CITY OF SAN JOSÉ

COMPREHENSIVE ANNUAL FINANCIAL REPORT

For the Fiscal Year Ended June 30, 2006

# FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM

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

CITY OF SAN JOSE

CAPITAL OF SILICON VALLEY

City of San José
Comprehensive Annual
Financial Report

For the Fiscal Year
Ended June 30, 2006

# Federated City Employees' Retirement System

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

**Edward F. Overton**
Director


City of San José
Department of Retirement Services

1737 North First Street, Suite 580
San José, California 95112-4505
408.392.6700 Phone
408.392.6732 Fax
www.sjretirement.com

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# Board Chair Letter

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

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

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 Federated City Employees' Retirement System's (the System) Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2006. Some significant events worthy of note during this fiscal year were as follows:

The System earned a time-weighted rate of return of 10.81% on investments, compared to 9.27% for its benchmark and 9.44% for the Trust Universe Comparison Service Public Fund Median. The System has earned an annualized return of 9.23% since the performance measurement inception of December 31, 1993. The fair value of the System's investments increased from $1,512,163,000 to $1,623,956,000, 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.

In December 2005, an amendment to the San José Municipal Code (Chapter 3.44) was approved to provide a flat 3% cost-of-living adjustment to the retirees and survivors, effective April 1, 2006.

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 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 Continuance Plan.

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, the actuarial consultants, and the Fund performance evaluators have produced a sound fund capable of continued growth. The Board of Administration and its staff are available to provide additional information when requested.

Sincerely,

DAVID BUSSE, Chair
Board of Administration

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# Introductory Section

# Letter of Transmittal

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

City of San José
**DEPARTMENT OF RETIREMENT SERVICES**
Board of Administration
Federated City Employees' Retirement System
1737 North First Street, Suite 580
San 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 Federated City Employees' Retirement System (the System) 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 System's management. Macias Gini & O'Connell LLP, the System's independent auditor, has audited the accompanying financial statements. Management believes that internal control is adequate and the accompanying statements, schedules and tables are fairly presented and free from material misstatement.

The System was established in 1941 and began using the CAFR format for the fiscal year ended June 30, 2000. Information contained in this report is designed to provide a complete and accurate financial review of the year's operations. I am proud to report that last year's CAFR was awarded the Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association ("GFOA"). I encourage you to review the narrative introduction, overview and analysis located in Management's Discussion and Analysis beginning on page 14.

*Structure of the Report*

This report is presented in five sections:

- The Introductory Section contains the chairman's report, the letter of transmittal, the Certificate of Achievement for Excellence in Financial Reporting, description of the System's management and organizational structure, a summary of the plan provisions and a listing of the professional service firms used.
- The Financial Section contains the report from the independent auditor, Macias Gini & O'Connell LLP, Management's Discussion and Analysis, and the basic financial statements of the System and certain required supplementary information and other supplementary information.
- The Investment Section contains the Investment Consultant's statement produced by the Northern Trust, the System's investment performance consulting firm, along with investment policies and graphs and schedules regarding asset allocation, asset diversification and performance.
- The Actuarial Section contains the certification letter produced by the independent actuary, Gabriel, Roeder, Smith & Company, along with the results of the System's last bi-annual valuation (2003).
- The Statistical Section contains graphs and schedules with comparative data related to additions, deductions, benefits, and membership. The section also includes the schedules related to Postemployment Healthcare Benefits.

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

*Certificate of Achievement*

The GFOA awarded a Certificate of Achievement for Excellence in Financial Reporting to the System 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

# Letter of Transmittal *Continued*

principles and applicable legal requirements. A Certificate of Achievement is valid only for one year. The System first received the certificate for its fiscal year ended June 30, 2000 CAFR with its first application. We believe our current report continues to conform to the Certificate of Achievement Program Requirements, and we are submitting it to GFOA to determine its eligibility for another certificate.

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

### *Major Initiatives*

The System 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 Police & Fire Department Retirement Plan.

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 from July 2, 2006. The new rates increased the City's contribution from 17.12% to 21.98% and increased the Employees' contribution from 6.06% to 7.58%. Funding status of the Plan was reduced from 98% to 81%. It was reduced due to an increase in unfunded accrued actuarial liability ("UAAL") from $31 million to $327 million. This increase in UAAL is mainly due to experience losses and assumption changes made to reflect longer life expectancies and earlier retirements.

In December 2005, an amendment to the Chapter 3.44 of Title 3 of the San José Municipal Code was approved to provide for a flat 3% cost-of-living adjustment effective April 1, 2006 for retirees and survivors of members or retirees.

