Comprehensive Annual

Financial Report

A Component Unit of

The City of Houston, Texas

July 1, 2011 through

June 30, 2012

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

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.

TABLE OF CONTENTS

HPOPS

FOR TODAY & TOMORROW

SECTION ONE

INTRODUCTORY SECTION

HOUSTON POLICE OFFICERS' PENSION SYSTEM

HPOPS
FOR TODAY & TOMORROW

November 16, 2012

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, 2012 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.

Houston Police Officers' Pension System
602 Sawyer, Suite 300
Houston, Texas 77007
(713) 869-8734 phone
(713) 869-7657 fax
www.hpops.org

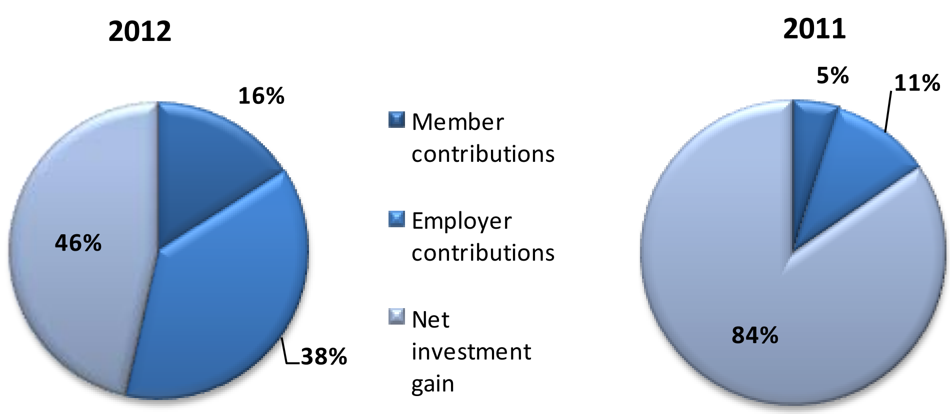
The System was established in 1947, funded by a $100,000 Treasury note, and offered retiring members a pension of $75 per month. Today, the System has investments of over $3.5 billion and offers a variety of pension benefits to members and their beneficiaries. Members have the option to defer their benefits, 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 2012 to be $83 million with a shortfall in the fixed payment of $17 million as a contribution receivable. For fiscal year 2013, the City's contribution is to be $93 million with a shortfall of $8.5 million as a contribution receivable. The City gave the System an undivided interest in the Houston Police Department Headquarters and a parking garage, both owned by the City, to finance the contribution receivable. For fiscal year 2014 the City's contribution is to be a fixed payment of $103 million. The number of active members increased slightly in fiscal year 2012 compared to 2011 as the number of new hires to the Houston Police Department (HPD) outpaced retirements. Contributions from members increased in fiscal 2012 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 3.0% in 2012, as opposed to a positive return of 21.1% in 2011. The 2012 fiscal year proved to be quite challenging, as economic growth failed to accelerate as anticipated and the fiscal situation in Europe continues to deteriorate.

Active members:	2012	2011	Increase (Decrease)
Fully vested	1,758	1,733	25
Nonvested:			
Hired or rehired before October 9, 2004	1,955	2,135	(180)
Hired or rehired after October 9, 2004	1,617	1,443	174
	5,330	5,311	19

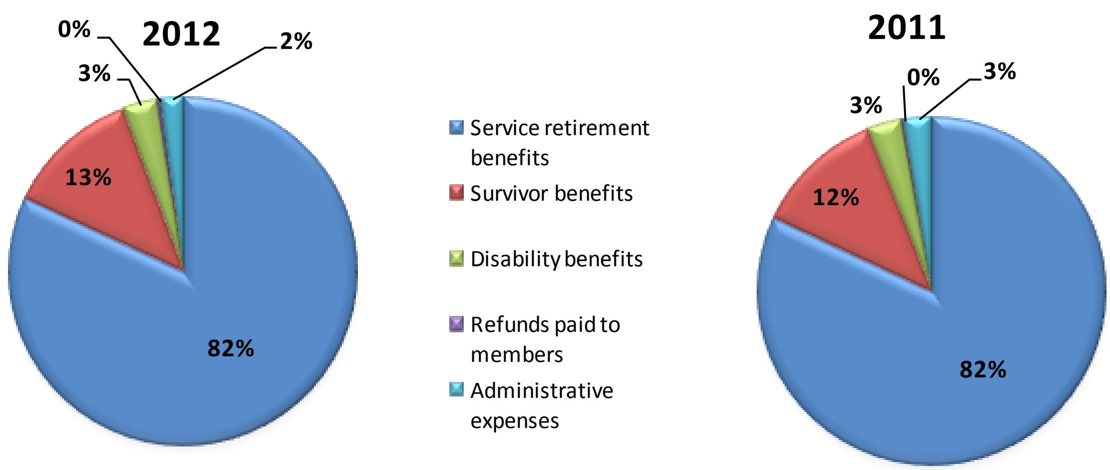
	$000's		Increase (Decrease)	Increase (Decrease)
	2012	2011	Amount	Percentage
Member contributions	$ 35,151	$ 35,122	$ 29	0.1%
Employer contributions	83,027	78,287	4,740	6.1%
Net investment gain	102,580	622,006	(519,426)	-83.5%
Total	$ 220,758	$ 735,415	$ (514,657)	-70.0%



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 65 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
	2012	2011		
Service retirement benefits	$ 151,144	$ 144,920	$ 6,224	4.3%
Survivor benefits	22,841	21,385	1,456	6.8%
Disability benefits	6,029	5,736	293	5.1%
Refunds paid to members	704	420	284	67.6%
Administrative expenses	3,689	4,364	(675)	(15.5%)
Total	$ 184,407	$ 176,825	$ 7,582	4.3%



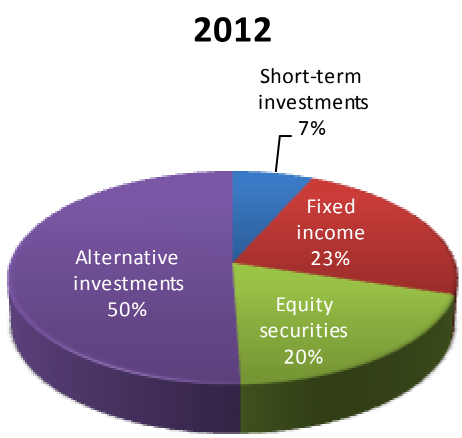
Total benefits paid, which include lump sum payments, increased in 2012 as compared to 2011 due mainly to the cost of living increase and an increase in the number of retirees. Administrative expenses decreased mainly due to a decrease in legal expenses arising from a lawsuit the System brought against a former investment manager. For further information regarding the System's financial condition, refer to Management's Discussion and Analysis in the Financial Section of this report.

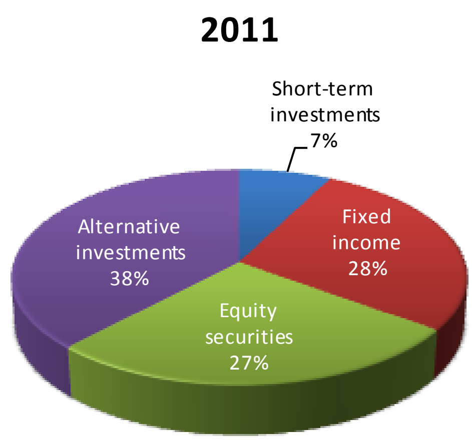
Investments

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

	$000's		Increase (Decrease) Amount	Increase (Decrease) Percentage
	2012	2011		
Short-term investments	$ 234,171	$ 268,819	$ (34,648)	(12.9%)
Fixed income	815,920	988,908	(172,988)	(17.5%)
Equity securities	699,993	962,752	(262,759)	(27.3%)
Alternative investments	1,785,987	1,359,950	426,037	31.3%
Foreign currency contracts	-	516	(516)	(100.0%)
Total	$ 3,536,071	$ 3,580,945	$ (44,874)	(1.3%)





During the first half of fiscal year 2012, financial markets were turbulent as the European debt crisis created significant volatility in the markets. Most of the year's gains were made in the second half of the year, as European nations dealt with the crisis and markets experienced a decrease in volatility and an increase in risk appetite. While the System had a solid return of 3.0% during fiscal year 2012, ranking it in the twelfth percentile in the Northern Trust investment universe for public employee pension funds with greater than one billion in assets, the System marginally under-performed its custom benchmark rate of return by 0.3% due in part to the credit oriented structure of our fixed income allocation, which underperformed the interest rate heavy broad market index. The System's hedge fund allocation, returning 4.1%, also underperformed, as it is compared to an absolute return target of 11.6%, which the portfolio is projected to return over long-term cycles. To a lesser degree, the System's domestic equity and private equity portfolios also contributed to the relative underperformance.

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 decreased slightly from 83.3% at July 1, 2010 to 82.8% at July 1, 2011. The actuarial accrued liability increased $255 million and the actuarial value of assets increased $191 million. As a result, the System's Unfunded Actuarial Accrued Liability increased $64 million to $770 million as of July 1, 2011. The increase in the Unfunded Actuarial Accrued Liability is due to a combination of factors including the increase in the actuarial value of assets less than assumed and contributions below the actuarially required amount 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. Most of the new systems are already implemented and the staff is working to maintain and further enhance these systems to provide greater efficiencies and reduce costs. The new Member Website continues to grow and provide Members and Survivors more information on their benefits and provide them a self-service for standard processes. The System continues to receive positive feedback and increased participation through the Member Website.

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 59. Professional service providers who provided services to the System during the year are listed below.

Actuarial	Gabriel Roeder Smith & Company	**Money Management**	AQR Capital Management LLC
			Ashmore Investment Management Limited
Auditing	BDO USA, LLP		BlackRock Institutional Trust Company
	Bickley Prescott & Co.		Brandes Investment Partners
			Bridgewater Associates, Inc.
Consulting	Mercer Investment Consulting Inc.		Causeway Capital Management
	Franklin Park Associates, LLC		The Clifton Group
			Dimensional Fund Advisors
Custodian	The Northern Trust Company		Driehaus Capital Management, Inc.
			First Eagle Investment Mgmt, LLC
Legal Service	Burford, Hawash, Meade & Gaston LLP		First Quadrant LP
	Gibbs & Bruns, LLP		MacKay-Shields Financial Corp.
	Hawash, Meade & Gaston LLP		PanAgora Asset Management, Inc.
	Strasburger & Price, LLP		Shenkman Capital Management, Inc.
Legal Service/Lobbyists	HillCo Partners, LLC		
	Locke Lord Bissell & Liddell LLP		

Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (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, 2011. This was the 18th consecutive year that the System has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

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

Acknowledgements

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

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

Sincerely,

Board of Trustees

Board of Trustees

HPOPS
FOR TODAY & TOMORROW

November 16, 2012

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 2012 Comprehensive Annual Financial Report (CAFR). The CAFR provides a comprehensive picture of HPOPS' finances for the fiscal year ending June 30, 2012, as well as an overview of the year's highlights.

In last year's letter we discussed our concerns about the recovering economy, political unrest in the Middle East, and the sovereign debt crisis in Europe. These concerns are still with us and they weighed on the financial markets throughout our fiscal year as the average public pension fund with assets greater than one billion dollars was only able to realize a rather disappointing investment return of around 1.4 percent. HPOPS was able to more than double that with a return of 3.0 percent, as we were relatively well positioned to weather these volatile markets.

HPOPS will continue to diligently 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,

Ralph D. Marsh
Chairman

Houston Police Officers' Pension System

602 Sawyer, Suite 300
Houston, Texas 77007
(713) 869-8734 phone
(713) 869-7657 fax
www.hpops.org

BOARD OF TRUSTEES AND ADMINISTRATIVE STAFF

TRUSTEES ELECTED BY ACTIVE, INACTIVE AND RETIRED POLICE OFFICERS

RALPH D. MARSH
Chairman

JAMES E. MONTERO
Vice-Chairman

TERRY BRATTON
Secretary

JOSEPH GLEZMAN
Trustee

J. LARRY DOSS
Trustee

TRUSTEES BY STATE STATUTE

CRAIG T. MASON
City Treasurer

FLETCHER THORNE-THOMSEN, JR.
Mayor's Representative

POLICE PENSION OFFICE PERSONNEL

JOHN E. LAWSON
Executive Director

ERIC OLSON
Director of Administration

JUDY G. BAKER
Benefits Manager

CLARK OLINGER
Assistant Benefits Manager

PATRICK S. FRANEY
Chief Investment Officer

ROBERT ARTHUR
General Counsel

KEVIN T. O'TOOLE
Accounting Manager

STEPHEN SHALAGAN
Records Manager

BRIAN POER
IT Manager

CASE WILLS
Developer

SHERYL BAINES
Benefits Assistant

REGINA WARD
Benefits Assistant

STACEY GALO
Investment Analyst

NICK DANG
Attorney

LAJUANA SCOTT
Accountant

STEPHANIE SEGURA
Records Assistant

TONI DEWILLIS
Administrative Assistant

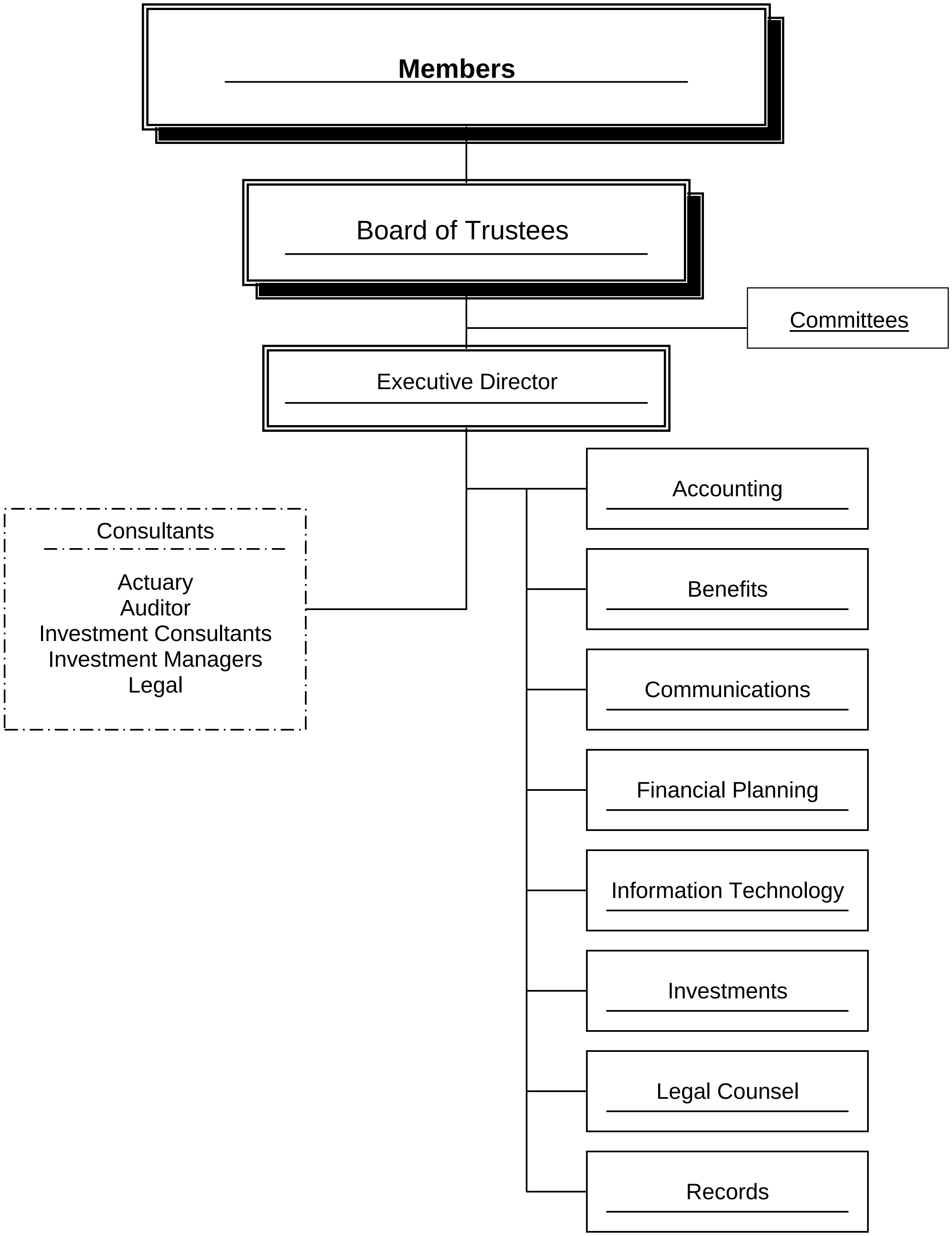
ANGELA CARTWRIGHT
Receptionist

AMELIA WEBER
Benefits Assistant

RICHARD GABLE
Financial Planner

NEAL WALLACH
Investment Analyst/Strategist

ORGANIZATION CHART



See Page 44 – 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, 2011

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.

