CITY OF SAN JOSÉ
COMPREHENSIVE ANNUAL
FINANCIAL REPORT

For the Fiscal Year Ended June 30, 2005

SAN JOSE
CAPITAL OF SILICON VALLEY

FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM

A Pension Trust Fund of the City of San José, California

Edward F. Overton
Director

City of San José
Department of Retirement Services
1737 North First Street, Suite 580
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Board Chair Letter

Federated City Employees' Retirement System

SAN JOSE
CAPITAL OF SILICON VALLEY

The Honorable Mayor and City Council
Members of the Federated
City Employees' Retirement System
City of San José
San José, California

September 2, 2005

Dear Mayor, Council Members and Plan Members:

On behalf of the members of the Board of Administration, I am pleased to present the Federated City Employees' Retirement System's (the System) Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2005. Some significant events worthy of note during this fiscal year were as follows:

- The System earned a time-weighted rate of return of 8.91% on investments, compared to 9.54% for its benchmark and 9.36% for the Trust Universe Comparison Service Public Fund Median.
- The System conducted a retiree health survey and presented the recommendations at a Health Symposium.
- The Board continued to rebalance the portfolio based on the Asset Modeling Study that was completed in fiscal year 2003-04.
- The Board completed the classification and compensation study.
- The System continued to make enhancements to the web member services and website.
- The Board still remains committed to complying with the California Pension Protection Act (Prop 162).

The Board believes that the professional services rendered by the staff, the auditors, investment counselors, the actuarial consultants, and the Fund performance evaluators have produced a sound fund capable of continued growth. The Board of Administration and its staff are available to provide additional information when requested.

Sincerely,

DAVID BUSSE, CHAIR
BOARD OF ADMINISTRATION

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Federated City Employees' Retirement System

SAN JOSE
CAPITAL OF SILICON VALLEY

City of San José
Department of Retirement Services
Board of Administration
Federated City Employees' Retirement System
1737 North First Street, Suite 580
San Jose, California 95112-4505

EDWARD F. OVERTON
DIRECTOR, RETIREMENT SERVICES

September 2, 2005

Dear Board Members:

I am pleased to present the Comprehensive Annual Financial Report (CAFR) of the Federated City Employees' Retirement System (the System) for the fiscal year ended June 30, 2005. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, rests with the System's management. Macias Gini & Company LLP, the System's independent auditor, has audited the accompanying financial statements. Management believes that internal control is adequate and the accompanying statements, schedules and tables are fairly presented and free from material misstatement.

The System was established in 1941 and switched to the CAFR format for the fiscal year ended June 30, 2000. Information contained in this report is designed to provide a complete and accurate financial review of the year's operations. I am proud to report that last year's CAFR was awarded the Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association. The System also received the Public Pension Standards Award in recognition of meeting professional standards for plan design and administration by the Public Pension Coordinating Council. I encourage you to review the narrative introduction, overview and analysis located in Management's Discussion and Analysis beginning on page 16.

Structure of the Report

This report is presented in five sections:

• The Introductory Section contains the chairman's report, the letter of transmittal, the Certificate of Achievement for Excellence in Financial Reporting, description of the System's management and organizational structure, a summary of the plan provisions and a listing of the professional service firms used.

• The Financial Section contains the report from the independent auditor, Macias Gini & Company LLP, Management's Discussion and Analysis, and the basic financial statements of the System and certain required supplementary information and other supplementary information.

• The Investment Section contains the Investment Consultant's statement produced by the Bank of New York, the System's investment performance consulting firm, along with investment policies and graphs and schedules regarding asset allocation, asset diversification and performance.

• The Actuarial Section contains the certification letter produced by the independent actuary, Gabriel, Roeder, Smith & Company, along with the results of the System's last bi-annual valuation (2003).

• The Statistical Section contains graphs and schedules with comparative data related to additions, deductions, benefits, and membership.

I trust that you and the members of the System will find this CAFR helpful in understanding the System; a plan that continues to maintain a strong and positive financial future.

Certificate of Achievement

The Government Finance Officers Association of the United States and Canada ("GFOA") awarded a Certificate of Achievement for Excellence

LETTER OF TRANSMITTAL *Continued*

Excellence in Financial Reporting to the System for its CAFR for the fiscal year ended June 30, 2004. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

To be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized CAFR, whose contents meet or exceed program standards. This report must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid only for one year. The System has received the certificate for four consecutive years. The System first received the certificate for its fiscal year ended June 30, 2000 CAFR with its first application. We believe our current report continues to conform to the Certificate of Achievement Program Requirements, and we are submitting it to GFOA to determine its eligibility for another certificate.

The CAFR was prepared to conform to the principles of governmental accounting and reporting set forth by the Governmental Accounting Standards Board. Transactions of the System are reported on the accrual basis of accounting. Sufficient internal accounting controls exist to provide reasonable assurance regarding the safekeeping of assets and fair presentation of the financial statements and supporting schedules.

The System also received the Public Pension Coordinating Council's Public Pension Standards 2003 Award. It is a bi-annual award presented to public pension plans in recognition of meeting professional standards for plan design and administration as set forth in the Public Pension Standards.

Major Initiatives

During the fiscal year 2004-05 the System also conducted a health survey, which resulted in approximately 300 responses. The survey included the retirees' concerns regarding health plans and the recommendations were made at a Health Symposium in August 2005.

The System continued to make enhancements to the web member services and website. During the fiscal year 2004-05 open enrollment, members were able to download forms directly from the website.

The System also conducted a Class and Compensation Study for the Retirement Department's staff. The study resulted in an upgrade to the accountant's position. The System continued implementation of the asset allocation targets approved following completion of an asset liability modeling study in 2002. The new asset allocation added an allocation to private markets and increased its allocation to developed international equities while reducing its allocation to real estate. Transition to the new asset allocation targets continued during the 2004-05 fiscal year with the hiring of a global fixed income manager.

Effective July 1, 2004, the System's Actuary assisted the System in simplifying the reserve categories. As a result the Employer Contributions, Retired Employees Annuity, Benefits Payable, and Contingency Reserve categories were eliminated and the balance transferred to the General Reserve category.

CHANGES IN SYSTEM MEMBERSHIP

System membership changes for the defined benefit pension plan for FY2005 were as follows:

	2005	2004	Increase (Decrease)	Change
Active Members*	4,603	4,750	(147)	-3.1%
Retired Members	2,079	1,933	146	7.6%
Survivors**	406	399	7	1.8%
TOTAL	**7,088**	**7,082**	**6**	**0.1%**

* *Active members include deferred vested members, members who have left City service but remain a member of the Plan.*

** *Survivor total includes ex-spouses.*

Letter of Transmittal *Continued*

Financial and Economic Summary

For the fiscal year ended June 30, 2005, the time-weighted rate of return for the System was 8.91% with the Benchmark Index return of 9.54%. The System ranked in the 61st percentile of the Trust Universe Comparison Service ("TUCS") – Public Fund Universe. Maintaining a long-term perspective is important when dealing with retirement assets. The annualized return since inception was 9.10%, which is ahead of the actuarial assumption rate of 8.25%.

The U.S. economy has been hampered by higher oil prices but core inflation is not significant. We continue to experience slow growth which may result in lower earnings over the next fiscal year. Investment returns in the first half of 2005 have been weak and interest rates appear to be rising. The System's investment consultant, The Bank of New York, believes that the historically conservative asset allocation strategy followed by the System's Board has benefited the plan's long-term return. The System is well structured to meet its investment objectives as defined in the Investment Policy Statement.

Investment Summary

The Board of Administration has exclusive control of all investments of the System and is responsible for the establishment of investment objectives, strategies and policies. Members of the Board serve in a fiduciary capacity and must discharge their duties with respect to the System and the investment portfolio solely in the interest of, and for the exclusive purposes of providing benefits to, members of the System and defraying the reasonable cost of administration.

The System has had relatively favorable performance during a volatile period in the capital markets. The portfolio earned a time-weighted rate of return of 8.91% versus 9.54% for Trust Universe Comparison Service ("TUCS"), which placed the System's total return in the third quartile of TUCS Public Funds and All Master Trusts Universe. Over long-term periods, the portfolio has earned a total return of 10.86% over the past three years and 6.00% over the past five years. The System's net assets increased during the year from $1,406,724,000 to $1,512,163,000.

Funding

The System's funding objective is to meet long-term benefit obligations through contributions and investment income. Based on the June 30, 2003 actuarial report, the funding ratio of the System was approximately 98%. A history of the System's funding progress is presented on page 39. The net increase in System assets for FY 2005 was $105,439,000. Details of the components of this increase are included in the Statement of Changes in Plan Net Assets on page 26.

Conclusion

I would like to take this opportunity to thank the members of the System for their confidence in the plan management during the past year. I also want to express my thanks to the Board of Administration for its dedicated effort in supporting the staff through this past year. I thank the consultants and staff for their commitment to the System and for their diligent work to assure the System's continued successful operation.

Respectfully Submitted,

EDWARD F. OVERTON
DIRECTOR, RETIREMENT SERVICES

Certificate of Achievement in Financial Reporting

Certificate of Achievement for Excellence in Financial Reporting

Presented to

San Jose Federated City Employees' Retirement System, California

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2004

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

Government Finance Officers Association of the United States and Canada Corporation Seal Chicago

President

Executive Director

Public Pension Standards Award

PPCC

Public Pension Coordinating Council

Public Pension Standards

2003 Award

Presented to

City of San Jose Retirement Services

In recognition of meeting professional standards for
plan design and administration as
set forth in the Public Pension Standards.

Presented by the Public Pension Coordinating Council, a confederation of

National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

Alan H. Winkle

Alan H. Winkle
Program Administrator

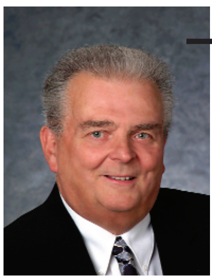
Board of Administration

The Retirement System is administered by a seven-member Board of Administration composed of two City Council members, a member from the Civil Service Commission, two City employees elected by members of the system, a Retiree Representative, and a public member who is not connected with the City and has significant banking or investment experience selected by the four Board members and approved by the City Council. The Board is appointed by the City Council and serves in accordance with Section 2.08.300 of the San José Municipal Code.

As of June 30, 2005, the members of the Board were as follows

DAVID BUSSE, CHAIR

Civil Service Commission member appointed in February 2003. His current term expires December 1, 2006.



WILLIAM A. THOMAS, VICE CHAIR

Retired Plan member appointed in August 2001. His current term expires November 30, 2008.

BRADLEY IMAMURA

Employee Representative appointed to the Board in December 1993. His current term expires November 30, 2005.

DAVID CORTESE

City Council Member appointed to the Board on January 1, 2005.

FORREST WILLIAMS

City Council member appointed to the Board in August 2001.

JEFFREY PERKINS

Public member appointed to the Board in June 1996. His current term expires November 30, 2006.

MIKE YOSHIMOTO

Employee Representative appointed to the Board in December 1999. His current term expires November 30, 2007.

Administration

OUTSIDE CONSULTANTS

ACTUARY
Gabriel, Roeder, Smith & Company
Roseville, CA

ATTORNEY
Saltzman & Johnson
San Francisco, CA

ATTORNEY, REAL ESTATE
Bingham McCutchen, LLP
East Palo Alto, CA

AUDITOR
Macias Gini & Company LLP
Walnut Creek, CA

A list of Investment Professionals begins on page 57 of the Investment Section of this report.

STANDING PUBLIC MEETINGS

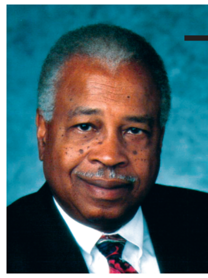
BOARD MEETINGS:
Second Thursday of the Month
8:30 AM

COMMITTEE FOR INVESTMENTS:
Quarterly

COMMITTEE OF THE WHOLE:
Quarterly

REAL ESTATE COMMITTEE:
Quarterly

Agendas for all public meetings are posted on the bulletin board in front of City Hall and on the department's website at ***http://sjretirement.com/fed/meetings/agendas.asp*** *or they can be obtained in the retirement office at 1737 North First Street, Suite 580, San Jose, CA 95112. Meeting times and locations are subject to change, please call our office at 408 392-6700 for current information.*



EDWARD F. OVERTON

DIRECTOR, RETIREMENT SERVICES

THOMAS J. WEBSTER

DEPUTY DIRECTOR

Department of Retirement Services Administration

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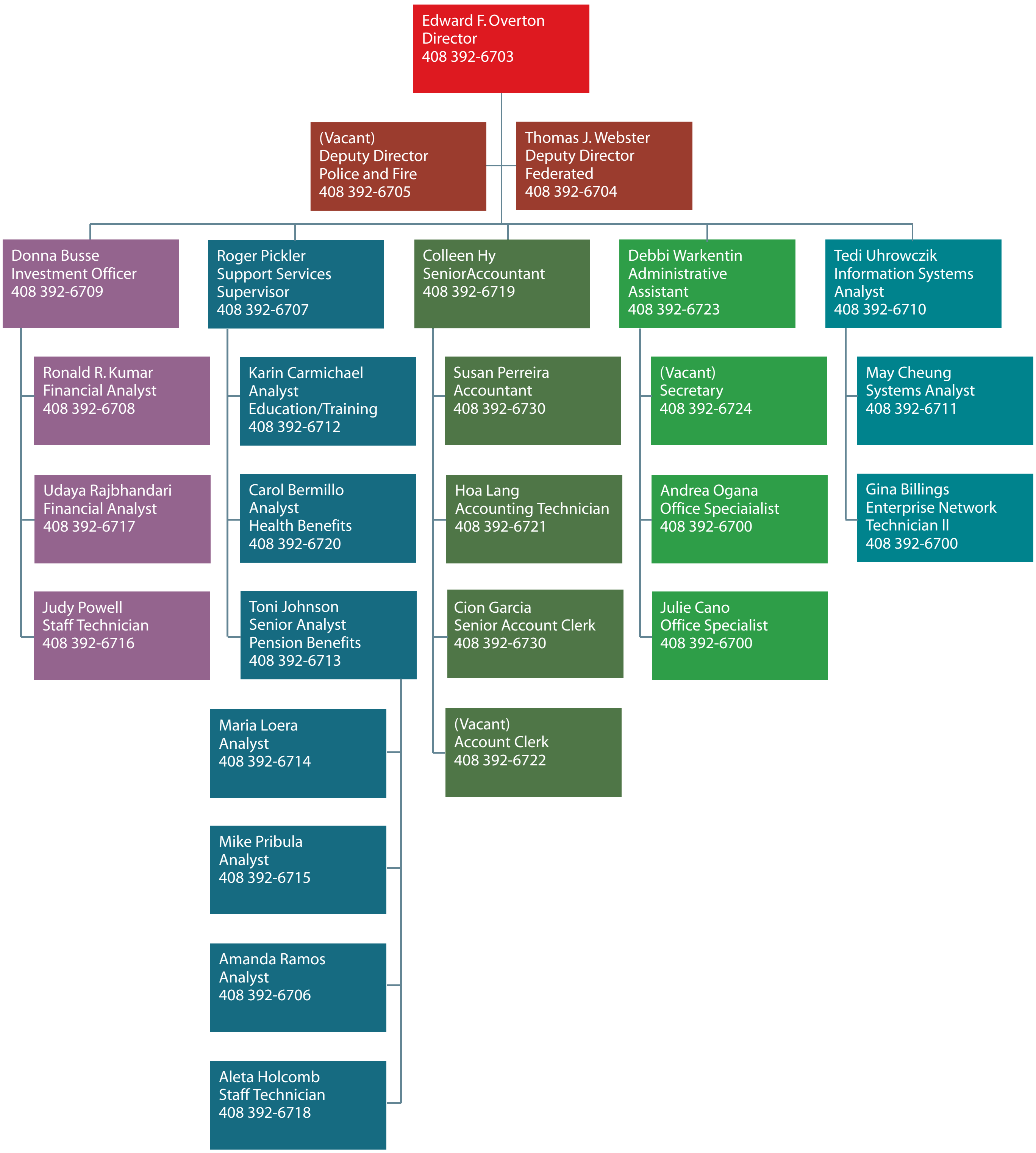
DEPARTMENT OF RETIREMENT SERVICES ORGANIZATIONAL CHART



SUMMARY OF THE PRINCIPAL PLAN PROVISIONS

MEMBERSHIP

Mandatory for all full-time non-safety employees.

MEMBER CONTRIBUTION

All members contribute 6.06% of base salary.

CITY'S CONTRIBUTION

The City contributes 17.12% of the base salary. The financing is designed to provide reserves sufficient to meet the accrued and accruing liabilities under the prescribed benefit schedule. (Rates are reviewed following each actuarial survey.)

RETIREMENT

Members may retire at age 55 with five or more years of service or at any age with 30 years of service.

RETIREMENT ANNUITY

The retirement annuity payable is the Final Average Salary multiplied by 2.5% per year of service (Maximum Benefit: 75% of the Final Average Salary).

FINAL AVERAGE SALARY

The average monthly salary for the highest twelve (12) consecutive months.

DISABILITY RETIREMENT

Non-Service Connected

A non-service connected disability annuity is available to members with five (5) or more years of service if the disability is permanent and prevents the member from performing any work in his/her present classification. The base non-service connected disability annuity is the greater of 40% of the Final Average Salary or the earned retirement allowance (Final Average Salary x 2.5% x Number of Years of Service). The annuity will be reduced by .5% for each year of age under 55.

For those entering the system September 1, 1998 or later, the calculation is as follows:

20% of Final Average Salary for 6 years of service;
add 2% for each year of service in excess of 6 years but less than 16 years;
add 2.5% for each year of service in excess of 16 years of service.

Service-Connected

A service-connected disability is available if the disability is permanent and directly due to and caused by actual performance of employment within the City. The minimum service-connected disability annuity is 40% of the final average salary. There is no minimum service requirement for a service-connected disability nor reduction factor due to age.
The disability benefit is offset by certain workers' compensation payments. If a member has more than 16 years of service with the City of San José, they will also receive 2.5% of the Final Average Salary for each year in excess of 16 in addition to the 40% benefit for a Service Connected Disability.
(Maximum Benefit: 75% of the Final Average Salary)

TERMINATION BENEFITS

Upon termination, the member will be paid all of his or her accumulated contributions and interest in full satisfaction of all rights and benefits under this Retirement System except that a member terminating with at least five (5) years of service may elect to leave the accumulated contributions and interest on deposit with option of reciprocity.

DEFERRED RETIREMENT

Contributions left on deposit by a member terminating with at least five (5) years of service (vesting) entitle the employee to a retirement annuity upon attaining age 55.

RECIPROCITY

Effective December 9, 1994, the City entered into an agreement with the California Public Employees' Retirement System (PERS) that extends reciprocal benefits to members. In certain situations, this agreement results in improved retirement benefits for members who move from one eligible retirement system to another. If a member terminates and goes to a California PERS agency or a reciprocal agency and claims reciprocity, they may leave their accumulated contributions and interest on deposit regardless of years of service.

Summary of the Principal Plan Provisions *Continued*

COST OF LIVING

The Board of Administration determines the change in the cost of living (COL) each year using the most current December Consumer Price Index. This Index is in accordance with San Jose Municipal Code "for all urban consumers (CPI-U) San Francisco-Oakland Metropolitan Area" as published by the Bureau of Labor Statistics of the United States Department of Labor. The Board determines the change to be effective beginning April first each year. A maximum of 3% is granted with any excess accumulated for use in future years. A retiree receives no COL adjustment for the first year, then receives a pro-rated adjustment for the months before the next April first. Survivors will be paid their next COL adjustment at the same time it would have been paid to the retiree. There is no break in the COL schedule.

DEATH BEFORE RETIREMENT

The surviving spouse of an eligible employee who dies before retirement will receive a retirement allowance determined by the years of service times 2.5% times the final average salary (minimum of 40% and maximum of 75%). Unmarried children are entitled to an allowance to age 18 (22 if they are full time students) if there is no spouse. The allowance is as follows:

1 child receives 25% of the spousal benefit
2 children share 50% of the spousal benefit
3+ children share 75% of the spousal benefit

The beneficiary, in the event that no family members are eligible for a monthly allowance, is entitled to a return of the member's contributions and interest plus a death benefit of one month's salary for each year of service (up to six years).

If the employee is 55 and has 20 or more years of service at the time of death, his/her spouse will retain the survivorship allowance for life. If not, the spouse loses the allowance upon a remarriage.

DEATH AFTER RETIREMENT

The surviving spouse receives one-half* of the member's retirement allowance until death and a $500 death benefit (* At the time of retirement, the member may select an alternative option allowing for a survivorship allowance of up to 100% of the member's allowance). If there is no surviving spouse, dependent children are eligible for an allowance. The allowance is:

1 child receives 25% of spousal benefit
2 children share 50% of spousal benefit
3+ children share 75% of spousal benefit

MANAGEMENT

The System is under the management of a seven (7) member Board of Administration consisting of two City Council members, a Civil Service Commissioner, a public member with significant banking or investment experience, a retiree representative, and two elected employees who are members of the Retirement System.

ADMINISTRATION

A full-time Director is employed by the City. He serves as Secretary and Chief Executive Officer to the Board of Administration.

The Fund pays the cost of the personnel who are employed for the purpose of managing the Retirement System. It also pays any directly related administrative costs.

Bank of New York is employed as custodian of fund assets and collector of investment income.

ACTUARIAL SOUNDNESS

Gabriel, Roeder, Smith & Company is retained for regular, continuing actuarial services. Plan and benefit provisions are periodically reviewed to assure continuing soundness.

Summary of the Principal Plan Provisions *Continued*

INVESTMENT AUTHORITY AND POLICY

The investment authority is broad and allows maximum utilization of the System's resources. Nationally known investment advisory services including Atlanta Capital Management; Bank of Ireland; BlackRock Financial Management; Boston Company Asset Management; Brandywine Asset Management; Dodge and Cox; DRA Advisors; Eagle Asset Management; Fidelity Investments; Loomis Sayles; MIG Realty Advisors; Northern Trust; Pathway Capital Management; Prudential Real Estate Investors are retained for full-time investment counsel. The Bank of New York is retained as the investment performance consultant and Strategic Investment Solutions, Inc. as the investment consultant.