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 System and the Police & Fire Department Retirement Plan.

### *Changes in System Membership*

System membership changes for the defined benefit pension plan for fiscal years 2005–06 were as follows:

| | *2006* | *2005* | *Increase/ (Decrease)* | *Percent Change* |
|---|---|---|---|---|
| Active Members* | 4,524 | 4,603 | (79) | -1.7% |
| Retired Members | 2,206 | 2,079 | 127 | 6.1% |
| Survivors** | 415 | 406 | 9 | 2.2% |
| **TOTAL** | **7,145** | **7,088** | **57** | **0.8%** |

* *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 9.23%, which is ahead of the actuarial assumption rate of 8.25%. The fair value of the System's investments increased from $1,512,163,000 to $1,623,956,000, 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 System's investment consultant, The Northern Trust Company, believes that the asset allocation strategy followed by the System's Board has benefited the plan's long-term return. The System is well structured to meet its investment objectives as defined in the Investment Policy Statement.

### *Investment Summary*

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

# Letter of Transmittal *Continued*

For the fiscal year ended June 30, 2006, the time-weighted rate of return for the System was 10.81% versus the Benchmark return of 9.27%, which placed the System's total return in the second 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 12.11% over the past three years and 8.24% over the past five years, and ranked in the 40th and the 8th percentiles, respectively, of the TUCS Public Fund Universe.

*Funding*

The System'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 System was approximately 80.9%. A six-year history of the System's funding progress is presented on page 40. The net increase in System assets for fiscal year 2005–06 was $111,793,000. Details of the components of this increase are included in the Statements of Changes in Plan Net Assets on page 24.

*Conclusion*

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

Respectfully Submitted,

Edward F. Overton
Director, Retirement Services

# Certificate of Achievement in Financial Reporting

## Certificate of Achievement for Excellence in Financial Reporting

Presented to

San Jose Federated City

Employees Retirement System,

California

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

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

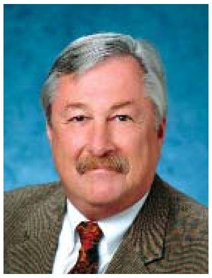
President

Executive Director

# Board of Administration

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

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



**DAVID BUSSE, CHAIR**

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

**WILLIAM A. THOMAS, VICE CHAIR**

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

**TIM CALLAHAN**

*Employee Representative appointed to the Board in December 2005. His current term expires November 30, 2009.*

**DAVID CORTESE**

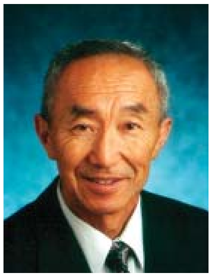
*City Council Member appointed to the Board on January 1, 2005.*

**FORREST WILLIAMS**

*City Council member appointed to the Board in August 2001.*

**JEFFREY PERKINS**

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



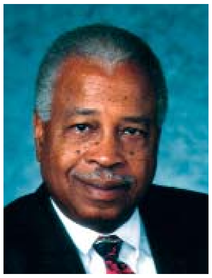
**MIKE YOSHIMOTO**

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

# Administration/Outside Consultants

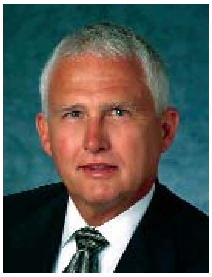
**EDWARD F. OVERTON**

DIRECTOR, RETIREMENT SERVICES



**THOMAS J. WEBSTER**

DEPUTY DIRECTOR,
CHIEF OPERATIONS OFFICER



***STANDING PUBLIC MEETINGS***

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

COMMITTEE FOR INVESTMENTS:
Quarterly

COMMITTEE OF THE WHOLE:
Quarterly

REAL ESTATE COMMITTEE:
Quarterly

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

***OUTSIDE CONSULTANTS***

ACTUARY
Gabriel, Roeder, Smith & Company
San Diego, CA

OUTSIDE COUNSEL
Saltzman & Johnson
San Francisco, CA

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

AUDITOR
Macias Gini & O'Connell LLP
Walnut Creek, CA

*A list of Investment Professionals begins on page 59 of the Investment Section of this report.*

