending collateral	368,331	196,200	297,146
Receivables	21,396	36,195	27,943
Cash	172	559	283
<b>Total Assets</b>	<b>3,970,994</b>	<b>3,196,728</b>	<b>2,972,398</b>
<b>Liabilities</b>			
Foreign currency contracts	-	1,002	382
Due to brokers	70,195	25,970	2,250
Securities lending collateral	368,331	196,200	297,146
Accrued investment and professional fees	1,154	1,036	1,025
Other liabilities	697	493	874
<b>Total Liabilities</b>	<b>440,377</b>	<b>224,701</b>	<b>301,677</b>
Plan net assets held in trust for pension benefits	\$ 3,530,617	\$ 2,972,027	\$ 2,670,721

*See accompanying independent auditors' report.*

# Houston Police Officers' Pension System

## Management's Discussion and Analysis Fiscal Year Ended June 30, 2011

The System's net assets increased by approximately \$558,590 thousand in fiscal year 2011 and \$301,306 thousand in fiscal 2010. In both periods these increases were driven primarily by government liquidity programs and the anticipation of improving economic conditions. These gains were realized despite significant periods of volatility due to budgetary and debt issues in the U.S. and concerns regarding Eurozone sovereign debt issues. The System experienced a positive investment return of 21.1% in 2011 as opposed to positive 13.7% in 2010 and a negative return of (18.2)% in 2009. 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:	2011	2010	2009
<b>Contributions:</b>			
City	\$ 78,287	\$ 73,192	\$ 68,000
Members	35,122	34,218	32,519
<b>Total contributions</b>	<b>113,409</b>	107,410	100,519
Investment income (loss)	621,557	364,650	(607,482)
Net income from securities lending activities	449	473	1,427
<b>Total additions (deductions)</b>	<b>735,415</b>	472,533	(505,536)
<b>Deductions:</b>			
Benefits paid to members	172,041	161,735	144,112
Refunds to members	420	547	618
Professional and administrative expense	4,364	8,945	7,311
<b>Total deductions</b>	<b>176,825</b>	171,227	152,041
<b>Net increase (decrease)</b>	<b>558,590</b>	301,306	(657,577)
Plan net assets held in trust for pension benefits, beginning of year	2,972,027	2,670,721	3,328,298
Plan net assets held in trust for pension benefits, end of year	\$ 3,530,617	\$ 2,972,027	\$ 2,670,721

*See accompanying independent auditors' report.*

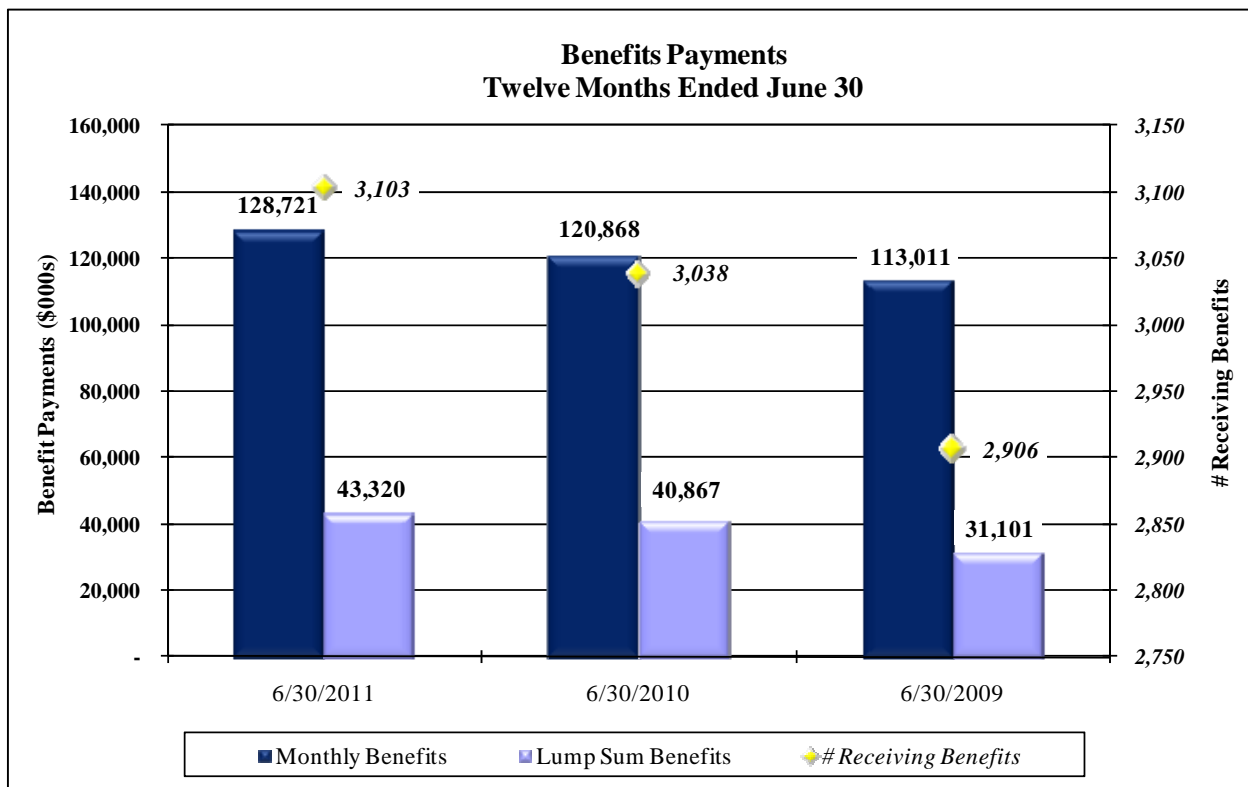
The October 9, 2004 Agreement with the City requires contribution payments for fiscal year 2011 equal to the amount contributed in 2010 of \$73,000 thousand plus \$5,000 thousand, resulting in contribution payments of \$78,000 thousand. For fiscal year 2010, the City was contractually required to contribute an amount equal to the amount contributed in 2009 of \$68,000 thousand plus \$5,000 thousand, resulting in contribution payments of \$73,000 thousand. These contractual provisions account for the increase in City contributions for the years ended June 30, 2011 and June 30, 2010. As discussed in Note 4, the contributions were partially paid from the proceeds of pension obligation bonds in 2009, partially paid from the proceeds of a revenue bond financing facility in 2010 and paid in its entirety from the City budget in 2011.

"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

# Houston Police Officers' Pension System

## Management's Discussion and Analysis Fiscal Year Ended June 30, 2011

chart below compares the components of benefits paid to members for the years ended June 30, 2011, 2010, and 2009. Total benefits paid in 2011 increased by approximately \$10,306 thousand or 6.4% compared to 2010, 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 2010 increased by approximately \$17,623 thousand or 12.2% compared to 2009, 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 \$10,072 thousand per month during 2010 to \$10,727 thousand per month during 2011, as the number of members and survivors receiving benefits increased by 65 during this time period. 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.



There was a decrease of \$4,581 thousand in professional and administrative expenses during 2011 as compared to 2010. This decrease is mainly due to a decrease 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, manages all aspects of benefits administration, investment tracking, accounting and financial reporting. The first phase of the project, the software development for benefits administration and data migration, was completed in December 2009. The second phase of the project, investment tracking, was completed in September 2010. There was an increase of \$1,079 thousand in professional and administrative expenses during 2010 as compared to 2009 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.

# Houston Police Officers' Pension System

## Management's Discussion and Analysis Fiscal Year Ended June 30, 2011

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### System Highlights

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The System's funded ratio pursuant to its most recent actuarial valuation dated July 1, 2010 was 83% representing an unfunded actuarial accrued liability of \$706,029 thousand. The System's funded ratio as of July 1, 2009 was 79% representing an unfunded actuarial accrued liability of \$937,556 thousand. The System's Agreement with the City provides that beginning in 2012, 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

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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)

<i>June 30,</i>	<b>2011</b>	<b>2010</b>
<b>Assets</b>		
<b>Investments, at fair value</b> (Note 2 and Note 3):		
Short term investments	\$ 268,819	\$ 240,209
Fixed income	988,908	721,061
Equity securities	962,752	967,066
Alternative investments	1,359,950	1,035,288
Foreign currency contracts	516	-
<b>Total investments</b>	<b>3,580,945</b>	<b>2,963,624</b>
<b>Prepaid management fees</b>	<b>150</b>	<b>150</b>
<b>Invested securities lending collateral</b> (Note 3):	<b>368,331</b>	<b>196,200</b>
<b>Receivables</b>		
Members	1,933	1,841
Investments	10,075	7,848
Due from brokers	9,315	26,464
Other receivables	73	42
<b>Total Receivables</b>	<b>21,396</b>	<b>36,195</b>
<b>Cash</b>	<b>172</b>	<b>559</b>
<b>Total Assets</b>	<b>\$ 3,970,994</b>	<b>\$ 3,196,728</b>
<b>Liabilities and Plan Net Assets</b>		
<b>Liabilities:</b>		
Foreign currency contracts	\$ -	\$ 1,002
Due to brokers	70,195	25,970
Securities lending collateral (Note 3)	368,331	196,200
Accrued investment and professional fees	1,154	1,036
Other liabilities	697	493
<b>Total Liabilities</b>	<b>440,377</b>	<b>224,701</b>
<b>Plan net assets held in trust for pension benefits</b>	<b>\$ 3,530,617</b>	<b>\$ 2,972,027</b>

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



**Houston Police Officers' Pension System**  
**Statements of Changes in Plan Net Assets (\$000's)**

<i>Years ended June 30,</i>	<b>2011</b>	<b>2010</b>
<b>Contributions</b> (Note 1 and Note 4):		
City	\$ 78,287	\$ 73,192
Members	35,122	34,218
<b>Total contributions</b>	<b>113,409</b>	<b>107,410</b>
<b>Investment income:</b>		
Net appreciation in fair value of investments	594,052	330,724
Interest:		
Short-term investments	302	981
Fixed income	30,878	29,048
<b>Total interest income</b>	<b>31,180</b>	<b>30,029</b>
Dividends	18,998	16,608
Other income	365	72
<b>Total investment income</b>	<b>644,595</b>	<b>377,433</b>
<b>Less investment expense</b>	<b>(23,038)</b>	<b>(12,783)</b>
<b>Net income from investing activities</b>	<b>621,557</b>	<b>364,650</b>
<b>Securities lending activities</b> (Note 3):		
Securities lending income	599	631
Securities lending expense	(150)	(158)
<b>Net income from securities lending activities</b>	<b>449</b>	<b>473</b>
<b>Total additions</b>	<b>\$ 735,415</b>	<b>\$ 472,533</b>
<b>Deductions:</b>		
Benefits paid to members	\$ 172,041	\$ 161,735
Refunds to members (Note 1)	420	547
Professional and administrative expense	4,364	8,945
<b>Total deductions</b>	<b>176,825</b>	<b>171,227</b>
<b>Net increase</b>	<b>558,590</b>	<b>301,306</b>
<b>Plan net assets held in trust for pension benefits, beginning of period</b>	<b>2,972,027</b>	<b>2,670,721</b>
<b>Plan net assets held in trust for pension benefits, end of period</b>	<b>\$ 3,530,617</b>	<b>\$ 2,972,027</b>

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

# Houston Police Officers' Pension System

## Notes to Financial Statements

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### 1. Plan Description and Contribution Information

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*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,	2011	2010
Retirees and beneficiaries:		
Currently receiving benefits	3,087	2,989
Not yet receiving benefits	23	20
Active members:		
Fully vested	1,733	1,745
Nonvested:		
Hired or rehired before October 9, 2004	2,135	2,271
Hired or rehired after October 9, 2004	1,443	1,338
<b>Total members</b>	<b>8,421</b>	<b>8,363</b>

The following sections describe the benefit structure in effect at June 30, 2011 and 2010. 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. On June 30, 2011 the System and the City entered into an agreement (the June 30, 2011 Agreement) that altered the City payment schedule and extended the contract term which began on October 9, 2004, through June 30, 2023 and thereafter renews for one-year terms through June 30, 2040 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.

# Houston Police Officers' Pension System

## Notes to Financial Statements

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*Pensionable Pay* - Eligible members of the System will have their retirement or DROP benefit (see below) 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.

# Houston Police Officers' Pension System

## Notes to Financial Statements

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*Supplemental Monthly Benefit* (13<sup>th</sup> 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**

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*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.

# Houston Police Officers' Pension System

## Notes to Financial Statements

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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

# Houston Police Officers' Pension System

## Notes to Financial Statements

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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.

# Houston Police Officers' Pension System

## Notes to Financial Statements

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, 2011 and 2010.