II. FINANCIAL SECTION

Independent Auditor's Report

MACIAS GINI & COMPANY LLP

Macias Gini & Company LLP
2175 N. California Boulevard, Suite 645
Walnut Creek, California 94596

925.274.0190 phone
925.274.3819 fax
www.maciasgini.com

The Board of Administration
City of San José Federated City Employees'
Retirement System

We have audited the accompanying statements of plan net assets of the City of San José Federated City Employees' Retirement System (System), a pension trust fund of the City of San José, California, as of June 30, 2005 and 2004, and the related statements of changes in plan net assets for the fiscal 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 and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. 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 the 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.

As discussed in Note 2(a), the financial statements of the System are intended to present only the plan net assets and changes in plan net assets of the System. They do not purport to, and do not, present fairly the financial position of the City of San José, California, as of June 30, 2005 and 2004, and the changes in its financial position for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the statements referred to above present fairly, in all material respects, the financial position of the System as of June 30, 2005 and 2004, and the changes in its financial position for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2(g) to the basic financial statements, effective July 1, 2004, the System adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposits and Investment Risk Disclosures - an amendment of GASB Statement No. 3*.

Independent Auditor's Report *Continued*

Macias Gini & Company LLP

Macias Gini & Company LLP
2175 N. California Boulevard, Suite 645
Walnut Creek, California 94596

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In accordance with *Government Auditing Standards,* we have also issued our report dated September 2, 2005, on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis and the schedules designated as other required supplementary information in the table of contents, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the System's basic financial statements. The introductory section, other supplementary information in the financial section, the investment, actuarial and statistical sections listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The other supplementary information in the financial section has been subjected to auditing procedures applied in the audits 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. The introductory, investment, actuarial and statistical sections have not been subjected to auditing procedures applied in the audits of the basic financials statements and, accordingly, we express no opinion on them.

Macias, Gini & Company LLP

CERTIFIED PUBLIC ACCOUNTANTS
WALNUT CREEK, CALIFORNIA
SEPTEMBER 2, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM

SAN JOSE
CAPITAL OF SILICON VALLEY

City of San José
Department of Retirement Services
Board of Administration
Federated City Employees' Retirement System
1737 North First Street, Suite 580
San Jose, California 95112-4505

EDWARD F. OVERTON
DIRECTOR, RETIREMENT SERVICES

MANAGEMENT'S DISCUSSION AND ANALYSIS

We are pleased to provide this overview and analysis of the financial activities of the Federated City Employees' Retirement System (the System) for the fiscal years ended June 30, 2005 and 2004.

Financial Highlights for Fiscal Year 2005

• The net assets of the System at the close of the fiscal year 2005 are $1,512,163,000 (net assets held in trust for pension benefits and postemployment healthcare benefits). All of the net assets are available to meet the System's ongoing obligations to plan participants and their beneficiaries.

• The System's total net assets held in trust for pension benefits and postemployment healthcare benefits increased by $105,439,000 or 7.5%, primarily as a result of a strengthening in the investment market.

• The System's funding objective is to meet long-term benefit obligations through contributions and investment income. As of June 30, 2003, the date of our last actuarial valuation, the funded ratio for the System was approximately 98%. In general, this indicates that for every dollar of benefits due we have approximately $.98 of assets to cover it.

•Additions to Plan Net Assets for the year were $187,317,000, which includes member and employer contributions of $65,160,000, net investment income of $121,943,000, and net securities lending income of $214,000.

• Deductions in Plan Net Assets increased from $73,571,000 to $81,878,000 over the prior year, or approximately 11.3% due to an increase in retirement and healthcare benefits, which was attributable to enhanced benefits and an increased number of beneficiaries along with increased health premium costs.

Overview of the Financial Statements

The following discussion and analysis is intended to serve as an introduction to the System's financial statements, which are comprised of these components:

1. Statement of Plan Net Assets
2. Statement of Changes in Plan Net Assets
3. Notes to the Basic Financial Statements

Please note, however, that this report also contains other supplementary information in addition to the basic financial statements themselves.

The Statement of Plan Net Assets is a snapshot of account balances at fiscal year-end. It indicates the assets available for future payments to retirees and any current liabilities that are owed at this time.

The Statement of Changes in Plan Net Assets, on the other hand, provides a view of current year additions to and deductions from the System.

MANAGEMENT'S DISCUSSION AND ANALYSIS *Continued*

Both statements are in compliance with generally accepted accounting principles (GAAP) as set forth by the Governmental Accounting Standards Board. GAAP requires certain disclosures and that Pension Trust Funds use the full accrual method of accounting. The System complies with all material requirements of these pronouncements.

The Statement of Plan Net Assets and the Statement of Changes in Plan Net Assets report information about the System's activities. These statements include all assets and liabilities, using the full accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's additions and deductions are taken into account regardless of when cash is received or paid. All investment gains and losses are shown at trade date, not settlement date. In addition, both realized and unrealized gains and losses on investments are reported.

These two statements report the System's net assets held in trust for pension benefits and postemployment healthcare benefits (net assets)—the difference between assets and liabilities. Over time, increases and decreases in the System's net assets are one indicator of whether its financial health is improving or deteriorating. Other factors, such as market conditions, should also be considered in measuring the System's overall health (see the System's financial statements beginning on page 24 of this report).

Notes to the Basic Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements (see Notes to Basic Financial Statements on page 28 of this report).

Other Information. In addition to the financial statements and accompanying notes, this report presents certain required supplementary information concerning the System's progress in funding its obligations to provide pension benefits to members, employer contributions and actuarial methods and assumptions (see Other Required Supplementary Information beginning on page 39 of this report).

The combining schedules, schedules of administrative expenses, investment manager fees and other investment expenses, and payments to consultants are presented immediately following the required supplementary information on pensions.

Financial Analysis

As previously noted, net assets may serve over time as a useful indication of the System's financial position (see Table 1a on page 18). The assets of the System exceeded its liabilities at the close of fiscal year 2005.

As of June 30, 2005, $1,512,163,000 in total net assets was held in trust for pension benefits and postemployment healthcare benefits. All of the net assets are available to meet the System's ongoing obligation to plan participants and their beneficiaries.

As of June 30, 2005, total net assets increased by 7.5% over the prior year primarily due to a decrease in payables to brokers, which decreased $119,423,000 from the prior year.

As of June 30, 2004, $1,406,724,000 in total net assets was held in trust for pension benefits and postemployment healthcare benefits (see Table 1b on page 18). This total represented an increase of 15.5% in net assets over the prior year primarily due to an increase in the fair value of investments.

As of June 30, 2005, receivables decreased by $120,321,000, or 69.9% mainly due to a decrease in receivables from brokers and others. In the previous year, receivables increased by $160,872,000, or 1413.5% due to an increase in receivables from brokers and other.

As of June 30, 2005, total liabilities decreased by $84,390,000, or 26.2%, compared with June 30, 2004, due mainly to a decrease in payable to brokers. As of June 30, 2004, total liabilities increased by $190,455,000 or 144.1% due to an increase in payable to brokers.

MANAGEMENT'S DISCUSSION AND ANALYSIS *Continued*

Reserves

The System's reserves are established from contributions and the accumulation of investment income, after satisfying investment and administrative expenses (see table on page 31). The Defined Benefit Pension Plan Net Assets are allocated between the Retirement Fund, which includes postemployment healthcare benefits, and the Cost-of-Living Fund.

The appreciation in the fair value of investments and the five-year smoothing of investment gains and losses resulted in an increase in the "unrealized gains (loss) on investments held" reserve of $27,960,000 as of June 30, 2005.

For 2004, the appreciation in the fair value of investments and the five-year smoothing of investment gains and losses resulted in an increase in the "unrealized gains (loss) on investments held" reserve of $111,004,000.

FCERS NET ASSETS (TABLE 1A)
As of June 30, 2005 and 2004

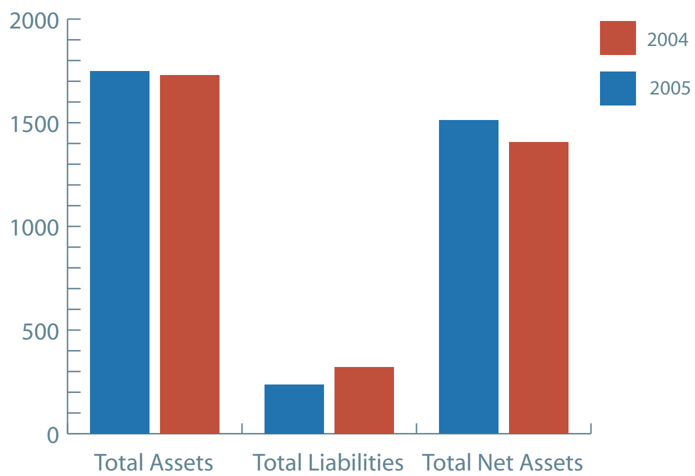
	2005	2004	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Receivables	$ 51,932,000	$ 172,253,000	$(120,321,000)	-69.9%
Investments at Fair Value	1,698,430,000	1,557,060,000	141,370,000	9.1%
Total Assets	**1,750,362,000**	**1,729,313,000**	**21,049,000**	**1.2%**
Current Liabilities	238,199,000	322,589,000	(84,390,000)	-26.2%
Total Liabilities	**238,199,000**	**322,589,000**	**(84,390,000)**	**-26.2%**
Net Assets	**$ 1,512,163,000**	**$1,406,724,000**	**$ 105,439,000**	**7.5%**

FCERS NET ASSETS (TABLE 1B)
As of June 30, 2004 and 2003

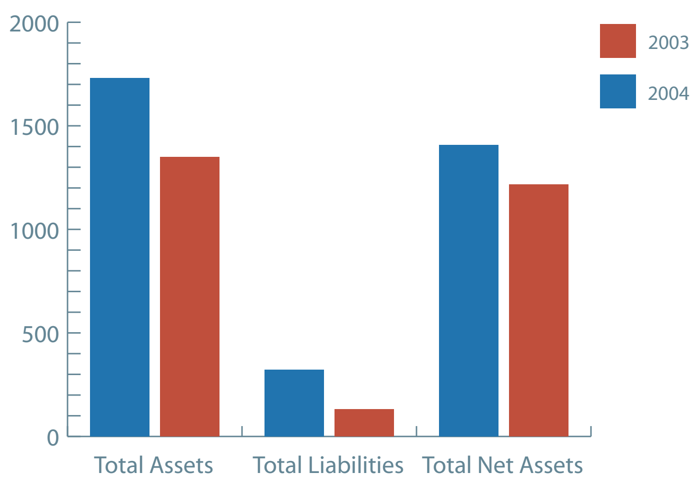
	2004	2003	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Receivables	$ 172,253,000	$ 11,381,000	$ 160,872,000	1413.5%
Investments at Fair Value	1,557,060,000	1,338,542,000	218,518,000	16.3%
Total Assets	**1,729,313,000**	**1,349,923,000**	**379,390,000**	**28.1%**
Current Liabilities	322,589,000	132,134,000	190,455,000	144.1%
Total Liabilities	**322,589,000**	**132,134,000**	**190,455,000**	**144.1%**
Net Assets	**$1,406,724,000**	**$1,217,789,000**	**$ 188,935,000**	**15.5%**

Management's Discussion and Analysis *Continued*

FCERS Plan Net Assets
(Dollars in Millions)



FCERS Plan Net Assets
(Dollars in Millions)



Management's Discussion and Analysis *Continued*

FCERS Activities

The market appreciation during fiscal year 2005 resulted in increased net assets by $105,439,000, thereby accounting for a 7.5% increase over the prior year. Key elements of this increase are described in the sections that follow.

Additions to Plan Net Assets

The assets needed to finance retirement benefits are accumulated through the collection of employer and employee contributions and through earnings on investments (net of investment expense). Additions for the fiscal year ended June 30, 2005, totaled $187,317,000 (see Table 2a below).

By the fiscal year ended June 30, 2005, overall additions had decreased by $75,189,000, or 28.6% from the prior year primarily due to a decline in net investment income, which decreased by $81,267,000 or 40.0%. The investment section of this report reviews the results of investment activity for the fiscal year ended June 30, 2005 starting on page 47. Also during the fiscal year, employer contributions increased by $4,066,000, or 9.4% due to an increase in covered payroll.

Additions for the fiscal year ended June 30, 2004 totaled $262,506,000, representing an increase of $130,049,000 or 98.2%, from the prior year also primarily due to increase in net investment income which increased $127,999,000, or 170.2% (see Table 2b below).

ADDITIONS TO PLAN NET ASSETS (TABLE 2A)

For the Fiscal Years Ended June 30, 2005 and 2004

	2005	2004	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Employee Contributions	$ 17,612,000	$ 15,585,000	$ 2,027,000	13.0%
Employer Contributions	47,548,000	43,482,000	4,066,000	9.4%
Net Investment Income*	121,943,000	203,210,000	(81,267,000)	-40.0%
Net Securities Lending Income	214,000	229,000	(15,000)	-6.6%
Total Additions	**$ 187,317,000**	**$ 262,506,000**	**$ (75,189,000)**	**-28.6%**

** Net of Investment Expenses of $4,538,000 and $4,700,000 in 2005 and 2004 respectively*

ADDITIONS TO PLAN NET ASSETS (TABLE 2B)

For the Fiscal Years Ended June 30, 2004 and 2003

	2004	2003	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Employee Contributions	$ 15,585,000	$ 14,808,000	$ 777,000	5.2%
Employer Contributions	43,482,000	42,277,000	1,205,000	2.9%
Net Investment Income (Loss)*	203,210,000	75,211,000	127,999,000	170.2%
Net Securities Lending Income	229,000	161,000	68,000	42.2%
Total Additions	**$ 262,506,000**	**$ 132,457,000**	**$ 130,049,000**	**98.2%**

** Net of Investment Expenses of $4,700,000 and $3,793,000 in 2004 and 2003, respectively*

Management's Discussion and Analysis *Continued*

DEDUCTIONS FROM PLAN NET ASSETS (TABLE 3A)

For the Fiscal Years Ended June 30, 2005 and 2004

	2005	2004	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Retirement Benefits	$ 60,438,000	$ 53,578,000	$ 6,860,000	12.8%
Healthcare Insurance Premiums	13,393,000	11,438,000	1,955,000	17.1%
Death Benefits	5,437,000	5,454,000	(17,000)	-0.3%
Refund of Contributions	927,000	1,188,000	(261,000)	-22.0%
Administrative and other	1,683,000	1,913,000	(230,000)	-12.0%
Total Deductions	**$ 81,878,000**	**$ 73,571,000**	**$ 8,307,000**	**11.3%**

DEDUCTIONS FROM PLAN NET ASSETS (TABLE 3B)

For the Fiscal Years Ended June 30, 2004 and 2003

	2004	2003	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Retirement Benefits	$ 53,578,000	$ 46,814,000	$ 6,764,000	14.4%
Healthcare Insurance Premiums	11,438,000	9,191,000	2,247,000	24.4%
Death Benefits	5,454,000	4,752,000	702,000	14.8%
Refund of Contributions	1,188,000	714,000	474,000	66.4%
Administrative and other	1,913,000	1,631,000	282,000	17.3%
Total Deductions	**$ 73,571,000**	**$ 63,102,000**	**$ 10,469,000**	**16.6%**

CHANGES IN PLAN NET ASSETS (TABLE 4A)

For the Fiscal Years Ended June 30, 2005 and 2004

	2005	2004	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Total Additions	$ 187,317,000	$ 262,506,000	$ (75,189,000)	-28.6%
Total Deductions	81,878,000	73,571,000	8,307,000	11.3%
Net Increase (Decrease) in Plan Assets	**$ 105,439,000**	**$ 188,935,000**	**$ (83,496,000)**	**-44.2%**

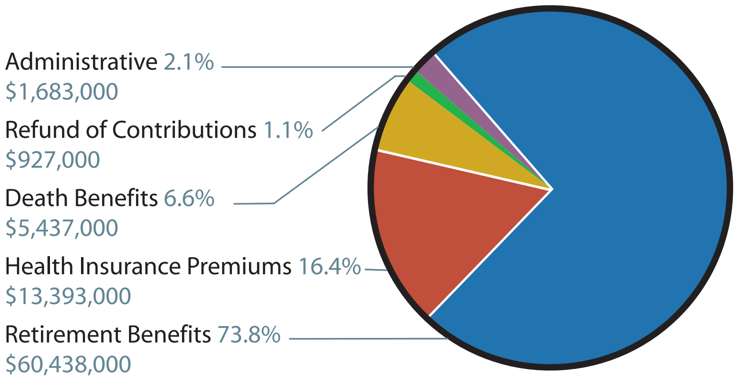
CHANGES IN PLAN NET ASSETS (TABLE 4B)

For the Fiscal Years Ended June 30, 2004 and 2003

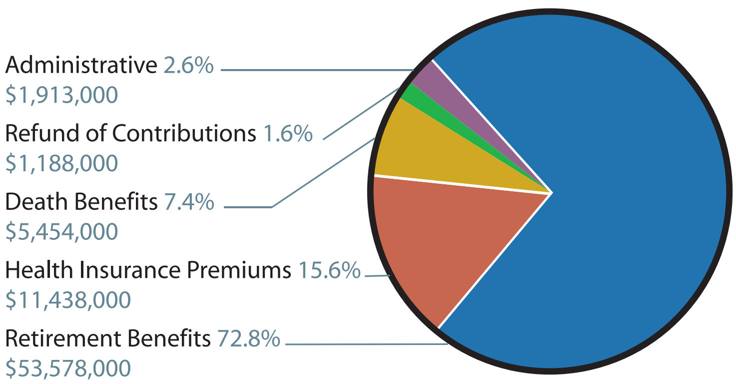
	2004	2003	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Total Additions	$ 262,506,000	$ 132,457,000	$ 130,049,000	98.2%
Total Deductions	73,571,000	63,102,000	10,469,000	16.6%
Net Increase in Plan Assets	**$ 188,935,000**	**$ 69,355,000**	**$ 119,580,000**	**172.4%**

MANAGEMENT'S DISCUSSION AND ANALYSIS *Continued*

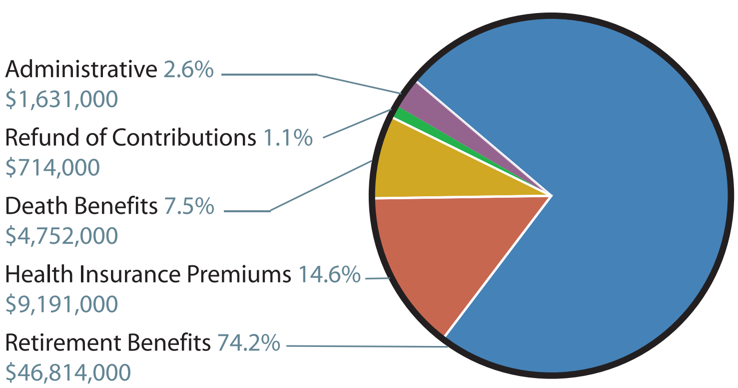
Deductions From Plan Net Assets 2005



Deductions From Plan Net Assets 2004



Deductions From Plan Net Assets 2003



Deductions from Plan Net Assets

The System was created to provide lifetime retirement annuities, survivor benefits and permanent disability benefits to qualified members and their beneficiaries. The cost of such programs includes recurring benefit payments, as designated by the System, refund of contributions to terminated employees, and the cost of administering the System.

Deductions for the fiscal year ended June 30, 2005 totaled $81,878,000, an increase of 11.3% over fiscal year ended June 30, 2004 (see Table 3a on page 21). Increases in retirement benefits of $6,860,000, and healthcare insurance premiums of $1,955,000, were the primary reasons for the increase in deductions. Retirement benefits increased due to an increased number of beneficiaries. Healthcare insurance costs increased due to higher premiums and administrative expenses increased primarily as a result of an increase in payroll costs due to increased staffing.

Deductions for the fiscal year ended June 30, 2004 totaled $73,571,000, an increase of 16.6% over June 30, 2003 (see Table 3b on page 21). Increases in retirement benefits of $6,764,000, and healthcare insurance premiums of $2,247,000 were the primary reasons for increased expenses.

MANAGEMENT'S DISCUSSION AND ANALYSIS *Continued*

The System's Fiduciary Responsibilities

The System's Board and management staff are fiduciaries of the pension trust fund. Under the California Constitution the assets can only be used for the exclusive benefit of plan participants and their beneficiaries.

Requests for Information

This financial report is designed to provide the Board of Administration, Mayor and City Council, our membership, taxpayers, and investment managers with a general overview of the System's finances and to account for the money it receives. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

Federated City Employees' Retirement System
1737 North First Street, Suite 580
San Jose, California 95112-4505

Respectfully Submitted,

Edward F. Overton
Director, Retirement Services

Basic Financial Statements

Statements of Plan Net Assets

June 30, 2005 and 2004

(Dollars in Thousands)

	2005		
	Pension Benefits	**Postemployment Healthcare Benefits**	**Total**
ASSETS:			
Receivables:			
Employee contributions	$ 403	$ 171	$ 574
Employer contributions	1,418	205	1,623
Brokers and others	41,204	2,300	43,504
Accrued investment income	5,901	330	6,231
Total receivables	**48,926**	**3,006**	**51,932**
Investments, at fair value:			
Securities and other			
U.S. Treasury notes and bonds	121,714	6,668	128,382
U.S. government agency securities	157,628	8,635	166,263
International government bonds	50,669	2,776	53,445
Domestic corporate bonds	140,919	7,720	148,639
International corporate bonds	44,278	2,426	46,704
Domestic equity securities	625,515	34,269	659,784
International equity securities	230,358	12,619	242,977
Private market equity	961	53	1,014
State and local obligations	990	54	1,044
International forward currency contracts	164	9	173
Collective short-term investment funds	31,070	1,702	32,772
Real estate	47,246	2,637	49,883
Securities lending cash collateral investment pool	158,504	8,846	167,350
Total investments	**1,610,016**	**88,414**	**1,698,430**
Total assets	**1,658,942**	**91,420**	**1,750,362**
LIABILITIES:			
Payable to brokers	65,580	3,660	69,240
Securities lending collateral due to borrowers	158,504	8,846	167,350
Other liabilities	1,530	79	1,609
Total liabilities	**225,614**	**12,585**	**238,199**
NET ASSETS HELD IN TRUST FOR:			
Pension benefits	1,433,328	-	1,433,328
Postemployment healthcare benefits	-	78,835	78,835
Total net assets	**$ 1,433,328**	**$ 78,835**	**$ 1,512,163**

(A schedule of funding progress is presented on page 39.)

