

**CITY OF SAN JOSÉ
COMPREHENSIVE ANNUAL
FINANCIAL REPORT**

For the Fiscal Year
Ended June 30, 2006

**POLICE AND
FIRE DEPARTMENT
RETIREMENT PLAN**

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

Edward F. Overton
Director



**City of San José
Department of Retirement Services**

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BOARD CHAIR LETTER



The Honorable Mayor and City Council
Members of the Police and Fire Retirement Plan
City of San José
San José, California

October 2, 2006

Dear Mayor, Council Members and Plan Members:

On behalf of the members of the Board of Administration, I am pleased to present the Police and Fire Department Retirement Plan's ("Plan") Comprehensive Annual Financial Report for the fiscal year ended June 30, 2006. Some significant events worthy of note during this fiscal year were as follows:

- The Plan earned a time-weighted rate return of 14.3% on investments, compared to 12.5% for its benchmark and 9.4% for the Trust Universe Comparison Service Public Fund Median. The Plan has earned an annualized return of 9.8% since the performance measurement inception of January 1, 1971. The fair value the Plan's investments increased from \$2,100,847,000 to \$2,315,139,000, net of pending purchases and sales, excluding securities lending collateral.
- The Board accepted the results of the biannual experience study for the period ended June 30, 2005 and approved the new actuarial assumptions. The adopted rates took effect on July 2, 2006.
- The Board continued to make enhancements to the web member services and retirement website and the extension of the fiber optics communications project was completed during the fiscal year. The Board also purchased Levi, Ray & Shoup's Platinum Business Continuity Plan.

- The Retirement Office space was increased by an additional 2,160 square feet with a conference room on the 6th floor of 1737 N. First Street.
- The Board continued to rebalance the portfolio based on the Asset Liability Modeling Study that was completed in fiscal year 2003-04.

The Board believes that the professional services rendered by the staff, the auditors, investment counselors, actuarial consultant, 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,

MARK SKEEN, Chair
Board of Administration

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INTRODUCTORY SECTION

LETTER OF TRANSMITTAL



City of San José

Department of Retirement Services

Board of Administration

Police and Fire Department Retirement Plan

1737 North First Street, Suite 580

San José, California 95112-4505

EDWARD F. OVERTON

DIRECTOR, RETIREMENT SERVICES

October 2, 2006

Dear Board Members:

I am pleased to present the Comprehensive Annual Financial Report ("CAFR") of the Police and Fire Department Retirement Plan ("Plan") for the fiscal year ended June 30, 2006. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, rests with the Plan's management. Macias Gini & O'Connell LLP, the Plan's independent auditor, has audited the accompanying financial statements. Management believes internal control is adequate and the accompanying statements, schedules, and tables are fairly presented and free from material misstatement.

The Plan was established in 1946 and began using the CAFR format starting with 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. 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 a letter of transmittal, the Certificate of Achievement for Excellence in Financial Reporting, a listing of the professional services used, description of the Plan's management and organizational structure, and a summary of the plan provisions.
- The Financial Section contains the independent auditor's report from Macias Gini & O'Connell LLP, Management's Discussion and Analysis, the basic financial statements of the Plan, certain required supplementary information and other supplementary information.
- The Investment Section contains the report of investment activity produced by Mercer Investment Consulting, the Plan's investment 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 Plan's last bi-annual valuation (2003).
- The Statistical Section contains graphs and schedules with comparative data related to additions, deductions, benefits, and membership. The section also includes the schedules related to Postemployment Healthcare Benefits.

I trust that you and the members of the Plan will find this CAFR helpful in understanding the Plan; 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 in Financial Reporting to the Plan for its CAFR for the fiscal year ended June 30, 2005. 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. We believe this report continues to conform to the Certificate of Achievement Program Requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

LETTER OF TRANSMITTAL *Continued*

This CAFR was prepared to conform to the principles of governmental accounting and reporting set forth by the Governmental Accounting Standards Board. Transactions of the Plan 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.

Major Initiatives

The Plan continued to make enhancements to the web member services and the website during the fiscal year 2005-06. The extension of fiber optics communications from the intersection of Skyport Drive and North First Street to the Retirement Office in conjunction with the Airport Department's fiber optics expansion project was completed during the fiscal year. The Plan also purchased Levi, Ray & Shoup's Platinum Business Continuance Plan. The costs of both items were shared with the Federated City Employees' Retirement System.

The Board accepted the results of the biannual experience study for the year ended June 30, 2005 and approved new actuarial assumptions. The adopted rates took effect on July 2, 2006. The new rates increased the City's contribution from 25.04% to 25.22% and increased the Employees' contribution from 11.16% to 11.26%. Funding status of the Plan was reduced from 100.20% to 97.81%. It was reduced due to an increase in unfunded accrued actuarial liability ("UAAL") which is mainly due to experience losses and assumption changes made to reflect longer life expectancies and earlier retirements.

The Retirement Office space was increased by an additional 2,160 square feet with a conference room on the 6th floor of 1737 N. First Street. The cost was split between the Plan and the Federated City Employees' Retirement System. The Plan continued to rebalance the investment portfolio based on the new targets that were adopted in fiscal year 2003-04.

Changes in Plan Membership

Plan membership changes for the defined benefit pension plan for fiscal year 2005-06 were as follows:

	2006	2005	Increase	Change
Active Members*	2,116	2,073	43	2.1%
Retired Members	1,207	1,189	18	1.5%
Survivors**	272	256	16	6.3%
TOTAL	3,595	3,518	77	2.2%

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

** Survivor total includes ex-spouses.

Financial and Economic Summary

Maintaining a long-term perspective is important when dealing with retirement assets. The annualized return since inception was 9.8% (performance consultant calculates inception as of January 1971), which is ahead of the actuarial assumption rate of 8.0%. The fair value of the System's investments increased from \$2,100,847,000 to \$2,315,139,000, net of pending purchases and sales, excluding securities lending collateral.

As of June 30, 2006, the U.S. economy continues to be impacted by higher oil prices. Core inflation is beginning to be a concern but not yet alarming. The Federal Reserve raised short term interest rates twice during the fiscal year and long term rates increased slightly. The U.S. economy continues to grow slowly, which may result in lower earnings over the next fiscal year. Investment returns in the first half of 2006 have been weak. The Plan's investment consultant, Mercer Investment Consulting, believes that the historically conservative asset allocation strategy followed by the Plan's Board has benefited the plan's long-term return. The Plan 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 Retirement Plan 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 Plan and the investment portfolio solely in the interest of, and for the exclusive purposes of providing benefits to, members of the Plan and defraying the reasonable cost of administration.

For the fiscal year ended June 30, 2006, the time-weighted rate of return for the Plan was 14.3% versus the Benchmark return of 12.5%, which placed the Plan's total return in the first quartile of the Trust Universe Comparison Service ("TUCS") Public Fund and TUCS Master Trust Universe. Over long term periods, the portfolio has earned total annualized returns of 13.9% over the past three years and 9.0% over the past five years, and ranked in the 15th and zero percentiles, respectively, of the TUCS Public Fund Universe.

Funding

The Plan's funding objective is to meet long-term benefit obligations through contributions and investment income. As of June 30, 2005, the funding ratio of the Defined Benefit Pension Plan was at approximately 97.81%. A six-year history

LETTER OF TRANSMITTAL *Continued*

of the Defined Benefit Pension Plan's funding progress is presented on page 42. The net increase in Plan assets for the fiscal year 2005-06 was \$211,260,000. 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 Plan 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 Plan and for their diligent work to assure the Plan'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 Police and Fire
Department Retirement Plan,
California

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2005

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.



Carla E. Fudge

President

Jeffrey R. Emer

Executive Director

BOARD OF ADMINISTRATION

The Retirement Plan is administered by a seven-member Board of Administration composed of two City Council members, a member from the Civil Service Commission, two Plan members—one from the Police Department and one from the Fire Department, a member who has retired under the provision of the Plan, and a member who holds a position in the City Administration at a level of Deputy Department

Head or higher and who has experience in the investment or management of public funds, retirement funds, institutional funds, or endowment funds, in accordance with Section 2.08.400 of the San José Municipal Code.

As of June 30, 2006, the members of the Board were as follows:



MARK SKEEN, CHAIRMAN

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



KEN HEREDIA, VICE CHAIRMAN

Retired Plan Member appointed to the Board in May 2000. His current term expires November 30, 2008.



BRET MUNCY

Employee Representative for the Police Department appointed to the Board in December 2001. His current term expires November 30, 2009.



BILL BRILL

Civil service commission member appointed on October 27, 1998. His current term expires December 1, 2009.



LARRY LISENBEE

City Administration Member appointed to the Board in February 2006.



DAVID CORTESE

City Council Member appointed to the Board on January 1, 2001.



CINDY CHAVEZ

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

ADMINISTRATION/OUTSIDE CONSULTANTS

EDWARD F. OVERTON

DIRECTOR, RETIREMENT SERVICES



THOMAS J. WEBSTER

DEPUTY DIRECTOR,
CHIEF OPERATIONS OFFICER



STANDING PUBLIC MEETINGS

BOARD MEETINGS:

First Thursday of the Month
8:30 AM

INVESTMENT COMMITTEE:

Third Thursday of the Month
10:00 AM - Department of Retirement
Services Office

INVESTMENT 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/PF/Meetings/Agendas.asp>
or they can be obtained in the Retirement Office at:
1737 North First Street, Suite 580,
San José, CA 95112-4505.
Meeting times and locations are subject to
change, please call our office at:
408.392.6700 for current information.*

OUTSIDE CONSULTANTS

ACTUARY

Mercer Human Resource Consulting
San Francisco, CA

OUTSIDE COUNSEL

Saltzman & Johnson
San Francisco, CA

ATTORNEY, REAL ESTATE

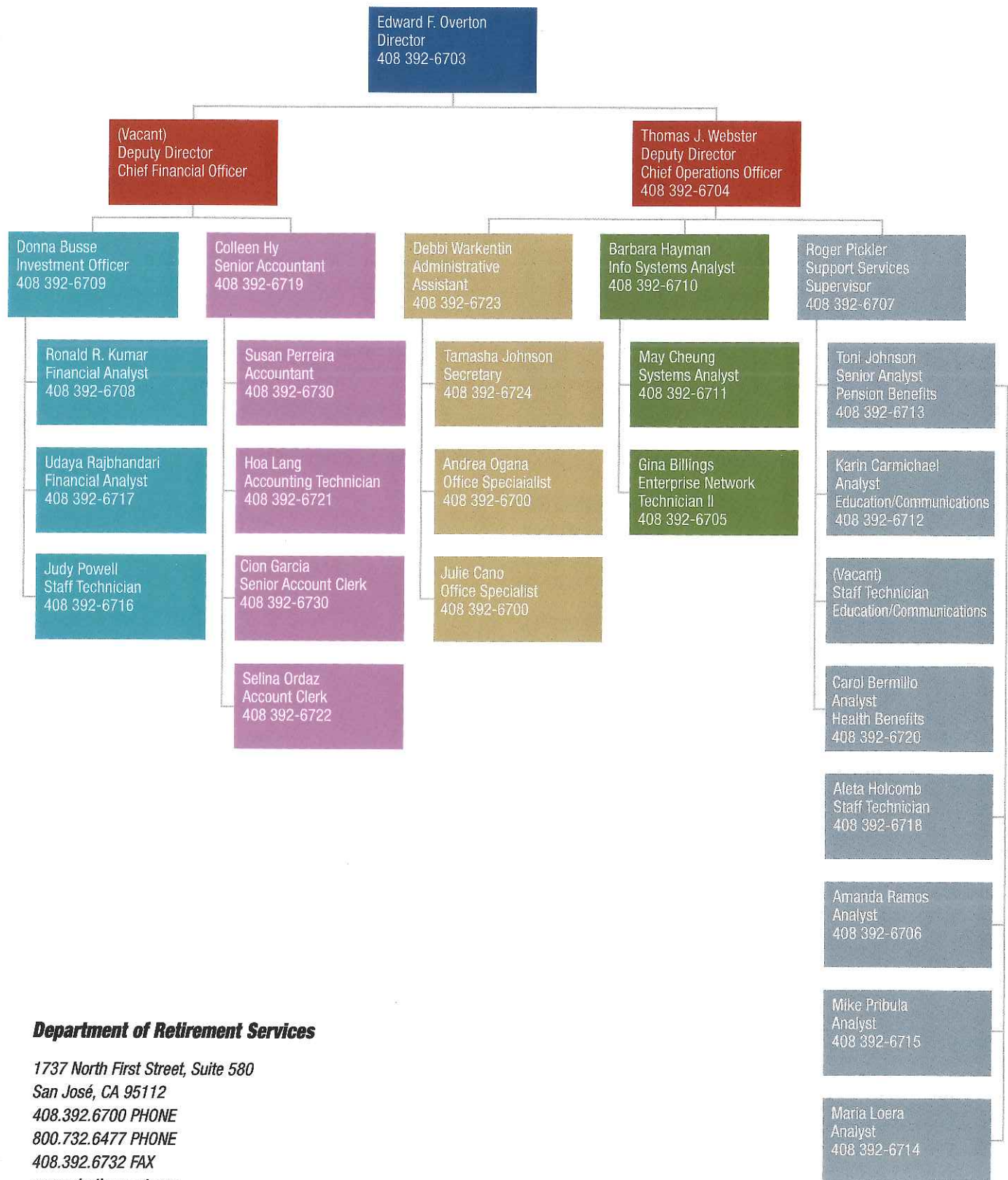
Nossaman, Guthner, Knox & Elliott LLP
San Francisco, CA

AUDITOR

Macias Gini & O'Connell LLP
Walnut Creek, CA

*A list of Investment Professionals
begins on page 61 of the
Investment Section of this report.*

DEPARTMENT OF RETIREMENT SERVICES ORGANIZATIONAL CHART



SUMMARY OF THE PRINCIPAL SYSTEM PROVISIONS

MEMBERSHIP

Mandatory for all full-time safety employees.

MEMBER CONTRIBUTION

All members contribute 8.27% of base salary.

CITY'S CONTRIBUTION

The City contributes 21.77% of the base salary.

INTEREST

Two percent annual interest is calculated each biweekly pay period and is added to employee contributions. This interest is derived from investments.

TERMINATION BENEFITS

Upon termination, the member shall be paid all of his/her accumulated contributions and interest in full satisfaction of all rights and benefits under this Retirement Plan. The City's contributions and interest will not be refunded to the employee.

MILITARY LEAVE CREDIT

If during employment with the City of San José a member has served in the military, the City will pay the member's contributions into the Retirement System for that period of time if the following conditions exist: (1) a time of war, a national emergency proclaimed by the President or the Congress, or (2) Service outside the United States as requested by the United Nations. This is not refundable to an employee who resigns and requests a refund of contributions.

VESTING OF PENSION CREDIT

After 10 years of service, a member may resign his/her position with the Police or Fire Department and leave the accumulated contributions in the Retirement Plan. A member who vests in this fashion is eligible to retire later at age 55 or when 20 years have elapsed from the original hire date. For a deferred vested retirement, the monthly retirement allowance is calculated with the same formula as a service retirement (See Below).

SERVICE RETIREMENT

An employee who reaches the normal retirement age of 55 with 20 years of service; an employee of age 50 with 25 years of service; an employee of any age with 30 years of service; or

an employee of age 70 with no service requirement is entitled to a monthly retirement allowance equal to the final compensation multiplied by 2.5% multiplied by years of service up to 30 years (Maximum benefit, 75% of final average salary) if the employee retired prior to February 4, 1996. After February 4, 1996 but prior to February 4, 2000, the monthly allowance consists of final compensation multiplied by 2.5% for the first 20 years of service, by 3% for the next ten years (Maximum benefit, 80% of final average salary). After February 4, 2000, the monthly allowance consists of final compensation multiplied by 2.5% for the first 20 years of service, by 3% for the next five years of service, by 4% for the next 5 years of service (Maximum benefit, 85% of final average salary).

SERVICE-CONNECTED DISABILITY

If an employee suffers a service-related disability before retirement, an annual benefit is paid equal to 50% of final compensation. For members with more than 20 years of service, the monthly retirement allowance is the final average salary multiplied by 50%, plus the final average salary multiplied by 2.5% for each year over 20 if a member retires prior to February 4, 1996 (Maximum benefit, 75% of final average salary). After February 4, 1996 but prior to February 4, 2000, the monthly allowance consists of the final average salary multiplied by 50%, plus final average salary multiplied by 3% for each year over 20 years of service (Maximum benefit, 80% of final average salary). After February 4, 2000, the monthly allowance consists of the final average salary multiplied by 50%, plus final average salary multiplied by 3% for each year over 20 but less than 25 years of service, plus 4% of final average salary for each year over 25 but less than 30 years of service (Maximum benefit, 85% of final average salary).

NON-SERVICE-CONNECTED DISABILITY

Retirement for a non-service-connected disability with at least 2 years of service will provide the following benefit: For members with 2 to 20 years of service, the monthly retirement allowance is 32% multiplied by the final compensation for the first two years plus 1% for each additional year of service. After February 4, 1996 but prior to February 4, 2000, for members with over 20 years of service, the benefit consists of 50% of final average salary, plus final average salary multiplied by 3% for each year over 20 years of service (Maximum benefit, 80% of final average salary). After February 4, 2000, the monthly allowance consists of 50% of the final average salary, plus final average salary multiplied by 3% for each year over 20 but less than 25 years of service,

SUMMARY OF THE PRINCIPAL PLAN PROVISIONS *Continued*

plus 4% of final average salary for each year over 25 but less than 30 years of service (Maximum benefit, 85% of final average salary).

EARLY SERVICE RETIREMENT

Retirement at age 50 to 55 with at least 20 years of service: Members' retirement allowance shall be calculated as if the members were at least 55, and then reduced according to guidelines set forth in Section 3.36.810 of the City of San José Municipal Code.

MANDATORY RETIREMENT

Age 70.

SURVIVORSHIP ALLOWANCE

The surviving spouse will receive 37.5% of the final compensation if the member dies while entitled to immediate retirement for service, dies at any age due to a service-connected injury or illness, is retired for service, or is retired for service-connected disability. Optional Retirement Allowances are available. For those that retire on or after February 4, 2000, the surviving spouse of a member who is entitled to a retirement benefit greater than 75% of final compensation gets a spousal benefit equal to 50% of the member benefit up to a maximum of 42.5% of final compensation.

If the member dies before age 55 with two or more years of service due to a non-service connected injury or illness, or if the member is retired for non-service-connected disability, the spouse will receive 24% of final compensation for two years of service and 0.75% for each year thereafter (Maximum: 37.5%).

Surviving child or children conceived prior to retirement will receive the following:

- 1 child receives 25% of the final compensation
- 2 children share 37.5% of the final compensation
- 3+ children share 50% of the final compensation

Unless the death is service-connected in which case the eligible child or children will receive the following:

- 1 child receives 25% of the final compensation
- 2 children share 50% of the final compensation
- 3+ children share 75% of the final compensation

The maximum family benefit is 75% of the final compensation. If the sum of spousal benefit plus the children's benefit is greater than 75%, the children's benefit is reduced. Dependent children are paid to age 18 or to age 22 if full-time students.

REMARRIAGE OF SPOUSE

If the employee is 55 at time of death and has twenty years of service, or the member is entitled to 30 years of service regardless of age, the spouse will retain allowance for life. If less than 20 years or under age 55, the spouse loses the allowance upon a remarriage, unless the person was an eligible surviving spouse as of October 1, 1999 or becomes an eligible surviving spouse of a member who had retired as of October 1, 1999.

POST-RETIREMENT MARRIAGE

Effective June 11, 2002, the Post-Retirement Optional Settlement allows for payment of an annuity to a spouse if a member marries after retirement. To do this, the member must take a reduced allowance to provide the spouse a benefit. The election of the Post-Retirement Optional Settlement must be filed within 30 days after the date of the marriage if a retiree marries after June 12, 2002. If the retiree marries after June 12, 2002, the election becomes effective one year from the date of marriage.

MANAGEMENT

The System is under the management of a seven member Board of Administration consisting of two City Council persons, a Civil Service Commissioner, and two elected employees who are members of the retirement plan, a member who has retired under the provisions of the Plan and a member who holds a position in the City Administration at a level of Deputy Department Head or higher and who has experience in the investment or management of public funds, retirement funds, institutional fund or endowment funds.

The Board of Administration is a policy-making body and responsible for the proper operation of the Plan. The Plan operates as an independent trust, separate and distinct from the City and other entities. The administration of the Plan is under its guidance and direction and is subject to such rules, regulations and directives as it may adopt from time to time. Members, except for public members, serve without compensation. The City Attorney provides legal advice and counsel.

SUMMARY OF THE PRINCIPAL PLAN PROVISIONS *Continued*

ADMINISTRATION

A full-time Director is employed by the Board. 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 Plan. It also pays any directly related administrative costs.

State Street Bank and Trust is employed as custodian of fund assets and collector of investment income.

ACTUARIAL SOUNDNESS

Plan and benefit provisions are periodically reviewed to assure continuing actuarial soundness.

INVESTMENT AUTHORITY AND POLICY

The investment authority is broad and flexible, allowing maximum utilization of the System's resources. Nationally known investment advisory services including Alliance Capital Management Corp.; Bank of Ireland Asset Management; The Boston Company; Boston Partners Asset Management; Brandes Investment Partners; Credit Suisse Asset Management; Globalt, Inc.; HarbourVest Partners; Income Research & Management; INTECH; Kennedy Associates Real Estate Counsel; MIG Realty Advisors; New Amsterdam Partners; Pantheon Ventures; Portfolio Advisors; Provident Investment Counsel; Rhumblin Advisors; Seix Investment Advisors; Trust Company of the West; UBS Global Asset Management; Western Asset Management Company; and William Blair & Company are retained for full-time investment counsel. Mercer Investment Consulting is retained as the pension consultant.

COST OF LIVING

The cost-of-living (COL) provision provides a flat 3% annual adjustment in February. Survivors will be paid their first COL increase as if they were a new retiree according to the above schedule.

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FINANCIAL SECTION

INDEPENDENT AUDITOR'S REPORT



MACIAS GINI & O'CONNELL LLP
 CERTIFIED PUBLIC ACCOUNTANTS & MANAGEMENT CONSULTANTS

Board of Administration
 City of San José Police and Fire
 Department Retirement Plan

3000 S Street, Suite 300
 Sacramento, CA 95816
 916.928.4600

2175 N. California Boulevard, Suite 645
 Walnut Creek, CA 94596
 925.274.0190

515 S. Figueroa Street, Suite 325
 Los Angeles, CA 90071
 213.286.6400

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying statements of plan net assets of the City of San José Police and Fire Department Retirement Plan (Plan), a pension trust fund of the City of San José, California, as of June 30, 2006 and 2005, and the related statements of changes in plan net assets for the fiscal years then ended. These financial statements are the responsibility of the Plan'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 Plan'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 Plan are intended to present only the plan net assets and changes in plan net assets of the Plan. They do not purport to, and do not, present fairly the financial position of the City of San José, California, as of June 30, 2006 and 2005, 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 financial statements referred to above present fairly, in all material respects, the financial position of the Plan as of June 30, 2006 and 2005, and the changes in financial position for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 2, 2006 on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain

INDEPENDENT AUDITOR'S REPORT *Continued*

MACIAS GINI & O'CONNELL LLP
CERTIFIED PUBLIC ACCOUNTANTS & MANAGEMENT CONSULTANTS

3000 S Street, Suite 300
Sacramento, CA 95816
916.928.4600

2175 N. California Boulevard, Suite 645
Walnut Creek, CA 94596
925.274.0190

515 S. Figueroa Street, Suite 325
Los Angeles, CA 90071
213.286.6400

provisions of laws, regulations, contracts, and grant agreements 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 audit.

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 audit was conducted for the purpose of forming an opinion on the Plan'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 the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are 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 the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Macias, Gini & Company LLP

Certified Public Accountants
Walnut Creek, California

October 2, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)



City of San José

Department of Retirement Services

Board of Administration

Police & Fire Department Retirement Plan

1737 North First Street, Suite 580

San José, California 95112–4505

EDWARD F. OVERTON

DIRECTOR, RETIREMENT SERVICES

- Additions to Plan Net Assets for the year were \$306,490,000, which includes member and employer contributions of \$72,176,000, net investment income before securities lending income of \$233,278,000, and net securities lending income of \$1,036,000.
- Deductions from Plan Net Assets increased from \$86,497,000 to \$95,229,000 over the prior year, or approximately 10.1% due primarily to increased benefit payments and healthcare insurance premiums.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

We are pleased to provide this overview and analysis of the financial activities of the Police and Fire Department Retirement Plan (the Plan) for the fiscal years ended June 30, 2006 and 2005. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our Letter of Transmittal, which begins on page 2 of this report.