(\$000's)	6/30/2011		6/30/2010	
	Fair Value	Percent of Net Assets	Fair Value	Percent of Net Assets
Level I	\$ 556,486	15.5 %	\$ 454,645	15.4 %
Level II	2,684,828	75	2,212,010	74.6
Level III	339,631	9.5	296,969	10.0
	<b>\$ 3,580,945</b>	<b>100.0 %</b>	<b>\$ 2,963,624</b>	<b>100.0 %</b>

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)
<b>Balance June 30, 2010</b>	\$ 296,969
Purchases	55,843
Sales	(75,074)
Realized Gain/Loss	28,859
Unrealized Gain/Loss Change	33,034
Transfers in/(out) of level III	-
<b>Balance June 30, 2011</b>	<b>\$ 339,631</b>

*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.

*Reclassification* – Certain legal expenses previously reported as a component of investment expense for the year ended June 30, 2010 have been reclassified as professional and administrative expense in the amount of \$555 thousand. This amount represents the portion of legal expenses for the lawsuit discussed in Note 6 that previously was allocated to the System's investment department operating expense based upon a ratio of investment department personnel costs to total personnel costs. One hundred percent of these legal costs are classified as professional and administrative expense for both 2011 and 2010 in the accompanying statements of changes in plan net assets. This reclassification had no effect on net plan assets held in trust for pension benefits.

### 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.

# Houston Police Officers' Pension System

## Notes to Financial Statements

*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, 2011 and June 30, 2010, the System had a balance of \$172 thousand and \$559 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, 2011, the System's bank balance of \$172 thousand was not exposed to custodial credit risk. In addition, at June 30, 2011, the System had approximately \$6,700 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, 2011, the System's fixed income assets that are not government guaranteed represented 76.0% 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, 2011

Fixed Income Security Type	Market Value (\$000's)	Percent of Total	Weighted Average Credit Quality
Corporate Bonds	\$ 230,628	18.3 %	B
International Government Bonds	93,549	7.4	AAA
Mutual Bond Funds	361,789	28.8	Not Rated
Bank Loans	1,218	0.1	BB
Short Term Investment Funds	268,819	21.4	Not Rated
<b>Total</b>	<b>\$ 956,003</b>	<b>76.0 %</b>	

### Ratings Dispersion Detail June 30, 2011 (\$000's)

Credit Rating Level	Corporate Bonds	International Government Bonds	Mutual Bond Funds	Bank Loans	Short Term Investment Funds
AAA	\$ -	\$ 46,879	\$ -	\$ -	\$ -
AA	-	12,476	-	-	-
BBB	6,564	-	-	-	-
BB	85,494	-	-	514	-
B	115,189	-	-	-	-
CCC	18,582	-	-	-	-
CC	241	-	-	-	-
Not Rated	4,558	34,194	361,789	704	268,819
<b>Total</b>	<b>\$ 230,628</b>	<b>\$ 93,549</b>	<b>\$ 361,789</b>	<b>\$ 1,218</b>	<b>\$ 268,819</b>



# Houston Police Officers' Pension System

## Notes to Financial Statements

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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, 2011, 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, 2011**

Security Type	Market Value (\$000's)	Percent of Total	Weighted Average Modified Duration (years)
US Treasuries	\$ 301,724	24.0 %	7.5
Corporate Bonds	230,628	18.3	4.8
International Government Bonds	93,549	7.4	8.0
Mutual Bond Funds	361,789	28.8	3.3
Bank Loans	1,218	0.1	3.0
Short Term Investment Funds	268,819	21.4	0.1
<b>Total</b>	<b>\$ 1,257,727</b>	<b>100.0 %</b>	<b>4.3</b>

# Houston Police Officers' Pension System

## Notes to Financial Statements

### Modified Duration Analysis by Security Type June 30, 2011

	Market Value (\$000's)	Average Modified Duration	Contribution to Modified Duration
<b>U.S. Treasuries</b>			
1 to 10 years maturities	206,639	4.8	3.3
10 to 20 years maturities	78,326	12.3	3.2
Greater than 20 years maturities	16,759	17.5	1.0
<b>Total</b>	<b>\$ 301,724</b>		<b>7.5</b>
<b>Corporate Bonds</b>			
Less than 1 year to maturity	\$ 2,410	0.5	0.0
1 to 10 years maturities	216,972	4.6	4.4
10 to 20 years maturities	9,046	8.2	0.3
Greater than 20 years maturities	2,200	11.1	0.1
<b>Total</b>	<b>\$ 230,628</b>		<b>4.8</b>
<b>International Government Bonds</b>			
1 to 10 years maturities	59,131	4.4	2.8
10 to 20 years maturities	20,611	11.6	2.6
Greater than 20 years maturities	13,807	17.5	2.6
<b>Total</b>	<b>\$ 93,549</b>		<b>8.0</b>
<b>Bank Loans</b>			
1 to 10 years maturities	\$ 1,218	3.0	3.0
<b>Total</b>	<b>\$ 1,218</b>		<b>3.0</b>

*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, 2011, is shown in the table on the next page.

# Houston Police Officers' Pension System

## Notes to Financial Statements

### Foreign Currency Exposure by Asset Class (\$000's) June 30, 2011

Currency	Short Term Investments	Equities	Fixed Income	Alternative Investments	Options on Foreign Currencies	Total
Australian dollar	\$ 46	\$ -	\$ -	\$ -	\$ -	\$ 46
Brazilian real	-	480	-	-	-	480
British pound sterling	38	35,896	7,011	-	(6,470)	36,475
Canadian dollar	879	-	-	-	-	879
Euro	2,003	85,029	42,996	\$ 31,305	(44,265)	117,068
Hong Kong dollar	-	3,340	-	\$ -	-	3,340
Japanese yen	356	46,153	44,490	-	(44,534)	46,465
New Zealand dollar	-	875	-	-	-	875
Norwegian krone	-	638	-	-	-	638
Singapore dollar	-	2,311	-	-	78	2,389
South Korean won	-	4,503	-	-	-	4,503
Swedish krona	7	3,205	-	-	-	3,212
Swiss franc	321	15,908	-	-	(290)	15,939
<b>Total</b>	<b>\$ 3,650</b>	<b>\$ 198,338</b>	<b>\$ 94,497</b>	<b>\$ 31,305</b>	<b>\$ (95,481)</b>	<b>\$ 232,309</b>

*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, 2011 the weighted-average maturity of the collateral pool was 29 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, 2011 and 2010, was \$368,331 thousand and \$196,200 thousand, respectively. The System also had non-cash collateral at June 30, 2011, of \$20,387 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, 2011 and 2010 was \$380,561 thousand and \$190,358 thousand, respectively. At June 30, 2011, the System had no credit risk exposure to borrowers because the amounts the System owes the borrowers, \$388,718 thousand, exceeds the amounts the borrowers owe the System, \$380,561 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.

# Houston Police Officers' Pension System

## Notes to Financial Statements

The fair value balance and notional amounts of derivative instruments outstanding at June 30, 2011, 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, 2011		
		Classification	Amount	Notional Value
Investment derivatives:				
Short Term Investments	\$ 996	Short term investments	\$ 996	\$ 9,450
Futures contracts				
Fixed Income Futures contracts	\$ (158)	Fixed Income	\$ (158)	\$ 84,141
Equity Futures contracts	\$ 579	Equity	\$ 579	\$ 164,944
Foreign currency contracts				
British pound sterling	\$ 126	Foreign currency contracts	\$ 617	£ (4,109)
Euro	\$ (55)	Foreign currency contracts	\$ (545)	€ (30,493)
Japanese yen	\$ 442	Foreign currency contracts	\$ 442	¥ (3,632,245)
Singapore dollar	\$ 1	Foreign currency contracts	\$ 1	\$ 95
Swiss franc	\$ 2	Foreign currency contracts	\$ 2	SFr. -246

\* 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, 2011. 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 contracts 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.

# Houston Police Officers' Pension System

## Notes to Financial Statements

- *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, 2011, is shown in the table below.

Currency	Short Term Investments Futures	Equity Futures	Fixed Income Futures	Foreign currency contracts
British pound sterling	\$ 1,023	\$ -	\$ 2,508	\$ (6,470)
Canadian dollar	825	4,265	-	-
Euro	-	-	17,666	(44,265)
Japanese yen	4,942	-	11,358	(44,534)
Singapore dollar	-	-	-	78
Swiss franc	-	-	-	(290)
<b>Total</b>	<b>\$ 6,790</b>	<b>\$ 4,265</b>	<b>\$ 31,532</b>	<b>\$ (95,481)</b>

*Alternative Investments* – As of June 30, 2011 and 2010, 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).

Investment Type	Fair Value (\$000's)	
	June 30, 2011	June 30, 2010
<i>Private Equity</i>		
Leveraged Buyouts	\$ 137,665	\$ 120,421
Special Situations	109,560	95,866
Venture Capital	65,373	62,072
<i>Other Alternatives</i>		
Hedge Funds	412,086	286,340
Real Estate Funds	25,815	14,053
Risk Parity	609,451	456,536
<b>Total</b>	<b>\$ 1,359,950</b>	<b>\$ 1,035,288</b>

Supplemental Information on investment and professional expenses included in Schedule II on page 29 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.

# Houston Police Officers' Pension System

## Notes to Financial Statements

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### 4. Contributions and Reserves

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Contributions – Members hired prior to October 9, 2004 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 \$78,000 thousand for fiscal year 2011. In the June 30, 2011 Agreement, it was agreed that for fiscal year 2012 the amount to be contributed would be an \$83,000 thousand fixed payment, with any shortfall in the fixed payment not to exceed \$17,000 thousand. For fiscal year 2013, the amount to be contributed would be a \$93,000 thousand fixed payment, with any shortfall in the fixed payment not to exceed \$8,500 thousand, and for fiscal year 2014, it requires a \$103,000 thousand fixed payment. To finance the allowed shortfalls, the City in the June 30, 2011 Agreement, gave the System an undivided interest (Property Interest) in real property owned by the City known as the Houston Police Department Headquarters located at 1200 Travis Street, Houston, Texas, and a parking garage located at 801 Polk Street, Houston, Texas (Real Property). The percentage of the Property Interest is the ratio of the unpaid shortfall debt (plus any unpaid interest) to the appraised value of the Real Property on June 21, 2011, plus an extra 10% to allow for differing valuations and changes in value during the period the Property Interest is held by the System. The City will make quarterly payments to the System of interest on the shortfall at a rate of 8.5% per annum, not compounded, until the shortfall is repaid. For the fiscal year 2012 shortfall, the quarterly interest payments will be \$361 thousand and for the fiscal year 2013 shortfall, the quarterly interest payments will be \$181 thousand.

On or before January 1, 2012, the City shall place the Real Property on the market for sale and lease back, the proceeds of which sale will be allocated between the City and HPOPS according to their respective Property Interests. Until any sale takes place, the City shall have, at its sole option and discretion, the right to purchase the System's Property Interest for the amount of the unpaid shortfall debt and the prorated amount of interest due as of the date of repurchase. If the Real Property has not been sold by July 1, 2015, the City shall buy back on that date the System's Property Interest for the amount of the unpaid shortfall debt plus any accrued interest.

For all subsequent fiscal years, and until the funded ratio reaches 100%, City payments shall increase each fiscal year by \$10,000 thousand until said 100% funding is reached. Once the System reaches a 100% funded ratio, the City will pay the actuarially required rate, but not less than 16.00% of payroll. In addition, beginning in 2012, 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 \$3,516,000 thousand, a 5% decline in the funded ratio below the floor would require the City to pay approximately \$212,000 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 ratio to 85%, and the funded ratio as of July 1, 2010 is 83%, both of which are in excess of the floor provisions discussed above.

Assuming an annual increase in City payments of \$10,000 thousand per year beginning in fiscal 2015 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.

# Houston Police Officers' Pension System

## Notes to Financial Statements

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Pursuant to the terms of the June 30, 2011 Agreement and based on the July 1, 2010 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, 2021.

(\$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
2011	\$ 121,040	\$ 78,000	64.4	32.0
2012	133,550	83,000	62.1	34.9
2013	145,912	93,000	63.7	37.5
2014	157,392	103,000	65.4	39.7
2015	168,305	113,000	67.1	41.6
2016	178,279	123,000	69.0	43.1
2017	187,248	133,000	71.0	44.2
2018	195,390	143,000	73.2	45.1
2019	202,845	153,000	75.4	45.6
2020	209,732	163,000	77.7	46.0
2021	215,931	173,000	80.1	46.0

The October 9, 2004 Agreement provided 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 from 2005 through 2009 totaling \$137,865 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. None of the City's fiscal 2011 obligations were financed utilizing bonds.

The ARC as a percentage of pay for 2011 is 32.0%. This rate consists of 20.2% to cover Normal Costs and 11.8% to amortize the unfunded actuarial accrued liability over 30 years.