See accompanying notes to basic financial statements

Continued

Basic Financial Statements *Continued*

Statements of Plan Net Assets *Continued*

June 30, 2005 and 2004

(Dollars in Thousands)

	2004		
	Pension Benefits	**Postemployment Healthcare Benefits**	**Total**
ASSETS:			
Receivables:			
Employee contributions	$ 379	$ 98	$ 477
Employer contributions	1,196	120	1,316
Brokers and others	155,163	8,842	164,005
Accrued investment income	6,107	348	6,455
Total receivables	**162,845**	**9,408**	**172,253**
Investments, at fair value:			
Securities and other			
U.S. Treasury notes and bonds	76,499	4,274	80,773
U.S. government agency securities	170,131	9,506	179,637
International government bonds	89,332	4,991	94,323
Domestic corporate bonds	115,277	6,441	121,718
International corporate bonds	10,245	572	10,817
Domestic equity securities	578,602	32,329	610,931
International equity securities	206,720	11,550	218,270
State and local obligations	742	41	783
International forward currency contracts	483	27	510
Collective short-term investment funds	45,239	2,498	47,737
Real estate	56,018	3,191	59,209
Securities lending cash collateral investment pool	125,217	7,135	132,352
Total investments	**1,474,505**	**82,555**	**1,557,060**
Total assets	**1,637,350**	**91,963**	**1,729,313**
LIABILITIES:			
Payable to brokers	178,492	10,171	188,663
Securities lending collateral due to borrowers	125,217	7,135	132,352
Other liabilities	1,486	88	1,574
Total liabilities	**305,195**	**17,394**	**322,589**
NET ASSETS HELD IN TRUST FOR:			
Pension benefits	1,332,155	-	1,332,155
Postemployment healthcare benefits	-	74,569	74,569
Total net assets	**$ 1,332,155**	**$ 74,569**	**$ 1,406,724**

(A schedule of funding progress is presented on page 39.)

See accompanying notes to basic financial statements

BASIC FINANCIAL STATEMENTS *Continued*

Statements of Changes in Plan Net Assets

For the Fiscal Years Ended June 30, 2005 and 2004

(Dollars in Thousands)

	2005		
	Pension Benefits	**Postemployment Healthcare Benefits**	**Total**
ADDITIONS:			
Contributions:			
Employee	$ 12,393	$ 5,219	$ 17,612
Employer	41,552	5,996	47,548
Total contributions	**53,945**	**11,215**	**65,160**
Investment income:			
Net appreciation in fair value of investments	82,296	4,657	86,953
Interest income	23,552	1,332	24,884
Dividend income	5,774	326	6,100
Net rental income	8,086	458	8,544
Less investment expense	(4,293)	(245)	(4,538)
Net investment income before securities lending income	**115,415**	**6,528**	**121,943**
Securities lending income:			
Earnings	2,608	147	2,755
Rebates	(2,269)	(129)	(2,398)
Fees	(136)	(7)	(143)
Net securities lending income	**203**	**11**	**214**
Net investment income	**115,618**	**6,539**	**122,157**
Total additions	**169,563**	**17,754**	**187,317**
DEDUCTIONS:			
Retirement benefits	60,438	-	60,438
Healthcare insurance premiums	-	13,393	13,393
Death benefits	5,437	-	5,437
Refund of contributions	927	-	927
Administrative expenses and other	1,588	95	1,683
Total deductions	**68,390**	**13,488**	**81,878**
Net increase	**101,173**	**4,266**	**105,439**
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS AND POSTEMPLOYMENT HEALTHCARE BENEFITS:			
Beginning of year	1,332,155	74,569	1,406,724
End of year	**$ 1,433,328**	**$ 78,835**	**$ 1,512,163**

See accompanying notes to basic financial statements

Continued

Basic Financial Statements *Continued*

Statements of Changes in Plan Net Assets *Continued*

For the Fiscal Years Ended June 30, 2005 and 2004

(Dollars in Thousands)

2004	Pension Benefits	Postemployment Healthcare Benefits	Total
ADDITIONS:			
Contributions:			
Employee	$ 12,394	$ 3,191	$ 15,585
Employer	39,534	3,948	43,482
Total contributions	**51,928**	**7,139**	**59,067**
Investment income:			
Net appreciation in fair value of investments	163,684	9,378	173,062
Interest income	21,114	1,242	22,356
Dividend income	5,889	346	6,235
Net rental income	5,909	348	6,257
Less investment expense	(4,439)	(261)	(4,700)
Net investment income before securities lending income	**192,157**	**11,053**	**203,210**
Securities lending income:			
Earnings	1,712	101	1,813
Rebates	(1,353)	(80)	(1,433)
Fees	(143)	(8)	(151)
Net securities lending income	**216**	**13**	**229**
Net investment income	**192,373**	**11,066**	**203,439**
Total additions	**244,301**	**18,205**	**262,506**
DEDUCTIONS:			
Retirement benefits	53,578	-	53,578
Healthcare insurance premiums	-	11,438	11,438
Death benefits	5,454	-	5,454
Refund of contributions	1,188	-	1,188
Administrative expenses and other	1,799	114	1,913
Total deductions	**62,019**	**11,552**	**73,571**
Net increase	**182,282**	**6,653**	**188,935**
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS AND POSTEMPLOYMENT HEALTHCARE BENEFITS:			
Beginning of year	1,149,873	67,916	1,217,789
End of year	**$ 1,332,155**	**$ 74,569**	**$ 1,406,724**

See accompanying notes to basic financial statements

NOTES TO BASIC FINANCIAL STATEMENTS

For the Fiscal Years Ended June 30, 2005 and 2004

NOTE 1 - DESCRIPTION OF THE PLAN

The following description of the City of San José Federated City Employees' Retirement System (System) is provided for general information purposes only. Employees and members should refer to the City of San José Municipal Code for more complete information.

(a) General

The System, consisting of a single employer Defined Benefit Pension Plan and a Postemployment Healthcare Plan, was established in 1941 and last amended June 30, 2005, to provide retirement benefits for certain employees of the City of San José (City). The System is considered to be a part of the City's financial reporting entity and is included in the City's basic financial statements as a pension trust fund. The System is administered by the Director of Retirement, an employee of the City, under the direction of the Federated City Employees' Retirement System Board of Administration (Board of Administration). The contribution and benefit provisions and all other requirements are established by City ordinance. The System is responsible for all direct administrative costs, which are funded by investment earnings, except for certain support services, which are provided by the City.

All full-time and eligible part-time employees of the City, except employees who are members of the City's Police and Fire Department Retirement Plan, are required to be members of the System. Total payroll, except for Police and Fire employees, amounted to approximately $292,677,000 and $311,395,000 for 2005 and 2004, respectively. Covered payroll amounted to approximately $277,939,000 and $288,136,000 for 2005 and 2004, respectively.

Participants of the Postemployment Healthcare Plan are also participants of the Defined Benefit Pension Plan. As of June 30, 2005 and 2004, employee membership data related to the System was as follows:

	2005	2004
Defined Benefit Pension Plan:		
Retirees and beneficiaries currently receiving benefits	2,485	2,332
Terminated vested members not yet receiving benefits	448	443
Active members	4,155	4,307
Total	**7,088**	**7,082**
Postemployment Healthcare Plan:		
Retirees and beneficiaries currently receiving benefits	1,839	1,711
Terminated vested members not yet receiving benefits	59	62
Active members	4,155	4,307
Total	**6,053**	**6,080**

The System is not subject to the provisions of the Employee Retirement Income Security Act of 1974.

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

(b) Pension Benefits

An employee with five or more years of service who reaches the normal retirement age of 55, or an employee of any age with 30 years of service, is entitled to annual pension benefits equal to 2.5% of final average annual salary for each year of service up to a maximum benefit of 75% of final compensation. Final compensation is the average annual salary during the highest 12 months of consecutive service. In addition, retirement benefits are adjusted for an annual cost-of-living allowance (COLA). The current maximum increase in the COLA is 3% per year.

If employees terminate employment before completing five years of service, the right to receive their portion of the accumulated plan benefits attributable to the City's contributions is forfeited; however, an employee's accumulated contribution plus earnings thereon is refunded. Refunds are paid out on a lump-sum basis. The forfeited amount of the City's contributions remains in the System. In the case of reciprocity, the member may leave contributions in the System with less than five years of service.

Effective December 9, 1994, the System entered into an agreement with the California Public Employees' Retirement System (PERS) that extends reciprocal retirement benefits to members. In certain situations, this agreement results in improved retirement benefits for members who move from one eligible retirement system to another.

(c) Death Benefits

If an employee's death before retirement is service related, or is non-service related (employee has at least five years of service), a surviving spouse is paid an annual annuity benefit equal to 2.5% of final compensation multiplied by the number of years of service (minimum of 40% and maximum of 75% of final compensation) until he or she remarries or dies. Deferred vested members are not eligible for the 40% minimum. The allowance will continue even if the spouse remarries if the member was at least 55 years old and had at least 20 years of service. If there is no surviving spouse, unmarried children up to 18 years of age, or up to 22 years of age if a full-time student, are entitled to a benefit payment based on the spousal benefit such that no one child shall receive more than 25% of the spousal benefit and the sum for all eligible children shall not exceed 75% of the spousal benefit. If no family members are eligible, the employee's contributions plus one month's salary for each year of service up to a maximum of six years of service are returned to the employee's beneficiary or estate.

If an employee dies after retirement, $500 is paid to the employee's beneficiary or estate. In addition, the employee's surviving spouse continues to receive, for life, 50% of the employee's annual pension benefit as defined above. If there is no surviving spouse, 25% of the spouse's benefit payment is made to each eligible child as defined above, but the maximum benefit to children cannot exceed 75% of the benefit that would have been paid to a surviving spouse.

The State Legislature has enacted the California Domestic Partner Rights and Responsibilities Act of 2003 which extends the rights and duties of marriage to persons registered with the Secretary of State as domestic partners on and after January 1, 2005. It is anticipated that the System will be amended to conform to state law.

(d) Disability Benefits

If an employee suffers a service related disability before retirement, the annual disability benefit paid is 40% of final average salary. The maximum benefit is 75% of final average salary. For members with more than 16 years of services, the monthly retirement allowance is the final average salary multiplied by 40% plus the final average salary multiplied by 2.5% for each year over 16.

If an employee with at least five years of service suffers a non-service related disability, the annual disability benefit is equal to the greater of: (1) 2.5% of final compensation multiplied by the number of years of

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

(d) Disability Benefits *Continued*

service, up to a maximum of 30 years; or (2) 40% of final compensation. The benefit is reduced by 0.5% of final compensation for each year an employee's age is under 55.

If an employee was hired on or after September 1, 1998, the benefit is calculated using the following formula: 20% of final compensation, plus 2% for each year of service in excess of six but less than 16, plus 2.5% for years of service in excess of 16.

(e) Postemployment Healthcare Benefits

The City of San José Municipal Code provides that retired employees with 15 or more years of service, their survivors, or those retired employees who are receiving at least 37.5% of final compensation are entitled to payment of 100% of the lowest priced medical insurance plan available to an active federated City employee. Members and eligible survivors must pay for the difference between the amount of the premium for their selected plan and the portion paid by the System. However, the System pays the entire premium cost for dental insurance coverage.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation

The System is reported in a pension trust fund in the City of San José's basic financial statements. The financial statements of the System present only the financial activities of the System and are not intended to present the financial position and changes in financial position of the City of San José in conformity with accounting principles generally accepted in the United States of America (GAAP).

(b) Basis of Accounting

The financial statements of the System are prepared on the accrual basis of accounting. Contributions are recognized as revenue when due pursuant to formal commitments as well as statutory and contractual commitments (at the end of the pay period). Benefits and refunds of contributions are recognized when due and payable under the provisions of the Plan. Activities of the Defined Benefit Pension Plan and the Postemployment Healthcare Plan are accounted for separately. It is required by the municipal code that transactions of the Defined Benefit Pension Plan be accounted for in two funds: a Retirement Fund and a Cost-of-Living Fund.

The preparation of the financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the disclosed amount of additions and deductions during the reporting periods. Actual results could differ from those estimates.

(c) Investments

Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price on the last business day of the fiscal year at current exchange rates, if applicable. Investments that do not have an established market are reported at estimated fair value. The fair value of real estate investments is based on independent appraisals.

Purchases and sales of securities are reflected on the trade date. Investment income is recognized as earned. Rental income is recognized as earned, net of expenses.

(d) Plan Net Assets Held in Trust for Pension and Postemployment Healthcare Benefits

The System is required by the City of San José Municipal Code to establish various reserves in the plan net assets. The Plan Net Assets are allocated between the Defined Benefit Pension Plan (which includes the Retirement Fund and the Cost-of-Living Fund) and the Postemployment Healthcare Plan. As of June 30, 2005 and 2004, the net assets, totaling $1,512,163,000 and $1,406,724,000 respectively, are allocated as follows:

Notes to Basic Financial Statements *Continued*

(Dollars in Thousands)	Retirement Fund	Cost-of-Living Fund	Total Defined Benefits Pension Plan	Post-employment Halthcare Plan	Total
June 30, 2005:					
Employee contributions	$ 160,816	$ 47,028	$ 207,844	$ 11,985	$ 219,829
Supplemental retiree benefit	15,324	-	15,324	-	15,324
Unrealized gains (losses) on investments held	77,995	56,848	134,843	5,813	140,656
General reserve	804,744	271,636	1,076,380	59,974	1,136,354
Total	**$ 1,058,879**	**$ 375,512**	**$ 1,434,391**	**$ 77,772**	**$1,512,163**
June 30, 2004:					
Employee contributions	$ 156,891	$ 47,829	$ 204,720	$ 13,674	$ 218,394
Employer contributions	286,627	119,646	406,273	24,982	431,255
Retired employees' annuity	349,427	109,712	459,139	30,456	489,595
Benefits payable	104,077	-	104,077	-	104,077
Supplemental retiree benefit	14,567	-	14,567	-	14,567
Contingency reserve	12,088	-	12,088	1,053	13,141
Unrealized gains (losses) on investments held	57,970	50,322	108,292	4,404	112,696
General reserve	-	22,999	22,999	-	22,999
Total	**$ 981,647**	**$ 350,508**	**$ 1,332,155**	**$ 74,569**	**$ 1,406,724**

The System's reserves are established from member and employer contributions and the accumulation of investment income, after satisfying investment and administrative expenses. Effective July 1, 2004, the System's Actuary assisted the System in simplifying the reserve categories. As a result the Employer contributions, Retired employees' annuity, Benefits payable, and Contingency reserve categories were eliminated and the balances transferred to the General Reserve category. The System's reserves are described as follows:

Employee Contributions Reserve represent the total accumulated employee contributions of current active and deferred members plus credited interest.

Employer Contributions Reserve represent the total accumulated employer contributions of current active and deferred members plus credited interest (included in General Reserve in 2005.)

Retired Employees Annuity Reserve represent the total accumulated transfers from the Employee Contributions Reserve, Employer Contributions Reserve and credited interest (included in General Reserve in 2005.)

Benefit Payable Reserve (for the Retirement Fund only) represents 90% of total accumulated excess earnings plus credited interest (included in General Reserve in 2005.)

Supplemental Retiree Benefit Reserve (for the Retirement Fund only) represents 10% of total accumulated excess earnings plus credited interest.

Contingency Reserves (for the Retirement Fund and Postemployment Healthcare Plan only) represent reserves accumulated for future earnings deficiencies for fiscal year 2004 (included in General Reserve in 2005.)

Unrealized Gains (Loss) on Investment Held Reserves represent unrealized gains and losses recognized in the financial statements as a result of GASB Statement No. 25, which requires reporting investments at fair value instead of cost. This reserve is a function of changes in the market value of plan assets.

General Reserve (for the Cost-of-Living Fund only) represent net earnings resulting from interest earnings, realized investment gains and losses for fiscal year 2004. Effective July 1, 2004, the General Reserve category also represents an accumulation of funds necessary to pay all accumulated vested retirement obligations.

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *Continued*

(e) Reclassifications

Certain amounts in fiscal year 2004 have been reclassified to conform with the fiscal year 2005 presentation.

(f) New Accounting Pronouncement

During fiscal year 2005, the System adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures - an amendment of GASB Statement No. 3.* This Statement modifies the custodial credit risk disclosures required by Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements* and addresses deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. Accordingly, the investments disclosure has been revised to conform with the provisions of GASB Statement No. 40. While comparative GASB 40 disclosures will be provided in succeeding years, such disclosures for fiscal year 2004 are not available.

NOTE 3 – INVESTMENTS

Investments are subject to certain types of risks, including interest rate risk, custodial credit risk, credit quality risk, foreign currency risk, and concentration of credit risk. The following describes those risks:

Interest Rate Risk – The fair value of fixed maturity investments fluctuate in response to changes in market interest rates. Increases in prevailing interest rates generally translate into decreases in fair value of those instruments. The fair value of interest sensitive instruments may also be affected by the creditworthiness of the issuer, prepayment options, relative values of alternative investments, and other general market conditions. Certain fixed maturity investments have call provisions that could result in shorter maturity periods. GNMAs in the amount of $3,035,000 and U.S. government agency securities in the amount of $123,696,000 are backed by mortgage pass-throughs which are highly sensitive to interest rate changes. Therefore, if interest rates decline, the mortgages are subject to prepayment by borrowers. However, the System's intent is to hold all fixed maturity investments until maturity, and accordingly, fixed maturity investments are classified in the following tables as if they were held to maturity.

Custodial Credit Risk – Custodial credit risk is the risk that the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party if that outside party fails. The System's custodian holds all investments of the System in the System's nominee name except for the assets held in pooled funds, which are under custody of the managers' custodian bank.

Credit Quality Risk – Nationally recognized statistical rating organizations provide ratings of debt securities quality based on a variety of factors, such as the financial condition of the issuers, which provide investors with some idea of the issuer's ability to meet its obligations. The System's assets shall generally be invested in investment grade, marketable, fixed-income securities. Domestic fixed maturity investment grade shall be defined as being rated Baa/BBB or better by two of the following three rating services; Moody's Investor Services (Moody's), Standard & Poor's Corporation (S&P) or Fitch Rating Services (Fitch). In the event that ratings are provided by only two agencies and the third is non-rated, the most conservative (lowest) rating will be assigned. If only one agency assigns a rating, that rating will be used. Up to 15% investment in BB or B securities will be permitted with written authorization of the Board. The investment managers employed to manage domestic fixed-income securities will have discretion in the day-to-day management of the funds under their control. International fixed maturity must be at least Aa3/AA-. If the corresponding ratings assigned by S&P and Moody's are not equivalent the higher rating will be used for purposes of measuring portfolio and security quality. If a security is not rated by S&P or Moody's, the equivalent rating determined by the investment manager's research department will be used. If bonds are downgraded below the minimum credit quality allowable in the guidelines at the time of purchase, the Manager is permitted to hold up to 2% of the System's portfolio managed by the individual manager, using the lower of S&P,

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 3 – INVESTMENTS *Continued*

Moody's, and Fitch rating in the event of a split-rated security. Short-term investments may consist of commercial paper rated at least A1 or P1, repurchase agreements, short-term U.S. securities, and other money market investments.

Foreign Currency Risk – The risk that changes in exchange rates will adversely affect the fair value of an investment. To mitigate this risk, individual investment managers are permitted to defensively hedge currency to mitigate the impact on currency fluctuation on the underlying asset value.

Concentration of Credit Risk – The System's investment policy limits the aggregate amount that can be invested in each class of investments. The policy limits are as follows:

Domestic Equity – Minimum 38% and maximum 48% of the market value of the aggregate portfolio.

International Equity – Minimum 10% and maximum 20% of the market value of the aggregate portfolio.

Domestic Bonds – Minimum 24% and maximum 34% of the aggregate portfolio.

Global Bonds – Minimum 4% and maximum 10% of the aggregate portfolio.

Private Markets – Limited to 6% of the market value of the aggregate portfolio. During the fiscal year, the Board approved temporarily placing the funds allotted to the private markets asset class in the System's equity asset class. The System will continue to follow the alternate asset allocation targets until the Private Markets mandate is fully funded.

Real Estate – Minimum 3% and maximum 9% of the aggregate portfolio. Real Estate investments include a warehouse located in Northern California, and an interest in three real estate funds managed by third parties.

The collective short-term investment fund is used for overnight investment of all excess cash in the System's funds. It is invested by the System's Custodian, and held in the System Custodian's name. This fund consists of:

• Short-term fixed obligations of the U.S. government or any federal agency, or of other issuers that are fully guaranteed by the U.S. government or a federal agency as to repayment of principal and interest;

• Repurchase agreements with major banks and U.S. government securities dealers that are collateralized by obligations of the U.S. government or a federal agency, or obligations fully guaranteed by the U.S. government or a federal agency; and

• Fully insured bank deposits.

