HPOPS

FOR TODAY & TOMORROW

Comprehensive Annual

Financial Report

A Component Unit of

The City of Houston, Texas

July 1, 2007 through

June 30, 2008

HOUSTON POLICE OFFICERS' PENSION SYSTEM
John E. Lawson, Executive Director
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HPOPS

FOR TODAY & TOMORROW

SECTION ONE

INTRODUCTORY SECTION

December 5, 2008

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, 2008 is submitted herewith. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, rests with the management of the System. This CAFR is divided into five sections:

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

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

The System was established in 1947, funded by a $100,000 Treasury note, and offered retiring members a pension of $75 per month. Today, the System has investments of $3.4 billion and offers a variety of pension benefits to members and their beneficiaries. Members have the option to defer their benefits, take a proportionate retirement benefit, or retire under a regular service retirement. Members also may access a disability retirement, either duty or non-duty connected.

Major Initiatives

The System 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 to discuss any 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 used by many members.

The System's staff is currently engaged in a project to update and enhance the technology and infrastructure used to administer the System. This includes updating multiple internal systems for managing electronic document, workflow and benefits calculations. These upgrades will not just provide HPOPS with new tools to administer the System, but they are being implemented in a way to gain efficiencies and improve reliability and backups. The use of technology will enable HPOPS to provide a higher level of service to members, which includes additional functions and features through the member area of the System Web site.

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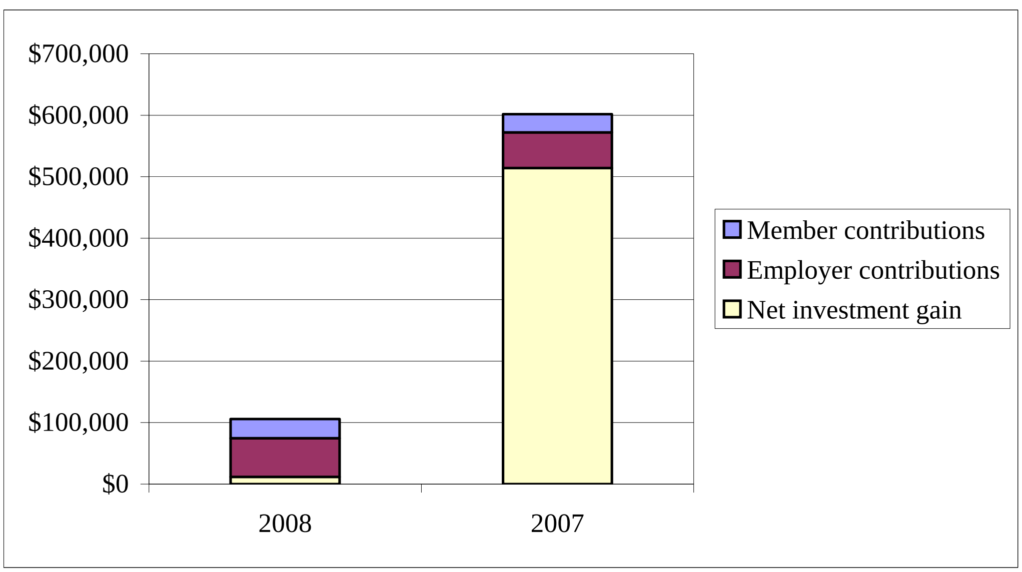
Additions to Plan Net Assets

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 2008 to be $5 million over the $58 million the City contributed in fiscal year 2007 and increases by $5 million over that amount for fiscal 2009. The number of active members increased in fiscal year 2008 compared to 2007 due to new hires to the Houston Police Department (HPD). Contributions from members increased in fiscal 2008 along with the increase in active members. The System experienced a positive investment return of 0.3% in 2008, which was a decrease from the positive return of 17.9% in 2007. This decrease is primarily due to a down turn in performance of both domestic and international equity markets during the last quarter of fiscal year 2008 brought on by instability in the credit markets and resulting investor concerns over the slowing economy.

Active members:	2008	2007	Increase (Decrease)
Fully vested	1,849	1,940	(91)
Nonvested:			
Hired or rehired before October 9, 2004	2,458	2,495	(37)
Hired or rehired after October 9, 2004	753	447	306
	5,060	4,882	178

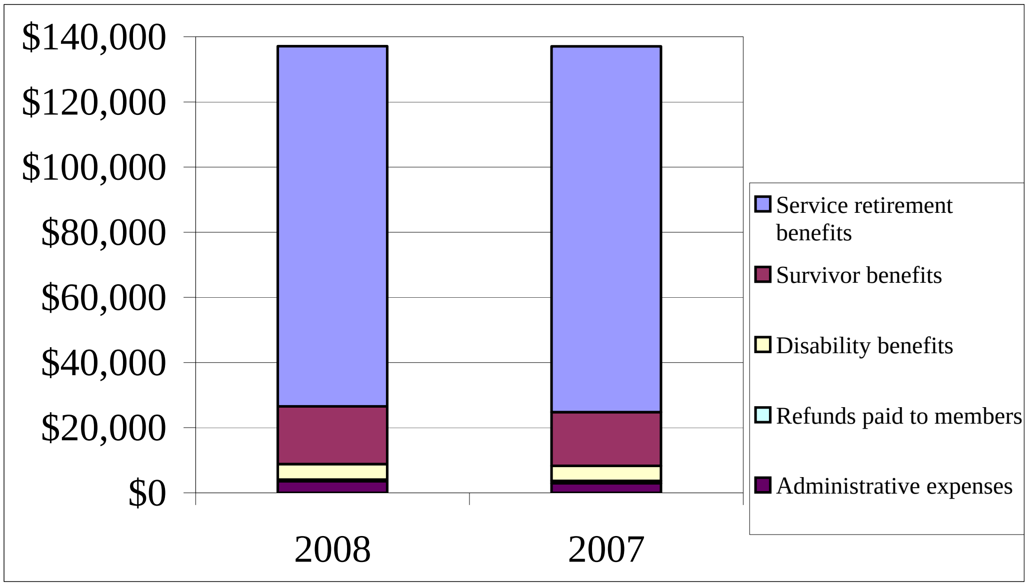
	$000's		Increase	Increase
	2008	2007	(Decrease)	(Decrease)
Member contributions	$ 31,003	$ 29,489	$ 1,514	5%
Employer contributions	63,000	58,000	5,000	9%
Net investment gain	11,742	514,112	(502,370)	-98%
Total	$ 105,745	$ 601,601	$ (495,856)	-82%



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 61 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 2008	$000's 2007	Increase (Decrease) Amount	Increase (Decrease) Percentage
Service retirement benefits	$ 110,542	$ 112,257	$ (1,715)	(1.5%)
Survivor benefits	17,734	16,482	1,252	7.6%
Disability benefits	4,773	4,612	161	3.5%
Refunds paid to members	500	739	(239)	(32.3%)
Administrative expenses	3,564	2,950	614	20.8%
Total	$ 137,113	$ 137,040	$ 73	0.1%

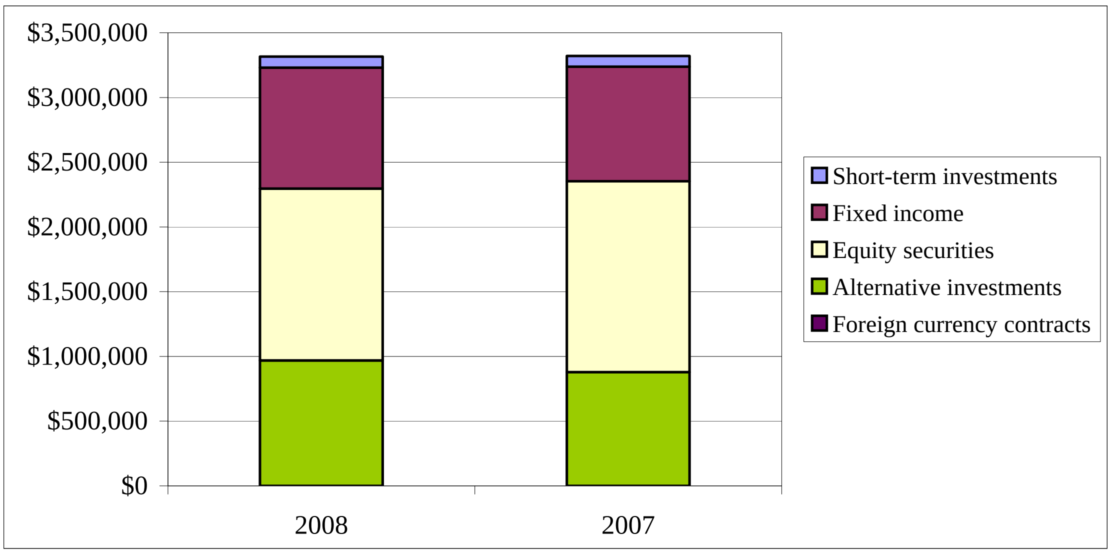


Total benefits paid, which include lump sum payments, increased in 2008 as compared to 2007 due mainly to the cost of living increase and an increase in the number of retirees. Administrative expenses increased mainly due to expense for the planned development of the System's enterprise software system. For further information regarding the System's financial condition, refer to Managements Discussion and Analysis in the financial section of this report.

Investments

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

	$000's 2008		$000's 2007		Increase (Decrease) Amount	Increase (Decrease) Percentage
Short-term investments	$	85,625	$	82,338	$ 3,287	4.0%
Fixed income		933,536		885,284	48,252	5.5%
Equity securities		1,327,892		1,474,702	(146,810)	(10.0%)
Alternative investments		968,618		877,750	90,868	10.4%
Foreign currency contracts		-		416	(416)	(100.0%)
Total	$	3,315,671	$	3,320,490	$ (4,819)	0%



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

The past year saw volatility in the performance of both the domestic and international equities markets, especially in the last quarter of the year. During our fiscal year, the System was able to outperform the financial markets in domestic equities and in fixed income, and on a total fund basis we outperformed our benchmark by 0.6%. The Board firmly believes that by maintaining a disciplined investment approach and with reasonable diversification, the System will meet its long-term investment goals. Further details regarding the System's investments are included in the investment section of this report.

Accounting System and Internal Controls

The financial statements and related information included in the financial section of this report are the responsibility of the Board of Trustees and management of the System. The financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) and presented in accordance with guidance provided by applicable statements issued by the Governmental Accounting Standards Board (GASB). The System's independent auditors have audited the financial statements, and their report is included herein.

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

Funding

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

The most recent actuarial valuation shows the funded position of the System at July 1, 2007 increased from the funding level at July 1, 2006. The actuarial accrued liability increased $224 million and the actuarial value of assets increased $323 million. As a result, the System's Unfunded Actuarial Accrued Liability decreased $99 million to $852 million as of July 1, 2007. The increase in the Unfunded Actuarial Accrued Liability is due to a combination of factors including actuarial gains from liability sources and the recognition of prior asset gains 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.

Professional Services

The Board of Trustees appoints professional consultants to perform services that are considered essential for the operation of the System. The independent auditor's report, issued by BDO Seidman, LLP, is included on page 17 of this report. The actuarial report, certified by Towers Perrin, is included on page 58. Professional service providers engaged by the System are listed in the following table.

Consulting

Abbott Capital Management
Hammond Associates

Custodian

The Northern Trust Company

Actuarial

Towers Perrin

Auditing

BDO Seidman, LLP
Bickley Prescott & Co.

Legal Service

Gibbs & Bruns, LLP
Godwin Pappas Langley Ronquillo, LLP

Money Management

Arnhold & S. Bleichroeder
Ashmore Investment Management Ltd.
Barclays Global Investors
Brandes Investment Partners
Bridgewater Associates, Inc.
Causeway Capital Management
The Clifton Group
Driehaus Capital Management, Inc.
MacKay-Shields Financial Corp.
NWQ Investment Management Company
Shenkman Capital Management, Inc.
State Street Global Advisors *

Legal Service/Lobbyists

HillCo Partners, LLC
Locke Liddell Sapp

* Services were terminated December 13, 2007

Certificate of Achievement

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Houston Police Officers' Pension System for its comprehensive annual financial report for the fiscal year ended June 30, 2007. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of state and local government financial reports.

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

A Certificate of Achievement is valid for a period of one year only. The System has received a Certificate of Achievement for the last 14 consecutive years (fiscal years 1994-2007). We believe our current report continues to conform to the Certificate of Achievement program requirements, and we will be submitting it to the GFOA.

Acknowledgements

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

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

Sincerely,

Board of Trustees

Board of Trustees

December 5, 2008

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 2008 Comprehensive Annual Financial Report (CAFR). The CAFR provides a comprehensive picture of HPOPS' finances for the fiscal year ending June 30, 2008, as well as an overview of the year's highlights.

While the fiscal year ended with volatility in financial markets, this report demonstrates that HPOPS continues to manage the System's assets responsibly. HPOPS was able to obtain a positive 0.3% investment return in spite of the dramatic changes to the investment landscape. We at HPOPS continue to plan for the future of all of our current members as well as those members to come. We encourage you to read on to learn more about HPOPS.

Sincerely,

J. Larry Doss
Chairman

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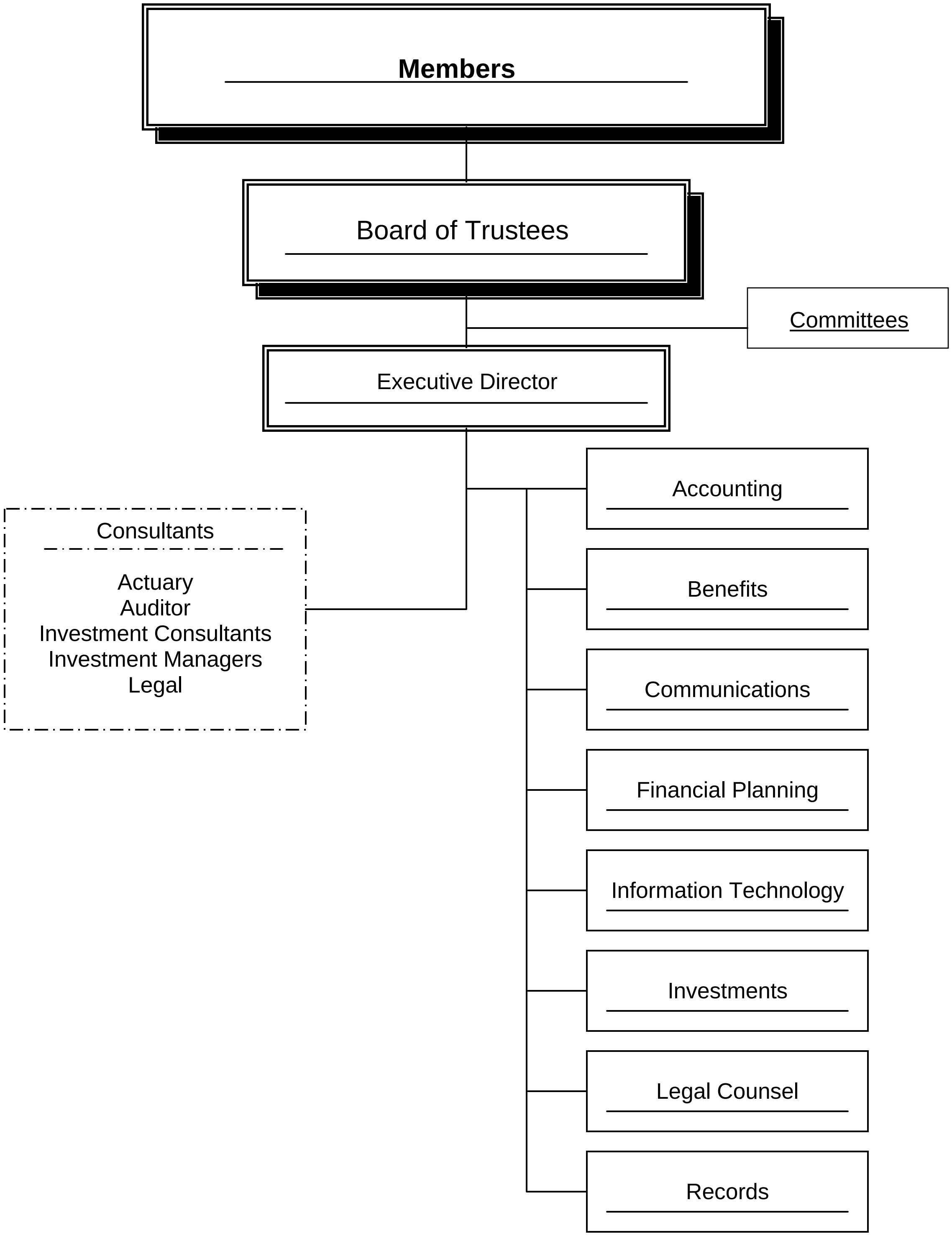
BOARD OF TRUSTEES AND ADMINISTRATIVE STAFF