# Department of Retirement Services Organizational Chart

- **Edward F. Overton**, Director, 408 392-6703
  - **(Vacant)**, Deputy Director, Chief Financial Officer
    - **Donna Busse**, Investment Officer, 408 392-6709
      - Ronald R. Kumar, Financial Analyst, 408 392-6708
      - Udaya Rajbhandari, Financial Analyst, 408 392-6717
      - Judy Powell, Staff Technician, 408 392-6716
    - **Colleen Hy**, Senior Accountant, 408 392-6719
      - Susan Perreira, Accountant, 408 392-6730
      - Hoa Lang, Accounting Technician, 408 392-6721
      - Cion Garcia, Senior Account Clerk, 408 392-6730
      - Selina Ordaz, Account Clerk, 408 392-6722
  - **Thomas J. Webster**, Deputy Director, Chief Operations Officer, 408 392-6704
    - **Debbi Warkentin**, Administrative Assistant, 408 392-6723
      - Tamasha Johnson, Secretary, 408 392-6724
      - Andrea Ogana, Office Speciaialist, 408 392-6700
      - Julie Cano, Office Specialist, 408 392-6700
    - **Barbara Hayman**, Info Systems Analyst, 408 392-6710
      - May Cheung, Systems Analyst, 408 392-6711
      - Gina Billings, Enterprise Network Technician II, 408 392-6705
    - **Roger Pickler**, Support Services Supervisor, 408 392-6707
      - Toni Johnson, Senior Analyst, Pension Benefits, 408 392-6713
        - Aleta Holcomb, Staff Technician, 408 392-6718
        - Amanda Ramos, Analyst, 408 392-6706
        - Mike Pribula, Analyst, 408 392-6715
        - Maria Loera, Analyst, 408 392-6714
      - Karin Carmichael, Analyst, Education/Communications, 408 392-6712
      - (Vacant), Staff Technician, Education/Communications
      - Carol Bermillo, Analyst, Health Benefits, 408 392-6720

***Department of Retirement Services Administration***

*1737 North First Street, Suite 580*
*San José, CA 95112*
*408.392.6700 PHONE*
*800.732.6477 PHONE*
*408.392.6732 FAX*
*www.sjretirement.com*

# Summary of the Principal Plan Provisions

## MEMBERSHIP

Mandatory for all full-time non-safety employees.

## MEMBER CONTRIBUTION

All members contribute 6.06% of base salary.

## CITY'S CONTRIBUTION

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

## RETIREMENT

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

## RETIREMENT ANNUITY

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

## FINAL AVERAGE SALARY

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

## DISABILITY RETIREMENT

**Non-Service-Connected**
A non-service-connected disability annuity is available to members with five (5) or more years of service if the disability is permanent and prevents the member from performing any work in his/her present classification. The base non-service-connected disability annuity is the greater of 40% of the Final Average Salary or the earned retirement allowance (Final Average Salary 2.5% x Number of Years of Service up to 30 years). The annuity will be reduced by .5% for each year of age under 55.

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

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

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

## TERMINATION BENEFITS

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

## DEFERRED RETIREMENT

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

## RECIPROCITY

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

## COST OF LIVING

Effective April 1, 2006, the cost-of-living (COL) provision provides a flat 3% annual adjustment in April for retirees and survivors.

# Summary of the Principal Plan Provisions *Continued*

## DEATH BEFORE RETIREMENT

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

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

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

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

## DEATH AFTER RETIREMENT

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

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

## MANAGEMENT

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

## ADMINISTRATION

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

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

The Northern Trust is employed as custodian of fund assets and collector of investment income.

## ACTUARIAL SOUNDNESS

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

## INVESTMENT AUTHORITY AND POLICY

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

# Financial Section

# Independent Auditor's Report

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

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

## INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying statements of plan net assets of the City of San José Federated City Employees' Retirement System (System), a pension trust fund of the City of San José, California, as of June 30, 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 System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2(a), the financial statements of the System are intended to present only the plan net assets and changes in plan net assets of the System. They do not purport to, and do not, present fairly the financial position of the City of San José, California, as of June 30, 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 statements referred to above present fairly, in all material respects, the financial position of the System 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 accordance with *Government Auditing Standards*, we have also issued our report dated October 2, 2006 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and 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 audits.

# 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

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 System's basic financial statements. The introductory section, other supplementary information in the financial section, the investment, actuarial and statistical sections listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The other supplementary information in the financial section has been subjected to 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 JOSE
CAPITAL OF SILICON VALLEY

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

EDWARD F. OVERTON
DIRECTOR, RETIREMENT SERVICES

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

We are pleased to provide this overview and analysis of the financial activities of the Federated City Employees' Retirement System (the System) for the fiscal years ended June 30, 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 System at the close of the fiscal year 2006 are $1,623,956,000 (net assets held in trust for pension benefits and postemployment healthcare benefits). All of the net assets are available to meet the System's ongoing obligations to plan participants and their beneficiaries.