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 3 - INVESTMENTS *Continued*

The following tables provide information as of June 30, 2005, concerning the fair value of investments, interest rate risk, and international currency risk:

Investment Maturities at Fair Value (Dollars in Thousands)

Type of Investment	0-3 Months	3-6 Months	6 Months-1Year	1-5 Years	6-10 Years	More Than 10 years	Total Fair Value	Cost
Fixed Maturity Domestic								
U.S. Treasury Securities	$ 20,459	$ 6,962	$ 17,769	$ 53,192	$ 8,904	$ 21,096	$ 128,382	$ 128,067
GNMA	-	-	-	-	-	3,035	3,035	3,038
U.S. Gov't Agency Securities	-	-	611	11,535	27,883	100,882	140,911	138,393
Asset Backed Securities	-	-	-	1,476	7,324	7,016	15,816	15,433
Collateralized Mortgage Options	-	-	-	-	109	6,392	6,501	6,399
Corporate Bonds	-	-	304	47,704	44,988	55,643	148,639	142,938
Municipals	-	-	-	1,044	-	-	1,044	1,041
Collective Short Term Investment Fund	32,772	-	-	-	-	-	32,772	32,812
Total Domestic Fixed Maturity	**$ 53,231**	**$ 6,962**	**$ 18,684**	**$ 114,951**	**$ 89,208**	**$ 194,064**	**$ 477,100**	**$ 468,121**
International Government Bonds								
British Pound	-	-	-	-	1,089	2,256	3,345	3,407
Danish Krone	-	-	-	1,679	-	-	1,679	1,785
Euro Currency	-	-	-	14,149	2,304	8,353	24,806	26,147
Japanese Yen	-	-	-	9,292	-	-	9,292	9,940
Mexican Peso	-	-	-	1,054	584	-	1,638	1,595
New Zealand Dollar	-	-	-	-	465	-	465	441
Singapore Dollar	-	-	-	2,115	3,682	-	5,797	5,996
Swedish Krona	-	-	-	1,784	1,831	-	3,615	4,123
United States Dollar Denominated	-	-	-	-	1,648	1,160	2,808	2,510
Total International Government Bonds	**$ -**	**$ -**	**$ -**	**$ 30,073**	**$ 11,603**	**$ 11,769**	**$ 53,445**	**$ 55,944**
International Corporate Bonds								
Australian Dollar	-	-	-	1,459	489	-	1,948	1,966
Brazilian Real	-	-	-	-	944	-	944	937
British Pound	-	-	-	1,982	1,431	-	3,413	3,554
Canadian Dollar	-	-	-	1,218	692	576	2,486	2,444
Euro Currency	-	-	-	7,548	1,443	-	8,991	9,543
Japanese Yen	2,084	2,167	-	16,590	-	-	20,841	21,963
New Zealand Dollar	-	-	-	498	-	-	498	510
United States Dollar Denominated	-	-	-	2,328	4,022	1,233	7,583	7,514
Total International Corporate Bonds	**$ 2,084**	**$ 2,167**	**$ -**	**$ 31,623**	**$ 9,021**	**$ 1,809**	**$ 46,704**	**$ 48,431**
Total International Fixed Maturity	**$ 2,084**	**$ 2,167**	**$ -**	**$ 61,696**	**$ 20,624**	**$ 13,578**	**$ 100,149**	**$ 104,375**
Total Fixed Maturity	**$ 55,315**	**$ 9,129**	**$ 18,684**	**$ 176,647**	**$ 109,832**	**$ 207,642**	**$ 577,249**	**$ 572,496**

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 3 - INVESTMENTS *Continued*

Type of Investment	Total Fair Value	Cost
Equities		
Domestic	$ 659,784	$ 578,405
Private Equity	1,014	1,243
Total Domestic Equities	**660,798**	**579,648**
International		
Australian Dollar	5,532	5,503
British Pound	26,891	25,764
Canadian Dollar	5,391	5,471
Euro Currency	46,950	43,616
Hong Kong Dollar	4,418	4,303
Japanese Yen	26,732	26,454
Mexican Peso	751	750
Norwegian Krone	4,808	4,664
South African Rand	2,597	2,554
South Korean Won	3,552	3,457
Swedish Krona	1,890	1,872
Swiss Franc	10,433	8,209
USD Denominated	6,576	6,598
Pooled International Equity	96,456	52,437
Total International Equities	**242,977**	**191,652**
Total Equities	**903,775**	**771,300**
Real Estate	**49,883**	**43,983**
International Forward Currency Contracts	**173**	**-**
Securities Lending Cash Collateral *(see note 4)*	**167,350**	**163,371**
Total Investments	**$ 1,698,430**	**$ 1,551,150**

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 3 – INVESTMENTS *Continued*

The following table provides information as of June 30, 2005, concerning credit quality risk:

RATING OF FIXED MATURITIES *(Dollars in Thousands)*

S & P Rating	Fair Value	Fair Value as a Percentage of Total Fixed Maturity Fair Value
AAA**	$ 378,513	65.572%
AA	24,467	4.239%
A	27,992	4.849%
BBB	43,663	7.564%
BB	41,815	7.244%
B	2,467	0.427%
Not Available*	58,332	10.105%
Total	**$ 577,249**	**100.000%**

** Includes Collective Short-Term Investment Fund*
** * Includes Investments guaranteed by the United States Government*

International Forward Currency Contracts – The System has made investments in forward currency contracts, which are commitments to purchase or sell stated amounts of international currency. The System utilizes these contracts to control exposure and facilitate the settlement of international security purchase and sale transactions. At June 30, 2005 and 2004, the System's net position in these contracts is recorded at fair value as international forward currency contracts. The fair values of forward currency contracts are determined by quoted currency prices from national exchanges. The System's investments in forward currency contracts bear credit risk in that parties to the contracts may fail to perform according to the terms of the contract. As of June 30, 2005, total commitments in forward currency contracts to purchase and sell international currencies were $5,162,000 and $5,162,000, respectively, with market values of $5,162,000 and $4,989,000 respectively. As of June 30, 2004, total commitments in forward currency contracts to purchase and sell international currencies were $48,733,0000 and $48,733,000, respectively, with market values of $49,310,000 and $48,800,000, respectively. The System's commitments relating to forward currency contracts are settled on a net basis.

NOTE 4 – SECURITIES LENDING PROGRAM

The San José municipal code and the investment policy, adopted by the Board, permit the use of a securities lending program with its principal custodian bank. (The investment policy requires that loan maturities cannot stretch beyond one year, and no more than 15% of the portfolio can be lent longer than six months.) The System has a custodial agreement with the Bank of New York, which authorizes Bank of New York to loan securities in the System's investment portfolio under such terms and conditions as the Bank of New York deems advisable and to permit the loaned securities to be transferred into the name of the borrowers. The System receives a fee from the borrower for the use of the loaned securities. If the loaned securities are not returned by the borrower, the Bank of New York is responsible for replacement of the loaned securities with other securities of the same issuer, class and denomination, or if such securities are not available on the open market, the Bank of New York is required to credit the System's account with the market value of such unreturned loaned securities. All securities loan agreements can be terminated on demand within a period specified in each agreement by either the System or borrowers.

Securities lending collateral represents investments purchased with cash collateral, as well as securities collateral that may be pledged or sold without a default by the borrower. Securities lending transactions collateralized with securities that cannot be pledged or sold without borrower default are not reported as assets and liabilities in the statement of net assets. The System does not match the maturities of investments made with cash collateral with the securities on loan.

The System authorized Bank of New York to invest and reinvest cash collateral in securities fully guaranteed by the United States government, high grade commercial paper registered under the Securities Act of 1933, certificates of deposit of U.S. banks, and repurchase agreements with respect to Government Securities. At June 30, 2005, the System's cash collateral was invested in repurchase agreements ($135,866,000), with a weighted average maturity of 1.49 days and certificates of deposit ($31,484,000), with a weighted average maturity of 325 days. The repurchase agreements held at June 30, 2005 were

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 4 – SECURITIES LENDING *Continued*

unrated by S&P and Moody's. Of the certificates of deposit held at June 30, 2005, 84% carried credit quality ratings of A-1 and P-1 and 16% carried credit quality ratings of AA and Aa2 by S&P and Moody's, respectively. All of the underlying investments of the System's securities lending cash collateral are held by the counterparty, not in the name of the System.

The loaned securities as of June 30, 2005 and 2004, consisted of U.S. Treasury securities, U.S. government agency securities, international government and corporate bonds, domestic corporate bonds, domestic equity securities, and international equity securities.

In return, the System receives collateral in the form of cash or securities equal to at least 102% of the transferred securities plus accrued interest for reinvestment.

As of June 30, 2005, the underlying securities loaned by the System as a whole amounted to approximately $215,227,000. The cash collateral and the non-cash collateral totaled $167,350,000 and $52,985,000, respectively. As of June 30, 2004, the underlying securities loaned by the System as a whole amounted to approximately $131,583,000. The cash collateral and the non-cash collateral totaled $132,352,000 and $6,687,000, respectively. The System has no exposure to credit risk related to the securities lending transactions as of June 30, 2005 and 2004.

SECURITIES LENDING - INVESTMENTS AND COLLATERAL RECEIVED (AT FAIR VALUE)

TYPE OF INVESTMENT LENT *(Dollars in Thousands)*	**2005**	**2004**
For Cash Collateral		
U.S. government and agencies	$ 78,019	$ -
Domestic corporate bonds	14,731	89,024
Domestic equity securities	70,045	32,598
International corporate bonds	-	1,010
International government bonds	522	2,535
Total Lent for Cash Collateral	**163,317**	**125,167**
For Non-Cash Collateral		
Domestic corporate bonds	86	4,411
U.S. government agency securities	50,678	-
International equity securities	363	2,005
International government bonds	783	-
Total Lent for Non-Cash Collateral	**51,910**	**6,416**
Total Securities Lent	**$ 215,227**	**$ 131,583**
TYPE OF COLLATERAL RECEIVED		
Cash Collateral	**$ 167,350**	**$ 132,352**
Non-cash Collateral		
For lent domestic corporate bonds	99	4,500
For lent U.S. government agency securities	51,861	-
For lent international equities	377	2,187
For lent international government bonds	648	-
Total Non-cash collateral	**52,985**	**6,687**
Total Collateral Received	**$ 220,335**	**$ 139,039**

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 5 – CONTRIBUTIONS – FUNDING POLICY

Contributions to the Defined Benefit Pension Plan for both the City and the participating employees are based upon an actuarially determined percentage of each employee's base salary sufficient to provide adequate assets to pay benefits when due. The significant actuarial assumptions used to compute the actuarially determined contribution requirement are the same as those used to compute the actuarial accrued liability shown in the Schedule of Funding Progress for the Defined Benefit Pension Plan (see page 39).

Unlike contributions to the Defined Benefit Pension Plan, contributions to the Postemployment Healthcare Plan for both the City and the participating employees are based upon an actuarially determined percentage of each employee's base salary sufficient to provide adequate assets to pay benefits when due, over the next 15 years.

The City and the participating employee contribution rates in effect during the fiscal years ended June 30, 2005 and 2004, were as follows:

	CITY		EMPLOYEE	
Period	Pension	Healthcare	Pension	Healthcare
7/04/04 - 6/30/05	14.96 %	2.16 %	4.26 %	1.80 %
7/01/03 - 7/03/04	13.82 %	1.38 %	4.04 %	1.04%

NOTE 6 – POSTEMPLOYMENT HEALTHCARE BENEFIT PLAN

In August 2004, the GASB issued Statement No. 43 *Reporting for Postemployment Benefit Plans Other Than Pension Plans,* effective for the System's fiscal year beginning July 1, 2006. The postemployment healthcare benefit plan will be required to disclose information about the current funded status of the postemployment healthcare benefit plan as of the most recent actuarial valuation date along with the actuarial methods and assumptions used in the valuation. Additionally, the postemployment healthcare benefit plan will be required to include historical trend information on the funded status of the postemployment healthcare benefit plan and employer contributions to the Plan. The System has not yet determined the full effect that Statement No. 43 will have on its financial statements.

Other Required Supplementary Information

Schedule of Funding Progress
Defined Benefit Pension Plan *(Unaudited – see accompanying independent auditor's report)*

(Dollars in Thousands)

Funding Progress – GASB No. 25

Actuarial Valuation Date	Actuarial Value of Assets[a]	Actuarial Accrued Liability (AAL)	Unfunded (over funded) AAL	Funded Ratio	Annual Covered Payroll[b]	Unfunded (over funded) AAL as a Percentage of Annual Covered Payroll
June 30, 1999	$ 804,860	$ 862,226	$ 57,366	93%	$ 196,178	29%
June 30, 2001	1,060,144	1,072,333	12,189	99%	252,696	5%
June 30, 2003	1,280,719	1,311,691	30,972	98%	292,961	11%

Actuarial valuations have been performed bi-annually through June 30, 2003.

(a) Reported at "smoothed market" value determined using a technique that smoothes the effect of short-term volatility in the market value of investments over a five-year period.

(b) Annual covered payroll represents the actuarial estimate of annual covered payroll for the subsequent year.

OTHER REQUIRED SUPPLEMENTARY INFORMATION *Continued*

Schedule of Employer Contributions
Defined Benefit Pension Plan *(Unaudited – see accompanying independent auditor's report)*

(Dollars in Thousands)

Fiscal Year Ended June 30,	Annual Required Employer Contributions	Percentage Contributed
2000	$ 34,146	100%
2001	35,284	100%
2002	41,011	100%
2003	38,411	100%
2004	39,534	100%
2005	41,552	100%

Other Required Supplementary Information *Continued*

Schedule of Actuarial Methods and Assumptions

Defined Benefit Pension Plan *(Unaudited – see accompanying independent auditor's report)*

For the Fiscal Year Ended June 30, 2005

DESCRIPTION	METHOD/ASSUMPTION
Valuation date	June 30, 2003
Actuarial cost method	Entry age normal cost method
Amortization method for actuarial accrued liabilities	Level percentage of payroll
Remaining amortization period	30 years
Actuarial asset valuation method	5 year smoothed market
Actuarial assumptions:	
Assumed rate of return on investments	8.25% per annum
Postretirement mortality	The 1983 Group Annuity Mortality Table for males, with one-year setback is used for male members. The 1983 Group Annuity Mortality Table for females, with one year set forward, is used for female members.
Active service, withdrawal, death, disability service retirement	Tables based on current experience
Salary increases	Total System payroll is assumed to increase 4.5% per year. Graded increases ranging from 8.00% at age 25 to 5.0% at ages 65 and over. Of the total salary increases 4.50% is for inflation and merit and longevity.
Cost-of-living adjustments	3.00% a year

Other Supplementary Information

Combining Schedule of Defined Benefit Pension Plan Net Assets

As of June 30, 2005

(Dollars in Thousands)

	Retirement Fund	Cost-of-Living Fund	Total
ASSETS:			
Receivables:			
Employee contributions	$ 318	$ 85	$ 403
Employer contributions	1,151	267	1,418
Brokers and others	30,974	10,230	41,204
Accrued investment income	4,439	1,462	5,901
Total receivables	**36,882**	**12,044**	**48,926**
Investments, at fair value:			
Securities and other			
U.S. Treasury notes and bonds	89,784	31,930	121,714
U.S. government agency securities	116,276	41,352	157,628
International government bonds	37,377	13,292	50,669
Domestic corporate bonds	103,951	36,968	140,919
International corporate bonds	32,662	11,616	44,278
Domestic equity securities	461,421	164,094	625,515
International equity securities	169,927	60,431	230,358
Private market equity	709	252	961
State and local obligations	730	260	990
International forward currency contracts	121	43	164
Collective short-term investment funds	22,920	8,150	31,070
Real estate	35,504	11,742	47,246
Securities lending cash collateral investment pool	119,112	39,392	158,504
Total investments	**1,190,494**	**419,522**	**1,610,016**
Total assets	**1,227,376**	**431,566**	**1,658,942**
LIABILITIES:			
Payable to brokers	49,282	16,298	65,580
Securities lending collateral due to borrowers	119,112	39,392	158,504
Other liabilities	1,166	364	1,530
Total liabilities	**169,560**	**56,054**	**225,614**
Net assets held in trust for pension benefits	**$ 1,057,816**	**$ 375,512**	**$ 1,433,328**

Other Supplementary Information *Continued*

Combining Schedule of Changes in Defined Benefit Pension Plan Net Assets

For the Fiscal Year Ended June 30, 2005

(Dollars in Thousands)

	Retirement Fund	Cost-of-Living Fund	Total
ADDITIONS:			
Contributions:			
Employee	$ 9,741	$ 2,652	$ 12,393
Employer	33,698	7,854	41,552
Total contributions	**43,439**	**10,506**	**53,945**
Investment income:			
Net appreciation in fair value of investments	61,915	20,381	82,296
Interest income	17,708	5,844	23,552
Dividend income	4,341	1,433	5,774
Net rental income	6,095	1,991	8,086
Less investment expense	(3,250)	(1,043)	(4,293)
Net investment income before securities lending income	**86,809**	**28,606**	**115,415**
Securities lending income:			
Earnings	1,960	648	2,608
Rebates	(1,718)	(551)	(2,269)
Fees	(90)	(46)	(136)
Net securities lending income	**152**	**51**	**203**
Net investment income	**86,961**	**28,657**	**115,618**
Total additions	**130,400**	**39,163**	**169,563**
DEDUCTIONS:			
Retirement benefits	48,791	11,647	60,438
Death benefits	3,453	1,984	5,437
Refund of contributions	726	201	927
Administrative expenses and other	1,261	327	1,588
Total deductions	**54,231**	**14,159**	**68,390**
Net increase	76,169	25,004	101,173
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS:			
Beginning of year	981,647	350,508	1,332,155
End of year	**$ 1,057,816**	**$ 375,512**	**$ 1,433,328**

Other Supplementary Information *Continued*

Schedules of Administrative Expenses and Other

For The Fiscal Years Ended June 30, 2005 and 2004

	2005			2004
	Original Budget	**Actual**	**Variance Positive (Negative)**	**Actual**
Personnel services:				
Permanent staff expense	$ 1,230,761	$ 1,153,962	$ 76,799	$ 1,128,051
Temporary staff expense	20,000	19,111	889	7,481
Total personnel services	**1,250,761**	**1,173,073**	**77,688**	**1,135,532**
Professional services:				
Actuarial services	25,000	20,315	4,685	40,552
Medical services	65,000	19,842	45,158	29,877
Audit	35,000	24,332	10,668	23,911
Legal counsel	35,000	15,875	19,125	6,051
Pension benefit information	2,000	1,966	34	1,749
Investment manager search consultant	-	-	-	21,057
Human resources consultant	-	(2,026)	2,026	36,500
Document imaging and support and maintenance	7,500	3,125	4,375	139,750
Web development and maintenance	19,500	17,223	2,277	55,482
Total professional services	**189,000**	**100,652**	**88,348**	**354,929**
Communication:				
Postage	16,000	16,120	(120)	18,434
Printing	21,000	9,227	11,773	20,000
Communication	10,000	1,188	8,812	5,505
Data processing	8,000	6,077	1,923	5,950
Total communication	**55,000**	**32,612**	**22,388**	**49,889**
Structure and equipment:				
Copier lease	8,000	3,946	4,054	4,694
Copier maintenance	1,000	601	399	459
Furniture	3,000	289	2,711	1,224
Equipment	5,000	3,383	1,617	5,876
Equipment repair and miscellaneous services	4,000	3,186	814	1,577
Pension administration system maintenance	45,702	34,892	10,810	32,202
Software enhancements	90,000	71,581	18,419	72,032
Computer hardware/software	26,000	8,132	17,868	9,133
Total structure and equipment	**182,702**	**126,010**	**56,692**	**127,197**
Miscellaneous:				
Office expense	11,000	9,599	1,401	9,530
Dues/subscriptions	7,000	6,522	478	6,681
Training	75,000	64,558	10,442	60,813
Travel	85,000	65,516	19,484	27,814
Non-employee board member stipend	3,300	3,750	(450)	2,550
Rent on building	145,000	100,787	44,213	137,842
Total miscellaneous	**326,300**	**250,732**	**75,568**	**245,230**
Total administrative expenses and other	**$ 2,003,763**	**$ 1,683,079**	**$ 320,684**	**$ 1,912,777**

Other Supplementary Information *Continued*

Schedules of Investment Expenses

For the Fiscal Years Ended June 30, 2005 and 2004

	2005	2004
Equity:		
Domestic equity	$ 1,194,833	$ 1,330,224
International equity	1,240,012	1,085,672
Total Equity	**2,434,845**	**2,415,896**
Fixed Income:		
Domestic fixed income	841,357	759,838
Global fixed income	143,401	318,272
International fixed income	200,213	-
Total Fixed Income	**1,184,971**	**1,078,110**
Private Markets	24,218	-
Real Estate	574,087	786,783
Total Investment Managers' Fees	**4,218,121**	**4,280,789**
Other Investment Services Fees:		
Investment consultant	113,798	142,238
Proxy voting	7,375	8,550
Real estate legal fees	559	68,854
Custodian	198,058	199,630
Total Other Investment Service Fees	**$ 319,790**	**$ 419,272**
Total Investment Expenses	**$ 4,537,911**	**$ 4,700,061**

Other Supplementary Information *Continued*

Schedules of Payments to Consultants

For the Fiscal Years Ended June 30, 2005 and 2004

Firm	Nature of Service	2005	2004
Courtland Partners	Investment Manager Search Consultant	$ -	$ 21,057
CPS Human Resources	Human Resource Consultant	(2,026)	23,000
Levi, Ray & Shoup	Web Development, Maintenance and Hosting	17,223	55,482
Levi, Ray & Shoup	Document Imaging & Support and Maintenance	3,125	139,750
Macias Gini & Company	External Auditors	24,332	23,911
Maximus	Human Resource Consultant	-	13,500
Medical Director/Other Medical	Medical Consultant	19,842	29,877
Pension Benefit Information	Reports on Beneficiary Deaths	1,966	1,749
Saltzman & Johnson	Legal Counsel	11,160	6,051
Klausner & Kaufman	Legal - Attendance at Retreat	4,715	-
Gabriel, Roeder, Smith & Company	Actuarial Consultant	20,315	40,552
	Total	**$ 100,652**	**$ 354,929**

III. INVESTMENT SECTION

Report on Investment Activity

THE BANK OF NEW YORK
NEW YORK'S FIRST BANK - FOUNDED 1784 BY ALEXANDER HAMILTON

ONE WALL STREET, NEW YORK, N.Y. 10286

August 26, 2005

Mr. Edward F. Overton
Director, Retirement Services
Federated City Employees' Retirement System
1737 N. First Street, Suite 580
San Jose, California 95112-4505

Dear Mr. Overton:

This letter reviews the investment activity of the Federated City Employees' Retirement System of San Jose during the fiscal year ended June 30, 2005 for the Comprehensive Annual Financial Report. The System had a total return of 8.91% during this period. From an asset allocation perspective, the exposures to international equities and real estate were particularly helpful in enhancing returns during the fiscal year. In terms of performance, the small cap growth manager and the small cap value manager both significantly outperformed their benchmarks.