ORGANIZATION CHART



See Page 43 – 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, 2007

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

President

Executive Director

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SECTION TWO

FINANCIAL SECTION

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BDO Seidman, LLP
Accountants and Consultants

333 Clay St., Suite 4700
Houston, Texas 77002
Telephone: 713-659-6551
Fax: 713-659-3238

Independent Auditors' Report

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

We have audited the accompanying statements of plan net assets of the Houston Police Officers' Pension System (the System) as of June 30, 2008 and 2007, 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, 2008 and 2007, and its changes in plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits of the basic financial statements were performed for the purposes of forming an opinion on those financial statements taken as a whole. The supplemental information included in Schedules I and II on pages 42 through 43, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

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

BDO Seidman, LLP

October 21, 2008
Houston, Texas

Houston Police Officers' Pension System

Management's Discussion and Analysis
Fiscal Year Ended June 30, 2008

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, 2008, 2007 and 2006. The intent of this discussion and analysis is to look at the System's financial performance as a whole; readers should review the financial statements, notes to the financial statements, required supplementary information and other schedules, in order to enhance their understanding of the System's financial performance.

Financial Statements

These financial statements consist of the Statements of Plan Net Assets, Statements of Changes in Plan Net Assets, Notes to Financial Statements and other required supplementary information. The System is a single employer contributory defined benefit pension plan. The System is a component unit of the City of Houston, Texas (the City) only to the extent the System receives contributions equal to a fixed amount or percentage of the pensionable pay of active members in accordance with Article 6243g-4, Vernon's Texas Civil Statutes, (the Governing Statute) or contracts pursuant to Section 27 thereof, and as such, its reports are included in the Fiduciary Funds of the City as restricted assets.

Financial Highlights

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

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

Years ended June 30:	**2008**	2007	2006
Assets			
Investments at fair value	**$ 3,315,671**	$ 3,320,490	$ 2,887,333
Invested securities lending collateral	**496,426**	517,637	574,793
Receivables	**38,189**	52,992	28,064
Cash	**123**	184	158
Total Assets	**3,850,409**	3,891,303	3,490,348
Liabilities			
Foreign currency contracts	**312**	-	-
Due to brokers	**23,425**	11,643	18,336
Securities lending collateral	**496,426**	517,637	574,793
Accrued investment and professional fees	**1,506**	1,952	1,766
Other liabilities	**442**	405	348
Total Liabilities	**522,111**	531,637	595,243
Plan net assets held in trust for pension benefits	**$ 3,328,298**	$ 3,359,666	$ 2,895,105

The System's net assets decreased by approximately $31,368 thousand in fiscal year 2008 over 2007 primarily due to weakening performance in both domestic and international equity markets mainly in the last quarter brought on by investor concerns over the slowing economy and credit market instability. Fixed income markets during the year saw weak gains on far less volatility, while alternative investments markets, including the commodities market, saw modest gains throughout the year only to give back some of those gains by the end of the year. The System's net assets increased by approximately $464,561 thousand in fiscal year 2007 over 2006 primarily due to strong performance in public and private equity markets. The System experienced a positive investment return of 0.3% in 2008 as opposed to positive 17.9% in 2007 and a positive return of 11.2% in 2006. These rate 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. These investment returns can be seen in the Investment income figures in the accompanying chart. Changes in receivables are primarily a result of the timing of investment transactions.

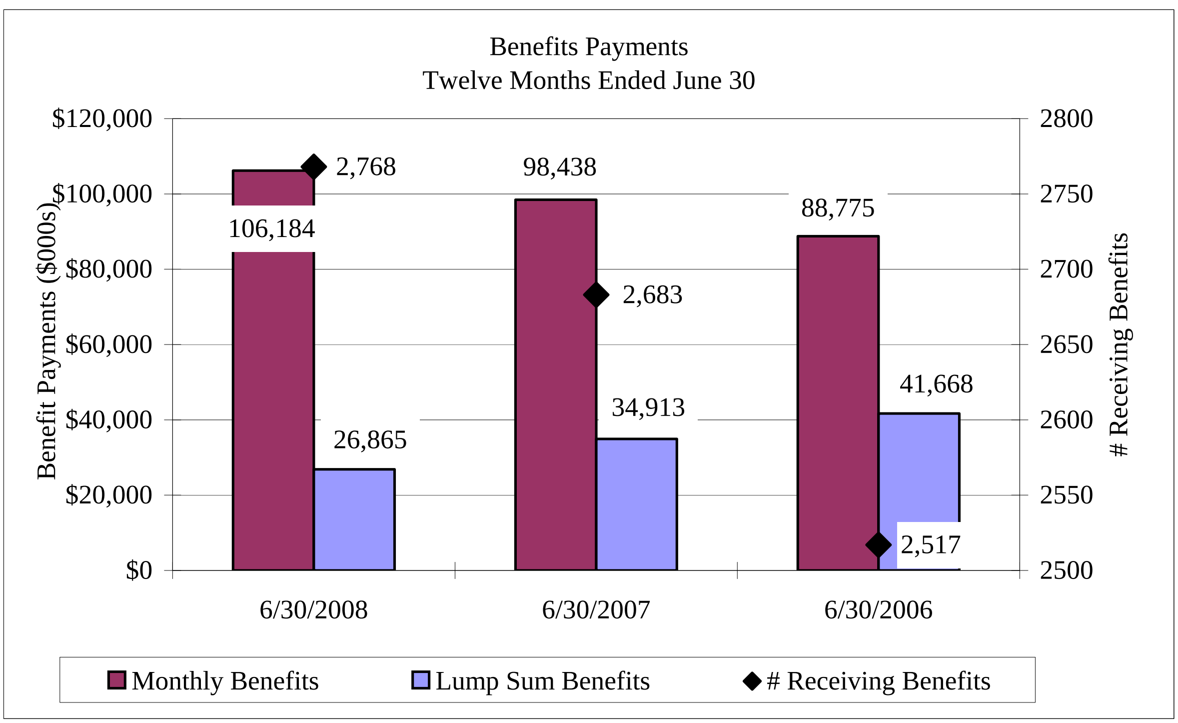
A summary of the Statements of Changes in Plan Net Assets for the System is as follows ($000's):

Years ended June 30:	**2008**	2007	2006
Contributions:			
City	**$ 63,000**	$ 58,000	$ 53,068
Members	**31,003**	29,489	28,863
Total contributions	**94,003**	87,489	81,931
Investment income	**9,350**	512,873	294,966
Net income from securities lending activities	**2,392**	1,239	1,101
Total additions	**105,745**	601,601	377,998
Deductions:			
Benefits paid to members	**133,049**	133,351	130,443
Refunds to members	**500**	739	700
Professional and administrative expense	**3,564**	2,950	2,958
Total deductions	**137,113**	137,040	134,101
Net increase (decrease)	**(31,368)**	464,561	243,897
Plan net assets held in trust for pension benefits, beginning of year	**3,359,666**	2,895,105	2,651,208
Plan net assets held in trust for pension benefits, end of year	**$ 3,328,298**	$ 3,359,666	$ 2,895,105

See accompanying independent auditors' report.

The October 9, 2004 Agreement with the City requires contribution payments for fiscal year 2008 equal to the amount contributed in 2007 of $58,000 thousand plus $5,000 thousand, resulting in contribution payments of $63,000 thousand. For fiscal year 2007, the City was contractually required to contribute an amount equal to the amount contributed in 2006 of $53,000 thousand plus $5,000 thousand, resulting in contribution payments of $58,000 thousand. These contractual provisions account for the increase in City contributions for the years ended June 30, 2008 and June 30, 2007. As discussed in Note 4, the contributions were partially paid from the proceeds of pension obligation bonds.

"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, 2008, 2007, and 2006. Total benefits paid in 2008 decreased by approximately $302 thousand or (0.2)% compared to 2007, mainly due to a decrease in lump sum benefits. Total benefits paid in 2007 increased by approximately $2,908 thousand or 2.2% compared to 2006, due mainly to the cost of living increase and an increase in the number of retirees. Average monthly benefit payments increased from approximately $8,203 thousand per month during 2007 to $8,849 thousand per month during 2008, as the number of members and survivors receiving benefits increased by 90 during this time period. Average monthly benefit payments increased from approximately $7,398 thousand per month during 2006 to $8,203 thousand per month during 2007, as the number of members and survivors receiving benefits increased by 169 during this time period.



There was an increase of $614 thousand in professional and administrative expenses during 2008 as compared 2007. This increase is mainly due to expense for the planned development of the System's enterprise software system. This project will result in a System-wide integrated software to manage all aspects of benefits administration, investment tracking, accounting and financial reporting. The project began in January 2008 and is scheduled to be completed May 2009. There was a slight decrease of $8 thousand in professional and administrative expenses during 2007 as compared to 2006 mainly as a result of operational efficiencies.

System Highlights

The System's funded ratio pursuant to its most recent actuarial valuation dated July 1, 2007 was 78% representing an unfunded actuarial accrued liability of $852,753 thousand. The System's funded ratio as of July 1, 2006 was 74% representing an unfunded actuarial accrued liability of $951,770 thousand.

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,		**2008**		2007
Assets				
Investments, at fair value (Note 2 and Note 3):				
Short term investments	**$**	**85,625**	$	82,338
Fixed income		**933,536**		885,284
Equity securities		**1,327,892**		1,474,702
Alternative investments		**968,618**		877,750
Foreign currency contracts		**-**		416
Total investments		**3,315,671**		3,320,490
Invested securities lending collateral (Note 3):		**496,426**		517,637
Receivables				
Members		**1,486**		1,235
Investments		**13,309**		17,170
Due from brokers		**23,261**		34,455
Other receivables		**133**		132
Total Receivables		**38,189**		52,992
Cash		**123**		184
Total Assets	**$**	**3,850,409**	$	3,891,303
Liabilities and Plan Net Assets				
Liabilities:				
Foreign currency contracts	**$**	**312**	$	-
Due to brokers		**23,425**		11,643
Securities lending collateral (Note 3)		**496,426**		517,637
Accrued investment and professional fees		**1,506**		1,952
Other liabilities		**442**		405
Total Liabilities		**522,111**		531,637
Plan net assets held in trust for pension benefits (see Schedule of Funding Progress, pg. 23)	**$**	**3,328,298**	$	3,359,666

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,		**2008**		2007
Contributions (Note 1 and Note 4):				
City	**$**	**63,000**	$	58,000
Members		**31,003**		29,489
Total contributions		**94,003**		87,489
Investment income:				
Net appreciation (depreciation) in fair value of investments		**(26,749)**		459,957
Interest:				
Short-term investments		**6,524**		7,722
Fixed income		**28,079**		30,582
Total interest income		**34,603**		38,304
Dividends		**19,540**		27,581
Other income		**142**		147
Total investment income		**27,536**		525,989
Less investment expense		**(18,186)**		(13,116)
Net income from investing activities		**9,350**		512,873
Securities lending activities (Note 3):				
Securities lending income		**3,189**		1,652
Securities lending expense		**(797)**		(413)
Net income from securities lending activities		**2,392**		1,239
Total additions	**$**	**105,745**	$	601,601
Deductions:				
Benefits paid to members	**$**	**133,049**	$	133,351
Refunds to members (Note 1)		**500**		739
Professional and administrative expense		**3,564**		2,950
Total deductions		**137,113**		137,040
Net increase (decrease)		**(31,368)**		464,561
Plan net assets held in trust for pension benefits, beginning of period		**3,359,666**		2,895,105
Plan net assets held in trust for pension benefits, end of period	**$**	**3,328,298**	$	3,359,666

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).

At June 30, 2008, the System's membership consisted of the following:

Description	Number
Retirees and beneficiaries:	
Currently receiving benefits	2,768
Not yet receiving benefits	16
Active members:	
Fully vested	1,849
Nonvested:	
Hired or rehired before October 9, 2004	2,458
Hired or rehired after October 9, 2004	753
Total members	7,844

The following sections describe the benefit structure in effect at June 30, 2008. On September 29, 2004 the System and the City entered into an agreement (the October 9, 2004 Agreement) that altered the benefit structure of the System. The contract has a term beginning on October 9, 2004 extending through June 30, 2017 and thereafter renews for one-year terms through June 30, 2034 unless either party terminates the agreement. The benefits described below include those for members hired or rehired on or before October 9, 2004 as well as benefits for members hired or rehired subsequent to October 9, 2004.

Eligibility – Members become eligible to receive a service pension upon retirement with twenty years of service. Members also have the option to select a Delayed Retirement, which allows for vesting after ten years of service with a pension benefit payable at age 60. 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 twenty years of service plus 2.00% of pensionable pay for each year in excess of twenty 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 twenty years of service plus 2.00% of the member's pensionable pay for each year in excess of twenty years subject to a maximum of 80%. Retired members and surviving spouses are entitled to receive an additional $150 per month in order to defray group medical insurance costs.

Pensionable Pay - Prior to October 9, 2004 pensionable pay, as referred to herein, was referred to as Average Total Direct Pay (ATDP). ATDP was calculated as the annualized highest biweekly pay received by a member in the last twelve months before retirement or entrance into DROP (see below). Biweekly pay was composed of recurring pay types such as for regular hours worked, plus, ad hoc items of pay such as certain types of overtime and certain types of shift pay. As a part of the October 9, 2004 Agreement eligible members of the System had the option until October 7, 2007 of using either a Locked-In Benefit or a Sliding Average Benefit as pensionable pay in the calculation of their retirement or DROP benefit. The Locked-In Benefit is the ATDP for the twelve months prior to October 9, 2004 and the Sliding Average Benefit is based upon ATDP for the twelve months prior to October 9, 2004 and all pay periods subsequent to that date but prior to the earlier of the member's retirement date or October 7, 2007, excluding all types of overtime pay. Members retiring after October 7, 2007 will have their retirement or DROP benefit calculated on pensionable pay, which is referred to as Final Average Pay, and is defined as the average of all pay types received by a member over the three years prior to retirement or entrance into DROP exclusive of all categories of overtime.

Deferred Retirement Option Plan – The Deferred Retirement Option Plan (DROP) provides for an optional method of accruing pension benefits. Generally, members with at least twenty 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 ten or fewer credited years of service, or 2.75% per year for credited service in excess of ten 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 ten years up to twenty years and 2.00% per year for credited service equal to or in excess of twenty years.