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

President

Executive Director

THIS PAGE INTENTIONALLY BLANK

SECTION TWO

FINANCIAL SECTION

Page

THIS PAGE INTENTIONALLY BLANK

Tel: 713-659-6551
Fax: 713-659-3238
www.bdo.com

333 Clay St., Suite 4700
Houston, TX 77002

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, 2012 and 2011, 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, 2012 and 2011, 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
October 9, 2012

Management's Discussion and Analysis
Fiscal Year Ended June 30, 2012

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, 2012, 2011 and 2010. 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):

As of June 30:	**2012**	2011	2010
Assets			
Investments at fair value	**$ 3,536,071**	$ 3,580,945	$ 2,963,624
Prepaid management fees	**-**	150	150
Invested securities lending collateral	**113,063**	368,331	196,200
Receivables	**40,050**	21,396	36,195
Cash	**309**	172	559
Total Assets	**3,689,493**	3,970,994	3,196,728
Liabilities			
Foreign currency contracts	**352**	-	1,002
Due to brokers	**7,660**	70,195	25,970
Securities lending collateral	**113,063**	368,331	196,200
Accrued investment and professional fees	**878**	1,154	1,036
Other liabilities	**572**	697	493
Total Liabilities	**122,525**	440,377	224,701
Plan net assets held in trust for pension benefits	**$ 3,566,968**	$ 3,530,617	$ 2,972,027

See accompanying independent auditors' report.

The System's net assets increased by approximately $36,351 thousand in fiscal year 2012 over 2011 as world markets continued to experience significant periods of volatility due to concerns regarding Eurozone sovereign debt issues. These concerns lessened during the second half of the year as European nations apparently agreed to recapitalize debt-laden banks and to bolster several nearly insolvent governments. The System's net assets increased by approximately $558,590 thousand in fiscal year 2011 over 2010 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 3.0% in 2012 as opposed to a positive return of 21.1% in 2011 and a positive return of 13.7% in 2010. 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 and of the accrual of the $17,000 thousand contributions shortfall (see further discussion below).

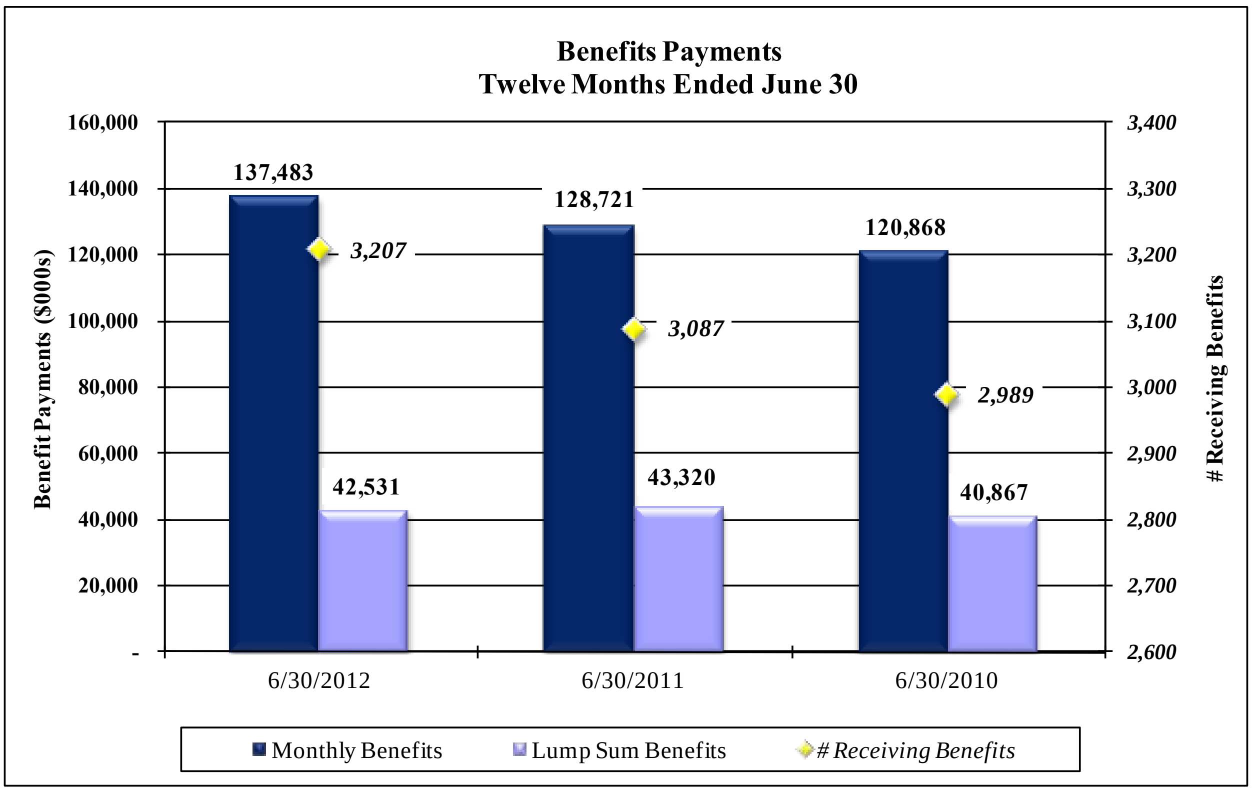
A summary of the Statements of Changes in Plan Net Assets for the System is as follows ($000's):

Years ended June 30:	**2012**	2011	2010
Contributions:			
City	**$ 83,027**	$ 78,287	$ 73,192
Members	**35,151**	35,122	34,218
Total contributions	**118,178**	113,409	107,410
Investment income	**102,095**	621,557	364,650
Net income from securities lending activities	**485**	449	473
Total additions	**220,758**	735,415	472,533
Deductions:			
Benefits paid to members	**180,014**	172,041	161,735
Refunds to members	**704**	420	547
Professional and administrative expense	**3,689**	4,364	8,945
Total deductions	**184,407**	176,825	171,227
Net increase	**36,351**	558,590	301,306
Plan net assets held in trust for pension benefits, beginning of year	**3,530,617**	2,972,027	2,670,721
Plan net assets held in trust for pension benefits, end of year	**$ 3,566,968**	$ 3,530,617	$ 2,972,027

See accompanying independent auditors' report.

The June 30, 2011 Agreement with the City requires contribution payments for fiscal year 2012 equal to an $83,000 thousand fixed payment, with any shortfall in the fixed payment not to exceed $17,000 thousand. For fiscal year 2011, the City was contractually required to contribute an amount equal to the amount contributed in 2010 of $73,000 thousand plus $5,000 thousand, resulting in contribution payments of $78,000 thousand. These contractual provisions account for the increase in City contributions for the years ended June 30, 2012 and June 30, 2011. As discussed in Note 4, the contributions were partially paid from the proceeds of a revenue bond financing facility in 2010, paid in its entirety from the City budget in 2011 and only $66,000 thousand paid from the City budget in 2012 with the remaining $17,000 thousand allowed shortfall as a secured contributions receivable.

"Benefits paid to members" consist of both lump sum payments and monthly payments of retirement, disability, and survivor benefits. The System's benefit payment structure provides that members and survivors have the option to receive distributions from their lump sum accounts either on or after the date they begin receiving monthly benefit payments. Due to this ad hoc nature of lump sum distributions the summary results in the accompanying Statements of Changes in Plan Net Assets will not show any distinct trends in the "Benefits paid to members" category. The chart below compares the components of benefits paid to members for the years ended June 30, 2012, 2011, and 2010. Total benefits paid in 2012 increased by approximately $7,973 thousand or 4.6% compared to 2011, mainly due to the annual cost of living adjustment (COLA) and a larger number of benefit recipients. Total benefits paid in 2011 increased by approximately $10,306 thousand or 6.4% compared to 2010, 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 $10,727 thousand per month during 2011 to $11,454 thousand per month during 2012, due to a combination of the annual COLA and the fact that the number of members and survivors receiving benefits increased by 120 during this time period. Average monthly benefit payments increased from approximately $10,072 thousand per month during 2010 to $10,727 thousand per month during 2011, due to a combination of the annual COLA and the fact that the number of members and survivors receiving benefits increased by 98 during this time period.



There was a decrease of $675 thousand in professional and administrative expenses during 2012 as compared to 2011. 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). 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. The second phase of the project, investment tracking, was completed in September 2011.

System Highlights

The System's funded ratio pursuant to its most recent actuarial valuation dated July 1, 2011 was 83% representing an unfunded actuarial accrued liability of $770,090 thousand. The System's funded ratio as of July 1, 2010 was 83% representing an unfunded actuarial accrued liability of $706,029 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%.

Contacting the System's Management

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

Houston Police Officers' Pension System

Statements of Plan Net Assets ($000's)

June 30,		**2012**		2011
Assets				
Investments, at fair value (Note 2 and Note 3):				
Short term investments	**$**	**234,171**	$	268,819
Fixed income investments		**815,920**		988,908
Equity securities		**699,993**		962,752
Alternative investments		**1,785,987**		1,359,950
Foreign currency contracts		**-**		516
Total Investments		**3,536,071**		3,580,945
Prepaid management fees		**-**		150
Invested securities lending collateral (Note 3):		**113,063**		368,331
Receivables				
City (Note 3 and Note 4)		**17,000**		-
Members		**760**		1,933
Investments		**7,120**		10,075
Due from brokers		**14,890**		9,315
Other receivables		**280**		73
Total Receivables		**40,050**		21,396
Cash		**309**		172
Total Assets	**$**	**3,689,493**	$	3,970,994
Liabilities and Plan Net Assets				
Liabilities:				
Foreign currency contracts	**$**	**352**	$	-
Due to brokers		**7,660**		70,195
Securities lending collateral (Note 3)		**113,063**		368,331
Accrued investment and professional fees		**878**		1,154
Other liabilities		**572**		697
Total Liabilities		**122,525**		440,377
Plan net assets held in trust for pension benefits	**$**	**3,566,968**	$	3,530,617

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

Houston Police Officers' Pension System

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

Years ended June 30,		**2012**		2011
Contributions (Note 1 and Note 4):				
City	**$**	**83,027**	$	78,287
Members		**35,151**		35,122
Total contributions		**118,178**		113,409
Investment income:				
Net appreciation in fair value of investments		**53,935**		594,052
Interest:				
Short-term investments		**387**		302
Fixed income investments		**46,734**		30,878
Total interest income		**47,121**		31,180
Dividends		**19,200**		18,998
Other income		**1,135**		365
Total investment income		**121,391**		644,595
Less investment expense		**(19,296)**		(23,038)
Net income from investing activities		**102,095**		621,557
Securities lending activities (Note 3):				
Securities lending income		**646**		599
Securities lending expense		**(161)**		(150)
Net income from securities lending activities		**485**		449
Total additions	**$**	**220,758**	$	735,415
Deductions:				
Benefits paid to members	**$**	**180,014**	$	172,041
Refunds to members (Note 1)		**704**		420
Professional and administrative expense		**3,689**		4,364
Total deductions		**184,407**		176,825
Net increase		**36,351**		558,590
Plan net assets held in trust for pension benefits, beginning of period		**3,530,617**		2,972,027
Plan net assets held in trust for pension benefits, end of period	**$**	**3,566,968**	$	3,530,617

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

1. Plan Description and Contribution Information

General – The Houston Police Officers' Pension System (the System) was created in 1947 by an act of the Fiftieth Legislature of the State of Texas, and is governed by Article 6243g-4, Vernon's Texas Civil Statutes (the Governing Statute) and contracts pursuant to Section 27 thereof. The System is a single employer contributory defined benefit pension plan covering police officers employed full time by the City of Houston (the City) that provides for service, disability and death benefits for eligible members and their beneficiaries. The System is a local governmental plan and, therefore, is not subject to the Employee Retirement Income Security Act of 1974 (ERISA). The System is a component unit of the City only to the extent the System receives contributions equal to an amount or percentage of Pay of active members in accordance with the Governing Statute.

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

June 30,	2012	2011
Retirees and beneficiaries:		
Currently receiving benefits	3,207	3,087
Not yet receiving benefits	22	23
Active members:		
Fully vested	1,758	1,733
Nonvested:		
Hired or rehired before October 9, 2004	1,955	2,135
Hired or rehired after October 9, 2004	1,617	1,443
Total members	8,559	8,421

The following sections describe the benefit structure in effect at June 30, 2012 and 2011. 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.

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 benefit. 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 with more than 10 years of service are eligible for a Delayed Retirement payable at age 55.

Supplemental Monthly Benefit (13^{th} check) – In years in which certain investment performance and actuarial funding requirements are met, the System issues a supplemental monthly benefit payment to retired members and a supplemental credit to DROP participant's accounts in an amount equal to their normal monthly benefit. Members hired or rehired subsequent to October 9, 2004 are not eligible for this benefit.

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

Reciprocal Retirement Program – Members who have not attained the necessary years of service for retirement are eligible to participate in the System's Reciprocal Retirement Program if they also have pension service with other City departments. This program allows members with the necessary cumulative years of service to combine their service credit with other City retirement systems and receive a proportionate retirement benefit from the System.

Post Retirement Option Plan – The Post Retirement Option Plan (PROP) allows retired members to have all or a portion of their monthly retirement and DROP lump sum credited to a notional account maintained by the System which accumulates interest and can be disbursed to the member under certain options as designated by the System. Surviving spouses can transfer a DROP or PROP balance to a PROP account of their own but are not eligible to credit all or a portion of their survivor benefit to a PROP account. Members hired or rehired subsequent to October 9, 2004 are not eligible for this benefit.