### 5. Funding Status

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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 most recent valuation shows the funded position of the System increased from 79% at July 1, 2009 to 83% at July 1, 2010. This decrease in the Unfunded Actuarial Accrued Liability is due to a combination of offsetting factors including contributions below the actuarially required amount, changes in the actuarial value of assets, and changes in actuarial assumptions. 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. It is estimated that this change in method decreased the

# Houston Police Officers' Pension System

## Notes to Financial Statements

System's Actuarial Accrued Liability by \$308,621 thousand. This decrease, in conjunction with actuarial losses from liability sources of \$77,094 thousand and an increase in the actuarial value of assets greater than assumed of \$95,757 thousand, resulted in an Unfunded Actuarial Accrued Liability of \$706,029 thousand at July 1, 2010. Absent this change in the Actuarial Cost Method, the System's Funded Ratio at July 1, 2010 would have been 78%.

The funded status of the System as of July 1, 2010, the most recent actuarial valuation date, is as follows:

*Actuarial Funded Status as of Actuarial Valuation Date July 1, 2010 (\$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
\$ 3,526,703	\$ 4,232,732	\$ 706,029	83 %	\$ 377,779	187 %

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 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, 2010
Actuarial cost method	Projected unit credit
Amortization method	Level percent of payroll Amortization over a constant open period of 30 years
Remaining amortization period	30 years
Asset valuation method	20% adjustment method
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 2.5%
	Attributable to merit increases 0.0% to 12.0%
	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

## Notes to Financial Statements

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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 based upon the System's funded status as of July 1, 2009 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 60% during that period absent increases in contribution rates or adjustments to the System's benefit structure.

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 June 30, 2011 Agreement, which provides a revenue stream based on the previously described funding schedule and 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 in the actuarial value of assets, the July 1, 2010 actuarial value of \$3,526,703 thousand is \$554,676 thousand greater than the fair value \$2,972,027 thousand. The \$554,676 thousand in deferred losses will be recognized in future years offset by any deferred gains, and as these losses are recognized, the unfunded liability can be expected to increase 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 46% over the next 10 years while actuarial projections indicate that the System's funded ratio will decline to below 60% during this period of time.

### **6. Litigation**

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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, the System contends that 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 percent of the cash collateral was held by the swap provider and 75 percent of the collateral was held by State Street, which invested all 75 percent of the cash collateral 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 System alleges the IMA did not require State Street to invest or keep the cash collateral in the LDBF or any other particular cash management fund that would allow the cash collateral to be exposed to large losses.

The LDBF was represented to be the fund of choice for State Street's commingled version of the Commodities Strategy, and likewise was selected by State Street to be used by the System's separately managed account that allowed State Street full discretionary powers to choose the LDBF subject to the fiduciary limitations and other terms of the IMA. The LDBF was represented to be an unleveraged enhanced cash fund that sought investment returns of the J P Morgan 1 month U.S. Libor Index plus 50 basis points. In order to meet this aspirational, but not mandated, target, State Street represented it would maximize income while preserving capital by investing in a

# Houston Police Officers' Pension System

## Notes to Financial Statements

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diversified portfolio of highly rated fixed income securities. 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 percent) were invested solely in sub-prime residential mortgage-backed related securities and non investment grade derivatives.

By early summer of 2007, the sub-prime securities market was encountering severe, negative market conditions, and as a result, the LDBF's sub-prime securities became highly illiquid with little or no market, and huge losses were being realized by the LDBF on the sale of securities even when they could be sold. Without prior notice to the System, substantially all of the LDBF participants, including the other proprietary funds managed by State Street that made up the vast majority of investors in the LDBF, liquidated and redeemed their units for cash with the LDBF obtaining cash by selling or borrowing against the most highly rated sub-prime securities ("AAA"). Beginning in early August 2007, the few remaining State Street funds in the LDBF redeemed their interests for an in-kind, allegedly "pro-rata" distributions of sub-prime securities with State Street claiming each participant in the Fund would be receiving a perfect slice of the in-kind securities and the redemption would not affect liquidity of the remaining participants in the fund. Unknown to the System, only days later it would be trapped in a fund, with only one other participant, holding mostly small and odd lots of illiquid subprime securities and worthless swaps. The System terminated the Commodities Strategy (and thus was entitled to receive the cash collateral invested in the LDBF) in November 2007. Instead the System received a distribution of partial cash (\$14,270 thousand) and securities (allegedly worth \$13,315 thousand) approximately a month later. The securities which could not be sold because of an admitted lack of liquidity were later sold for a fraction of the alleged value and the System incurred actual damages in excess of \$35,000 thousand as a result of State Street's alleged wrongdoings, and has suffered attorney fees and legal costs in excess of \$6,000 thousand in prosecuting this case. In August 2008, the System filed its lawsuit against State Street seeking to recover its losses plus management, legal fees and other legal expenses. In February, 2010, after much of the civil discovery was conducted in the consolidated related civil cases in Multi-District Litigation (MDL), 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 by the System was required to receive these 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 damages it is legally entitled to receive under the law. Recently, in July 2011, the case was remanded by the MDL Panel for separate trial in the Southern District of Texas. The System is seeking trial at the earliest possible date.

### **7. Commitments and Contingencies**

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As described in Note 1, there are 3,578 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, 2011 and 2010, aggregate contributions from these members of the System were approximately \$160,842 thousand and \$149,680 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, 2011 and 2010, the total accumulated lump sum benefit due to DROP members was approximately \$764,147 thousand and \$708,161 thousand, respectively.

At June 30, 2011 and 2010, the total accumulated lump sum benefit due to PROP participants was \$373,431 thousand and \$323,707 thousand, respectively.

The System has outstanding commitments to various limited partnerships totaling \$214,752 thousand and \$218,992 thousand, as of June 30, 2011 and 2010, respectively.

# Houston Police Officers' Pension System

## Notes to Financial Statements

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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).

<u>Period</u>	<u>Monthly Base Rent</u>	<u>Fiscal Year</u>	<u>Total Rent</u>
July 2011 - April 2012	\$ 16	2012	\$ 192
May 2012 - April 2015	17	2013	203
		2014	203
		2015	169
		<u>Beyond 2015</u>	<u>-</u>
			<u>\$ 767</u>

**Houston Police Officers' Pension System**  
**Required Supplementary Information (Unaudited)**

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*Schedule of Funding Progress (\$000's) <sup>(1)</sup>*

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, 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
July 1, 2010	3,526,703	4,232,732	706,029	83	377,779	187

- (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 <sup>(2)</sup>	Cash Payments as a Percent of Actuarial Required Contribution	Annual Required Contribution as a Percentage of Pay
2006	\$ 100,170	\$ 53,000	23.0 <sup>(3)</sup>	31.2 %
2007	107,443	58,000	26.1 <sup>(4)</sup>	34.0
2008	107,865	63,000	26.0 <sup>(5)</sup>	32.1
2009	108,621	68,000	44.2 <sup>(6)</sup>	30.9
2010	116,315	73,000	45.6 <sup>(7)</sup>	31.7
2011	121,040	78,000	64.4	32.0

- (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 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.
- (4) 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.
- (5) 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.
- (6) 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.
- (7) 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.

# Houston Police Officers' Pension System

## Required Supplementary Information (Unaudited)

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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:

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Valuation date		July 1, 2010
Actuarial cost method		Projected Unit Credit
Amortization method		Level percent of payroll Amortization over a constant open period of 30 years
Remaining amortization period		30 years
Asset valuation method		20% adjustment method
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		2.5%
Attributable to merit increases		0.0% to 12.0%
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%	

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# Houston Police Officers' Pension System

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

<i>Year ended June 30,</i>	2011	2010
<b>Investment services:</b>		
Custodial services	\$ 231	\$ 226
Money management services	21,736	11,268
Consulting services	644	790
Department Operating Expense	428	499
<b>Total investment services</b>	<b>23,039</b>	<b>12,783</b>
<b>Professional services:</b>		
Actuarial services	60	42
Auditing services	96	110
Election audit services	10	1
Legal services	1,409	5,667
Lobbyist services	316	307
<b>Total professional services</b>	<b>1,891</b>	<b>6,127</b>
<b>Administrative expenses:</b>		
Computers and technology	159	346
Education	32	43
Fiduciary insurance	79	84
Office rent	169	171
Other office costs	2,034	2,174
<b>Total administrative expenses</b>	<b>2,473</b>	<b>2,818</b>
	<b>\$ 27,403</b>	<b>\$ 21,728</b>

*See accompanying independent auditors' report.*

# Houston Police Officers' Pension System

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

<i>Twelve Months Ended June 30, 2011</i>	Official System Position	Expense	Nature of Services
Mercer Investment Consulting, Inc.	Consultant	644	Consulting
The Northern Trust Company	Custodian	231	Custodian
AQR Capital Management LLC	Money Manager	554	Money Management
Ashmore Investment Management Limited	Money Manager	3,371	Money Management
BlackRock Institutional Trust Company	Money Manager	511	Money Management
Brandes Investment Partners	Money Manager	667	Money Management
Bridgewater Associates, Inc.	Money Manager	12,559	Money Management
Causeway Capital Management	Money Manager	623	Money Management
The Clifton Group	Money Manager	270	Money Management
Dimensional Fund Advisors	Money Manager	479 *	Money Management
Driehaus Capital Management, Inc.	Money Manager	380	Money Management
First Eagle Investment Mgmt, LLC	Money Manager	757	Money Management
First Quadrant LP	Money Manager	326	Money Management
Franklin Park Associates, LLC	Money Manager	367	Money Management
MacKay-Shields Financial Corp.	Money Manager	410	Money Management
PanAgora Asset Management, Inc.	Money Manager	88	Money Management
Shenkman Capital Management, Inc.	Money Manager	374	Money Management
Gabriel Roeder Smith & Co.	Actuary	60	Actuarial
BDO USA, LLP	Auditors	96	Auditing
Burford & Maney, PC	Attorneys	329	Legal Service
Burford, Hawash, Meade & Gaston LLP	Attorneys	395	Legal Service
Gibbs & Bruns, LLP	Attorneys	459	Legal Service
Strasburger & Price, LLP	Attorneys	76	Legal Service
Accumyn, L.L.C.	Consultant	26	Legal Service
The Advocates	Consultant	53	Legal Service
J. Philip Ferguson	Consultant	3	Legal Service
Navigant Consulting, Inc.	Consultant	44	Legal Service
HillCo Partners, LLC	Attorneys	157	Lobbyists
Locke Lord Bissell & Liddell LLP	Attorneys	150	Lobbyists
Bickley Prescott & Co.	Consultant	10	Election Auditing
Other	Other	33	Other
<b>Total investment and professional services</b>		<b>\$ 24,502</b>	

\* 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**

	<u>Page</u>
Introduction and Commentary	48
Strategy and Performance Review	49
Rates of Return	55
Investment Holdings	56
Brokerage Commissions	58



### **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 strategies. 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 strategy that contributes diversification, liquidity and a predictable stream of income; and that dampens volatility in investment returns.
- Diversification into alternative investments provides the System with an opportunity to enhance returns and to achieve broader diversification of the System's assets.

### **Investment 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's asset 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 target and the actual asset allocation of the System at June 30, 2011 are as follows:

	<b>Target % of Fund</b>	<b>Current Actual % of Fund</b>	<b>Dollars Invested (000's)</b>
Domestic Equity	15.5%	15.5%	\$ 546,167
International Equity	15.5%	15.6%	549,635
<b>Total Equity</b>	<b>31.0%</b>	<b>31.0%</b>	<b>1,095,802</b>
Fixed Income	21.0%	23.5%	828,935
High Yield	7.5%	7.1%	250,156
<b>Total Fixed Income</b>	<b>28.5%</b>	<b>30.6%</b>	<b>1,079,091</b>
Private Equity	10.0%	8.9%	313,425
Risk Parity	15.0%	15.6%	549,451
Hedge Funds	10.5%	11.7%	412,784
Real Assets	5.0%	0.7%	25,815
<b>Total Alternatives</b>	<b>40.5%</b>	<b>36.9%</b>	<b>1,301,475</b>
<b>Total Cash</b>	<b>0.0%</b>	<b>1.5%</b>	<b>53,894</b>
<b>Total Fund</b>	<b>100.0%</b>	<b>100.0%</b>	<b>\$ 3,530,262</b>

Markets rallied during the first half of fiscal year 2011 due to improving economic reports, speculation of a QE 3 package and the extension of the Bush tax cuts. The market rally came to a halt in the second half of the year as the sovereign debt crisis in Europe worsened and global economic reports indicated deteriorating conditions. The System had a strong return of 21.1% during fiscal year 2011.

The System outperformed its benchmark rate of return by 0.9%, primarily due to the strong performance of our hedge fund managers and our fixed income allocation. The System's investments in emerging markets debt also contributed to the outperformance as well as superior performance from two of our active managers, Causeway Capital and First Eagle.

*Domestic Equity*

The System's domestic equity investments generated a 33.3% return, marginally outperforming the 32.4% 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 so this outperformance is primarily due the superior performance of our actively managed strategies vs. the benchmark.