Financial Highlights for Fiscal Year 2006

- The net assets of the Plan at the close of the fiscal year 2006 are \$2,311,039,000 (net assets held in trust for pension benefits and postemployment healthcare benefits.) All of the net assets are available to meet the Plan's ongoing obligations to plan participants and their beneficiaries except the Supplemental Retiree Benefit Reserve of \$18,155,000.
- The Plan's total net assets held in trust for pension benefits and postemployment healthcare benefits increased by approximately \$211,261,000 or 10.1%, primarily as a result of the appreciation of the fair value of investments caused by the strengthening equity investment market.

Overview of the Financial Statements

The following discussion and analysis are intended to serve as an introduction to the Plan'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 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 plan.

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 state and local government pension plan reports use the full accrual method of accounting. The Plan complies with all material requirements of these pronouncements.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited) *Continued*

The *Statement of Plan Net Assets* and the *Statement of Changes in Plan Net Assets* report information about the Plan'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 are shown on investments.

These two statements report the Plan's net assets held in trust for pension benefits and postemployment healthcare benefits (net assets)—the difference between assets and liabilities—as one way to measure the Plan's financial position. Over time, increases and decreases in the Plan'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 Plan's overall health (see the Plan's basic financial statements on pages 24–27 of this report).

Notes to 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 pages 28–41 of this report).

Other Information. In addition to the financial statements and accompanying notes, this report presents certain required supplementary information concerning the Plan's progress in funding its obligations to provide pension benefits to members and employer contributions (see *Required Supplementary Information* beginning on page 41 of this report).

The 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 Plan's financial position (see Table 1a on page 18). The assets of the Plan exceeded its liabilities at the close of fiscal year 2006 and 2005.

As of June 30, 2006, \$2,311,039,000 in total net assets was held in trust for pension benefits and postemployment healthcare benefits (see Table 1a on page 18). All of the net assets are available to meet the Plan's ongoing obligation to

plan participants and their beneficiaries, except assets held in the Supplemental Retiree Benefit Reserve of \$18,155,000, which is used to provide supplemental benefits to retirees on a discretionary basis.

As of June 30, 2006, total net assets increased by 10.1% over the prior year primarily due to net appreciation in fair value of investments of \$182,068,000.

As of June 30, 2005, \$2,099,778,000 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 9.9% in net assets over the prior year primarily due to appreciation in the fair value of investments of \$156,324,000.

As of June 30, 2006, receivables increased by \$97,413,000 or 245.4% mainly due to an increase in receivables from brokers and others for year-end investment trades. In the previous year, receivables increased by \$11,813,000 or 42.4%, also due to an increase in receivables from brokers and others for year-end investment trades.

As of June 30, 2006, total liabilities increased by \$212,803,000, or 46.4%, compared with June 30, 2005, due mainly to increases in payable to brokers for year-end investment trades and securities lending collateral due to borrowers.

As of June 30, 2005, total liabilities increased by \$160,727,000 or 53.9% also due to an increase in securities lending collateral due to borrowers.

Reserves

The Plan's reserves are established from contributions and the accumulation of investment income, after satisfying investment and administrative expenses (see tables on pages 46 and 47). In December 2001 the Supplemental Retiree Benefit Reserve (SRBR) was established. The SRBR represents funds required by the San Jose Municipal Code to be set aside from investment earnings to provide supplemental benefits to retirees.

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 on investments held" of \$42,339,000 and \$64,501,000 as of June 30, 2006 and 2005, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited) *Continued*

POLICE AND FIRE PLAN'S NET ASSETS (TABLE 1A)

As of June 30, 2006 and 2005

	2006	2005	Increase Amount	Increase Percent
Receivables	\$ 137,111,000	\$ 39,698,000	\$ 97,413,000	245.4%
Investments at Fair Value	2,845,449,000	2,518,798,000	326,651,000	13.0%
Total Assets	2,982,560,000	2,558,496,000	424,064,000	16.6%
Current Liabilities	671,521,000	458,718,000	212,803,000	46.4%
Total Liabilities	671,521,000	458,718,000	212,803,000	46.4%
Net Assets	\$ 2,311,039,000	\$ 2,099,778,000	\$ 211,261,000	10.1%

POLICE AND FIRE PLAN'S NET ASSETS (TABLE 1B)

As of June 30, 2005 and 2004

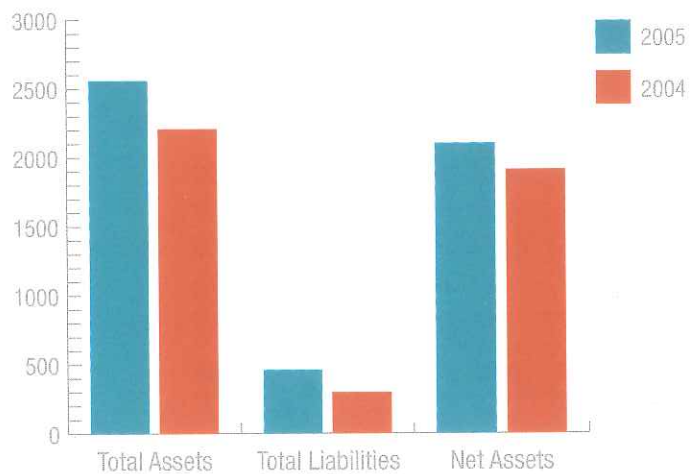
	2005	2004	Increase Amount	Increase Percent
Receivables	\$ 39,698,000	\$ 27,885,000	\$ 11,813,000	42.4%
Investments at Fair Value	2,518,798,000	2,180,341,000	338,457,000	15.5%
Total Assets	2,558,496,000	2,208,226,000	350,270,000	15.9%
Current Liabilities	458,718,000	297,991,000	160,727,000	53.9%
Total Liabilities	458,718,000	297,991,000	160,727,000	53.9%
Net Assets	\$ 2,099,778,000	\$ 1,910,235,000	\$ 189,543,000	9.9%

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited) *Continued*

POLICE AND FIRE PLAN'S NET ASSETS *As of June 30, 2006* (Dollars in Millions)



POLICE AND FIRE PLAN'S NET ASSETS *As of June 30, 2005* (Dollars in Millions)



MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited) *Continued*

ADDITIONS TO PLAN NET ASSETS (TABLE 2A)

For the Fiscal Years Ended June 30, 2006 and 2005

	2006	2005	Increase Amount	Increase Percent
Employee Contributions	\$ 22,174,000	\$ 21,913,000	\$ 261,000	1.2%
Employer Contributions	50,002,000	48,253,000	1,749,000	3.6%
Net Investment Income*	233,278,000	205,217,000	28,061,000	13.7%
Net Securities Lending Income	1,036,000	657,000	379,000	57.7%
Total Additions	\$ 306,490,000	\$ 276,040,000	\$ 30,450,000	11.0%

* Net of Investment Expenses of \$9,355,000 and \$8,017,000 in 2006 and 2005, respectively.

ADDITIONS TO PLAN NET ASSETS (TABLE 2B)

For the Fiscal Years Ended June 30, 2005 and 2004

	2005	2004	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Employee Contributions	\$ 21,913,000	\$ 20,929,000	\$ 984,000	4.7%
Employer Contributions	48,253,000	28,904,000	19,349,000	66.9%
Net Investment Income*	205,217,000	256,304,000	(51,087,000)	-19.9%
Net Securities Lending Income	657,000	541,000	116,000	21.4%
Total Additions	\$ 276,040,000	\$ 306,678,000	\$ (30,638,000)	-10.0%

* Net of Investment Expenses of \$8,017,000 and \$7,945,000 in 2005 and 2004, respectively.

DEDUCTIONS TO PLAN NET ASSETS (TABLE 3A)

For the Fiscal Years Ended June 30, 2006 and 2005

	2006	2005	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Retirement Benefits	\$ 75,189,000	\$ 69,102,000	\$ 6,087,000	8.8%
Healthcare Insurance Premiums	12,880,000	11,093,000	1,787,000	16.1%
Death Benefits	4,803,000	4,226,000	577,000	13.7%
Refund of Contributions	144,000	426,000	(282,000)	-66.2%
Administrative and Other	2,213,000	1,650,000	563,000	34.1%
Total Deductions	\$ 95,229,000	\$ 86,497,000	\$ 8,732,000	10.1%

DEDUCTIONS TO PLAN NET ASSETS (TABLE 3B)

For the Fiscal Years Ended June 30, 2005 and 2004

	2005	2004	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Retirement Benefits	\$ 69,102,000	\$ 61,449,000	\$ 7,653,000	12.5%
Healthcare Insurance Premiums	11,093,000	9,528,000	1,565,000	16.4%
Death Benefits	4,226,000	3,976,000	250,000	6.3%
Refund of Contributions	426,000	132,000	294,000	222.7%
Administrative and Other	1,650,000	2,089,000	(439,000)	-21.0%
Total Deductions	\$ 86,497,000	\$ 77,174,000	\$ 9,323,000	12.1%

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited) *Continued***CHANGES IN PLAN NET ASSETS (TABLE 4A)***For the Fiscal Years Ended June 30, 2006 and 2005*

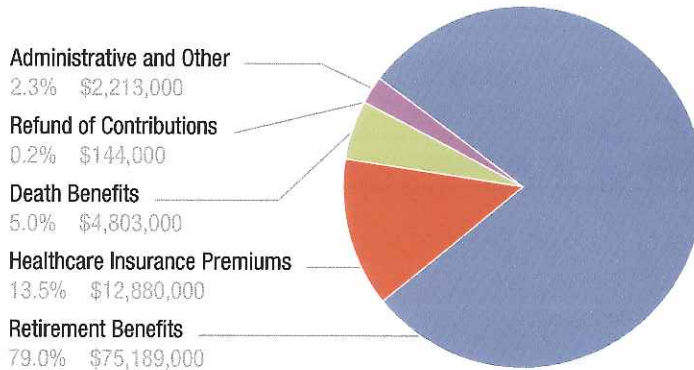
	2006	2005	Increase Amount	Increase Percent
Total Additions	\$ 306,490,000	\$ 276,040,000	\$ 30,450,000	11.0%
Total Deductions	95,229,000	86,497,000	8,732,000	10.1%
Net Increase in Plan Assets	\$ 211,261,000	\$ 189,543,000	\$ 21,718,000	11.5%

CHANGES IN PLAN NET ASSETS (TABLE 4A)*For the Fiscal Years Ended June 30, 2005 and 2004*

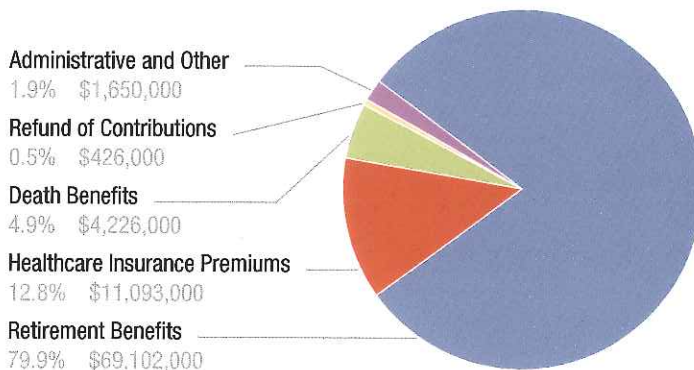
	2005	2004	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Total Additions	\$ 276,040,000	\$ 306,678,000	\$ (30,638,000)	-10.0%
Total Deductions	86,497,000	77,174,000	9,323,000	12.1%
Net Increase in Plan Assets	\$ 189,543,000	\$ 229,504,000	\$ (39,961,000)	-17.4%

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited) *Continued*

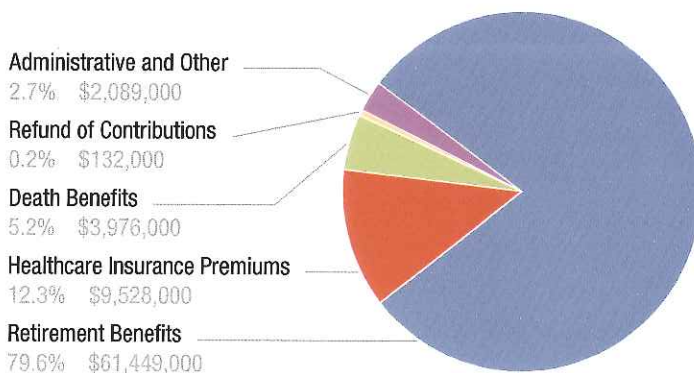
DEDUCTIONS FROM PLAN NET ASSETS 2006



DEDUCTIONS FROM PLAN NET ASSETS 2005



DEDUCTIONS FROM PLAN NET ASSETS 2004



The Police and Fire Plan Activities

Market returns were the main driver of increased net assets, which rose by \$211,261,000, thereby accounting for a 10.1% 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, 2006, totaled \$306,490,000 (see Table 2a on page 20).

By fiscal year ended June 30, 2006, overall additions had increased by \$30,450,000, or 11.0%, from the prior year primarily due to an increase of \$28,061,000, or 13.7% in net investment income excluding securities lending income, which was caused by investment appreciation. The Plan's time-weighted rate of return for the fiscal year ended June 30, 2006 was 14.3% versus 11.0% for the fiscal year 2004–05.

Additions for the fiscal year ended June 30, 2005, totaled \$276,040,000, which represented a decrease of \$30,638,000, or 10.0%, from 2004 primarily due to net investment income which decreased by 19.9% from the previous year (see Table 2b on page 20) offset by increase in employer contribution of \$19 million.

Deductions from Plan Net Assets

The Plan 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 Plan, refund of contributions to terminated employees, and the cost of administering the Plan.

Deductions for the fiscal year ended June 30, 2006 totaled \$95,229,000, an increase of 10.1% over June 30, 2005 (see Table 3a on page 20). Increases in retirement benefits of \$6,087,000 and healthcare insurance premiums of \$1,787,000 were the main reasons for increased expenses. Retirement benefits increased due to benefit enhancements and healthcare insurance costs increased due to higher premiums and administrative expenses.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited) *Continued*

Deductions for the fiscal year ended June 30, 2005 totaled \$86,497,000, an increase of 12.1% over June 30, 2004 (see Table 3b on page 20). Increases in retirement benefits of \$7,653,000 and healthcare insurance premiums of \$1,565,000 were the main reasons for increased expenses. Retirement benefits increased due to benefit enhancements and increased number of beneficiaries. Healthcare insurance costs increased due to higher premiums and administrative expenses.

The Plan's Fiduciary Responsibilities

The Plan's Board is the fiduciary 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.

Economic Factors and Rates Affecting Next Year

The Plan completed a new actuarial valuation dated 2005 and the rates adopted took effect July 2, 2006. The new rates increased the City contribution from 24.04% to 25.61% and increased the Employees' contribution from 11.16% to 11.26%. Funding status of the Plan was reduced from 100.20% to 97.81%. It was reduced due to an increase in unfunded accrued actuarial liability ("UAAL") which is mainly due to experience losses and assumption changes made to reflect longer life expectancies and earlier retirements.

The Plan's funding objective is to meet long-term benefit obligations through contributions and investment income. As of June 30, 2005, the date of our last actuarial valuation, the funded ratio for the Defined Benefit Pension Plan was approximately 97.81%. In general, this indicates that for every dollar of pension benefits due we have approximately \$0.98 of assets to cover it.

In addition, effective July 1, 2006, the Police Officers Association's new Memorandum of Agreement enhances retirement benefits to a maximum of 90% of their final average salary with 30 years of service. Please refer to *Note 7—Subsequent Events* of the notes to the financial statements.

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 Plan'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:

Police and Fire Department Retirement Plan
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

For the Fiscal Year Ended June 30, 2006 and 2005

(Dollars in Thousands)

	2006		
	Pension Benefits	Postemployment Healthcare Benefits	Total
ASSETS:			
Receivables:			
Employee contributions	\$ 627	\$ 219	\$ 846
Employer contributions	1,840	276	2,116
Brokers and others	125,104	2,207	127,311
Accrued investment income	6,719	119	6,838
Total receivables	134,290	2,821	137,111
Investments, at fair value:			
<i>Securities and other:</i>			
U.S. Treasury notes and bonds	195,574	3,451	199,025
U.S. government agency securities	171,142	3,020	174,162
International government bonds	27,891	492	28,383
Domestic corporate bonds	188,271	3,322	191,593
International corporate bonds	12,588	222	12,810
Domestic equity securities	860,894	15,192	876,086
International equity securities	658,755	11,625	670,380
Private equity	10,444	184	10,628
State and local obligations	1,495	26	1,521
Forward international currency contracts	(8)	-	(8)
Collective short-term investment funds	68,616	1,211	69,827
Real estate	181,060	3,195	184,255
Securities lending cash collateral investment pool	419,390	7,397	426,787
Total investments	2,796,112	49,337	2,845,449
Total assets	2,930,402	52,158	2,982,560
LIABILITIES:			
Payable to brokers	234,385	4,134	238,519
Securities lending collateral due to borrowers	419,390	7,397	426,787
Other liabilities	6,107	108	6,215
Total liabilities	659,882	11,639	671,521
NET ASSETS HELD IN TRUST FOR:			
Pension benefits	2,270,520	-	2,270,520
Postemployment healthcare benefits	-	40,519	40,519
Total net assets	\$ 2,270,520	\$ 40,519	\$ 2,311,039

(A schedule of funding progress is presented on page 41.)

See accompanying notes to basic financial statements.

(Continued)

BASIC FINANCIAL STATEMENTS *Continued***STATEMENTS OF PLAN NET ASSETS** *Continued**For the Fiscal Year Ended June 30, 2006 and 2005**(Dollars in Thousands)*

	2005		
	Pension Benefits	Postemployment Healthcare Benefits	Total
ASSETS:			
Receivables:			
Employee contributions	\$ 552	\$ 193	\$ 745
Employer contributions	1,423	218	1,641
Brokers and others	28,281	498	28,779
Accrued investment income	8,383	150	8,533
Total receivables	38,639	1,059	39,698
Investments, at fair value:			
<i>Securities and other:</i>			
U.S. Treasury notes and bonds	199,198	3,529	202,727
U.S. government agency securities	114,893	2,035	116,928
International government bonds	108,753	1,926	110,679
Domestic corporate bonds	177,200	3,139	180,339
International corporate bonds	18,538	328	18,866
Domestic equity securities	788,852	13,974	802,826
International equity securities	526,877	9,333	536,210
State and local obligation	1,586	28	1,614
Forward international currency contracts	(60)	(1)	(61)
Collective short-term investment funds	64,794	1,148	65,942
Real estate	111,012	2,138	113,150
Securities lending cash collateral investment pool	363,126	6,452	369,578
Total investments	2,474,769	44,029	2,518,798
Total assets	2,513,408	45,088	2,558,496
LIABILITIES:			
Payable to brokers	83,059	1,470	84,529
Securities lending collateral due to borrowers	363,126	6,452	369,578
Other liabilities	4,526	85	4,611
Total liabilities	450,711	8,007	458,718
NET ASSETS HELD IN TRUST FOR:			
Pension benefits	2,062,697	-	2,062,697
Postemployment healthcare benefits	-	37,081	37,081
Total net assets	\$ 2,062,697	\$ 37,081	\$ 2,099,778

*(A schedule of funding progress is presented on page 41.)**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, 2006 and 2005

(Dollars in Thousands)

	2006		
	Pension Benefits	Postemployment Healthcare Benefits	Total
ADDITIONS:			
Contributions:			
Employee	\$ 16,432	\$ 5,742	\$ 22,174
Employer	43,473	6,529	50,002
Total contributions	59,905	12,271	72,176
Investment income:			
Net appreciation in fair value of investments	178,896	3,172	182,068
Interest income	29,154	521	29,675
Dividend income	22,547	403	22,950
Net rental income	7,799	141	7,940
Less investment expense	(9,189)	(166)	(9,355)
Net investment income before securities lending income	229,207	4,071	233,278
Securities lending income:			
Earnings	15,161	271	15,432
Rebates	(13,708)	(245)	(13,953)
Fees	(435)	(8)	(443)
Net securities lending income	1,018	18	1,036
Net investment income	230,225	4,089	234,314
Total additions	290,130	16,360	306,490
DEDUCTIONS:			
Retirement benefits	75,189	-	75,189
Healthcare insurance premiums	-	12,880	12,880
Death benefits	4,803	-	4,803
Refund of contributions	144	-	144
Administrative expenses and other	2,171	42	2,213
Total deductions	82,307	12,922	95,229
Net increase	207,823	3,438	211,261
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS AND POSTEMPLOYMENT HEALTHCARE BENEFITS:			
Beginning of year	2,062,697	37,081	2,099,778
End of year	\$ 2,270,520	\$ 40,519	\$ 2,311,039

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, 2006 and 2005

(Dollars in Thousands)

	2005		
	Pension Benefits	Postemployment Healthcare Benefits	Total
ADDITIONS:			
Contributions:			
Employee	\$ 16,240	\$ 5,673	\$ 21,913
Employer	41,835	6,418	48,253
Total contributions	58,075	12,091	70,166
Investment income:			
Net appreciation in fair value of investments	153,629	2,695	156,324
Interest income	28,556	503	29,059
Dividend income	20,871	368	21,239
Net rental income	6,496	116	6,612
Less investment expense	(7,878)	(139)	(8,017)
Net investment income before securities lending income	201,674	3,543	205,217
Securities lending income:			
Earnings	5,742	101	5,843
Rebates	(4,819)	(85)	(4,904)
Fees	(277)	(5)	(282)
Net securities lending income	646	11	657
Net investment income	202,320	3,554	205,874
Total additions	260,395	15,645	276,040
DEDUCTIONS:			
Retirement benefits	69,102	-	69,102
Healthcare insurance premiums	-	11,093	11,093
Death benefits	4,226	-	4,226
Refund of contributions	426	-	426
Administrative expenses and other	1,617	33	1,650
Total deductions	75,371	11,126	86,497
Net increase	185,024	4,519	189,543
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS AND POSTEMPLOYMENT HEALTHCARE BENEFITS:			
Beginning of year	1,877,673	32,562	1,910,235
End of year	\$ 2,062,697	\$ 37,081	\$ 2,099,778

See accompanying notes to basic financial statements.

NOTES TO BASIC FINANCIAL STATEMENTS

For The Fiscal Years Ended June 30, 2006 and 2005

NOTE 1 – DESCRIPTION OF THE PLAN

The following description of the City of San José Police and Fire Department Retirement Plan (Plan) 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 Plan, consisting of a single employer Defined Benefit Pension Plan and a Postemployment Healthcare Plan, was established in 1961 and last amended June 16, 2006, to provide retirement benefits for sworn employees of the Police and Fire Departments of the City of San José (City). The Plan 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 Plan is administered by the Director of Retirement Services, an employee of the City, under the direction of a Board of Administration. The

contribution and benefit provisions and all other requirements are established by City ordinance. The Plan is responsible for all direct administrative costs except for certain support services, which are provided by the City. Total direct administrative expenses and other amounted to approximately \$2,213,000 and \$1,650,000 for 2006 and 2005, respectively. These costs are financed through investment earnings.

All sworn officers of the City's Police and Fire Departments are required to be members of the Plan. Total payroll amounted to approximately \$224,633,000 and \$221,805,000 for 2006 and 2005, respectively. Covered payroll amounted to approximately \$198,131,000 and \$196,543,000 in 2006 and 2005, respectively.

Participants of the Postemployment Healthcare Plan are also participants of the Defined Benefit Pension Plan. As of June 30, 2006 and 2005, employee membership data related to the Plan was as follows:

Defined Benefit Pension Plan:	2006	2005
Retirees and beneficiaries currently receiving benefits	1,479	1,445
Terminated vested members not yet receiving benefits	72	69
Active members	2,044	2,004
Total	3,595	3,518
Postemployment Healthcare Plan:		
Retirees and beneficiaries currently receiving benefits	1,328	1,295
Terminated vested members not yet receiving benefits	15	15
Active members	2,044	2,004
Total	3,387	3,314

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

(b) Pension Benefits

An employee with 10 or more years of service who resigns and leaves his/her contributions in the Plan; an employee who reaches the normal retirement age of 55 with 20 years of service; an employee of age 50 with 25 years of service; an employee of any age with 30 years of service; or an employee of age 70 with no service requirement is entitled to a monthly retirement allowance equal to the final compensation multiplied by 2.5% multiplied by years of service up to 30

years (maximum benefit, 75% of final average salary) if the employee retired prior to February 4, 1996. After February 4, 1996 but prior to February 4, 2000, the monthly allowance consists of final compensation multiplied by 2.5% for the first 20 years of service, by 3% for the next ten years (maximum benefit, 80% of final average salary). After February 4, 2000, the monthly allowance consists of final compensation multiplied by 2.5% for the first 20 years of service, by 3% for the next five years of service, by 4% for the next 5 years of service (maximum benefit, 85% of final average salary).