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

2. Summary of Significant Accounting Policies

Basis of Presentation – As defined by generally accepted accounting principles established by the Governmental Accounting Standards Board (GASB) the accompanying financial statements include solely the accounts of the System, which include all programs, activities and functions relating to the accumulation and investment of the assets and related income necessary to provide the service, disability and death benefits required under the terms of the Governing Statutes and amendments thereto.

Basis of Accounting - Basis of accounting is the method by which revenues and expenses are recognized in the accounts and are reported in the financial statements. The accrual basis of accounting is used for the System. Under the accrual basis of accounting, revenues are recognized when they are earned and collection is reasonably assured, and expenses are recognized when the liability is incurred. Member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the Governing Statute. Dividend income is recorded on the ex-dividend date. Income from other investments is recorded when earned. Gains and losses on sales of securities are recognized on the trade date. The cost of investments sold is determined using the average cost method.

Investment Valuation - Statutes of the State of Texas authorize the System to invest surplus funds in a manner provided by the Government Code, Title 8, Subtitle A, Subchapter C. These statutes stipulate that the governing body of the System is responsible for the management and administration of the funds of the System and shall determine the procedure it finds most efficient and beneficial for the management of the reserve fund of the System. The governing body may directly manage the investments of the System or may choose and contract for professional investment management services. Investments are reported at fair value in accordance with GASB 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools.

Under the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC or Codification), ASC 820, Fair Value Measurements and Disclosures, defines fair value, establishes a framework for measuring fair value, expands disclosures about fair value measurements, and is consistent with valuations required by GASB 31. The System elected to include the ASC 820 disclosures as of July 1, 2008.

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

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

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

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

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

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

Equity securities consist of individual shares of equity securities plus units of commingled stock funds of both US and foreign entities.

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

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

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 a Level I price.

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

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

The following table summarizes the valuation of the System's investments in accordance with the above ASC 820 fair value hierarchy levels as of June 30, 2012 and 2011.

($000's)	6/30/2012			6/30/2011		
		Fair Value	Percent of Net Assets		Fair Value	Percent of Net Assets
Level I	$	503,107	14.2 %	$	556,486	15.5 %
Level II		2,681,540	75.9		2,684,828	75.0
Level III		351,424	9.9		339,631	9.5
	$	**3,536,071**	**100.0 %**	**$**	**3,580,945**	**100.0 %**

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

	Fair Value ($000's)	
Balance June 30, 2011	$	339,631
Purchases		71,933
Sales		(73,472)
Realized Gain/Loss		34,185
Unrealized Gain/Loss Change		(20,853)
Transfers in/(out) of Level III		-
Balance June 30, 2012	$	351,424

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 on June 20, 2012. The Board believes that the System is designed and continues to operate in compliance with the applicable requirements of the Internal Revenue Code.

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

3. Investments

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

Custodial Credit Risk – Custodial credit risk for deposits is the risk that in the event of a bank failure, the System's deposits may not be returned to them. The System considers only demand deposits as cash. The System does not have a deposit policy regarding custodial credit risk. As of June 30, 2012 and June 30, 2011, the System had a balance of $309 thousand and $172 thousand, respectively, on deposit at a financial institution. Beginning December 31, 2010 through December 31, 2012, the Federal Depository Insurance Corporation (FDIC) fully insured all noninterest-bearing transaction accounts at this financial institution. Therefore, as of June 30, 2012, none of the

System's bank balance of $309 thousand was exposed to custodial credit risk. In addition, at June 30, 2012, the System had approximately $3,665 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, 2012, the System's fixed income assets that are not U.S. government guaranteed represented 75.1% of the System's fixed income plus short term investments portfolio. The tables below summarize the System's fixed income portfolio exposure levels and credit qualities.

Average Credit Quality and Exposure Levels of Non-U.S. Government Guaranteed Securities
June 30, 2012

Fixed Income Security Type	Market Value ($000's)	Percent of Total	Weighted Average Credit Quality
Corporate Bonds	$ 121,566	11.6	B
Corporate Convertible Bonds	1,090	0.1	BBB
International Government Bonds	101,784	9.7	AAA
Mutual Bond Funds	329,382	31.4	Not Rated
Short Term Investment Funds	234,171	22.3	Not Rated
Total	$ 787,993	75.1	

Ratings Dispersion Detail
June 30, 2012
($000's)

Credit Rating Level	Corporate Bonds	Corporate Convertible Bonds	International Government Bonds	Mutual Bond Funds	Short Term Investment Funds
AAA	$ -	$ -	$ 45,388	$ -	$ -
AA	-	-	14,480	-	-
BBB	2,708	771	-	-	-
BB	41,107	-	-	-	-
B	63,842	197	-	-	-
CCC	10,747	-	-	-	-
C	386	-	-	-	-
NR	2,776	122	41,915	329,382	234,171
Total	$ 121,566	$ 1,090	$ 101,783	$ 329,382	$ 234,171

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, which is essentially that the counterparty will be unable to fulfill its obligations, which are then 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, 2012, the System did not have any single investment 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, 2012

Security Type	Market Value ($000's)	Percent of Total	Weighted Average Modified Duration (years)
US Treasuries	$ 262,098	24.9 %	7.6
Corporate Bonds	121,566	11.6	4.8
Corporate Convertible Bonds	1,090	0.1	5.4
International Government Bonds	101,784	9.7	8.0
Mutual Bond Funds	329,382	31.4	4.2
Short Term Investment Funds	234,171	22.3	0.2
Total	$ 1,050,091	100.0 %	4.6

Modified Duration Analysis by Security Type
June 30, 2012

U.S. Treasuries	Market Value ($000's)	Average Modified Duration	Contribution to Modifed Duration
1 to 10 years maturities	$ 179,431	4.6	3.1
10 to 20 years maturities	62,097	12.4	2.9
Greater than 20 years maturities	20,570	19.9	1.6
Total	$ 262,098		7.6
Corporate Bonds			
1 to 10 years maturities	$ 115,249	4.6	4.4
10 to 20 years maturities	6,039	8.2	0.4
Greater than 20 years maturities	278	19.4	0.0
Total	$ 121,566		4.8
Corporate Convertible Bonds			
1 to 10 years maturities	$ 893	1.1	0.9
Greater than 20 years maturities	197	24.7	4.5
Total	$ 1,090		5.4
International Government Bonds			
1 to 10 years maturities	$ 66,308	4.6	3.0
10 to 20 years maturities	23,444	11.9	2.7
Greater than 20 years maturities	12,032	19.2	2.3
Total	$ 101,784		8.0

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. International and global managers 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, 2012, is shown in the table on the next page.

Foreign Currency Exposure by Asset Class ($000's)
June 30, 2012

Currency	Short Term Investments	Equities	Fixed Income	Alternative Investments	Foreign Currency Contracts	Total
Australian dollar	$ 46	$ -	$ -	$ 184	$ -	$ 230
Brazilian real	-	261	-	-	-	261
British pound sterling	16	29,670	7,957	-	(7,998)	29,645
Canadian dollar	307	-	-	-	-	307
Euro	3,485	54,489	47,718	29,675	(50,648)	84,719
Hong Kong dollar	-	4,026	-	-	-	4,026
Japanese yen	278	30,386	47,227	-	(47,702)	30,189
Singapore dollar	-	2,450	-	-	-	2,450
South Korean won	14	4,165	-	-	-	4,179
Swedish krona	12	1,957	-	-	-	1,969
Swiss franc	165	11,157	-	-	-	11,322
Total	$ 4,323	$ 138,561	$ 102,902	$ 29,859	$ (106,348)	$ 169,297

Contributions Receivable – The June 30, 2011 Agreement with the City provided 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. This contribution receivable of $17,000 thousand is secured by 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) and is further discussed in footnote 4.

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, 2012 the weighted-average maturity of the collateral pool was 43 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, 2012 and 2011, was $113,063 thousand and $368,331 thousand, respectively. The System also had non-cash collateral at June 30, 2012 and 2011, of $90 thousand and $20,387 thousand respectively, 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, 2012 and 2011 was $111,525 thousand and $380,561 thousand, respectively. At June 30, 2012, the System had no credit risk exposure to borrowers because the amounts the System owes the borrowers, $113,153 thousand, exceeds the amounts the borrowers owe the System, $111,525 thousand.

Derivatives – The System's investment managers may invest in derivatives if permitted by the guidelines established by the System's Board of Trustees. The System's staff monitors guidelines and compliance. From time to time the System's investment managers will invest in equity, fixed income and short term futures contracts along with foreign currency forward contracts. No derivatives are purchased with borrowed funds.

The fair value balance and notional amounts of derivative instruments outstanding at June 30, 2012, 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, 2012 Classification	Fair Value at June 30, 2012 Amount	Notional Value
Investment derivatives:				
Short Term Investments Futures contracts	$ (682)	Short term Investments	$ (682)	$ (79,690)
Fixed Income Futures contracts	$ 861	Fixed Income	$ 861	$ 32,151
Equity Futures contracts	$ 5,302	Equity	$ 5,302	$ 207,937
Foreign currency contracts:				
British pound sterling	$ (57)	Foreign Currency Contracts	$ (57)	£ (4,343)
Euro	$ (195)	Foreign Currency Contracts	$ 11	€ (13,306)
Japanese yen	$ 5	Foreign Currency Contracts	$ (201)	¥ (42,560)

* All changes in fair value are reported in Net appreciation 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, 2012. Such amounts are reported as a component of Net appreciation (depreciation) in the Statement of Changes in Plan Net Assets and are reported in the Statement of Plan Net Assets as Due to or Due from brokers for futures contacts and as Foreign currency contracts for currency forward contracts.

Futures are used to obtain market exposure and to take advantage of mis-pricing opportunities. When a position is taken in a futures contract, a margin is posted and the contract is subject to daily mark-to-market adjustments. Foreign currency contracts are used to hedge against the currency risk in the System's investments in foreign equity and fixed income securities. To liquidate the contract prior to expiration an offsetting position in the same contract must be taken. These derivatives are used to enhance yields and provide incremental income.

These derivative instruments are subject to the following risks:

- *Custodial Credit Risk* – Custodial credit risk for derivative instruments is the risk that, in the event of the failure of the counterparty to a transaction, the System will not be able to recover the value of the derivative instruments or collateral securities that are in the possession of an outside party. Consistent with the System's investment policy, the System's derivative instruments were held by the counterparty that was acting as the System's agent.
- *Credit Risk* – Credit risk is 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* – Interest rate risk is 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, 2012, is shown in the table below.

	($000's)			
Currency	Short Term Investments Futures	Equity Futures	Fixed Income Futures	Foreign Currency Contracts
Australian dollar	$ 46	$ -	$ -	$ -
British pound sterling	-	-	184	(6,869)
Canadian dollar	178	9,081	-	-
Euro	-	-	2,910	(17,080)
Japanese yen	(2,186)	(26)	4,555	(528)
Total	$ (1,962)	$ 9,055	$ 7,649	$ (24,477)

Alternative Investments – As of June 30, 2012 and 2011, the System was invested in various partnerships, separate accounts and commingled funds across various types of alternative investments as detailed in the following chart ($000's).

	Fair Value ($000's)	
Investment Type	June 30, 2012	June 30, 2011
Private Equity		
Leveraged Buyouts	$ 128,402	$ 137,665
Special Situations	107,418	109,560
Venture Capital	64,868	65,373
Other Alternatives		
Hedge Funds	535,857	412,086
Real Estate Funds	50,736	25,815
Risk Parity	898,706	609,451
Total	$ 1,785,987	$ 1,359,950

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.

4. Contributions and Reserves

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. In the June 30, 2011 Agreement, it was agreed that for fiscal year 2012 the amount to be contributed was 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, 2012, 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 interest payments to the System based 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 are $361 thousand and for the fiscal year 2013 shortfall, the quarterly interest payments will be $181 thousand.

In accordance with the June 30, 2011 Agreement, the City on December 29, 2011, placed 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. As of June 30, 2012, the Real Property remains unsold.

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, a 5% decline in the funded ratio below the floor would require the City to pay approximately $224,407 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. This change decreased the System's Actuarial Accrued Liability by approximately $308,621 thousand.

City contributions in the Statements of Changes in Plan Net Assets may be greater than the contractually agreed amounts, as members are allowed to contribute accumulated sick and vacation pay to the System upon retirement and such contributions are classified as City contributions.

Pursuant to the terms of the June 30, 2011 Agreement and based on the July 1, 2011 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, 2022.

($000's) Years Ended June 30,	Actuarial Required Contribution (ARC)	Cash Payments Required by Agreements	Cash Payments as a Percentage of ARC	Annual Required Contribution as a Percentage of Pay
2012	$ 126,932	$ 83,000	65.4	32.7
2013	133,927	93,000	69.4	33.8
2014	139,846	103,000	73.7	34.8
2015	144,657	113,000	78.1	35.4
2016	147,109	123,000	83.6	35.4
2017	150,336	133,000	88.5	35.4
2018	152,720	143,000	93.6	35.2
2019	154,118	153,000	99.3	34.8
2020	154,688	163,000	105.4	34.1
2021	154,304	173,000	112.1	33.1
2022	153,038	183,000	119.6	32.0

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. To the best of the System’s knowledge, none of the City’s fiscal 2011 or 2012 obligations were financed utilizing bonds.

The ARC as a percentage of pay for 2012 is 32.7%. This rate consists of 20.1% to cover Normal Costs and 12.6% to amortize the unfunded actuarial accrued liability over 30 years.

5. Funding Status

The System's actuary conducts periodic valuations to determine the adequacy of the employer contribution rates, to describe the financial condition of the System, and to analyze changes in the System's condition. The most recent valuation shows the funded position of the System decreased slightly from 83.3% at July 1, 2010 to 82.8% at July 1, 2011. The actuarial accrued liability increased $255,410 thousand and the actuarial value of assets increased $191,349 thousand. As a result, the System's Unfunded Actuarial Accrued Liability increased $64,061 thousand to $770,090 thousand as of July 1, 2011. The increase in the Unfunded Actuarial Accrued Liability is due to a combination of factors including the increase in the actuarial value of assets less than assumed and contributions below the actuarially required amount.

The funded status of the System as of July 1, 2011, the most recent actuarial valuation date, is as follows:

Actuarial Funded Status as of Actuarial Valuation Date of July 1, 2011 ($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)
$ 3,718,052	$ 4,488,142	$ 770,090	83 %	$ 388,409	198 %

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents 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, 2011	
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	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%

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, 2010 indicated that if the System achieves its 8.5% actuarial investment return assumption over the period ending in 2020, 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, 2011 actuarial value of $3,718,052 thousand is $187,435 thousand greater than the fair value $3,530,617 thousand. The $187,435 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.

6. Litigation

From June 2006 through December 2007, the System was invested in a fully collateralized commodities strategy which was implemented by hiring a commodities strategy manager through execution of the First Amendment to an Investment Management Agreement ("IMA") with State Street Bank and Trust Co. ("State Street"). Under the IMA, 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 select from various cash management vehicles (the LDBF was one such vehicle) subject to its fiduciary obligations 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 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 ($14.27 million) and securities (allegedly worth $13.315 million) 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 million as a result of State Street's alleged wrongdoings, and has suffered attorney fees and legal costs in excess of $6 million in prosecuting this case.