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

Refunds of Member Contributions – A member with less than 20 years of credited pension service may elect to obtain a refund of member contributions upon termination of service with the Houston Police Department (HPD). This refund does not include interest. Members with at least ten but less than 20 years of credited pension service, who terminate service with the HPD, have the option of a Delayed retirement. Members hired or rehired subsequent to October 9, 2004 are eligible for a refund of contributions until they attain age 55 and 10 years of service.

Delayed Retirement – A member with at least 10 but less than 20 years of credited pension service at termination of employment with the HPD has the option of either a refund of member contributions, without interest, or a Delayed Retirement benefit. The Delayed benefit is payable at age 60 and is calculated at 2.75% of pensionable pay for each year of credited pension service. Members hired or rehired subsequent to October 9, 2004 are not eligible for a Delayed Retirement.

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

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

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

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

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

2. Summary of Significant Accounting Policies

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

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

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

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

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

Federal Income Tax – A favorable determination that the System is qualified and exempt from Federal income taxes was received May 26, 2006. 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. As of June 30, 2008 and June 30, 2007, the System had a balance of $123 thousand and $184 thousand, respectively, on deposit at a financial institution. The Federal Depository Insurance Corporation (FDIC) covered cash on deposit up to $100 thousand at this financial institution. As of June 30, 2008, $23 thousand of the System's bank balance of $123 thousand was exposed to custodial credit risk. Subsequent to June 30, 2008, the federal government passed legislation that increased FDIC coverage to $250 thousand per account at this financial institution. In addition, at June 30, 2008, the System had approximately $6,417 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, 2008, the System's fixed income assets that are not government guaranteed represented 64.7% of the System's fixed income portfolio. The tables on this and the following page 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 ($000's)

Fixed Income Security Type	Market Value June 30, 2008	Percent of All Fixed Income Assets	Weighted Average Credit Quality
Corporate Bonds	$ 99,604	10.7%	B
International Government Bonds	81,876	8.8%	AA
Mutual Bond Funds	377,601	40.4%	Not Rated
Bank Loans	44,513	4.8%	B
Non-Government Backed C.M.O.s	7	0.0%	AAA
Total	$ 603,601	64.7%	

Ratings Dispersion Detail
June 30, 2008
($000's)

Credit Rating Level	Corporate Bonds	International Government Bonds	Mutual Bond Funds	Bank Loans	Non-Government Backed C.M.O.s
AAA	$ 549	$ 31,345			$ 7
AA		34,359			
A	1,268	14,261			
BBB	1,585				
BB	34,902			$ 6,326	
B	44,576			15,119	
CCC	8,409				
CC	192				
C	196				
D	109				
Not Rated	7,818	1,911	$ 377,601	23,068	
Total	$ 99,604	$ 81,876	$ 377,601	$ 44,513	$ 7

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

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

Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributable to the magnitude of the System's investment in a single issue. The System's operational guidelines 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, 2008, the System did not have any investments in any one organization which represented greater than 5% of plan net assets.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair values of the System's financial instruments. This risk is managed within the portfolio using the modified duration methodology. It is widely used in the management of fixed income portfolios and estimates the sensitivity of a bond's price to interest rate changes. 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 on this and the following 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 of Fixed Income Assets by Security Type
($000's)

Fixed Income Security Type	Market Value June 30, 2008	% of All Fixed Income Assets	Weighted Average Modified Duration (years)
US Treasuries	$ 329,935	35.3%	15.2
Corporate Bonds	99,604	10.7%	4.7
International Government Bonds	81,876	8.8%	6.4
Mutual Bond Funds	377,601	40.4%	5.0
Bank Loans	44,513	4.8%	0.0
Non-Government Backed C.M.O.'s	7	0.0%	0.2
Total	$ 933,536	100.0%	8.4

Modified Duration Analysis - Corporate Bonds, International Government Bonds, Bank Loans and Non-Government Backed C.M.O.'s ($000's)

Corporate Bonds	Market Value June 30, 2008	Average Modified Duration	Contribution Modifed Duration
Less than 1 year to maturity	$ 1,277	0.7	0.0
1 to 10 years maturities	92,704	4.5	4.2
10 to 20 years maturities	4,810	8.5	0.4
Greater than 20 years maturities	813	10.0	0.1
Total	$ 99,604		4.7
International Government Bonds			
Less than 1 year to maturity	$ 299	1.1	0.0
1 to 10 years maturities	56,001	3.5	2.4
10 to 20 years maturities	11,113	11.3	1.5
Greater than 20 years maturities	14,463	14.0	2.5
Total	$ 81,876		6.4
Bank Loans			
Less than 1 year to maturity	$ 485	0.0	0.0
1 to 10 years maturities	44,028	0.0	0.0
Total	$ 44,513		0.0
Non-Government Backed C.M.O.'s			
Greater than 20 years maturities	$ 7	0.2	0.2
Total	$ 7		0.2

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-dollar denominated investments are translated into US dollars at the bid prices of such currencies against US dollars at each balance sheet date. Realized and unrealized gains and losses on investments which result from changes in foreign currency exchange rates have been included in the net appreciation in fair value of investments. Net realized foreign currency gains and losses resulting from changes in exchange rates include foreign currency gains and losses between trade date and settlement date of investment securities transactions, foreign currency transactions and the difference between the amounts of interest and dividends recorded on the books of the System and the amount actually received. The System's exposure to foreign currency risk in U.S. dollars as of June 30, 2008, is shown in the table below.

Foreign Currency Exposure by Asset Class ($000's)
June 30, 2008

Currency	Short Term Investments	Equities	Fixed Income	Alternative Investments	Options on Foreign Currencies	Total
Australian dollar	$ (38)					$ (38)
British pound sterling	2	$ 64,770	$ 5,323		$ (5,307)	64,788
Canadian dollar	21	4,646	1,615		(1,615)	4,667
Danish krone			950		(953)	(3)
Euro	483	125,098	37,482	$ 18,765	(37,569)	144,259
Hong Kong dollar		2,052				2,052
Japanese yen	169	91,372	36,976		(37,023)	91,494
New Zealand dollar		1,475				1,475
Norwegian krone		2,113				2,113
South Korean won		3,453			55	3,508
Swedish krona	55	9,346	401		(459)	9,343
Swiss franc	612	13,441				14,053
	$ 1,304	$ 317,766	$ 82,747	$ 18,765	$ (82,871)	$ 337,711

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 market value of the securities on loan changes, the borrower must adjust the collateral accordingly. At June 30, 2008, the System had no credit risk exposure to borrowers because the amounts the System owes the borrowers, $496,426 thousand, exceeds the amounts the borrowers owe the System, $358,938 thousand, as shown in the table on the following page.

June 30,	Fair Value ($000's) 2008	2007
Investments held by System's agent in System's name:		
Short term investments	**$ 85,625**	$ 82,338
Fixed income	**666,252**	537,456
Equity	**1,236,238**	1,342,464
Alternative investments	**968,618**	877,750
Foreign currency contracts	**-**	416
Securities lending collateral investment pool	**496,426**	517,637
	$ 3,453,159	$ 3,358,061
Investments held by brokers under securities loans with cash collateral:		
Fixed income	**$ 267,284**	$ 347,828
Equity	**91,654**	132,238
	$ 358,938	$ 480,066

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, 2008 the weighted-average maturity of the collateral pool was 54 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, 2008 and 2007, was $368,008 thousand and $491,076 thousand, respectively. The balance of the collateral at June 30, 2008 and 2007, of $128,418 thousand and $26,561 thousand, respectively, consists 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, 2008 and 2007 was $483,249 thousand and $505,883 thousand, respectively.

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

These derivative instruments are subject to the following risks:

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

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

- *Basis Risk* – The risk that arises when variable interest rates on a derivative and an associated bond or other interest-paying financial instrument are based on different indexes.

- *Termination Risk* – The risk that a derivative's unscheduled end will adversely affect an investment manager's strategy.

Rollover Risk – The risk that a derivative associated with the System's fixed income investments does not extend to the maturity of those investments.

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

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

The average futures balance outstanding, not including foreign currency contracts, during the fiscal years ending June 30, 2008 and 2007 was $103,745 thousand and $65,064 thousand, respectively. Futures outstanding, not including foreign currency contracts, at June 30, 2008 and 2007 were $131,156 thousand and $125,043 thousand, respectively.

The contract or notional amounts of these instruments reflect the extent of the System's involvement in each class of financial instrument as of June 30, 2008 as follows ($000's):

June 30,	**2008**			2007		
Description	Contracts	Notional Value	Exposure	Contracts	Notional Value	Exposure
Futures on Treasury Bills and equivalents	7	$ 4,208	$ (33)	9	$ 5,370	$ (76)
Commodity Futures	20	82,634	82,634	-	-	-
Equity Futures	4	48,834	(1,964)	4	58,877	(166)
Fixed Income Futures	12	55,204	209	13	60,796	(376)
Long foreign currency contracts	80	180,893	638	105	77,584	5
Short foreign currency contracts	80	(181,205)	(951)	105	(77,167)	411
Total		$ 190,568	$ 80,533		$ 125,460	$ (202)

Alternative Investments – As of June 30, 2008, 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 ($000's)	
Investment Type	**June 30, 2008**	June 30, 2007
Private Equity		
Leveraged Buyouts	**$ 111,459**	$ 120,439
Special Situations	**99,656**	101,515
Venture Capital	**77,407**	76,624
Other Alternatives		
Hedge Funds	**236,114**	201,471
Real Estate	**4,415**	60
Structured Beta	**356,627**	304,581
Commodities	**82,940**	73,060
	$ 968,618	$ 877,750

Supplemental Information on investment and professional expenses included in Schedule II on page 26 herein does not include the investment management fees and performance fees imbedded in the structure of the private equity investments listed above. Rather, these fees are a component of the Net appreciation in fair value of investments in the accompanying Statement of Changes in Plan Net Assets.

4. Contributions and Reserves

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

In the October 9, 2004 Agreement, it was agreed that in lieu of contributions to the System made pursuant to actuarial valuations, the City will make cash payments to the System in accordance with a payment schedule as provided for in such agreement. This cash payment schedule requires a payment of $63,000 thousand for fiscal 2008. For fiscal years 2009 through 2012 the City has agreed to pay the amount contributed in 2008 plus an amount increasing by $5,000 thousand each year. Beginning in fiscal year 2013 and until the System's Funded Ratio reaches 100%, the City payments shall increase each fiscal year by the greater of $5,000 thousand or if the scheduled City payment is less than the actuarially required contribution, $10,000 thousand per year. City contributions in the Statements of Changes in Plan Net Assets may be greater than the contractually agreed amounts, as members are allowed to contribute accumulated sick and vacation pay to the System upon retirement and such contributions are classified as City contributions.

Pursuant to the terms of the October 9, 2004 Agreement and based on the July 1, 2007 actuarial valuation the City contribution rates and the Actuarial Required Contributions are as shown below for five years ending June 30, 2013.

($000's)

Years Ended June 30,	Actuarial Required Contribution	Cash Payments Required by Agreements	Cash Payments as a Percent of Actuarial Required Contribution	Annual Required Contribution as a Percentage of Pay
2009	$ 111,641	$ 68,000	60.9 %	32.1 %
2010	105,109	73,000	69.5	29.2
2011	102,082	78,000	76.4	27.4
2012	100,256	83,000	82.8	26.0
2013	99,375	93,000	93.6	24.9

The October 9, 2004 Agreement provides that the City may make these cash payments from any source, including pension obligation bonds. Senate Bill 1696 became law on September 1, 2003 and authorized municipalities to issue obligations to fund all or any part of an unfunded liability. This law requires the City to enter into a written agreement with the System that states the date or dates that the System will accept the net proceeds of the obligations to be issued in payment of all or a portion of the unfunded liability.

The October 9, 2004 Agreement was based upon projections wherein the City's annual cash payments would be less than the Actuarial Required Contribution (ARC) in each year through 2017 at which time the payments would begin to exceed the ARC. Scheduled payment amounts in 2008 represent 55.1% of the ARC projection. Subsequent to 2017 the scheduled payments were originally projected to be in excess of the ARC increasing to 200% of the ARC in 2035. Due to actuarial losses and the resulting increase in the ARC for 2006 and subsequent years, the scheduled payments are not projected to exceed the ARC in 2017 or reach 200% of the ARC in 2035 as originally estimated.

The ARC as a percentage of pay for 2008 is 32.1%. This rate consists of 16.0% to cover Normal Costs and 16.1% 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 at July 1, 2007 increased from the funding level at July 1, 2006. The actuarial accrued liability increased $224,535 thousand and the actuarial value of assets increased $323,552 thousand. As a result, the System's Unfunded Actuarial Accrued Liability decreased $99,017 thousand to $852,753 thousand as of July 1, 2007, which equates to a funded ratio of 78%. The decrease in the Unfunded Actuarial

Accrued Liability is due to a combination of factors including actuarial gains from liability sources and recognition of prior asset gains. The funded status of the System as of July 1, 2007, the most recent actuarial valuation date, is as follows:

Actuarial Funded Status as of Actuarial Valuation Date July 1, 2007 ($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)
$ 3,004,927	$ 3,857,680	$ 852,753	78 %	$ 336,029	254 %

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AALs for benefits.

Additional information as of the latest actuarial valuation follows:

Valuation date	July 1, 2007	
Actuarial cost method	Entry age normal	
Amortization method	Entry age normal Level percent of payroll Amortization over a constant open period of 30 years	
Remaining amortization period	30 years	
Asset valuation method	5 year smoothed market	
DROP interest credit rate	8.5% with maximum 5-year average of 7.0%	
Actuarial assumptions:	Investment rate of return:	8.5%
	Payroll growth rate:	
	Attributable to inflation	3.5%
	Attributable to merit increases	0.0% to 9.5%
	Annual cost of living adjustment	80% of increase in CPI for All Urban Consumers (CPI-U), minimum of 2.4% and maximum of 8.0%

The System’s Unfunded Actuarial Accrued Liability is projected to decrease from approximately $742,128 thousand as of July 1, 2008 to $679,963 thousand as of July 1, 2014. These projected Unfunded Actuarial Accrued Liabilities equate to funded ratios of 82.0% and 87.0% respectively. In the projections used as a basis for the October 9, 2004 Agreement the System’s Unfunded Actuarial Liability as of July 1, 2015 was originally projected to be $1,145,954 thousand or a funded ratio of 78.0%.

In accordance with the terms of the October 9, 2004 Agreement the City is obligated to make certain cash payments to the System but is no longer obligated to make payments to the System in amounts that have been actuarially determined to be sufficient to cover all future benefit payments of the System. If, however, the System achieves a funded ratio of 75% or 80% in any year subsequent to 2013 then the City will be required to annually contribute amounts to the System, which are sufficient to maintain such funded ratios.

If the City is unable to meet its funding obligations due to a shortfall of tax revenues, an inability to obtain or raise funds through the issuance of pension obligation bonds or from other sources, or if the System does not achieve the actuarial assumptions inherent in these projections, then the System's unfunded actuarial accrued liability and the City's funding obligations will continue to increase above the rates outlined above and ultimately there could be insufficient assets to cover all future benefit payments of the System. The financial condition of the System and its ability to meet future obligations is predicated on the funding provisions in the Governing Statute and the October 9, 2004 Agreement, which provides a revenue stream based on a percentage of active members' pensionable pay. If the funding schedule is maintained and adequate earnings and gains are provided on investments, the System is projected to eventually be adequately funded. If the City does not meet its funding obligations, the System's unfunded actuarial accrued liability and the City's future funding obligations will continue to increase above the rates outlined above.