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 1 – DESCRIPTION OF THE PLAN *Continued*

Final compensation is the average monthly salary during the highest 12 consecutive months of service, limited to 108% of salary paid during the 12 months immediately preceding the last 12 months of service. These benefit rates and formulas are based on the outcome of the arbitration process and approval by the Plan Board in July 1998. 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 and elect to receive a return of contributions, the accumulated plan benefits attributable to the City's contributions is forfeited; however, an employee's accumulated contribution plus 2% interest per annum is refunded. Refunds are paid out on a lump-sum basis. The forfeited amount of the City's contributions remains in the Plan.

(c) Death Benefits

The spouse or domestic partner receives the greater of 50% of the member's benefit or 37.5% of the final average salary if: (1) an employee's death is service related; or (2) an employee's death is non-service related and occurs with at least 20 years of service; or (3) a retiree dies who was retired from service or who received a service related disability. Optional retirement allowances are available.

Additionally, an annual benefit for dependent children up to 18 years of age, or up to 22 years of age if a full-time student, is paid at a rate of 25% of final compensation per child with a maximum family benefit of 75% of final compensation if death is service related.

If an employee's death is non-service related and the employee has at least two years of service, the Plan allows for an annual annuity of 24% of the employee's final compensation for the first two years of service, plus 0.75% for each year thereafter, to be paid to his/her surviving spouse or domestic partner until remarriage (maximum of 37.5% of final average salary or 50% of the member's benefit, whichever is greater). These benefits are also paid to the surviving spouse or domestic partner of a retiree on a non-service related disability. Additionally, annual benefits for dependent children up to 18 years of age, or 22 years of age if a full-time student, are as follows:

- One child - 25% of final compensation
- Two children - 37.5% of final compensation
- Three or more children - 50% of final compensation

The maximum annual benefit paid to a family under any circumstances is 75% of final compensation. If the employee has no spouse or domestic partner or children, a lump sum equal to the greater of the employee's accumulated contributions or \$1,000 is paid to his/her estate.

(d) Disability Benefits

If an employee suffers a service-related disability before retirement, an annual benefit is paid equal to 50% of final compensation. For members with more than 20 years of service, the monthly retirement allowance is the final average salary multiplied by 50%, plus the final average salary multiplied by 2.5% for each year over 20 if a member retired prior to February 4, 1996 (maximum benefit, 75% of final average salary). After February 4, 1996 but prior to February 4, 2000, the monthly allowance consists of the final average salary multiplied by 50%, plus final average salary multiplied by 3% for each year over 20 years of service (maximum benefit, 80% of final average salary). After February 4, 2000, the monthly allowance consists of the final average salary multiplied by 50%, plus final average salary multiplied by 3% for each year over 20 but less than 25 years of service, plus 4% of final average salary for each year over 25 but less than 30 years of service (maximum benefit, 85% of final average salary).

Retirement for a non-service-connected disability with at least 2 years of service will provide the following benefit: For members with 2 to 20 years of service, the monthly retirement allowance is 32% multiplied by the final compensation for the first two years plus 1% for each additional year of service. After February 4, 1996 but prior to February 4, 2000, for members with over 20 years of service, the benefit consists of 50% of final average salary, plus final average salary multiplied by 3% for each year over 20 years of service (maximum benefit, 80% of final average salary). After February 4, 2000, the monthly allowance consists of 50% of the final average salary, plus final average salary multiplied by 3% for each year over 20 but less than 25 years of service, plus 4% of final average salary for each year over 25 but less than 30 years of service (maximum benefit, 85% of final average salary).

(e) Postemployment Healthcare Benefits

The City of San José Municipal Code provides that retired employees with 15 years or more of service, their survivors, or those retired employees who are receiving a pension benefit of at least 37.5% of final compensation are entitled to payment of 100% of the lowest priced medical insurance plan available to an active police and fire employee. However, the Plan pays the entire premium cost for dental insurance coverage.

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation

The financial statements of the Plan present only the financial activities of the Plan 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 Plan 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 generally accepted accounting principles 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

The City of San José Municipal Code Section 3.36.530 delegate authority to the Board of Administration to reinvest the moneys of the retirement fund as provided in Section 3.36.540. The Board has adopted detailed investment guidelines consistent with conditions and limitations set forth in Section 3.36.540.

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. The Plan's investments in pooled funds have the underlying securities valued by the fund manager in accordance with the above standards. As of June 30, 2006, the Plan had the following pooled fund holdings: \$20,932,000 in fixed income, \$234,125,000 in international equities, \$50,000,000 in real estate, and \$10,628,000 in private equities.

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 Plan 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, 2006 and 2005, the net assets, totaling \$2,311,039,000 and \$2,099,778,000, respectively, are allocated as follows (in thousands):

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *Continued*

	Retirement Fund	Cost-of- Living Fund	Defined Benefit Pension Benefits Plan	Post- Employment Healthcare Plan	Total
June 30, 2006:					
Employee contributions	\$ 157,324	\$ 47,327	\$ 204,651	\$ 3,967	\$ 208,618
Supplemental retiree benefit	18,155	-	18,155	-	18,155
Unrealized gains (losses) on investments held	222,478	92,030	314,508	5,611	320,119
General reserve	1,208,846	524,360	1,733,206	30,941	1,764,147
Total	\$ 1,606,803	\$ 663,717	\$ 2,270,520	\$ 40,519	\$ 2,311,039
June 30, 2005:					
Employee contributions	\$ 142,802	\$ 43,452	\$ 186,254	\$ 3,607	\$ 189,861
Supplemental retiree benefit	17,708	-	17,708	447	18,155
Unrealized gains (losses) on investments held	194,086	78,792	272,878	4,902	277,780
General reserve	1,113,415	472,442	1,585,857	28,125	1,613,982
Total	\$ 1,468,011	\$ 594,686	\$ 2,062,697	\$ 37,081	\$ 2,099,778

Employer contributions are paid directly into the general reserve. Employee contributions are accounted for separately due to the possibility of their return to the member upon separation from City employment.

The Supplemental Retiree Benefit Reserve (SRBR) represents funds required by statute to be set aside from investment earnings to provide supplemental benefits to retirees. The SRBR was established in December 2001, upon adoption of Ordinance number 26536 of the City of San José Municipal Code.

Unrealized Gains (Losses) on Investments Held Reserve represents 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 was established to help offset the impact of market fluctuation. Annually, income and losses from investments stated at fair value are placed in this account.

(e) Allocation of Investment Income

Earnings on investments, excluding unrealized gains and losses, are recorded first in the general reserve category of net assets. An allocation is made bi-annually from the general reserve category to the employee contributions category of net assets based on the balance in that account at an annual rate of 2%, as specified by the City of San José Municipal Code. After the close of each fiscal year, the SRBR will be allocated 10% of the earnings in excess of the assumed actuarial rate for the Retirement Plan. Any earnings in excess of 2% of total employee contributions reserve balance and the SRBR allocation remain in the general reserve category.

(f) Reclassifications

Certain amounts in fiscal year 2005 have been reclassified to conform with the fiscal year 2006 presentation.

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

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. The Plan does not have a policy regarding interest rate risk. As of June 30, 2006, GNMA's in the amount of \$22,588,000 and U.S. government agency securities in the amount of \$147,356,000 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 Plan'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. In 2005, the GNMA's were in the amount of \$29,410,000 and the amount for US government agency securities backed by mortgage pass-throughs were \$74,326,000. In addition as of June 30, 2006, \$8,200,000 of the asset backed securities, \$13,549,000 of the collateralized mortgage obligations, and \$2,870,000 of the corporate securities are floating rate securities tied to the 1 to 3 month LIBOR. In 2005, the amounts for the same type of securities were \$15,523,000, \$14,321,000, and \$2,895,000, respectively.

Custodial Credit Risk – Custodial credit risk is the risk that the Plan will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Plan's custodian holds all investments of the Plan in the Plan's name except for the assets held in pooled funds, which are under custody of the investment 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. All domestic and international bonds and notes in which the Plan's assets are invested, and which mature one year or more from the date of original

issues, are required to carry a rating of "BBB" or better by two of the following three services: Standard & Poor's (S&P), Moody's Investors' Service (Moody's), or Fitch Ratings (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; or, if unrated, shall be of equivalent quality in the judgment of the investment manager to a similar domestic issue. Investment managers may, with prior written authorization from the Plan, invest a maximum of 20% of their fixed income portfolio in bonds or notes that are rated B or BB. If bonds are downgraded below the minimum credit quality allowable in the Plan's investment policy statement at the time of purchase, the investment 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. The Plan may hedge against the possible adverse effects of currency fluctuations on the Plan's portfolio of international fixed income obligations when it is considered appropriate. This is typically achieved using forward currency contracts. 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 Plan'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 29% and maximum 39% of the fair value of the aggregate portfolio.

International Equity – Minimum 10% and maximum 25% of the fair value of the aggregate portfolio.

Emerging Market Equity – Limited to 8% of the fair value of the aggregate portfolio.

Domestic fixed Income – Minimum 15% and maximum 25% of the fair value of the aggregate portfolio.

Long Duration Fixed Income – Limited to 7% of the fair value of the aggregate portfolio.

Private Market Equity – Limited to 8% of the fair value of the aggregate portfolio. The Board approved temporarily placing the funds allotted to the private equity asset class into the Plan's small cap asset class.

NOTES TO BASIC FINANCIAL STATEMENTS *Continued***NOTE 3 – INVESTMENTS** *Continued*

Real Estate – Limited to 17% of the market value of the aggregate portfolio. Real estate investments include: apartment complexes in Houston, TX, and Colorado Springs, CO; office buildings in Denver, CO, in San José, CA, near Chicago, IL, and in Anchorage, AK; and warehouses in Nashville, TN, and near Minneapolis, MN. The properties have leases with various terms.

Government short-term investment fund – The fund is used for overnight investment of all excess cash in the Plan's funds. It is invested by the Plan Custodian, and held in the Plan 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.

The following tables provide information as of June 30, 2006 and 2005, concerning the fair value of investments, interest rate risk, and foreign currency risk:

(Dollars in Thousands)

INVESTMENT MATURITIES AT FAIR VALUE AS OF JUNE 30, 2006

Type of Investment	0-3 Months	3-6 Months	6 months-1 Year	1-5 Years	6-10 Years	More Than 10 Years	Total Fair Value	Cost
Fixed Maturity								
Domestic								
U.S. Treasury Securities	\$ 1,383	\$ 1,249	\$ 9,100	\$ 104,180	\$ 46,276	\$ 36,687	\$ 198,875	\$ 201,864
U.S. Treasury Strip	-	-	-	-	-	150	150	153
GNMA	-	-	-	-	-	22,588	22,588	22,761
FHLB	1,848	668	-	879	823	-	4,218	4,303
FHLMC	-	-	-	3,054	25	32,594	35,673	36,178
FNMA	-	-	415	431	4,456	106,381	111,683	113,541
Asset Backed Securities	-	-	-	9,461	1,848	10,383	21,692	21,783
Collateralized Mortgage Obligations	-	-	-	1,156	-	54,752	55,908	56,533
Corporate Bonds	674	374	4,224	17,911	19,920	65,138	108,241	114,310
State and Local Obligations	-	-	-	-	-	1,521	1,521	1,616
Pooled Domestic Bonds	-	-	-	-	5,752	-	5,752	4,587
Government Short Term Investment Fund	69,827	-	-	-	-	-	69,827	69,827
Total Domestic Fixed Maturity	73,732	2,291	13,739	137,072	79,100	330,194	636,128	647,456
International								
Government Bonds								
Swiss Franc	-	-	799	-	-	-	799	796
Euro Currency	2,242	-	-	-	-	-	2,242	2,233
Japanese Yen	5,174	-	-	-	-	-	5,174	5,260
United States Dollar Denominated	-	344	-	-	-	4,644	4,988	5,193
Total International Government Bonds	7,416	344	799	-	-	4,644	13,203	13,482
Corporate Bonds								
Euro Currency	-	-	-	-	-	-	-	-
Japanese Yen	-	-	-	-	-	-	-	-
United States Dollar Denominated	-	-	-	2,053	5,306	5,451	12,810	13,094
Total International Corporate Bonds	-	-	-	2,053	5,306	5,451	12,810	13,094
Pooled International Fixed Maturity	-	-	-	-	-	15,180	15,180	11,340
Total International Fixed Maturity	7,416	344	799	2,053	5,306	25,274	41,193	37,916
Total Fixed Maturity	\$ 81,148	\$ 2,635	\$ 14,538	\$ 139,125	\$ 84,406	\$ 355,469	\$ 677,321	\$ 685,372

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*NOTE 3 – INVESTMENTS *Continued*

Type of Investment	Total Fair Value	Cost
Equity		
Domestic	\$ 876,086	\$ 717,745
International		
Australian Dollar	6,932	4,690
Brazilian Real	5,369	4,129
British Pound	68,735	63,032
Canadian Dollar	7,598	5,990
Chilean Peso	940	802
Euro Currency	144,410	117,831
Hong Kong Dollar	10,393	7,966
Indian Rupee	5,614	6,427
Indonesian Rupiah	378	470
Japanese Yen	81,224	64,176
Malaysian Ringgit	1,293	1,212
Mexican Peso	3,973	2,413
New Taiwan Dollar	7,117	6,249
New Zealand Dollar	1,368	2,059
Norwegian Krone	1,549	792
Singapore Dollar	9,704	5,810
South African Rand	1,555	1,500
South Korean Won	9,402	7,164
Swedish Krona	2,923	2,696
Swiss Franc	28,467	22,631
United States Dollar Denominated	37,311	33,664
Total International Currency Equity	436,255	361,703
Pooled International Equity	234,125	139,652
Total International Equity	670,380	501,355
Total Equities	1,546,466	1,219,100
Private Equity	10,628	9,980
Real Estate	184,255	184,125
	194,883	194,105
Forward International Currency Contracts, net	(8)	-
Securities Lending Collateral Investment Pool	426,787	426,787
Total Investments	\$ 2,845,449	\$ 2,525,364

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*NOTE 3 – INVESTMENTS *Continued**(Dollars in Thousands)*

INVESTMENT MATURITIES AT FAIR VALUE AS OF JUNE 30, 2005

Type of Investment	0-3 Months	3-6 Months	6 months- 1 Year	1-5 Years	6-10 Years	More Than 10 Years	Total Fair Value	Cost
Fixed Maturity								
Domestic								
U.S. Treasury Securities	\$ 17,709	\$ -	\$ 991	\$ 101,339	\$ 26,882	\$ 53,589	\$ 200,510	\$ 198,355
U.S. Treasury Strips	-	-	-	-	-	2,217	2,217	1,669
GNMA	-	-	-	-	-	29,410	29,410	29,316
FHLB	-	1,850	446	1,577	-	-	3,873	3,918
FHLMC	-	-	-	17	202	22,361	22,580	22,422
FNMA	-	2,000	-	855	604	55,210	58,669	58,325
Other U.S. Gov't Agency Securities	-	-	-	-	-	2,396	2,396	2,281
Asset Backed Securities	-	-	-	5,481	3,600	19,672	28,753	28,737
Collateralized Mortgage Obligations	-	-	-	1,248	-	21,391	22,639	22,700
Corporate Bonds	704	71	1,812	18,234	34,261	67,533	122,615	117,699
State and Local Obligation	-	-	-	-	-	1,614	1,614	1,545
Pooled Domestic Bonds	-	-	-	-	6,332	-	6,332	5,273
Government Short Term Investment Fund	65,942	-	-	-	-	-	65,942	65,945
Total Domestic Fixed Maturity	84,355	3,921	3,249	128,751	71,881	275,393	567,550	558,185
International								
Government Bonds								
Australian Dollar	-	-	-	3,527	-	-	3,527	3,575
British Pound	-	-	-	1,194	4,933	-	6,127	6,073
Canadian Dollar	-	-	-	-	3,619	-	3,619	3,362
Danish Krone	-	-	-	1,114	-	-	1,114	1,217
Euro Currency	-	-	2,456	24,225	14,673	12,902	54,256	46,548
Japanese Yen	-	-	-	13,176	2,384	-	15,560	15,138
United States Dollar Denominated	-	-	-	687	911	3,891	5,489	5,126
Total International Government Bonds	-	-	2,456	43,923	26,520	16,793	89,692	81,039
Corporate Bonds								
Euro Currency	-	-	-	2,253	644	-	2,897	2,922
Japanese Yen	-	-	-	10,897	1,689	-	12,586	12,128
United States Dollar Denominated	-	-	-	2,815	568	-	3,383	3,407
Total International Corporate Bonds	-	-	-	15,965	2,901	-	18,866	18,457
Pooled International Fixed Maturity	-	-	-	-	-	20,987	20,987	14,790
Total International Fixed Maturity	-	-	2,456	59,888	29,421	37,780	129,545	114,286
Total Fixed Maturity	\$ 84,355	\$ 3,921	\$ 5,705	\$ 188,639	\$ 101,302	\$ 313,173	\$ 697,095	\$ 672,471

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 3 – INVESTMENTS *Continued*

Type of Investment	Total Fair Value	Cost
Equity		
Domestic	\$ 802,826	\$ 653,722
International		
Australian Dollar	6,865	5,180
Brazilian Real	4,365	3,375
British Pound	74,887	75,163
Canadian Dollar	11,757	11,366
Egyptian Pound	1,009	257
Euro Currency	142,335	123,561
Hong Kong Dollar	6,942	5,141
Hungarian Forint	1,031	1,168
Indonesian Rupiah	1,035	895
Japanese Yen	79,756	73,524
Malaysian Ringgit	569	570
Mexican Peso	4,627	3,292
New Taiwan Dollar	5,721	5,212
New Turkish Lira	883	870
New Zealand Dollar	2,321	2,059
Norwegian Krone	1,930	1,303
Singapore Dollar	7,053	5,828
South African Rand	1,554	893
South Korean Won	6,287	4,866
Swedish Krona	2,389	2,682
Swiss Franc	29,637	25,360
United States Dollar Denominated	26,374	22,008
Total International Currency Equity	419,327	374,573
Pooled International Equity	116,883	50,091
Total International Equity	536,210	424,664
Total Equities	1,339,036	1,078,386
Real Estate	113,150	120,544
Forward International Currency Contracts, net	(61)	-
Securities Lending Collateral Investment Pool	369,578	359,583
Total Investments	\$ 2,518,798	\$ 2,230,984

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 3 – INVESTMENTS *Continued*

The following table provides information as of June 30, 2006 and 2005, concerning credit quality risk:

Ratings of Fixed Maturities for June 30, 2006

(Dollars in Thousands)

S&P Quality Rating	Fair Value	Fair Value as a Percentage of Total Fixed Maturity
AAA	\$352,527	52.0%
AA	18,179	2.7%
AA	42,475	6.3%
BBB	44,528	6.6%
BB	11,888	1.8%
B	7,402	1.1%
CCC & Below	278	0.0%
Not Rated*	200,044	29.5%
TOTAL	\$677,321	100.0%

* This category includes the pooled domestic and international bonds; Government Short-Term Investment Fund; GNMA, FNMA, and FHMLC TBA's (underlying securities to be announced)

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

Ratings of Fixed Maturities for June 30, 2005

(Dollars in Thousands)

S&P Quality Rating	Fair Value	Fair Value as a Percentage of Total Fixed Maturity
AAA	\$385,365	55.3%
AA	32,627	4.7%
A	46,566	6.7%
BBB	49,116	7.0%
BB	13,374	1.9%
B	6,162	0.9%
CCC & Below	360	0.1%
Not Rated*	163,525	23.4%
TOTAL	\$697,095	100.0%

* This category includes the pooled domestic and international bonds; Government Short-Term Investment Fund; GNMA, FNMA, and FHMLC TBA's (underlying securities to be announced)

Forward International Currency Contracts - The Plan has made investments in forward currency contracts, which are commitments to purchase or sell stated amounts of international currency. The Plan utilizes these contracts to control exposure and facilitate the settlement of international security purchase and sale transactions. At June 30, 2006 and 2005, the Plan's net position in these contracts is recorded at fair value as forward international currency contract investments. The fair values of forward currency contracts are determined by quoted currency prices from national exchanges. The Plan'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, 2006, total commitments in forward currency contracts to purchase and sell international currencies were \$1,496,000 and \$1,496,000 respectively, with fair values of \$1,505,000 and \$1,497,000, respectively. As of June 30, 2005, the Plan had commitments in international currency contracts to purchase and sell international currencies of \$45,998,000 and \$45,998,000, respectively, with fair values of \$45,610,000 and \$45,549,000, respectively. The Plan's commitments relating to forward currency contracts are settled on a net basis.

NOTE 4 – SECURITIES LENDING PROGRAM

The Plan has a custodial agreement with State Street Corporation (State Street) which authorizes State Street to loan the securities in the Plan's investment portfolio under such terms and conditions as State Street deems advisable and to permit the loaned securities to be transferred into the name of the borrowers. The Plan does not have a threshold for securities lending. The Plan receives a fee from the borrower for the use of the loaned securities. If the loaned securities are not returned by the borrower, State Street 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, State Street is required to credit the Plan'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 Plan or borrowers.

Securities lending collateral represent investments in an investment pool purchased with cash collateral, as well as securities collateral that the Plan may not pledge or sell without a borrower default. 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 Plan does not match the maturities of investments made with cash collateral with the securities on loan.

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 4 – SECURITIES LENDING PROGRAM *Continued*

The Plan authorized State Street Bank and Trust to invest and reinvest cash collateral in State Street's pooled investment vehicle which must have an effective duration of 120 days or less. Securities with maturities of 13 months or more must have a rating of A or better by at least two nationally recognized statistical rating organizations, or if unrated, be of comparable quality. Securities with maturities of less than 13 months are rated at least A-1/P-1. As of June 30, 2006, the size of the cash collateral pooled vehicle was \$81.8 billion and the weighted average maturity of 58.46 days. The cash collateral investments included asset backed securities (34.24% of the pool), certificates of deposit (21.24%), corporate securities (18.31%) and other bank notes (26.21%). As of June 30, 2005, the size of the pool was \$73.5 billion and the weighted average maturity was 39.62 days. Investments included asset backed securities (25.4%), certificates of deposit (21.48%), corporate securities (17.4%), time deposits (10.68%) and other bank notes (25.04%). All of the underlying investments of the System's securities lending cash collateral are held by the counterparty, not in the name of the Plan.

The loaned securities as of June 30, 2006 and 2005 consisted of U.S. Treasury securities, U.S. government agency securities, domestic corporate bonds, domestic equity securities, and international equity securities. In return, the Plan receives collateral in the form of cash or securities equal to 102% for domestic and 105% for international of the transferred securities plus accrued interest for reinvestment.

As of June 30, 2006, the underlying securities loaned by the Plan as a whole amounted to approximately \$421,775,000. The cash collateral and the non-cash collateral totaled \$426,787,000 and \$1,983,000, respectively. As of June 30, 2005, the underlying securities loaned by the Plan as a whole amounted to approximately \$364,547,000. The cash collateral totaled \$369,578,000 and non-cash collateral totaled \$5,063,000. The Plan has no exposure to credit risk related to the securities lending transactions as of June 30, 2006 and 2005.

As of June 30, 2006 the fair value of the collateral provided was 101.7% of the fair value of the investments lent, thus did not meet the Plan's policy of 102% due to daily market fluctuations. However, on July 1, 2006, borrowers delivered \$4.7 million to the Plan's custodian to bring the fair value of collateral to 102% of the fair value of investments lent.

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*NOTE 4 – SECURITIES LENDING PROGRAM *Continued*

SECURITIES LENDING – INVESTMENT AND COLLATERAL RECEIVED (AT FAIR VALUE) (Dollars in Thousands)

TYPE OF INVESTMENT LENT	2006	2005
For Cash Collateral		
Domestic corporate bonds	\$ 11,622	\$ 11,173
Domestic equity securities	175,866	91,403
U.S. government agency securities	4,820	3,601
U.S. treasury securities	162,276	184,666
International equity securities	65,227	68,740
Total Lent for Cash Collateral	419,811	359,583
For Non-Cash Collateral		
Domestic equity securities	7	28
U.S. treasury securities	1,957	4,936
Total Lent for Non-Cash Collateral	1,964	4,964
Total Securities Lent	\$ 421,775	\$ 364,547

TYPE OF COLLATERAL RECEIVED	2006	2005
Cash Collateral	\$ 426,787	\$ 369,578
Non-cash Collateral		
For lent domestic equity securities	7	30
For lent US treasury securities	1,976	5,033
Total Non-cash collateral	1,983	5,063
Total Collateral Received	\$ 428,770	\$ 374,641

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 5 – CONTRIBUTIONS - FUNDING POLICY

Pursuant to San José Municipal Code 3.36.1520, the Police and Fire Retirement Plan Board of Administration is authorized to determine the amount of monthly or bi-weekly contributions. 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 pages 41 and 42).

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 10 years.

The City and the participating employee contribution rates in effect during the fiscal years ended June 30, 2006 and 2005 were as follows:

Period	CITY		EMPLOYEE	
	Pension	Healthcare	Pension	Healthcare
7/03/05–6/30/06	21.77 %	3.27 %	8.27 %	2.89 %
7/04/04–7/02/05	21.32 %	3.27 %	8.27 %	2.89 %
7/01/04–7/03/04	12.01 %	2.21 %	8.44 %	1.81 %

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 Plan'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 Plan has not yet determined the full effect that Statement No. 43 will have on its financial statements.