Background

The objectives of the System, as indicated in the Investment Policy Statement, are to assure sufficient funding for disbursements; to attempt to insure that investment earnings are sufficiently high, along with employee and City contributions, to offset liabilities in perpetuity; to strive for the highest total returns consistent with safety in accordance with accepted investment practices; to maintain an appropriate asset allocation; and to control costs. The Board has established an investment structure and process that effectively meet these goals.

Quarterly performance reports are provided by The Bank of New York, the System's custodian, based on plan accounting data. The Bank of New York adheres to the CFA Institute's performance presentation standards and also assists the Board in a consultative capacity in monitoring the performance of the investment managers.

The Economy and the Capital Markets

At the start of the fiscal year, it became apparent that the Federal Reserve would raise the federal funds rate to reverse the accommodative monetary policy it had pursued to support economic growth during and after the recession. Many investors expected that long-term interest rates would rise in response to the increases in short-term interest rates. In fact, the Federal

Report on Investment Activity *Continued*

THE BANK OF NEW YORK

Reserve did raise the federal funds rate in a series of increases from 1.25% on June 30, 2004, to 3.25% on June 30, 2005. Economic data, however, continued to send mixed signals. Overall growth was actually quite respectable, as real GDP rose 3.6% during the fiscal year. One continuing area of strength was the housing market, which benefited from the low long-term interest rates. During various months, however, growth in payroll employment seemed quite lackluster. After these periods, as bond market participants sensed that economic growth might be more subdued than some had anticipated, bond prices rallied.

As the yield on the 10-year Treasury note dipped below 4.00%, bond prices fell after the next series of positive economic reports. Although oil prices rose steadily during the fiscal year, inflation remained relatively tame, as the consumer price index rose 2.5%. Excluding food and energy, the increase was 2.0%. The net result was that despite steady increases in short-term interest rates and rising oil prices, the bond market essentially remained in a trading range for much of the year. The yield on the 10-year Treasury note was 4.58% on June 30, 2004 and 3.91% on June 30, 2005. The total return of the Lehman Brothers Aggregate bond index was 6.80% during the fiscal year, compared to 0.33% during the prior fiscal year.

For much of the fiscal year, the stock market was fixated on high oil prices and an expected slowdown in consumer spending. Other than during the fourth quarter of 2004, when the market had a brief but intense rally, the market essentially drifted for most of the period. The total return of the Russell 1000, which includes large and mid capitalization stocks, was 7.92%, compared to 19.47% in the prior fiscal year. As has been the pattern for the last several years, small cap stocks outperformed large cap stocks. The total return of the Russell 2000 was 9.45% during the fiscal year. Value stocks continued to outperform growth stocks across all capitalization sectors. US investors in international stocks in developed markets benefited from the depreciation of the dollar during much of the period. The total return of EAFE was 13.65% during the fiscal year.

Investment Results

The Federated City Employees' Retirement System of San Jose has had relatively favorable performance during a volatile period in the capital markets. As of June 30, 2005, the total return of the system was 8.91% on a 1-year basis, 10.86% on a 3-year basis, and 6.00% on a 5-year basis.

Peer group comparisons are a useful means of assessing a fund's performance relative to the experience of other institutional investors. As part if its performance measurement service, the Bank of New York participates in the Trust Universe Comparison Service (TUCS), whose members are among the largest custody banks in the United States. The TUCS universe consists of many large institutional funds. On a 1-year basis, the total return of the System ranked in the third quartile of all master trusts and public funds in the TUCS universe. (The first quartile is the top

Report on Investment Activity *Continued*

THE BANK OF NEW YORK

25% of all funds; the second quartile is the next 25%, etc.) On a 3- and 5-year basis, however, the total return of the System ranked in the first quartile of all master trusts and public funds. Moreover, the System's risk profile, in terms of the volatility of returns, was relatively low. The System has both active and passive managers. A significant portion of the equity assets are invested in a Russell 3000 index fund, which encompasses large, mid, and small capitalization stocks. The System was also invested in an All Cap Growth index fund as a temporary measure during the fiscal year. In terms of its active managers, growth and value styles are represented for large and small capitalization stocks. The large cap growth manager, which emphasizes investments in high quality stocks, outperformed its benchmark during the fiscal year, underperformed the benchmark on a 3-year basis, but significantly outperformed its benchmark on a 5-year basis. The large cap value manager slightly underperformed its benchmark during the fiscal year. The small cap growth manager, which employs an RGARP strategy (rapid growth at a reasonable price), has had consistently favorable performance for the last five years. The small cap value manager, which invests in a large number of stocks with relatively low price/earnings ratios, has also consistently outperformed its benchmark during the last five years.

A relatively new international equity manager underperformed its benchmark during the fiscal year, while another long-standing international equity manager was terminated towards the end of the fiscal year and replaced with two new managers. The domestic fixed income managers had mixed results, as one manager outperformed the benchmark while the other underperformed the benchmark. The international fixed income manager was terminated during the year and replaced with a manager with a global mandate. The System's real estate portfolio has provided steady double-digit returns during a volatile period in the capital markets. This exposure to real estate has been an important factor in the System's overall relatively favorable performance.

The System has terminated several investment managers and hired new ones in an ongoing effort to maintain performance at a high level and to achieve its investment goals. As the second half of the fiscal year provided only small returns in most asset classes, it is clear that continued high oil prices and rising short-term interest rates have presented a challenging environment for the capital markets. Nevertheless, the System has a diversified portfolio designed to deliver favorable results over long periods.

Yours truly,

Bernard Schoenfeld

Bernard Schoenfeld
Vice President

Statement of Investment Policy

General Environment

The purpose of this Investment Policy Statement (IPS) is to assist the San Jose Federated City Employees' Retirement System's Board ("Board") and its delegate in effectively supervising, monitoring and evaluating the investment of the System's assets.

The System's investment program is defined in the various sections of the IPS by:

• Stating in a written document the Board's attitudes, expectations, objectives and guidelines for the investment of all the System's assets.

• Setting forth an investment structure for managing all the System's assets. This structure includes various asset classes, investment management styles, asset allocation and acceptable ranges that, in total, are expected to produce a sufficient level of overall diversification and total investment return over the long-term.

• Providing guidelines for the investment System that control the level of overall risk and liquidity assumed in that System, so that all the System's assets are managed in accordance with stated objectives.

• Encouraging effective communications between the Board, the investment consultant(s) (Consultant) and the money managers.

• Establishing formalized criteria to monitor, evaluate and compare the performance results achieved by the money managers on a quarterly basis, or as deemed appropriate.

• Complying with all applicable fiduciary, prudence and due diligence requirements that experienced investment professionals would utilize, and with all applicable laws, rules and regulations from various local, state, federal and international political entities that may impact the System's assets.

This IPS has been formulated, based upon consideration by the Board of the financial implications of a wide range of policies, and describes the prudent investment process that the Board deems appropriate.

The objectives of the System have been established in conjunction with a comprehensive review of the current and projected financial requirements. The Board shall:

(1) Require that the Retirement System be sufficiently funded to assure that all disbursement obligations will be met.

(2) Attempt to insure that the investment earnings be sufficiently high to provide a funding source, along with contributions from City employees and the City, in order to offset liabilities in perpetuity.

(3) Strive for the highest total return on investment funds consistent with safety in accordance with accepted investment practices and maintain an appropriate asset allocation policy that is compatible with the objectives of the System.

(4) Control costs of administering the System's assets and managing the investments.

(5) Outperform a passively managed portfolio invested in the proportions described in the Plan's Asset Allocation targets.

(6) Perform in the top 50% of a broad universe of Public Pension Plans.

Statement of Investment Policy *Continued*

Asset Allocation Policy

The following policy has been identified by the Board as having the greatest expected investment return and the resulting positive impact on asset values and funded status without exceeding a prudent level of risk. The Board determined this policy after evaluating the implications of increased investment return versus increased variability of return for a number of potential investment policies with varying commitments to stocks and bonds.

It shall be the Policy of the System to invest its assets in accordance with the maximum and minimum range, valued at market value, for each asset class as stated below:

ASSET ALLOCATION OF INVESTMENT PLAN

Asset Class	Minimum	Target	Maximum
Domestic Equity	38%	43%	48%
International Equity	10%	15%	20%
Domestic Bonds	24%	29%	34%
Global Bonds	4%	7%	10%
Real Estate	3%	6%	9%

The investment policy is expected to have a high likelihood of meeting the objectives outlined in the "Statement of Investment Objectives" section which preceded this section.

(Procedure 620.2)

The Investment Policy, including asset allocation, is intended to provide a means for controlling the overall risk of the portfolio while ensuring that investment earnings will be sufficiently high to provide a funding source to offset liabilities in perpetuity. The policy should not unduly constrain the discretionary, tactical decision-making process of the investment managers so that the funds earn the highest total returns while remaining in accordance with accepted investment practices.

The Investment Policy and the strategic asset allocation are determined using certain capital market assumptions. These assumptions include the expected median return and standard deviation for each asset category and the expected correlation coefficients among the asset classes. When these presumptions change materially, the policy needs to be modified to compensate for those changes so that the Retirement System remains sufficiently funded to meet all distribution needs.

Time Horizon

The asset allocation ranges established by this investment policy represent the long-term perspective. As such, rapid unanticipated market shifts or changes in economic conditions may cause the asset mix to fall outside the policy range. These divergences should be of a short-term nature. The Director of Retirement Services will review the asset mix of the Plan on a semi-monthly basis and cause the asset mix to be rebalanced to within the policy range as necessary and in accordance with the rebalancing guidelines set forth in Procedure 620.3-F. Additionally, the Board will review the strategic asset allocation on an annual basis to determine if there is a need to make any changes. A formal asset liability study will be conducted every 3 to 5 years.

Risk Tolerances and Volatility

The Board recognizes the difficulty of achieving the System's investment objectives in light of the uncertainties and complexities of contemporary investment markets. The Board also recognizes that some risk must be assumed to achieve the System's long-term investment objectives.

In establishing the risk tolerances of the IPS, the ability to withstand short and intermediate term variability were considered.

STATEMENT OF INVESTMENT POLICY *Continued*

Re-balancing of Strategic Allocation
(Procedure 620.3-F)
The Plan's asset allocation will be reviewed relative to the targets on a semi-monthly basis and action will be taken to re-balance to within the target ranges by means of asset transfers among the categories.

When necessary and/or available, cash inflows/outflows will be deployed in a manner consistent with the strategic asset allocation of the System.

General guidelines for re-balancing the portfolio are as follows:

1) When the allocation to a particular asset class reaches 95-100% of the maximum or 100-105% of the minimum, the fund will be re-balanced to the target over the following 60 days. The cash surplus within the Fund will be used to rebalance the portfolios. **If the cash surplus is not sufficient, the following rebalancing procedures shall be implemented.**

a) Transfers shall first be taken from asset classes above the maximum range, then from asset classes above the target but below the maximum. If there is only one manager in the asset class, transferred assets shall first consist of cash in the portfolio. If the cash is not sufficient, then the manager will be requested to liquidate that portion of the portfolio which will result in the manager's portfolio coming within the specific target range.

b) Transfers shall first be made to asset classes below the minimums, then to asset classes below the targets, unless the managers in those classes are already holding excess cash or they feel it would be imprudent to increase their size.

c) Transfers to or from the Domestic Stock asset class should be made such that the asset class remains style neutral. The portfolio should remain biased towards large capitalization over small capitalization. Transferred assets shall first consist of cash in the portfolios. If the cash is not sufficient, then the managers will be requested to liquidate that portion of the portfolios which will result in the asset class coming within the specific target range and remaining balanced between Growth and Value.

d) Since the Domestic Equity Class represents a large part of the Fund, it can be balanced internally through the use of secondary targets established within the class. The table below provides an example of how balances within the class are maintained. To determine whether the target is met for each of these categories, a subtotal is computed for the assets held by each group of managers. The percentage of the total portfolio that each group represents is determined, and compared against the target levels. When the allowable variation is exceeded, the procedures for adjustments between asset classes are then applied within the domestic equities class to meet the secondary target levels.

SECONDARY ASSET CLASS, DOMESTIC EQUITIES

Asset Class	As a % of the Domestic Equity Portfolio	As a Equivalent % of the Total Portfolio	Allowable Variation from the % of the Equity Portfolio
Index Fund	50%	17.4%	+/- 4.5%
Large Cap Value	12%	3.4%	+/- 2.5%
Large Cap Growth	10%	2.9%	+/- 2.5%
Small Cap Value	7%	3.6%	+/- 1.5%
Small Cap Growth	6%	3.1%	+/- 1.5%
All Cap Growth	15%	4.4%	+/- 2.5%

Statement of Investment Policy *Continued*

2) All transfers should be made in accordance with the cash management policy.

3) The less liquid Real Estate and Private Equity investment will be treated separately for purposes of rebalancing in order not to force liquidation of holdings.

Liquidity

The Board has authorized the Director of Retirement Services to review the projected cash flow needs of the System at least annually and indicate to the investment managers the required liquidity. If necessary, cash flow needs will be coordinated through the System's rebalancing procedures as described in the previous section. If additional funds are required from the System's equity managers, the Director will communicate the cash flow requirements giving advanced written notice so the managers have sufficient time to comply.

Diversification

Investments shall be diversified with the intent to minimize the risk of large investment losses. Consequently, the total portfolio will be constructed and maintained to provide prudent diversification with regard to the concentration of holdings in individual issues, issuers, or industries.

Specifically, no single investment shall exceed the guidelines established under the Manager and Securities Guidelines section.

As a general rule, System assets placed with an investment manager will not represent more than 10% of that manager's assets.

Supervision

The Investment Manager shall continually supervise the investment securities in the Fund, and shall purchase, sell, substitute, redeem, or convert securities as they should deem advisable.

Brokerage Policy

All transactions effected for the System will be "subject to the best price and execution." The lowest commission rate need not mean the best realized price. Execution capability, price and overall effectiveness shall be considered, along with commission rate.

Any manager who is engaged in or has a direct pecuniary interest in a business other than investment counseling, such as a broker or dealer in securities shall not be permitted to use such business with regard to the System assets without prior written approval by the Board.

If a manager utilizes brokerage from the plan assets to effect "soft dollar" transactions, detailed records will be kept and communicated to the Board.

The Plan's investment managers shall follow the direction of the Board. It is the policy of the Board to instruct the investment managers to direct transaction orders to particular broker-dealers, including equity, fixed income, both domestic and international. The instructions from the Board currently is for the investment managers to direct as much as possible of the Plan's commission business as is practicable, subject to the best price and execution. The instruction and direction is to be construed within the normal activity of the investment manager, with no increased or decreased trading activity to occur because of the instruction. Where given discretion to establish and execute transactions through accounts with one or more broker-dealer firms as it may select, the manager must attempt to obtain "best available price and most favorable execution" with respect to all of the portfolio transactions.

Soft Dollars accumulated through the System's brokerage program may be used to pay for any System expense permitted under the regulations of the Department of Labor (including, but not limited to, legal, accounting, education, management, etc.) and approved by the Board.

Statement of Investment Policy *Continued*

Performance Objectives

Investment performance will be measured quarterly but it is not expected that the performance goals identified below will be satisfied in any single quarter or year. It is expected that these goals will be satisfied over a rolling five-year period or a full market cycle. However, action by the Board with regard to retention or dismissal of investment managers is not precluded by virtue of these time periods.

Total Fund Investments

The total fund's performance, in aggregate, will be expected to achieve a rate of return which exceeds a fund benchmark representative of the Asset Allocation objective as follows:

(Procedure 610.2)

Specific guidelines and benchmarks are established below for each category of managers. Generally, however, investment managers are expected to rank in the top half of a database of similarly styled managers, and earn an average return which exceeds an appropriate index over annualized three and five year periods net of fees.

Managers are considered to have achieved this objective if their performance meets all guidelines on a cumulative three and five year annualized period. If the performance is longer than five years, the manager is expected to satisfy the performance objectives in a majority of the rolling five year periods.

Investment managers with less than five years of experience with the Fund are considered to have achieved performance objectives if their performance meets guidelines for the three year annualized time period or since inception period if the manager's track record is less than three years.

Benchmark	With Private Markets	Without Private Markets
Russell 1000	28%	34%
Russell 2000	7%	9%
MSCI EAFE and/or ACWI-ex US	15%	15%
Lehman Aggregate Bond Index	34%	29%
Citibank World Govt. Bond Index	7%	7%
NCREIF Property Index	6%	6%
Private Markets (S&P 500 plus 300 basis points)	3%	0%

Statement of Investment Policy *Continued*

Fixed-Income Investments

The objectives for investment managers of the domestic fixed-income component of the total portfolio are:

(1) Earn an average annual return from income and capital appreciation which exceeds the Lehman Aggregate Bond Index over a three and five year annualized time period net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.

(2) Achieve performance results which will rank in the top half of investment managers which utilize a similar investment style.

Domestic Equity Investments

The objectives for investment managers of the domestic equity component of the total portfolio are:

(1) Achieve returns which exceed an appropriate index, (i.e. S&P 500, Russell 2000, etc.) over a three and five year annualized time period net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.

(2) Achieve performance results which will rank in the top half of investment managers which utilize a similar investment style.

(3) If bonds are downgraded below the minimum credit quality allowable in the guidelines at the time of purchase, the Manager is permitted to hold up to 2% of the Plan's portfolio managed by the individual manager, using the lower of S&P, Moody's, and Fitch's rating in the event of a split-rated security.

Passive Equity Investment

The objective for investment managers of the passive domestic equity component of the total portfolio is to achieve returns equal to the appropriate index with minimal tracking error.

International Equity Investments

The objectives for investment managers of the international equity component of the total portfolio are:

(1) Achieve returns which exceed an appropriate index (the Morgan Stanley All Country World Ex US Index, MSCI EAFE Index) over a three and five year annualized time period net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods. Achieve performance results in the top half of investment managers which utilize a similar style of investment.

Global Fixed-Income Investments

The objective for the investment managers of the global fixed-income component of the total portfolio are:

(1) Achieve rates of return which exceed the Citibank World Government Non-Dollar Bond Index over a three and five year annualized time period net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.

(2) Achieve returns that will rank in the top half of investment managers which utilize a similar investment style.

Real Estate Investments

(1) Achieve returns which exceed an appropriate index, (i.e. NCRIEF) net of fees over a market cycle

(2) The real estate manager(s) will be expected to achieve returns that rank in the upper half of a broad universe of real estate funds.

INVESTMENT PROFESSIONALS

Investment Managers

Domestic Equities:

Atlanta Capital Management
Large Cap Growth
Atlanta, GA

Brandywine Asset Management
Small Cap Value
Wilmington, DE

Dodge & Cox
San Francisco, CA

Eagle Asset Management, Inc.
Small Cap Growth
St. Petersburg, FL

Northern Trust Quantitative Advisors
Russell 1000 Growth Index,
Russell 2000 Growth Index
Russell 3000 Index
Chicago, IL

PRIVATE MARKET EQUITIES:

Pathway Capital Management, LLC
Private Market Equities
Irvine, CA

International Equities:

Bank of Ireland Asset Management
Dublin, Ireland

The Boston Company Asset Management, LLC
Boston, MA

Domestic Fixed Income:

Dodge & Cox
San Francisco, CA

BlackRock Financial Management
New York, NY

GLOBAL FIXED INCOME:

Loomis Sayles
Boston, MA

Real Estate:

DRA Advisors, Inc.
New York, NY

Fidelity Investments
Boston, MA

MIG Realty Advisors
Cleveland, OH

Prudential Real Estate Investors
Newark, NJ

Consultant

The Bank of New York
New York, NY

Strategic Investment Solutions, Inc.
San Francisco, CA

Custodian

The Bank of New York
New York, NY

Proxy Voting

Investor Responsibility Research Center
Washington, DC

Schedule of Investment Results

Gross Performance Summary by Assets Class

Periods Ending June 30, 2005

Basis of Calculation: Time-weighted Rate of Return

	One Year	Three Years	Five Years
TOTAL FUND	**8.9%**	**10.9%**	**6.0%**
Benchmark	9.5%	9.7%	4.3%
TUCS All Master Trust Median	9.5%	9.7%	3.5%
TUCS Public Fund Universe Median	9.4%	9.5%	3.5%
TOTAL DOMESTIC FIXED INCOME	**6.6%**	**6.4%**	**7.5%**
Lehman Brothers Aggregate Bond Index	6.8%	5.8%	7.4%
TUCS Domestic Fixed Income Median	7.2%	6.5%	7.8%

	One Quarter
TOTAL GLOBAL FIXED INCOME	**-1.5%**
Citigroup World Government Bond Index	-1.4%
TUCS Unhedged Global Fixed Income Median	-0.6%

	One Year	Three Years	Five Years
TOTAL DOMESTIC EQUITY	**8.2%**	**9.4%**	**1.6%**
S&P 500 Index	6.3%	8.3%	-2.4%
TUCS Equity Median	8.7%	10.2%	1.6%
TOTAL INTERNATIONAL EQUITY	**13.4%**	**10.7%**	**-0.2%**
EAFE Index	13.7%	12.1%	-0.6%
MSCI ACWI ex-US	17.0%	14.1%	0.8%
TUCS International Equity Median	15.3%	13.1%	1.9%
TOTAL REAL ESTATE	**17.7%**	**19.0%**	**15.5%**
NCREIF Property Index	18.0%	12.1%	10.6%
TUCS Real Estate Median	18.8%	12.9%	10.6%

Schedule of Investment Results *Continued*

Net Performance Summary by Investment Manager

For Periods Ending June 30, 2005

The table below details the rates of return for the System's investment managers over various time periods. Returns for one year or greater are annualized. Each "+" represents a benchmark the manager has outperformed.

Source: The Bank of New York Investment Performance Evaluation Report June 30, 2005.