The figures in the accompanying unaudited Schedule of Funding Progress (the Unfunded Actuarial Accrued Liability (UAAL) and the Funded Ratio) are based on actuarial calculations that make use of the actuarial value of assets, not the fair value. Since asset gains and losses (earnings greater or less than the 8.50% investment return assumption for example) are recognized 20% per year for five years in the actuarial value of assets, the July 1, 2007 actuarial value of $3,004,927 thousand is $354,739 thousand less than the fair value $3,359,666 thousand. The $354,739 thousand in deferred gains will be recognized over the next five years, and as these gains are recognized, the unfunded liability can be expected to decrease by a corresponding amount, over and above other expected increases or decreases.

6. Litigation

At June 30, 2007 the System was invested in a fully collateralized commodities strategy, which was reported at June 30, 2007 as part of alternative investments on the Statements of Plan Net Assets This strategy was implemented through the use of commodity swaps with a portion of the collateral held by the swap provider and a portion of the collateral held by the asset manager. At June 30, 2007, the asset manager had their approximately $54,298 thousand share of the collateral invested in their proprietary Limited Duration Bond Fund (the Fund). The asset manager has represented that as of June 30, 2007 the Fund was leveraged 3.5 times and approximately 90% of Fund assets were invested in sub-prime mortgage-backed securities.

During July and August of 2007 the sub-prime market experienced difficulties resulting in significant mark-to-market losses in this Fund and substantially all of the Fund participants took a distribution of their investment in the Fund. The asset manager also took in-kind distributions of the proportionate share of the remaining securities in the Fund that were allocable to ownership interests in the Fund attributable to other proprietary bond funds managed by the asset manager. The System terminated the commodities strategy after suffering realized losses of over $30 million as a result of its investment in the Limited Duration Bond Fund and has filed a lawsuit against the asset manager seeking to recover its losses, plus management and legal fees. The lawsuit is still in progress and the System cannot estimate the ultimate outcome of these proceedings at this time.

7. Commitments and Contingencies

As described in Note 1, there are 3,211 non-vested active members of the System entitled to refunds of their accumulated contributions, without interest, upon termination of employment with the City prior to being eligible for pension benefits. At June 30, 2008 and 2007, aggregate contributions from these members of the System were approximately $122,354 thousand and $106,150 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, 2008 and 2007, the total accumulated lump sum benefit due to DROP members was approximately $578,268 thousand and $492,662 thousand, respectively.

At June 30, 2008 and 2007, the total accumulated lump sum benefit due to PROP participants was $220,269 thousand and $192,253 thousand, respectively.

The System has outstanding commitments to various limited partnerships totaling $219,783 thousand and $105,581 thousand, as of June 30, 2008 and 2007, 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 2007 - April 2008	$ 15
May 2008 - April 2012	16
May 2012 - April 2015	17

Fiscal Year	Total Rent
2008	$ 180
2009	190
2010	190
2011	190
2012	192
Beyond 2012	575
	$ 1,517

8. Subsequent Events

Subsequent to year-end, the credit and liquidity crisis in the United States and throughout the global financial system triggered significant events and substantial volatility in world financial markets and the banking system that have had a significant negative impact on foreign and domestic financial markets. As a result, the System's investment portfolio has incurred a significant decline in fair value since June 30, 2008. The value of the System's investments has a direct impact on its funded status. The actual impact of these events on the System's funded status and future required contributions cannot be determined at this time.

Required Supplementary Information (Unaudited)

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, 2002	$ 2,337,157	$ 2,593,730	$ 256,573	90	$ 286,150	90
July 1, 2003	2,394,411	2,874,738	480,327	83	300,405	160
July 1, 2004	2,466,070	3,339,224	873,154	74	329,840	265
July 1, 2005	2,508,794	3,392,974	884,180	74	321,057	275
July 1, 2006	2,681,375	3,633,145	951,770	74	327,080	291
July 1, 2007	3,004,927	3,857,680	852,753	78	336,029	254

(1) The System's actuaries have indicated that these valuation data are "reasonable actuarial results." However, a different set of results could also be considered reasonable actuarial results, since the Actuarial Standards of Practice describe a 'best-estimate range' for each assumption, rather than a single best-estimate value. Thus, reasonable results differing from those presented above could have been developed by selecting different points within the best-estimate ranges for various assumptions.

Schedule of Employer Contributions ($000's)

Years Ended June 30,	Actuarial Required Contribution	Cash Payments Required by Agreements [(2)]	Cash Payments as a Percent of Actuarial Required Contribution	Annual Required Contribution as a Percentage of Pay
2003	$ 58,661	$ 34,645	59.1	20.5
2004	73,299	36,645	50.0	24.4
2005	94,004	36,645	14.7 [(3)]	28.5
2006	100,170	53,000	23.0 [(4)]	31.2
2007	107,443	58,000	26.1 [(5)]	34.0
2008	114,250	63,000	24.5 [(6)]	34.0

(2) Amounts for 2003 through 2004 represent amounts paid pursuant to previous agreements between the System and the City.
(3) The percentage contributed figure for 2005 has been calculated based on $13,780 thousand since the remainder of the fiscal 2005 cash payment was from the proceeds of pension obligation bonds and, as such, must be excluded from such calculations.
(4) The percentage contributed figure for 2006 has been calculated based on $23,000 thousand since the remainder of the fiscal 2006 cash payment was from the proceeds of pension obligation bonds and, as such, must be excluded from such calculations.
(5) The percentage contributed figure for 2007 has been calculated based on $28,000 thousand since the remainder of the fiscal 2007 cash payment was from the proceeds of pension obligation bonds and, as such, must be excluded from such calculations.
(6) The percentage contributed figure for 2008 has been calculated based on $28,000 thousand since the remainder of the fiscal 2008 cash payment was from the proceeds of pension obligation bonds and, as such, must be excluded from such calculations.

Required Supplementary Information (Unaudited)

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

Valuation date	July 1, 2007
Actuarial cost method	Entry age normal
Amortization method	Level percent of payroll Amortization over a constant open period of 30 years
Remaining amortization period	30 years
Asset valuation method	5 year smoothed market
DROP interest credit rate	8.5% with maximum 5-year average of 7.0%
Actuarial assumptions:	
Investment rate of return	8.5%
Payroll growth rate:	
Attributable to inflation	3.5%
Attributable to merit increases	0.0% to 9.5%
Annual cost of living adjustment	80% of increase in CPI for All Urban Consumers (CPI-U), minimum of 2.4% And maximum of 8.0%

Houston Police Officers' Pension System

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

Year ended June 30,		2008		2007
Investment services:				
Custodial services	$	216	$	213
Money management services		16,736		11,972
Consulting services		900		650
Department Operating Expense		334		281
Total investment services		18,186		13,116
Professional services:				
Actuarial services		48		74
Auditing services		67		54
Election audit services		1		1
Legal services		246		104
Lobbyist services		307		335
Total professional services		669		568
Administrative expenses:				
Computers and technology		637		186
Education		37		30
Fiduciary insurance		83		81
Office rent		177		173
Other office costs		1,961		1,912
Total administrative expenses		2,895		2,382
	$	21,750	$	16,066

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, 2008	Official System Position	Expense	Nature of Services
Abbott Capital Management	Consultant	$ 400	Consulting
Hammond Associates	Consultant	500	Consulting
The Northern Trust Company	Custodian	216	Custodian
Arnhold & S. Bleichroeder	Money Manager	991	Money Management
Ashmore Investment Management Limited	Money Manager	2,829	Money Management
Barclays Global Investors	Money Manager	1,579	Money Management
Brandes Investment Partners	Money Manager	1,179	Money Management
Bridgewater Associates, Inc.	Money Manager	7,128	Money Management
Causeway Capital Management	Money Manager	656	Money Management
The Clifton Group	Money Manager	216	Money Management
Driehaus Capital Management, Inc.	Money Manager	849	Money Management
MacKay-Shields Financial Corp.	Money Manager	318	Money Management
NWQ Investment Management Company	Money Manager	673	Money Management
Shenkman Capital Management, Inc.	Money Manager	251	Money Management
State Street Global Advisors	Money Manager	67	Money Management
Towers Perrin	Actuary	48	Actuarial
BDO Seidman, LLP	Auditors	67	Auditing
Gibbs & Bruns, LLP	Attorneys	220	Legal Service
Godwin Pappas Langley Ronquillo, LLP	Attorneys	11	Legal Service
HillCo Partners, LLC	Attorneys	157	Lobbyists
Locke Liddell Sapp	Attorneys	150	Lobbyists
Bickley Prescott & Co.	Consultant	1	Election Auditing
Other	Other	15	Other
Total investment and professional services		18,521	

See accompanying independent auditors' report.

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SECTION THREE

INVESTMENT SECTION

Responsibilities of the Board of Trustees

The primary fiduciary fiscal responsibility of the Board of Trustees is to insure that the System's assets are responsibly managed in accordance with the actuarial needs of the System, and also with sound, generally accepted financial investment procedures. The determination of the appropriate asset mix is based on capital market assumptions that incorporate historical returns, volatility and correlation of various asset classes as well as the consideration of current and forward-looking market conditions.

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

Investment Philosophy and Objectives

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

- Over the long term, the risk of owning equities has been, and should continue to be, rewarded with a somewhat greater return than that available from fixed income investments.

- Fixed income investments provide the System with an investment vehicle that contributes diversification, liquidity and a predictable stream of income; and that dampens volatility in investment returns.

- Diversification into alternative investments provides the System with an opportunity to enhance returns and to achieve broader diversification of the System's assets.

Investment Policy

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

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

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

Investment Strategy and Performance

The System has an asset allocation strategy in place that was initially designed to meet its overall investment objective of a long-term 8.5% annualized rate of return. This allocation strategy is reviewed periodically by the Board and is changed in anticipation of or in response to changing market conditions. The current asset allocation and the actual asset allocation of the System at June 30, 2008 was as follows:

	Target % of Fund	Current Actual % of Fund	Dollars Invested (000's)
Domestic Equity	20.5%	21.5%	$ 713,873
International Equity	20.0%	18.7%	621,357
Total Equity	40.5%	40.1%	1,335,230
Fixed Income	21.0%	24.1%	800,847
High Yield	10.0%	4.9%	162,716
Total Fixed Income	31.0%	28.9%	963,563
Private Equity	10.0%	8.7%	290,431
Structured Beta	10.0%	10.7%	356,627
Hedge Funds	2.5%	7.2%	241,335
Real Assets	2.5%	0.1%	4,415
Currency	1.0%	0.0%	-
Commodities	2.5%	2.5%	82,672
Total Alternatives	28.5%	29.3%	975,480
Total Cash	0.0%	1.6%	54,584
Total Fund	100.0%	100.0%	$ 3,328,857

Fiscal 2008 witnessed volatile U.S. and International equity market performance. Rising energy prices spurred concerns of a prolonged bout of inflation, and lingering mortgage-related problems continued to weigh heavily on markets. The most significant contributor to the funds performance was fixed income, driven by emerging market debt and TIPS. The alternative equity portfolio had strong returns for the fourth year in succession, which significantly improved our total fund investment rate of return.

HPOPS was able to outperform the financial markets in most areas during the fiscal year and on a total fund basis we outperformed our benchmark 0.3% versus negative 0.3%. International equity under-performed the MSCI ACWI ex U.S. Index negative 15.2% to negative 6.2%; this under-performance is attributed to the value tilt in the international equity portfolio. All other asset classes out performed their designated benchmark.

Domestic Equity

The System's domestic equity investments generated a negative 10.4% return, exceeding the negative 12.7% return of its benchmark, the Russell 3000. This out-performance is due to a combination of excess returns from active management and investment weightings that differed from the benchmark. The superior performance of Arnhold & Bleichroeder and Driehaus was offset to a degree by the below-benchmark performance of NWQ, the Barclays Global Investors (BGI) Alpha Tilts Fund and Attalus Capital. NWQ underperformed because of excess exposure to the financial sector, in particular lending institutions while the BGI fund underperformed due to weaknesses in their fundamental stock-picking model. The Attalus Capital portable alpha strategy underperformed because of their allocation to underlying strategies that proved to be out-of-favor in the current market environment. Assets under management, annualized rates of return and fees paid to domestic equity managers for the fiscal year ending June 30, 2008 are as follows (dollars in 000's):

Manager	Style	Assets	% Returns	Fees
Arnhold & Bleichroeder	Large Cap Value	$ 174,354	-4.2%	$ 991
BGI*	Enhanced S&P 500 Index	-	-8.8%	726
Attalus Capital	S&P 500 Alpha Transport Strategy	83,626	-15.2%	1,255
BGI	Russell 2000 Index	37,585	-16.8%	28
BGI**	S&P 500 Index	258,283	-8.4%	10
Driehaus Capital Mgmt	Mid Cap Growth	68,196	35.6%	849
NWQ Investment Mgmt	Large Cap Value	91,829	-23.2%	673
		$ 713,873		$ 4,532

*Withdrew from fund on 5/31/2008
**Funded on 5/31/2008

	HPOPS	Benchmark
# of holdings	2365	3000
Avg Market Cap	$54.6 Billion	$72.4 Billion
Portfolio P/E	16.4	15.3
Portfolio P/Book	2.5	2.3
Portfolio Beta (3-yr)	1.1	1.0

International Equity

The System's international equity investments returned negative 15.2%, significantly underperforming the negative 6.2% return of the MSCI ACWI ex U.S. benchmark for the fiscal year. This overall underperformance was due to underperformance of all of the System's active managers as can be seen in the accompanying chart. Assets under management, annualized rates of return and fees paid to international equity managers for the fiscal year ending June 30, 2008 are as shown on the following page (dollars in 000's):

Manager	Style	Assets	% Returns	Fees
BGI*	Enhanced EAFE Index	$ -	-5.9%	$ 144
BGI	Emerging Markets	110,167	3.3%	534
BGI**	ACWI Ex-US	82,701	-6.6%	10
BGI***	EAFE Small Cap	78,192	-14.9%	85
Brandes	EAFE	244,967	-15.4%	1,179
Causeway Capital	EAFE	105,330	-12.6%	656
		$ 621,357		$ 2,608

* Liquidated on 5/31/2008
** Funded on 4/30/2008
*** Funded on 9/30/2007

	HPOPS	Benchmark
# of holdings	150	1171
Avg Market Cap	$47.2 Billion	$59.9 Billion
Portfolio P/E	11.6	12.8
Portfolio P/Book	1.3	1.9
Portfolio Beta (3-yr)	1.0	1.0

High Yield

High yield investments are segregated by HPOPS as a separate asset class with a target allocation of 10% of the System's total assets. The System has implemented significant tactical changes to its high yield allocation during the last several years as described below.