- Members will receive a monthly allowance for a service-retirement consisting of final compensation multiplied by 2.5% for the first 20 years of service and by 4% for the next 10 years of service (maximum benefit, 90% of final average salary).
- Members will receive a monthly allowance for a service-connected disability consisting of final compensation multiplied by 50% plus 4% for each year in excess of 20 years of service (maximum benefit, 90% of final average salary).
- Members with more than 20 years of service will receive a monthly allowance for a non-service-connected disability consisting of final compensation multiplied by 50% plus 4% for each year in excess 20 years of service (maximum benefit, 90% of final average salary).

NOTE 7 – SUBSEQUENT EVENTS

CONTINGENCY

The Memorandum of Agreement ("MOA") for both the International Association of Fire Fighters Local 230 ("Local 230") and the Police Officers Association ("POA") for retirement benefits expired June 30, 2004. The POA signed a new MOA in December 2005 with the following changes to be effective July 1, 2006:

The new MOA with Local 230 is still pending and has now gone to arbitration. The POA also has a re-opener provision in their new MOA in the event that the City and Local 230 enter into an agreement covering the term of the POA MOA which includes superior enhanced retirement benefits.

ACTUARIAL VALUATION (Unaudited)

The Plan completed a new actuarial valuation in 2005 and the rates were adopted effective July 2, 2006. The new rates increase the contribution from the City from 25.04% to

NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

NOTE 7 – SUBSEQUENT EVENTS *Continued*

25.22% and for the employees the rate increases from 11.16% to 11.26%. Funding status of the Plan was reduced from 100.2% to 97.8%. The POA increase in benefits discussed above under "Contingency" will increase the actuarial liability of the Police and Fire Plan, but the increased liability has not been included in the actuarial report as of June 20, 2005.

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS - DEFINED BENEFIT PENSION PLAN

(Unaudited)

Funding Progress-GASB No. 25

Actuarial Valuation Date	Actuarial Value of Assets (1) (a)	Entry Age Actuarial Accrued Liability (AAL) (2) (b)	Over Funded AAL (OAAL) (a-b)	Funded Ratio (a/b)	Annual Covered Payroll (3) (c)	OAAL as a Percentage of Covered Payroll ((a-b)/c)
6/30/97 (4)	\$1,124,294,000	\$1,030,168,000	\$94,126,000	109.1%	\$129,850,000	72%
6/30/99 (5)	\$1,440,117,000	\$1,276,364,000	\$163,753,000	112.8%	\$144,125,000	114%
6/30/01 (6)	\$1,713,812,000	\$1,492,732,000	\$221,080,000	114.8%	\$171,779,000	129%
6/30/03	\$1,826,287,000	\$1,823,200,000	\$3,087,000	100.2%	\$202,222,000	2%

(1) Excludes accounts payable and postemployment healthcare plan assets.

(2) Excludes postemployment healthcare liability.

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

(4) After reflection of the Arbitrator Decision to improve Retirement and Health Benefits in 1998, to include involuntary overtime pay as pensionable salary.

(5) After reflection of benefit improvements effective February 4, 2000.

(6) After reflection of adoption of SRBR program.

Actuarial valuations have been performed biennially through June 30, 2003.

REQUIRED SUPPLEMENTARY INFORMATION *Continued*

SCHEDULE OF ACTUARIAL METHODS AND ASSUMPTIONS

(Unaudited)

For Fiscal Year Ended June 30, 2006

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	14 years, closed
Actuarial asset valuation method	5 year smoothed market
Actuarial assumptions:	
Assumed rate of return on investments	8% per annum
Postretirement mortality	The 1994 Male Group Annuity Mortality Table, with four-year setback, is used for male members. The 1994 Female Group Annuity Mortality Table with one year set forward, is used for female members.
Active service, withdrawal, death, disability service retirement	Based upon the June 30, 2003 Experience Analysis
Salary increases	10.10% for employees for the first five years of service; graded increases thereafter ranging from 9.8% at age 25 to 4.7% at ages 60 and over. Of the total salary increases of 4.50%, 3% is for inflation and 1.5% is real across-the-board salary increase.
Cost-of-living adjustments	3.00% a year

REQUIRED SUPPLEMENTARY INFORMATION *Continued***SCHEDULE OF EMPLOYER CONTRIBUTIONS - DEFINED BENEFIT PENSION PLAN**

(Unaudited)

(Dollars In Thousands)

Fiscal Year Ended June 30,	Annual Required Employer Contributions	Percentage Contributed
2001	\$ 22,157	100%
2002	23,748	100%
2003	23,511	100%
2004	24,412	100%
2005	41,835	100%
2006	43,473	100%

OTHER SUPPLEMENTARY INFORMATION

COMBINING SCHEDULE OF DEFINED BENEFIT PENSION PLAN NET ASSETS

June 30, 2006

<i>(Dollars in Thousands)</i>	Retirement Fund	Cost-of-Living Fund	Total
ASSETS:			
Receivables:			
Employee contributions	\$ 447	\$ 180	\$ 627
Employer contributions	1,246	594	1,840
Brokers and others	88,500	36,604	125,104
Accrued investment income	4,759	1,960	6,719
Total receivables	94,952	39,338	134,290
Investments, at fair value:			
<i>Securities and other</i>			
U.S. Treasury notes and bonds	138,427	57,147	195,574
U.S. government agency securities	121,134	50,008	171,142
International government bonds	19,741	8,150	27,891
Domestic corporate bonds	133,258	55,013	188,271
International corporate bonds	8,910	3,678	12,588
Domestic equity securities	609,339	251,555	860,894
International equity securities	466,266	192,489	658,755
Private equity	7,392	3,052	10,444
State and local obligations	1,059	436	1,495
Forward international currency contracts	(6)	(2)	(8)
Collective short-term investment funds	48,566	20,050	68,616
Real estate	128,154	52,906	181,060
Securities lending cash collateral investment pool	296,696	122,694	419,390
Total investments	1,978,936	817,176	2,796,112
Total assets	2,073,888	856,514	2,930,402
LIABILITIES:			
Payable to brokers	165,815	68,570	234,385
Securities lending collateral due to borrowers	296,696	122,694	419,390
Other liabilities	4,574	1,533	6,107
Total liabilities	467,085	192,797	659,882
Plan net assets held in trust for pension benefits	\$ 1,606,803	\$ 663,717	\$ 2,270,520

OTHER SUPPLEMENTARY INFORMATION *Continued*

COMBINING SCHEDULE OF CHANGES IN DEFINED BENEFIT PENSION PLAN NET ASSETS

For the Fiscal Year Ended June 30, 2006

<i>(Dollars in Thousands)</i>	Retirement Fund	Cost-of-Living Fund	Total
ADDITIONS:			
Contributions:			
Employee	\$ 11,722	\$ 4,710	\$ 16,432
Employer	29,431	14,042	43,473
Total contributions	41,153	18,752	59,905
Investment income:			
Net appreciation in fair value of investments	125,700	53,196	178,896
Interest income	20,646	8,508	29,154
Dividend income	15,973	6,574	22,547
Net rental income	5,576	2,223	7,799
Less investment expense	(6,573)	(2,616)	(9,189)
Net investment income before securities lending income	161,322	67,885	229,207
Securities lending income:			
Earnings	10,744	4,417	15,161
Rebates	(9,714)	(3,994)	(13,708)
Fees	(309)	(126)	(435)
Net securities lending income	721	297	1,018
Total investment income	162,043	68,182	230,225
Total additions	203,196	86,934	290,130
DEDUCTIONS:			
Retirement benefits	59,730	15,459	75,189
Death benefits	2,856	1,947	4,803
Refund of contributions	112	32	144
Administrative expenses and other	1,706	465	2,171
Total deductions	64,404	17,903	82,307
Net increase	138,792	69,031	207,823
PLAN NET ASSETS HELD IN TRUST FOR PENSION BENEFITS:			
Beginning of year	1,468,011	594,686	2,062,697
End of year	\$ 1,606,803	\$ 663,717	\$ 2,270,520

OTHER SUPPLEMENTARY INFORMATION *Continued***SCHEDULES OF ADMINISTRATIVE EXPENSES AND OTHER***For the Fiscal Years Ended June 30, 2006 and 2005*

	2006			2005	
	Original Budget	Actual	Variance Positive (Negative)	Actual	
<i>(Dollars in Thousands)</i>					
Personal services	\$ 1,326,755	\$ 1,285,532	\$ 41,223	\$ 1,031,764	
Non-personal/equipment	639,500	522,842	116,658	429,184	
Professional services	501,000	404,134	96,866	189,639	
Total administrative expenses and other	\$ 2,467,255	\$ 2,212,508	\$ 254,747	\$ 1,650,587	

OTHER SUPPLEMENTARY INFORMATION *Continued*

SCHEDULES OF INVESTMENT EXPENSES

For the Fiscal Years Ended June 30, 2006 and 2005

	2006	2005
Equity:		
Domestic equity	\$ 2,913,250	\$ 2,718,443
International equity	2,592,530	2,148,497
Emerging market equity managers	1,223,765	1,105,391
Total equity	6,729,545	5,972,331
Fixed income:		
Domestic fixed income	851,824	936,783
Global fixed income	349,693	367,833
Long duration fixed income	230,117	119,869
Total fixed income	1,431,634	1,424,485
Real Estate:	440,556	143,736
Total investment managers' fees	8,601,735	7,540,552
Other investment service fees:		
Investment consultant	95,000	120,000
Proxy voting	24,400	16,594
Real estate legal fees	232,520	131,220
Real estate appraisals	53,100	-
Custodian	348,104	208,806
Total other investment service fees	753,124	476,620
TOTAL INVESTMENT EXPENSES	\$ 9,354,859	\$ 8,017,172

OTHER SUPPLEMENTARY INFORMATION *Continued***SCHEDULES OF PAYMENTS TO CONSULTANTS***For the Fiscal Years Ended June 30, 2006 and 2005*

Firm	Nature of Service	2006	2005
Avery, William & Associate	Human Resource Consultant	\$ 12,200	\$ -
Levi, Ray, & Shoup	Web Development	15,323	17,223
Levi, Ray, & Shoup	Document Imaging and Support and Maintenance	7,500	3,125
Macias Gini & O'Connell LLP	External Auditors	31,380	24,332
Medical Director/Other Medical	Medical Consultant	93,016	91,529
Pension Benefit Information	Reports on Deceased Benefit Recipients	2,261	1,967
Saltzman & Johnson	Legal Counsel	43,116	27,068
CPS Human Resources	Human Resource Consultant	-	(2,026)
Mercer Human Resources	Actuarial Consultant	84,338	26,421
Towers, Perrin, Forster & Crosby, Inc.	Disability Procedure Audit	115,000	-
Total		\$ 404,134	\$ 189,639



INVESTMENT SECTION

REPORT ON INVESTMENT ACTIVITY

MERCER

Investment Consulting

REPORT ON INVESTMENT ACTIVITY

Mercer Investment Consulting
777 South Figueroa Street, Suite 2000
Los Angeles, CA 90017-5818

213.346.2200 phone
213.346.2680 fax
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August 2, 2006

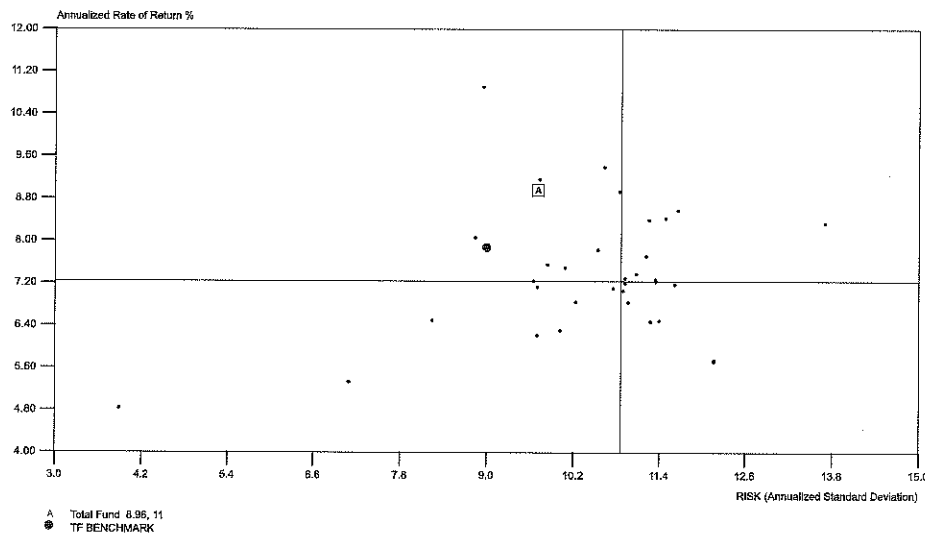
Mr. Edward Overton
Secretary, Board of Administration
San José Police and Fire Retirement System
1737 North First Street, Suite 580
San Jose, CA 95112-4505

Dear Mr. Overton:

During the Plan's fiscal year ending June 30, 2006, the San José Police and Fire Retirement System's investment return was up 14.3%. When compared with the TUCS Public Fund Universe, the return placed in the **0 percentile, which is literally off the chart**. The median return for the public plan universe was 9.4%. It is also important to note that the 14.3% annual return is significantly higher than the actuarial earnings assumption of 8%. A time weighted total return for the Plan's assets is calculated every quarter by Mercer Investment Consulting.

The Trustees maintain a conservative investment strategy which has produced remarkably higher returns over the past five years (with less risk) than the vast majority of public plans of similar size. **The five year return was also at the top of the universe placing in the 0 percentile!** The following five year graph shows the return and risk characteristics of the Plan compared to its peer universe.

Total Funds Billion Dollar – Public
Risk-Return Comparisons / 5 Years Ending June 30, 2006



REPORT ON INVESTMENT ACTIVITY *Continued***MERCER**

Investment Consulting

Page 2

August 2, 2006

Mr. Edward Overton

San José Police and Fire Retirement System

Mercer calculates and reviews the investment performance based on custodial statements in compliance with Association for Investment Management and Research (AIMR) standards. Mercer also reconciles performance calculations with the Plan's investment managers each quarter to ensure accuracy. Economic updates are reviewed with the Trustees each quarter to keep them informed of global and domestic developments.

The U.S. economy continues to be impacted by higher oil prices. Core inflation is beginning to be a concern but not yet alarming. Two global developments have exacerbated inflation concerns. Obviously the unrest in the Middle East has led to higher oil prices. Secondarily, but no less significant, is the economic growth in China. As infrastructure and manufacturing expansion has continued in China, their competitive purchasing of commodities has led to higher prices. Consequently, inflation in the US has begun to increase.

The US economy continues to grow, albeit slowly, which may result in lower earnings over the next fiscal year. Investment returns in the first half of calendar year 2006 have been weak. The Federal Reserve raised short term rates twice this year and long term rates increased slightly. The possibility of a recession developing still appears to be remote. We remain optimistic that the next fiscal year will continue to produce competitive returns.

Respectfully submitted,



Thomas J. Lightvoet

STATEMENT OF INVESTMENT POLICY

GENERAL ENVIRONMENT

Investments in the San José Police and Fire Department Retirement Plan are subject to the restrictions specified in the San José Municipal Code 3.36.540. Further investment management guidelines are imposed by the Board of Administration.

INVESTMENT GUIDELINES

General

The Board Shall:

- (1) Require that the Retirement System be actuarially sound to assure that all disbursement obligations will be met.
- (2) Attempt to insure that 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 invested funds consistent with safety in accordance with accepted investment practices.
- (4) Have the authority to grant specific exceptions to any part of the Investment Policy Statement where in their judgment the exception may add value to the fund without undue risk.

Asset Allocation

The following policy has been identified by the Board of Administration 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 Plan to invest its assets in accordance with the maximum and minimum range, valued at market, for each asset class as stated below:

ASSET ALLOCATION OF INVESTMENT PLAN

<i>Asset Class</i>	<i>Minimum</i>	<i>Target</i>	<i>Maximum</i>
Domestic Equity	29%	34%	39%
International Equity	10%	20%	25%
Emerging Market Equity	0%	5%	8%
Domestic Fixed Income	15%	20%	25%
Long Duration Fixed Income	0%	4%	7%
Real Estate	0%	12%	17%
Private Market Equity	0%	5%	8%

The following chart illustrates the targets and ranges set for the secondary asset class, Domestic Equities.

SECONDARY TARGETS, DOMESTIC EQUITIES

<i>Asset Class</i>	<i>As a % of Domestic Equity Portfolio</i>	<i>Allowable Variation from the % of the Equity Portfolio</i>	<i>As an Equivalent % of the Total Portfolio</i>
Index Fund	26%	+/- 3.0%	9.0%
Large Cap Value	30%	+/- 3.5%	10.0%
Large Cap Growth	30%	+/- 3.5%	10.0%
Small Cap Value	7%	+/- 1.5%	2.5%
Small Cap Growth	7%	+/- 1.5%	2.5%

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 Plan.

STATEMENT OF INVESTMENT POLICY *Continued*

The general guideline for re-balancing the portfolio would be 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.

It is understood that the Fund managers at any point in time may not be fully invested. However, managers are expected to be fully funded, and cash positions in excess of 7% require the manager to notify the Board of Administration in writing. While the Plan's assets may be partially invested in cash equivalents, for asset allocation purposes these funds shall be considered invested in the asset classes of the respective managers. In turn, each manager's performance will be evaluated on the total amount of funds under the manager's management.

The asset allocation ranges established by this investment policy represent the long-term perspective. As such, rapid unanticipated market shifts may cause the asset mix to fall outside the policy range. Any divergence should be of a short-term nature. The Board of Administration will review the asset mix of the Plan on a quarterly basis and cause the asset mix to be rebalanced to within the policy range as necessary.

Investment managers may request temporary exemptions from guideline limits by submitting written requests to the Board of Administration for prior approval. For special situations, the Board of Administration can grant special exemptions from the guidelines. In no case can a manager actively exceed guideline limits without formal prior approval by the Board.

Diversification

Investment diversification is consistent with the intent to minimize the risk of large losses to the Plan. Consequently, the total Fund will be constructed by the individual portfolio managers to attain prudent diversification in several asset classes. To ensure adequate diversification, no manager will hold more than 5% of the manager's portion of the total Plan assets in any single security with the exception of government backed securities and real estate equity. As a general rule, Plan assets placed with an investment manager will not represent more than 10% of that manager's total assets.

Volatility

Consistent with the desire for adequate diversification, the investment policy is based on the assumption that the volatility (the standard deviation of returns) of the portfolio will be relative to that of the market. Consequently, it is expected that the volatility of a commitment-weighted composite of the market indices, e.g., S&P 500 Index for stocks and Lehman Brothers Aggregate Bond Index for bonds and U.S. T-Bills for cash, will be commensurate with the Plan's volatility.

Liquidity

Presently there is not a requirement to maintain significant liquid reserves for the payment of pension benefits. The Board has authorized the Board of Administration Secretary to review the projected cash flow requirements at least annually and indicate to investment managers the required liquidity.

Contributions are expected to be in excess of net benefit payments over the foreseeable future, resulting in a positive cash flow, which will be reinvested by the Fund manager who receives the cash flow.

Fixed Income

The Board shall require that the majority of the fixed income portfolio be invested in high quality, (investment grade) marketable bonds as provided in Section 3.36.540. Whether a global fixed income manager is employed, or separate domestic and international fixed income managers are employed, the manager(s) is (are) to invest in accordance with the following guidelines (please refer to section entitled INVESTMENT GUIDELINES, General (4) for exception policy):

- (1) Portfolio investments will be composed primarily of fixed income securities (including short-term obligations) denominated in either United States or foreign currencies. Securities may be issued by domestic or foreign governments, domestic or foreign government agencies and instrumentalities, international banks or other international organizations, corporations or other forms of business organizations.
- (2) The investment manager may also purchase securities of other categories. These investments may be used within prudent limits to manage risk, lower transaction costs, or augment returns as long as leverage is not applied. The manager will invest the assets at such times, in such amounts and in such investments as the manager shall determine in its discretion.

STATEMENT OF INVESTMENT POLICY *Continued*

Fixed Income *Continued*

- 3) Deposits in banks or banking institutions, domestic or foreign, may be made. Because the fundamental objective is to enhance the rate of return calculated in U.S. dollars, and currency exchange gains and losses are included in the calculation of total return, currency hedging shall be permitted, at the discretion of the manager, to protect the value of specific investments in U.S. dollar terms.
- (4) All bonds and notes in which the assets are invested, and which mature one year or more from the date of original issues, shall carry a rating of "BBB" or better by two of the following three rating services: Standard & Poors, Moodys Investor Services, or 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; or, if unrated, shall be of equivalent quality in the judgment of the investment manager to a similar domestic issue. Managers may, with prior written authorization, invest a maximum of 20% of their fixed income portfolio in bonds or notes that are rated B or BB.
- (5) 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. The Manager will continue to notify staff of the downgrade and confer with staff as to whether the security will continue to be held or disposed. The Manager will also provide quarterly reporting on the downgraded securities.
- (6) The fund will be valued in United States dollars on the last business day of each month, and on such other "Valuation Dates" as the Board may deem appropriate. For valuation purposes, all foreign currency, foreign deposits and securities quoted in foreign currencies shall be converted into dollars pursuant to methods consistently followed and uniformly applied.
- (7) The manager may invest a portion of the assets in commingled accounts with specific mandates such as high yield trust funds with prior approval by the Board. The average credit quality of the commingled account shall be a "B" or better rating.

Domestic Common Stock

The primary emphasis of the common stock portfolio will be on high quality, readily marketable securities offering potential for above average return as protection against inflation. Common stock investments are limited to those meeting all of the following criteria (please refer to section entitled INVESTMENT GUIDELINES, General (4) for exception policy):

- (1) Investment in any corporation shall not exceed 5% of the outstanding shares of the corporation.
- (2) Not more than 5% of the total assets at market may be invested in preferred stocks.
- (3) Not more than 5% of any Investment Manager's portfolio at market shall be invested in the common stock of any corporation, except when:
 - The security has a weighting greater than 5% in the manager's benchmark and
 - The manager has received prior written permission from the Director, Retirement Services. The Director will then inform the Investment Committee of any exceptions that were granted.
- (4) The manager will invest the assets at such times, in such amounts and in such investments as the manager shall determine in its discretion.

International Common Stock

The following are guidelines for International Equity portfolios (please refer to section entitled INVESTMENT GUIDELINES, General (4) for exception policy):

Developed Markets

- (1) The portfolio will be invested primarily in non-U.S. common stocks. Investment in American Depositary Receipts (ADR's) is permitted but they will not be considered U.S. equities. U.S. equities are not permitted. The maximum amount of developed markets international common stock to be held is 20% of the Fund's total assets valued at market. The Board will cause the asset mix to be rebalanced to remain within the 20% restriction. A maximum of 20% of a manager's international equity portfolio may be invested in emerging markets.

STATEMENT OF INVESTMENT POLICY *Continued*

- (2) Holding cash or cash equivalents, either U.S. or non-U.S., for the purpose of protecting the portfolio against perceived adverse equity market conditions abroad, will not be permitted. However, while the manager is expected to remain fully invested over time, cash and cash equivalent holdings will be permitted up to maximum of 7% of the manager's portfolio for the purpose of making country and security adjustments to the portfolio.
- (3) To ensure proper diversification, the fund will be invested in a wide variety of economic sectors and countries. No one equity position will represent more than a total of 5% of the portfolio.

Emerging Markets

- (1) The portfolio will be invested in non-U.S. common stocks. Investment in American Depositary Receipts (ADR's) is permitted but they will not be considered U.S. equities. U.S. equities are not permitted. The maximum amount of emerging international common stock to be held is 8% of the Fund's total assets valued at market. The Board will cause the asset mix to be rebalanced to remain within the 8% restriction.
- (2) Holding cash or cash equivalents, either U.S. or non-U.S., for the purpose of protecting the portfolio against perceived adverse equity market conditions abroad, will not be permitted. However, while the manager is expected to remain fully invested over time, cash and cash equivalent holdings will be permitted up to maximum of 7% of the manager's portfolio for the purpose of making country and security adjustments to the portfolio.
- (3) To ensure proper diversification, the fund will be invested in a wide variety of economic sectors and countries. No one equity position will represent more than a total of 5% of the portfolio, except when:
 - The security has a weighting greater than 5% in the manager's benchmark and the manager has received prior written permission from the Director, Retirement Services. The Director will then inform the Investment Committee of any exceptions that were granted.