In August 2008, the System filed its lawsuit against State Street seeking to recover its losses plus management fees, 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 $21.6 million to the System. The penalty portion of the payment does not offset the System's damages, and no release by the System was required to receive those funds.

In August 2011, the case was remanded by the MDL Panel for separate trial in the United States District Court for the Southern District of Texas. Motions for summary judgment filed by both State Street and the System are pending before the district court. The System is seeking trial at the earliest possible date. 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.

7. Commitments and Contingencies

As described in Note 1, there are 3,572 non-vested active members of the System who are entitled to refunds of their accumulated contributions, without interest, upon termination of employment with the City prior to being eligible for pension benefits. At June 30, 2012 and 2011, aggregate contributions from these members of the System were approximately $167,920 thousand and $160,842 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, 2012 and 2011, the total accumulated lump sum benefit due to DROP members was approximately $819,967 thousand and $764,147 thousand, respectively.

At June 30, 2012 and 2011, the total accumulated lump sum benefit due to PROP participants was $441,137 thousand and $373,431 thousand, respectively.

The System has outstanding commitments to various limited partnerships totaling $215,768 thousand and $214,752 thousand, as of June 30, 2012 and 2011, respectively.

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

Period	Monthly Base Rent
July 2011 - April 2012	$ 16
May 2012 - April 2015	17

Fiscal Year	Total Rent
2013	$ 203
2014	203
2015	169
Beyond 2015	-
	$ 575

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

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (Surplus) (UAAL) (b-a)	Funded Ratio (%) (a/b)	Projected Annual Covered Payroll (c)	UAAL as Percentage of Covered Payroll ((b-a)/c)
July 1, 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	937,555	79	366,924	256
July 1, 2010	3,526,703	4,232,732	706,029	83	377,779	187
July 1, 2011	3,718,052	4,488,142	770,090	83	388,409	198

(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 (ARC)	Cash Payments Required by Agreements [(2)]	Cash Payments as a Percentage of ARC	ARC as a Percentage of Pay
2007	$ 107,443	$ 58,000	26.1 % [(3)]	34.0 %
2008	107,865	63,000	26.0 [(4)]	32.1
2009	108,621	68,000	44.2 [(5)]	30.9
2010	116,315	73,000	45.6 [(6)]	31.7
2011	121,040	78,000	64.4	32.0
2012	126,932	66,000 [(7)]	52.0	32.7

(2) The amounts listed are in accordance with a payment schedule as provided for in the October 9, 2004 Agreement between the System and the City.

(3) The percentage contributed figure for 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.

(4) 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.

(5) 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.

(6) 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.

(7) The cash payment amount for 2012 was to be $83,000 thousand, but per the June 30, 2011 Agreement between the System and the City, the City was allowed a shortfall of $17,000 thousand.

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

Valuation date	July 1, 2011
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	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

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

Year ended June 30,	2012	2011
Investment services:		
Custodial services	$ 239	$ 231
Money management services	17,764	21,736
Consulting services	600	644
Department Operating Expense	273	428
Total investment services	18,876	23,039
Professional services:		
Actuarial services	48	60
Auditing services	97	96
Election audit services	15	10
Legal services	651	1,409
Lobbyist services	338	316
Total professional services	1,149	1,891
Administrative expenses:		
Computers and technology	92	159
Education	32	32
Fiduciary insurance	79	79
Office rent	170	169
Other office costs	2,330	2,034
Total administrative expenses	2,703	2,473
	$ 22,728	$ 27,403

See accompanying independent auditors' report.

Houston Police Officers' Pension System

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

Twelve Months Ended June 30, 2012	Official System Position	Expense	Nature of Services
Mercer	Consultant	$ 600	Consulting
The Northern Trust Company	Custodian	239	Custodian
AQR Capital Management LLC	Money Manager	756	Money Management
Ashmore Investment Management Limited	Money Manager	3,846	Money Management
BlackRock	Money Manager	297	Money Management
Brandes Investment Partners	Money Manager	421	Money Management
Bridgewater Associates, Inc.	Money Manager	8,963	Money Management
Causeway Capital Management	Money Manager	504	Money Management
The Clifton Group	Money Manager	293	Money Management
Dimensional Fund Advisors	Money Manager	258 *	Money Management
Driehaus Capital Management, Inc.	Money Manager	175	Money Management
First Eagle Investment Mgmt, LLC	Money Manager	628	Money Management
First Quadrant LP	Money Manager	467	Money Management
Franklin Park Associates, LLC	Money Manager	400	Money Management
MacKay-Shields Financial Corp.	Money Manager	339	Money Management
PanAgora Asset Management, Inc.	Money Manager	129	Money Management
Shenkman Capital Management, Inc.	Money Manager	288	Money Management
Gabriel Roeder Smith & Co.	Actuary	48	Actuarial
BDO USA, LLP	Auditors	97	Auditing
Burford, Hawash, Meade & Gaston LLP	Attorneys	527	Legal Service
Gibbs & Bruns, LLP	Attorneys	11	Legal Service
Hawash, Meade & Gaston LLP	Attorneys	31	Legal Service
Strasburger & Price, LLP	Attorneys	70	Legal Service
HillCo Partners, LLC	Attorneys	157	Lobbyists
Locke Lord LLP	Attorneys	178	Lobbyists
Bickley Prescott & Co.	Consultant	15	Election Auditing
Other	Other	15	Other
Total investment and professional services		$ 19,752	

* 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.

SECTION THREE

INVESTMENT SECTION

Responsibilities of the Board of Trustees

The primary fiduciary fiscal responsibility of the Board of Trustees is to insure that the System's assets are responsibly managed in accordance with the actuarial needs of the System, and also with sound, generally accepted financial investment procedures. The determination of the appropriate asset mix is based on capital market assumptions that incorporate historical returns, volatility, liquidity, 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:

- Diversification should be based upon the prudent allocation of risk rather than solely the allocation of capital.

- Asset classes are priced to have long-term expected returns above cash and their return above cash is proportional to their risk (they have similar Sharpe Ratios). Since asset classes have similar expected Sharpe Ratios, they can be made competitive through the prudent use of leverage or leverage-like techniques.

- 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, 2012 are as follows:

	Target % of Fund	Current Actual % of Fund	Dollars Invested (000's)
Domestic Equity	13.0%	14.1%	$ 498,833
International Equity	11.0%	11.0%	390,198
Total Equity	24.0%	25.0%	889,031
Fixed Income	18.0%	19.8%	704,395
Credit Strategies	7.5%	7.8%	276,741
Total Fixed Income	25.5%	27.6%	981,136
Private Equity	10.0%	8.5%	302,094
Risk Parity	25.0%	25.3%	898,706
Hedge Funds	10.5%	11.0%	388,852
Real Assets	5.0%	1.4%	50,736
Total Alternatives	50.5%	46.2%	1,640,388
Total Cash	0.0%	1.1%	39,823
Total Fund	100.0%	100.0%	$ 3,550,378

Financial markets were turbulent during the first half of fiscal year 2012 as news of the ever worsening European debt crisis dominated headlines. During the second half of the year, markets experienced a decrease in volatility and an increase in risk appetite as concerns over the Eurozone economy gradually eased. The System had a solid return of 3.0% during fiscal year 2012 which ranked HPOPS in the twelfth percentile in the Northern Trust investment universe for public employee pension funds with greater than one billion in assets.

HPOPS marginally under-performed its custom benchmark rate of return by 0.3% due in part to the structure of our fixed income allocation, which will typically underperform a broad market index such as the BC Aggregate index during risk-off periods. The System's hedge fund allocation was also a meaningful contributor to the under-performance versus the System's custom benchmark. The hedge fund portfolio returned 4.1% beating the HFRI index by 8.6%, however in HPOPS' custom benchmark the hedge fund allocation is compared to an absolute return target of 11.6% (which the portfolio is projected to return over long-term cycles) resulting in a 7.5% underperformance this fiscal year. To a lesser degree the System's domestic equity and private equity portfolios also contributed to the relative underperformance.

The System's asset allocation has had a strong risk budgeting component for the previous seven years which has resulted in significant diversification away from our previous equity-centric structure. HPOPS has added low volatility, low correlation assets to our mix including significant allocations to TIPS, hedge funds, risk parity and other low volatility approaches. This low(er) risk approach has produced an annualized measure of volatility risk that is in the fourth quartile of our custodian's universe of similar public employee pension funds while at the same time producing first decile investment returns in the same universe.

Domestic Equity

The System's domestic equity investments generated a 2.8% return, underperforming the 3.8% 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 underperformance is primarily due the underperformance of active strategies.

First Eagle underperformed their benchmark, the Russell 1000, by approximately 5.0% during fiscal year 2012. In the first half of the year, they essentially matched the performance of their benchmark. During the second half of the year, First Eagle underperformed the Russell 1000 by approximately 4.9% due to poor security selection. Performance was particularly impaired by their investment in certain energy stocks and an underweight to the technology sector.

Driehaus outperformed its benchmark by approximately 0.9% during fiscal year 2012. They experienced strong outperformance during the first quarter of the year, led by stock selection within the health care sector. Over the last three quarters of the year Driehaus' performance was impaired by an underweight to the energy sector and security selection within the consumer discretionary sector.

Assets under management, annualized rates of return and fees paid to domestic equity managers for the fiscal year ending June 30, 2012 are as follows (dollars in 000's):

Manager	Style	Assets	% Returns	Fees
First Eagle	Large Cap Core	$ 125,025	-0.6%	$ 628
BlackRock	S&P 500 Index	65,955	3.8%	20
BlackRock	Russell 2000 Index[1]	-	n/a	8
Clifton Group	Russell 3000 Futures replication[2]	74,226	4.0%	59
Driehaus Capital Mgmt	Large Cap Growth	48,411	6.6%	175
Panagora	Quality Stock Portfolio	185,216	5.8%	129
		$ 498,833		$ 1,019

[1]Terminated 9/30/11

[2]Futures are fully funded

	HPOPS	Benchmark
# of holdings	3729	3000
Avg Market Cap	$92.8 Billion	$88.4 Billion
Portfolio P/E	14.32	15.20
Portfolio P/Book	2.45	2.11
Portfolio Beta (3-yr)	0.97	1.00

International Equity

The System's international equity investments returned negative 14.2%, slightly outperforming the negative 14.6% return of the MSCI ACWI ex U.S. benchmark for the fiscal year. This outperformance was primarily due to the implementation of a currency hedge, a tactical shift reducing our small cap emerging markets equity exposure and the superior performance of Causeway Capital.

Brandes essentially matched the performance of its benchmark the MSCI EAFE Index returning negative 13.4%. Their performance was constrained by poor security selection within and an overweight to the telecommunications and information technology sectors.

Causeway outperformed the return of its benchmark, the MSCI EAFE Index during fiscal year 2012 by 2.1%. Strong stock selection in a broad array of cyclical industries led to out-performance during the year.

Assets under management, annualized rates of return and fees paid to international equity managers for the fiscal year ending June 30, 2012 are as follows (dollars in 000's):

Manager	Style	Assets	% Returns	Fees
BlackRock	EAFE Small Cap[1]	$ -	n/a	$ 15
BlackRock	Emerging Markets Passive	69,545	-16.3%	157
Brandes	Frontier Markets[1]	-	n/a	67
BlackRock	World Equity ex-US	28,276	-14.9%	30
Brandes	EAFE	75,819	-13.4%	421
Causeway Capital	EAFE	80,611	-11.2%	504
Clifton Group	World Equity ex-US Futures[2]	97,174	-15.2%	67
DFA	Emerging Markets Equity	33,504	-21.0%	258
Clifton Group	Currency Hedge[3,4]	5,269	0.1%	49
		$ 390,198		$ 1,568

[1]Terminated 9/30/2011
[2]Futures are fully funded
[3]Funded 10/18/2011
[4] Notional FMV at 6/30 $84.1 million

	HPOPS	Benchmark
# of holdings	6948	1888
Avg Market Cap	$36.8 Billion	$42.3 Billion
Portfolio P/E	10.4	12.56
Portfolio P/Book	1.03	1.36
Portfolio Beta (3-yr)	1.00	1.00

Credit

HPOPS has a dedicated allocation to credit strategies designed to take advantage of perceived opportunities in the credit markets. Credit 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 October 2011, the System reduced its allocation to high yield by 2.5% in favor of opportunistic strategies. The environment appeared more favorable for investing in opportunistic credit due to, among other factors, continued dislocations in the credit markets and required credit derivative unwinds resulting from regulatory capital changes. Assets under management, annualized rates of return and fees paid to credit managers for the fiscal year ending June 30, 2012 are on the next page (dollars in 000's):

Manager	Style	Assets	% Returns	Fees
MacKay Shields	High Yield	$ 77,662	8.3%	$ 339
Shenkman Capital Mgmt	High Yield	51,378	7.7%	288
Brevan Howard[1]	Opportunistic Credit	31,519	5.1%	796
Silver Point[1]	Opportunistic Credit	33,551	11.8%	1,193
Elliott[2]	Opportunistic Credit	30,569	1.7%	444
Och Ziff [2]	Opportunistic Credit	42,882	18.8%	1,338
Anchorage[3]	Opportunistic Credit	9,180	4.7%	127
		$ 276,741		$ 4,525

[1] Inception 10/31/11
[2] Inception 11/30/11
[3] Inception 12/31/11

	HPOPS	Benchmark
# of securities[1]	417	1,606
Yield to Maturity	6.32	6.63
Effective Duration	3.67	3.86
Quality Rating S&P	B+	B+

[1]Opportunistic credit portfolio positions not included.

Fixed Income

The System's fixed income strategy consists of a separate allocation to a global fixed income mandate, inflation indexed bonds, an emerging market sovereign debt mandate, an emerging markets local currency strategy and an emerging markets corporate high yield bond fund. The System's fixed income portfolio underperformed its benchmark with a fiscal year return of 4.2% versus the 7.5% return on the Barclay's Aggregate Bond Index for the same time period. Assets under management, annualized rates of return and fees paid to fixed income managers for the fiscal year ending June 30, 2012 are as follows (dollars in 000's):

Manager	Style	Assets	% Returns	Base Fee
Clifton	TIPS	$ 209,000	12.2%	$ 62
Ashmore[1]	Sovereign Debt Mutual Fund	32,497	4.4%	1,182
Ashmore	Local Currency Mutual Fund	36,137	-7.6%	1,861
Ashmore	Emerging Markets High Yield	46,748	-0.4%	803
Ashmore[2]	Total Return Fund	214,000	n/a	n/a
Bridgewater[3]	Global Fixed Income, Hedged	166,013	8.0%	-
		$ 704,395		$ 3,908

[1] *Funded on 10/31/2011*
[2] *Funded on 6/30/2012*
[3] *Fees are commingled with the fee struture for the Bridgewater hedge fund strategy disclosed elsewhere in this document*

Alternative Investments

The System's alternative investment program consists of allocations to private equity, hedge funds, risk parity strategies and real assets. The private equity program 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. Although the private equity program is a relatively mature strategy, it remains underfunded by approximately 1.5% due in part to distributions exceeding deployed capital and essentially no new commitments during calendar year 2010 as the System was conducting its search and transitioning to the new private equity consultant. The System had investments in, or commitments to, 71 individual private equity partnerships with 44 general partners at June 30, 2012. The current allocation within this strategy is approximately 43% in leveraged buyouts, 36% in special situation funds and 21% in venture capital. This program required $47.4 million of additional funding during fiscal 2012 while at the same time generating distributions of $70.3 million for the same period. This private equity program generated returns for the 2012 fiscal year of 8.9% versus a return of 11.3% for its benchmark, the S&P 500 plus 5%.