The System had a tactical underweight to high yield throughout the fiscal year. In addition, beginning in January 2008 the System expanded the mandate of its high yield managers to include bank loans so that as of June 30, 2008 approximately 36% of the high yield allocation consisted of bank loans. Assets under management, annualized rates of return and fees paid to high yield managers for the fiscal year ending June 30, 2008 are as follows (dollars in 000's):

Manager	Style	Assets	% Returns	Fees
MacKay Shields	High Yield	$ 99,217	-1.8%	$ 318
Shenkman Capital Mgmt	High Yield	63,499	1.3%	251
		$ 162,716		$ 569

	HPOPS	Benchmark
# of securities	591	1,300
Yield to Maturity	9.3	10.9
Effective Duration	2.1	4.6
Quality Rating S&P	B+	B+

Fixed Income

The System's fixed income strategy consists of a passive strategy benchmarked to the Lehman Brothers Long Government/Credit Bond Index, in combination with separate allocations to a global fixed income mandate, inflation indexed bonds, and two emerging market mandates. The System's fixed income assets out-performed its benchmark with a fiscal year return of 12.9% versus the 7.1% return on the Lehman Brothers 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, 2008 are as follows (dollars in 000's):

Manager	Style	Assets	% Returns	Base Fee
BGI*	Core Active Bond Index	$ -	3.9%	$ 10
BGI	Long Duration Gov/Credit Bond Index	98,771	6.8%	32
Clifton Group	Long Duration Passive TIPS	332,738	14.2%	103
State Street **	Long Duration Passive TIPS	-	N/A	48
Ashmore	Emerging Market Debt	172,714	12.1%	1,275
Ashmore	Local Currency Debt	112,118	18.5%	1,554
Bridgewater	Global Fixed Income	84,506	5.1%	-
		$ 800,847		$ 3,022

* Liquidated on 11/30/2007
** Liquidated on 4/20/2007

Alternative Investments

The System's alternative investment program consists of allocations to private equity, hedge funds, a structured beta strategy, commodities, and real assets. The private equity program is managed by Abbott Capital Management and Hammond Associates and is a relatively mature strategy in that the System has reached its investment target of approximately 10% of total assets while still having $207 million of outstanding commitments. The System had investments in or commitments to 65 individual private equity partnerships at June 30, 2008. The current allocation within this strategy is approximately 40% in leveraged buyouts, 35% in special situations funds and 25% in venture capital. This program required $46.5 million in additional funding during fiscal 2008 while at the same time generating distributions of $72.6 million for the same period. This private equity program generated returns for the 2008 fiscal year of 3.2% versus a return of negative 8.1% of its benchmark, the S&P 500 plus 5%.

The System also has a 6.0% allocation to hedge funds and had $241 million actually invested as of June 30, 2008. These strategies generated fiscal year performance of approximately 13.4%. The System also maintains a commodities strategy managed by The Clifton Group. This strategy was previously managed by State Street Global Advisors and lost over 50% of its value subsequent to June 30, 2007 due to the effects of leverage and sub-prime mortgage exposure in the State Street cash collateral strategy. The fiscal year performance of the commodities strategy is negative 27.4% vs. a positive 41.6% for the DJ AIG Commodity Index. The underperformance is attributable to the collapse of the State Street collateral. Assets under management, annualized rates of return and fees paid to alternative investments managers for the fiscal year ending June 30, 2008 are as shown on the following page (dollars in 000's):

Manager	Style	Assets	% Returns	Base Fee	Incentive Fee
Abbott Capital	Private Equity	$ 279,731	3.6%	$ 400	$ -
Hammond Associates*	Private Equity	-	N/A	-	$ -
Internal	Private Equity	10,700	0.0%	-	$ -
Bridgewater All Weather	Structured Beta	356,627	17.1%	679	-
Bridgewater Pure Alpha	Hedge Fund	97,352	31.1%	1,320	5,129
Hammond Associates	Hedge Funds	143,983	8.3%	500	-
Clifton Group Commodities	Commodities	82,672	27.6%	43	-
State Street	Commodities	-	-47.3%	19	-
Hammond Associates	Real Assets	4,415	N/A	-	-
		$ 975,480		$ 2,961	$ 5,129

* $50 million committed but not invested at June 30, 2008.

Cash Securitization

The cash securitization program was first funded on February 28, 2007 and is managed by The Clifton Group. Clifton is in charge of securitizing the cash in our accounts by purchasing equity and fixed income futures in order to obtain a higher yield than would otherwise be earned. During fiscal year 2008 the cash securitization program added 15 basis points to the funds return (dollars in 000’s).

Manager	Style	Assets	% Returns	Base Fee
Clifton Group	Cash Securitization	$ 26,397	0.1%	$ 70
		$ 26,397		$ 70

Securities Lending

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

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

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

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

	2008	2007	2006
Avg Securities on Loan	$ 492,463	$ 495,168	$ 469,879
Avg Eligible Securities	$ 1,242,246	$ 1,360,986	$ 1,377,965
% on Loan	39.6%	36.4%	34.1%
HPOPS Net Earnings	$ 2,392	$ 1,239	$ 1,101
Duration of Collateral Pool (days)	54	35	39

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	Lehman Brothers Aggregate	High Yield	Citigroup HY	Alternative Investments
2004	21.6	19.0	22.9	20.4	41.0	32.5	4.6	10.4	11.6	10.3	30.1
2005	13.5	9.7	10.5	8.1	14.4	17.0	19.0	0.3	9.3	10.4	24.8
2006	11.2	10.3	12.6	9.6	26.4	28.4	4.5	6.8	6.3	4.2	16.5
2007	17.9	15.9	21.5	20.0	29.3	30.2	9.8	6.1	11.6	11.6	11.8
2008	0.3	-0.3	-10.4	-12.7	-15.2	-6.2	12.9	7.1	-0.6	-2.3	9.5

Compound Annualized Rates of Return by Year (%)
Years Ended June 30, 2008

Year	System Total	Composite Benchmark	Domestic Equity	Russell 3000	Int'l Equity	MSCI ACWI ex U.S.	Fixed Income	Lehman Brothers Aggregate	High Yield	Citigroup HY	Alternative Investments
2	8.8	7.3	4.3	2.4	4.7	10.5	11.3	6.6	5.3	4.4	13.0
3	9.6	8.4	7.0	4.7	11.5	16.2	9.0	4.1	5.6	4.3	9.9
5	12.7	10.1	10.7	8.4	17.5	19.4	10.0	3.9	7.5	6.7	17.8
10	8.2	6.9	6.1	3.5	10.5	7.7	8.2	5.6	7.5	5.0	8.3

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, 2008

Shares	Description	Market Value ($000's)	% of Total Domestic Equity
172,622	Lockheed Martin	$ 17,031	2.7%
352,233	Amphenol Corp	15,808	2.5%
171,346	Eaton Corp	14,559	2.3%
65,815	US Steel	12,161	1.9%
93,241	Devon Energy	11,204	1.8%
435,900	Wells Fargo	10,353	1.7%
558,546	Clear Channel	9,959	1.6%
135,021	Parker-Hannifin	9,630	1.5%
284,682	Linear Tech Corp	9,272	1.5%
234,232	Tyco Electronics	8,390	1.3%

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

As of June 30, 2008

Shares	Description	Market Value ($000's)	% of Total International Equity
2,123	Nippon	$ 10,414	1.7%
587,400	Deutsche Telekom	9,625	1.6%
135,437	Sanofi-Aventis	9,054	1.5%
991,300	Mitsubishi	8,800	1.4%
189,650	Astrazeneca	8,085	1.3%
350,800	Glaxosmithkline	7,770	1.3%
729,849	Ericsson	7,620	1.2%
1,455,029	Royal Bk Scot	6,226	1.0%
323,100	Centrais Eletricas	6,087	1.0%
174,000	Mitsui Sumitomo	6,008	1.0%

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

Schedule of Ten Largest Domestic Fixed Income Holdings

As of June 30, 2008

Par Value ($000's)	Description	Market Value ($000's)	% of Total U.S. Fixed Income
$ 62,988	US Treas Infl Indexed Bonds 2.375 Due 01-15-2025	$ 75,995	16.6%
42,272	US Treas Infl Indexed Bonds 3.875 Due 04-15-2029	72,092	12.8%
37,636	US Treas Bds Inflation Indexed 3.625 Due 4-15-2028	62,647	12.1%
44,900	US Treas Bds Infl IX Bond 2% Due 01-15-2026	48,570	10.5%
35,100	US Treas Bds Infl IX 2.375 Due 1-15-2027	39,548	8.2%
17,400	US Treas Bds 1.75 Due 1-15-2028	17,094	6.7%
10,928	US Treas Infl IX Bds 3.375 due 4-15-2032 AR12 due 4-15-2032	16,696	2.9%
1,145	NXP SR SECD BT 7.875 due 10-15-2014/10-15-2007	1,072	0.2%
1,150	First Data Corp due 10-01-2014	1,055	0.2%
970	PVTPL Energy Future Hldgs Corp Sr Nt 10.875 Due 11-01-2017	997	0.2%

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

As of June 30, 2008

Par Value ($000's)	Description	Market Value ($000's)	% of Total Non-U.S. Fixed Income
$ 750,000	Japan (Govt of) 1.4% Bonds 20/12/13 JPY'256'	$ 7,145	1.9%
600,000	Japan (Govt of) 1.2% Bonds 20/09/11 JPY'60''	5,723	1.5%
600,000	Japan (Govt of) 0.5% Bonds 20/06/10 JPY'47''	5,630	1.5%
500,000	Japan (Govt of) 1.4% Bonds 20/12/11 JPY'235'	4,785	1.3%
490,000	Japan (Govt of) 2.1% Bonds 20/09/24 JPY'72'	4,695	1.3%
2,100	Italy (Rep of) 6% BTP 1/5/31 EUR1000	3,608	1.0%
1,740	UK (Govt of) 4.75% STK 7/12/38 GBP100	3,515	1.0%
2,000	France (Govt of) 6.5% OAT 25/4/11 EUR1	3,331	0.9%
2,100	France (Govt of) 4% OAT 25/4/13 EUR1	3,226	0.9%
2,000	Italy (Rep of) 4.25% BTP 1/11/09 EUR1000	3,153	0.9%

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, 2008

Brokers	Shares	Commissions	Principal	Commissions Per Share
Driehaus Securities Corp.	6,721,522	$ 324,656	$ 331,749,146	$ 0.048
Merrill Lynch Pierce Fenner & Smith	3,754,673	169,149	137,155,364	0.045
Goldman Executing & Clearing	7,086,439	107,143	270,130,790	0.015
Bear Stearns	2,622,879	59,642	95,312,491	0.023
BNY ESI Securities Co.	785,109	32,487	29,258,863	0.041
Bernstein, Sanford Co.	674,719	31,308	30,961,026	0.046
Jefferies & Company	1,145,995	30,037	39,086,675	0.026
Citigroup Global Markets Inc/Smith Barney	826,089	28,691	26,594,095	0.035
Deutsche Bank Securities Inc.	480,282	22,906	20,718,870	0.048
LEK Securities	1,259,638	22,044	47,145,220	0.018

International Equity Trading - Ten Largest by Total Commissions Paid

For the year ended June 30, 2008

Brokers	Shares	Commissions	Principal	Commissions in Basis Points
Morgan Stanley & Co.	2,157,199	$ 32,821	$ 34,749,356	15.2
CS First Boston Group	1,132,949	19,674	16,099,855	17.4
Goldman Sachs & Co.	912,948	19,189	11,857,597	21.0
JP Morgan Securities	1,717,188	19,138	13,946,044	11.1
Deutsche Bank Securities	781,710	17,530	12,919,513	22.4
Merrill Lynch Fenner & Smith	1,019,995	16,043	14,892,738	15.7
Lehman Brothers Int'l	1,189,762	15,718	10,988,604	13.2
Bear Stearns	641,916	12,539	10,599,106	19.5
UBS	1,447,442	12,459	11,705,143	8.6
Citigroup Global Ltd.	591,865	12,167	9,323,659	20.6

ACTUARIAL SECTION

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Houston Police Officers Pension System

Actuarial Valuation Report as of July 1, 2007

December 2007

TOWERS PERRIN
HR SERVICES

TOWERS PERRIN
HR SERVICES

Actuarial Certification, Reliances and Distribution

This report describes the results of an actuarial valuation of the Houston Police Officers Pension System. The Houston Police Officers Pension System retained Towers Perrin to perform this actuarial valuation for the purposes of determining the funding status for the plan year July 1, 2007 through June 30, 2008.

The consulting actuaries are members of the Society of Actuaries and other professional actuarial organizations and meet their "General Qualification Standard for Prescribed Statements of Actuarial Opinions" relating to pension plans.

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

The actuarial methods and assumptions used in this valuation were selected by the Board of Trustees. The Board has sole authority to determine the actuarial assumptions. In our opinion, the actuarial assumptions used (i) are appropriate for purposes of the valuation, (ii) in the aggregate, are reasonably related to the experience of the Fund and to reasonable expectations as of the valuation date, and (iii) meet the parameters established by Governmental Accounting Standard Board Statement No. 25.

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

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

It should be noted that other than the City agreement to maintain a funded status floor as specified under the 2004 Meet and Confer (see City Contribution Schedule on page 73), the City funding schedule could potentially not be sufficient to cover all future benefit payments of the Houston Police Officers Pension System. Moreover, it is possible that the Houston Police Officers Pension System will fall below the funded status floor as actual experience differs from assumed and/or assumptions change. Towers Perrin has not been provided detailed provisions on how the funded status floor will be maintained if the funded status declines below specified levels.

The information contained in this report was prepared for the internal use of the Houston Police Officers Pension System and its auditors in connection with our actuarial valuation of the pension plan. It is neither intended nor necessarily suitable for other purposes. The Houston Police Officers Pension System may also distribute this actuarial valuation report to the appropriate authorities who have the legal right to require the Houston Police Officers Pension System to provide them with this report, in which case, the Houston Police Officers Pension System will use best efforts to notify Towers Perrin in advance of this distribution. Further distribution to, or use by, other parties of all or part of this report is expressly prohibited without Towers Perrin's prior written consent.

Adam S. Berk
A.S.A., C.F.A., E.A., M.A.A.A.

Lloyd Nordstrom
F.S.A., E.A., M.A.A.A.

Towers Perrin
December, 2007

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

Valuation Date	Actuarial Accrued Liability (AAL)	Actuarial Value of Assets (AVA)	AVA as a Percentage of AAL	Unfunded AAL (Surplus)	Covered Payroll	UAAL (Surplus) as a Percentage of Covered Payroll
July 1, 1984	$ 507,883	$ 230,143	45 %	$ 277,740	$ 111,489	249 %
July 1, 1986	454,067	420,487	93	33,580	125,963 *	27
July 1, 1987	488,387	505,483	104	(17,096)	126,960	-13
July 1, 1988	524,894	516,177	98	8,717	121,667	7
July 1, 1989	581,681	585,358	101	(3,677)	122,803	-3
July 1, 1990	663,278	676,684	102	(13,406)	126,665 **	-11
July 1, 1992	853,975	774,785	91	79,190	143,020	55
July 1, 1993	936,674	857,535	92	79,139	159,321	50
July 1, 1994	984,495	947,456	96	37,039	162,143	23
July 1, 1995	1,000,423	1,038,256	104	(37,833)	174,761	-22
July 1, 1996	1,199,748	1,168,056	97	31,692	182,251	17
July 1, 1997	1,258,217	1,329,570	106	(71,353)	187,134	-38
July 1, 1998	1,549,341	1,518,081	98	31,260	196,364	16
July 1, 1999	1,773,829	1,746,312	98	27,517	246,569 ***	11
July 1, 2000	1,966,404	2,013,491	102	(47,087)	250,691	-19
July 1, 2001	2,306,427	2,226,307	97	80,120	264,226	30
July 1, 2002	2,593,730	2,337,157	90	256,573	286,150	90
July 1, 2003	2,874,738	2,394,411	83	480,327	300,405	160
July 1, 2004	3,339,224	2,466,070	74	873,154	329,840	265
July 1, 2005	3,392,974	2,508,794	74	884,154	321,057	275
July 1, 2006	3,633,145	2,681,375	74	951,770	327,080	291
July 1, 2007	3,857,680	3,004,927	78	852,753	336,029	254

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

Prepared by Towers Perrin

Historical Solvency Test ($000)

Valuation Date	Actuarial Accrued Liability for: Employee Contributions	Retirees, Beneficiaries, and Vested Deferreds	Active Participants (City-Financed Portion)	Actuarial Value of Assets	Portion of Actuarial Accrued Liability Covered by Assets		
	(1)	(2)	(3)		(1)	(2)	(3)
July 1, 1989	$ 82,919	$ 222,585	$ 276,177	$ 585,358	100%	100%	100%
July 1, 1990	87,430	261,114	314,734	676,684	100	100	100
July 1, 1991	98,099	338,914	416,962	774,785	100	100	81
July 1, 1992	105,464	372,674	458,536	857,535	100	100	83
July 1, 1993	114,279	401,989	468,227	947,456	100	100	92
July 1, 1994	123,471	416,053	460,899	1,038,256	100	100	100
July 1, 1995	91,687	764,518	343,543	1,168,056	100	100	91
July 1, 1996	95,615	812,498	350,104	1,329,570	100	100	100
July 1, 1998	99,298	1,017,723	432,320	1,518,081	100	100	93
July 1, 1999	107,008	1,157,882	508,939	1,746,312	100	100	95
July 1, 2000	111,099	1,324,079	531,225	2,013,491	100	100	100
July 1, 2001	138,248	707,152	1,461,027*	2,226,307	100	100	95
July 1, 2002	145,255	718,779	1,729,696	2,337,157	100	100	85
July 1, 2003	153,634	838,090	1,883,014	2,394,411	100	100	74
July 1, 2004	153,088	995,841	2,190,295	2,466,070	100	100	60
July 1, 2004	153,088	995,841	2,190,295	2,466,070	100	100	60
July 1, 2006	262514	1,421,330	1,949,301	2,681,375	100	100	51
July 1, 2007	275,990	1,575,900	2,005,790	3,004,927	100	100	57

* Beginning July 1, 2001 the Actuarial Accrued Liability for DROP Participants was included in the Active liability.