Real Estate

The Board may elect to invest in commercial, industrial, and residential real estate or real estate related debt instruments provided that:

- (1) The real estate is defined as any real property within the United States improved by multifamily dwelling, industrial or commercial buildings.
- (2) Real estate related debt instruments shall be defined as first mortgages.
- (3) The fund shall at no time:
 - (a) Invest directly or indirectly more than 25% of the fund's assets, valued at market, in real estate investment as defined hereinabove; nor,
 - (b) Invest directly or indirectly more than 5% of the fund's assets, valued at market, in any one property, project, or debt instrument regardless of the manner of investment.
- (4) The investment advisors employed by the Board to assist in the location and acquisition of real estate must bring their proposal to the Board for approval.

(Please refer to section entitled INVESTMENT GUIDELINES, General (4) for exception policy.)

Private Equity

Subject to specific approval of the Investment Committee of the Board of Administration, investments may be made for the purpose of creating a diversified portfolio of private markets. Examples of such private markets investments include, but are not limited to, venture capital partnerships, leveraged buyout funds, private debt, and private placements. While it is expected that the majority of these assets will be invested within the United States, a portion can be allocated to non-US investments, with a primary focus on Europe. Investments may be made in secondary investments on an opportunistic basis (please refer to section entitled INVESTMENT GUIDELINES, General (4) for exception policy).

STATEMENT OF INVESTMENT POLICY *Continued*

Private Equity *Continued*

It is expected that these investments will typically be structured through the use of Fund of Funds managers. Therefore, it is possible that those managers would engage in direct investments or co-investments, in which the Plan would purchase majority control in individual corporate entities.

Funds that are committed, but not yet drawn down, may be invested in the Plan's small cap equity funds, as the risk/reward characteristics of these funds most closely match those of Private Equities.

The following sub-category allocations were derived to be consistent with the investable universe within private markets. The ranges reflect long-term averages, once the 5% allocation to Private Equities has been fully committed. During the initial investment period, approximately four to six years, it is expected that sub-category allocations may fall outside the approved ranges.

<i>Sub-Category*</i>	<i>Minimum</i>	<i>Target</i>	<i>Maximum</i>
Buyouts	40%	60%	70%
Venture Capital	20%	30%	50%
Debt-Related	0%	10%	20%

** International allocations and secondary investments are reflected within each sub-category.*

Derivatives

Exposure to economic risk through the use of derivatives must be consistent with the Plan's overall investment policy, as well as its individual manager specific investment guidelines. Investment managers are not authorized to use derivative securities, or strategies, that do not comply with the Plan's basic objective of achieving the highest return on investment funds, consistent with safety, and in accordance with accepted investment practices.

Managers are specifically prohibited from using derivative or synthetic securities that expose the Plan to potentially high price volatility or are either speculative or leveraged, or whose marketability may become severely limited.

Generally, the Plan allows for the following uses of derivatives:

- Equity and Bond index futures contracts are permitted.
- An international manager may defensively hedge currency as a part of the investment management and risk reduction process and as described in the section pertaining to the international equity and fixed income managers. Currency forward or futures contracts may be used in this process.
- New York Stock Exchange listed American Depository Receipts (ADRs) may be used by the domestic equity managers for up to 10 % of the portfolio investments at cost. The international equity manager may use ADRs in place of the foreign securities when their research indicates the ADR issues are more attractively valued.
- The fixed income investment managers may hold derivative securities known as Collateralized Mortgage Obligations (CMOs) collateralized by GNMA, FNMA, FHLMC mortgage-backed instruments. The CMOs must possess price risk characteristics consistent with, or superior to, the risk characteristics of the underlying conventional mortgage pass-through securities. Fixed income managers may also purchase securities of other categories, including options and financial futures contracts traded over-the-counter or on organized securities exchanges. Offsetting cash positions must be maintained against all delayed settlement transactions.
- Derivative securities should not be utilized by portfolio managers to materially increase a portfolio's duration or leverage as characterized by its stated investment style. Managers must be granted specific written authorization from the Plan in order to implement applications of derivative instruments not listed above.

Mini-Tender Offers

Mini-Tender offers are tender offers for less than five percent of a company's stock. As a fiduciary, a manager will deal with mini-tender offers with the diligence and good faith expected for any investment decision. A manager may participate in mini-tender offers with the agreement that any negligent actions related to mini-tender offers will be subject to indemnification of losses by the manager.

STATEMENT OF INVESTMENT POLICY *Continued*

Credit Unions

No retirement fund assets shall be deposited in any such institution in excess of an amount insured by an agency of the Federal Government, and shall be made only if the rate of return and degree of safety offered are competitive with other investment opportunities.

Manager Discretion

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 Plan assets without prior written approval by the Board.

Subject to these guidelines and policies, the Fund's Investment Managers have full discretion to sell, substantiate, redeem or convert securities, as they deem advisable. It is the intention of the Board to contract with an independent agency to vote domestic equity proxies according to the plan proxy voting guidelines. However, international equity proxies are to be voted by the investment managers or any agent or service selected by the investment manager.

With the consent of the Board, compliance with the foregoing guidelines may be waived, either with respect to a specific transaction or transactions, or generally. The Board will, in addition, consult with the investment manager from time to time, at the investment manager's request, as to the continuing applicability of the guidelines and whether amendments may be appropriate.

Performance Goals

In order to insure that investment opportunities available over a specific time period are fairly evaluated, the Board of Administration will utilize comparative performance statistics to evaluate investment results. Accordingly, each investment manager is expected to achieve the following minimum performance standards over a rolling five year time period or a full market cycle.

Domestic Equity Managers

- (1) Performance within the top half of the appropriate Mercer's Equity Style Universe.
- (2) Net of fees, manager performance shall exceed the return of the appropriate benchmark by the following:
100 basis points for large-cap equity managers,
150 basis points for mid-cap equity managers, and
200 basis points for small-cap equity managers.
- (3) The risk associated with the manager's portfolio as measured by the variability of quarterly returns (standard deviation) must not exceed that of the manager's benchmark index without a corresponding increase in performance above that index.

Domestic Fixed Income Managers

- (1) Performance within the top half of Mercer's Bond Funds Universe.
- (2) Net of fees, manager performance shall exceed by 50 basis points, the return of the Lehman Brothers Aggregate Bond Index.
- (3) The risk associated with the manager's portfolio as measured by the variability of quarterly returns (standard deviation) must not exceed that of the Lehman Brothers Aggregate Bond Index without a corresponding increase in performance above the index.

STATEMENT OF INVESTMENT POLICY *Continued*

Performance Goals *Continued*

International Equity Managers

DEVELOPED MARKETS

- (1) Performance within the top half of Mercer's International Equity Fund Universe.
- (2) Net of fees, manager performance shall exceed by 150 basis points, the return of the Morgan Stanley EAFE Index for international equity managers.
- (3) The risk associated with the manager's portfolio as measured by the variability of quarterly returns (standard deviation) must not exceed that of the MSCI EAFE Index without a corresponding increase in performance above the index.

EMERGING MARKETS

- (1) Performance within the top half of Mercer's Emerging Markets Equity Peer Group.
- (2) Net of fees, manager performance shall exceed by 200 basis points, the return of the MSCI Emerging Market Free Index for emerging markets managers.
- (3) The risk associated with the manager's portfolio as measured by the variability of quarterly returns (standard deviation) must not exceed that of the MSCI EMF Index without a corresponding increase in performance above the index.

International Fixed Income Managers

- (1) Performance above median in Mercer's International Bond Fund Universe.
- (2) Net of fees, manager performance shall exceed by 75 basis points, the return of the Citigroup World Government Bond Index.
- (3) The risk associated with the manager's portfolio as measured by the variability of quarterly returns (standard deviation) must not exceed that of the Citigroup World Government Bond Index without a corresponding increase in performance above the index.

Real Estate Managers

- (1) Performance above median in Mercer's Real Estate Funds Universe.
- (2) Net of fees, manager performance shall exceed by 150 basis points, the return of the National Counsel of Real Estate Investment Fiduciaries (NCREIF) Classic Property Index or the NCREIF Classic Property Pacific Index for the portfolio with the majority of properties in California.
- (3) The risk associated with the manager's portfolio must not exceed that of the NCREIF or NCREIF Pacific Index without a corresponding increase in performance above the index.

Private Equity

The Private Equities portfolio is an illiquid investment with a five to ten year investment horizon. The return expectation for Private Equity managers is S&P 500 Index plus 300 basis points over time.

STATEMENT OF INVESTMENT POLICY *Continued*

Periodic Reviews of Manager Performance

The performance of each manager will be reviewed versus its benchmark every quarter. These benchmarks consist of both asset class indexes and peer group universes. Each manager's performance should exceed their passive index benchmark and each manager should be above the median of an appropriate universe.

As good managers will occasionally have poor performance for several periods, there is some grace period permitted for performance to improve. Conversely, the performance will be reviewed with sufficient frequency to permit identification of substandard performance as quickly as possible.

Procedure:

1. Each manager is expected to produce performance equal to or better than their benchmark index for one year, three year, and five year cumulative periods.

Managers are considered to achieve this objective if their performance exceeds their benchmark for two of the three periods of one year or longer.

2. The expectation to produce above median performance in an appropriate peer group for one year, three year, and five year cumulative periods will be factored in only when the majority of investment managers are underperforming the benchmark.

Managers are considered to achieve this objective if they rank above the median manager for two of the three periods of one year or longer and the performance in the third period is not less than the 62nd percentile.

3. If a manager has less than five years performance, we will review the periods reported by the consultant, such as one quarter, one year and since inception. However, no action will be taken for placement on the watch list until two years after inception date.

4. If there is a failure to meet the performance objective, the following rules should be applied:

- a) A manager's (with at least two years of performance since inception) failure to meet their objective for four successive quarters will place the manager on the watch list. If a manager is consistently on the borderline, sometimes meeting objectives and sometimes failing to meet objectives, the manager may be placed on the watch list.
- c) During the next four quarters, the manager's performance will be closely monitored to see if it is warranted for the manager to be placed on probation.
- d) A manager placement on probation should result in review by the Investment Committee. Upon a critical review of the manager, the Investment Committee may grant up to one year further for improvement to take place upon officially recognizing the substandard performance and explicitly granting an extension of time for improvement. At the time of granting such extraordinary extension, the Investment Committee may delegate to the Director, Retirement Services, the authority to direct the manager to immediately suspend all trading except as specifically directed by the Director. If there has been improvement in performance, the Investment Committee may extend the probation beyond one year.

During the period of any such extraordinary extension, the investment staff should monitor the portfolio and transactions of such manager to ensure that excessive risk is not being taken in an attempt to "catch up". If in the judgment of the Director, such manager is managing the portfolio in such a manner that indicates that excessive risk is being taken, the Director should use the previously delegated authority to terminate or restrict the manager's activities.

5. In order to be taken off probation and placed on the watch list, a manager must beat their benchmark for 2 successive quarters (i.e. March and June) OR beat their benchmark at one-year following four quarters of good performance.
6. In order to be taken off the watch list, a manager must beat their benchmark for an additional 2 successive quarters (i.e. September and December) OR have an additional four quarters of good performance.

STATEMENT OF INVESTMENT POLICY *Continued*

Extraordinary Reviews of Managers

If an event occurs within a manager's organization that is likely to impact the manager's organization, the Director, Retirement Services, shall make a determination whether such event compromises the investment process or in any other manner might negatively impact the management of the Plan's assets.

Such events would include but are not limited to:

- a) Loss of any significant investment professional directly involved with the management of Plan assets or of such significance to the manager's overall investment process as to call into question the future efficacy of that process.
- b) Sale, offer for sale, or offer to purchase the manager's business to/by another entity.
- c) Significant financial difficulty or loss of a sizable portion of the manager's assets under management.
- d) Filing or announcement of regulatory action of non-trivial nature, particularly that involving violations of the Investment Advisers Act of 1940, the Securities Act of 1933, or the Securities Exchange Act of 1934, or any state Blue Sky Law to which the manager is subject.
- e) Any other event which in the discretion of the Director appear to put the Fund's assets at risk of loss, either actual or opportunity.

Any of these events may trigger a due diligence visit to the firm by the Investment Committee, being placed on the watch list, being put on probation or termination depending on the seriousness of the event and the probability of impacting the management of the Plan's assets.

INVESTMENT PROFESSIONALS

Investment Managers

Domestic Equities:

Boston Partners Asset Management
Large Cap Value
Los Angeles, CA

Globalt, Inc.
Large Cap Growth
Atlanta, GA

INTECH
Large Cap Growth
Princeton, NJ

New Amsterdam Partners
Large Cap Growth
New York, NY

Provident Investment Counsel, Inc.
Small Cap Growth
Pasadena, CA

Rhumblin Advisors
S&P 500 Index
Small Cap Growth Index
Boston, MA

Trust Company of the West
Small Cap Value
Los Angeles, CA

UBS Global Asset Management
Large Cap Value
Chicago, IL

Private Market Equities:

HarbourVest Partners
Boston, MA

Pantheon Ventures
San Francisco, CA

Portfolio Advisors
Darien, CT

International Equities:

Bank of Ireland Asset Management
Dublin, Ireland

International Equities: Continued

Brandes Investment Partners
San Diego, CA

William Blair & Co.
Chicago, IL

Domestic Fixed Income:

Seix Investment Advisors
Upper Saddle River, NJ

Western Asset Management Company
Pasadena, CA

Income Research & Management
Boston, MA

Global Fixed Income:

Credit Suisse Asset Management
London, England

Real Estate:

MIG Realty Advisors
Cleveland, OH

Kennedy Associates Real Estate Counsel, Inc.
Seattle, WA

Consultant

Mercer Investment Consulting
Los Angeles, CA

Custodian

State Street Bank & Trust Company
Boston, MA

Proxy Voting

Institutional Shareholder Services
Rockville, MD

SCHEDULE OF INVESTMENT RESULTS

GROSS PERFORMANCE SUMMARY BY ASSET CLASS

For Periods Ending June 30, 2006

Source: Mercer Investment Consulting Investment Performance Evaluation Report June 30, 2006.

Basis of Calculation: Time-weighted Rate of Return

	One Year	Three Years	Five Years
TOTAL FUND	14.3%	13.9%	9.0%
Benchmark	12.5%	12.4%	7.9%
Mercer Funds Billion Dollar Public Median	11.9%	13.4%	7.2%
TUCS Public Fund Universe Median	9.4%	11.4%	6.3%
TOTAL DOMESTIC FIXED INCOME	-0.3%	3.4%	5.6%
Lehman Brothers Aggregate Bond Index	-0.8%	2.1%	5.0%
Mercer US Fixed Income Core Median	-0.3%	2.5%	5.4%
	One Quarter	One Year	Inception (01/05)
TOTAL LONG DURATION FIXED INCOME	-1.2%	-6.4%	-0.2%
Lehman Brothers U.S. Gov/Credit-Long Term Index	-1.5%	-6.5%	0.2%
Mercer US Fixed Long Duration Universe Median	-1.3%	-5.9%	
	One Year	Three Years	Five Years
TOTAL GLOBAL FIXED INCOME	-2.3%	3.5%	8.3%
Citigroup World Gov't Bond Index	-0.4%	4.2%	8.5%
Mercer Global Fixed Income Unhedged Median	0.8%	4.8%	9.4%
TOTAL DOMESTIC EQUITY	10.2%	14.3%	5.0%
S&P 500 Index	8.6%	11.2%	2.5%
Mercer US Equity Median	11.8%	15.9%	6.8%
TOTAL INTERNATIONAL EQUITY	27.4%	25.4%	11.1%
MSCI EAFE Net Dividend Index	26.6%	23.9%	10.0%
Mercer International Equity Median	27.8%	24.5%	11.5%
TOTAL INT'L EMERGING MKT EQUITY	32.2%	34.1%	N/A
MSCI Emerging Markets Index	35.9%	34.8%	21.5%
Mercer Emerging Markets Equity Median	37.8%	37.4%	23.3%
TOTAL REAL ESTATE	14.8%	7.5%	7.1%
NCREIF Property Index	20.2%	15.1%	11.7%
Mercer Real Estate Median	21.4%	17.3%	12.6%

SCHEDULE OF INVESTMENT RESULTS *Continued*

NET PERFORMANCE SUMMARY BY INVESTMENT MANAGER

For Periods Ending June 30, 2006

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: Mercer Investment Consulting Investment Performance Evaluation Report June 30, 2006.

Basis of Calculation: Time-weighted Rate of Return

	<i>One Year</i>	<i>Three Years</i>	<i>Five Years</i>
DOMESTIC FIXED INCOME			
Seix Investment Advisors	-0.8%	2.6% +=	4.8%
Lehman Brothers Aggregate Bond Index + 50 bps	-0.3%	2.6%	5.5%
Mercer US Fixed Income Core Median	-0.3%	2.5%	5.4%
	<i>One Year</i>	<i>Three Years</i>	<i>Inception (07/02)</i>
Western Asset Management Company	-0.2% ++	3.8% ++	6.5% +
Lehman Brothers Aggregate Bond Index + 50 bps	-0.3%	2.6%	4.3%
Mercer US Fixed Income Core Median	-0.3%	2.5%	N/A
	<i>One Quarter</i>	<i>One Year</i>	<i>Inception (01/05)</i>
Income Research Management	-1.3% +=	-6.7%	-0.5%
Lehman US Gov/Credit-Long Term Index + 50 bps	-1.4%	-6.0%	0.7%
Mercer US Fixed Long Duration Universe Median	-1.3%	-5.9%	N/A
	<i>One Year</i>	<i>Three Years</i>	<i>Five Years</i>
GLOBAL FIXED INCOME			
Credit Suisse Investment Management	-1.0%	3.7%	8.3%
Citigroup World Gov't Bond Index + 75 bps	0.4%	5.0%	9.2%
Mercer Global Fixed Income Unhedged Median	0.8%	4.8%	9.4%
	<i>One Year</i>	<i>Three Years</i>	<i>Five Years</i>
DOMESTIC EQUITY			
Rhumbline Advisors (Index)	8.6% =	11.1%	2.6% +
S&P 500 Index	8.6%	11.2%	2.5%
Mercer US Equity Median	11.8%	15.9%	6.8%
Boston Partners (Large Cap Value)	14.2% ++	16.0% +	7.0%
Russell 1000 Value Index + 100 bps	13.1%	16.7%	7.9%
Mercer Large Cap Value Universe Median	11.7%	15.4%	7.2%
UBS Global Asset Mgmt (Large Cap Value)	9.5%	13.9% +	7.0% +
Russell 3000 Index + 100 bps	10.6%	13.6%	4.5%
Mercer Large Cap Value Universe Median	11.7%	15.4%	7.2%

SCHEDULE OF INVESTMENT RESULTS *Continued*

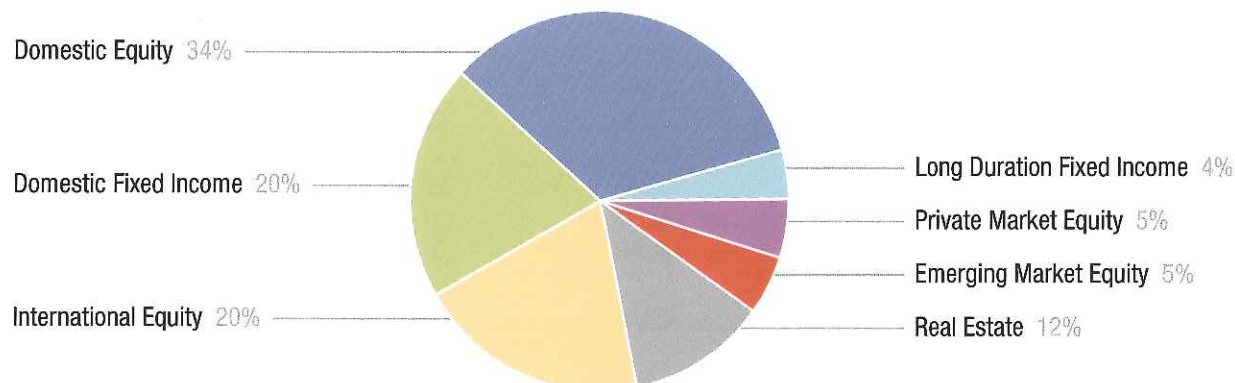
	<i>One Year</i>	<i>Three Years</i>	<i>Five Years</i>
DOMESTIC EQUITY <i>Continued</i>			
New Amsterdam Partners (Large Cap Growth)	6.3%	13.7% ++	5.3% ++
S&P 500 + 100 bps	9.6%	12.2%	3.5%
Mercer Large Cap Growth Universe Median	7.6%	10.2%	0.9%
Globalt, Inc. (Large Cap Growth)	1.2%	8.7%	-1.3%
Russell 1000 Growth Index + 100 bps	6.9%	9.3%	0.2%
Mercer Large Cap Growth Universe Median	7.6%	10.2%	0.9%
	<i>One Quarter</i>	<i>One Year</i>	<i>Inception (10/03)</i>
Intech (Large Cap Growth)	-4.5%	6.6%	11.0% +
Russell 1000 Growth Index + 100 bps	-3.9%	6.9%	8.6%
Mercer Large Cap Growth Universe Median	-4.1%	7.6%	N/A
	<i>One Quarter</i>	<i>One Year</i>	<i>Inception (12/04)</i>
Rhumblin Advisors (Small Cap Core Index)	-5.2%	14.4%	10.4% +
Russell 2000 Index	-5.0%	14.6%	10.1%
Mercer Small Cap Core Universe Median	-4.7%	14.9%	N/A
	<i>One Quarter</i>	<i>One Year</i>	<i>Three Years</i>
TCW (Small Cap Value)	-6.4%	11.5%	15.2%
Russell 2000 Value Index + 200 bps	-4.6%	16.6%	20.7%
Mercer Small Cap Value Universe Median	-3.1%	14.5%	21.6%
	<i>One Year</i>	<i>Three Years</i>	<i>Five Years</i>
Provident Investment Counsel (Small Cap Growth)	13.2%	14.8%	2.1%
Russell 2000 Growth Index + 200 bps	16.6%	18.3%	5.5%
Mercer Small Cap Growth Universe Median	15.1%	17.9%	6.7%
	<i>One Year</i>	<i>Three Years</i>	<i>Five Years</i>
INTERNATIONAL EQUITY			
Bank of Ireland Asset Management	22.5%	19.6%	7.0%
MSCI EAFE Net Dividend Index + 150 bps	28.1%	25.4%	11.5%
Mercer International Equity Median	27.8%	24.5%	11.5%
Brandes Investment Partners	27.7%	27.6% ++	12.8% ++
MSCI EAFE Net Dividend Index + 150 bps	28.1%	25.4%	11.5%
Mercer International Equity Median	27.8%	24.5%	11.5%
	<i>One Quarter</i>	<i>One Year</i>	<i>Three Years</i>
William Blair & Co	-3.4%	27.7%	25.7% +
MSCI AC World Free ex US Index +150bps	0.3%	29.4%	26.8%
Mercer International Equity Median	0.1%	27.8%	24.5%

SCHEDULE OF INVESTMENT RESULTS *Continued*

	<i>One Quarter</i>	<i>One Year</i>	<i>Three Years</i>
INTERNATIONAL EMERGING MARKETS EQUITY			
Alliance Capital Management	-6.2%	32.5%	34.1%
MSCI Emerging Markets Free Index + 200 bps	-4.0%	37.9%	36.8%
Mercer Emerging Markets Equity Median	-4.4%	37.8%	37.4%
Boston Company Asset Management	-5.2%	29.3%	31.5%
MSCI Emerging Markets Free Index + 200 bps	-4.0%	37.9%	36.8%
Mercer Emerging Markets Equity Median	-4.4%	37.8%	37.4%
	<i>One Year</i>	<i>Three Years</i>	<i>Five Years</i>
INTERNATIONAL EQUITY			
MIG Realty Advisors	14.3%	8.7%	9.9%
NCREIF Property Index + 150 bps	21.7%	16.6%	13.1%
Mercer Real Estate Median	21.4%	17.3%	12.6%
	<i>One Quarter</i>	<i>One Year</i>	<i>Inception (10/03)</i>
Kennedy Associates	2.1%	13.8%	10.9%
NCREIF Property Index + 150 bps	3.9%	21.7%	17.2%
Mercer Real Estate Median	4.6%	21.4%	N/A