First Eagle outperformed their benchmark, the Russell 1000, by approximately 3.4% during fiscal year 2011. In the first half of the year, they outperformed primarily as a result of their overweight to the consumer discretionary and materials sectors versus the benchmark. As financial markets declined in the second half of

## INVESTMENT SECTION

the fiscal year, First Eagle underperformed the Russell 1000 by approximately 2.0% due their underweight to the industrials sector vs. the benchmark and their overweight to the financial sector versus the benchmark.

Driehaus underperformed its benchmark by approximately 2.0% during fiscal year 2011. They experienced strong outperformance during the first half of the year, led by stock selection within and an overweight to the consumer discretionary sector. The overweight to the consumer discretionary sector and underweight to the consumer staples sector hurt Driehaus during the second half of the year, as did security selection within the energy and industrials sectors.

Assets under management, annualized rates of return and fees paid to domestic equity managers for the fiscal year ending June 30, 2011 are as follows (dollars in 000's):

Manager	Style	Assets	% Returns	Fees
First Eagle	Large Cap	\$ 149,387	35.3%	\$ 757
BlackRock	S&P 500 Index	95,789	31.7%	29
BlackRock	Russell 2000 Index	36,063	38.0%	27
Clifton Group	S&P 500 Futures <sup>1</sup>	71,550	31.6%	68
Driehaus Capital Mgmt	Large Cap Growth	61,110	33.1%	380
Panagora	Quality Stock Portfolio <sup>2</sup>	132,268	28.9%	88
		<u>\$ 546,167</u>		<u>\$ 1,349</u>

<sup>1</sup>Futures are fully funded

<sup>2</sup>Funded 8/31/2010

	<u>HPOPS</u>	<u>Benchmark</u>
# of holdings	2683	3000
Avg Market Cap	\$77.8 Billion	\$71.2 Billion
Portfolio P/E	16.64	15.86
Portfolio P/Book	2.61	2.21
Portfolio Beta (3-yr)	1.06	1.00

### *International Equity*

The System's international equity investments returned 29.1%, slightly underperforming the 29.7% return of the MSCI ACWI ex U.S. benchmark for the fiscal year. This underperformance was due to a combination of active management and asset allocation, including an overweight to emerging market equity which underperformed developed international equity markets.

Brandes underperformed its benchmark the MSCI EAFE Index by approximately 4.7%. The majority of their underperformance occurred during the first half of the fiscal year as a result of their underweight to the industrials and financials sectors versus the benchmark. During the second half of the year Brandes marginally underperformed the MSCI EAFE due to stock selection in the information technology sector and their exposure to European bank holdings.

Causeway outperformed the return of its benchmark, the MSCI EAFE Index during fiscal year 2011 by 4.5%. Strong stock selection led to outperformance during the market rally in 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, 2011 are on the next page (dollars in 000's):

INVESTMENT SECTION

Manager	Style	Assets	% Returns	Fees
BlackRock	EAFE Small Cap	\$ 45,798	37.7%	\$ 70
BlackRock	Emerging Markets Passive	55,280	27.8%	141
BlackRock	World Equity ex-US	44,160	30.1%	42
BlackRock	Frontier Markets <sup>2</sup>	32,047	9.1%	203
Brandes	EAFE	104,862	26.2%	667
Causeway Capital	EAFE	114,284	35.4%	623
Clifton Group	World Equity ex-US Futures <sup>1</sup>	56,074	32.3%	58
DFA	Emerging Markets Equity	97,130	28.1%	479
		<u>\$ 549,635</u>		<u>\$ 2,283</u>

<sup>1</sup>Futures are fully funded

<sup>2</sup>Funded 8/31/2010

	HPOPS	Benchmark
# of holdings	7776	1869
Avg Market Cap	\$31.8 Billion	\$48.1 Billion
Portfolio P/E	11.79	13.52
Portfolio P/Book	1.33	1.55
Portfolio Beta (3-yr)	0.98	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 a significant tightening of credit spreads. The environment became more favorable for investing in high yield bonds during the year and a shift to our long-term allocation was implemented during August and September. Assets under management, annualized rates of return and fees paid to high yield managers for the fiscal year ending June 30, 2011 are as follows (dollars in 000's):

Manager	Style	Assets	% Returns	Fees
MacKay Shields	High Yield	\$ 149,014	13.2%	\$ 410
Shenkman Capital Mgmt	High Yield	101,142	13.3%	374
		<u>\$ 250,156</u>		<u>\$ 784</u>

	HPOPS	Benchmark
# of securities	552	1,606
Yield to Maturity	7.20	7.62
Effective Duration	2.40	4.61
Quality Rating S&P	B+	B+

*Fixed Income*

The System's fixed income strategy consists of a separate allocation to a global hedged 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

**INVESTMENT SECTION**

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, 2011 are as follows (dollars in 000's):

<b>Manager</b>	<b>Style</b>	<b>Assets</b>	<b>% Returns</b>	<b>Base Fee</b>
Clifton	TIPS	\$ 267,229	7.7%	\$ 70
Ashmore	Emerging Market Fixed Income	102,929	18.5%	841
Ashmore	Local Currency Debt	162,486	16.6%	1,537
Ashmore	Local Currency Mutual Fund <sup>1</sup>	24,877	-0.5%	18
Ashmore	Emerging Markets High Yield	69,480	19.7%	975
Bridgewater <sup>2</sup>	Global Fixed Income, Hedged	201,934	0.9%	-
		<u>\$ 828,935</u>		<u>\$ 3,441</u>

<sup>1</sup> Funded on 6/03/2011

<sup>2</sup> Fees are commingled with the fee structure 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 is now managed by Franklin Park, although the portfolio still contains funds recommended by Abbott Capital who managed the asset class from 1997 – 2008, as well as funds recommended by Mercer (formerly Hammond Associates) who served as the interim manager between Abbott Capital and Franklin Park. 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 \$144 million of outstanding commitments. The System had investments in, or commitments to, 76 individual private equity partnerships with 40 general partners at June 30, 2011. The current allocation within this strategy is approximately 44% in leveraged buyouts, 35% in special situation funds and 21% in venture capital. This program required \$42.5 million of additional funding during fiscal 2011 while at the same time generating distributions of \$72.7 million for the same period. This private equity program generated returns for the 2011 fiscal year of 21.4% versus a return of 36.2% of its benchmark, the S&P 500 plus 5%.

The System also has a 10.5% allocation to hedge funds and had \$413 million actually invested as of June 30, 2011. These strategies generated fiscal year performance of approximately 17.9%.

The System increased its allocation to risk parity from 10% to 15% during the year. 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. These strategies generated a fiscal year performance of approximately 20.0%.

Assets under management, annualized rates of return and fees paid to alternative investments managers for the fiscal year ending June 30, 2011 are shown on the next page (dollars in 000's):

INVESTMENT SECTION

<b>Manager</b>	<b>Style</b>	<b>Assets</b>	<b>% Returns</b>	<b>Base Fee</b>
Bridgewater	Risk Parity	\$ 270,999	17.7%	\$ 532
AQR	Risk Parity	143,933	22.4%	554
First Quadrant	Risk Parity	134,519	21.0%	326
Bridgewater	Hedge Funds <sup>1</sup>	180,248	35.2%	12,027
Mercer	Hedge Funds	189,509	9.5%	600
Attalus	Hedge Fund	43,027	4.9%	470
Mercer	Real Assets <sup>2</sup>	25,815	17.5%	-
Franklin Park	Private Equity	313,425	21.4%	367
		<u>\$ 1,301,475</u>		<u>\$ 14,876</u>

<sup>1</sup> Includes the Pure Alpha and Pure Alpha Major Markets (PAMM) funds. PAMM was funded on 12/1/2010.

<sup>2</sup> Fees included in the \$600 thousand annual fee listed for Mercer Hedge Funds.

*Cash*

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 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.

<b>Manager</b>	<b>Style</b>	<b>Assets (000s)</b>	<b>% Returns</b>	<b>Base Fee (000s)</b>
Clifton Group	Cash Securitization	\$ 26,250	19.8%	\$ 74
		<u>\$ 26,250</u>		<u>\$ 74</u>

*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.

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INVESTMENT SECTION

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

	<b>2011</b>	<b>2010</b>	<b>2009</b>
<b>Avg Securities on Loan</b>	\$ 270,426	\$ 275,442	\$ 331,878
<b>Avg Eligible Securities</b>	\$ 1,057,458	\$ 952,124	\$ 823,736
<b>% on Loan</b>	25.6%	28.9%	40.3%
<b>HPOPS Net Earnings</b>	\$ 449	\$ 473	\$ 1,427
<b>Duration of Collateral Pool (days)</b>	32	34	36

**Report Preparation**

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



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

Year	System Total	Composite Benchmark	Domestic Equity	Russell 3000	Int'l Equity	MSCI		Barclays Aggregate	High Yield	Citigroup HY	Alternative Investments
						ACWI ex U.S.	Fixed Income				
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
2011	21.1	20.2	33.3	32.4	29.1	29.7	9.4	3.9	13.3	15.3	20.1

**Compound Annualized Rates of Return by Year (%)**  
**Periods Ended June 30, 2011**

Year	System Total	Composite Benchmark	Domestic Equity	Russell 3000	Int'l Equity	MSCI		Barclays Aggregate	High Yield	Citigroup HY	Alternative Investments
						ACWI ex U.S.	Fixed Income				
2	17.3	16.2	23.5	23.8	20.0	19.7	10.5	6.7	16.9	20.4	17.5
3	4.0	5.6	0.3	4.0	1.5	-0.4	6.4	6.5	10.8	11.9	5.5
5	5.9	6.1	1.9	3.4	2.4	3.7	8.4	6.5	8.4	8.9	8.8
10	6.9	6.6	4.0	3.4	7.0	7.5	9.1	5.8	9.4	8.9	6.9

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, 2011*

<b>Shares</b>	<b>Description</b>	<b>Market Value (\$000's)</b>	<b>% of Total Domestic Equity</b>
143,504	3M Company	\$ 13,611	2.5%
64,261	IBM Corp.	11,024	2.0%
399,283	Comcast Corp.	10,118	1.9%
119,959	Exxon Mobil Corp.	9,762	1.8%
330,098	Kinder Morgan Inc.	9,484	1.7%
120,049	Devon Energy Corp.	9,461	1.7%
85,803	Eastman Chemical Co.	8,758	1.6%
169,318	American Express Co.	8,754	1.6%
230,848	Home Depot Inc.	8,361	1.5%
258,489	Nielsen Holdings	8,055	1.5%

**Schedule of Ten Largest Non-U.S. Equity Holdings**

*As of June 30, 2011*

<b>Shares</b>	<b>Description</b>	<b>Market Value (\$000's)</b>	<b>% of Total International Equity</b>
70,032	Sanofi	\$ 5,629	1.0%
104,200	Toyota Motor Corp.	4,258	0.8%
72,018	Total EUR2.5	4,164	0.8%
169,300	Eni Spa	4,003	0.7%
275,709	Reed Elsevier NV	3,700	0.7%
57,905	Akzo Nobel NV	3,652	0.7%
92,100	Honda Motor Co.	3,518	0.6%
318,881	Rolls Royce Holdings	3,302	0.6%
75,078	British American Tobacco	3,292	0.6%
1,237,517	Vodafone Group	3,284	0.6%

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

**Schedule of Ten Largest Domestic Fixed Income Holdings**

*As of June 30, 2011*

<b>Par Value (\$000's)</b>	<b>Description</b>	<b>Market Value (\$000's)</b>	<b>% of Total U.S. Fixed Income</b>
\$ 11,008	US Treas Infl Indexed Bonds 2.375 Due 01-15-2025 BEO	\$ 15,093	5.6%
7,672	US Treas Bds Inflation Index Linked 3.875% 04-15-2029	14,379	5.4%
12,700	US Treas NTS 1.25% TIPS 15/04/20 USD1000 07-15-2020	13,851	5.2%
8,340	US Treas Bonds 3.00 Index Linked Notes Due 07-15-2012 REG	10,833	4.1%
8,200	US Treas NTS Index Linked 2.36434 Due 01-15-2014 REG	10,751	4.0%
8,600	US Treas BDS Index Linked 2.00 Due 01-15-2026 REG	10,646	4.0%
5,696	US Treas BDS Inflation Indexed Due 04-15-2028/12-09-1999 REG	10,427	3.9%
7,880	US Treas NTS Index Linked 1.875 Due 07-15-2013 REG	10,250	3.8%
7,300	US Treas NTS Inflation Indexed 2.00 Due 07-15-2014 REG	9,497	3.6%
7,350	US Treas NTS Index Linked 2.375 Due 01-15-2017 REG	9,349	3.5%