The System also has a 10.5% allocation to hedge funds and had $389 million actually invested as of June 30, 2012. These strategies generated fiscal year performance of approximately 4.1%.

The System increased its allocation to risk parity from 15% to 25% 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 11.1%.

Assets under management, annualized rates of return and fees paid to alternative investments managers for the fiscal year ending June 30, 2012 are as follows (dollars in 000's):

Manager	Style	Assets	% Returns	Base Fee
Bridgewater	Risk Parity	$ 420,224	18.0%	$ 770
AQR	Risk Parity	239,515	4.9%	756
First Quandrant	Risk Parity	238,967	5.4%	467
Bridgewater	Hedge Funds[1]	192,745	9.9%	8,193
Mercer	Hedge Funds	194,053	1.0%	600
Attalus	Hedge Fund[2]	2,054	-4.7%	229
Mercer	Real Assets[3]	50,736	19.6%	-
Franklin Park	Private Equity	302,094	8.9%	400
		$ 1,640,388		$ 11,415

[1] Includes the Pure Alpha and Pure Alpha Major Markets (PAMM) funds.

[2] Attalus was terminated on 12/31/11; the $2.1 M is the 5% holdback of redemption proceeds to be returned upon completion of the annual audit.

[3] 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.

Manager	Style	Assets (000s)	% Returns	Base Fee (000s)
Clifton Group	Cash Securitization	$ 13,057	-3.2%	$ 56
		$ 13,057		$ 56

Securities Lending

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

This program generates incremental income for HPOPS but is subject to certain risks. These risks include (1) the possibility that the borrower cannot return the securities and (2) that the investments in which Northern invests the collateral lose money. This first risk is controlled by strict guidelines on which borrowers will be approved to participate in the program and daily adjustment of the collateral for changes in the market value of the securities that are out on loan. The second risk is controlled by strict quality and duration guidelines on the securities that the collateral can be invested in. In June 2008 the System switched to a "government only" collateral pool thus avoiding exposure to the liquidity issues experienced by many securities lending collateral pools during the credit crisis.

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

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

	2012	2011	2010
Avg Securities on Loan	$ 229,535	$ 270,426	$ 275,442
Avg Eligible Securities	$ 939,576	$ 1,057,458	$ 952,124
% on Loan	24.4%	25.6%	28.9%
HPOPS Net Earnings	$ 557	$ 491	$ 473
Duration of Collateral Pool (days)	40	32	34

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 ACWI ex U.S.	Fixed Income	Barclays Aggregate	High Yield	Citigroup HY	Alternative Investments
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
2012	3.0	3.3	2.8	3.8	-14.2	-14.6	4.2	7.5	8.6	7.6	8.0

Compound Annualized Rates of Return by Year (%)
Periods Ended June 30, 2012

Year	System Total	Composite Benchmark	Domestic Equity	Russell 3000	Int'l Equity	MSCI ACWI ex U.S.	Fixed Income	Barclays Aggregate	High Yield	Citigroup HY	Alternative Investments
2	11.7	11.9	17.0	17.2	5.2	5.3	6.8	5.7	10.9	11.4	13.9
3	12.3	12.0	16.2	16.7	7.3	7.0	8.3	6.9	13.4	16.0	14.3
5	3.1	3.2	-1.4	0.4	-5.7	-4.6	7.2	6.8	7.6	8.1	6.8
10	8.2	7.0	6.1	5.8	6.4	6.7	8.8	5.6	9.4	10.2	10.3

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, 2012

Shares	Description	Market Value ($000's)	% of Total Domestic Equity
165,078	Exxon Mobil Corp.	$ 14,126	2.8%
259,769	Kraft Food Inc.	10,032	2.0%
183,929	Tyco Int'l Ltd.	9,721	1.9%
171,307	Amphenol Corp.	9,408	1.9%
43,954	IBM Corp.	8,597	1.7%
279,184	Microsoft Corp.	8,540	1.7%
398,636	General Electric Co.	8,308	1.7%
94,651	Berkshire Hathaway In	7,887	1.6%
74,223	Chevron Corp.	7,831	1.6%
96,564	Humana Inc.	7,478	1.5%

Schedule of Ten Largest Non-U.S. Equity Holdings
As of June 30, 2012

Shares	Description	Market Value ($000's)	% of Total International Equity
49,690	British American Tobacco	$ 2,526	0.6%
220,175	Reed Elsevier NV	2,518	0.6%
33,406	KT&G Corp.	2,368	0.6%
95,947	GDF Suez	2,284	0.6%
39,769	Novartis AG	2,223	0.6%
104,100	Eni Spa	2,217	0.6%
28,813	Sanofi	2,184	0.6%
73,000	JGC Corp.	2,100	0.5%
45,918	Total Eur2.5	2,069	0.5%
42,990	Akzo Nobel NV	2,021	0.5%

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

Schedule of Ten Largest Domestic Fixed Income Holdings

As of June 30, 2012

Par Value ($000's)	Description	Market Value ($000's)	% of Total U.S. Fixed Income
$ 6,808	US TREAS INFL INDEXED BONDS 2.375 DUE 01-15-2025 BEO	$ 10,942	2.3%
8,900	USA TREASURY NTS 1.125% TIPS 15/1/21 01-15-2021	10,770	2.2%
4,572	UNITED STATES TREAS BDS INFLATION LINKED 3.875% 04-	10,337	2.1%
7,580	US TREAS NTS 1.25% TIPS 15/04/20 USD1000 07-15-2020	9,283	1.9%
3,896	US TREAS BONDS 5.0808725 04-15-2028	8,549	1.8%
7,800	US TREAS NTS INDEX LINKED NOTE .125 DUE 01-15-2022	8,388	1.7%
5,300	US TREAS BDS INDEX LINKED 2.00 DUE 01-15-2026 REG	7,839	1.6%
5,650	US TREAS NTS INDEX LINKED 2.36434 DUE 01-15-2014 REG	7,303	1.5%
5,300	US TREAS NTS INFLATION LINKED 2.50 DUE 07-15-2016	6,911	1.4%
5,380	US TREAS NTS INDEX LINKED 1.875 DUE 07-15-2013 REG	6,901	1.4%

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

As of June 30, 2012

Par Value ($000's)	Description	Market Value ($000's)	% of Total Non-U.S. Fixed Income
730,000	JAPAN(GOVT OF) 1.4% BDS 20/12/13	$ 9,323	1.9%
530,000	JAPAN(GOVT OF) 2.1% BDS 20/09/24	7,432	1.5%
400,000	JAPAN GOVT BOND 1.7% 20 SEP 2017	5,393	1.1%
350,000	JAPAN(GOVT OF) 1.3% BDS 20/12/19	4,643	0.9%
3,100	GERMANY(FED REP) 4.25% BDS 04/07/14	4,258	0.9%
2,500	FRANCE(GOVT OF) 2.5% BDS 12/01/2014	3,278	0.7%
1,900	FRANCE(GOVT OF) 2% BDS 12/07/15	2,498	0.5%
180,000	JAPAN(GOVT OF) 2.1% BDS 20/12/26	2,495	0.5%
1,140	UK(GOVT OF) 4.75% STK 07/12/38	2,381	0.5%
1,100	UK(GOVT OF) 5% GILT 07/03/18	2,113	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, 2012

Brokers	Shares	Commissions	Principal	Commissions Per Share
Cap Institutional Services Inc	1,439,360	$ 57,335	$ 54,651,710	$ 0.040
Merrill Lynch	1,046,876	30,533	42,147,024	0.029
UBS	1,878,240	26,526	83,566,668	0.014
Goldman Sachs	2,458,951	25,503	104,264,535	0.010
JP Morgan	1,512,235	25,282	55,778,862	0.017
Knight Direct LLC	1,210,960	23,911	64,747,017	0.020
Liquidnet Inc	1,279,432	22,170	46,794,267	0.017
Barclays Capital	491,653	14,333	24,489,798	0.029
Bernstein, Sanford C. & Co.	266,354	10,198	13,645,557	0.038
Nomura Securities	685,041	9,857	32,952,203	0.014

International Equity Trading - Ten Largest by Total Commissions Paid

For the year ended June 30, 2012

Brokers	Shares	Commissions	Principal	Commissions Per Share
Citigroup	2,598,119	$ 13,273	$ 24,604,845	$ 0.005
UBS Securities	1,943,713	11,723	19,163,619	0.006
Merrill Lynch	873,130	9,253	6,309,011	0.011
Deutsche Bank	549,028	7,937	4,804,453	0.014
Morgan Stanley	1,016,917	7,044	4,503,017	0.007
Goldman Sachs & Co.	528,798	5,250	3,271,013	0.010
Credit Argicole Securities	452,844	4,888	4,152,871	0.011
Societe Generale	87,682	4,432	3,095,312	0.051
Barclays Capital Inc.	249,755	4,283	2,842,662	0.017
JP Morgan Securities	150,268	3,442	2,194,350	0.023

SECTION FOUR

ACTUARIAL SECTION

THIS PAGE INTENTIONALLY BLANK

GRS Gabriel Roeder Smith & Company
Consultants & Actuaries

HOUSTON POLICE OFFICERS' PENSION SYSTEM

ACTUARIAL VALUATION REPORT

FOR THE YEAR BEGINNING JULY 1, 2011

GRS Gabriel Roeder Smith & Company
Consultants & Actuaries

5605 N. MacArthur Blvd.
Suite 870
Irving, TX 75038-2631

469.524.0000 phone
469.524.0003 fax
www.gabrielroeder.com

October 11, 2011

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

Subject: **Actuarial Valuation Report as of July 1, 2011**

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, 2011. 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, 2011 actuarial valuation will be used by the Board when determining the employer contribution rate for the year beginning July 1, 2012 and ending June 30, 2013.

Under the 2011 Meet & Confer Agreement between the Board and the City of Houston, a funding schedule was implemented resulting in a minimum $83 million employer contribution for the fiscal year ending June 30, 2012, increasing by $10 million each year thereafter until HPOPS' funded ratio reaches 100%. However, for FY 2012 and FY 2013, the City may contribute $17 million and $8.5 million respectively less than required with any shortfall to be financed at an interest rate of 8.5% and made up for in FY2015. A fixed payment of $103 million is to be made for City Fiscal year 2014. In addition, once the System reaches an 80% funded status, the City will make additional payments in the fiscal year following a determination that the System has fallen below 80%. Finally, once the System reaches the actuarially required rate, 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, 2013 is not set by this actuarial valuation as of July 1, 2011. Therefore, the actuarially calculated contribution rate from this valuation will not be contributed. Based upon a projected payroll of approximately $390 million, the City's calculated contribution amount should be almost $130 million. Instead, City contributions of $83 million *less the loan amount of $17 million for FY 2012* and $93 million *less the loan amount of $8.5 million* for FY 2013 are to be made under the terms of the above funding schedule. A payment of $103 million is to be made for FY2014.

Houston Police Officers' Pension System
October 11, 2011
Page 2

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, 2011). 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, 2011 is 82.8%. The funded ratio measured on the market value of assets drops to 78.7% as of July 1, 2011.

The calculated employer contribution rate for FY 2013 is 32.68%. This rate is greater than the 32.04% rate calculated in the 2010 valuation. This is primarily due to the asset loss in FY 2011 on an actuarial value basis (7.2% versus the 8.5% assumed annual rate-of-return), but it also stems from the calculated contribution rate not being contributed to the System. These losses were partially offset by liability gains driven primarily by salary increases being less than assumed and fewer retirements than expected. 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 $187.4 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 over 35% of payroll before decreasing to just over 32% during the next 10 years as the funded ratio falls to below 80%.

Benefit provisions

The benefit provisions reflected in this valuation are those which were in effect on July 1, 2011. 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
October 11, 2011
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 there were no changes from those used in the prior valuation.

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, 2011 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. GRS is not responsible for the accuracy or completeness of the information provided to us.

Asset and financial information as of July 1, 2011 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, 2011.

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

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, 2011	July 1, 2010
Membership		
• Number of:		
- Active members	5,312	5,347
- Retirees and beneficiaries	3,088	2,985
- Inactive members	33	24
- Total	8,433	8,356
• Annualized Payroll supplied by HPOPS	$ 375,275	$ 365,003
Calculated Contribution rates		
• Employer	32.68%	32.04%
• Member[1]	9.26%	9.22%
Assets ($000s)		
• Market value	$ 3,530,617	$ 2,972,027
• Actuarial value	3,718,052	3,526,703
• Estimation of return on market value	21.0%	13.5%
• Estimation of return on actuarial value	7.2%	4.4%
• Employer contribution	$ 78,287	$ 73,192
• Member contribution	$ 35,122	$ 34,218
• Ratio of actuarial value to market value	105.3%	118.7%
Actuarial Information		
• Employer normal cost %	20.11%	20.20%
• Unfunded actuarial accrued liability (UAAL)	$ 770,090	$ 706,029
• Amortization rate	12.57%	11.84%
• Funding period	30.0 years	30.0 years
• GASB funded ratio	82.8%	83.3%
Projected employer contribution based on calculated rate		
• Fiscal year ending June 30,	2012	2011
• Projected payroll (millions)	$ 388.4	$ 377.8
• Projected employer contribution (millions) (actual contribution rate set by Meet & Confer)	$ 126.9	$ 121.0

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

Schedule of Funding Progress ($000)

Date	Actuarial Value of Assets (AVA)	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL) (3) - (2)	Funded Ratio (2)/(3)	Annual Payroll	UAAL as % of Payroll (4)/(6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
July 1, 1993	$ 947,456	$ 984,495	$ 37,039	96.2%	$ 162,143	22.8%
July 1, 1994	1,038,256	1,000,423	(37,833)	103.8%	174,761	(21.6%)
July 1, 1995	1,168,056	1,199,748	31,692	97.4%	182,251	17.4%
July 1, 1996	1,329,570	1,258,217	(71,353)	105.7%	187,134	(38.1%)
July 1, 1998	1,518,081	1,549,341	31,260	98.0%	196,364	15.9%
July 1, 1999 *	1,746,312	1,773,829	27,517	98.4%	246,569	11.2%
July 1, 2000	2,013,491	1,966,404	(47,087)	102.4%	250,691	(18.8%)
July 1, 2001	2,226,307	2,306,427	80,120	96.5%	264,226	30.3%
July 1, 2002	2,337,157	2,593,730	256,573	90.1%	286,150	89.7%
July 1, 2003	2,394,411	2,874,738	480,327	83.3%	300,405	159.9%
July 1, 2004	2,466,070	3,339,224	873,154	73.9%	329,840	264.7%
July 1, 2005	2,508,794	3,392,974	884,180	73.9%	321,057	275.4%
July 1, 2006	2,681,375	3,633,145	951,770	73.8%	327,080	291.0%
July 1, 2007	3,004,927	3,857,680	852,753	77.9%	336,029	253.8%
July 1, 2008	3,337,612	4,078,963	741,351	81.8%	351,525	210.9%
July 1, 2009	3,430,946	4,368,501	937,556	78.5%	366,924	255.5%
July 1, 2010**	3,526,703	4,232,732	706,029	83.3%	377,779	186.9%
July 1, 2011	3,718,052	4,488,142	770,090	82.8%	388,409	198.3%