INVESTMENT REVIEW

TARGET ASSET ALLOCATION *As of June 30, 2006*



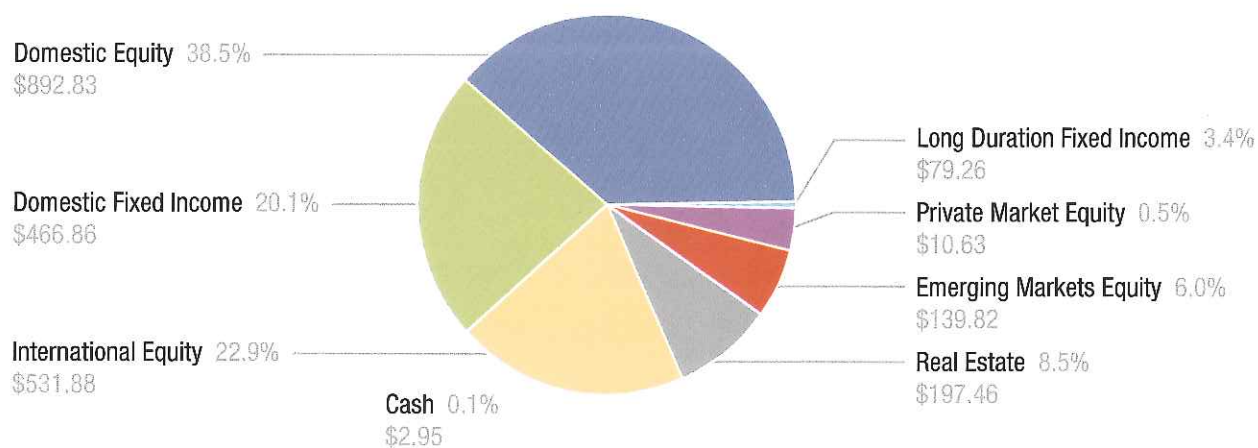
ACTUAL ASSET ALLOCATION Non-GAAP Basis (In Millions)

June 30, 2006

Asset Class	Actual
Domestic Equity	\$892.83
Private Market Equity	10.63
International Equity	531.88
Emerging Markets Equity	139.82
Domestic Fixed Income	466.86
Long Duration Fixed Income	79.26
Real Estate*	197.46
Cash	2.95
TOTAL	\$2,321.69

* Includes leverage

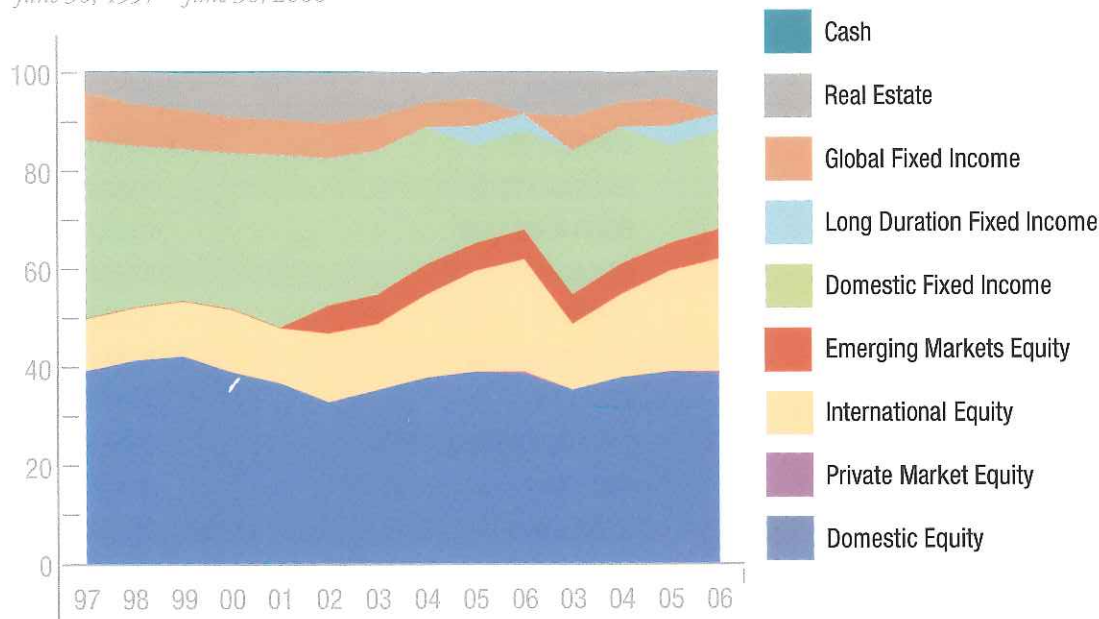
ACTUAL ASSET ALLOCATION (In Millions) *As of June 30, 2006*



INVESTMENT REVIEW *Continued*

HISTORICAL ASSET ALLOCATION (ACTUAL)

June 30, 1997 – June 30, 2006

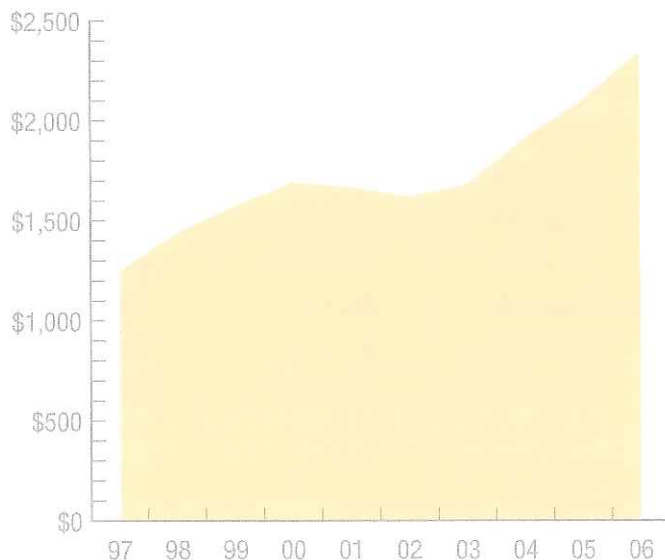


MARKET VALUE GROWTH OF PLAN ASSETS

For Ten Years Ended June 30, 2006 (In Millions)

HISTORY OF PERFORMANCE FOR FISCAL YEARS 1997–2006

(Based on Market Value)



LIST OF LARGEST ASSETS HELD

LARGEST STOCK HOLDINGS (by Market Value)

June 30, 2006

Shares	Country	Description	Market Value in \$US
332,424.00	UNITED STATES	CITIGROUP INC	\$16,036,133.76
575,800.00	UNITED STATES	MICROSOFT CORP	13,416,140.00
205,098.00	UNITED STATES	EXXON MOBIL CORP	12,582,762.30
154,039.00	UNITED STATES	CONOCOPHILLIPS	10,094,175.67
143,404.00	UNITED STATES	JOHNSON + JOHNSON	8,592,767.68
198,858.00	UNITED STATES	JPMORGAN CHASE + CO	8,352,036.00
26,600.00	SWITZERLAND	NESTLE SA	8,338,285.71
149,632.00	UNITED STATES	PROCTER AND GAMBLE CO	8,319,539.20
136,250.00	UNITED STATES	AMERICAN INTL GROUP INC	8,045,562.50
243,275.00	UNITED STATES	GENERAL ELEC CO	8,018,344.00

LARGEST BOND HOLDINGS (by Market Value)

June 30, 2006

Par Value	Country	Description	Interest Rate in %	Maturity Date	Market Value in \$US
42,500,000.00	UNITED STATES	FNMA TBA JUL 30 SINGLE FAM	5.00%	12/1/2099	\$39,727,538.00
35,930,000.00	UNITED STATES	UNITED STATES TREAS NTS	4.88%	5/31/2011	35,570,700.00
17,080,000.00	UNITED STATES	UNITED STATES TREAS NTS	5.63%	5/15/2008	17,214,771.45
16,470,000.00	UNITED STATES	UNITED STATES TREAS NTS	4.25%	1/15/2011	15,903,843.75
17,130,000.00	UNITED STATES	UNITED STATES TREAS NTS	4.00%	2/15/2015	15,786,365.63
14,510,000.00	UNITED STATES	UNITED STATES TREAS NTS	3.38%	12/15/2008	13,926,198.86
13,667,000.00	UNITED STATES	UNITED STATES TREAS BDS	4.50%	2/15/2036	12,257,590.63
11,900,000.00	UNITED STATES	FNMA TBA JUL 30 SINGLE FAM	5.50%	12/1/2099	11,424,929.39
11,400,000.00	UNITED STATES	GNMA I TBA JUL 30 SINGLE FAM	6.00%	12/1/2099	11,302,922.16
9,568,000.00	UNITED STATES	FHLMC TBA JUL 30 GOLD SINGLE	6.00%	12/1/2099	9,417,752.74

A complete list of portfolio holdings is available upon request.

SCHEDULE OF INVESTMENT FEES

For the Fiscal Year Ended June 30, 2006

	Assets Under Mgt. at Market Value* (Non-GAAP Basis)	Fees	Basis Points
INVESTMENT MANAGERS' FEES			
Domestic Equity Managers	\$ 903,463,000	\$ 2,913,250	32
International Equity Managers	531,879,000	2,592,530	49
Emerging Market Equity Managers	139,816,000	1,223,765	88
Domestic Fixed Income Managers	466,864,000	851,824	18
Long Duration Fixed Income Manager	79,263,000	230,117	29
Global Fixed Income Manager**	379,000	349,693	N/A
Real Estate Managers	197,464,00	440,556	22
Cash	2,948,000	-	N/A
TOTAL	\$ 2,322,076,000	\$ 8,601,735	37
OTHER INVESTMENT SERVICE FEES			
Investment Consultant	N/A	\$ 95,000	N/A
Proxy Voting	N/A	24,400	N/A
Custodian	N/A	348,104	N/A
Real Estate Legal Fees	N/A	232,520	N/A
Real Estate Appraisals	N/A	53,100	N/A
TOTAL		\$ 753,124	

*Includes Cash in Managers' Accounts; Non-GAAP Basis

**Manager terminated at the end of fiscal year 2005-06

SCHEDULE OF COMMISSIONS

For the Year Ending June 30, 2006

Brokerage Firm	Number of Shares Traded	Total Commissions	Commission Per Share
ABG SECURITIES	39,600.00	\$ 3,973.84	\$ 0.10035
ABG SECURITIES AS (STOCKHOLM)	13,750.00	1,250.67	0.09096
ABN AMRO BANK NV	178,384.00	3,343.07	0.01874
ABN AMRO EQUITIES AUSTRALIA LTD	6,441.00	151.13	0.02346
ABN AMRO SECURITIES (USA) INC	22,200.00	1,327.57	0.05980
ACENTO SECURITIES LLC	2,700.00	114.00	0.04222
ADAMS HARKNESS + HILL, INC	40,975.00	1,652.00	0.04032
ARNHOLD S BLEICHROEDER INC	10,000.00	500.00	0.05000
AVALON RESEARCH GROUP INC	2,300.00	115.00	0.05000
AVONDALE PARTNERS LLC	14,400.00	720.00	0.05000
B RILEY AND CO INC.	3,520.00	148.80	0.04227
BAIRD, ROBERT W., & COMPANY INCORPORATED	163,785.00	6,810.90	0.04158
BANC OF AMERICA SECURITIES	2,887.00	170.88	0.05919
BANC/AMERICA SECUR.LLC MONTGOMEY DIV	405,748.00	10,941.55	0.02697
BANCO ITAU SA	1,000.00	23.32	0.02332
BANCO PACTUAL S.A.	75,800.00	3,499.61	0.04617
BANCO SANTANDER CENTRAL HISPANO	557,900.00	8,199.08	0.01470
BANCO WARBURG DILLON READ S/A	1,100.00	125.79	0.11435
BANK AM BELLEVUE	10,034.00	2,108.33	0.21012
BANK J.VONTOBEL UND CO. AG	2,500.00	222.56	0.08902
BANQUE NATIONALE DU CANADA	8,100.00	334.81	0.04133
BEAR STEARNS + CO INC	345,300.00	16,851.95	0.04880
BEAR STEARNS SECURITIES CORP	818,110.00	32,861.02	0.04017
BEREAN CAPITAL, INC. 2	54,500.00	2,246.00	0.04121
BERENBERGBANK	500.00	99.27	0.19854
BNP PARIBAS PEREGRINE SECS LT ASIA	1,771,000.00	2,709.22	0.00153
BNP PARIBAS PEREGRINE SECURITIES	1,269,000.00	5,687.20	0.00448
BNP PARIBAS PEREGRINE SECURITIES LT	5,000.00	11.75	0.00235
BNY BROKERAGE INC	373,940.00	13,761.00	0.03680
BNY DIRECT EXECUTION	51,850.00	1,026.50	0.01980
BRIDGE TRADING	600.00	30.00	0.05000
BRIDGE TRADING COMPANY	65,790.00	3,289.50	0.05000
BROADCORTCAPITAL (THRU ML)	124,300.00	6,215.00	0.05000
BROCHHOUSE COOPER	134,600.00	965.53	0.00717
BROCKHOUSE + COOPER INC MONTREAL	72,250.00	1,923.50	0.02662
BROCKHOUSE + COOPER, INC.	10,000.00	120.88	0.01209
BROWN BROTHERS HARRIMAN + CO	7,750.00	387.50	0.05000

SCHEDULE OF COMMISSIONS *Continued**For the Year Ending June 30, 2006*

Brokerage Firm	Number of Shares Traded	Total Commissions	Commission Per Share
BTN RESEARCH	7,900.00	\$ 395.00	\$ 0.05000
B-TRADE SERVICES LLC	58,400.00	1,276.00	0.02185
BUCKINGHAM RESEARCH GROUP	42,735.00	1,764.40	0.04129
C. L. GLAZER & COMPANY, INC.	4,350.00	174.00	0.04000
C.E. UNTERBERG, TOWBIN"	6,500.00	260.00	0.04000
CABRERA CAPITAL MARKETS	183,992.00	5,760.17	0.03131
CABRERA CAPITAL MARKETS INC.	8,500.00	340.00	0.04000
CALYON SECURITIES (USA) INC	48,288.00	847.19	0.01754
CANACCORDADAMS INC.	39,230.00	1,348.20	0.03437
CANTOR FITZGERALD + CO.	95,610.00	3,772.40	0.03946
CAPEL CURE MYERS GILTS	92,100.00	1,149.43	0.01248
CAPEL, JAMES HSBC SECURITIES INC.	13,000.00	377.00	0.02900
CAPITAL INSTITUTIONAL SVCS INC EQUITIES	150,750.00	3,402.33	0.02257
CAZENOVE + CO	396,657.00	5,098.14	0.01285
CAZENOVE GILTS	1,000.00	25.66	0.02566
CHEEVERS + CO	70,500.00	2,928.00	0.04153
CHEVREUX DE VIRIEU NORDIC LDN	1,000.00	116.35	0.11635
CIBC WORLD MARKETS CORP	85,819.00	3,681.95	0.04290
CIBC WORLD MKTS INC	13,600.00	572.25	0.04208
CITIBANK	31,600.00	1,488.02	0.04709
CITIGROUPGLOBAL MARKETS INC	2,868,719.00	33,345.87	0.01162
CITIGROUPGLOBAL MARKETS INC.	1,449,535.00	14,124.19	0.00974
CITIGROUPGLOBAL MARKETS LIMITED	561,460.00	18,109.96	0.03226
CITIGROUPGLOBAL MARKETS UK EQUITY LTD	104,844.00	2,214.87	0.02113
CLSA SECURITIES KOREA LTD.	5,125.00	3,418.17	0.66696
COCHRAN,CARONIA SECURITIES LLC	20,900.00	1,006.00	0.04813
COLLINS STEWART + CO	60,904.00	2,643.66	0.04341
CREDIT AGRICOLE INDOSUEZ CHEUV	400.00	94.30	0.23575
CREDIT AGRICOLE INDOSUEZ CHEUVREUX	124,593.00	15,030.71	0.12064
CREDIT LYONNAIS SECURITIES	148,731.00	3,987.87	0.02681
CREDIT LYONNAIS SECURITIES (USA) INC	951,600.00	15,085.33	0.01585
CREDIT LYONNAIS SECURITIES ASIA/GUERNSEY	8,136,842.00	60,231.31	0.00740
CREDIT LYONNAIS SECURITIES(ASIA)	61,000.00	411.31	0.00674
CREDIT SUISSE FIRST BOSTON	4,311,000.00	15,210.17	0.00353
CREDIT SUISSE FIRST BOSTON (EUROPE)	14,878.00	3,911.33	0.26289
CREDIT SUISSE FIRST BOSTON (EUROPE) LTD	844,495.00	8,104.04	0.00960
CREDIT SUISSE FIRST BOSTON CORPORATION	2,232,538.00	38,540.93	0.01726

SCHEDULE OF COMMISSIONS *Continued**For the Year Ending June 30, 2006*

Brokerage Firm	Number of Shares Traded	Total Commissions	Commission Per Share
CREDIT SUISSE SECURITIES (USA) LLC	986,538.00	\$ 24,084.35	\$ 0.02441
CS FIRST BOSTON	5,493.00	784.19	0.14276
CS FIRST BOSTON (HONG KONG) LIMITED	5,000.00	14.77	0.00295
CSFB	163,500.00	1,630.92	0.00998
CSFB EQUITIES 1 CABOT SQUARE	683,351.00	4,833.11	0.00707
CSFB RESEARCH (MALAYSIA) SDN BHD	1,146,800.00	1,998.19	0.00174
D CARNEGIE AG	66,900.00	2,925.73	0.04373
DAIWA	60.00	389.70	6.49500
DAIWA SECURITIES	15.00	39.01	2.60067
DAIWA SECURITIES AMERICA INC	161,269.00	4,602.58	0.02854
DAVENPORT & CO. OF VIRGINIA, INC.	11,950.00	445.50	0.03728
DAVIS, MENDEL AND REGENSTEIN	285,200.00	13,567.00	0.04757
DAVY (J+E)	95,430.00	1,807.14	0.01894
DAVY STOCKBROKERS	5,000.00	128.94	0.02579
DBS SECURITIES	40,000.00	91.47	0.00229
DBS VICKERS SECS PTE LTD	59,500.00	296.96	0.00499
DBS VICKERS SECURITIES (SINGAPORE)	61,000.00	283.28	0.00464
DBS VICKERS SECURITIES SING	7,000.00	37.08	0.00530
DEUTSCHE BANK AG LONDON	321,844.00	7,275.11	0.02260
DEUTSCHE BANK SECURITIES INC	1,386,195.00	27,342.63	0.01972
DEUTSCHE SECURITIES ASIA LIMITED	1,600.00	754.79	0.47174
DEUTSCHE SECURITIES ASIA LTD	5,796.00	711.25	0.12271
DONALDSON+ CO INCORPORATED	46,600.00	1,864.00	0.04000
DOUGHERTY COMPANY	18,850.00	942.50	0.05000
DOWLING & PARTNERS	27,600.00	1,338.00	0.04848
DRESDNER KLEINWORT BENSON NORTH AMERICA	826,300.00	2,319.71	0.00281
DRESDNER KLEINWORTH WASSERSTEIN SEC LLC	185,800.00	8,118.77	0.04370
DSP MERRILL LYNCH LTD	118,000.00	2,308.70	0.01957
EDWARDS AG SONS INC	91,850.00	4,336.50	0.04721
EMP RESEARCH PTRNS	17,800.00	890.00	0.05000
EUROMOBILIARE SIM S.P.A.	243,000.00	2,183.22	0.00898
EXANE S.A.	28,420.00	4,692.15	0.16510
EXANE, INC.	1,800.00	460.53	0.25585
FAGENSON + CO INC	7,500.00	300.00	0.04000
FIDELITY CAPITAL MARKETS	7,000.00	350.00	0.05000
FIRST ALBANY CAPITAL INC.	28,260.00	1,400.00	0.04954
FIRST ANALYSIS SECURITIES CORP	11,800.00	499.00	0.04229

SCHEDULE OF COMMISSIONS *Continued**For the Year Ending June 30, 2006*

Brokerage Firm	Number of Shares Traded	Total Commissions	Commission Per Share
FIRST ASSOCIATES INV INC	23,200.00	\$ 975.69	\$ 0.04206
FIRST CLEARING, LLC	14,900.00	745.00	0.05000
FOX PITT KELTON INC	83,415.00	3,891.60	0.04665
FOX-PITT KELTON LTD	23,035.00	2,484.20	0.10784
FRANK RUSSELL SEC/BROADCORT CAP CLEARING	57,000.00	2,733.00	0.04795
FRIEDMAN BILLINGS + RAMSEY	181,345.00	7,339.90	0.04047
FULCRUM GLOBAL PARTNERS LLC	12,500.00	606.00	0.04848
G TRADE SERVICES LTD	427,066.00	3,663.06	0.00858
GARANTIA DTVM S/A	490.00	296.17	0.60443
GARDNER RICH + CO	4,900.00	245.00	0.05000
GARP STEARNS & SECURITIES CO	6,100.00	244.00	0.04000
GENUITY CAPITAL MARKET CA	9,000.00	370.90	0.04121
GERSON LEHRMAN GROUP BROKERAGE SERV LLC	60,700.00	2,985.00	0.04918
GOLDMAN SACHS (ASIA) LLC	15,800.00	3,648.93	0.23094
GOLDMAN SACHS + CO	4,139,191.00	65,536.13	0.01583
GOLDMAN SACHS EXECUTION + CLEARING	962,130.00	26,666.35	0.02772
GOLDMAN SACHS INTERNATIONAL LONDON	375,931.00	3,581.93	0.00953
GOLDMAN SACHS INTL LTD	7,248.00	112.90	0.01558
GOLDSMITH& HARRIS (THRU BEAR STEARNS)	3,675.00	154.00	0.04190
GOODBODY STOCKBROKERS	135,505.00	2,504.12	0.01848
GREEN STREET ADVISORS	15,700.00	785.00	0.05000
GUZMAN + CO	164,200.00	4,875.53	0.02969
HARRIS NESBITT CORP.	17,300.00	713.00	0.04121
HEFLIN + CO LLC	1,400.00	56.00	0.04000
HIBERNIA SOUTHCOAST CAPITAL INC	31,755.00	1,278.20	0.04025
HOEFER AND ARNETT INC.	10,300.00	515.00	0.05000
HOWARD WEIL DIVISION LEGG MASON	5,680.00	261.20	0.04599
HSBC BANKPLC	166,722.00	425.03	0.00255
HSBC SECURITIES INC (JAMES CAPEL)	100,579.00	1,837.91	0.01827
IMPERIAL CAPITAL LLC	35,500.00	1,680.00	0.04732
ING BANK N V	19,100.00	2,554.96	0.13377
ING BARING SECURITIES LTD SEOUL	17,660.00	8,771.78	0.49670
ING BARINGS CORP	15,371.00	461.40	0.03002
INSTINET	2,311,523.00	83,331.94	0.03605
INSTINET CANADA	14,005.00	610.53	0.04359
INSTINET CLEARING SERVICES INC	94,239.00	4,711.95	0.05000
INSTINET FRANCE S.A.	14,700.00	3,132.23	0.21308

SCHEDULE OF COMMISSIONS *Continued**For the Year Ending June 30, 2006*

Brokerage Firm	Number of Shares Traded	Total Commissions	Commission Per Share
INSTINET INVESTMENT SERVICES LIMITED	8,000.00	\$ 90.35	\$ 0.01129
INSTINET U.K. LTD	300,666.00	9,716.75	0.03232
INSTINETCLEARING SERVICES, INC.	450.00	22.50	0.05000
INTERDIN BOLSA S.V.B., S.A.	4,000.00	183.41	0.04585
INVESTMENT TECHNOLOGY GROUP INC.	295,902.00	7,448.03	0.02517
INVESTMENT TECHNOLOGY GROUP LTD	857,638.00	19,488.43	0.02272
ISI GROUPEQUITIES	182,300.00	9,115.00	0.05000
ISI GROUPINC	51,800.00	2,390.00	0.04614
ITG SECURITIES (HK) LTD	213,900.00	8,304.81	0.03883
IXIS SECURITIES	17,400.00	1,246.11	0.07162
J B WERE AND SON	1,977.00	46.40	0.02347
J P MORGAN INDIA PRIVATE LTD	163,400.00	2,349.65	0.01438
J P MORGAN SECURITIES INC	477,723.00	18,150.93	0.03799
J.P MORGAN SECURITIES	476,000.00	1,267.96	0.00266
J.P. MORGAN SECURITIES LIMITED	81,187.00	3,569.15	0.04396
JANNEY MONTGOMERY, SCOTT INC.	36,300.00	1,585.00	0.04366
JEFFERIES+ COMPANY INC	804,262.00	23,001.80	0.02860
JM MORGANSTANLEY SECS PVT LTD	30,800.00	4,704.47	0.15274
JMP SECURITIES	141,335.00	4,066.00	0.02877
JOH BERENBERG GOSSLER AND CO	30,100.00	2,457.21	0.08163
JONES & ASSOCIATES INC	118,407.00	4,092.76	0.03457
JP MORGAN	10,000.00	27.56	0.00276
JP MORGANCHASE	4,000.00	12.00	0.00300
JP MORGANCHASE BANK	5,000.00	13.74	0.00275
JP MORGANSECURITIES AUSTRALIA LTD	66,700.00	1,291.97	0.01937
JP MORGANSECURITIES INC	1,100.00	28.14	0.02558
JP MORGANSECURITIES LIMITED	1,735,170.00	20,775.23	0.01197
JP MORGANSECURITIES SINGAPORE	5,000.00	14.90	0.00298
JPMORG SEC(FAR EAST)LTD SEOUL	13,652.00	783.98	0.05743
JPMORGAN CHASE BANK	17,634.00	586.37	0.03325
JPMORGAN SECURITIES(ASIA PACIFIC)	200.00	41.09	0.20545
JPMORGAN SECURITIES(ASIA PACIFIC)LTD	748,100.00	7,818.36	0.01045
KAUFMAN BROTHERS	15,800.00	790.00	0.05000
KBC FINANCIAL PRODUCTS UK LTD	20,300.00	2,219.11	0.10932
KEEFE BRUYETTE + WOODS INC	141,030.00	5,179.20	0.03672
KEMPEN + CO N.V.	3,800.00	118.72	0.03124
KING, CL,& ASSOCIATES, INC	4,500.00	135.00	0.03000