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

*As of June 30, 2011*

<b>Par Value (\$000's)</b>	<b>Description</b>	<b>Market Value (\$000's)</b>	<b>% of Total Non-U.S. Fixed Income</b>
850,000	Japan (Govt of) 1.4% Bonds 20/12/13 JPY'256'	\$ 10,835	1.9%
530,000	Japan (Govt of) 2.1% Bonds 20/09/24 JPY'72"	7,049	1.3%
400,000	Japan Govt Bond 1.7% 20 SEP 2017	5,299	0.9%
350,000	Japan (Govt of) 1.3% Bds 20/12/19 JPY100000	4,477	0.8%
2,500	France (Govt of) 2.5% Bds 12/01/2014 EUR1	3,679	0.7%
2,100	France (Govt of) 4% OAT 25/04/2013 EUR1	3,171	0.6%
2,000	France (Govt of) 3.75% OAT 25/04/21 EUR1	2,981	0.5%
1,640	UK (Govt of) 4.75% STK 07/12/38 GBP100	2,844	0.5%
1,700	France (Govt of) 3.75% BDS 25/04/17 EUR1	2,582	0.5%
180,000	Japan (Govt of) 2.1% Bds 20/12/26 JPY100000000	2,362	0.4%

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, 2011*

<b>Brokers</b>	<b>Shares</b>	<b>Commissions</b>	<b>Principal</b>	<b>Commissions Per Share</b>
Cap Institutional Services Inc	1,657,215	\$ 66,056	\$ 62,942,971	\$ 0.015
Driehaus Securities	1,961,969	47,478	82,108,981	0.024
Merrill Lynch	1,428,729	41,570	43,814,931	0.029
Liquidnet Inc.	1,689,280	30,927	63,866,123	0.018
Goldman Sachs	3,046,473	28,251	82,073,678	0.009
Citigroup	1,045,078	27,571	45,413,937	0.026
UBS	861,114	20,526	40,987,777	0.024
Credit Suisse First Boston Corp.	2,567,411	18,156	88,521,882	0.007
Bernstein, Sanford C. & Co.	427,782	16,663	18,769,658	0.039
Baypoint Trading LLC	754,911	14,090	42,135,207	0.019

**International Equity Trading - Ten Largest by Total Commissions Paid**

*For the year ended June 30, 2011*

<b>Brokers</b>	<b>Shares</b>	<b>Commissions</b>	<b>Principal</b>	<b>Commissions Per Share</b>
Morgan Stanley	5,413,604	\$ 24,729	\$ 43,703,732	\$ 0.005
Citigroup	6,066,669	19,775	42,937,188	0.003
Merrill Lynch	1,486,162	17,138	17,682,158	0.012
Deutsche Bank	1,192,140	12,620	8,421,026	0.011
Sanford Bernstein	3,825,700	12,379	35,251,615	0.003
UBS Securities	256,338	8,878	5,624,439	0.035
Nomura Securities	267,705	8,386	5,792,234	0.031
JP Morgan Securities	549,347	7,199	5,142,658	0.013
Barclays Capital Inc.	219,432	6,947	4,718,739	0.032
Credit Suisse First Boston Corp.	582,181	5,674	6,073,546	0.010

SECTION FOUR  
**ACTUARIAL SECTION**

	<u>Page</u>
Actuary's Certification Letter	62
Executive Summary	66
Schedule of Funding Progress	67
Historical Solvency Test	68
Historical Active Participant Data	69
Retirees, Beneficiaries, and Disabled Participants Added to and Removed from Rolls	70
Membership Data	71
Summary of Actuarial Methods and Assumptions	72
Summary of Plan Provisions	80



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**HOUSTON POLICE OFFICERS' PENSION SYSTEM**  
ACTUARIAL VALUATION REPORT  
FOR THE YEAR BEGINNING JULY 1, 2010



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Consultants & Actuaries

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November 9, 2010

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

**Subject: Actuarial Valuation Report as of July 1, 2010**

Dear Members of the Board:

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, 2010. 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, 2010 actuarial valuation will be used by the Board when determining the employer contribution rate for the year beginning July 1, 2011 and ending June 30, 2012.

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, 2012 is not set by this actuarial valuation as of July 1, 2010. Therefore, the actuarially calculated contribution rate from this valuation will not be contributed. Based upon a projected payroll of approximately \$370 million, the City's calculated contribution amount should be in the neighborhood of \$120 million. Instead, City contributions of \$78 million for FY 2011 and \$83 million for FY 2012 are to be made under the terms of the above funding schedule.



The contribution rate and liabilities are computed using the Projected Unit Credit (PUC) 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, with the employer normal cost being the difference between the total normal cost 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, 2010). The amortization period is set by statute, and was modified under the Meet and Confer.

### **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, 2010 is 83.3%. The funded ratio measured on the market value of assets drops to 70.2% as of July 1, 2010. Based on the new assumptions, the funded ratio was 84.5% as of the 2009 valuation.

The calculated employer contribution rate for FY 2012 is 32.04%. This rate is greater than the 31.73% rate calculated in the 2009 valuation and also the recalculated rate of 31.52% based on the new assumptions. This is primarily due to the significant asset loss in FY 2010 on an actuarial value basis, but also stems from the calculated contribution rate not being contributed to the System. 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 of assets recognize 20% of the difference (5 year smoothing) between the market value of assets and the expected actuarial value of assets, based on the assumed valuation rate of return. There are currently \$554.7 million in asset losses being deferred that will be recognized in the future and will continue to drive decreases in the funded ratio and increases in the rate required to amortize the UAAL over 30 years unless offset by future gains. 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 approximately 46% of payroll over the next 10 years as the funded ratio falls below 60%.

It should be further noted that, other than the City of Houston's agreement to maintain a funded status floor beginning in Fiscal Year 2013 as specified under the 2004 Meet & Confer Agreement, the current City funding schedule may not be sufficient to cover all future benefit payments of HPOPS. Moreover, the System is projected to be below the initial funded status floor of 75% and it is likely the floor provisions in their current form will not be applicable.

### **Benefit provisions**

The benefit provisions reflected in this valuation are those which were in effect on July 1, 2010. There were no changes in the benefit provisions since the prior valuation. The benefit provisions are summarized in Appendix B of our Report.

**Gabriel Roeder Smith & Company**

Houston Police Officers' Pension System

November 9, 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 assumptions used in this valuation were adopted by the Board based on the recommendations from GRS during the Experience Study following the July 1, 2009 actuarial valuation and differ from the assumptions used in the prior valuation. Among the actuarial assumptions and methods that changed were the actuarial cost method, asset valuation method, salary scale, and certain demographic assumptions. These are detailed on page 7 of this report.

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, 2010 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, 2010 was supplied to us by the HPOPS staff, as well.

### **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.

### **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, 2010.

**Gabriel Roeder Smith & Company**

Houston Police Officers' Pension System

November 9, 2010

Page 4

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 the Statements of the Governmental Accounting Standards Board. The undersigned are independent actuaries and consultants. All of the undersigned are Enrolled Actuaries, Members of the American Academy of Actuaries, and 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, EA, MAAA

Consultant

**Executive Summary (dollar amounts are in millions)**

Item	July 1, 2010	July 1, 2009 After Changes	July 1, 2009 Before Changes
<b>Membership</b> <ul style="list-style-type: none"> <li>• Number of: <ul style="list-style-type: none"> <li>- Active members</li> <li>- Retirees and beneficiaries</li> <li>- Inactive members</li> <li>- Total</li> </ul> </li> <li>• Annualized Payroll supplied by HPOPS</li> </ul>	        	        	        
<b>Calculated Contribution rates</b> <ul style="list-style-type: none"> <li>• Employer</li> <li>• Member<sup>1</sup></li> </ul>	  	  	  
<b>Assets (\$000s)</b> <ul style="list-style-type: none"> <li>• Market value</li> <li>• Actuarial value</li> <li>• Estimation of return on market value</li> <li>• Estimation of return on actuarial value</li> <li>• Employer contribution</li> <li>• Member contribution</li> <li>• Ratio of actuarial value to market value</li> </ul>	       	       	       
<b>Actuarial Information</b> <ul style="list-style-type: none"> <li>• Employer normal cost %</li> <li>• Unfunded actuarial accrued liability (UAAL)</li> <li>• Amortization rate</li> <li>• Funding period</li> <li>• GASB funded ratio</li> </ul>	     	     	     
<b>Projected employer contribution based on calculated rate</b> <ul style="list-style-type: none"> <li>• Fiscal year ending June 30,</li> <li>• Projected payroll (millions)</li> <li>• Projected employer contribution (millions)</li> </ul> <p>(actual contribution rate set by Meet &amp; Confer)</p>	   	   	   

<sup>1</sup> 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		Annual Payroll	UAAL as % of Payroll (4)/(6)
			Accrued Liability (UAAL) (3) - (2)	Funded Ratio (2)/(3)		
(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%
July 1, 2010**	3,526,703	4,232,732	706,029	83.3%	377,779	186.9%

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

\*\* Change to Projected Unit Credit cost method. Prior results were provided based on Entry Age Normal.

**Historical Solvency Test (\$000)**

Valuation Date	Aggregated Accrued Liabilities for				Actuarial Value of Assets	by Reported Assets		
	Active Members Contributions	Retirees Beneficiaries and Vested Terminations <sup>1</sup>	Members (City Financed Portion)			(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%	
July 1, 2010	149,252	1,998,683	2,084,797	3,526,703	100.0%	100.0%	66%	

Note: Dollar amounts in \$000

<sup>1</sup> Column (3) included AAL for DROP participants until 2000, now in Column (4)

**Historical Active Participant Data**

<u>Valuation Date</u>	<u>Active Count</u>	<u>Average Age</u>	<u>Average Svc</u>	<u>Covered Payroll</u>	<u>Average Salary</u>	<u>Percent Changes</u>
(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 <sup>(1)</sup>	\$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 <sup>(2)</sup>	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 <sup>(3)</sup>	\$44,196 <sup>(3)</sup>	22.3% <sup>(3)</sup>
2000	4,137	36.7	N/A	\$179,415	\$43,368	-1.9%
2001 <sup>(4)</sup>	5,325	40.2	N/A	\$264,226 <sup>(5)</sup>	\$49,620 <sup>(5)</sup>	14.4% <sup>(5)</sup>
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 <sup>(6)</sup>	\$65,966 <sup>(6)</sup>	4.5% <sup>(6)</sup>
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%
2010	5,347	41.9	15.3	\$377,779	\$70,652	1.0%

<sup>(1)</sup> Reflects the November 1, 1990 pay increase.

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

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

<sup>(4)</sup> Beginning July 1, 2001, includes active participants eligible for DROP.

<sup>(5)</sup> Beginning July 1, 2001, the definition of total direct pay changed from the average of the last 26 pay periods to the highest bi-

<sup>(6)</sup> 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**

Valuation July 1, (1)	Added to Rolls		Removed from Rolls		Rolls-End of Year		% Increase in Annual Allowances (8)	Average Annual Allowances (9)
	Number (2)	Annual Allowances (3)	Number (4)	Annual Allowances (5)	Number (6)	Annual Allowances (7)		
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
2010	165	8,891	56	2,355	3,009	129,274	5.3%	42,963

\* 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, 2010 (1)	July 1, 2009 (2)	July 1, 2008 (3)
1. Active members			
a. Number	5,347	5,245	5,065
b. Number in DROP	1,740	1,728	1,844
c. Total payroll	\$ 377,779	\$ 366,924	\$ 351,525
Payroll in DROP	\$ 145,454	\$ 141,783	\$ 148,951
d. Average salary	70,652	69,957	69,403
e. Average age	41.9	41.8	42.0
f. Average service	15.3	15.4	15.7
2. Inactive participants			
a. Vested	24	22	19
b. Total annual benefits (deferred)	\$ 602	\$ 551	\$ 463
c. Average annual benefit	25,077	25,054	24,344
3. Service retirees			
a. Number	2,290	2,200	2,130
b. Total annual benefits	\$ 102,021	\$ 95,152	\$ 89,808
c. Average annual benefit	44,551	43,251	42,163
d. Average age	62.9	62.5	62.2
4. Disabled retirees			
a. Number	140	131	119
b. Total annual benefits	\$ 5,490	\$ 4,935	\$ 4,224
c. Average annual benefit	39,213	37,672	35,496
d. Average age	52.6	51.9	50.8
5. Beneficiaries and spouses			
a. Number	555	547	541
b. Total annual benefits	\$ 21,161	\$ 22,100	\$ 20,880
c. Average annual benefit	38,128	40,402	38,595
d. Average age	67.9	67.8	66.9

## Summary of Actuarial Assumptions and Methods

The following methods and assumptions were used in preparing the July 1, 2010 actuarial valuation report.

### 1. Valuation Date

The valuation date is as of July 1<sup>st</sup>, 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 Projected Unit Credit (PUC) 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 is the present value of the portion of projected benefits that is attributable to service accrued in the current year. Under the PUC cost method, if actual plan experience is close to assumptions, the normal cost will increase each year for each employee as he or she approaches retirement age. However, if the age/service/gender characteristics of the active group remain relatively constant, the total normal cost can be expected to remain somewhat level as a percentage of payroll.