* 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: Active Members Contributions	Retirees Beneficiaries and Vested Terminations[1]	Members (City Financed Portion)	Actuarial Value of Assets	by Reported Assets: (5)/(2)	[(5)-(2)]/(3)	[(5)-(2)-(3)]/(4)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
July 1, 1993	$ 114,279	$ 401,989	$ 468,227	$ 947,456	100.0%	100.0%	92%
July 1, 1994	123,471	416,053	460,899	1,038,256	100.0%	100.0%	100%
July 1, 1995	91,687	764,518	343,543	1,168,056	100.0%	100.0%	91%
July 1, 1996	95,615	812,498	350,104	1,329,570	100.0%	100.0%	100%
July 1, 1998	99,298	1,017,723	432,320	1,518,081	100.0%	100.0%	93%
July 1, 1999	107,008	1,157,882	508,939	1,746,312	100.0%	100.0%	95%
July 1, 2000	111,099	1,324,079	531,225	2,013,491	100.0%	100.0%	100%
July 1, 2001	138,248	707,152	1,461,027	2,226,307	100.0%	100.0%	95%
July 1, 2002	145,255	718,779	1,729,696	2,337,157	100.0%	100.0%	85%
July 1, 2003	153,634	838,090	1,883,014	2,394,411	100.0%	100.0%	74%
July 1, 2004	153,088	995,841	2,190,295	2,466,070	100.0%	100.0%	60%
July 1, 2005	249,804	1,259,243	1,883,927	2,508,794	100.0%	100.0%	53%
July 1, 2006	262,514	1,421,330	1,949,301	2,681,375	100.0%	100.0%	51%
July 1, 2007	275,990	1,575,900	2,005,790	3,004,927	100.0%	100.0%	57%
July 1, 2008	294,678	1,726,121	2,058,165	3,337,612	100.0%	100.0%	64%
July 1, 2009	312,489	1,872,226	2,183,786	3,430,946	100.0%	100.0%	57%
July 1, 2010	149,252	1,998,683	2,084,797	3,526,703	100.0%	100.0%	66%
July 1, 2011	160,828	2,146,222	2,181,093	3,718,052	100.0%	100.0%	65%

Note: Dollar amounts in $000

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

Historical Active Participant Data

Valuation Date (1)	Active Count (2)	Average Age (3)	Average Svc (4)	Covered Payroll (5)	Average Salary (6)	Percent Changes (7)
1988	4,239	35.0	N/A	$121,667	$28,702	1.6%
1989	4,105	35.7	N/A	$122,803	$29,915	4.2%
1990	4,073	36.2	N/A	$126,665[1]	$31,099	4.0%
1992	4,120	36.8	N/A	$143,020	$34,714	11.6%
1993	4,498	36.7	N/A	$159,321	$35,420	2.0%
1994	4,705	36.8	N/A	$162,143	$34,462	-2.7%
1995	4,921	36.9	N/A	$174,761	$35,513	3.0%
1996[2]	4,395	35.1	N/A	$150,903	$34,335	-3.3%
1997	4,282	35.5	N/A	$149,631	$34,944	1.8%
1998	4,247	35.9	N/A	$153,479	$36,138	3.4%
1999	4,253	36.3	N/A	$187,967[3]	$44,196[3]	22.3%[3]
2000	4,137	36.7	N/A	$179,415	$43,368	-1.9%
2001[4]	5,325	40.2	N/A	$264,226[5]	$49,620[5]	14.4%[5]
2002	5,352	40.7	N/A	$286,150	$53,466	7.8%
2003	5,387	41.3	N/A	$300,405	$55,765	4.3%
2004	5,225	41.7	N/A	$329,840	$63,127	13.2%
2005	4,867	42.0	N/A	$321,057[6]	$65,966[6]	4.5%[6]
2006	4,785	42.3	N/A	$327,080	$68,355	3.6%
2007	4,879	42.1	N/A	$336,029	$68,873	0.8%
2008	5,065	42.0	15.7	$351,525	$69,403	0.8%
2009	5,245	41.8	15.4	$366,924	$69,957	0.8%
2010	5,347	41.9	15.3	$377,779	$70,652	1.0%
2011	5,312	42.3	15.7	$388,409	$73,119	3.5%

[1] Reflects the November 1, 1990 pay increase.

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

[3] Definition of covered payroll changed from base pay to total direct pay less overtime.

[4] Beginning July 1, 2001, includes active participants eligible for DROP.

[5] Beginning July 1, 2001, the definition of total direct pay changed from the average of the last 26 pay periods to the highest bi-

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

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

	Added to Rolls		Removed from Rolls		Rolls-End of Year			
Valuation July 1,	Number	Annual Allowances	Number	Annual Allowances	Number	Annual Allowances	% Increase in Annual Allowances	Average Annual Allowances
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1993	106	$ 2,172	64	$ 953	1,419	$ 27,286	7.1%	$ 19,229
1994	107	2,425	48	847	1,478	29,464	8.0%	19,935
1995	893	19,109	36	602	2,335	48,624	65.0%	20,824
1996 *	182	3,481	29	618	2,488	52,772	8.5%	21,211
1998	159	3,483	28	589	2,619	63,957	21.2%	24,420
1999	150	3,770	46	1,001	2,723	70,432	10.1%	25,866
2000	233	6,421	36	857	2,920	76,401	8.5%	26,165
2001 **	131	3,755	1,250	33,892	1,801	54,006	(29.3%)	29,987
2002	104	2,809	46	1,113	1,859	55,013	1.9%	29,593
2003	106	2,967	47	1,109	1,918	61,531	11.8%	32,081
2004	220	9,172	33	1,014	2,105	70,307	14.3%	33,400
2005	353	15,962	55	1,776	2,403	86,933	23.6%	36,177
2006	254	10,195	66	2,197	2,549	96,812	11.4%	37,980
2007	175	8,056	49	1,809	2,717	105,481	9.0%	38,823
2008	149	11,889	57	1,995	2,809	115,375	9.4%	41,073
2009	154	9,639	63	2,275	2,900	122,738	6.4%	42,324
2010	165	8,891	56	2,355	3,009	129,274	5.3%	42,963
2011	171	10,567	59	2,218	3,121	137,623	6.5%	44,096

* 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

	July 1, 2011	July 1, 2010	July 1, 2009
	(1)	(2)	(3)
1. Active members			
a. Number	5,312	5,347	5,245
b. Number in DROP	1,728	1,740	1,728
c. Total payroll ($000)	$ 388,409,256	$ 377,778,615	$ 366,924,317
Payroll in DROP ($000)	$ 147,732,433	$145,454,000	$ 141,783,378
d. Average salary	73,119	70,652	69,957
e. Average age	42.3	41.9	41.8
f. Average service	15.7	15.3	15.4
2. Inactive participants			
a. Vested	33	24	22
b. Total annual benefits (deferred)	$ 898,045	$ 601,844	$ 551,186
c. Average annual benefit	27,213	25,077	25,054
3. Service retirees			
a. Number	2,378	2,290	2,200
b. Total annual benefits	$ 108,763,539	$ 102,021,476	$ 95,152,334
c. Average annual benefit	45,737	44,551	43,251
d. Average age	63.3	62.9	62.5
4. Disabled retirees			
a. Number	144	140	131
b. Total annual benefits	$ 5,774,687	$ 5,489,800	$ 4,934,979
c. Average annual benefit	40,102	39,213	37,672
d. Average age	53.3	52.6	51.9
5. Beneficiaries and spouses			
a. Number	566	555	547
b. Total annual benefits	$ 22,186,944	$ 21,161,225	$ 22,099,785
c. Average annual benefit	39,200	38,128	40,402
d. Average age	68.3	67.9	67.8

Summary of Actuarial Assumptions and Methods

The following methods and assumptions were used in preparing the July 1, 2011 actuarial valuation report.

1. Valuation Date

   The valuation date is as of July 1^{st} , 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

	Service	
Age	<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%

Mortality Improvement: To account for future mortality improvement, the tables for healthy retiree mortality selected above were chosen so that the assumed mortality rates are smaller than the rates observed in the last experience study, covering experience for FY 2005 – FY 2009.

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 27th 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 (D R O P)

Eligibility — 20 years of service and sworn in prior to October 9, 2004.

Benefit

- After September 1, 1995 but prior to September 1, 1997 — Eligible participants may elect to participate in the DROP until they leave active service. The member's retirement pension will be calculated based on service and earnings at the time the DROP is elected.

A notional account will be maintained for each DROP participant. This account will be credited with the following amounts while the member is participant of the DROP:

– The member's monthly retirement pension, including applicable cost-of-living adjustments,

– The member's contribution to the Pension System, and

– Investment earnings/losses at the rate of the Pension System's earnings/losses averaged over a five-year period. Effective July 1, 2001, this rate is subject to a minimum of 0%.

A benefit equal to the DROP account balance is paid at the time the member leaves active service. The payment is made as a single lump sum.

If a DROP participant suffers an on-duty disability resulting in the inability to perform his/her usual and customary duties as a police officer or dies in the line of duty, he (or his survivors) are allowed to revoke the DROP election and to receive the more generous on-duty disability or death benefits.

- After September 1, 1997 but prior to December 1, 1998

The Pension System recomputed the benefit of each person who entered the DROP before September 1, 1997. The benefit was increased in the same manner as the retiree's benefit.

- After December 1, 1998 but prior to July 1, 2001

The Pension System recomputed the benefit of each person who entered the DROP before December 1, 1998. The benefit was recalculated based on Total Direct Pay less overtime upon entry to the DROP. This recomputed benefit is effective for all payments on or after December 1, 1998.

- After July 1, 2001 but prior to October 9, 2004

The Pension System recomputed the benefit of each person who entered the DROP before July 1, 2001. The member's benefit was increased by the result of multiplying the difference between 55% and the percentage used at the time of DROP entry in computing the member's benefit for the first 20 years of service by the base salary of the member at the time of DROP entry. Retroactive cost-of-living increases were applied to the increased benefit. The account balance for each participant was recomputed as if this new benefit had been effective since DROP entry.

- After October 9, 2004

A minimum of 3.00% interest will be credited to existing DROP accounts with a maximum of 7.00%. If the actuary certifies that past service costs are fully funded, the credit may be as high as 10.00%.

Benefit Recalculation	Effective July 1, 2001, monthly benefit at retirement will be recalculated to be the greater of (i) current monthly benefit, or (ii) monthly benefit based on service at DROP entry and Final Compensation at retirement date.
Back DROP Option	Effective on July 1, 2001, a back DROP option is available for all eligible participants. The DROP account is recalculated under the option based on what the account balance would have been had the participant elected the DROP earlier than he/she actually did. The initial DROP entry date cannot be backdated prior to September 1, 1995 or prior to 20 years of credited service, and must be on the first of the month selected.

Postretirement Option Plan (PROP)

Eligibility	Retired from DROP and sworn in prior to October 9, 2004.
Benefit	
▸ After November 28, 1998 but prior to July 1, 2001	A retired member is allowed to leave all or a portion of their DROP account in the System. These accounts are credited every calendar year with the 30-year Treasury bond rate as of June of the preceding year.
▸ After July 1, 2001	The interest rate earned on PROP accounts will be the same as the interest rate credited to DROP accounts, including a minimum credited rate of 0%.

Partial Lump Sum Optional Payment (PLOP)

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

Disability Retirement

Eligibility	Effective July 1, 2001, participant partially or totally disabled is eligible for Disability Retirement as defined below: – Total: Disability is defined as “unable to perform his/her usual and customary duties as a police officer”. – Partial: Disability is an impairment which renders the participant unable to work as a police officer and which is expected to last 12 months.

Benefit	
▸ Duty-connected	Total: The service retirement benefit accrued to date of disability (or 20 years, if greater). Partial: 35% of final compensation is payable for life or as long as he remains incapacitated.
▸ Not duty-connected	Total or partial: The disability benefit is 2.75% of final compensation times years of service up to 20, minimum 27.5% of final compensation.
Additional Benefits	For participants before October 9, 2004, an education allowance equal to 100% of final compensation less disability benefit is payable for up to four years for off-duty or duty-related disability. Proportionate members injured while on-duty as a municipal worker will receive immediate off-duty benefit upon Board approval.

Survivor Benefits

Eligibility	Surviving spouses and dependent children and parents of participants, including surviving spouses of retired or disabled participants who were not married at the time of retirement or disability, provided the spouse was married to the participant for at least 5 years at the time of death.
Benefit	
▸ Prior to September 1, 1997	If duty-connected: monthly lifetime benefit equal to 100% of final compensation at date of death. If not duty-connected: monthly lifetime benefit equal to 100% of the service retirement benefit the participant had accrued at the time of death. Spouse's benefit upon death after retirement: monthly lifetime benefit equal to actual benefit payable at time of death. Dependent children's benefit if no surviving spouse: the benefit that would have been payable to the spouse is divided equally among the dependent children. If there is a surviving spouse, the dependent children of Plan 1 and Plan 2 participants receive $25 per month. Dependent children include unmarried children who are under age 18, and for Plan 3, full-time students under age 22, or permanently disabled children.

	Dependent parent's income if no surviving spouse or children, but there is a dependent parent: the benefit that would have been payable to the spouse will be paid to the dependent parent.
‣ After September 1, 1997 but prior to July 1, 2001	The Pension System recomputed the benefit of each survivor whose original benefit was computed prior to September 1, 1997. The benefit was increased in the same manner as the retiree's benefit.
‣ After July 1, 2001	The Pension System recomputed the benefit of each survivor whose original benefit was computed prior to July 1, 2001. The benefit was increased in the same manner as the retiree's benefit.
Additional Benefits	Effective December 1, 1998, a $5,000 lump sum is paid upon the death of an active member who was sworn in prior to October 9, 2004.
	Effective July 1, 2001, an extra monthly benefit of $150.00 is payable for life. Children receiving equivalent of the spouse's benefit do not receive this additional benefit.

Benefit Adjustments

Cost-of-Living	
‣ Prior to October 9, 2004	Monthly benefits for participants receiving payments are increased each April 1 by 2/3 of the increase in the Consumer Price Index for All Urban Consumers (CPI-U) for the preceding calendar year. Effective September 1, 1997 this increase is subject to a minimum of 3.0% per year compounded and a maximum increase of 8.0% per year compounded.
‣ After October 9, 2004	Monthly benefits for participants receiving payments are increased each April 1 by 80% of the increase in the Consumer Price Index for All Urban Consumers (CPI-U) for the preceding year, with a minimum of 2.4% and a maximum of 8%.
13th Benefit Check	Effective November 28, 1998, a 13th benefit check is paid to current retirees and DROP members when: – The assets on the fund equal or exceed the liabilities after the 13th benefit check is paid. – The return on investments for the preceding fiscal year exceeds 9.25%. – The payment of the benefit will not cause the City of Houston's contribution to the System to increase. – Effective October 9, 2004, the funded ratio of the plan must be at least 120% for the 13th check to be paid out.