SCHEDULE OF COMMISSIONS *Continued**For the Year Ending June 30, 2006*

Brokerage Firm	Number of Shares Traded	Total Commissions	Commission Per Share
KLEINWORTBENSON SECURITIES LIMITED	204,624.00	\$ 3,404.73	\$ 0.01664
KNIGHT SECURITIES	84,600.00	2,807.00	0.03318
KOOKMIN BANK KOREA	3,200.00	1,511.11	0.47222
KOTAK SECURITIES	115,300.00	5,968.52	0.05177
KYOBO SECURITIES CO. LTD	540.00	1,354.15	2.50769
LA BRANCHE FINANCIAL #2	23,700.00	538.50	0.02272
LAZARD CAPITAL MARKETS LLC	49,910.00	2,055.30	0.04118
LEERINK SWANN AND COMPANY	108,050.00	5,279.50	0.04886
LEGG MASON WOOD WALKER INC	55,950.00	2,510.00	0.04486
LEHMAN BROTHERS INC	1,420,976.00	16,795.05	0.01182
LEHMAN BROTHERS INTERNATIONAL (EUROPE)	1,160,607.00	16,602.82	0.01431
LEHMAN BROTHERS INTL (EUROPE) SEOUL BR	7,503.00	138.18	0.01842
LEHMAN BROTHERS SECS (ASIA)	4,000.00	10.97	0.00274
LIQUIDNETING	2,157,796.00	53,705.73	0.02489
LOMBARD, ODIER AND CIE	10,300.00	1,086.75	0.10551
LOOP CAPITAL MKTS LLC	20,900.00	964.00	0.04612
LYNCH JONES AND RYAN INC	3,007,056.00	136,610.77	0.04543
MACQUARIEBANK LIMITED	83,000.00	453.08	0.00546
MACQUARIEDAY CUTTEN	21,000.00	110.41	0.00526
MACQUARIEEQUITIES (USA) INC	2,000.00	90.49	0.04525
MACQUARIEEQUITIES LIMITED (SYDNEY)	234,500.00	4,480.26	0.01911
MACQUARIESECURITIES (SINGAPORE)	161,000.00	1,434.39	0.00891
MACQUARIESECURITIES LIMITED	1,917,575.00	7,740.20	0.00404
MACQUARIESECURITIES LTD SEOUL	16,232.00	1,738.00	0.10707
MCDONALD AND COMPANY SECURITIES, INC.	162,790.00	5,537.60	0.03402
MERRILL LYNCH	1,800.00	6.46	0.00359
MERRILL LYNCH INTERNATIONAL	3,253,420.00	51,961.65	0.01597
MERRILL LYNCH PEIRCE FENNER AND S	5,006,567.00	32,060.42	0.00640
MERRILL LYNCH PROFESSIONAL CLEARING CORP	138,860.00	6,197.40	0.04463
MERRILL LYNCH SA CVTM	5,700.00	371.27	0.06514
MERRILL LYNCH, PIERCE FENNER AND SMITH	68,734.00	2,594.45	0.03775
MERRILL LYNCH, PIERCE, FENNER + SMITH, INC	530,986.00	15,520.23	0.02923
MERRIMAN CURHAN FORD + CO	79,750.00	2,884.00	0.03616
MIDWEST RESEARCH SECURITIES	138,000.00	6,295.00	0.04562
MITSUBISHI SECURITIES USA	9.00	20.83	2.31444
MIZUHO SEC	2,500.00	114.25	0.04570
MIZUHO SECURITIES USA INC	482,000.00	3,355.01	0.00696

SCHEDULE OF COMMISSIONS *Continued**For the Year Ending June 30, 2006*

Brokerage Firm	Number of Shares Traded	Total Commissions	Commission Per Share
MOORS + CABOT INC	5,710.00	\$ 228.40	\$ 0.04000
MORGAN (J.P.) SECURITIES INC., SL	35,355.00	688.78	0.01948
MORGAN KEEGAN & CO INC	11,800.00	542.00	0.04593
MORGAN STANLEY	6,000.00	194.57	0.03243
MORGAN STANLEY AND CO INTERNATIONAL	5,066.00	835.34	0.16489
MORGAN STANLEY AND CO INTL TAIPEI METRO	76,734.00	1,513.14	0.01972
MORGAN STANLEY AND CO. INTERNATIONAL	163,337.00	3,454.17	0.02115
MORGAN STANLEY CO INCORPORATED	4,444,220.00	41,615.19	0.00936
MORGAN STANLEY SECURITIES LIMITED	32,154.00	622.14	0.01935
NATIONAL FINANCIAL SERVICES CORP.	126,108.00	5,227.32	0.04145
NBG INTERNATIONAL LTD LONDON	5,300.00	803.30	0.15157
NCB STOCKBROKERS LTD	19,022.00	621.07	0.03265
NEEDHAM +COMPANY	123,015.00	4,868.80	0.03958
NESBITT BURNS	285,743.00	8,376.98	0.02932
NEUBERGERAND BERMAN	1,100.00	33.00	0.03000
NOMURA	19.00	115.32	6.06947
NOMURA INTERNATIONAL PLC	18.00	288.84	16.04667
NOMURA SECURITIES INTERNATIONAL INC	98,231.00	12,753.45	0.12983
NUMIS SECURITIES LIMITED	27,200.00	534.15	0.01964
NYFIX TRANSACTION SERVICES #2	6,400.00	127.50	0.01992
O NEIL, WILLIAM AND CO. INC/BCC CLRG	72,300.00	3,615.00	0.05000
OCBC SECURITIES PRIVATE LIMITED	53,000.00	246.93	0.00466
ODDO FINANCE	8,250.00	4,117.76	0.49912
OKOBANK OSUUSPANKKIEN KESKUSPANKKI	3,200.00	18.45	0.00577
OPPENHEIMER & CO. INC.	184,450.00	8,782.00	0.04761
ORION SECURITIES	1,200.00	29.27	0.02439
OSCAR GRUSS & SON INC	2,200.00	110.00	0.05000
PACIFIC AMERICAN SECURITIES, LLC	34,700.00	1,418.00	0.04086
PACIFIC CREST SECURITIES	174,830.00	6,334.90	0.03623
PACIFIC GROWTH EQUITIES	48,900.00	2,445.00	0.05000
PALJ CAPITAL LLC	8,900.00	445.00	0.05000
PERSHING	67,412.00	2,133.23	0.03164
PERSHING DLJ S L	4,392,235.00	85,589.67	0.01949
PERSHING LLC	124,181.00	6,258.34	0.05040
PERSHING SECURITIES LIMITED	362,532.00	11,169.39	0.03081
PETRIE PARKMAN & CO INC	5,100.00	195.00	0.03824
PIPELINE TRADING SYSTEMS LLC	6,900.00	138.00	0.02000

SCHEDULE OF COMMISSIONS *Continued*

For the Year Ending June 30, 2006

Brokerage Firm	Number of Shares Traded	Total Commissions	Commission Per Share
PIPER JAFFRAY	81,295.00	\$ 3,235.80	\$ 0.03980
PRECURSORGROUP	1,900.00	95.00	0.05000
PRUDENTIAL EQUITY GROUP	204,100.00	9,908.00	0.04854
PULSE TRADING LLC	5,800.00	232.00	0.04000
R W PRESSPRICH + CO INC	7,700.00	321.00	0.04169
RASHID HUSSAIN SECURITIES SDN	73,600.00	938.39	0.01275
RAYMOND JAMES AND ASSOCIATES INC	131,280.00	5,757.25	0.04385
RBC CAPITAL MARKETS	54,800.00	2,558.00	0.04668
RBC DOMINION SECURITIES INC.	122,665.00	3,124.08	0.02547
REDBURN PARTNERS LLP	36,800.00	1,598.85	0.04345
ROSENBLATT SECURITIES INC	53,900.00	1,079.21	0.02002
ROTH CAPITAL PARTNERS LLC	33,520.00	1,398.80	0.04173
S.G. COWEN & CO., LLC	89,360.00	4,428.00	0.04955
S.S KANTILAL ISHWARLAL SECURITIES	58,200.00	3,716.83	0.06386
SALOMON SMITH BARNEY KOREA LTD	24,749.00	4,486.65	0.18129
SAMSUNG SECURITIES CO LTD	9,410.00	2,865.84	0.30455
SAMUEL A RAMIREZ & COMPANY INC	2,100.00	84.00	0.04000
SANDERS MORRIS MUNDY	3,605.00	144.20	0.04000
SANDLER ONEILL + PART LP	107,273.00	3,753.92	0.03499
SANFORD C. BERNSTEIN LTD	334,687.00	5,959.84	0.01781
SANFORD CBERNSTEIN CO LLC	76,200.00	3,035.50	0.03984
SBK BROOKS INVESTMENY CORP	40,800.00	1,882.00	0.04613
SCOTIA CAPITAL (USA) INC	17,500.00	768.86	0.04393
SCOTIA CAPITAL INC	47,100.00	2,049.76	0.04352
SCOTT & STRINGFELLOW, INC	86,550.00	3,570.00	0.04125
SIDOTI & CO. LLC	1,100.00	41.00	0.03727
SIDOTI + COMPANY LLC	20,600.00	858.00	0.04165
SIEBERT BRANFORD SHANK & CO	1,700.00	429.80	0.25282
SIMMONS +COMPANY INTERNATIONAL	66,610.00	2,758.40	0.04141
SOCIETE GENERALE LONDON BRANCH	142,400.00	2,776.21	0.01950
SOLEIL SECURITIES	12,115.00	522.60	0.04314
SOUTHWESTSECURITIES	17,000.00	445.75	0.02622
STANFORD GROUP CO	4,300.00	188.00	0.04372
STATE STREET BANK + TRUST CO LONDON	2,278.00	109.46	0.04805
STATE STREET BANK AND TRUST CO	130.00	20.61	0.15854
STATE STREET BROKERAGE SERVICES	54,120.00	1,631.60	0.03015
STEPHENS,INC.	25,300.00	947.00	0.03743

SCHEDULE OF COMMISSIONS *Continued**For the Year Ending June 30, 2006*

Brokerage Firm	Number of Shares Traded	Total Commissions	Commission Per Share
STERNE, AGEE & LEACH, INC.	4,200.00	\$ 168.00	\$ 0.04000
STIFEL NICOLAUS + CO INC	16,800.00	811.00	0.04827
SUNTRUST CAPITAL MARKETS, INC.	51,600.00	2,570.00	0.04981
THE BENCHMARK COMPANY, LLC	1,000.00	20.00	0.02000
THEMIS TRADING LLC	9,713.00	291.39	0.03000
THINKEQUITY PARTNERS LLC	27,279.00	1,048.17	0.03842
THOMAS WEISEL PARTNERS	201,225.00	8,797.55	0.04372
THOMAS WEISEL PARTNERS LLC	18,500.00	785.00	0.04243
TOKYO-MITSUBISHI SECURITIES (USA)	26,993.00	4,070.85	0.15081
U.S. BANCORP PIPER JAFFRAY INC	73,033.00	3,224.99	0.04416
U.S. CLEARING CORPORATION	3,400.00	136.00	0.04000
UBS AG	2,430,260.00	28,579.16	0.01176
UBS AG LONDON	9,567.00	44.18	0.00462
UBS FINANCIAL SERVICES INC	9,100.00	455.00	0.05000
UBS SECURITIES	637,200.00	2,216.63	0.00348
UBS SECURITIES CANADA INC	57,820.00	3,414.82	0.05906
UBS SECURITIES LLC	719,921.00	27,768.11	0.03857
UNIBANCO-UNIAO DE BANCOS BRASIL	30,088.00	4,382.03	0.14564
WACHOVIA CAPITAL MARKETS, LLC	151,750.00	6,902.50	0.04549
WARBURG DILLON READ (ASIA) LTD	1,812,628.00	9,447.37	0.00521
WARBURG DILLON READ SECURITIES LTD	13,504.00	1,743.40	0.12910
WAVE SECURITIES	67,600.00	1,352.00	0.02000
WAVE SECURITIES LLC	338,480.00	3,660.80	0.01082
WEDBUSH MORGAN SECURITIES INC	74,110.00	2,702.30	0.03646
WEEDEN + CO.	552,729.00	15,600.37	0.02822
WELLS FARGO SECURITIES LLC	400.00	16.00	0.04000
WESTDEUTSCHE LANDESBANK GIROZENTRALE	6,610.00	952.11	0.14404
WESTMINSTER RESEARCH ASSOCIATION	800.00	40.00	0.05000
WESTMINSTER RESEARCH ASSOCIATE	61,600.00	3,080.00	0.05000
WILLIAM BLAIR & COMPANY, L.L.C	184,300.00	7,583.00	0.04114
WILLIAMS CAPITAL GROUP LP (THE)	28,100.00	1,153.00	0.04103
WR HAMBRECHT + CO	10,400.00	520.00	0.05000
YORKTON SECURITIES INC	1,700.00	72.36	0.04256
ZIONS DIRECT, INC.	5,900.00	295.00	0.05000
TOTAL	95,196,242.00	\$ 1,770,550.83	\$ 0.01860

INVESTMENT SUMMARY

Non-GAAP Basis

As of June 30, 2006 (In Thousands)

EQUITIES	Market Value	% of Portfolio
Consumer Discretionary	\$ 132,142	5.71%
Consumer Staples	49,064	2.12%
Energy	75,110	3.24%
Financials	177,406	7.66%
Health Care	108,875	4.70%
Industrials	122,313	5.28%
Materials	23,838	1.03%
Technology/Telecom Services	165,347	7.14%
Utilities	21,921	0.95%
Miscellaneous	70	0.00%
Foreign Equity	670,380	28.96%
TOTAL EQUITIES	\$ 1,546,466	66.79%
FIXED INCOME		
US Treasury	\$ 199,025	8.60%
US Government Agency	174,162	7.52%
Domestic Corporate Bonds	191,593	8.28%
State and Local Obligations	1,521	0.07%
Foreign Government	28,383	1.23%
Foreign Corporate	12,810	0.55%
TOTAL FIXED INCOME	\$ 607,494	26.25%
OTHER INVESTMENTS		
Short Term	\$ 70,946	3.06%
Real Estate	184,255	7.96%
Private Equities	10,628	0.46%
TOTAL OTHER INVESTMENTS	\$ 265,829	11.48%
PENDINGS	\$ (104,650)	-4.52%
TOTAL	\$ 2,315,139	100.00%

INVESTMENT PROPERTIES



Camelback Pointe Apartments

258-unit luxury apartment community
in Colorado Springs, CO.
Acquired as sole owner in December 1997.

Citibank Office Plaza
100,303 sq.ft. five-story office building
located in Oak Brook, IL.
Acquired as sole owner in December 1998.



Crescent VII

135,044 sq.ft. six-story office building located in
the Denver Tech Center in Greenwood Village, CO.
Acquired as sole owner in June 1998.

The Deerwood Apartments
186-unit luxury mid-rise apartment community
located in Houston, TX.
Acquired as sole owner in January 1996.



INVESTMENT PROPERTIES *Continued*



Eagle USA Warehouse

128,000 sq.ft. single-story distribution warehouse facility
located in Eagan, MN.
Invested as sole shareholder in January 2002.

First American Office Plaza

82,596 sq.ft. six-story office building
located in San José, CA.
Invested as sole shareholder in December 1999.



Mid South Logistec II Center

450,000 sq.ft. one-story industrial warehouse
located in Nashville, TN.
Invested as sole shareholder in November 1999.

Calais Office Center I & II

Two office buildings totaling 198,995 sq.ft.
located in Anchorage, AK.
Acquired in a joint-venture with a
local developer, JL Properties.



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ACTUARIAL SECTION

ACTUARY CERTIFICATION LETTER

MERCER

Human Resource Consulting

Mercer Human Resource Consulting
111 SW Fifth Avenue, Suite 2800
Portland, OR 97204-3693

503.273.5912 phone
503.273.5999 fax
marciachapman@mercerc.com
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ACTUARIAL CERTIFICATION

The actuarial valuation required for the City of San Jose Police and Fire Retirement Plan has been prepared as of June 30, 2003 by Mercer Human Resource Consulting. In preparing this valuation, we employed generally accepted actuarial methods and assumptions to evaluate the System's assets, liabilities and future contribution requirements. Our calculations are based upon member data and financial information provided to us by the System's staff. This information has not been audited by us, but it has been reviewed and found to be consistent, both internally and with prior years' information.

The contribution requirements are determined as a percentage of payroll. Employer rates provide for both normal cost and a contribution to amortize any unfunded or over-funded actuarial accrued liabilities. The Board elected to amortize the System's unfunded actuarial accrued liability over a 40 year period, beginning in 1977, with 14 years remaining as of the June 30, 2003 valuation date.

The actuarial value of assets used for the purposes of this valuation reflects the Supplemental Retiree Benefits Reserve (SRBR) program. The SRBR program reduced the value of the assets by \$19,695,306 as of June 30, 2003.

The ratio of actuarial value of assets to actuarial accrued liabilities decreased from 114.8% to 100.2% as a result of this valuation. The primary causes of the decrease were the lower than expected investment return on the System's assets and the higher than expected salary increases.

The Board has adopted new actuarial assumptions following the experience study of the System as of June 30, 2003. In our opinion, the recommended assumptions and methods, when applied in combination, fairly represent past and anticipated future experience of the System.

A list of the supporting schedules we prepared for inclusion in the actuarial, statistical and financial sections of the Systems CAFR report is provided below.

1. Summary of Assumptions and Funding Method
2. Schedule of Active Member Valuation Data
3. Retirees and Beneficiaries Added to and Removed From Payroll
4. Actuarial Analysis of Financial Experience
5. Assumption Changes
6. Solvency Test
7. Major Provisions of the Retirement Plan
8. Schedule of Funding Progress
9. System Membership and Benefit Statistics

ACTUARY CERTIFICATION LETTER *Continued***MERCER**

Human Resource Consulting

Future contribution requirements may differ from those determined in the valuation because of:

- differences between actual experience and anticipated experience;
- changes in actuarial assumptions or methods;
- changes in statutory provisions; and
- differences between the contribution rates determined by the valuation and those adopted by the Board.

This report conforms with the requirements of the governing state and local statutes, accounting rules, and generally accepted actuarial principles and practices. The following undersigned actuaries are members of the American Academy of Actuaries and meet the Qualification Standards to render the actuarial opinion contained herein.



Marcia Chapman, FSA, EA, MAAA



Moe Tun, FSA, MAAA

SUMMARY OF ASSUMPTIONS AND FUNDING METHOD

The following assumptions have been adopted by the Retirement Board as of June 30, 2003:

ASSUMPTIONS

Valuation Interest Rate	8%
Inflation Rate	3%
Real Across-the-Board	
Salary Increase	1.5%
Post-Retirement Mortality	
(a) Service	
Males	1994 Male Group Annuity Mortality Table (set back 4 years)
Females	1994 Female Group Annuity Mortality Table (set forward 1 year)
(b) Disability	PERS Industrial Disability Table 88 92 (set back 5 years)
Pre-Retirement Mortality	Based upon the 6/30/2003 Experience Analysis
Withdrawal Rates	Based upon the 6/30/2003 Experience Analysis
Disability Rates	Based upon the 6/30/2003 Experience Analysis
Service Retirement Rates	Based upon the 6/30/2003 Experience Analysis
Salary Scales	10.1% for the first five years of service. Graded increases thereafter ranging from 9.8% at age 25 to 4.7% at ages 60 and over. Of the total salary increases, 4.5% is for inflation and real across-the-board salary increase.
Percentage of Members	
Married	85%
Reciprocity	75% of all terminated vested members are assumed to be employed by a reciprocal entity.
Assets	Five year smoothed recognition of total market return that differs from the 8% return target.

FUNDING METHOD

The System's liability is being funded on the Entry Age Normal Cost method with the Unfunded Actuarial Accrued Liability being amortized on a closed basis over a period of 40 years beginning in 1977, with 14 years remaining on the June 30, 2003 valuation date.

PROBABILITIES OF SEPARATION PRIOR TO RETIREMENT

	withdrawal 0-1	withdrawal 1-2	withdrawal 2-3	withdrawal 3-4	withdrawal 4-5	withdrawal 5-10	withdrawal 10+	deferred disability	ordinary disability	duty disability	ordinary death	duty death	retirement
<=20	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0080	0.0000	0.0000	0.0001	0.0000	0.0000
21	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0080	0.0000	0.0001	0.0001	0.0000	0.0000
22	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0080	0.0000	0.0001	0.0001	0.0000	0.0000
23	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0080	0.0000	0.0001	0.0001	0.0000	0.0000
24	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0080	0.0000	0.0001	0.0001	0.0000	0.0000
25	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0080	0.0000	0.0002	0.0001	0.0000	0.0000
26	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0080	0.0001	0.0002	0.0001	0.0001	0.0000
27	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0080	0.0001	0.0003	0.0001	0.0001	0.0000
28	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0080	0.0001	0.0002	0.0001	0.0001	0.0000
29	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0080	0.0001	0.0002	0.0001	0.0001	0.0000
30	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0001	0.0007	0.0001	0.0001	0.0000
31	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0001	0.0006	0.0001	0.0001	0.0000
32	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0001	0.0003	0.0001	0.0001	0.0000
33	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0001	0.0008	0.0002	0.0002	0.0000
34	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0002	0.0015	0.0002	0.0002	0.0000
35	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0004	0.0015	0.0002	0.0002	0.0000
36	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0006	0.0015	0.0002	0.0002	0.0000
37	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0008	0.0018	0.0002	0.0002	0.0000
38	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0010	0.0019	0.0002	0.0002	0.0000
39	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0012	0.0020	0.0002	0.0002	0.0000
40	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0014	0.0020	0.0002	0.0003	0.0000
41	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0016	0.0020	0.0002	0.0003	0.0000
42	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0016	0.0021	0.0002	0.0003	0.0000
43	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0016	0.0029	0.0002	0.0003	0.0000
44	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0070	0.0016	0.0041	0.0003	0.0003	0.0000
45	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0050	0.0014	0.0063	0.0003	0.0003	0.0000
46	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0045	0.0012	0.0080	0.0003	0.0004	0.0000
47	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0040	0.0010	0.0102	0.0003	0.0004	0.0000
48	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0030	0.0010	0.0129	0.0003	0.0004	0.0000
49	0.0800	0.0200	0.0200	0.0200	0.0130	0.0065	0.0020	0.0030	0.0010	0.0163	0.0003	0.0004	0.0000
50	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0010	0.0300	0.0004	0.0004	0.0900
51	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0010	0.0450	0.0004	0.0004	0.0700
52	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0010	0.0600	0.0004	0.0005	0.0700
53	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0010	0.0677	0.0005	0.0005	0.0700
54	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0010	0.0750	0.0005	0.0006	0.1000
55	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.1200	0.0005	0.0006	0.1700
56	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.1500	0.0006	0.0007	0.1500
57	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.1800	0.0006	0.0008	0.1300
58	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.1900	0.0007	0.0008	0.1300
59	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.2000	0.0008	0.0009	0.1800
60	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.2200	0.0009	0.0010	0.2200
61	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.2400	0.0010	0.0010	0.2600
62	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.2600	0.0011	0.0011	0.2600
63	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.2600	0.0012	0.0012	0.3600
64	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.2600	0.0014	0.0012	0.4700
65	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	1.0000
66	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	1.0000
67	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	1.0000
68	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	1.0000
69	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	1.0000
70	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	1.0000

YEARS OF LIFE EXPECTANCY AFTER SERVICE RETIREMENT

Age	Member	Beneficiary	Age	Member	Beneficiary
50	33.74	33.29	80	10.08	9.30
51	32.80	32.34	81	9.52	8.74
52	31.87	31.40	82	8.98	8.20
53	30.94	30.47	83	8.46	7.68
54	30.01	29.53	84	7.97	7.18
55	29.09	28.61	85	7.51	6.71
56	28.18	27.68	86	7.07	6.25
57	27.28	26.77	87	6.65	5.83
58	26.38	25.86	88	6.24	5.42
59	25.49	24.97	89	5.86	5.05
60	24.61	24.09	90	5.48	4.70
61	23.74	23.22	91	5.12	4.37
62	22.88	22.36	92	4.78	4.07
63	22.04	21.52	93	4.45	3.79
64	21.20	20.69	94	4.15	3.53
65	20.38	19.88	95	3.87	3.28
66	19.57	19.09	96	3.61	3.06
67	18.78	18.30	97	3.37	2.85
68	18.01	17.53	98	3.15	2.65
69	17.26	16.77	99	2.95	2.48
70	16.53	16.01	100	2.77	2.31
71	15.81	15.26	101	2.60	2.16
72	15.11	14.53	102	2.46	2.02
73	14.43	13.81	103	2.33	1.89
74	13.77	13.11	104	2.20	1.78
75	13.11	12.43	105	2.09	1.70
76	12.48	11.76	106	1.97	1.63
77	11.85	11.11	107	1.87	1.57
78	11.25	10.49	108	1.76	1.53
79	10.66	9.88	109	1.67	1.50
			110	1.60	1.47

Member

94 GAM Male -4

Beneficiary

94 GAM Female +1

YEARS OF LIFE EXPECTANCY AFTER DISABILITY RETIREMENT

Age	Member	Beneficiary	Age	Member	Beneficiary
20	59.71	50	31.30	80	9.80
21	58.74	51	30.41	81	9.32
22	57.76	52	29.53	82	8.86
23	56.78	53	28.66	83	8.42
24	55.81	54	27.79	84	8.00
25	54.84	55	26.93	85	7.61
26	53.86	56	26.07	86	7.23
27	52.89	57	25.22	87	6.87
28	51.92	58	24.39	88	6.51
29	50.95	59	23.56	89	6.16
30	49.98	60	22.75	90	5.82
31	49.02	61	21.94	91	5.48
32	48.05	62	21.16	92	5.15
33	47.09	63	20.38	93	4.81
34	46.13	64	19.62	94	4.48
35	45.18	65	18.88	95	4.16
36	44.22	66	18.15	96	3.86
37	43.27	67	17.44	97	3.57
38	42.32	68	16.75	98	3.30
39	41.38	69	16.08	99	3.04
40	40.43	70	15.43	100	2.79
41	39.49	71	14.80	101	2.56
42	38.56	72	14.18	102	2.35
43	37.63	73	13.58	103	2.15
44	36.71	74	13.00	104	1.95
45	35.79	75	12.43	105	1.77
46	34.88	76	11.87	106	1.61
47	33.98	77	11.33	107	1.45
48	33.08	78	10.81	108	1.30
49	32.18	79	10.30	109	1.17

88' – 92' PERS Industrial Disability -5

SCHEDULE OF ACTIVE MEMBER VALUATION DATA

June 30, 1993 to June 30, 2003

Valuation Date	Number	Annual Payroll	Monthly Average Pay	% Increase in Average Pay*
June 30, 1993	1,785	\$98,831,000	\$4,614	Not Calculated
June 30, 1995	1,812	\$109,196,000	\$5,022	8.84%
June 30, 1997	1,954	\$129,850,000	\$5,538	10.27%
June 30, 1999	1,953	\$144,125,000	\$6,150	11.05%
June 30, 2001	2,107	\$171,799,000	\$6,795	10.49%
June 30, 2003	2,104	\$202,222,000	\$8,009	17.88%

* 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.