- The System's total net assets held in trust for pension benefits and postemployment healthcare benefits increased by $111,793,000 or 7.4%, primarily as a result of a strengthening in the investment market.

- Additions to Plan Net Assets for the year were $204,995,000, which includes member and employer contributions of $64,849,000, net investment income of $139,764,000, and net securities lending income of $382,000.

- Deductions in Plan Net Assets increased from $81,878,000 to $93,202,000 over the prior year, or approximately 13.8% due to an increase in retirement and healthcare benefits, which was attributable to enhanced benefits and an increased number of beneficiaries along with increased health premium costs.

### *Overview of the Financial Statements*

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

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

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

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

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 state and local government pension plan reports use the full accrual method of accounting. The System 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 System's activities. These statements include all assets and liabilities, using the full accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's additions and deductions are taken into account regardless of when cash is received or paid. All investment gains and losses are shown at trade date, not settlement date. In addition, both realized and unrealized gains and losses are shown on investments.

These two statements report the System's net assets held in trust for pension benefits and postemployment healthcare benefits (net assets)—the difference between assets and liabilities. Over time, increases and decreases in the System's net assets are one indicator of whether its financial health is improving or deteriorating. Other factors, such as market conditions, should also be considered in measuring the System's overall health (see the System's financial statements beginning on page 22 of this report).

*Notes to the Basic Financial Statements* provide additional information that is essential to a full understanding of the data provided in the financial statements (see Notes to Basic Financial Statements on page 26 of this report).

*Other Information*. In addition to the financial statements and accompanying notes, this report presents certain required supplementary information concerning the System's progress in funding its obligations to provide pension benefits to members, employer contributions and actuarial methods and assumptions (see *Required Supplementary Information* beginning on page 40 of this report).

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

### Financial Analysis

As previously noted, net assets may serve over time as a useful indication of the System's financial position (see Table 1a on page 16). The assets of the System exceeded its liabilities at the close of fiscal year 2006 and 2005.

As of June 30, 2006, $1,623,956,000 in total net assets was held in trust for pension benefits and postemployment healthcare benefits (see Table 1a on page 16). All of the net assets are available to meet the System's ongoing obligation to plan participants and their beneficiaries, except assets held in the Supplemental Retiree Benefit Reserve, which is used to provide supplemental benefits to retirees on a discretionary basis.

As of June 30, 2005, $1,512,163,000 in total net assets was held in trust for pension benefits and postemployment healthcare benefits (see Table 1b on page 16). This total represented an increase of 7.5% in net assets over the prior year primarily due to an increase in the fair value of investments.

As of June 30, 2006, total net assets increased by 7.4% over the prior year primarily due to appreciation in fair value of investments of $109,237,000.

As of June 30, 2005, total net assets increased by 7.5% over the prior year primarily due to appreciation in the fair value of investments of $86,953,000.

As of June 30, 2006, receivables decreased by $20,781,000, or 40.0% mainly due to a decrease in receivables from brokers and others. In the previous year, receivables decreased by $120,321,000, or 69.9% due to a decrease in receivables from brokers and other.

As of June 30, 2006, total liabilities decreased by $40,516,000, or 17.0%, compared with June 30, 2005, due mainly to a decrease in payable to brokers and securities lending collateral due to borrowers.

As of June 30, 2005, total liabilities decreased by $84,390,000, or 26.2%, compared with June 30, 2004, also due to a decrease in payable to brokers.

### Reserves

The System's reserves are established from contributions and the accumulation of investment income, after satisfying investment and administrative expenses (see table on page 29). The Defined Benefit Pension Plan Net Assets are allocated between the Retirement Fund, which includes postemployment healthcare benefits, and the Cost-of-Living Fund.

The appreciation in the fair value of investments and the five-year smoothing of investment gains and losses resulted in an increase in the "unrealized gains (loss) on investments held" reserve of $59,189,000 and $27,960,000 as of June 30, 2006 and 2005, respectively.