Historical Active Participant Data

Valuation Date	Number of Participants	Average Age	Annual Covered Payroll ($000)	Average Annual Covered Payroll	Percentage Increase in Average Covered Payroll
January 1, 1980	3,029	N/A	$ 58,169	$ 19,204	10.4%
January 1, 1982	3,243	N/A	89,529	27,607	43.8
July 1, 1984	3,997	N/A	111,489	27,893	1.0
July 1, 1986	4,526	33.5	125,963(1)	27,831	(0.2)
July 1, 1987	4,494	34.4	126,960	28,251	1.5
July 1, 1988	4,239	35.0	121,667	28,702	1.6
July 1, 1989	4,105	35.7	122,803	29,915	4.2
July 1, 1990	4,073	36.2	126,665(2)	31,099	4.0
July 1, 1992	4,120	36.8	143,020	34,714	11.6
July 1, 1993	4,498	36.7	159,321	35,420	2.0
July 1, 1994	4,705	36.8	162,143	34,462	(2.7)
July 1, 1995	4,921	36.9	174,761	35,513	3.0
July 1, 1996(3)	4,395	35.1	150,903	34,335	(3.3)
July 1, 1997	4,282	35.5	149,631	34,944	1.8
July 1, 1998	4,247	35.9	153,479	36,138	3.4
July 1, 1999	4,253	36.3	187,967(4)	44,196(4)	22.3(4)
July 1, 2000	4,137	36.7	179,415	43,368	(1.9)
July 1, 2001(5)	5,325	40.2	264,226(6)	49,620(6)	14.4(6)
July 1, 2002	5,352	40.7	286,150	53,466	7.8
July 1, 2003	5,387	41.3	300,405	55,765	4.3
July 1, 2004	5,225	41.7	329,840	63,127	13.2
July 1, 2005	4,867	42.0	321,226(7)	65,966(7)	4.5(7)
July 1, 2006	4,785	42.3	327,080	68,355	3.6
July 1, 2007	4,879	42.1	336,029	68,873	0.8

(1) Reflects the July 5, 1986 pay decrease.
(2) Reflects the November 1, 1990 pay increase.
(3) Includes those participants currently accruing benefits from the July 1, 1996 to July 1, 2000 valuation dates (i.e. excludes current DROP participants).
(4) Definition of covered payroll changed from base pay to total direct pay less overtime.
(5) Beginning July 1, 2001 includes active participants eligible for DROP.
(6) Beginning July 1, 2001 the definition of total direct pay changed from the average of the last 26 pay periods to the highest bi-weekly pay period.
(7) Beginning October 9, 2004 pensionable pay is the total of the last 26 pay periods, excluding CMEPP and SOSP.

Prepared by Towers Perrin

Inactive Participants Added to and Removed from Rolls

Period Ended	Added to Rolls		Removed from Rolls		Rolls at the End of the Year		Percentage Increase in Annual Benefits	Average Annual Benefit
	Number	Annual Benefits ($000)	Number	Annual Benefits ($000)	Number	Annual Benefits ($000)		
December 31, 1981	81	1,191	17	184	666	6,499	20.6	9,759
December 31, 1982	104	1,106	24	240	746	7,842	20.7	10,513
December 31, 1983	82	967	35	362	793	8,931	13.9	11,262
June 30, 1984	53	779	18	150	855	4,760	6.6	11,095
June 30, 1985	83	1,141	42	259	896	10,166	6.8	11,346
June 30, 1986	44	530	37	431	903	10,939	7.6	12,114
June 30, 1987	42	585	36	421	909	11,321	3.5	12,455
June 30, 1988	138	2,668	25	243	1,022	14,069	24.3	13,766
June 30, 1989	89	1,349	46	502	1,065	16,127	14.6	15,142
June 30, 1990	105	1,811	29	457	1,141	18,029	11.8	15,801
June 30, 1992	222	4,662	75	1,127	1,288	22,999	27.6	17,857
June 30, 1993	105	2,012	16	205	1,377	25,474	10.8	18,500
June 30, 1994	106	2,172	64	953	1,419	27,286	7.1	19,229
June 30, 1995	107	2,425	48	847	1,478	29,464	8.0	19,935
June 30, 1996*	893	19,109	36	602	2,335	48,624	65.0	20,824
June 30, 1997	182	3,481	29	618	2,488	52,772	8.5	21,211
June 30, 1998	159	3,483	28	589	2,619	63,957	21.2	24,420
June 30, 1999	150	3,770	46	1,001	2,723	70,432	10.1	25,866
June 30, 2000	233	6,421	36	857	2,920	76,401	8.5	26,165
June 30, 2001**	131	3,755	1,250	33,892	1,801	54,006	(29.3)	29,987
June 30, 2002	104	2,809	46	1,113	1,859	55,013	1.9	29,593
June 30, 2003	106	2,967	47	1,109	1,918	61,531	11.8	32,081
June 30, 2004	220	9,172	33	1,014	2,105	70,307	14.3	33,400
June 30, 2005	353	15,962	55	1,776	2,403	86,933	23.6	36,177
June 30, 2006	254	10,195	66	2,197	2,549	96,812	11.4	37,980
June 30, 2007	175	8,056	49	1,809	2,717	105,481	9.0	38,823

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

Change in Unfunded Actuarial Accrued Liability (Surplus) Since the Prior Valuation ($000)

■ Unfunded Actuarial Accrued Liability (Surplus) as of July 1, 2005	$ 884,180
■ Expected Change Due to Normal Operation	
– Normal Cost (City Portion)	52,974
– City Actuarially Determined Contribution	(100,170)
– Interest [(1)]	61,085
– Recognition of Prior Asset Losses (Gains)	15,471
– Net Expected Change Due to Normal Operation	$ 29,360
■ Expected Change Due to City Funding Less Than Actuarial Rate	49,063
■ Change Due to Actuarial Experience	
– Actuarial (Gain) Loss From Asset Sources	(13,961)
– Actuarial (Gain) Loss From Liability Sources	3,128
– Net Change due to Actuarial Experience	$ (10,833)
■ Change in Actuarial Assumptions and Methods	0
■ Unfunded Actuarial Accrued Liability (Surplus) as of July 1, 2006	$ 951,770
■ Expected Change Due to Normal Operation	
– Normal Cost (City Portion)	53,314
– City Actuarially Determined Contribution	(111,207)
– Interest [(1)]	60,323
– Recognition of Prior Asset Losses (Gains)	(72,605)
– Net Expected Change Due to Normal Operation	$ (70,175)
■ Expected Change Due to City Funding Less Than Actuarial Rate	55,422
■ Change Due to Actuarial Experience	
– Actuarial (Gain) Loss From Asset Sources	(53,404)
– Actuarial (Gain) Loss From Liability Sources	(30,860)
– Net Change due to Actuarial Experience	$ (84,264)
■ Change in Actuarial Assumptions and Methods	0
■ Unfunded Actuarial Accrued Liability (Surplus) as of July 1, 2007	$ 852,753

[(1)] Excludes interest on the unrecognized investment losses

Summary of Actuarial Methods and Assumptions

The following methods and assumptions were adopted for the Actuarial Valuation Report as of July 1, 2007.

Actuarial Methods

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

Economic Assumptions

Investment Return	8.5% per year, net of expenses
Payroll Growth Rate/Inflation	3.5% per year

Individual Merit Increase Rate

Service	Increase
1	7.00%
2	0.25
3	0.25
4	5.00
5	9.50
6	8.50
7	0.75
8	0.50
9	7.75
10	1.00
11	9.00
12	0.75
13	1.25
14	1.50
15	0.50
16	5.50
17	0.75
18 and over	0.00

Individual Pay Increase Rate	Merit plus 3%
DROP Crediting Rate	Five year average returns using actual return through June 30, 2005 and estimated 8.5% returns thereafter, with a maximum 5−year average of 7.0%.

Summary of Actuarial Methods and Assumptions (continued)

Demographic Assumptions

Entry Age

Date sworn.

DROP Participation Rates

100% of eligible active participants are assumed to elect the DROP. Participants are assumed to elect the maximum duration for the back DROP, up to 20 years.

Retirement Rates

► Participants as of October 9, 2004

Age	Service 20-21	22-23	24-25	26-27	28-29	30-39	40 and over
40-54	5%	5%	5%	10%	20%	20%	100%
55-59	5	10	10	30	30	40	100
60-64	10	10	25	50	50	50	100
65 and over	100	100	100	100	100	100	100

► New Participants After October 9, 2004

Age	Service 20-21	22-23	24-25	26-27	28-29	30-39	40 and over
55-59	5%	10%	10%	30%	30%	40%	100%
60-64	10	10	25	50	50	50	100
65 and over	100	100	100	100	100	100	100

Mortality Rates

► Active participants and nondisabled retirees

1994 Group Annuity Mortality Table (see table below for sample rates).

► Disabled retirees

1987 Commissioners Group Disabled Mortality Table (see table below for sample rates).

Disability Rates

Graduated rates (see table below for sample rates).

Percentage of Deaths and Disabilities in the Line of Duty

100%.

Termination Rates and Terminated Vested Pension Benefit Election

Graduated rates (see table below for sample rates). 50% of members eligible to receive a terminated vested pension are assumed to elect the pension at age 60 instead of a refund of contributions.

Summary of Actuarial Methods and Assumptions (continued)

Marital Status at Benefit Eligibility

▸ Percentage married	90%. (No beneficiaries other than the spouse assumed).
▸ Age difference	Husbands assumed to be three years older than wives.
Valuation Earnings	Pay excluding CMEPP and SOSP in the last 26 pay periods preceding the valuation date annualized and increased for one year of assumed pay increases, or $30,000 if larger. Grandfathered CMEPP and SOSP amounts were added back in on a prorated basis for determining transition earnings through 2007.
DROP balance and annuity	The DROP balance and annuity were calculated based on current valuation earnings projected to the back-DROP date. For members participating in DROP as of July 1, 2007, the actual amounts were compared to the estimate, and the greater value was used. No comparison was made if the actual DROP entry date was more than a year from the estimated date.

Sample Rates

Sample Rates per 100 Participants

	Non-disabled Mortality		Disabled Mortality (Ultimate)	Termination	Disability	
Age	Male	Female	All	All	Male	Female
20	0.05	0.03	2.82	4.44	0.08	0.10
25	0.07	0.03	2.82	3.99	0.08	0.10
30	0.08	0.04	2.82	3.02	0.08	0.12
35	0.09	0.05	2.82	1.92	0.10	0.16
40	0.11	0.07	2.82	0.92	0.14	0.22
45	0.16	0.10	2.82	0.21	0.21	0.30
50	0.26	0.14	2.82	0.00	0.37	0.54
55	0.44	0.23	2.82	0.00	0.79	1.08
60	0.80	0.44	3.14	0.00	2.15	2.86
65	1.45	0.86	3.98	0.00	0.00	0.00

Changes in Methods and Assumptions Since the Prior Valuation

There were no changes in methods and assumptions since the prior valuation.

Summary of Plan Provisions

Covered Members	All police officers sworn before September 1, 1975 are covered under Plan 1, except those who elected by December 31, 1981 to participate in Plan 3. All police officers sworn on or after September 1, 1975, but before September 1, 1981 are covered under Plan 2, except those who elected by December 31, 1981 to participate in Plan 3 and those from Police Cadet Classes 70 and 71 who elected to transfer to Plan 1. All other police officers are covered by Plan 3, except those from Police Cadet Classes 70 and 71 who elected to pay additional contributions and transfer to Plan 1.
Final Compensation	
Prior to November 28, 1998	Monthly base salary paid to the participant in his/her last month of service. For any participant from a position held for less than 3 years, final compensation is the average monthly base salary for the 3 years prior to retirement.
After November 28, 1998 but prior to July 1, 2001	Monthly total direct pay less overtime paid to the participant in his/her last month of service. For any participant from a position held for less than 3 years, final compensation is the average monthly base pay for the 3 years prior to retirement plus the other current components of total direct pay.
After July 1, 2001 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

Summary of Plan Provisions (cont.)

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.

Summary of Plan Provisions (cont.)

2) Benefit participant would have received had participant retired or entered the DROP immediately before October 9, 2004

3) Benefit calculated using a sliding average of the pay received for the pay periods elapsed since October 9, 2004.

New participants after October 9, 2004:

2.25% of Final Average Compensation for each of the first 20 years of service plus 2% of Final Average Compensation for each year of service in excess of 20 years, with a maximum of 80% of Final Average Compensation.

Additional Benefits — An extra monthly benefit of $150.00 is payable for life. Effective November 28, 1998, a $5,000 lump sum is payable upon retirement for members sworn prior to October 9, 2004.

Terminated Vested Pension Benefit

Eligibility — More than 10 but less than 20 years of service. Termination on or after November 28, 1998.

Benefit — 2.75% of final compensation times years of service. This benefit commences at age 60 or at termination of service if later.

Deferred Retirement Option Plan (DROP)

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

Benefit:

- After September 1, 1995 but prior to September 1, 1997

Eligible participants may elect to participate in the DROP until they leave active service. The member's retirement pension will be calculated based on service and earnings at the time the DROP is elected.

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

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

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

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

Summary of Plan Provisions (cont.)

	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.

Summary of Plan Provisions (cont.)

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.

Summary of Plan Provisions (cont.)

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. 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

Summary of Plan Provisions (cont.)

	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.

Summary of Plan Provisions (cont.)

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 will follow the following contribution schedule:

Fiscal Year Ending (June 30)	City Contribution Amount
2001	$ 30,645,000
2002	32,645,000
2003	34,645,000
2004	36,645,000
2005	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 plan's funded ratio is 100%, payments will increase each year by $5,000,000 or, if the scheduled payment is less than the actuarial rate, $10,000,000. In addition, once the plan's funded ratio is 100%, the city will pay the actuarially required rate, but not less than 16% of covered pay.