CHANGES IN RETIRANTS (INCLUDING BENEFICIARIES)

Time Period	At Beginning of Period	Added During Period	Removed During Period	At End of Period	Annual Retiree Payroll as of the Beginning of Period	Annual Retiree Payroll Added During Period*	Annual Retiree Payroll Removed During Period	Annual Retiree Payroll as of the End of Period	% Increase in Annual Retiree Payroll	Average Annual Allowance
6/30/1993-6/30/1995	700	157	33	824	\$18,958,000	\$7,264,000	\$639,000	\$25,583,000	31.94%	\$31,047
6/30/1995-6/30/1997	824	145	29	940	\$25,583,000	\$7,059,000	\$652,000	\$31,990,000	25.04%	\$34,032
6/30/1997-6/30/1999	940	156	36	1,060	\$31,990,000	\$9,962,000	\$880,000	\$41,072,000	28.39%	\$38,747
6/30/1999-6/30/2001	1060	145	41	1,164	\$41,072,000	\$10,272,000	\$1,351,000	\$49,993,000	21.72%	\$42,949
6/30/2001-6/30/2003	1164	159	52	1,271	\$49,993,000	\$13,806,000	\$1,485,000	\$62,314,000	24.65%	\$49,028

* Includes the Plan's annual cost-of-living adjustment as well as payroll for new retirees.

ACTUARIAL ANALYSIS OF FINANCIAL EXPERIENCE

(Dollars in thousands)

	2001–2003	1999–2001
Beginning of Period Unfunded Actuarial Accrued Liability	\$ (221,080)	\$ (163,753)
Expected Increase from Prior Valuation	\$ 1,042	\$ (3,967)
Salary Increase Greater (Less) than Expected	\$ 95,850	\$ 3,836
Asset Return Less (Greater) than Expected	\$ 131,775	\$ (63,490)
COLA increases Greater (Less) than Expected	\$ -	\$ -
(Gain)/Loss from Withdrawal	\$ (174)	\$ 23
Contribution Less (Greater) than Expected	\$ (27,026)	\$ (16,675)
SRBR	\$ 3,634	\$ 21,875
Other Experience	\$ 8,350	\$ (14,334)
Change in Economic & Non-economic Assumptions	\$ 4,542	\$ 15,404
End of Period UAAL	\$ (3,087)	\$ (221,080)

SOLVENCY TEST

July 1, 1993 to June 30, 2003

(Dollars in thousands)

Valuation Date	Aggregate Accrued Liabilities for				Portion of Accrued Liabilities Covered by Reported Assets			
	Active Members Contributions	Retired/Vested Members	Active Members (Employer Financed Portion)	Total	Actuarial Value of Assets	Active Member Contributions (1)	Retired/Vested Financed (2)	Active Member Financed Portion (3)
6/30/93	\$ 85,915	\$ 260,326	\$ 369,882	\$ 716,123	\$ 714,592	100%	100%	100%
6/30/95	\$ 100,010	\$ 351,327	\$ 377,402	\$ 828,739	\$ 854,414	100%	100%	107%
6/30/97	\$ 115,995	\$ 434,292	\$ 479,881	\$ 1,030,168	\$ 1,124,294	100%	100%	120%
6/30/99	\$ 117,755 *	\$ 595,196	\$ 563,413 *	\$ 1,276,364	\$ 1,440,117	100%	100%	129%
6/30/01	\$ 145,166	\$ 699,082	\$ 648,484	\$ 1,492,732	\$ 1,713,812	100%	100%	134%
6/30/03	\$ 167,203	\$ 881,064	\$ 774,934	\$ 1,823,200	\$ 1,826,287	100%	100%	100%

(1) Accumulated from member contribution account balances provided by the Retirement System

(2) Calculated based on assumptions adopted by the Board

(3) Calculated based on assumptions adopted by the Board and offset with Active member contribution account balances

Derived: (Actuarial Value of Assets - Active Member Contributions Liabilities - Retired and Vested Members Liabilities)

/ (Employer Financed Portion of Liabilities)

* These numbers have been revised

ASSUMPTION CHANGES

Mercer recommended changes to some of the assumptions. The following are the most significant:

- **Withdrawal** – Withdrawal rates are increased for members with service less than 5 years and decreased for members with more than 5 but less than 10 years of service. This reduced costs.
- **Vested Terminations** – Termination rates are increased. This reduced costs.
- **Service Retirement** – Service Retirement rates are decreased. This reduced costs.
- **Inflation** – Inflation assumption is changed from 4.5% to 3%. However, the COLA is subject to a maximum of 3% and, hence, there was no impact on the costs.
- **Salary Increase** – The merit and longevity component of the salary increase assumption is changed to reflect the actual merit and longevity increases over the last two years. This decreased costs.

We propose to introduce an across-the-board salary increase assumption of 1.5%. Combined with the inflation assumption of 3%, we will maintain the salary increase assumption of 4.5% before applying the merit and longevity increases.

- **Post-Retirement Mortality** – We recommend that the Board adopt a setback (i.e., a mortality improvement) to the current mortality table used for service and disability retirees to reflect the Plan's mortality experience when compared to the standard table that was adopted. The change increased costs.
- **Medical and Dental Premium Increases** – Short-term premium increases are raised to reflect anticipated experience. This increased costs.

MAJOR PROVISIONS OF THE RETIREMENT PLAN

Briefly summarized below are the major provisions of the 1961 San Jose Police and Fire Department Retirement Plan, as amended through June 30, 2003.

Final Average Salary (FAS)

Final average salary is defined as the highest 12 consecutive months of compensation earned, not to exceed 108% of compensation paid to the member during the 12 months immediately preceding the last 12 months of service. FAS excludes overtime pay and expense allowances.

Return of Contributions

If a member should resign or die before becoming eligible for retirement, his or her contributions plus 2% interest per annum will be refunded.

Service Retirement Benefit

Members with 20 years of service who have attained age 55 are eligible to retire. Members age 70 (no service requirement) and members with 30 years of service, regardless of age, are also eligible to retire.

The normal service retirement benefit is 2.5% of FAS per year of service up to 20 years of service, 3.0% of FAS per year of service for the next 5 years of service, and 4.0% of FAS per year of service over 25, not to exceed 85% of FAS.

A special study was performed by the plan's prior actuary in 1992 (and subsequently adopted by the Board) which allows members with 25 years of service to retire at age 50 with unreduced benefits. Otherwise, members age 50 with 20 years of service receive their accrued service retirement benefit, reduced for interest below age 55.

Ten years of service are required for vesting purposes.

Disability Benefit

Non-Service-Connected

Members with 2 years of service, regardless of age, are eligible for non-service-connected disability. The benefit is 32% of FAS for the first 2 years of service plus 1% of FAS for each successive year. The maximum benefit is 50% of FAS. For members with 20 or more years of service, the benefit is the same as that for the Service Retirement Benefit.

Service-Connected

Members may retire regardless of length of service, and the benefit is 50% of FAS. For members with service of more than 20 years, the additional benefit for each year of service is 3.0% of FAS for 21–25 years of service and 4.0% of FAS for 26–30 years of service (subject to a maximum of 85% of FAS).

Death Benefit (before and after retirement)

Non-Service-Connected

Eligibility is based on 2 years of service, regardless of age. The spouse receives 24% of FAS for the first 2 years of service plus 0.75% of FAS for each successive year. The maximum benefit is the greater of 50% of the member's benefit and 37.5% of FAS.

If a member has eligible dependent children (under age 18, or age 22 if a full time student), the benefits are as follows:

1 child	25% of FAS
2 children	37.5% of FAS
3 or more children	50% of FAS

The total benefits payable to a family shall not exceed 75% of FAS.

If a member does not have a spouse nor dependent children at death, a lump sum equal to the greater of the member's contributions or \$1,000 is paid to the estate.

These benefits are payable for active member deaths and deaths after non-service-connected disability retirement.

Service-Connected

The spouse receives the greater of 50% of the member's benefit and 37.5% of FAS. Eligible dependent children receive 25% of FAS per child. The total benefits payable to a family shall not exceed 75% of FAS.

These benefits are payable for active member deaths and deaths after service-connected disability retirement and service retirement.

MAJOR PROVISIONS OF THE RETIREMENT PLAN *Continued*

Death Benefit – Inactive Members (After Retirement)

The spouse receives 1.875% of FAS per year of service, not to exceed 37.5% of FAS or 42.5% of FAS if retirement is after 2000. Eligible dependent children receive the following:

1 child	1.25% of FAS per year of service
2 children	1.875% of FAS per year of service
3 or more children	2.5% of FAS per year of service

The total benefits payable to a family shall not exceed 75% of FAS.

Cost-of-Living

The increase in retirement allowance is subject to a maximum of 3% a year.

Post-Retirement Health and Dental

Retirees and survivors with 15 years of service, or receiving a benefit of at least 37.5% of FAS, receive the same medical coverage that the City pays for an active member. Members must have retired from active service to be eligible.

Members' Retirement Contributions

The members' contribution rates are recalculated on an actuarial basis at each actuarial study and equal to 3/11ths of the Normal Cost. The members presently contribute at the rate of 11.16% of pay.

City's Retirement Contributions

The City presently contributes at a rate of 25.04% of pay for all members. The City rate is the percentage of salary necessary, on an actuarial basis, to provide for the payment of the benefits promised, also taking into account the contributions being made by the members and the assets on hand. These rates are changed in accordance with the results of each actuarial study.



STATISTICAL SECTION

STATISTICAL REVIEW

CHANGES IN NET ASSETS FOR FISCAL YEARS 1997–2006 (In Thousands)

Pension Benefits (Schedule 1a)

Additions	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Member contributions	\$9,979	\$10,770	\$12,469	\$27,321	\$13,383	\$14,737	\$16,416	\$17,233	\$16,240	\$16,432
Employer contributions	24,685	23,643	23,522	13,254	22,157	23,748	23,511	24,412	41,835	43,473
Investment Income (net of expenses)	158,445	186,902	134,371	112,421	(4,039)	(31,729)	80,225	252,431	202,320	230,225
Total additions to plan net assets	193,109	221,315	170,362	152,996	31,501	3,756	120,152	294,076	260,395	290,130
Deductions (See Schedule 2a)										
Benefit payments	28,531	32,749	37,207	40,974	45,699	54,113	55,342	61,449	69,102	75,189
Death benefits	1,484	1,525	1,531	1,689	1,772	1,771	3,732	3,976	4,226	4,803
Refunds	402	343	167	194	615	518	276	132	426	144
Administrative expenses and other	723	972	823	996	1,517	1,773	1,583	2,053	1,617	2,171
Total deductions from plan net assets	31,140	35,589	39,728	43,853	49,603	58,175	60,933	67,610	75,371	82,307
Change in Net Assets	\$161,969	\$185,726	\$130,634	\$109,143	\$(18,102)	\$(51,419)	\$59,219	\$226,466	\$185,024	\$207,823

Postemployment Healthcare Benefits (Schedule 1b)

Additions	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Member contributions	\$1,732	\$1,800	\$1,679	\$2,866	\$2,159	\$3,114	\$3,521	\$3,696	\$5,673	\$5,742
Employer contributions	2,094	2,904	3,041	2,120	2,515	4,367	4,251	4,492	6,418	6,529
Investment Income (net of expenses)	2,089	6,212	2,273	2,490	(756)	(556)	1,415	4,414	3,554	4,089
Total additions to plan net assets	5,915	10,916	6,993	7,476	3,918	6,925	9,187	12,602	15,645	16,360
Deductions (See Schedule 2b)										
Healthcare insurance premiums	3,155	3,306	4,156	4,649	5,685	6,740	7,772	9,528	11,093	12,880
Administrative expenses and other	9	18	18	23	33	67	32	36	33	42
Total deductions from plan net assets	3,164	3,324	4,174	4,672	5,718	6,807	7,804	9,564	11,126	12,922
Change in Net Assets	\$2,751	\$7,592	\$2,819	\$2,804	\$(1,800)	\$118	\$1,383	\$3,038	\$4,519	\$3,438

Source: Pension Administration System

STATISTICAL REVIEW *Continued*

BENEFIT AND REFUND DEDUCTIONS FROM NET ASSETS BY TYPE (In Thousands)

Pension Benefits (Schedule 2a)

Type of Benefit	2006
<i>Age and Service Benefits</i>	
Retirees - Service	\$ 30,828
Retirees - Deferred Vested	892
Survivors - Service	741
Survivors - Deferred Vested	22
<i>Death in Service Benefits</i>	
	1,031
<i>Disability Benefits</i>	
Retirees - Service-connected	41,134
Retirees - Non-Service-connected	610
Survivors - Service-connected	2,876
Survivors - Non-Service-connected	133
<i>Ex-Spouse Benefits</i>	
	1,725
Total Benefits	\$ 79,992
<i>Type of Refund</i>	
<i>Separation</i>	\$ 144
Total Refunds	\$ 144

Postemployment Healthcare Benefits (Schedule 2b)

Type of Benefit	2006
<i>Age and Service Benefits</i>	
Retirees - Service	
Medical	\$ 3,871
Dental	492
Retirees - Deferred Vested	
Medical	119
Dental	15
Survivors - Service	
Medical	78
Dental	23
Survivors - Deferred Vested	
Medical	4
Dental	1
<i>Death in Service Benefits</i>	
Medical	165
Dental	35
<i>Disability Benefits</i>	
Retirees - Service-connected	
Medical	6,503
Dental	854
Retirees - Non-Service-connected	
Medical	147
Dental	21
Survivors - Service-connected	
Medical	408
Dental	118
Survivors - Non-Service-connected	
Medical	19
Dental	7
<i>Ex-Spouse Benefits</i>	
Medical	-
Dental	-
Total Benefits	\$ 12,880

Fiscal Year 2004-05 data not available due to system limitations.

Source: Pension Administration System

STATISTICAL REVIEW *Continued*

EMPLOYER AND EMPLOYEE CONTRIBUTION RATES FOR FISCAL YEARS 1997–2006

(Schedule 3)

Fiscal Year	Employee Rate (%)	Employer Rate (%)
1997	9.40	21.61
1998*	9.70	17.28
1999*	10.22	19.82
2000	10.22	20.11
2001	9.79	15.70
2002	9.79	15.70
2003	10.25	14.22
2004	10.25	14.22
2005	11.16	24.59
2006	11.16	25.04

*multiple rates this year

Source: Pension Administration System

RETIRED MEMBERS BY TYPE OF BENEFIT

As of June 30, 2006

PENSION BENEFITS

Amount Monthly Benefit	Number of Retirees & Beneficiaries	Type of Retirement*							Option Selected**				
		1	2	3	4	5	6	7	Unmod.	Opt. 1	Opt. 2	Opt. 3	Total
\$1 - 500	5	-	-	-	-	-	5	-	-	-	5	-	5
\$501 - 1000	24	-	-	2	1	-	16	5	5	-	19	-	24
\$1001 - 1500	85	1	-	44	4	2	27	7	12	-	73	-	85
\$1501 - 2000	87	2	-	42	20	3	16	4	28	1	58	-	87
\$2001 - 2500	112	6	-	44	44	1	10	7	57	-	55	-	112
\$2501 - 3000	102	3	-	26	58	2	10	3	61	4	36	1	102
\$3001 - 3500	104	5	1	8	78	7	3	2	87	1	14	2	104
\$3501 - 4000	110	17	2	4	83	2	1	1	83	-	14	13	110
\$4001 - 4500	113	33	-	4	76	-	-	-	79	4	14	16	113
\$4501 - 5000	115	48	-	4	62	-	1	-	81	5	14	15	115
\$5001 - 5500	143	63	-	3	76	-	-	1	124	4	5	10	143
\$5501 - 6000	122	54	-	-	68	-	-	-	100	6	4	12	122
\$6001 - 6500	86	46	-	-	39	1	-	-	68	1	7	10	86
\$6501 - 7000	67	32	-	-	35	-	-	-	49	4	5	9	67
Over \$7000	204	114	-	1	87	-	-	2	135	6	25	38	204
TOTAL	1479	424	3	182	731	18	89	32	969	36	348	126	1479

*Retirement Codes

- 1 Service
- 2 Early
- 3 Survivor (survivor of active employee) or Continuance (survivor of retired employee)
- 4 Service-Connected Disability
- 5 Non-Service-Connected Disability
- 6 Ex-Spouse
- 7 Deferred Vested

**Option Descriptions

- Unmodified Joint & Survivorship (standard default for married)
- 1 Contingent Joint & Survivorship (increased percentage to survivor/reduce pension to member)
- 2 Unmodified/No Survivor (standard default for unmarried)
- 3 Joint & Survivorship Pop-Up (same as option 1 but if spouse predeceases member, pension goes back to original pension calculation)

POSTEMPLOYMENT HEALTHCARE BENEFITS

Amount Monthly Benefit	Type of Subsidy	
	Health	Dental
Ineligible/Deferred	157	127
\$ 1 - 60	-	17
61 - 250	1	1335
251 - 500	356	-
501 - 750	97	-
751 - 1000	868	-
Total	1479	1479

Source: Pension Administration System

AVERAGE BENEFIT PAYMENT AMOUNTS

PENSION BENEFITS

	Years of Service Credit						
	0-5	6-10	11-15	16-20	21-25	26-30	31+
Retirement Effective Dates							
<i>Period 7/1/2005 to 6/30/2006</i>							
Average Monthly Benefit*	\$889	\$1,424	\$1,822	\$2,633	\$3,073	\$5,092	\$5,411
Average Final Average Salary**	\$1,778	\$2,934	\$3,716	\$5,290	\$5,164	\$6,674	\$6,725
Number of Retired Members***	7	47	61	76	189	462	129
Average Monthly Benefit*							
(for those whose FAS was unavailable)	\$-	\$414	\$735	\$1,741	\$2,405	\$3,835	\$4,103
Number of Retired Members***	0	3	6	14	36	137	32

* Monthly benefit does not include cost of living increases of 3% per year.

** Final Average Salary not available for those that retired prior to April 1998, except for service-connected disability retirees. Those without Final Average Salary are not included in Average Monthly Benefit.

*** Does not include Survivors and Ex-Spouses

Information presented in the above table is not readily available prior to fiscal year 2006.

POSTEMPLOYMENT HEALTHCARE BENEFITS

	Years of Service Credit						
	0-5	6-10	11-15	16-20	21-25	26-30	31+
Retirement Effective Dates							
<i>Period 7/1/2005 to 6/30/2006</i>							
Average Health Subsidy	\$571	\$662	\$722	\$735	\$731	\$772	\$742
Number of Health Participants*	7	45	56	79	216	453	129
Average Dental Subsidy	\$95	\$96	\$95	\$94	\$94	\$95	\$95
Number of Dental Participants*	7	49	59	80	222	461	129

* Does not include Survivors and Ex-Spouses

Information presented in the above table is not readily available prior to fiscal year 2006.

Source: Pension Administration System

RETIREMENTS DURING FISCAL YEAR 2005–06

Service Retirements

Police Department

BECERRA, MANUEL
CARTER, HOWARD
CLARK, WILLIAM R
DE MERS JR, DONALD O
FAGALDE, KEVIN P
GARZA, RICARDO T
GEIGER, RICHARD F
HENDRICKSON, DAVID A
HILL, LOUIS D
HIRATA, GARY M
HOSMER, WILLIAM D
JOHNSON, GARY D

KORVER, GREG L
MARTORANO, JOHN D
MC COURTIE, GLENN L
OBOS, ROBERT J
O'CONNOR, MICHAEL J
OLIVER, PETER S
RAUL, GARY L
SCHENCK, JOSEPH F
TREVINO, ANDY
VIZZUSI, GILBERT P
WEESNER, GREGORY L

Fire Department

ATKINSON, LACY L
CABIGAS, RUDY J
CARABAL, ROBERT W
COFFEY, MARVIN M
JOHNSON, CRAIG L
KING, ROBERT B
SILVA, LAWRENCE J
WELLS, CLARENCE R

Early Retirements

Police Department

NONE

Fire Department

NONE

Deferred Vested Retirements

Police Department

NONE

Fire Department

NONE

Service-Connected Disability Retirements

Police Department

DE BOARD, JOE R
MARCOTTE, STEVEN P
WICKER, JOSEPH P

Fire Department

BOWERS, PATRICK D
FLATLEY, JOHN P
O'STEEN, STEVEN R

Non-Service-Connected Disability Retirements

Police Department

NONE

Fire Department

NONE

Source: Pension Administration System

DEATHS DURING FISCAL YEAR 2005–06

Deaths After Retirement

Police Department

ANTHONY, DICK K
BROWN, EUGENE
CARDONA, VELMA F
DE LUCA, PETER P
EMMONS, JAMES L
FAZIO, ROBERT T

KOSIK, VICTOR A
MULLINS, FRED R
TOUSSAINT, HAROLD P
WHITLEY, FRED B

Fire Department

BRAUN, DUANE R
DEVITT, FRANCIS M
HAMILTON, THOMAS C
MAC LEAN, ARTHUR A
NOSEWORTHY, ALEC
ONZO, JOSEPH J

POTTER, ALBERT W
RODRIGUEZ, LUIS R
SCOTT, JOHN N
SELZER, WILLIAM J
YELTON, BOB

Deaths Before Retirement

Police Department

MC DANIEL, MARK A

Fire Department

MC CLANAHAN, CLIFFORD E CORONA, NICK U

Source: Pension Administration System



OTHER REPORTS

*Comprehensive Annual Financial Report 2005–06
San José Police and Fire Department Retirement Plan*

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS



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Board of Administration
City of San José Police and Fire
Department Retirement Plan

We have audited the financial statements of the City of San José Police and Fire Department Retirement Plan (Plan), a pension trust fund of the City of San José, California, as of and for the fiscal years ended June 30, 2006 and 2005, and have issued our report thereon dated October 2, 2006. 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 Plan'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 over financial reporting would not necessarily disclose all matters in the internal control 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Plan's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS** *Continued*



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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 that we reported to management of the Plan in a separate letter dated October 2, 2006.

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

October 2, 2006

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