Service Adjustments	Effective November 28, 1998, participants with previous service with the City in non-classified positions may use that service to satisfy the service requirement of 20 years for retirement purposes only. Effective July 1, 2001, participants who have service credit in more than one City of Houston Pension Plan may use their combined service to qualify for DROP participation. Effective July 1, 2001, participants involuntarily transferred to the System from the Houston Municipal Employees System will receive service under this plan for years worked while serving as a City Marshall, Airport Police or Park Police.

Contributions

Employee Contributions

‣ Prior to December 1, 1998	Each participant contributes 8.75% of base salary.
‣ After December 1, 1998 but before October 9, 2004	Each participant contributes 8.75% of average total direct pay less overtime.
‣ After October 9, 2004	
– Members sworn in prior to October 9, 2004	Each participant contributes 9.00% of pay. The additional 0.25% will be credited to the Plan's general fund.
– Others	Each participant contributes 10.25% of pay, which will be credited to the Plan's general fund.
Refunds	Refunds of contributions are made if (i) The participant dies before 10 years of service and the death is not duty-connected, (ii) The participant dies with no eligible survivor, (iii) A Plan 1 or 2 participant leaves service before eligibility for retirement after completing 5 years of service, or (iv) A Plan 3 participant leaves service with less than 20 years of service. Contributions are refunded without interest.

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

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

Beginning in Fiscal Year 2013 and continuing until the System's funded ratio is 100%, payments will increase each year by $10,000,000. For FY 2012 and FY 2013, the City may contribute $17 million and $8.5 million respectively less than required with any shortfall to be financed at an interest rate of 8.5% and made up for in FY2015. Once the System's funded ratio is 100%, the City will pay the actuarially required rate, but not less than 16% of covered pay. Therefore, a fixed payment of $103 million is to be made for FY2014 subsequent to the $83 million in FY2012 and $93 million in FY2013, with the above noted caveats.

In addition, on the first day of City Fiscal Year 2012, once the Funded Ratio reaches 80%, if it should ever be subsequently determined that the Funded Ratio has declined below such 80%, then the City Fiscal Year next following such determination, the City shall pay such additional amounts to HPOPS as necessary to increase the Funded Ratio to 80%.

Changes in Plan Provisions from Since the Prior Valuation

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

SECTION FIVE

STATISTICAL SECTION

Summary

This 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 89 shows the additions and deductions from plan net assets and the resulting changes in plan net assets for the ten years ending June 30, 2012. Contributions from members and the City have grown steadily during this time, doubling in amount, but the System's investment income, even with a loss in 2009, provides the most impact on additions to plan net assets. Deductions from plan net assets are primarily for benefits paid to members, which have almost tripled during this ten year period.

City and member contributions to the System are external sources of the additions to plan net assets. **Contribution Rates** on page 90 show what percent the City's and the members' contributions are of payroll for the ten years ending June 30, 2012. The accompanying chart of **Contributions and Benefits Paid** compares the total contributions made and the benefits paid for the ten years ending June 30, 2012. 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 91 provides details of the System's net investment gain/loss for the ten years ending June 30, 2012.

Deductions from Net Assets for Benefits and Refunds by Type on page 92 presents a detailed view of the benefits paid to members and refunds for the ten years ending June 30, 2012, and the chart on page 93 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 94, **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 95 provides a breakdown of the plan membership for the ten years ending June 30, 2012. For fiscal year 2012, active members increased by 19 to 5,330, retired members and their beneficiaries increased by 120, and terminated vested members decreased by one.

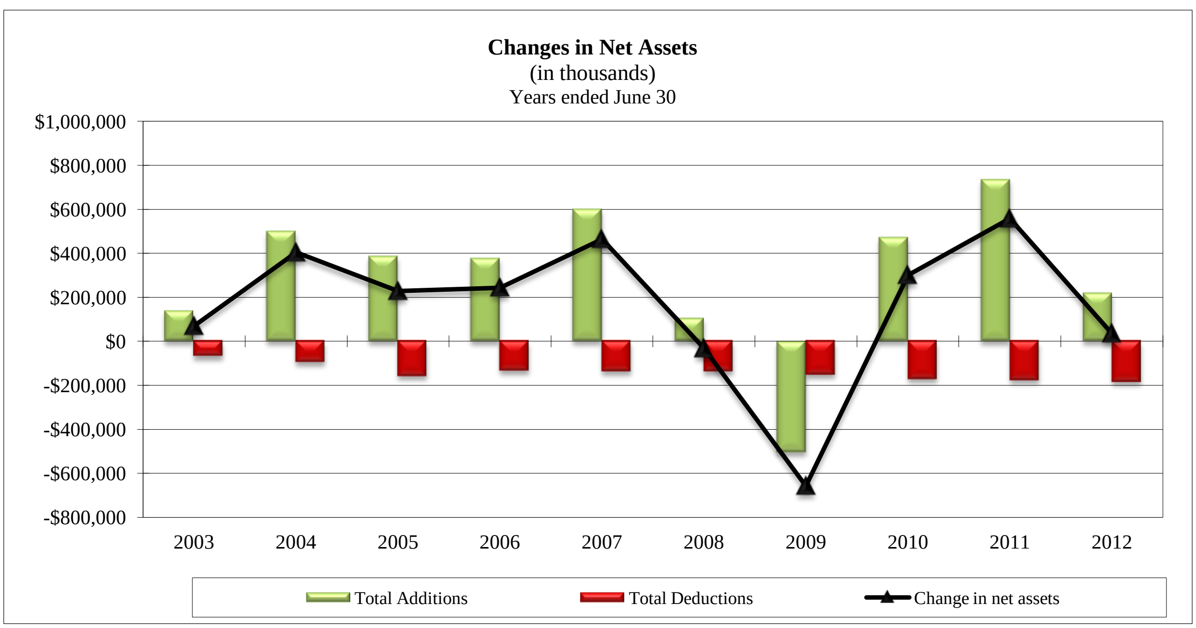
Operating Information

The **Pensions in Force** and **Pensions Awarded** schedules on page 96 provide the number of pensions by type, age and payment amount. The **Average Monthly Benefit Amounts by Years Credited Service** on page 97 presents the average final average salary and the number of retired members, in five-year increments of credited service, for the nine years ended June 30, 2012. The **DROP and PROP Activity** schedules on page 98 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, 2012.

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

Fiscal Year	2003	2004	2005	2006	2007
Additions					
City contributions	$ 34,645	$ 36,645	$ 37,125	$ 53,068	$ 58,000
Members contributions	24,008	26,393	28,410	28,863	29,489
Investment income (net of expenses)	80,202	437,007	320,561	294,966	512,873
Securities lending income (net of expenses)	583	741	876	1,101	1,239
Total additions to plan net assets	139,438	500,786	386,972	377,998	601,601
Deductions:					
Benefits paid to members	65,649	92,697	153,861	130,443	133,351
Refunds to members	992	852	1,198	700	739
Professional and administrative expense	2,746	2,768	3,473	2,958	2,950
Total deductions from plan net assets	69,387	96,317	158,532	134,101	137,040
Change in net assets	$ 70,051	$ 404,469	$ 228,440	$ 243,897	$ 464,561

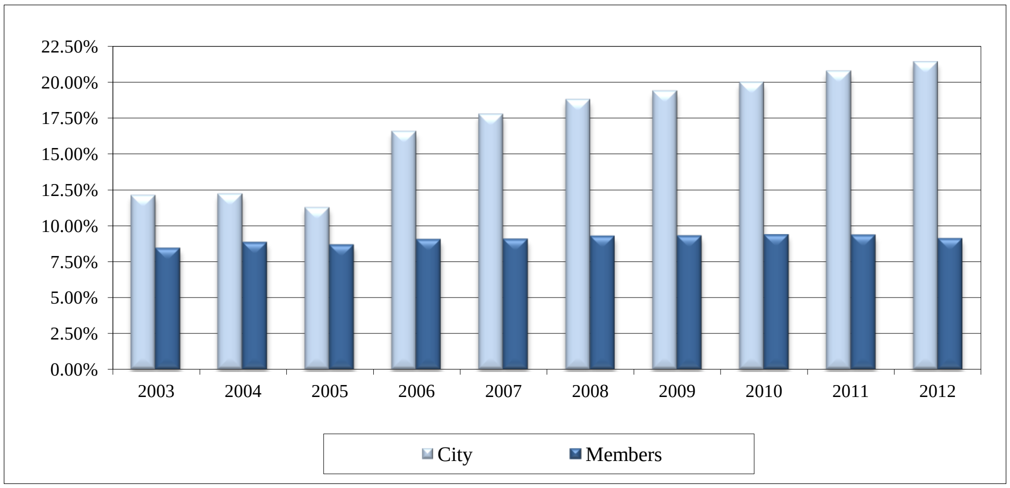
Fiscal Year	2008	2009	2010	2011	2012
Additions					
City contributions	$ 63,000	$ 68,000	$ 73,192	$ 78,287	$ 83,027
Members contributions	31,003	32,519	34,218	35,122	35,151
Investment income (net of expenses)	9,350	(607,482)	364,650	621,557	102,095
Securities lending income (net of expenses)	2,392	1,427	473	449	485
Total additions to plan net assets	105,745	(505,536)	472,533	735,415	220,758
Deductions:					
Benefits paid to members	133,049	144,112	161,735	172,041	180,014
Refunds to members	500	618	547	420	704
Professional and administrative expense	3,564	7,311	8,945	4,364	3,689
Total deductions from plan net assets	137,113	152,041	171,227	176,825	184,407
Change in net assets	$ (31,368)	$ (657,577)	$ 301,306	$ 558,590	$ 36,351

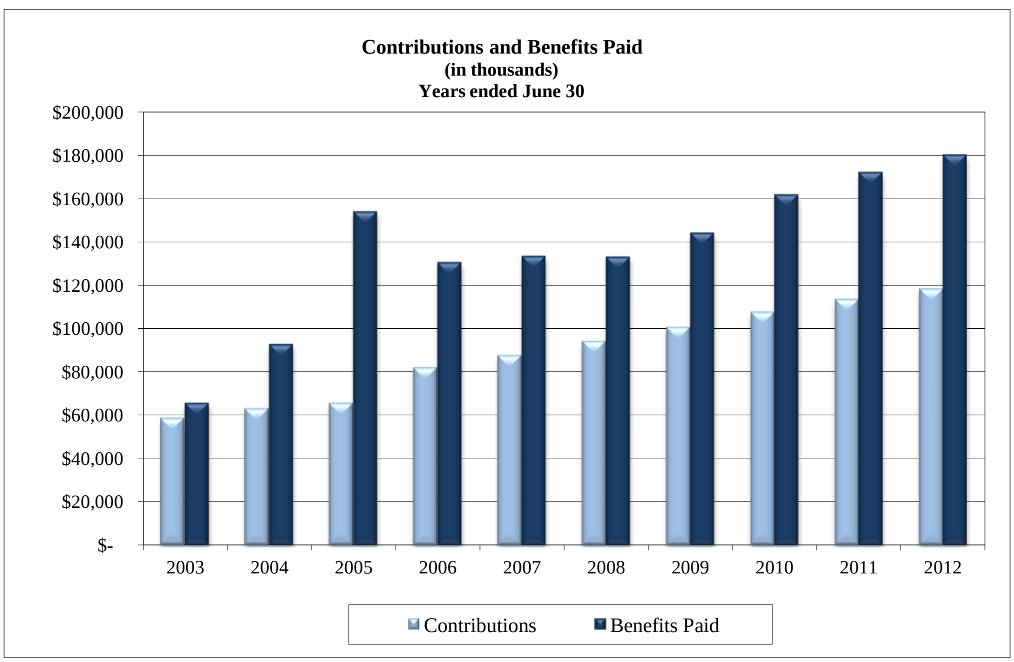


Contribution Rates

Previous Ten Fiscal Years

	Percent of Payroll	
Fiscal Year	City	Members
2003	12.11%	8.39%
2004	12.20%	8.79%
2005	11.26%	8.61%
2006	16.53%	8.99%
2007	17.73%	9.02%
2008	18.75%	9.23%
2009	19.34%	9.25%
2010	19.95%	9.33%
2011	20.72%	9.30%
2012	21.38%	9.05%





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

Fiscal Year	2003	2004	2005	2006	2007
Investing activities					
Net appreciation (depreciation) in fair value of investments	$ 37,084	$ 401,591	$ 275,205	$ 256,825	$ 459,957
Interest	35,918	29,477	35,006	30,201	38,304
Dividends	12,659	15,897	26,314	21,926	27,581
Alternative investments [(1)]	1,606	1,598			
Other income	306	333	282	157	147
Total	87,573	448,896	336,807	309,109	525,989
Less investment expense	(7,371)	(11,889)	(16,246)	(14,143)	(13,116)
Net income (loss) from investing activities	80,202	437,007	320,561	294,966	512,873
Securities lending activities					
Securities lending income	914	1,153	1,332	1,478	1,652
Securities lending expense	(331)	(412)	(456)	(377)	(413)
Net income from securities lending activities	583	741	876	1,101	1,239
Total investment income (loss)	80,785	437,748	321,437	296,067	514,112

Fiscal Year	2008	2009	2010	2011	2012
Investing activities					
Net appreciation (depreciation) in fair value of investments	$ (26,749)	$ (643,053)	$ 330,724	$ 594,052	$ 53,935
Interest	34,603	31,452	30,029	31,180	47,121
Dividends	19,540	13,170	16,608	18,998	19,200
Other income	142	57	72	365	1,135
Total	27,536	(598,374)	377,433	644,595	121,391
Less investment expense	(18,186)	(9,108)	(12,783)	(23,038)	(19,296)
Net income (loss) from investing activities	9,350	(607,482)	364,650	621,557	102,095
Securities lending activities					
Securities lending income	3,189	1,903	631	599	646
Securities lending expense	(797)	(476)	(158)	(150)	(161)
Net income from securities lending activities	2,392	1,427	473	449	485
Total investment income (loss)	$ 11,742	$ (606,055)	$ 365,123	$ 622,006	$ 102,580

(1) Income reported under alternative investments for 2003 - 2004 consists of distributions from private equity partnership investments of the System. These private equity partnerships use various methods to invest in private companies, usually loans or an equity investment. Distributions from these partnerships represent interest earned on loans, stock distributions or returns on equity investments. Prior to fiscal year 2005, the income portion of these distributions were recorded as income from alternative investments. Starting in fiscal year 2005, this income was reclassified to interest or dividends according to the nature of the underlying investment.