# Management's Discussion and Analysis (Unaudited) *Continued*

## FCERS NET ASSETS (TABLE 1A)

*As of June 30, 2006 and 2005*

| | 2006 | 2005 | Increase/ (Decrease) Amount | Increase/ (Decrease) Percent |
|---|---|---|---|---|
| Receivables | $ 31,151,000 | $ 51,932,000 | $ (20,781,000) | -40.0% |
| Investments at Fair Value | 1,790,488,000 | 1,698,430,000 | 92,058,000 | 5.4% |
| **Total Assets** | **1,821,639,000** | **1,750,362,000** | **71,277,000** | **4.1%** |
| Current Liabilities | 197,683,000 | 238,199,000 | (40,516,000) | -17.0% |
| **Total Liabilities** | **197,683,000** | **238,199,000** | **(40,516,000)** | **-17.0%** |
| **Net Assets** | **$ 1,623,956,000** | **$ 1,512,163,000** | **$ 111,793,000** | **7.4%** |

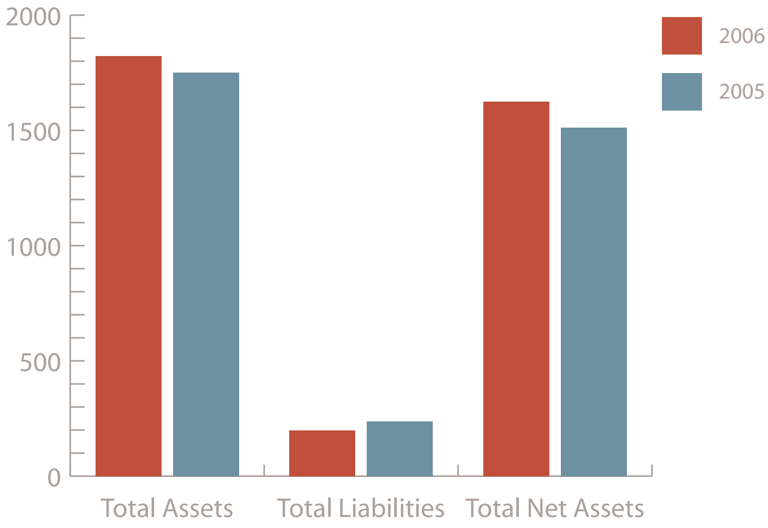
## FCERS NET ASSETS (TABLE 1B)

*As of June 30, 2005 and 2004*

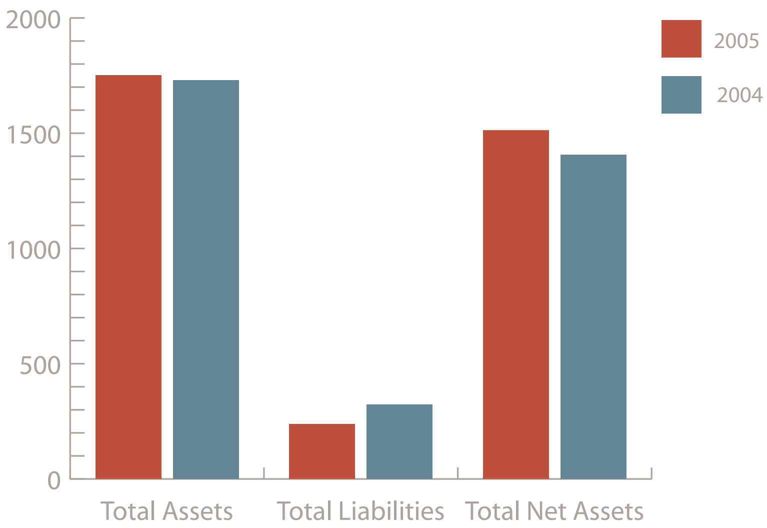
| | 2005 | 2004 | Increase/ (Decrease) Amount | Increase/ (Decrease) Percent |
|---|---|---|---|---|
| Receivables | $ 51,932,000 | $ 172,253,000 | $ (120,321,000) | -69.9% |
| Investments at Fair Value | 1,698,430,000 | 1,557,060,000 | 141,370,000 | 9.1% |
| **Total Assets** | **1,750,362,000** | **1,729,313,000**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

# Management's Discussion and Analysis (Unaudited) *Continued*

**FCERS NET ASSETS** *As of June 30, 2006*
(Dollars in Millions)




**FCERS 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/ (Decrease) Amount | Increase/ (Decrease) Percent |
|---|---|---|---|---|
| Employee Contributions | $ 17,621,000 | $ 17,612,000 | $ 9,000 | 0.1% |
| Employer Contributions | 47,228,000 | 47,548,000 | (320,000) | -0.7% |
| Net Investment Income* | 139,764,000 | 121,943,000 | 17,821,000 | 14.6% |
| Net Securities Lending Income | 382,000 | 214,000 | 168,000 | 78.5% |
| **Total Additions** | **$ 204,995,000** | **$ 187,317,000** | **$ 17,678,000** | **9.4%** |