Basis of Calculation: Time-weighted Rate of Return

	One Quarter	One Year	Inception (10/02)
DOMESTIC FIXED INCOME			
BlackRock Financial Management, Inc.	**2.8%**	**6.9% +**	**5.3% +**
Lehman Brothers Aggregate Bond Index	3.0%	6.8%	4.6%
TUCS Fixed Income Core Median	2.9%	7.2%	N/A

	One Year	Three Years	Five Years
Dodge and Cox	**5.9%**	**6.3%**	**8.0%**
Lehman Brothers Aggregate Bond Index	6.8%	5.8%	7.4%
TUCS Fixed Income Core Median	7.2%	6.5%	7.8%

	One Quarter	Inception (02/05)
GLOBAL FIXED INCOME		
Loomis Sayles	**-1.6%**	**-2.6%**
Citigroup World Government Bond Index	-1.4%	-2.6%
TUCS Unhedged Global Fixed Portfolio Median	-0.6%	N/A

	One Year	Three Years	Five Years
DOMESTIC EQUITY			
Northern Trust (Index)	**8.1% +**	**9.4%**	**-1.4% +**
Russell 3000	8.1%	9.5%	-1.4%
TUCS Equity Median	8.7%	10.2%	1.6%
Atlanta Capital (Large Cap Growth)	**3.3%**	**4.6%**	**-4.7% ++**
Russell 1000 Growth	1.7%	7.3%	-10.4%
TUCS Large Cap Growth Median	3.6%	6.1%	-6.4%
TUCS Equity Median	8.7%	10.2%	1.6%
Eagle Asset Management (Small Cap Growth)	**10.1% +++**	**12.8% +++**	**5.1% +++**
Russell 2000 Growth	4.3%	11.4%	-4.5%
TUCS Small Cap Growth Median	5.4%	11.8%	-2.6%
TUCS Equity Median	8.7%	10.2%	1.6%
Brandywine (Small Cap Value)	**16.4% +++**	**15.2% ++**	**21.2% +++**
Russell 2000 Value	14.4%	14.2%	16.1%
TUCS Small Cap Value Universe Median	14.5%	15.6%	15.8%
TUCS Equity Median	8.7%	10.2%	1.6%

Schedule of Investment Results *Continued*

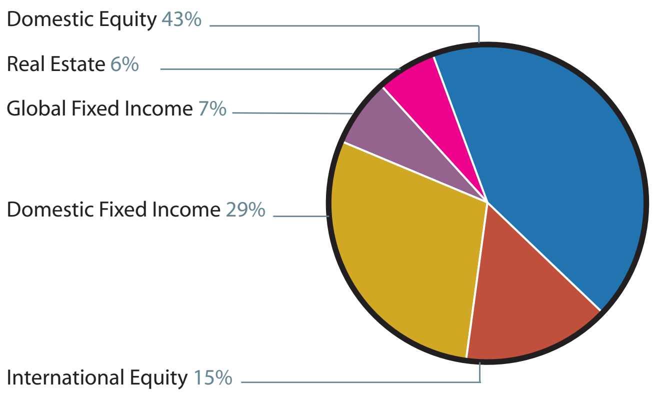
Net Performance Summary by Investment Manager

For Periods Ending June 30, 2005

	One Quarter	One Year	Inception (07/04)
DOMESTIC EQUITY			
Dodge & Cox (Large Cap Value)	**0.5%**	**12.4% ++**	**12.4%**
Russell 1000 Value Index	1.7%	14.1%	14.1%
TUCS Large Cap Value Median	2.0%	10.7%	N/A
TUCS Equity Median	2.5%	8.7%	N/A
	One Quarter	**One Year**	**Inception (02/05)**
INTERNATIONAL EQUITY			
Boston Company Asset Management, LLC	**-1.2%**	**12.9%**	**30.3% +**
MSCI ACWI ex-US	-0.0%	17.0%	29.3%
TUCS International Equity Median	-0.0%	15.3%	N/A
	One Year	**Three Years**	**Five Years**
Bank of Ireland Asset Management	**12.8% +**	**7.9%**	**-1.9%**
EAFE Index	13.7%	12.1%	-0.6%
TUCS International Equity Median	15.3%	13.1%	1.9%
REAL ESTATE			
MIG Realty Advisors	**-6.0%**	**20.1% ++**	**16.0% ++**
CIGNA (Formerly, TimesSquare)	**42.6% ++**	**14.9% ++**	**11.3% ++**
DRA	**11.2%**	**9.2%**	**11.2% ++**
NCREIF Property Index	18.0%	12.1%	10.6%
TUCS Real Estate Median	18.8%	12.9%	10.6%
	One Year	**Three Years**	**Inception (03/01)**
Fidelity	**41.3% ++**	**21.7% ++**	**15.5% +**
NCREIF Property Index	18.0%	12.1%	10.8%
TUCS Real Estate Median	18.8%	12.9%	N/A
	One Quarter	**One Year**	**Inception (06/04)**
PRISA	**5.7% ++**	**16.1%**	**16.1%**
NCREIF Property Index	5.3%	18.0%	18.0%
TUCS Real Estate Median	4.6%	18.8%	N/A

INVESTMENT REVIEW

Target Asset Allocation As of June 30, 2005

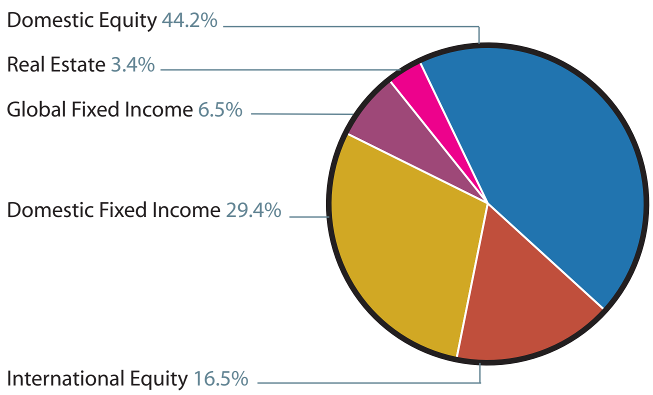


ACTUAL ASSET ALLOCATION

As of June 30, 2005 (in Millions)

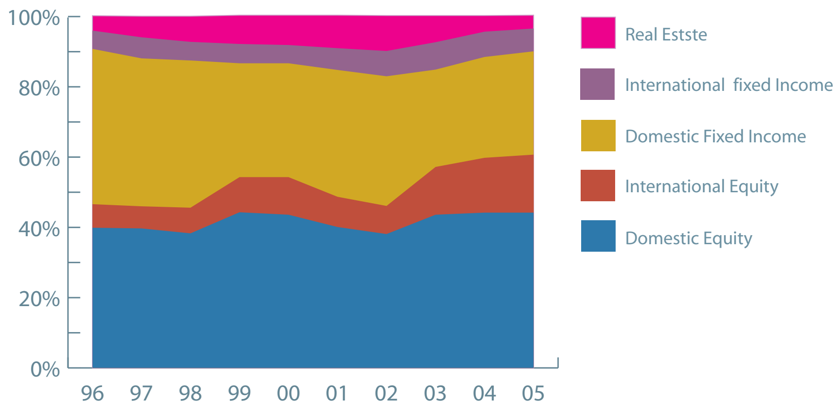
Asset Class		Actual
Domestic Equity	$	666.71
International Equity		248.83
Domestic Fixed Income		443.03
Global Fixed Income		97.35
Real Estate		51.09
Cash		1.03
Total	**$**	**1,508.04**

Actual Asset Allocation As of June 30, 2005

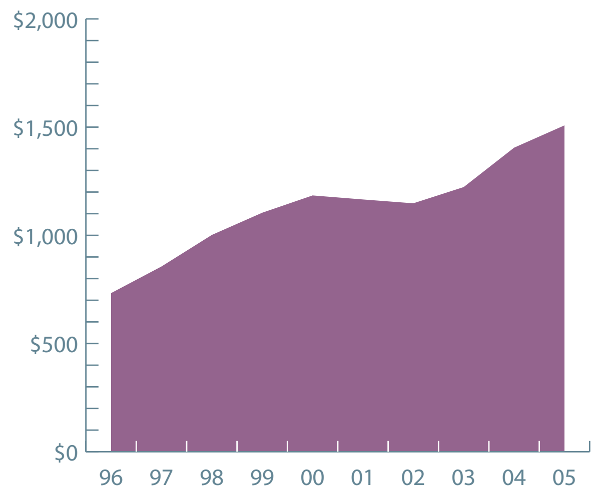


INVESTMENT REVIEW *Continued*

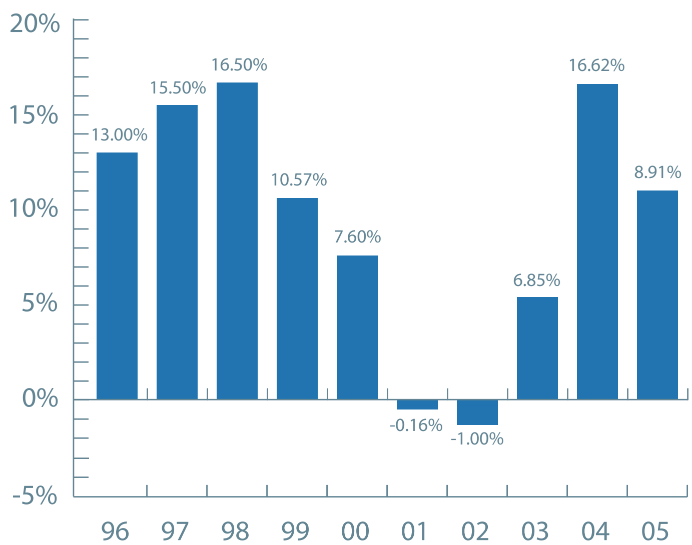
Historical Asset Allocation (Actual)
June 30, 1996 - June 30, 2005



Market Value Growth of Plan Assets
For Ten Years Ended June 30, 2005 (In Millions)



History of Performance For Fiscal Years 1996 - 2005
(Based on Market Value)



List of Largest Assets Held

LARGEST STOCK HOLDINGS (By Market Value)
June 30, 2005

Shares	Country	Description	Market Value in $US
298,600	UNITED STATES	BHP BILLITON PLC USD 0.5	$3,811,336
66,800	SWITZERLAND	NOVARTIS AG CHF 0.5	3,215,205
111,950	UNITED STATES	PFIZER INC USD 0.05	3,087,581
34,900	FRANCE	SANOFI-AVENTIS EUR 2.0	2,869,629
114,000	UNITED STATES	HEWLETT PACKARD CO USD 0.01	2,689,260
99,200	GERMANY	BAYERISCHE HYPO-UND VEREINS EUR 1.0	2,582,395
269,800	GREAT BRITAIN	CADBURY SCHWEPPES PLC 12.5P	2,577,963
102,800	GREAT BRITAIN	GLAXOSMITHKLINE PLC 25P	2,502,646
18,300	SWITZERLAND	ROCHE HOLDING AG	2,338,500
24,800	NORWAY	NORSK HYDRO ASA NOK 18.3	2,276,866

LARGEST BOND HOLDINGS (By Market Value)
June 30, 2005

Description	Country	Maturity Date	Par Value	Market Value in $US
UNITED STATES TREAS 3.125 JAN 31 07	UNITED STATES	1/31/07	20,820,000	$20,927,124
U. S. TREASURY NOTES	UNITED STATES	8/31/05	20,500,000	20,596,243
UNITED STATES TREAS N 2.0 15MAY2006	UNITED STATES	5/15/06	18,000,000	17,815,353
FANNIE MAE POOL 6.0 01AUG2035 TBA	UNITED STATES	8/1/35	12,500,000	12,821,583
U. S. TREASURY NOTES	UNITED STATES	4/30/07	11,890,000	11,956,077
UNITED STATES TREAS 4.375 MAY 15 07	UNITED STATES	5/15/07	8,000,000	8,151,261
UNITED STATES TREAS 1.625 31OCT2005	UNITED STATES	10/31/05	7,000,000	6,981,434
UNITED STATES TREAS 8.000 NOV 15 21	UNITED STATES	11/15/21	4,700,000	6,820,274
UNITED STATES TREAS 3.000 NOV 15 07	UNITED STATES	11/15/07	6,000,000	5,935,802
FEDERAL NATL M 555065 6.0 01NOV2014	UNITED STATES	11/1/14	21,350,000	5,420,833

A complete list of portfolio holdings is available upon request.

Schedule of Investment Fees

	Assets Under Mgt. at Market Value *	Fees	Basis Points
INVESTMENT MANAGERS' FEES:			
Domestic Equity Managers	$ 666,708,214	$ 1,219,051	18
International Equity Managers	248,834,201	1,240,012	50
Domestic Fixed Income Managers	443,027,679	841,357	19
Global Fixed Income Managers	97,350,774	343,614	35
Real Estate Managers	51,089,976	574,087	112
Cash	1,028,923	-	N/A
Total	**$ 1,508,039,768**	**$ 4,218,121**	28
OTHER INVESTMENT SERVICE FEES:			
Investment Consultant	N/A	$ 113,798	N/A
Proxy Voting	N/A	7,375	N/A
Custodian	N/A	198,058	N/A
Real Estate Legal Fees	N/A	559	N/A
Total		**$ 319,790**	

** Includes Cash in Managers' Accounts*

Schedule of Commissions

For the Year Ending June 30, 2005

Brokerage Firm	Number of Shares Traded	Total Commissions	Commission Per Share
ABEL NOSER CORPORATION	16,600.00	$ $670.00	$ 0.04036
ABN AMRO EQUITIES (UK) LONDON	56,819.00	$501.00	0.00882
ABN AMRO EQUITIES AUSTRALIA LIMITED	19,402.00	$561.00	0.02891
ABN AMRO EUROPEAN HUB, LONDON	134,470.00	1,509.00	0.01122
ADAMS, HARKNESS & HILL INC	9,125.00	$456.00	0.04997
ADP CLEARING AND OUTSOURCING	30,250.00	1,210.00	0.04000
B-TRADE SERVICES LLC	573,822.00	14,276.00	0.05275
BAIRD ROBERT W & CO INC	93,410.00	4,671.00	0.10001
BANC/AMERICA SECUR.LLC,MONTGOM	51,900.00	2,019.00	0.08265
BANK AM BELLEVUE, ZURICH	8,511.00	2,024.00	0.23781
BARCLAYS BANK PLC, NY	1,460,000.00	10,632.00	0.00728
BEAR STEARNS & CO INC	71,200.00	3,560.00	0.15000
BNY BROKERAGE INC	1,824,405.00	73,447.00	0.16883
CANTOR, FITZGERALD & CO., INC	228,985.00	8,706.00	0.08479
CAP INSTL SVCS INC-EQUITIES	179,527.00	7,447.00	0.07917
CAZENOVE AND CO. LTD	323,313.00	$542.00	0.00168
CIBC WORLD MARKETS CORP	104,548.00	4,072.00	0.03895
CITIGROUP GLOBAL MARKETS ASIA LTD	10,000.00	$140.00	0.01400
CITIGROUP GLOBAL MARKETS INC	278,655.00	11,715.00	0.20822
CITIGROUP GLOBAL MARKETS KOREA SEC	4,290.00	1,261.00	0.29394
CITIGROUP GLOBAL MARKETS LTD, LDN	446,382.00	2,926.00	0.00655
CITIGROUP GLOBAL MARKETS UK EQ LTD	22,835.00	91.00	0.00399
CLSA GUERNSEY LIMITED, GUERNSEY	10,593,841.00	1.00	0.00000
CLSA SECURITIES KOREA	141,493.00	6,434.00	0.04547
COLLINS STEWART (CSCS)+CO, LONDON	100,887.00	157.00	0.00156
CREDIT AGRICOLE INDO CHEUVREUX	2,725.00	219.00	0.08037
CREDIT LYONNAIS SECS LENDING	1,837.00	53.00	0.02885
CREDIT SUIS FST BOSTON (EUR), SEOUL	4,500.00	521.00	0.11578
CREDIT SUISSE FIRST BOSTON	420,478.00	12,511.00	0.14347
CREDIT SUISSE FIRST BOSTON EQUITIES	1,060,158.00	1,048.00	0.00099
DBTC AMERICAS/DEUTSCHE BANK AG LDN	9,923.00	105.00	0.01058
DEUTSCHE BANC/ALEX BROWN	24,325.00	551.00	0.04669
DEUTSCHE BANK AG, LONDON	488,933.00	5,201.00	0.01064
DRESDNER KLEINWORT WASSERSTEIN SEC	11,283.00	348.00	0.03084
EDWARDS, A.G., & SONS, INC.	34,575.00	1,729.00	0.10005
EMP RESEARCH PTRNS LLC	10,300.00	515.00	0.05000
FACTSET DATA SYSTEMS, INC.	8,400.00	420.00	0.05000
FIRST ALBANY CORPORATION	3,375.00	169.00	0.05007
FIRST CLEARING, LLC	2,700.00	135.00	0.05000
FOX-PITT KELTON LTD, LONDON	46,515.00	162.00	0.00348
FRIEDMAN, BILLINGS & RAMSEY	99,225.00	4,822.00	0.04860
FULCRUM GLOBAL PARTNERS LLC	36,400.00	1,820.00	0.05000

SCHEDULE OF COMMISSIONS *Continued*

For the Year Ending June 30, 2005

Brokerage Firm	Number of Shares Traded	Total Commissions	Commission Per Share
FUTURETRADE SECURITIES, LLC	6,400.00	$ 64.00	$ 0.01000
G-TRADE SERVICES DIV G-PORT	749,700.00	2,113.00	0.00282
GABELLI & CO	3,500.00	175.00	0.05000
GOLDMAN SACHS & CO	32,600.00	1,208.00	0.07656
GOLDMAN SACHS EXECUTION & CLEA	750.00	15.00	0.02000
GOLDMAN SACHS INTL BELGIUM ONLY	87,963.00	3,410.00	0.03877
GOLDMAN SACHS INTL LONDON	68,766.00	650.00	0.00945
GOODBODY STOCKBROKERS/DUBLIN	64,910.00	2,035.00	0.03135
HIBERNIA SOUTHCOAST CAPITAL	5,300.00	265.00	0.05000
INSTINET CORPORATION	60,825.00	1,217.00	0.04001
INVESTMENT TECHNOLOGY GROUP,	733,531.00	10,703.00	0.02606
ISI GROUP, INC.	14,650.00	732.00	0.09994
J B WERE AND SON, MELBOURNE	39,280.00	769.00	0.01958
J P MORGAN SECURITIES INC	22,900.00	698.00	0.07489
JEFFERIES & COMPANY, INC.	166,275.00	7,391.00	0.13762
JONES & ASSOCIATES, INC	114,522.00	4,359.00	0.08733
JP MORGAN CHASE BANK, LONDON	1,662.00	296.00	0.17810
JP MORGAN SECS AUST LTD PID 2972	46,989.00	732.00	0.01558
JP MORGAN SECS LTD, LONDON	120,971.00	1,977.00	0.01634
KEEFE BRUYETTE & WOODS INC.	1,125.00	56.00	0.04978
KNIGHT SECURITIES	98,130.00	4,817.00	0.09779
LABRANCHE FINC'L SVC INC/HBI	28,512.00	777.00	0.05555
LEERINK SWANN AND COMPANY	30,300.00	1,515.00	0.05000
LEGG MASON WOOD WALKER, INC	16,200.00	60.00	0.00370
LEHMAN BROTHERS INC, USA	154,737.00	6,017.00	0.14512
LEHMAN BROTHERS INTL EUROPE LDN	113,087.00	2,496.00	0.02207
LIQUIDNET INC	327,094.00	8,780.00	0.07000
LYNCH JONES & RYAN INC	15,350.00	590.00	0.07822
MCDONALD INVESTMENTS INC(KEYBA	47,630.00	2,382.00	0.10002
MERRILL LYNCH INTERNATIONAL LTD, GB	426,289.00	2,367.00	0.00555
MERRILL LYNCH INTL LTD EQUIT SETTL	13,226.00	359.00	0.02714
MERRILL LYNCH P F+SMITH INC CH NYC	64,658.00	1,007.00	0.01557
MERRILL LYNCH PIERCE FENNER &	289,200.00	9,548.00	0.11502
MERRILL LYNCH PIERCE FENNER + SMITH	372,016.00	4,334.00	0.01165
MERRILL LYNCH PROFESSIONAL	47,535.00	2,289.00	0.09639
MERRIMAN CURHAN FORD & CO	5,330.00	266.00	0.04991
MERRION CAPITAL GROUP, DUBLIN	4,439.00	169.00	0.03807
MORGAN STANLEY	40,354.00	1,870.00	0.04634
MORGAN STANLEY & CO	148,253.00	3,717.00	0.00876
MORGAN STANLEY AND CO INTL LTD,LDN	66,695.00	1,964.00	0.18507
MORGAN STANLEY AND CO INTL, SEOUL	2,680.00	820.00	0.05147
MORGAN STANLEY AND CO.	38,474.00	870.00	0.01237