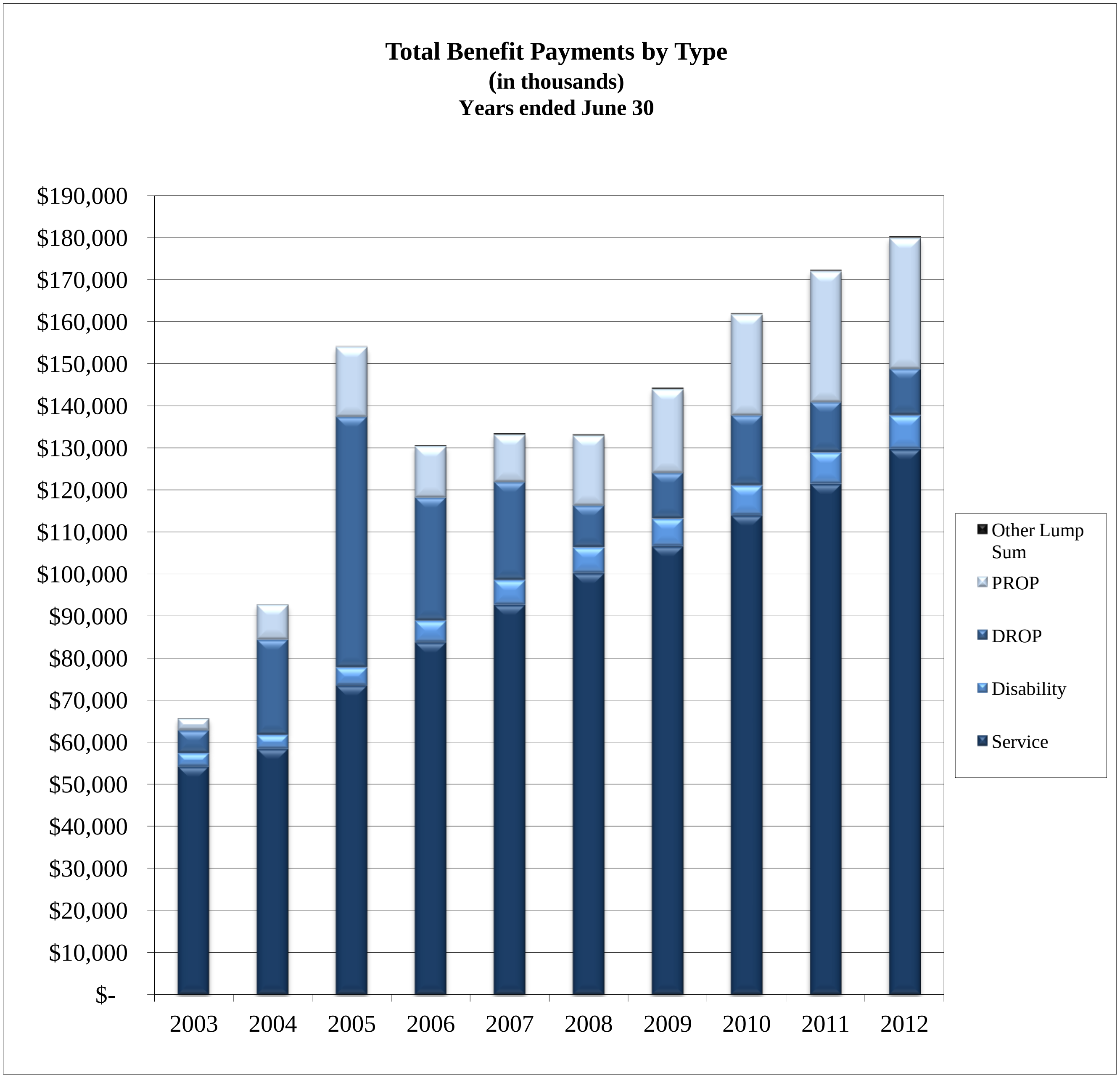
Deductions from Net Assets for Benefits and Refunds by Type
Previous Ten Fiscal Years
($000's)

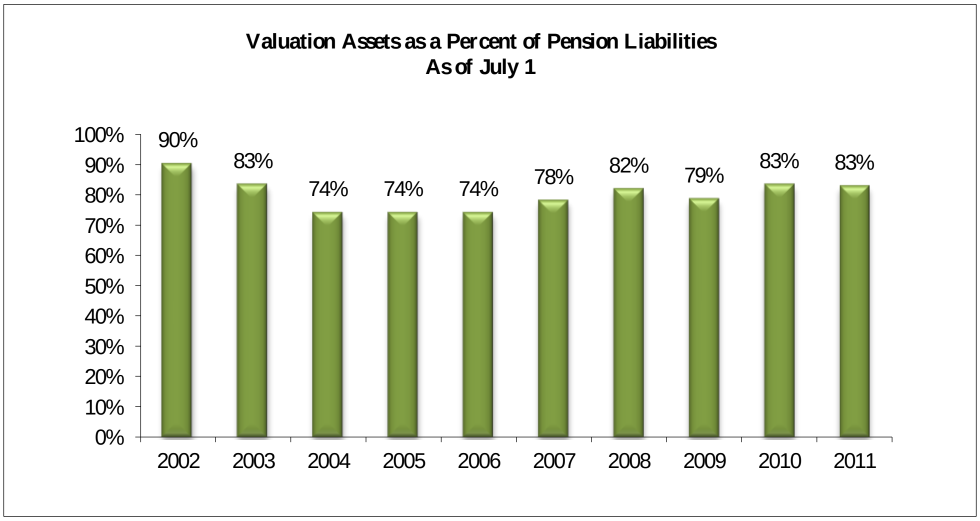
Fiscal Year	2003	2004	2005	2006	2007
Type of Benefit					
Service					
Retirees	$ 42,566	$ 45,912	$ 59,709	$ 69,074	$ 77,639
Survivors	11,640	12,466	13,733	14,612	14,965
Disability					
Retirees - duty	1,646	1,787	2,604	3,378	4,003
Retirees - nonduty	323	313	358	347	313
Survivors	1,178	1,238	1,310	1,364	1,517
Lump Sum					
DROP distributions	5,441	22,603	59,493	29,272	23,315
PROP distributions	2,815	8,352	16,649	12,233	11,303
Other *	40	25	5	163	296
Total benefits	$ 65,649	$ 92,697	$ 153,861	$ 130,443	$ 133,351
Type of Refund					
Death	$ 20	$ -	$ -	$ -	$ -
Separation	972	852	1,198	700	739
Total refunds	$ 992	$ 852	$ 1,198	$ 700	$ 739

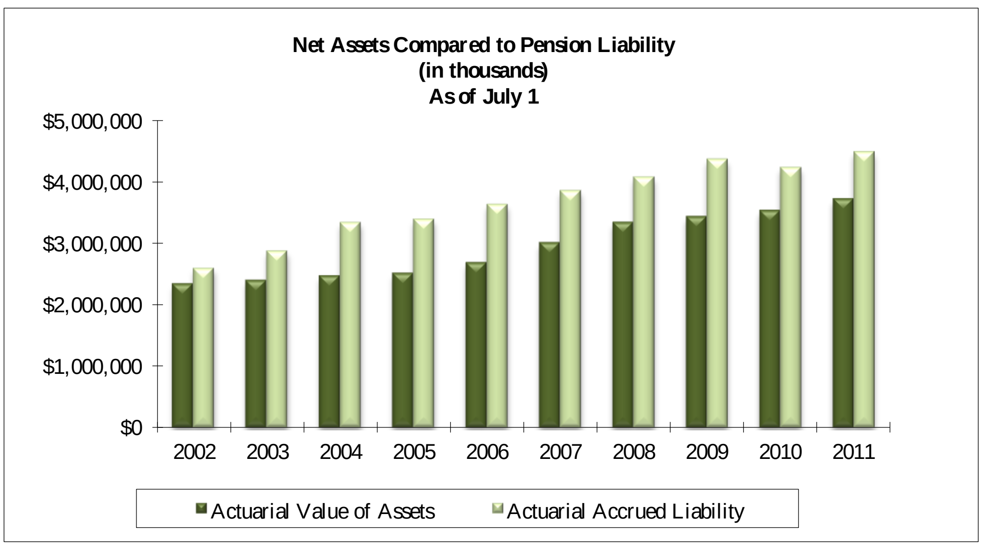
Fiscal Year	2008	2009	2010	2011	2012
Type of Benefit					
Service					
Retirees	$ 83,925	$ 89,226	$ 95,198	$ 101,854	$ 108,886
Survivors	16,203	17,291	18,612	19,425	20,694
Disability					
Retirees - duty	4,154	4,334	4,675	4,989	5,218
Retirees - nonduty	371	444	516	493	538
Survivors	1,531	1,715	1,868	1,960	2,147
Lump Sum					
DROP distributions	9,937	10,889	16,682	11,941	11,078
PROP distributions	16,680	19,922	24,035	31,125	31,180
Other *	248	291	149	254	273
Total benefits	$ 133,049	$ 144,112	$ 161,735	$ 172,041	$ 180,014
Type of Refund					
Death	$ -	$ 3	$ -	$ -	$ -
Separation	500	615	547	420	704
Total refunds	$ 500	$ 618	$ 547	$ 420	$ 704

* 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
$190,000
$180,000
$170,000
$160,000
$150,000
$140,000
$130,000
$120,000
$110,000
$100,000
$90,000
$80,000
$70,000
$60,000
$50,000
$40,000
$30,000
$20,000
$10,000
$-
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
Other Lump Sum
PROP
DROP
Disability
Service

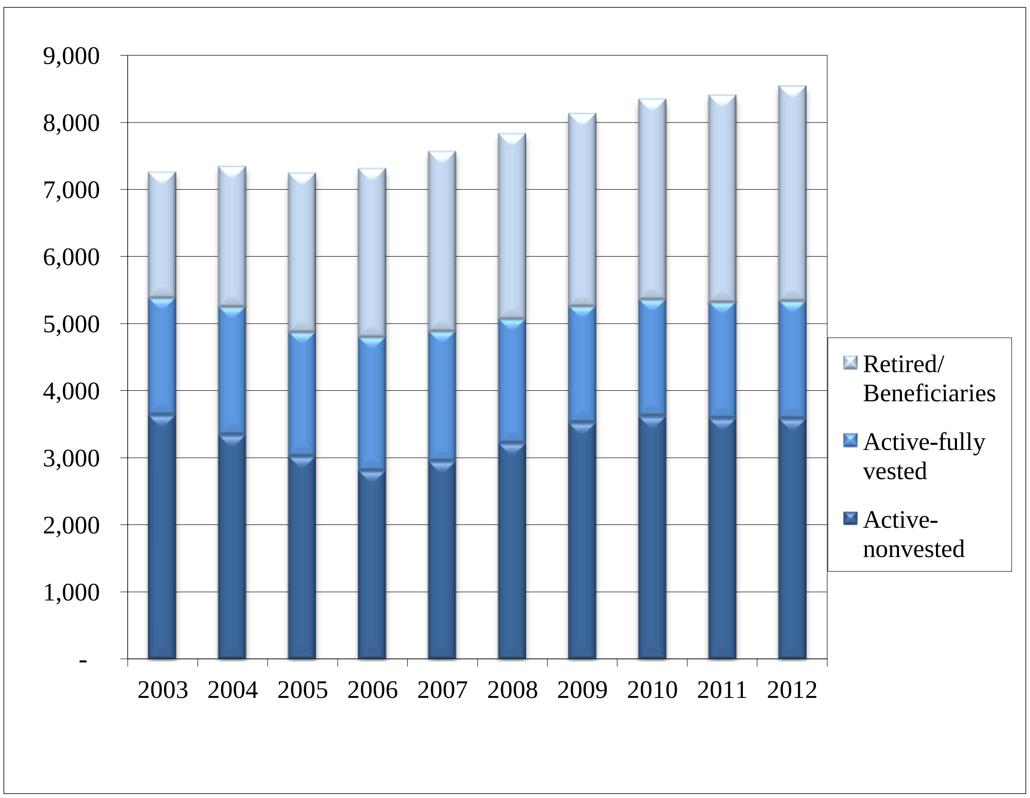




Charts through most recent actuarial valuation dated July 1, 2011.

Membership
Last Ten Fiscal Years

	Active		Retired/	Terminated	
Fiscal Year	Nonvested	Fully Vested	Beneficiaries	Vested	Totals
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
2012	3,572	1,758	3,207	22	8,559



Total Pensions in Force by Type and by Age
Year Ended June 30, 2012

		Type of Pension		
Age on June 30,	Total	Service	Disability	Survivor
Under 40	33	-	11	22
40-44	29	3	17	9
45-49	129	81	30	18
50-54	374	315	28	31
55-59	577	508	23	46
60-64	731	637	21	73
65-69	493	410	8	75
70-74	310	219	5	86
75-79	278	190	3	85
80-84	148	85		63
85 and over	105	36	1	68
Total	3,207	2,484	147	576

Pensions Awarded in Current Year by Type and by Age
Year Ended June 30, 2012

		Type of Pension		
Age on June 30,	Total	Service	Disability	Survivor
Under 40	2	-	1	1
40-44	5	2	2	1
45-49	26	23	1	2
50-54	50	49	-	1
55-59	44	41	1	2
60-64	24	19	-	5
65-69	9	3	-	6
70-74	7	1	-	6
75-79	6	-	-	6
80-85	1	-	-	1
85 and over	2	1	-	1
Total	176	139	5	32

Pensions Awarded in Current Year by Type and by Monthly Amount
Year Ended June 30, 2012

		Type of Pension		
Monthly Amount	Total	Service	Disability	Survivor
Under $1000	3	2	1	-
$1000-$2000	5	3	-	2
$2000-$3000	14	5	2	7
$3000-$4000	89	75	1	13
$4000-$5000	46	38	1	7
$5000-$6000	13	11	-	2
$6000 and over	6	5	-	1
Total	176	139	5	32

Average Monthly Benefit Amounts
Previous Nine Fiscal Years

Member Retiring During Fiscal Years		Years Credited Service <5	5-10	10-15	15-20	20-25	25-30	30-35	35-40	40-45	>45	All Members
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
2012	Avg monthly benefit	$ 972	$ 4,489	$ -	$ 2,605	$ 3,681	$ 4,011	$ 3,696	$ 4,148	$ 4,008	$ 5,642	$ 3,908
	Avg final Avg salary	$ 4,320	$ 4,489	$ -	$ 5,920	$ 6,606	$ 6,844	$ 6,663	$ 7,047	$ 6,047	$ 5,961	$ 6,726
	Avg DROP Balance	$ -	$ -	$ -	$ -	$146,704	$466,282	$729,916	$1,066,076	$1,179,404	$1,536,548	$584,831
	Number of retirees	1	1	-	1	17	70	33	15	3	2	143
Nine Years Ended June 30, 2012												
	Avg Monthly Benefit	$ 1,827	$ 2,065	$ 2,481	$ 3,061	$ 3,357	$ 3,638	$ 3,719	$ 4,302	$ 4,483	$ 5,214	$ 3,630
	Avg Final Avg Salary	$ 4,006	$ 4,055	$ 4,763	$ 5,484	$ 5,686	$ 6,112	$ 6,347	$ 6,555	$ 6,039	$ 5,800	$ 6,103
	Avg DROP Balance	$ 1,667	$ 4,768	$ 5,000	$ 15,958	$125,137	$404,055	$617,626	$ 791,015	$ 841,884	$1,007,422	$422,171
	Number of Retirees	3	21	23	23	375	497	373	160	27	7	1,509

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

DROP Activity
(dollars in thousands)
Years ended June 30

	DROP Accounts			DROP Participants		
Fiscal Year	Accumulations	Distributions	Total	Entrants	Withdrawals	Total
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	128	(112)	1,743
2012	66,898	(11,078)	819,967	148	(129)	1,762

PROP Activity
(dollars in thousands)
Years ended June 30

	PROP Accounts			PROP Participants		
Fiscal Year	Accumulations	Distributions	Total	Entrants	Withdrawals	Total
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	115	(29)	859
2012	98,886	(31,180)	441,137	144	(23)	980

HPOPS

FOR TODAY & TOMORROW

LIFE CYCLE PLANNING

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