** Net of Investment Expenses of $5,231,000 and $4,538,000 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 | $ 17,612,000 | $ 15,585,000 | $ 2,027,000 | 13.0% |
| Employer Contributions | 47,548,000 | 43,482,000 | 4,066,000 | 9.4% |
| Net Investment Income* | 121,943,000 | 203,210,000 | (81,267,000) | -40.0% |
| Net Securities Lending Income | 214,000 | 229,000 | (15,000) | -6.6% |
| **Total Additions** | **$ 187,317,000** | **$ 262,506,000** | **$ (75,189,000)** | **-28.6%** |

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

**DEDUCTIONS TO PLAN NET ASSETS (TABLE 3A)**

*For the Fiscal Years Ended June 30, 2006 and 2005*

| | 2006 | 2005 | Increase Amount | Increase Percent |
|---|---|---|---|---|
| Retirement Benefits | $ 68,438,000 | $ 60,438,000 | $ 8,000,000 | 13.2% |
| Healthcare Insurance Premiums | 15,904,000 | 13,393,000 | 2,511,000 | 18.7% |
| Death Benefits | 5,721,000 | 5,437,000 | 284,000 | 5.2% |
| Refund of Contributions | 1,246,000 | 927,000 | 319,000 | 34.4% |
| Administrative and other | 1,893,000 | 1,683,000 | 210,000 | 12.5% |
| **Total Deductions** | **$ 93,202,000** | **$ 81,878,000** | **$ 11,324,000** | **13.8%** |

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

# 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 | $ 204,995,000 | $ 187,317,000 | $ 17,678,000 | 9.4% |
| Total Deductions | 93,202,000 | 81,878,000 | 11,324,000 | 13.8% |
| **Net Increase (Decrease) in Plan Assets** | **$ 111,793,000** | **$ 105,439,000** | **$ 6,354,000** | **6.0%** |

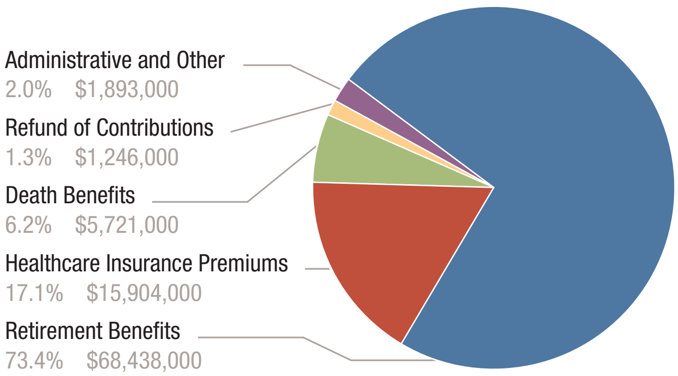
**CHANGES IN PLAN NET ASSETS (TABLE 4A)**

*For the Fiscal Years Ended June 30, 2005 and 2004*

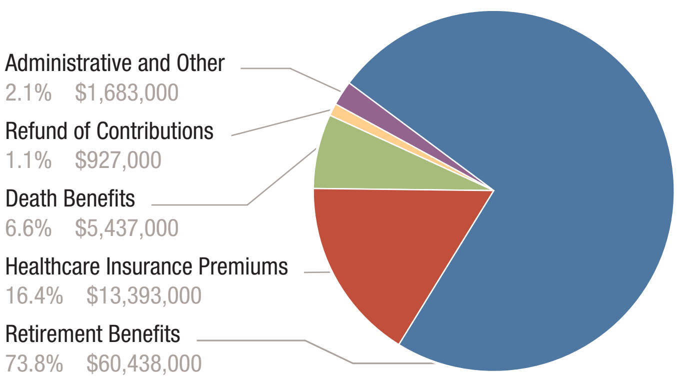
| | 2005 | 2004 | Increase/ (Decrease) Amount | Increase/ (Decrease) Percent |
|---|---|---|---|---|
| Total Additions | $ 187,317,000 | $ 262,506,000 | $ (75,189,000) | -28.6% |
| Total Deductions | 81,878,000 | 73,571,000 | 8,307,000 | 11.3% |
| **Net Increase in Plan Assets** | **$ 105,439,000** |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