SCHEDULE OF COMMISSIONS *Continued*

For the Year Ending June 30, 2005

Brokerage Firm	Number of Shares Traded	Total Commissions	Commission Per Share
MORGAN STANLEY CO INC NEW YORK	1,092,913.00	$ 2,045.00	$ 0.02237
MORGAN STANLEY SECURITIES, LONDON	1,827.00	11.00	0.37714
NATL FINANCIAL SERVICES CORP	10,375.00	311.00	0.04212
NCB STOCKBROKERS DUBLIN	25,870.00	868.00	0.01504
NEEDHAM & CO	1,175.00	59.00	0.06246
NESBITT BURNS INC/TORONTO	2,273.00	179.00	0.05000
NOMURA INTERNATIONAL PLC LONDON	34,202.00	1,798.00	0.26906
PACIFIC AMERICAN SECURITIES	9,300.00	372.00	0.05000
PERSHING AND COMPANY	4,405.00	46.00	0.05000
PRINCETON SECURITIES	20,400.00	612.00	0.04060
PRUDENTIAL EQUITY GROUP	81,680.00	4,084.00	0.00496
PULSE TRADING LLC	24,800.00	444.00	0.00283
RAYMOND, JAMES & ASSOC., INC.	1,300.00	65.00	0.04839
RBC DOMINION SECURITIES TORONTO	14,993.00	1,180.00	0.05000
RBC DOMINION SECURITIES,CORP.	40,700.00	2,035.00	0.05000
S.G. COWEN & CO., LLC	22,000.00	563.00	0.05000
SANDLER O'NEILL & PARTNERS LP	4,600.00	230.00	0.01471
SANFORD C BERNSTEIN & CO.,LLC	9,400.00	470.00	0.01315
SANFORD C. BERNSTEIN LONDON	13,930.00	333.00	0.02412
SBK-BROOKS INVESTMENT CORP	22,000.00	1,100.00	0.02370
SCOTT & STRINGFELLOW, INC	2,325.00	116.00	0.05000
SG AMERICAS SECURITIES LLC	6,000.00	180.00	0.04057
SOUTHWEST SECURITIES, INC.	19,688.00	800.00	0.05000
STANDARD & POOR'S SECS INC	7,200.00	360.00	0.05000
STATE ST BROKERAGE SERVICE INC	28,600.00	1,430.00	0.05000
STEPHENS, INC.	4,050.00	202.00	0.05000
SUNTRUST CAPITAL MARKETS, INC	76,279.00	3,666.00	0.05085
THE WILLIAMS CAPITAL GROUP LP	3,650.00	182.00	0.04564
THOMAS WEISEL PARTNERS LLC	19,700.00	484.00	0.03916
UBS AG LONDON EQUITIES	426,488.00	6,978.00	0.02053
UBS BUNTING WARBURG INC, TORONTO	29,429.00	2,046.00	0.05000
UBS SECURITIES ASIA LTD	194,307.00	2,477.00	0.03716
UBS SECURITIES LLC	84,208.00	2,194.00	0.08708
UBS SECURITIES LTD, SEOUL BRANCH	2,620.00	251.00	0.05024
VERITAS SECURITIES	39,600.00	1,708.00	0.01081
WACHOVIA SECS CAPITAL MARKET	74,200.00	3,459.00	0.12539
FWEDBUSH MORGAN SECURITIES,INC.	5,550.00	278.00	0.05009
WEEDEN & CO	27,050.00	1,212.00	0.08825
WILSHIRE ASSOCIATES INC	5,561.00	334.00	0.06006
TOTAL	26,237,778.00	$ 330,398.00	$ 0.01259

Investment Summary

As of June 30, 2005

Equities		Market Value	% of Portfolio
Consumer Non-Durables		$ 46,583,856	3.09%
Consumer Durables		9,143,341	0.61%
Materials and Services		67,795,119	4.50%
Capital Goods and Services		9,753,582	0.65%
Technology		29,275,292	1.94%
Energy		16,487,975	1.09%
Transportation		4,374,971	0.29%
Utilities		7,527,222	0.50%
Financial		40,157,259	2.66%
Miscellaneous		210,212	0.01%
Commingled		428,474,723	28.41%
Private Market Equities		1,014,164	0.07%
Foreign Equity		242,977,645	16.11%
	Total Equity	**$ 903,775,360**	**59.93%**
Fixed Income:			
US Treasury		$ 128,381,849	8.51%
US Government Agency		163,260,386	10.83%
Domestic Corporate Bonds		151,642,261	10.06%
State and Local Obligations		1,043,750	0.07%
Foreign Government		53,445,305	3.54%
Foreign Corporate		46,703,552	3.10%
	Total Fixed Income	**$ 544,477,103**	**36.11%**
Other Investment:			
Short Term		$ 32,344,002	2.14%
Real Estate		49,882,067	3.31%
	Total Other Investment	**$ 82,226,069**	**5.45%**
Pending		**$ (22,458,434)**	**-1.49%**
	Total	**$ 1,508,020,098**	**100.00%**

INVESTMENT PROPERTIES

Milpitas Warehouse

145,152 s.f. warehouse/distribution building, equally divided into four bays. Acquired jointly with the Police and Fire Department Retirement Plan in February 1986. The System purchased Police & Fire Retirement Plan's 50% interest in the property in November 2003.

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IV. ACTUARIAL SECTION

ACTUARY CERTIFICATION LETTER

GABRIEL, ROEDER, SMITH & COMPANY
CONSULTANTS & ACTUARIES

GABRIEL, ROEDER, SMITH & COMPANY
9580 Oak Avenue Park, Suite 7187
Folsom, CA 95630

916-774-7580
fax 916-774-7581

August 11, 2004

Board of Administration
City of San Jose - Federated City Employees' Retirement System
1737 N First St Suite 580
San Jose CA 95112-4505

Re: Actuary Valuation Certification

Members of the Board:

The actuarial valuation report for the City of San Jose Federated City Employees' Retirement System, completed as of June 30, 2003, reveals that the assets of the Federated Retirement System along with future contributions at the level recommended in that report will fully support the benefits of the System. This conclusion is based on financial and demographic data as of the valuation date and on current actuarial assumptions, which are based on the System's demographic and economic experience. This letter serves as the Actuary's certification letter and offers our independent actuarial review opinion.

In support of this opinion and certification, we have included the following information:

- The funding objective of the plan
- The frequency of the plan's actuarial valuations and date of the most recent actuarial valuation
- The source and degree of verification of the data used in the actuarial valuation
- Supporting schedules that we have prepared and attached
- The extent of our responsibility for the trend data schedules in the financial section of the report
- The assumptions and methods used to value plan assets and liabilities relative to the Government Accounting Standards Board (GASB) Statement No. 25
- Other disclosure

ACTUARY CERTIFICATION LETTER *Continued*

GABRIEL, ROEDER, SMITH & COMPANY
CONSULTANTS & ACTUARIES

The Funding Objective of the Plan

Chapters 3.28 and 3.44 of the San Jose Municipal Code and related ordinances establish that the required annual contribution to the plan, shared by the City and members is such that contribution rates, over time, shall remain level as a percentage of payroll.

This funding objective is currently being realized through contributions sufficient to pay the System's normal cost as well as amortizing unfunded liabilities over a combination of 30 years and the present value of future salaries.

The Frequency of the Plan's Actuarial Valuations and Date of the most Recent Actuarial Valuation

This plan is valued on a bi-annual basis, as of June 30. The most recent actuarial valuation was completed as of June 30, 2003.

The Source and Degree of Verification of the Data Used in the Actuarial Valuation

Computer files containing data on System membership of June 30, 2003 were provided by the City of San Jose Department of Retirement Services. While the participant data were not audited, the data was reviewed for reasonableness against the data provided for the prior valuation. All data was checked for internal consistency and for consistency with the data for the prior valuation.

Asset-related data were also received from the City of San Jose Department of Retirement Services and were used without further audit in the development of the actuarial value of assets.

Supporting Schedules

We have prepared the following supporting schedules for inclusion in this Financial Statement:

- Summary of actuarial assumptions and methods
- Schedule of active member valuation data
- Schedule of retirants and beneficiaries added to and removed from rolls
- Solvency test
- Analysis of financial experience.

ACTUARY CERTIFICATION LETTER *Continued*

GABRIEL, ROEDER, SMITH & COMPANY
CONSULTANTS & ACTUARIES

Trend Data Schedules in the Financial Section

All of the trend data information in the financial section of the report was calculated and summarized by Gabriel, Roeder, Smith & Co.

Actuarial Assumptions and Methods Used for Funding Purposes

The assumptions and methods used for funding purposes meet the parameters set for the disclosures presented in the financial section by Government Accounting Standards Board (GASB) Statement No. 25, Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contribution Plans. In our opinion, the assumptions are reasonably related to past experience and represent our best estimate of future conditions affecting the System. Nevertheless, the emerging costs of the System will vary from those presented in this report to the extent actual experience differs from that projected by the actuarial assumptions.

⋆ ⋆ ⋆

I am a Fellow of the Society of Actuaries and an Enrolled Actuary. I am a Member of the American Academy of Actuaries and have 35 years of experience in performing valuations for public retirement systems.

Sincerely,

Norman S. Losk, FSA, EA, MAAA
Senior Consultant

CML

Gabriel, Roeder, Smith & Company

Summary of Assumptions and Funding Method

Adopted Novermber, 2003

Interest Rate: 8.25% per year. The rate credited to Member contributions is 3%.

Salary Increases: Total System payroll is assumed to increase 4.5% per year. Annual salary increases for individuals vary by age reflecting 4.5% inflation and merit and longevity.

Sample rates

Age	Annual Salary Increase
25	8.0%
35	7.0%
45	6.0%
55	5.0%
65	5.0%

Cost-of-Living Increases: 3.0% per year.

Mortality: A. For Pensioners on Service Retirement and Beneficiaries

The 1983 Group Annuity Mortality Table for males with one year setback is used for male Members.

The 1983 Group Annuity Mortality Table for females, with a one-year set forward, is used for female Members.

Sample Rates

Deaths per 1,000

Age	Males	Females
45	1.9	1.3
50	3.1	2.0
55	4.6	2.7
60	6.2	4.0
65	8.2	5.3
70	10.2	7.1

B. For Pensioners on Disability Retirement:

1981 Disability Mortality Table

Sample Rates

Age	Deaths per 1,000
45	20.8
50	24.4
55	28.4
60	33.0
65	37.9
70	43.7

SUMMARY OF ASSUMPTIONS AND FUNDING METHOD *Continued*

Adopted Novermber, 2003

Rehire for Former Employees:	All former employees are assumed not to be rehired.
Disability:	Valuation of disability benefits are assumed to not be offset by Worker's Compensation.
Prior Service Benefits:	The liability for benefits attributed to pre-1975 service is assumed in proportion to its liability as of June 30, 1997, adjusted for changes in demographics.
Proportion of Members with Spouses at Retirement	85% of male employees and 60% of female employees are assumed married at retirement. Wives are assumed three years younger than husbands.
Asset Valuation Method	The Actuarial Value of Assets recognizes 20% of total return in excess of (or less than) the investment return assumption for each of the last five years. This method has the effect of smoothing volatility in investment returns as they affect the cost of benefits provided by the system.
	HEALTH SUBSIDY BENEFITS
Increase in Retiree Population	The covered Retiree population is assumed to increase 6.10% per year.
Covered Payroll Increase	4.5% per year.

Rates of Separation from Active Service

Males

Age	Withdrawal	Ordinary Death	Disability	Service Retirement	Death While Eligible	Service Disability	Deferred Vested
20	0.0660	0.0003	0.0000	0.0000	0.0000	0.0005	0.0150
21	0.0600	0.0003	0.0000	0.0000	0.0000	0.0005	0.0160
22	0.0540	0.0003	0.0000	0.0000	0.0000	0.0005	0.0170
23	0.0520	0.0003	0.0000	0.0000	0.0000	0.0005	0.0180
24	0.0500	0.0003	0.0000	0.0000	0.0000	0.0005	0.0190
25	0.0480	0.0003	0.0002	0.0000	0.0002	0.0005	0.0243
26	0.0450	0.0003	0.0002	0.0000	0.0002	0.0005	0.0236
27	0.0420	0.0003	0.0002	0.0000	0.0002	0.0005	0.0230
28	0.0390	0.0003	0.0002	0.0000	0.0002	0.0006	0.0226
29	0.0360	0.0004	0.0002	0.0000	0.0002	0.0006	0.0223
30	0.0330	0.0004	0.0002	0.0000	0.0002	0.0006	0.0219
31	0.0300	0.0004	0.0002	0.0000	0.0002	0.0006	0.0214
32	0.0270	0.0004	0.0002	0.0000	0.0002	0.0006	0.0209
33	0.0240	0.0004	0.0003	0.0000	0.0003	0.0006	0.0201
34	0.0210	0.0005	0.0003	0.0000	0.0003	0.0007	0.0194
35	0.0180	0.0005	0.0004	0.0000	0.0003	0.0007	0.0187
36	0.0156	0.0005	0.0004	0.0000	0.0004	0.0007	0.0170
37	0.0140	0.0005	0.0005	0.0000	0.0004	0.0007	0.0153
38	0.0132	0.0006	0.0005	0.0000	0.0004	0.0008	0.0137
39	0.0124	0.0006	0.0006	0.0000	0.0005	0.0008	0.0121
40	0.0124	0.0006	0.0006	0.0000	0.0005	0.0008	0.0103
41	0.0128	0.0007	0.0007	0.0000	0.0006	0.0009	0.0105
42	0.0112	0.0007	0.0007	0.0000	0.0006	0.0009	0.0100
43	0.0096	0.0007	0.0008	0.0000	0.0007	0.0009	0.0096
44	0.0088	0.0007	0.0008	0.0000	0.0009	0.0009	0.0092
45	0.0090	0.0008	0.0009	0.0000	0.0011	0.0009	0.0091
46	0.0081	0.0008	0.0010	0.0000	0.0013	0.0010	0.0089
47	0.0072	0.0008	0.0011	0.0000	0.0015	0.0011	0.0087
48	0.0068	0.0009	0.0012	0.0000	0.0017	0.0012	0.0082
49	0.0063	0.0009	0.0014	0.0000	0.0019	0.0013	0.0074
50	0.0061	0.0010	0.0016	0.0100	0.0021	0.0015	0.0065
51	0.0060	0.0011	0.0019	0.0050	0.0023	0.0018	0.0055
52	0.0055	0.0012	0.0022	0.0050	0.0025	0.0022	0.0043
53	0.0050	0.0013	0.0027	0.0050	0.0027	0.0027	0.0030
54	0.0050	0.0014	0.0033	0.0100	0.0029	0.0033	0.0015
55	0.0050	0.0015	0.0039	0.1700	0.0031	0.0040	0.0000
56	0.0050	0.0015	0.0046	0.0800	0.0033	0.0047	0.0000
57	0.0050	0.0016	0.0054	0.0800	0.0035	0.0056	0.0000
58	0.0050	0.0017	0.0063	0.0800	0.0037	0.0068	0.0000
59	0.0050	0.0018	0.0074	0.0800	0.0040	0.0084	0.0000
60	0.0000	0.0019	0.0085	0.1000	0.0043	0.0104	0.0000
61	0.0000	0.0020	0.0098	0.1300	0.0046	0.0124	0.0000
62	0.0000	0.0021	0.0112	0.2000	0.0049	0.0149	0.0000
63	0.0000	0.0022	0.0127	0.1700	0.0052	0.0181	0.0000
64	0.0000	0.0023	0.0143	0.2200	0.0055	0.0220	0.0000
65	0.0000	0.0024	0.0160	0.2500	0.0058	0.0026	0.0000
66	0.0000	0.0025	0.0000	0.4000	0.0061	0.0000	0.0000
67	0.0000	0.0026	0.0000	0.4000	0.0064	0.0000	0.0000
68	0.0000	0.0027	0.0000	0.4500	0.0067	0.0000	0.0000
69	0.0000	0.0028	0.0000	0.5000	0.0070	0.0000	0.0000
70	0.0000	0.0029	0.0000	1.0000	0.0073	0.0000	0.0000

Rates of Separation from Active Service *Continued*

Females

Age	Withdrawal	Ordinary Death	Disability	Service Retirement	Death While Eligible	Service Disability	Deferred Vested
20	0.0820	0.0001	0.0000	0.0000	0.0000	0.0003	0.0150
21	0.0740	0.0001	0.0000	0.0000	0.0000	0.0003	0.0150
22	0.0700	0.0001	0.0000	0.0000	0.0000	0.0003	0.0150
23	0.0660	0.0001	0.0000	0.0000	0.0000	0.0003	0.0150
24	0.0620	0.0001	0.0000	0.0000	0.0000	0.0003	0.0150
25	0.0580	0.0001	0.0002	0.0000	0.0001	0.0003	0.0210
26	0.0540	0.0001	0.0002	0.0000	0.0001	0.0003	0.0214
27	0.0500	0.0001	0.0002	0.0000	0.0001	0.0003	0.0220
28	0.0460	0.0002	0.0002	0.0000	0.0001	0.0003	0.0228
29	0.0420	0.0002	0.0002	0.0000	0.0001	0.0004	0.0238
30	0.0380	0.0002	0.0002	0.0000	0.0001	0.0004	0.0246
31	0.0348	0.0002	0.0002	0.0000	0.0001	0.0004	0.0249
32	0.0324	0.0002	0.0002	0.0000	0.0001	0.0004	0.0250
33	0.0308	0.0003	0.0002	0.0000	0.0001	0.0004	0.0249
34	0.0292	0.0003	0.0002	0.0000	0.0001	0.0004	0.0248
35	0.0224	0.0003	0.0002	0.0000	0.0001	0.0004	0.0247
36	0.0211	0.0003	0.0002	0.0000	0.0002	0.0005	0.0246
37	0.0198	0.0003	0.0002	0.0000	0.0002	0.0005	0.0245
38	0.0185	0.0004	0.0002	0.0000	0.0002	0.0005	0.0246
39	0.0172	0.0004	0.0002	0.0000	0.0002	0.0005	0.0247
40	0.0159	0.0004	0.0002	0.0000	0.0002	0.0005	0.0237
41	0.0148	0.0004	0.0002	0.0000	0.0003	0.0005	0.0212
42	0.0137	0.0005	0.0002	0.0000	0.0004	0.0005	0.0187
43	0.0133	0.0005	0.0003	0.0000	0.0005	0.0005	0.0162
44	0.0129	0.0006	0.0003	0.0000	0.0006	0.0005	0.0137
45	0.0125	0.0006	0.0003	0.0000	0.0007	0.0005	0.0111
46	0.0116	0.0006	0.0004	0.0000	0.0008	0.0006	0.0115
47	0.0107	0.0006	0.0004	0.0000	0.0009	0.0006	0.0120
48	0.0098	0.0007	0.0005	0.0000	0.0010	0.0007	0.0125
49	0.0089	0.0007	0.0005	0.0000	0.0011	0.0007	0.0130
50	0.0087	0.0008	0.0006	0.0025	0.0012	0.0008	0.0135
51	0.0085	0.0008	0.0008	0.0025	0.0013	0.0009	0.0130
52	0.0083	0.0008	0.0011	0.0025	0.0014	0.0010	0.0125
53	0.0081	0.0009	0.0015	0.0050	0.0015	0.0012	0.0120
54	0.0079	0.0009	0.0020	0.0050	0.0016	0.0015	0.0115
55	0.0084	0.0009	0.0026	0.1000	0.0018	0.0018	0.0050
56	0.0084	0.0010	0.0033	0.0400	0.0020	0.0022	0.0000
57	0.0084	0.0010	0.0041	0.0600	0.0022	0.0027	0.0000
58	0.0084	0.0011	0.0050	0.0600	0.0024	0.0033	0.0000
59	0.0084	0.0011	0.0060	0.0600	0.0026	0.0040	0.0000
60	0.0000	0.0012	0.0071	0.0700	0.0028	0.0018	0.0000
61	0.0000	0.0012	0.0083	0.0800	0.0030	0.0060	0.0000
62	0.0000	0.0013	0.0096	0.1500	0.0032	0.0073	0.0000
63	0.0000	0.0013	0.0110	0.0750	0.0034	0.0089	0.0000
64	0.0000	0.0014	0.0125	0.0750	0.0036	0.0120	0.0000
65	0.0000	0.0015	0.0140	0.2500	0.0038	0.0160	0.0000
66	0.0000	0.0016	0.0000	0.2500	0.0040	0.0000	0.0000
67	0.0000	0.0017	0.0000	0.3500	0.0042	0.0000	0.0000
68	0.0000	0.0018	0.0000	0.3500	0.0045	0.0000	0.0000
69	0.0000	0.0019	0.0000	0.4000	0.0048	0.0000	0.0000
70	0.0000	0.0020	0.0000	1.0000	0.0051	0.0000	0.0000

Schedule of Active Member Valuation Data

Contributing Members Only

Valuation Date	Number	Annual Payroll	Annual Average Pay	% Increase in Average Pay*
June 30, 2003	4,479	$ 292,961,371	$ 65,408	15.6%
June 30, 2001	4,466	$ 252,696,000	$ 56,582	7.9%
June 30, 1999	3,694	$ 196,178,000	$ 52,423	8.3%
June 30, 1997	3,642	$ 176,284,000	$ 48,403	6.8%
June 30, 1995	3,397	$ 153,918,000	$ 45,310	4.4%
June 30, 1993	3,360	$ 145,781,000	$ 43,387	-

** Reflects the increase in average salary for members at the beginning of the period versus those at the end of the period, it does not reflect the average salary increases received by members who worked the full period.*

Retirants & Beneficiaries Added to and Removed from Retiree Payroll

Two-Year Period	Beginning of Period Count	Beginning of Period Annual Allowances	Added to Rolls Count	Added to Rolls Annual Allowances	Removed from Rolls [1] Count	Removed from Rolls [1] Annual Allowances	End of Period Count	End of Period Annual Allowances	% Increase in Annual Allowances	Average Annual Allowances
2001-2003	2,030	$45,208,000	329	$10,151,748	171	$ 503,802	2,188	$54,855,946	21.3%	$25,071
1999-2001	1,824	$37,137,000	230	$ 6,655,000	24	$ 268,000	2,030	$45,208,000	21.7%	$22,270
1997-1999	1,745	$32,630,000	202	$ 4,642,000	123	$1,514,000	1,824	$37,137,000	13.8%	$20,360
1995-1997	1,636	$29,029,000	190	$ 4,143,000	81	$ 946,000	1,745	$32,630,000	12.4%	$18,699
1993-1995	1,497	$25,642,000	210	$ 4,420,000	71	$ 801,000	1,636	$29,029,000	13.2%	$17,744

1 This column consists of the following categories:
(a) Retirees and disabled retirees who die during the period and have no survior benefits
(b) Expiration of certain period benefits for deceased retirees.