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

Changes in Plan Provisions from Since the Prior Valuation

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

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SECTION FIVE

STATISTICAL SECTION

Summary

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

Financial Trends

The **Changes in Plan Net Assets** schedule shows the additions and deductions from plan net assets and the resulting changes in plan net assets for the ten years ending June 30, 2008. While contributions from members and the City have grown slowly and steadily, it is the System's investment income that provides the most impact on addition to plan net assets. Deductions to plan net assets are primarily for benefits paid to members.

City and member contributions to the System are external sources of the additions to plan net assets. **Contribution Rates** shows what percent the City's and the members' contributions are of payroll for the ten years ending June 30, 2008. The accompanying chart of **Contributions and Benefits Paid** compares the total contributions made and the benefits paid for the ten years ending June 30, 2008. The growth in benefits paid exceeds the growth in contributions in recent years, however the City's contributions under the October 9, 2004 agreement are scheduled to increase over the coming years.

Earnings from the System's investments are the fund's internal sources of and the larger component of additions to plan net assets. **Investment income** provides the details of the System's net investment gain/loss for the ten years ending June 30, 2008.

Deductions from Net Assets for Benefits and Refunds by Type presents a detailed view of the benefits paid to members and refunds for the ten years ending June 30, 2008, and the chart on page 83 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 have also grown in recent years.

The charts on page 86 graphically represent the funding progress of the System for the ten years ending June 30, 2008. The chart at the top of the page shows the percentage of the pension liability that is funded and the chart at the bottom of the page compares the actuarial value of the System's assets to the actuarial accrued liability. The existence of an unfunded actuarial liability does not necessarily indicate financial problems. The System and the City entered into an agreement on October 9, 2004, which if maintained and adequate earnings and gains are provided on investments, the System is projected to eventually be adequately funded.

Participant Information

The **Membership** schedule provides a breakdown of the plan membership for the ten years ending June 30, 2008. For fiscal year 2008, active members increased by 78, retired members and their beneficiaries increased by 85, and terminated vested members increased by one.

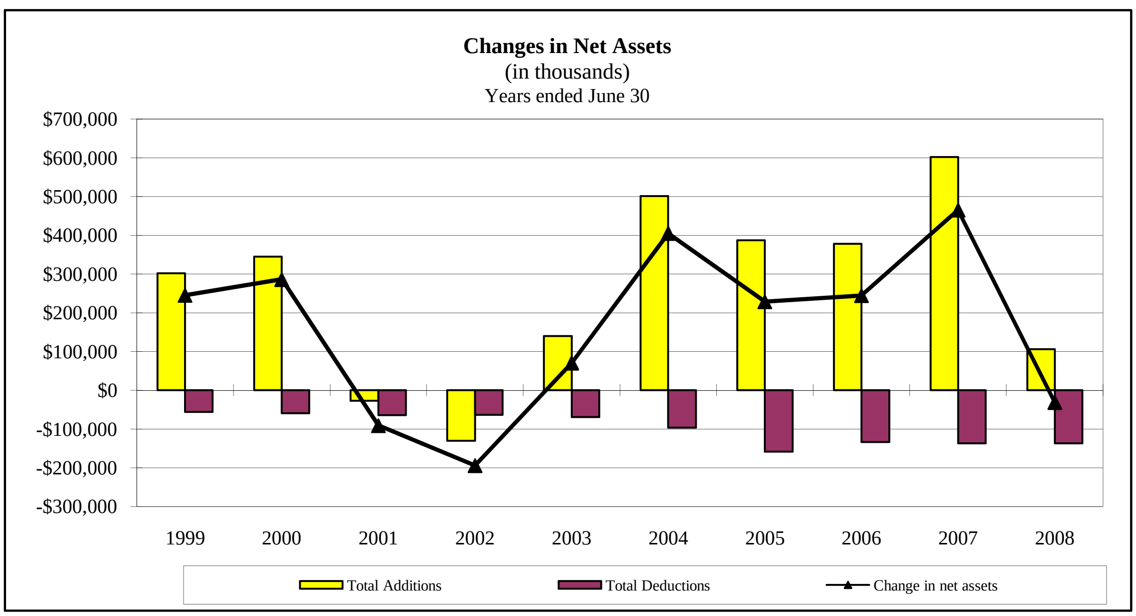
Operating Information

The **Pensions Awarded and Pensions in Force** schedules provide the number of pensions by type, age and payment amount. The **Average Monthly Benefit Amounts by Years Credited Service** presents the average final average salary and the number of retired members, in five-year increments of credited service, for the five years ended June 30, 2008. The **DROP and PROP Activity** schedules 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, 2008.

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

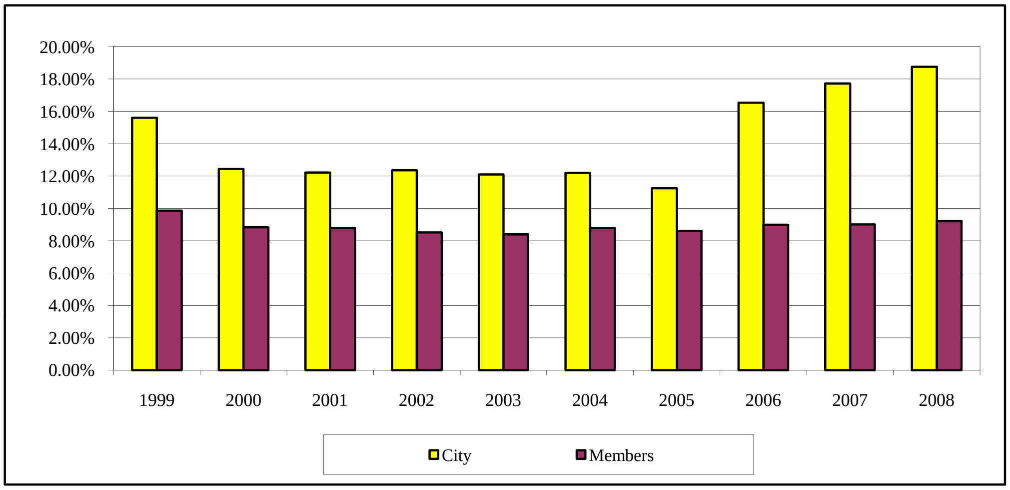
Fiscal Year	1999	2000	2001	2002	2003
Additions					
City contributions	$ 30,645	$ 30,645	$ 30,645	$ 32,645	$ 34,645
Members contributions	19,347	21,761	22,043	22,484	24,008
Investment income (net of expenses)	250,709	291,777	(80,864)	(186,657)	80,202
Securities lending income (net of expenses)	703	826	832	855	583
Total additions to plan net assets	301,404	345,009	(27,344)	(130,673)	139,438
Deductions:					
Benefits paid to members	53,626	55,421	60,328	59,783	65,649
Refunds to members	1,127	1,545	884	1,194	992
Professional and administrative expense	1,678	2,216	2,854	2,881	2,746
Total deductions from plan net assets	56,431	59,182	64,066	63,858	69,387
Change in net assets	$ 244,973	$ 285,827	$ (91,410)	$ (194,531)	$ 70,051

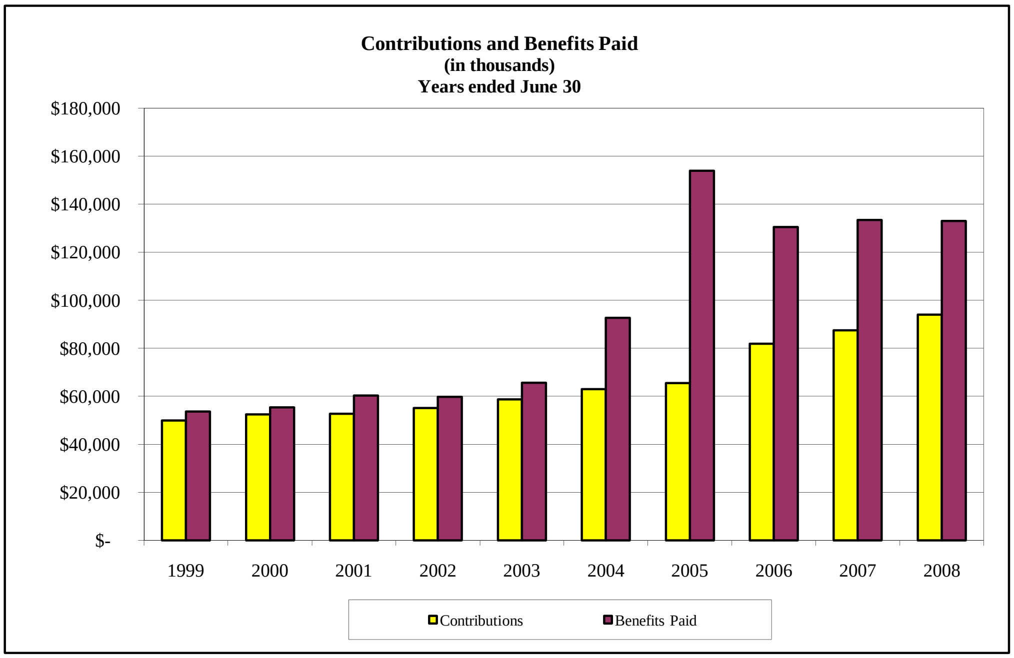
Fiscal Year	2004	2005	2006	2007	2008
Additions					
City contributions	$ 36,645	$ 37,125	$ 53,068	$ 58,000	$ 63,000
Members contributions	26,393	28,410	28,863	29,489	31,003
Investment income (net of expenses)	437,007	320,561	294,966	512,873	9,350
Securities lending income (net of expenses)	741	876	1,101	1,239	2,392
Total additions to plan net assets	500,786	386,972	377,998	601,601	105,745
Deductions:					
Benefits paid to members	92,697	153,861	130,443	133,351	133,049
Refunds to members	852	1,198	700	739	500
Professional and administrative expense	2,768	3,473	2,958	2,950	3,564
Total deductions from plan net assets	96,317	158,532	134,101	137,040	137,113
Change in net assets	$ 404,469	$ 228,440	$ 243,897	$ 464,561	$ (31,368)



Contribution Rates
Previous Ten Fiscal Years

	Percent of Payroll	
Fiscal Year	City	Members
1999	15.61%	9.85%
2000	12.43%	8.83%
2001	12.22%	8.79%
2002	12.35%	8.51%
2003	12.11%	8.39%
2004	12.20%	8.79%
2005	11.26%	8.61%
2006	16.53%	8.99%
2007	17.73%	9.02%
2008	18.75%	9.23%





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

Fiscal Year	1999	2000	2001	2002	2003
Investing activities					
Net appreciation (depreciation) in fair value of investments	$ 214,235	$ 252,445	$ (130,063)	$ (232,652)	$ 37,084
Interest	32,291	33,843	41,312	37,678	35,918
Dividends	9,870	12,880	14,293	13,672	12,659
Alternative investments (1)	55	440	1,107	2,361	1,606
Other income	111	160	326	541	306
Total	256,562	299,768	(73,025)	(178,400)	87,573
Less investment expense	(5,853)	(7,991)	(7,839)	(7,827)	(7,371)
Net income from investing activities	250,709	291,777	(80,864)	(186,227)	80,202
Securities lending activities					
Securities lending income	1,097	1,284	1,283	1,308	914
Securities lending expense	(394)	(458)	(451)	(453)	(331)
Net income from securities lending activities	703	826	832	855	583
Total investment income	251,412	292,603	(80,032)	(185,372)	80,785

Fiscal Year	2004	2005	2006	2007	2008
Investing activities					
Net appreciation (depreciation) in fair value of investments	$ 401,591	$ 275,205	$ 256,825	$ 459,957	$ (26,749)
Interest	29,477	35,006	30,201	38,304	34,603
Dividends	15,897	26,314	21,926	27,581	19,540
Alternative investments (1)	1,598				
Other income	333	157	282	147	142
Total	448,896	336,682	309,234	525,989	27,536
Less investment expense	(11,889)	(16,246)	(14,143)	(13,116)	(18,186)
Net income from investing activities	437,007	320,436	295,091	512,873	9,350
Securities lending activities					
Securities lending income	1,153	1,332	1,478	1,652	3,189
Securities lending expense	(412)	(456)	(377)	(413)	(797)
Net income from securities lending activities	741	876	1,101	1,239	2,392
Total investment income	$ 437,748	$ 321,312	$ 296,192	$ 514,112	$ 11,742

(1) Income reported under alternative investments for 1999 - 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 reclassed 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)

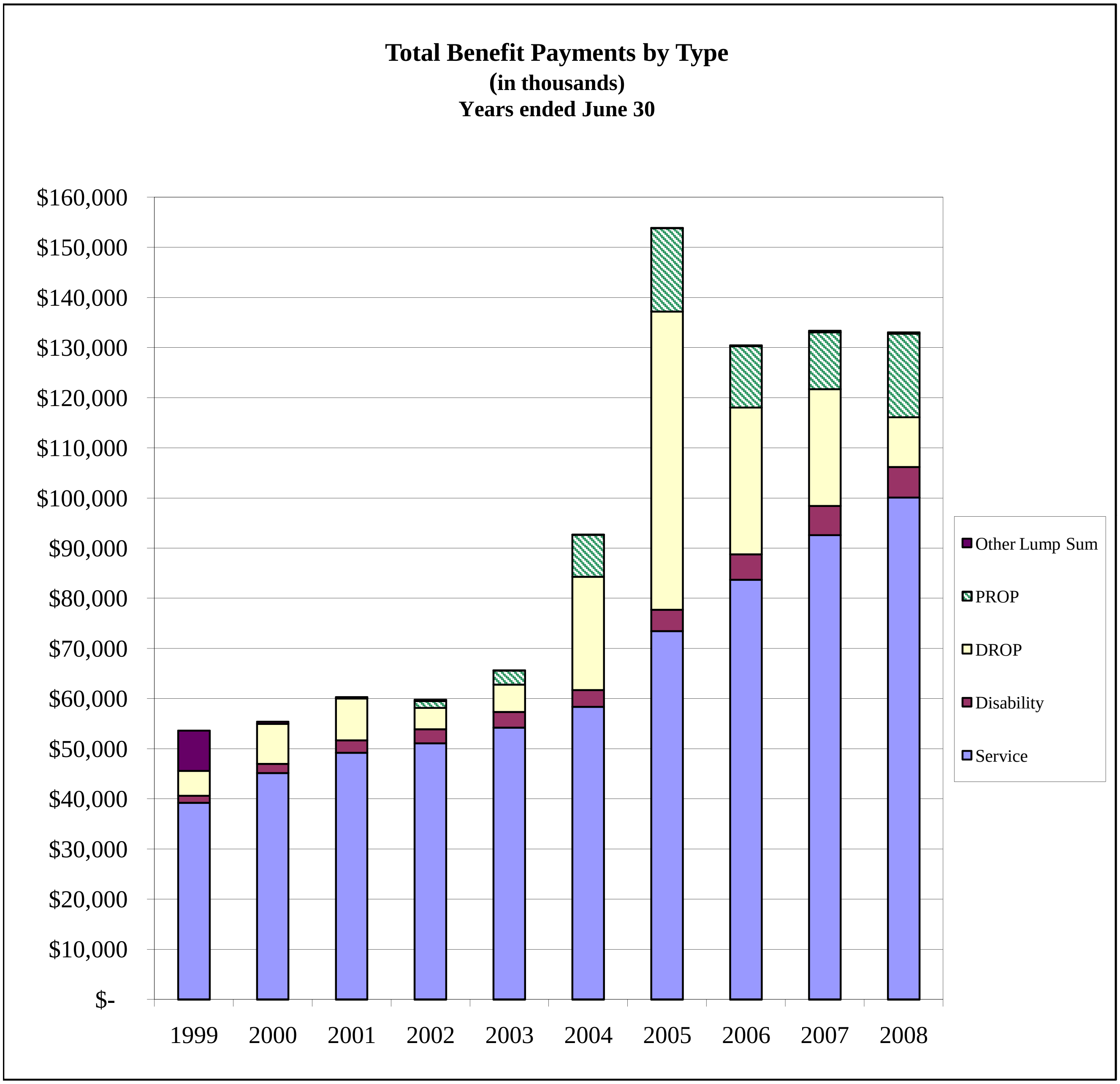
Fiscal Year	1999	2000	2001	2002	2003
Type of Benefit					
Service					
Retirees	$ 31,023	$ 35,747	$ 38,557	$ 40,126	$ 42,566
Survivors	8,182	9,406	10,641	10,934	11,640
Disability					
Retirees - duty	809	1,002	1,337	1,572	1,646
Retirees - nonduty	189	268	304	310	323
Survivors	441	548	836	941	1,178
Lump Sum					
DROP distributions	4,949	8,020	8,381	4,263	5,441
PROP distributions (1)			97	1,348	2,815
Other (2)	8,033	430	175	288	40
Total benefits	$ 53,626	$ 55,421	$ 60,328	$ 59,783	$ 65,649
Type of Refund					
Death	$ 34	$ 1	$ 49	$ -	$ 20
Separation	1,093	1,544	835	1,194	972
Total refunds	$ 1,127	$ 1,545	$ 884	$ 1,194	$ 992