# Management's Discussion and Analysis (Unaudited) *Continued*

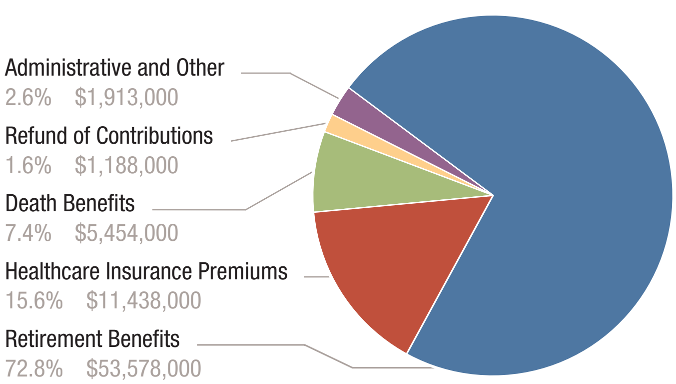
### DEDUCTIONS FROM PLAN NET ASSETS 2006




### DEDUCTIONS FROM PLAN NET ASSETS 2005




### DEDUCTIONS FROM PLAN NET ASSETS 2004




### *FCERS ACTIVITIES*

The market appreciation during fiscal year 2006 resulted in increased net assets by $111,793,000, thereby accounting for a 7.4% 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 $204,995,000 (see Table 2a on page 18).

By the fiscal year ended June 30, 2006, overall additions had increased by $17,698,000, or 9.4% from the prior year primarily due to an increase in net investment income, which increased by $17,821,000 or 14.6%. The System's time-weighted rate of return for the fiscal year ended June 30, 2006 was 10.81% versus 8.91% for the fiscal year 2004–05.

Additions for the fiscal year ended June 30, 2005 totaled $187,317,000, representing a decrease of $75,189,000 or 28.6%, from the prior year also primarily due to a decrease in net investment income which decreased $81,267,000, or 40.0% (see Table 2b on page 18). The decrease in net investment income was due to a decrease in net appreciation in fair value of investments.

#### *Deductions from Plan Net Assets*

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

Deductions for the fiscal year ended June 30, 2006 totaled $93,202,000, an increase of 13.8% over fiscal year ended June 30, 2005 (see Table 3a on page 18). Increases in retirement benefits of $8,000,000, and healthcare insurance premiums of $2,511,000, were the primary reasons for the increase in deductions. Retirement benefits increased due to benefit enhancements and increased number of beneficiaries.

# Management's Discussion and Analysis (Unaudited) *Continued*

Healthcare insurance costs increased due to higher premiums and administrative expenses which increased primarily as a result of an increase in payroll costs due to increased staffing.

Deductions for the fiscal year ended June 30, 2005 totaled $81,878,000, an increase of 11.3% over fiscal year ended June 30, 2004 (see Table 3b on page 18). Increases in retirement benefits of $6,860,000, and healthcare insurance premiums of $1,955,000, were also the primary reasons for the increase in deductions. Retirement benefits increased due to benefit enhancements and increased number of beneficiaries. Healthcare insurance costs increased due to higher premiums and administrative expenses.

### *The System's Fiduciary Responsibilities*

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

### *Economic Factors and Rates Affecting Next Year*

The System completed a new actuarial valuation dated June 30, 2005 and the rates were adopted effective July 2, 2006. The new rates increase the contributions from the City from 17.12% to 21.98% and the employees from 6.06% to 7.58%. Funding status of the Plan was reduced from 97.6% to 80.9%. Funding status was reduced due to an increase in unfunded accrued actuarial liability ("UAAL") from $31 million to $327 million. This increase in UAAL is mainly due to experience losses, such as continued smoothed in investment losses from 2001 and 2002, and a greater number of retirements than anticipated; and assumption changes made to reflect longer life expectancies and earlier retirements.

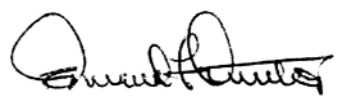
The System's funding objective is to meet long-term benefit obligations through contributions and investment income. As of June 30, 2005, the date of our last actuarial valuation, the funded ratio for the System was approximately 81%. In general, this indicates that for every dollar of benefits due we have approximately $.81 of assets to cover it.