Actuarial Analysis of Financial Experience

	Change in Contribution Rate
For Plan Year Ended June 30, 2003	
Investment Performance	2.78%
Liability Experience	2.60%
Change in Asset Valuation Method	-2.48%
Change in Assumptions	0.00%
Change in Benefit Provisions	0.00%
Total	**2.90%**
For Plan Year Ended June 30, 2001	
Investment Performance	-0.46%
Liability Experience	-1.62%
Change in Assumptions	0.00%
Change in Benefit Provisions	1.51%
Total	**-0.57%**
For Plan Year Ended June 30, 1999	
Investment Performance	-2.75%
Liability Experience	0.98%
Change in Assumptions	0.79%
Total	**-0.98%**
For Plan Year Ended June 30, 1997	
Investment Performance	-1.55%
Liability Experience	-1.04%
Change in Assumptions	-2.23%
Total	**-4.82%**

Solvency Test

Year Ended	(1) Active Members Contributions	(2) Retirants and Beneficiaries Accrued Liability	(3) Active Members Accrued Liability (Employer Portion)	Actuarial Value of Assets	Portion of Accrued Liabilities Covered by Reported Assets		
					(1)	(2)	(3)
2003	$224,874,793	$635,092,039	$451,723,795	$1,280,719,017	100%	100%	93%
2001	$210,377,000	$529,853,000	$332,103,000	$1,060,144,000	100%	100%	96%
1999	$196,887,000	$441,573,000	$223,766,000	$804,860,000	100%	100%	74%
1997	$167,837,000	$383,574,000	$184,361,000	$678,954,000	100%	100%	69%
1995	$133,805,000	$364,159,000	$160,211,000	$566,102,000	100%	100%	43%
1993	$104,098,000	$308,922,000	$170,099,000	$489,865,000	100%	100%	45%

Summary of Key Provisions

Summary of Retirement Benefits

1. Eligibility:	Members are eligible on their first day of City employment.
2. Final Compensation:	Highest 12-month average salary
3. Service Retirement:	
A) Eligibility:	Age 55 with five years of service, or any age with 30 years of service.
B)Benefit:	2.5% of Final Compensation for each year of service. Maximum benefit is 75% of Final Compensation.
C) Form of Payment:	Monthly benefit payable for the life of the member.
4. Disability Retirement:	
A) Eligibility:	Physically or mentally incapacitated so unable to perform duties of position. If disability is not service connected, then the member must have at least five years of City service.
B) Benefit:	2.5% of Final Compensation per year of service. The maximum benefit is 75% and the minimum benefit is 40% of Final Compensation. Any Workers' Compensation benefits are offset from the benefits under this system. If the disability was not service-connected, then the benefit is reduced by .5% of Final Compensation for each year of age under 55.
C) Form of Payment:	Monthly benefit payable for the life of the member.
5. Deferred Service Retirement:	
A) Eligibility:	Five years of membership prior to termination of City service. Member must leave contributions on deposit until retirement.
B) Benefit:	Same as Service Retirement, payable anytime after age 55.
C) Form of Payment:	Same as Service Retirement.

Summary of Key Provisions *Continued*

Summary of Retirement Benefits

6.Pre-Retirement Death Benefits:

A) Non-Service Connected with less than five years of service, or No Family Members Eligible for Allowance:

Member's beneficiary or estate receives (i), and (ii) where:

(i) = Accumulated contributions with interest.

(ii) = Lump sum benefit of one month's salary for each year of service, up to six years.

B) Service-Connected, or Non-Service Connected with five years of service:

Member's eligible survivor receives 100% of the benefit the Member would have received if he or she had been granted a disability benefit on the day before death, payable until the spouse remarries. If the Member was age 55 with 20 years of service at death, the benefit is payable for the lifetime of the Member's spouse.

7. Post-Retirement Death Benefits:

Member's eligible survivor receives (i) and (ii), where:

(i) = 50% continuance to surviving eligible spouse; if there is no surviving spouse, certain benefits are paid to the children.

(ii) = $500 death benefit allowance for burial expenses at death of retired member.

8. Post-retirement Cost-of-Living Benefits:

Each April 1, the benefits are increased by the percentage increase in CPI (to a maximum of 3%). Increases in CPI above 3% are "banked" to apply in years when CPI increase is less than 3%.

If the benefit has been paid less than 12 months, the 3% increase is proportionately decreased.

9. Employee Contributions:

The Members' contribution rates are recalculated on an actuarial basis at each actuarial study. Contributions are credited with 3% interest annually (the interest crediting provision was changed from 7.25% to 3% effective July 1, 2001).

Summary of Key Provisions *Continued*

Summary of Health Subsidy Benefits

1. Eligibility:

A) Medical	Fifteen years of service credit at retirement, or receiving an allowance of at least 37 1/2% of Final Compensation. Must be enrolled in a City medical insurance plan at retirement.
B) Dental	Five years of service credit at retirement, or receiving an allowance of at least 37 1/2% of Final Compensation. Must be enrolled in a City dental insurance plan at retirement.

2. Benefit:

A) Medical	The Retirement System pays the premium for the lowest cost medical plan offered by the City for single and family coverage. Members and eligible survivors pay for the difference in the premium for their selected plan and the portion paid by the Retirement System.
B) Dental	The Retirement System pays the entire cost of dental insurance coverage.

3. Contributions:	Both the City and the Members contribute to the Retirement System fund for medical and dental insurance benefits.

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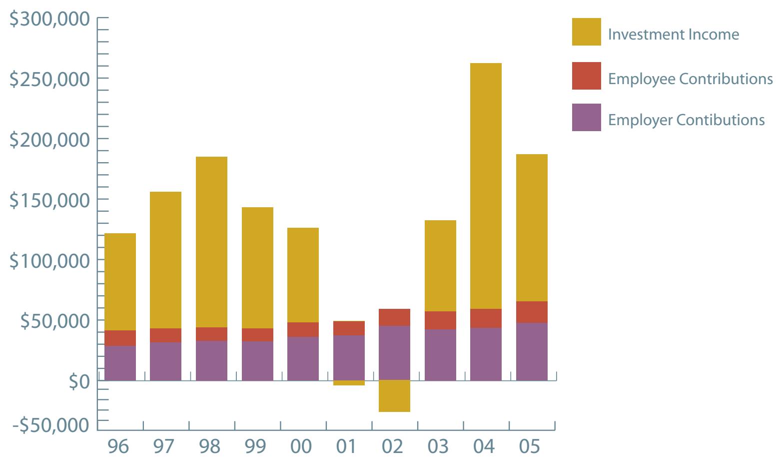
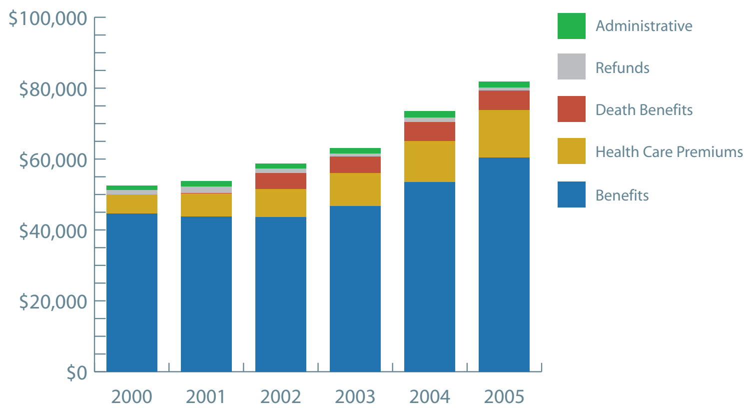
V.
STATISTICAL SECTION

Statistical Review

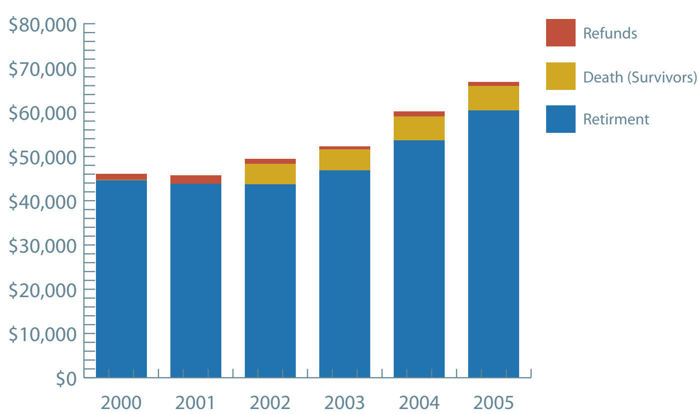
Additions by Source For Fiscal Years 1996 - 2005
(In Thousands)



Deductions by Type For Fiscal Years 2000 - 2005
(In Thousands)



Benefit Expenses by Type For Fiscal Years 2000 - 2005
(In Thousands)



Statistical Review *Continued*

Additions by Source for Fiscal Years 1996-2005

(Dollars in Thousands)

Year Ending	Employer Contributions	% of Annual Covered Payroll	Employee Contributions	% of Annual Covered Payroll	Investment Income (Loss) *	Total
1996	$ 28,411	18.59%	$ 12,876	6.70%	$ 80,420	$ 121,707
1997	31,441	19.22%	11,376	6.70%	113,039	155,856
1998	32,693	16.52%	11,129	5.31%	140,928	184,750
1999	32,387	16.52%	10,733	5.31%	99,907	143,027
2000	35,825	16.09%	12,400	4.76%	77,971	126,196
2001	37,034	16.09%	11,768	4.76%	(3,470)	45,332
2002	45,138	17.40%	13,858	4.96%	(25,698)	33,298
2003	42,277	15.20%	14,808	5.08%	75,372	132,457
2004	43,482	15.20%	15,585	5.08%	203,439	262,506
2005	47,548	17.12%	17,612	6.06%	122,157	187,317

*Net of Investment Expenses and brgining 1997, audit report includes unrealized gains in investment income

Deductions by Type for Fiscal Years 2000-2005

(Dollars in Thousands)

	2000	2001	2002*	2003*	2004*	2005*
Benefits	$ 44,655	$ 43,761	$ 43,696	$ 46,814	$ 53,578	$ 60,438
Health Care Premiums	5,236	6,530	7,804	9,191	11,438	13,393
Death Benefits	20	105	4,561	4,752	5,454	5,437
Refunds	1,386	1,886	1,207	714	1,188	927
Administrative	1,136	1,420	1,472	1,631	1,913	1,683
TOTAL	**$ 52,433**	**$ 53,702**	**$ 58,740**	**$ 63,102**	**$ 73,571**	**$ 81,878**

* Benefits and Death Benefits were reclassified in 2002, 2003, 2004, and 2005.

Benefit Expenses by Type for Fiscal Years 2000-2005

(Dollars in Thousands)

	2000	2001	2002*	2003*	2004*	2005*
Retirement	$ 44,655	$ 43,761	$ 43,696	$ 46,814	$ 53,578	$ 60,438
Death (Survivors)	20	105	4,561	4,752	5,454	5,437
Refunds	1,386	1,886	1,207	714	1,188	927
TOTAL	**$ 46,061**	**$ 45,752**	**$ 49,464**	**$ 52,280**	**$ 60,220**	**$ 66,802**

* Benefits and Death Benefits were reclassified in 2002, 2003, 2004, and 2005.

Retired Members by Type of Benefit

As of June 30, 2005

Amount Monthly Benefit	Number of Retirees & Beneficiaries	Type of Retirement						Option Selected			
		1	2	3	4	5	6	A	B	C	Total
$1 - 500	175	68	47	1		8	51	90	15	70	175
501 - 1000	308	115	90	8	6	25	64	151	14	143	308
1001 - 1500	415	165	121	33	31	7	58	222	29	164	415
1501 - 2000	342	215	49	35	18	4	21	222	20	100	342
2001 - 2500	297	217	28	25	12		15	214	19	64	297
2501 - 3000	244	210	9	6	7	2	10	182	15	47	244
3001 - 3500	195	167	6	5	2	1	14	151	14	30	195
3501 - 4000	141	131	7	1			2	108	12	21	141
4001 -4500	114	109	1	1			3	80	7	27	114
4501 - 5000	104	98	1	2			3	78	10	16	104
Over $5000	150	146		1			3	123	5	22	150
Total	**2485**	**1641**	**359**	**118**	**76**	**47**	**244**	**1621**	**160**	**704**	**2485**

Retirement Codes

1 Service
2 Survivor
3 Service Connected Disability
4 Non-Service Connected Disability
5 Ex-Spouse
6 Deferred Vested

Option Descriptions

A Unmodified - 50% Continuance
B Option 1: 100% Continuance/reduced pension
C No Survivor - No Continuance

Average Benefit Payment Amounts

Schedule of Average Annual Benefit Payments by Type as of June 30, 2003

	Survivor Single Life Annuity		Disabled Retiree Joint and Survivor Annuity		Disabled Retiree Single Life Annuity		Retiree Joint and Survivor Annuity		Retiree Single Life Annuity		
Age	**Count**	**Average**	**Count**	**Average**	**Count**	**Average**	**Count**	**Average**	**Count**	**Average**	**Total Count**
Under 30	6	5,249	-	-	-	-	-	-	-	-	6
30 to 34	1	17,766	-	-	-	-	-	-	-	-	1
35 to 39	2	33,589	6	16,997	1	18,785	-	-	-	-	9
40 to 44	5	12,863	6	17,552	1	29,639	-	-	-	-	12
45 to 49	8	20,839	8	16,618	3	22,108	-	-	-	-	19
50 to 54	15	23,963	27	21,495	4	22,888	16	54,591	6	46,724	68
55 to 59	18	16,610	22	20,567	6	27,515	182	35,303	66	31,938	294
60 to 64	33	17,082	25	21,404	1	14,276	279	32,971	45	25,807	383
65 to 69	52	15,457	24	21,898	2	16,851	266	29,425	16	21,685	360
70 to 74	50	15,049	21	21,018	2	15,281	264	26,955	15	22,340	352
75 to 79	63	13,077	12	19,352	1	16,515	233	24,177	9	9,673	318
80 to 84	51	11,235	8	16,740	-	-	173	19,001	4	12,842	236
85 to 89	43	10,619	5	12,150	2	13,164	53	18,290	7	15,032	110
90 & Up	8	13,721	-	-	-	-	7	13,465	5	14,499	20
Summary	**355**	**$14,335**	**164**	**$20,134**	**23**	**$21,425**	**1,473**	**$28,122**	**173**	**$26,288**	**2,188**

Average Annual Benefit **$25,071**

Retirements During Fiscal Year 2004-05

Service Retirements

ADRIANO, HONORATA N
ALVAREZ, CRISANTO
ANDERSON, BEVERLY J
ANTONOWICZ, DENISE A
ARCA, DONNA M
AZEVEDO, JANE E
BEGA, HENRY C
BISHOP, LEONA M
BLACK, SHEILA A
BLACKLAW, BONNIE B
BOGGESS, JUDY R
BONHAM, LOREN R
BOWERS, LINDA B
BOWMAN, TIMOTHY W
BRADLEY, IRENE M
BRANHAM, GEORGETTE E
BRISCOE, ALAN F
BUI, QUYEN T
CABANIA, ROSEMARY
CASTILLO, ROBERT O
CHAVEZ, FRANK F
CHENG, BRIAN
COATS, BARBARA ANN
COFFING, GAVIN S
COLEMAN, KAROLINE
CONRAD, ARTHUR
COOK, THOMAS M
COVERDALE, KITTY
CRABTREE, JAMES H
DAVIS, GLORIA
DE LA SERNA, MARTA
DEHN, DAVID A
DELGADO, JUAN R
DOBSON, EDWARD G
DURAN, JESS
ERKEL, SHELLEY M
FENNEMA, CAROL J
FITCH, MARGARET A
FLEMATE, EDWARD
FLICK, DENNIS W
FORTUNATI, TRILBE L
FOX, THOMAS J
FU, CHEING-MEI A
GALWEY, NANCY
GARCIA, FELIX C
GIBBS, JOHN C
GIBSON, MAUREEN M
GOKCEK, IBRAHIM
GREER, RONALD G
GUERRA, AMBROSE M
GUZMAN, KIM S
HAMMER, DANIEL L
HANNON, DENNIS A
HANSEN, MARIT
HENCKEN, DORIS ANN-EVANGELHO
HERNANDEZ, ERNEST G
HERNANDEZ, RICARDO R
HILLS, MARILYN H
HINZE, GARY J
HOLCOMB, JOHN W
HOLMBOE, ARLENE A
HOMEN, JOE L
HOWSMON, EVA G
JACKSON, ROBERT D
JOHNSON, JAMES C
JOYNER, HEWITT
KAMIMORI, SUE E
KERBER, TED J
KESTED, ROGER H
KETTMANN, FLEUR C
KNUDSEN, PATRICIA A
KOLLINGS, RICHARD K
KOWAL, DAVID H
KOY, SAVOEUN
KREVOLT, GAIL A
KUMAGAI, EDWARD K
LACOUNT, LINDA
LE GAULT, ANNA MARIE
LEABRES, DEMETRIO M
LEDESMA, IGNACIO G
LEWIS, JOSEPHINE
LIU, ARLENE Y
LLAMAS, EVA
LO FRANCO, MARILYN
LOOG, TRICIA A
LOOPER, WADE L
LOVATO, FRED
LUNA, GLORIA
LYNCH, GARY L
MADRIDEO, CONSUELO
MAGILL, PATRICK N
MARTINEZ, ROSALINDA
MASON, FAITH B
MATSUMOTO, MITSURU
MATSUNAMI, SATSUKI
MATTISON, JACQUELINE L
MATUDIO, LADISLAO G
MC BRIDE, JAMES
MC LAIN, BENJAMIN R
MEDEL, JESUS M
MENDEZ, VICTOR
MORTENSON, MALENE
MUNOZ, CHARLES W
NIX, LEON E
NOTRANGELO, ROBERTA L K
NOUCHI, ROBERT R
NUSE, JEFFREY A
NYHAN, GAIL C
OLSON, JAMES F
PEREA, DAVID J
PEREZ, JOE R
PIZANO, ROBERT
POPE, WILLIAM H
RAMOS, RUBEN
RESENDIZ, GILBERT A
RIBBS, PHILLIP H
RIGONAN, FLORESITA T
ROMER, FRANEY H
ROONEY, KATHLEEN A
ROSTAMIZADEH, SUZANNE
SCHIFANO, PATRICIA A
SCHMIDT, DALE A
SIMON, DEBORAH T
SINGER, GLORIA G
SMITH, TERRY K
STACK, CHARLES
STANLEY, RICHARD W
STAPLES, JOSEPH
STEENFOTT, JOYCE J
STRAUSBAUGH, RUSSELL P
SUYEISHI, FUMIKO
SWANSON, TONY D
TAKAHASHI, MELVIN A
TAKAKI, MAXWELL F
TARRICONE, LINDA D
TONSETH, RALPH
TORRES, JIMMY R
TOWNSEND, LAWRENCE A
TRUJILLO, MAX
UYEDA, LANCE D
VALBY, NANCY
VAN AUKEN, DEBORAH
VAN DER MOLEN, JUDY L
VERDIN, JESUS
VINSON, JAMES W
WARD, JEAN M
WELSH, DOROTHY L
WERDERMANN, ILSE
WEST, MILTON K
WHITE-AYRAUD, REBECCA
WISEMAN, LINDA
WOLFINGER, GARY F
WU, SEOK M
ZAMBONI, LUCILLE B
ZIA, THOMAS J

Source: Pension Administration System

Retirements During Fiscal Year 2004-05 *Continued*

Deferred Vested Retirements

ALLEN, DAVID M
BARR, MORRIS L
CIACCIARELLI, ARTHUR
COLLIER, VIRGINIA L
CUEVAS, ROBERT C
DEWEY, RODNEY F
FISHER, WILLIAM D
GREENE, TERRY W
GUIDO, FELIX
HANSEN, MARK S
HINZE, DOROTHY E
HOFFMAN, GARY P
HOURMANESH, MO
JONES, RAPHAEL S
LO FRANCO, JOHN A
MARTINEZ, NANCY C
MELLO, DENNIS
PARKS, LESLIE SAYOKO
PECOTA, DAVID C
POWELL, MARC E
RICCI, ADA M
THIELE, SHARON L

Service-Connected Disability Retirements

SCHELL, ECKHARD

Non Service-Connected Disability Retirements

BURYN, TED J
DABANIAN, DIMITRIOS
FRASER, CORY A
JUNCK, NAJOO
LONG, D ESTHER
YRIBE, JOE

Source: Pension Administration System

Deaths During Fiscal Year 2004-05

Deaths After Retirement

ALDOUS, LILLIAN E I
ATKINS, ROBERT H
BOURBON, ROBERT
CAMARA, DON J
DODD, DIANE A
DUNCAN, CLYDE R
EDWARDS, THOMAS E
ERICKSON, ELDON A
FRASER, CORY A
GALINDEZ, JULIO A
GATHERS, SALLI J
GEER, HAROLD A
GIANNOBULE, SALVADOR
GLESSING, JOHN P
HANDA, JINGO
HOAG, FRANK H
HOLEMAN, ROY B
HUBBARD, LESLIE G
IMOKAWA, HENRY
JANZEN, HERMAN A
KASPAR, DOROTHY
LARA, LEE H
LOCKWOOD, ARTHUR L
LOPES, JOHN W
LUCERO, FRANK A
MARTINEZ, JOSE A
MC ELROY, EILEEN M
MC GUIRE, MARIE L
NUNEZ, MANUEL
O'BRIEN, LORRAINE M
O'HEARON, ELEANOR K
PACHECO, ANTHONY P
PACHECO, EDWARD
PAPAVASILAKIS, LEON
POWELL, RUTH L
RIVARD, EMERSON R
RUCH, BOB A
RUIZ, JOSE L
SIMS, ETHEL J
SMITH, WILLIAM J
SOULE, ROGER
SUTTON, MAYNARD
VICARI, EDWARD J
WALL, EDWARD L
WINDHAUS, EVELYN
WRIGHT, FRED

Deaths Before Retirement

GARCIA, DAVID V
LOPEZ, CARLOS
MAI, KEAOPOLOHIWA L
ORTA, ALICIA
ROSA, DEBRA A

Source: Pension Administration System

VI. OTHER REPORTS

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Required by *Government Auditing Standards*

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The Board of Administration
City of San José Federated City Employees'
Retirement System

We have audited the financial statements of the City of San José Federated Employees' Retirement System (System), a pension trust fund of the City of San José, California, as of and for the fiscal years ended June 30, 2005 and 2004, and have issued our report thereon dated September 2, 2005, which included an explanatory paragraph indicating that, effective July 1, 2004, the System adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, Deposits and Investment Risk Disclosures - an amendment of GASB Statement No. 3. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Required by *Government Auditing Standards* Continued

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters we reported to management of the System in a separate letter dated September 2, 2005.

This report is intended solely for the information and use of the Board of Administration, management, and the City Council and is not intended to be and should not be used by anyone other than these specified parties.

Macias, Gini & Company LLP

CERTIFIED PUBLIC ACCOUNTANTS
WALNUT CREEK, CALIFORNIA
SEPTEMBER 2, 2005

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