Fiscal Year	2004	2005	2006	2007	2008
Type of Benefit					
Service					
Retirees	$ 45,912	$ 59,709	$ 69,074	$ 77,639	$ 83,925
Survivors	12,466	13,733	14,612	14,965	16,203
Disability					
Retirees - duty	1,787	2,604	3,378	4,003	4,154
Retirees - nonduty	313	358	347	313	371
Survivors	1,238	1,310	1,364	1,517	1,531
Lump Sum					
DROP distributions	22,603	59,493	29,272	23,315	9,937
PROP distributions (1)	8,352	16,649	12,233	11,303	16,680
Other (2)	25	5	163	296	248
Total benefits	$ 92,697	$ 153,861	$ 130,443	$ 133,351	$ 133,049
Type of Refund					
Death	$ -	$ -	$ -	$ -	$ -
Separation	852	1,198	700	739	500
Total refunds	$ 852	$ 1,198	$ 700	$ 739	$ 500

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

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

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


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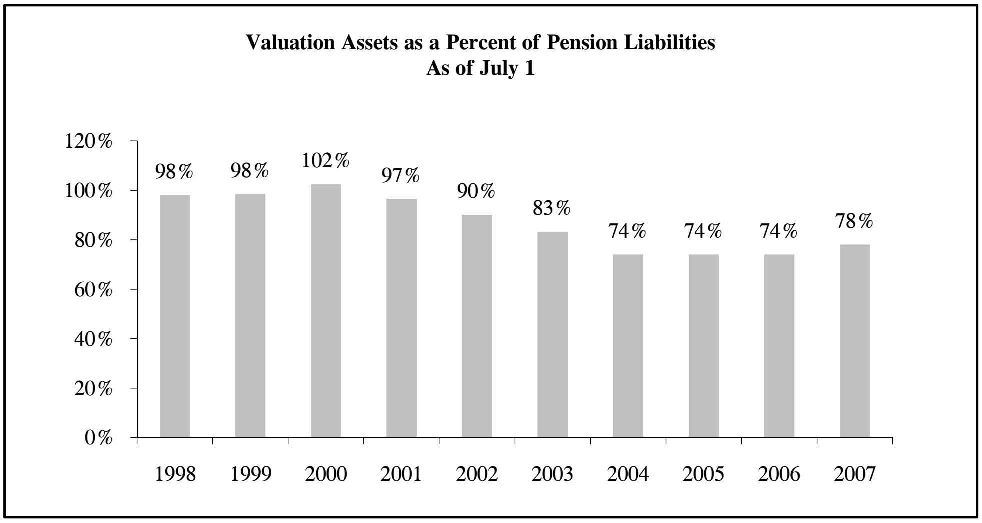
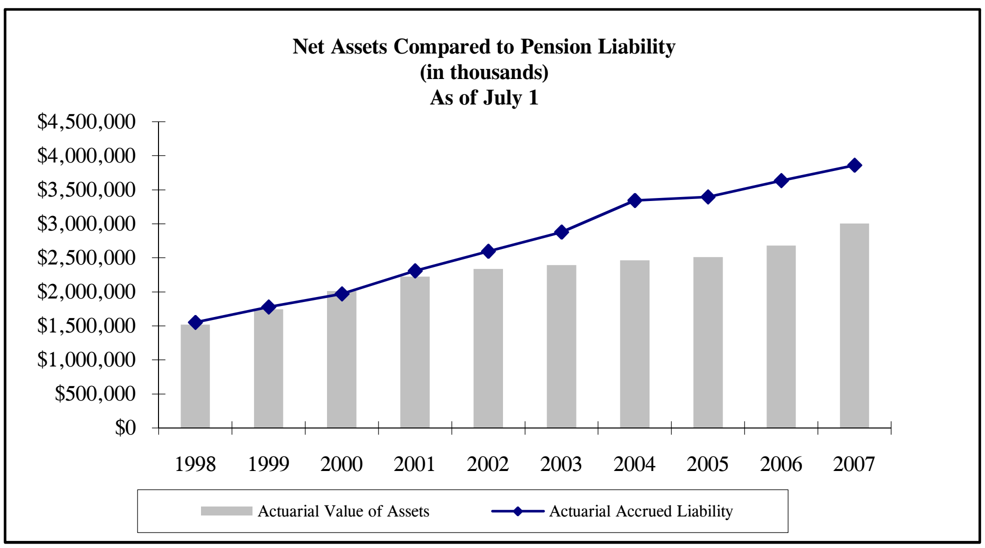
Other Lump Sum
PROP
DROP
Disability
Service



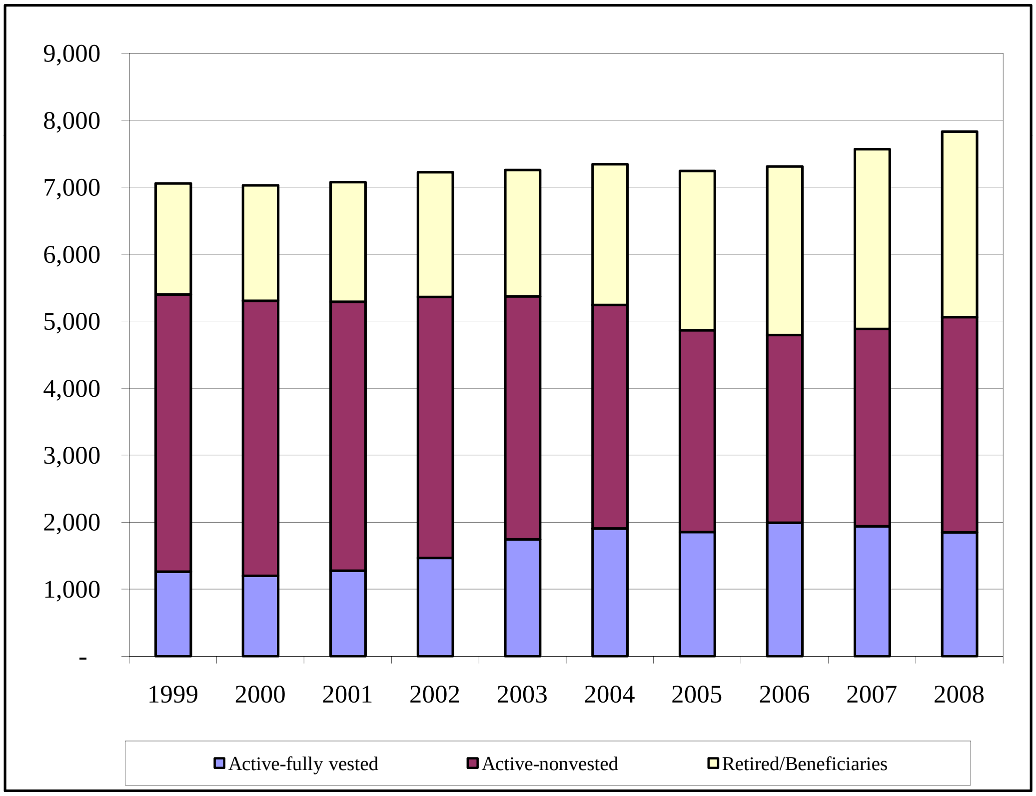


Charts through most recent actuarial valuation dated July 1, 2007.

Membership
Last Ten Fiscal Years

Fiscal Year	Active Fully Vested	Active Nonvested	Retired/ Beneficiaries	Terminated Vested *	Totals
1999	1,261	4,138	1,657		7,056
2000	1,198	4,107	1,723		7,028
2001	1,275	4,015	1,786		7,076
2002	1,466	3,895	1,864	5	7,230
2003	1,745	3,628	1,886	7	7,266
2004	1,907	3,335	2,100	10	7,352
2005	1,851	3,016	2,376	3	7,246
2006	1,992	2,802	2,517	15	7,326
2007	1,940	2,942	2,683	15	7,580
2008	1,849	3,211	2,768	16	7,844

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



Pensions Awarded in Current Year by Type and by Age
Year Ended June 30, 2008

		Type of Pension		
Age on June 30,	Total	Service	Disability	Survivor
Under 40	4	-	3	1
40-44	6	3	3	
45-49	27	23	1	3
50-54	36	33	-	3
55-59	31	25	-	6
60-64	23	19	-	4
65-69	3	-	-	3
70-74	5	-	-	5
75 and over	9	-	-	9
Total	144	103	7	34

Total Pensions in Force by Type and by Age
Year Ended June 30, 2008

		Type of Pension		
Age on June 30,	Total	Service	Disability	Survivor
Under 40	38	-	17	21
40-44	49	17	21	11
45-49	198	148	25	25
50-54	333	283	18	32
55-59	569	497	15	57
60-64	564	495	11	58
65-69	314	244	5	65
70-74	321	241	4	76
75-79	192	134	1	57
80-84	126	58	-	68
85 and over	64	16	2	46
Total	2,768	2,133	119	516

Pensions Awarded in Current Year by Type and by Monthly Amount
Year Ended June 30, 2008

		Type of Pension		
Monthly Amount	Total	Service	Disability	Survivor
Under $1000	1	-	1	-
$1000-$2000	4	1	2	1
$2000-$3000	18	1	3	14
$3000-$4000	94	80	1	13
$4000-$5000	19	15	-	4
$5000-$6000	5	4	-	1
$6000-$7000	2	1	-	1
$7000 and over	1	1	-	-
Total	144	103	7	34

Average Monthly Benefit Amounts
Previous Five Fiscal Years

Member Retiring During Fiscal Years		**Years Credited Service** <5	5-10	10-15	15-20	20-25	25-30	30+	**All Members**
2004	Average monthly benefit	$ -	$ 1,892	$ 1,875	$ 2,402	$ 3,096	$ 3,369	$ 4,023	$ 3,456
	Average final average salary	$ -	$ 3,970	$ 4,024	$ 4,577	$ 5,661	$ 6,043	$ 6,006	$ 5,820
	Average DROP Balance	$ -	$ 5,000	$ 5,000	$ 5,000	$ 88,499	$ 391,141	$ 536,444	$ 340,555
	Number of retirees	-	4	4	3	52	61	70	194
2005	Average monthly benefit	$ 3,582	$ 1,367	$ 2,213	$ 2,970	$ 3,278	$ 3,558	$ 4,134	$ 3,668
	Average final average salary	$ 3,582	$ 3,468	$ 4,779	$ 5,322	$ 5,970	$ 6,428	$ 6,293	$ 6,152
	Average DROP Balance	$ 5,000	$ 5,026	$ 5,000	$ 41,719	$ 103,644	$ 395,811	$ 583,494	$ 378,705
	Number of retirees	1	5	3	7	84	81	134	315
2006	Average monthly benefit	$ -	$ 2,432	$ 2,666	$ 2,809	$ 3,289	$ 3,455	$ 3,897	$ 3,510
	Average final average salary	$ -	$ 4,250	$ 4,848	$ 5,112	$ 5,952	$ 6,306	$ 6,190	$ 6,027
	Average DROP Balance	$ -	$ 5,000	$ 5,000	$ 5,000	$ 79,836	$ 382,006	$ 620,961	$ 355,204
	Number of retirees	-	7	3	4	55	44	71	184
2007	Average monthly benefit	$ -	$ 2,463	$ 2,742	$ -	$ 3,272	$ 3,472	$ 3,693	$ 3,447
	Average final average salary	$ -	$ 4,478	$ 4,930	$ -	$ 5,841	$ 6,284	$ 6,097	$ 6,004
	Average DROP Balance	$ -	$ 5,000	$ 5,000	$ -	$ 131,167	$ 379,358	$ 631,452	$ 367,727
	Number of retirees	-	1	7	-	58	46	61	173
2008	Average monthly benefit	$ -	$ 1,665	$ 2,502	$ 3,803	$ 3,498	$ 3,359	$ 3,918	$ 3,520
	Average final average salary	$ -	$ 4,405	$ 5,037	$ 6,914	$ 5,910	$ 3,021	$ 6,439	$ 6,052
	Average DROP Balance	$ -	$ 5,000	$ 5,000	$ 5,000	$ 144,905	$ 399,403	$ 704,850	$ 381,261
	Number of retirees	-	3	3	1	39	29	35	110
Five Years Ended June 30, 2008									
	Average Monthly Benefit	$ 3,582	$ 1,944	$ 2,442	$ 2,869	$ 3,276	$ 3,459	$ 3,975	$ 3,540
	Average Final Average Salary	$ 3,582	$ 4,033	$ 4,730	$ 5,223	$ 5,877	$ 5,913	$ 6,201	$ 6,025
	Average DROP Balance	$ 5,000	$ 5,006	$ 5,000	$ 22,136	$ 107,493	$ 389,891	$ 601,121	$ 365,033
	Number of Retirees	1	20	20	15	288	261	371	976

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
1999	$ 40,262	$ (4,949)	$ 100,938	115	(56)	1,072
2000	51,892	(8,020)	144,810	178	(59)	1,191
2001	104,768	(8,381)	241,197	159	(52)	1,298
2002	72,527	(4,263)	309,461	212	(74)	1,436
2003	74,268	(5,441)	378,288	297	(62)	1,671
2004	48,487	(22,603)	404,172	285	(185)	1,771
2005	46,126	(59,493)	390,805	372	(298)	1,845
2006	73,581	(29,272)	435,114	296	(168)	1,973
2007	80,863	(23,315)	492,662	120	(157)	1,936
2008	95,543	(9,937)	578,268	15	(100)	1,851

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

PROP Activity
(dollars in thousands)
Years ended June 30

	PROP Accounts			PROP Participants		
Fiscal Year	Accumulations	Distributions	Total	Entrants	Withdrawals	Total
1999	-	-	-	-	-	-
2000	$ 385	$ -	$ 385	8	-	8
2001	918	(97)	1,206	8	(1)	15
2002	14,935	(1,348)	14,793	95	(1)	109
2003	17,034	(2,815)	29,012	48	(4)	153
2004	45,144	(8,352)	65,804	119	(15)	257
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

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