- d. The accrued liability is the portion of the present value of projected benefits attributable to service credited prior to the valuation date. 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 recognizes 20% of the difference between the projected actuarial value and the market value at the valuation date. 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 2.50% inflation and productivity component, as follows:

Years of Service	Service-related Component	Total Annual Rate of Increase Including 2.50% Inflation & Productivity Component
(1)	(2)	(3)
1	12.00%	14.50%
2	9.00%	11.50%
3	7.25%	9.75%
4	6.00%	8.50%
5	5.50%	8.00%
6	5.00%	7.50%
7	4.25%	6.75%
8	4.00%	6.50%
9	3.50%	6.00%
10	3.25%	5.75%
11	3.00%	5.50%
12	2.75%	5.25%
13	2.50%	5.00%
14	2.25%	4.75%
15	2.00%	4.50%
16	1.75%	4.25%
17	1.50%	4.00%
18 and Over	0.00%	2.50%

- 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

Age	Service	
	<25	25+
40-49	3.0%	6.0%
50-54	5.0%	10.0%
55-59	12.0%	24.0%
60-64	15.0%	30.0%
65 +	100.0%	100.0%

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. Multiplied by 75% for Active members
- Healthy females - Based on the 1994 Group Annuity Mortality Table for females. Multiplied by 75% for Active members
- Disabled males and females – 1987 Commissioners Group Disabled Mortality Table.

Sample rates are shown below:

Age	Healthy Retired Males	Healthy Retired Females	Disabled Males	Disabled Females	Healthy Active Males	Healthy Active Females
(1)	(2)	(3)	(4)	(5)	(2)	(3)
25	0.07%	0.03%	2.82%	2.82%	0.05%	0.02%
30	0.08%	0.04%	2.82%	2.82%	0.06%	0.03%
35	0.09%	0.05%	2.82%	2.82%	0.06%	0.04%
40	0.11%	0.07%	2.82%	2.82%	0.08%	0.05%
45	0.16%	0.10%	2.82%	2.82%	0.12%	0.07%
50	0.26%	0.14%	2.82%	2.82%	0.19%	0.11%
55	0.44%	0.23%	2.82%	2.82%	0.33%	0.17%
60	0.80%	0.44%	3.14%	3.14%	0.60%	0.33%
65	1.45%	0.86%	3.98%	3.98%	1.09%	0.65%
70	2.37%	1.37%	5.71%	5.71%	1.78%	1.03%
75	3.72%	2.27%	8.19%	8.19%	2.79%	1.70%
80	6.20%	3.94%	11.84%	11.84%	4.65%	2.95%

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 service. Termination rates are not applied after a member becomes eligible for a retirement benefit, and disability rates are not applied for members in the DROP. Rates at selected ages and service levels are shown below.

Service Based Rates of Termination		
Service	Male	Female
1	2.46%	2.46%
3	2.22%	2.22%
5	1.98%	1.98%
7	1.74%	1.74%
9	1.50%	1.50%
11	1.26%	1.26%
13	1.02%	1.02%
15	0.78%	0.78%
17	0.54%	0.54%
19	0.30%	0.30%
20 +	0.25%	0.25%

Age Based Rates of Disability		
Age	Male	Female
20	0.1622%	0.1893%
25	0.1616%	0.1886%
30	0.1690%	0.1971%
35	0.1865%	0.2176%
40	0.2141%	0.2498%
45	0.2520%	0.2940%
50	0.3001%	0.3501%
55	0.3583%	0.4180%
60	0.4268%	0.4980%

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<sup>th</sup> 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 ( P R O P )**

**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 ( P L O P )**

**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. 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.

#### Additional Benefits

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
- ▶ After December 1, 1998 but before October 9, 2004
- ▶ After October 9, 2004

Each participant contributes 8.75% of base salary.

Each participant contributes 8.75% of average total direct pay less overtime.

– 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 30 <sup>th</sup> )		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**

	<u>Page</u>
Summary	90
Changes in Plan Net Assets	91
Contribution Rates	92
Contributions and Benefits Paid	92
Investment Income	93
Deductions from Net Assets for Benefits and Refunds by Type	94
Total Benefit Payments by Type	95
Valuation of Assets as a Percent of Pension Liabilities	96
Net Assets Compared to Pension Liability	96
Membership	97
Pensions Awarded and Pensions in Force	98
Average Monthly Benefit Amounts by Years Credited Service	99
DROP and PROP Activity	100



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## STATISTICAL SECTION

### Summary

This section 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 System's 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, 2011. 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, 2011. The accompanying chart of **Contributions and Benefits Paid** compares the total contributions made and the benefits paid for the ten years ending June 30, 2011. 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, 2011.

**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, 2011, 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, 2011. 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 improve its funded status.

#### *Participant Information*

The **Membership** schedule on page 97 provides a breakdown of the plan membership for the ten years ending June 30, 2011. For fiscal year 2011, active members decreased by 43, retired members and their beneficiaries increased by 98, and terminated vested members increased by three.

#### *Operating Information*

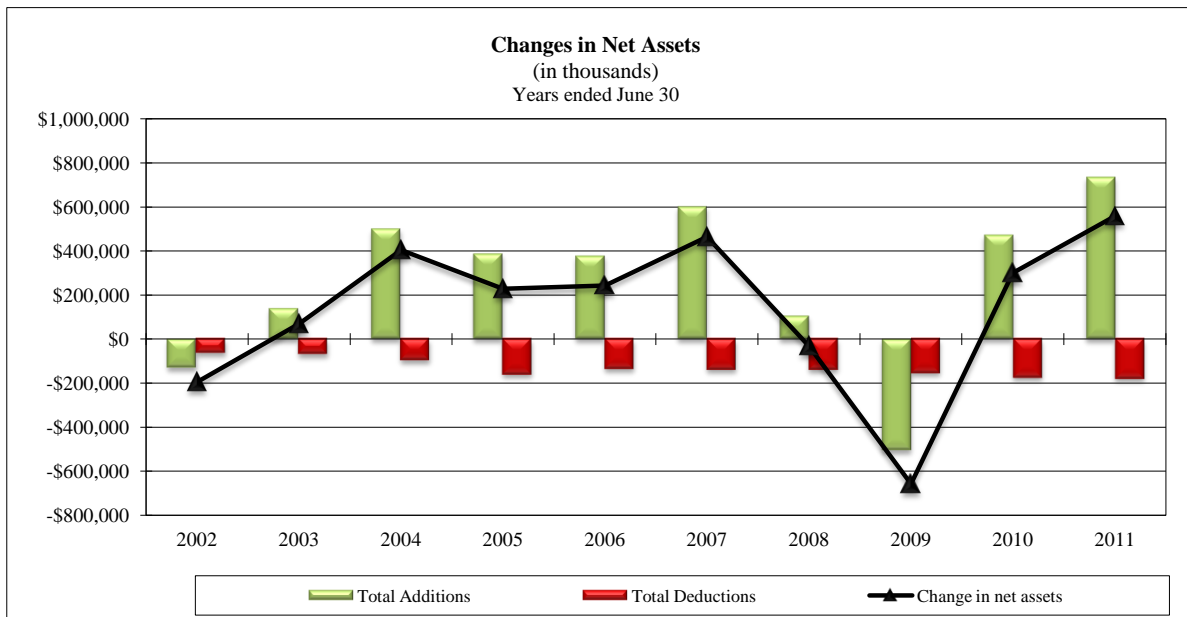
The **Pensions in Force** and **Pensions Awarded** schedules on page 98 provide the number of pensions by type, age and payment amount. The **Average Monthly Benefit Amounts by Years Credited Service** on page 99 presents the average final average salary and the number of retired members, in five-year increments of credited service, for the eight years ended June 30, 2011. 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, 2011.

STATISTICAL SECTION

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

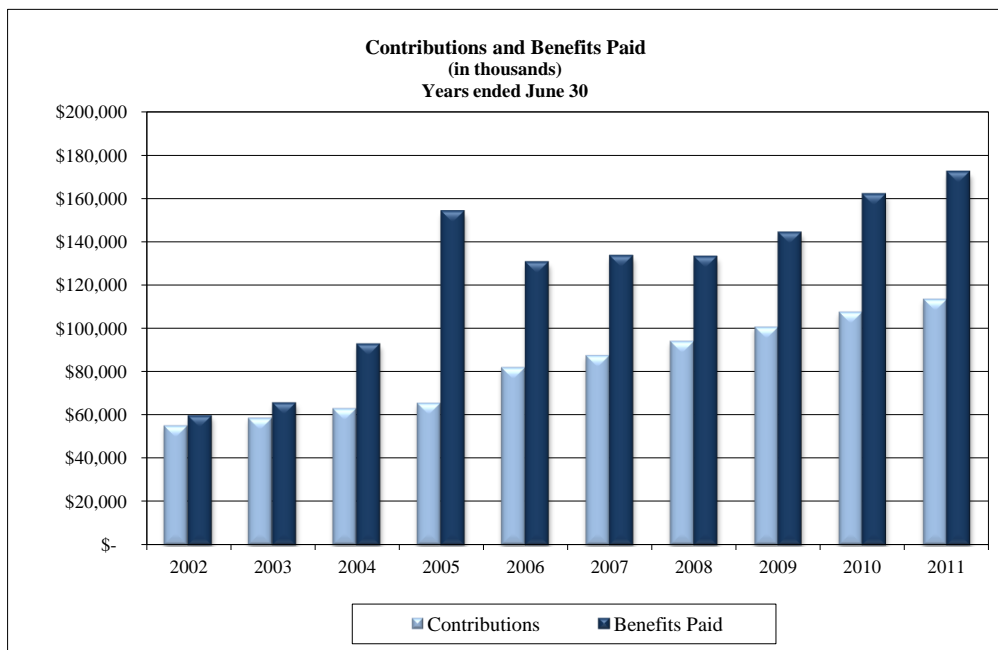
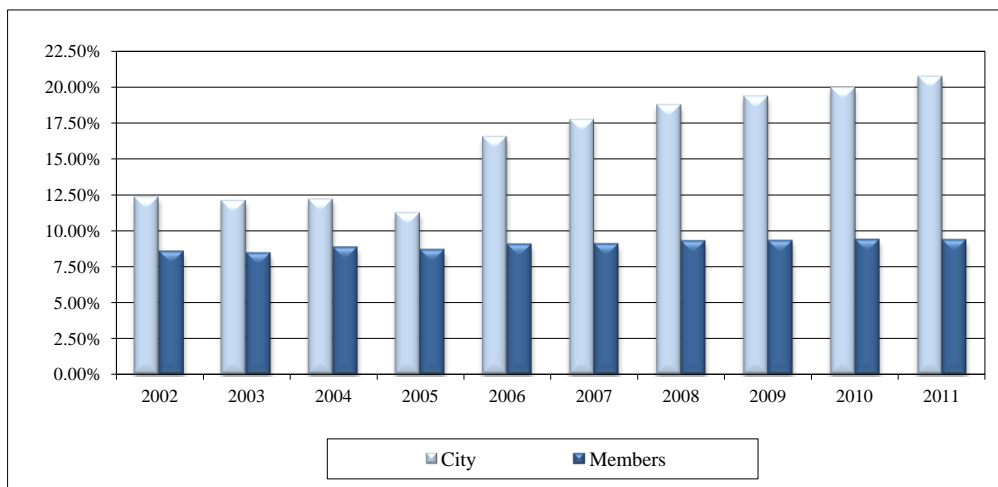
Fiscal Year	2002	2003	2004	2005	2006
<b>Additions</b>					
City contributions	\$ 32,645	\$ 34,645	\$ 36,645	\$ 37,125	\$ 53,068
Members contributions	22,484	24,008	26,393	28,410	28,863
Investment income (net of expenses)	(186,227)	80,202	437,007	320,561	294,966
Securities lending income (net of expenses)	855	583	741	876	1,101
<b>Total additions to plan net assets</b>	<b>(130,673)</b>	<b>139,438</b>	<b>500,786</b>	<b>386,972</b>	<b>377,998</b>
<b>Deductions:</b>					
Benefits paid to members	59,783	65,649	92,697	153,861	130,443
Refunds to members	1,194	992	852	1,198	700
Professional and administrative expense	2,881	2,746	2,768	3,473	2,958
<b>Total deductions from plan net assets</b>	<b>63,858</b>	<b>69,387</b>	<b>96,317</b>	<b>158,532</b>	<b>134,101</b>
<b>Change in net assets</b>	<b>\$ (194,531)</b>	<b>\$ 70,051</b>	<b>\$ 404,469</b>	<b>\$ 228,440</b>	<b>\$ 243,897</b>

Fiscal Year	2007	2008	2009	2010	2011
<b>Additions</b>					
City contributions	\$ 58,000	\$ 63,000	\$ 68,000	\$ 73,192	\$ 78,287
Members contributions	29,489	31,003	32,519	34,218	35,122
Investment income (net of expenses)	512,873	9,350	(607,482)	364,650	621,557
Securities lending income (net of expenses)	1,239	2,392	1,427	473	449
<b>Total additions to plan net assets</b>	<b>601,601</b>	<b>105,745</b>	<b>(505,536)</b>	<b>472,533</b>	<b>735,415</b>
<b>Deductions:</b>					
Benefits paid to members	133,351	133,049	144,112	161,735	172,041
Refunds to members	739	500	618	547	420
Professional and administrative expense	2,950	3,564	7,311	8,945	4,364
<b>Total deductions from plan net assets</b>	<b>137,040</b>	<b>137,113</b>	<b>152,041</b>	<b>171,227</b>	<b>176,825</b>
<b>Change in net assets</b>	<b>\$ 464,561</b>	<b>\$ (31,368)</b>	<b>\$ (657,577)</b>	<b>\$ 301,306</b>	<b>\$ 558,590</b>



**STATISTICAL SECTION**  
**Contribution Rates**  
**Previous Ten Fiscal Years**

Fiscal Year	Percent of Payroll	
	City	Members
<b>2002</b>	12.35%	8.51%
<b>2003</b>	12.11%	8.39%
<b>2004</b>	12.20%	8.79%
<b>2005</b>	11.26%	8.61%
<b>2006</b>	16.53%	8.99%
<b>2007</b>	17.73%	9.02%
<b>2008</b>	18.75%	9.23%
<b>2009</b>	19.34%	9.25%
<b>2010</b>	19.95%	9.33%
<b>2011</b>	20.72%	9.30%



STATISTICAL SECTION

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

Fiscal Year	2002	2003	2004	2005	2006
Investing activities					
Net appreciation (depreciation) in fair value of investments	\$ (232,652)	\$ 37,084	\$ 401,591	\$ 275,205	\$ 256,825
Interest	37,678	35,918	29,477	35,006	30,201
Dividends	13,672	12,659	15,897	26,314	21,926
Alternative investments <sup>(1)</sup>	2,361	1,606	1,598		
Other income	541	306	333	282	157
Total	(178,400)	87,573	448,896	336,807	309,109
Less investment expense	(7,827)	(7,371)	(11,889)	(16,246)	(14,143)
Net income (loss) from investing activities	(186,227)	80,202	437,007	320,561	294,966
Securities lending activities					
Securities lending income	1,308	914	1,153	1,332	1,478
Securities lending expense	(453)	(331)	(412)	(456)	(377)
Net income from securities lending activities	855	583	741	876	1,101
Total investment income (loss)	(185,372)	80,785	437,748	321,437	296,067

Fiscal Year	2007	2008	2009	2010	2011
Investing activities					
Net appreciation (depreciation) in fair value of investments	\$ 459,957	\$ (26,749)	\$ (643,053)	\$ 330,724	\$ 594,052
Interest	38,304	34,603	31,452	30,029	31,180
Dividends	27,581	19,540	13,170	16,608	18,998
Other income	147	142	57	72	365
Total	525,989	27,536	(598,374)	377,433	644,595
Less investment expense	(13,116)	(18,186)	(9,108)	(12,783)	(23,038)
Net income (loss) from investing activities	512,873	9,350	(607,482)	364,650	621,557
Securities lending activities					
Securities lending income	1,652	3,189	1,903	631	599
Securities lending expense	(413)	(797)	(476)	(158)	(150)
Net income from securities lending activities	1,239	2,392	1,427	473	449
Total investment income (loss)	\$ 514,112	\$ 11,742	\$ (606,055)	\$ 365,123	\$ 622,006

(1) Income reported under alternative investments for 2002 - 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.

STATISTICAL SECTION

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

Fiscal Year	2002	2003	2004	2005	2006
<b>Type of Benefit</b>					
<b>Service</b>					
Retirees	\$ 40,126	\$ 42,566	\$ 45,912	\$ 59,709	\$ 69,074
Survivors	10,934	11,640	12,466	13,733	14,612
<b>Disability</b>					
Retirees - duty	1,572	1,646	1,787	2,604	3,378
Retirees - nonduty	310	323	313	358	347
Survivors	941	1,178	1,238	1,310	1,364
<b>Lump Sum</b>					
DROP distributions	4,263	5,441	22,603	59,493	29,272
PROP distributions	1,348	2,815	8,352	16,649	12,233
Other *	288	40	25	5	163
<b>Total benefits</b>	<b>\$ 59,783</b>	<b>\$ 65,649</b>	<b>\$ 92,697</b>	<b>\$ 153,861</b>	<b>\$ 130,443</b>
<b>Type of Refund</b>					
Death	\$ -	\$ 20	\$ -	\$ -	\$ -
Separation	1,194	972	852	1,198	700
<b>Total refunds</b>	<b>\$ 1,194</b>	<b>\$ 992</b>	<b>\$ 852</b>	<b>\$ 1,198</b>	<b>\$ 700</b>

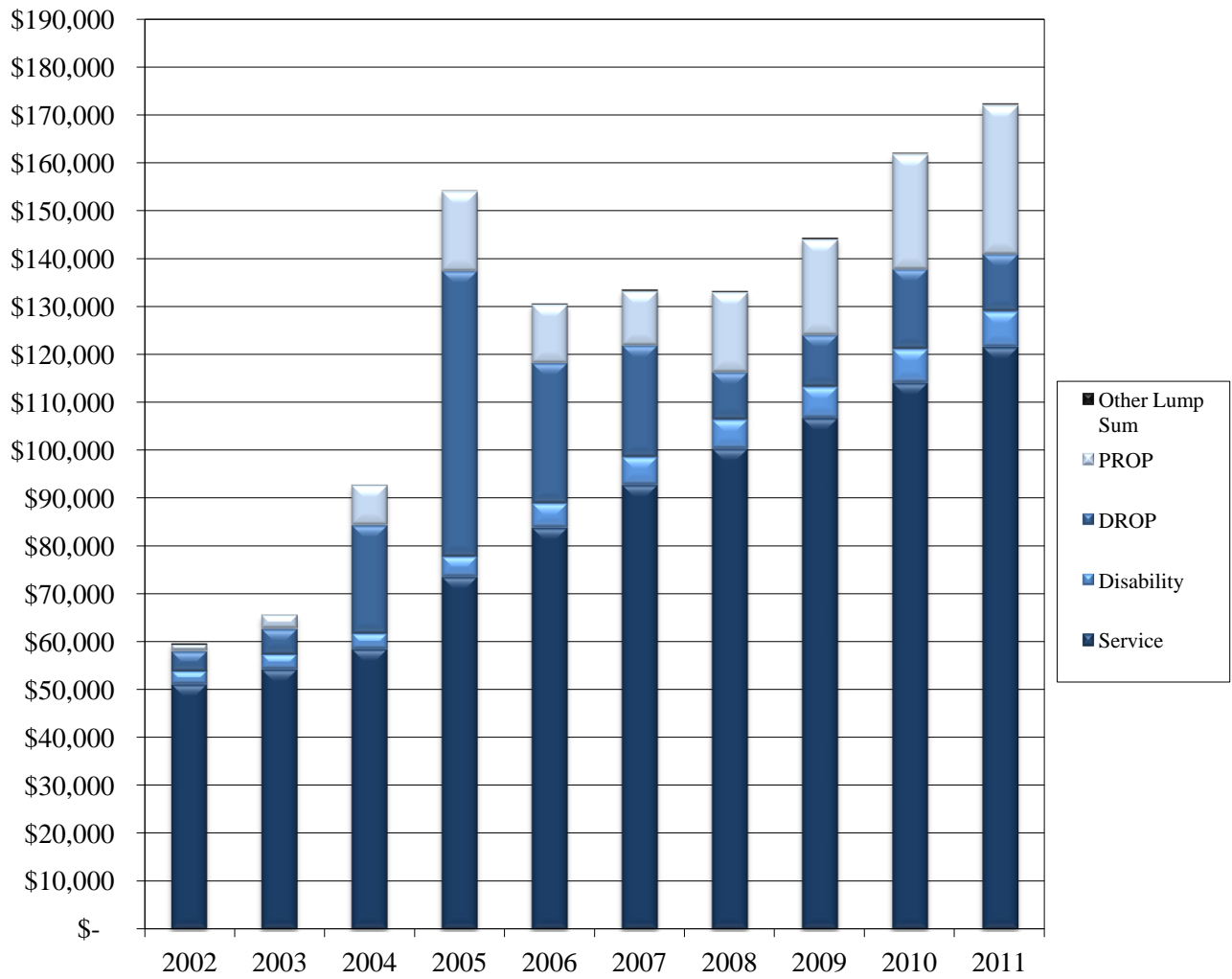
Fiscal Year	2007	2008	2009	2010	2011
<b>Type of Benefit</b>					
<b>Service</b>					
Retirees	\$ 77,639	\$ 83,925	\$ 89,226	\$ 95,198	\$ 101,854
Survivors	14,965	16,203	17,291	18,612	19,425
<b>Disability</b>					
Retirees - duty	4,003	4,154	4,334	4,675	4,989
Retirees - nonduty	313	371	444	516	493
Survivors	1,517	1,531	1,715	1,868	1,960
<b>Lump Sum</b>					
DROP distributions	23,315	9,937	10,889	16,682	11,941
PROP distributions	11,303	16,680	19,922	24,035	31,125
Other *	296	248	291	149	254
<b>Total benefits</b>	<b>\$ 133,351</b>	<b>\$ 133,049</b>	<b>\$ 144,112</b>	<b>\$ 161,735</b>	<b>\$ 172,041</b>
<b>Type of Refund</b>					
Death	\$ -	\$ -	\$ 3	\$ -	\$ -
Separation	739	500	615	547	420
<b>Total refunds</b>	<b>\$ 739</b>	<b>\$ 500</b>	<b>\$ 618</b>	<b>\$ 547</b>	<b>\$ 420</b>

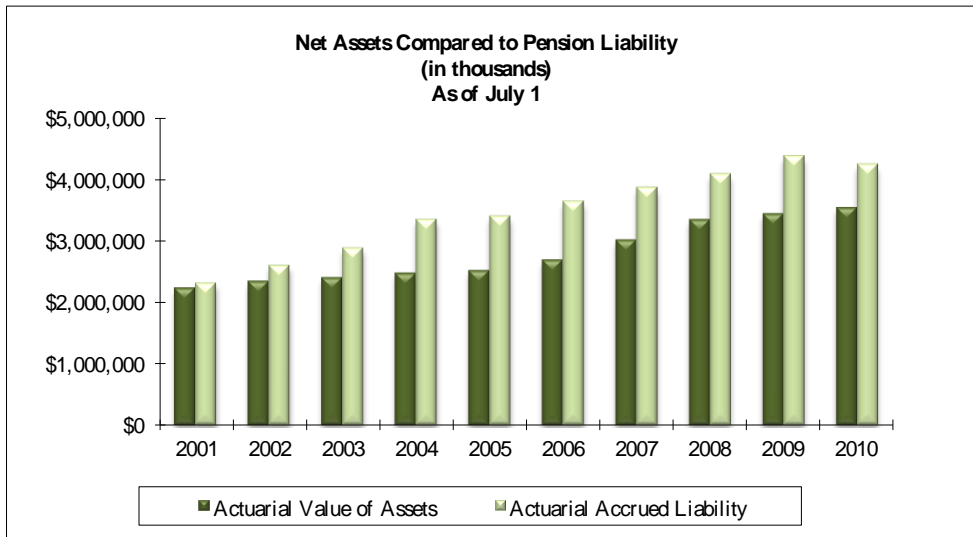
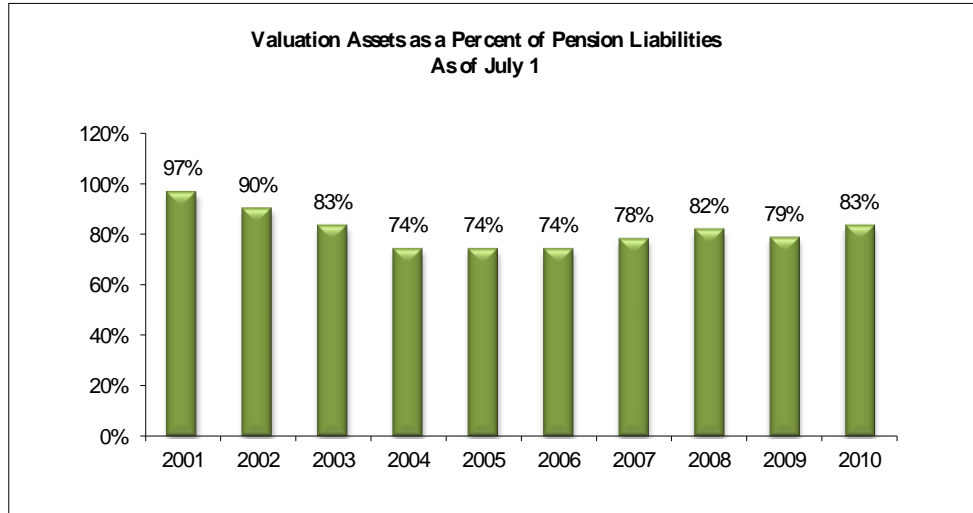
\* Lump Sum, Other: Under the provisions of Article 6243g-4, Vernon's Annotated Texas Statutes (VATS), Sec. 12(b) and Sec. 15(c) a member who retires, including a member who was a DROP participant, and begins to receive a monthly service pension shall receive a one-time lump sum payment of \$5,000. This 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



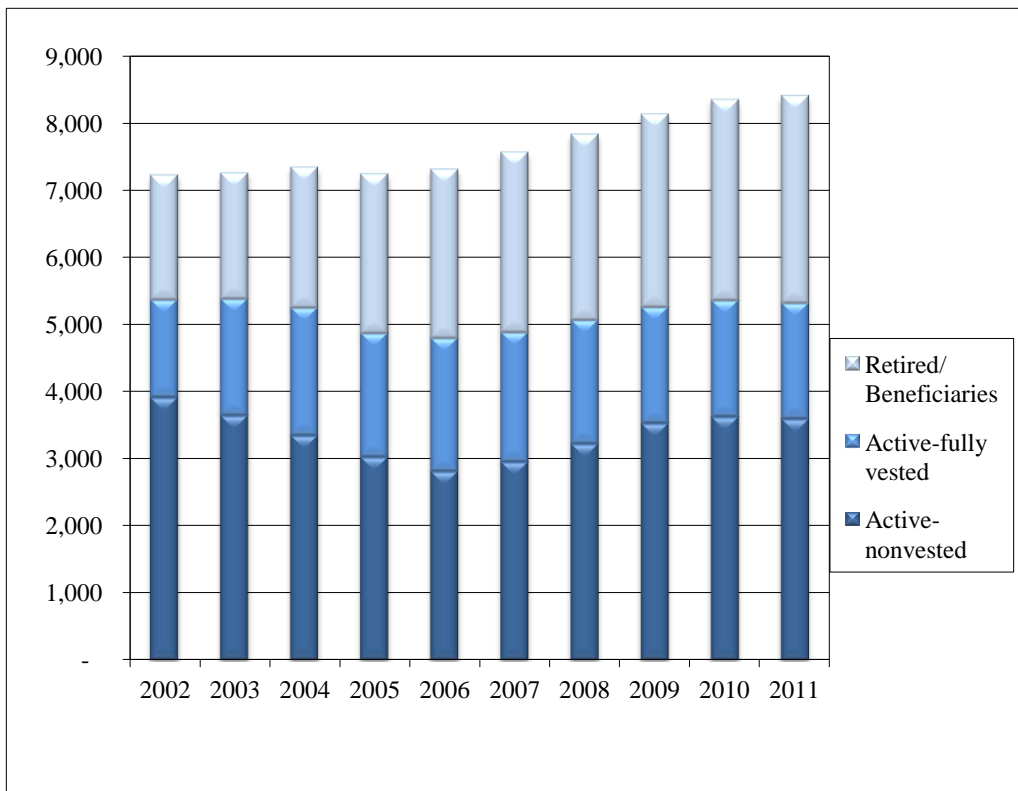


Charts through most recent actuarial valuation dated July 1, 2010.

STATISTICAL SECTION

**Membership  
Last Ten Fiscal Years**

Fiscal Year	Active		Retired/ Beneficiaries	Terminated Vested	Totals
	Nonvested	Fully Vested			
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
2011	3,578	1,733	3,087	23	8,421



STATISTICAL SECTION

**Total Pensions in Force by Type and by Age  
Year Ended June 30, 2011**

Age on June 30,	Total	Type of Pension		Survivor
		Service	Disability	
Under 40	34	-	11	23
40-44	37	4	21	12
45-49	147	97	30	20
50-54	349	295	25	29
55-59	575	509	21	45
60-64	747	649	21	77
65-69	396	327	5	64
70-74	308	217	6	85
75-79	255	176	2	77
80-84	170	88	-	82
85 and over	69	20	2	47
<b>Total</b>	<b>3,087</b>	<b>2,382</b>	<b>144</b>	<b>561</b>

**Pensions Awarded in Current Year by Type and by Age  
Year Ended June 30, 2011**

Age on June 30,	Total	Type of Pension		Survivor
		Service	Disability	
Under 40	7	-	2	5
40-44	5	3	1	1
45-49	15	12	1	2
50-54	46	44	1	1
55-59	47	47	-	-
60-64	25	19	-	6
65-69	2	-	-	2
70-74	9	1	-	8
75-79	4	-	-	4
80-85	3	-	-	3
85 and over	1	-	-	1
<b>Total</b>	<b>164</b>	<b>126</b>	<b>5</b>	<b>33</b>

**Pensions Awarded in Current Year by Type and by Monthly Amount  
Year Ended June 30, 2011**

Monthly Amount	Total	Type of Pension		Survivor
		Service	Disability	
Under \$1000	1	-	1	-
\$1000-\$2000	1	-	-	1
\$2000-\$3000	15	2	1	12
\$3000-\$4000	91	76	3	12
\$4000-\$5000	47	41	-	6
\$5000-\$6000	5	4	-	1
\$6000 and over	4	3	-	1
<b>Total</b>	<b>164</b>	<b>126</b>	<b>5</b>	<b>33</b>

STATISTICAL SECTION

**Average Monthly Benefit Amounts  
Previous Eight Fiscal Years**

Member Retiring During Fiscal Years	Years Credited Service										All Members
	<5	5-10	10-15	15-20	20-25	25-30	30-35	35-40	40-45	>45	
2004 Avg monthly benefit	\$ -	\$ 1,892	\$ 1,875	\$ 2,402	\$ 3,096	\$ 3,369	\$ 3,961	\$ 4,089	\$ 4,236	\$ -	\$ 3,456
Avg final Avg salary	\$ -	\$ 3,970	\$ 4,024	\$ 4,577	\$ 5,661	\$ 6,043	\$ 6,252	\$ 5,735	\$ 5,190	\$ -	\$ 5,820
Avg DROP Balance	\$ -	\$ 5,000	\$ 5,000	\$ 5,000	\$ 88,499	\$391,141	\$514,956	\$ 562,247	\$ 598,254	\$ -	\$340,555
Number of retirees	-	4	4	3	52	61	42	23	5	-	194
2005 Avg monthly benefit	\$ 3,582	\$ 1,367	\$ 2,213	\$ 2,970	\$ 3,278	\$ 3,558	\$ 3,782	\$ 4,778	\$ 4,922	\$ 5,043	\$ 3,668
Avg final Avg salary	\$ 3,582	\$ 3,468	\$ 4,779	\$ 5,322	\$ 5,970	\$ 6,428	\$ 6,181	\$ 6,682	\$ 6,279	\$ 5,736	\$ 6,152
Avg DROP Balance	\$ 5,000	\$ 5,026	\$ 5,000	\$41,719	\$103,644	\$395,811	\$532,399	\$ 657,685	\$ 731,751	\$795,771	\$378,705
Number of retirees	1	5	3	7	84	81	89	33	7	5	315
2006 Avg monthly benefit	\$ -	\$ 2,432	\$ 2,666	\$ 2,809	\$ 3,289	\$ 3,455	\$ 3,612	\$ 4,290	\$ 5,204	\$ -	\$ 3,510
Avg final Avg salary	\$ -	\$ 4,250	\$ 4,848	\$ 5,112	\$ 5,952	\$ 6,306	\$ 6,063	\$ 6,404	\$ 6,638	\$ -	\$ 6,027
Avg DROP Balance	\$ -	\$ 5,000	\$ 5,000	\$ 5,000	\$ 79,836	\$382,006	\$586,394	\$ 677,856	\$ 761,724	\$ -	\$355,204
Number of retirees	-	7	3	4	55	44	46	23	2	-	184
2007 Avg monthly benefit	\$ -	\$ 2,463	\$ 2,742	\$ -	\$ 3,272	\$ 3,472	\$ 3,450	\$ 4,329	\$ 4,219	\$ -	\$ 3,447
Avg final Avg salary	\$ -	\$ 4,478	\$ 4,930	\$ -	\$ 5,841	\$ 6,284	\$ 5,977	\$ 6,455	\$ 5,676	\$ -	\$ 6,004
Avg DROP Balance	\$ -	\$ 5,000	\$ 5,000	\$ -	\$131,167	\$379,358	\$578,912	\$ 739,378	\$ 740,515	\$ -	\$367,727
Number of retirees	-	1	7	-	58	46	44	16	1	-	173
2008 Avg monthly benefit	\$ -	\$ 1,665	\$ 2,502	\$ 3,803	\$ 3,498	\$ 3,359	\$ 3,771	\$ 4,031	\$ 5,045	\$ -	\$ 3,520
Avg final Avg salary	\$ -	\$ 4,405	\$ 5,037	\$ 6,914	\$ 5,910	\$ 3,021	\$ 6,461	\$ 6,286	\$ 6,949	\$ -	\$ 6,052
Avg DROP Balance	\$ -	\$ 5,000	\$ 5,000	\$ 5,000	\$144,905	\$399,403	\$654,515	\$ 772,141	\$ 947,241	\$ -	\$381,261
Number of retirees	-	3	3	1	39	29	23	10	2	-	110
2009 Avg monthly benefit	\$ -	\$ -	\$ -	\$ 3,064	\$ 3,698	\$ 3,518	\$ 3,677	\$ 4,396	\$ 4,266	\$ -	\$ 3,669
Avg final Avg salary	\$ -	\$ -	\$ -	\$ 6,415	\$ 2,559	\$ 5,242	\$ 6,623	\$ 6,635	\$ 6,165	\$ -	\$ 5,150
Avg DROP Balance	\$ -	\$ -	\$ -	\$ 5,000	\$221,852	\$359,788	\$720,598	\$ 980,656	\$ 969,869	\$ -	\$477,574
Number of retirees	-	-	-	2	29	50	36	8	3	-	128
2010 Avg monthly benefit	\$ -	\$ -	\$ 2,832	\$ 3,909	\$ 3,474	\$ 3,779	\$ 3,851	\$ 4,130	\$ 3,973	\$ -	\$ 3,770
Avg final Avg salary	\$ -	\$ -	\$ 5,149	\$ 5,888	\$ 6,016	\$ 6,382	\$ 6,932	\$ 6,895	\$ 5,871	\$ -	\$ 6,457
Avg DROP Balance	\$ -	\$ -	\$ 5,000	\$ 5,000	\$194,752	\$382,059	\$759,037	\$ 988,599	\$ 987,988	\$ -	\$501,842
Number of retirees	-	-	2	4	26	48	32	15	3	-	130
2011 Avg monthly benefit	\$ 926	\$ -	\$ 2,562	\$ 3,009	\$ 3,679	\$ 3,929	\$ 3,640	\$ 4,062	\$ 3,941	\$ -	\$ 3,816
Avg final Avg salary	\$ 4,117	\$ -	\$ 4,658	\$ 5,472	\$ 6,457	\$ 6,572	\$ 6,581	\$ 7,107	\$ 6,063	\$ -	\$ 6,584
Avg DROP Balance	\$ -	\$ -	\$ 5,000	\$ 5,000	\$131,819	\$442,433	\$698,025	\$1,065,857	\$1,047,127	\$ -	\$536,243
Number of retirees	1	-	1	1	15	68	28	17	1	-	132
Eight Years Ended June 30, 2011											
Avg Monthly Benefit	\$ 2,254	\$ 1,944	\$ 2,481	\$ 3,082	\$ 3,341	\$ 3,577	\$ 3,721	\$ 4,318	\$ 4,542	\$ 5,043	\$ 3,601
Avg Final Avg Salary	\$ 3,850	\$ 4,033	\$ 4,763	\$ 5,464	\$ 5,642	\$ 5,992	\$ 6,317	\$ 6,505	\$ 6,038	\$ 5,736	\$ 6,038
Avg DROP Balance	\$ 2,500	\$ 5,006	\$ 5,000	\$16,683	\$124,113	\$393,853	\$606,727	\$ 762,560	\$ 799,694	\$795,771	\$405,143
Number of Retirees	2	20	23	22	358	427	340	145	24	5	1,366

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**

Fiscal Year	DROP Accounts			DROP Participants		
	Accumulations	Distributions	Total	Entrants	Withdrawals	Total
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
2011	67,927	(11,941)	764,147	133	(117)	1,743

**PROP Activity**  
**(dollars in thousands)**  
**Years ended June 30**

Fiscal Year	PROP Accounts			PROP Participants		
	Accumulations	Distributions	Total	Entrants	Withdrawals	Total
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
2011	80,849	(31,125)	373,431	108	(22)	859



# HPOPS

FOR TODAY & TOMORROW

## **HOUSTON POLICE OFFICERS' PENSION SYSTEM**

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