### *Requests for Information*

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

**Federated City Employees' Retirement System**
1737 North First Street, Suite 580
San José, California 95112–4505

Respectfully Submitted,



Edward F. Overton
Director, Retirement Services

# Basic Financial Statements

## STATEMENTS OF PLAN NET ASSETS

*June 30, 2006 and 2005*

*(Dollars in Thousands)*

| | 2006 | | |
|---|---|---|---|
| | Pension Benefits | Postemployment Healthcare Benefits | Total |
| **ASSETS:** | | | |
| **Receivables:** | | | |
| Employee contributions | $ 441 | $ 187 | $ 628 |
| Employer contributions | 1,617 | 233 | 1,850 |
| Brokers and others | 21,212 | 1,133 | 22,345 |
| Accrued investment income | 6,006 | 322 | 6,328 |
| **Total receivables** | **29,276** | **1,875** | **31,151** |
| **Investments, at fair value:** | | | |
| *Securities and other:* | | | |
| U.S. Treasury notes and bonds | 65,702 | 3,449 | 69,151 |
| U.S. government agency securities | 170,592 | 8,956 | 179,548 |
| International government bonds | 61,368 | 3,222 | 64,590 |
| Domestic corporate bonds | 190,697 | 10,011 | 200,708 |
| International corporate bonds | 34,973 | 1,836 | 36,809 |
| Domestic equity securities | 670,930 | 35,222 | 706,152 |
| International equity securities | 277,486 | 14,567 | 292,053 |
| Private market equity | 7,559 | 397 | 7,956 |
| International forward currency contracts | 56 | 3 | 59 |
| Collective short-term investment funds | 29,303 | 1,538 | 30,841 |
| Real estate | 51,862 | 2,722 | 54,584 |
| Securities lending cash collateral investment pool | 140,532 | 7,505 | 148,037 |
| **Total investments** | **1,701,060** | **89,428** | **1,790,488** |
| **Total assets** | **1,730,336** | **91,303** | **1,821,639** |
| **LIABILITIES:** | | | |
| Payable to brokers | 45,171 | 2,412 | 47,583 |
| Securities lending collateral due to borrowers | 140,532 | 7,505 | 148,037 |
| Other liabilities | 1,965 | 98 | 2,063 |
| **Total liabilities** | **187,668** | **10,015** | **197,683** |
| **NET ASSETS HELD IN TRUST FOR:** | | | |
| Pension benefits | 1,542,668 | - | 1,542,668 |
| Postemployment healthcare benefits | - | 81,288 | 81,288 |
| **Total net assets** | **$ 1,542,668** | **$ 81,288** | **$ 1,623,956** |

*(A schedule of funding progress is presented on page 40.)*

*See accompanying notes to basic financial statements.*

*(Continued)*

# Basic Financial Statements *Continued*

## STATEMENTS OF PLAN NET ASSETS *Continued*

*June 30, 2006 and 2005*

*(Dollars in Thousands)*

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

*A schedule of funding progress is presented on page 40.)*

*See accompanying notes to basic financial statements.*

*(Continued)*

# 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 | $ 12,395 | $ 5,226 | $ 17,621 |
| Employer | 41,267 | 5,961 | 47,228 |
| **Total contributions** | **53,662** | **11,187** | **64,849** |
| **Investment income:** | | | |
| Net appreciation in fair value of investments | 103,564 | 5,673 | 109,237 |
| Interest income | 25,526 | 1,397 | 26,923 |
| Dividend income | 7,470 | 409 | 7,879 |
| Net rental income | 907 | 49 | 956 |
| Less investment expense | (4,957) | (274) | (5,231) |
| **Net investment income before securities lending income** | **132,510** | **7,254** | **139,764** |
| **Securities lending income:** | | | |
| Earnings | 6,603 | 361 | 6,964 |
| Rebates | (6,074) | (333) | (6,407) |
| Fees | (166) | (9) | (175) |
| **Net securities lending income** | **363** | **19** | **382** |
| **Net investment income** | **132,873** | **7,273** | **140,146** |
| **Total additions** | **186,535** | **18,460** | **204,995** |
| **DEDUCTIONS:** | | | |
| Retirement benefits | 68,438 | - | 68,438 |
| Healthcare insurance premiums | - | 15,904 | 15,904 |
| Death benefits | 5,721 | - | 5,721 |
| Refund of contributions | 1,246 | - | 1,246 |
| Administrative expenses and other | 1,790 | 103 | 1,893 |
| **Total deductions** | **77,195** | **16,007** | **93,202** |
| Net increase | 109,340 | 2,453 | 111,793 |
| **NET ASSETS HELD IN TRUST FOR PENSION BENEFITS AND POSTEMPLOYMENT HEALTHCARE BENEFITS:** | | | |
| Beginning of year | 1,433,328 | 78,835 | 1,512,163 |
| **End of year** | **$ 1,542,668** | **$ 81,288** | **$ 1,623,956** |

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

*See accompanying notes to basic financial statements.*

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

### *(a) General*

The System, consisting of a single employer Defined Benefit Pension Plan and a Postemployment Healthcare Plan, was established in 1941 and last amended October 14, 2005, to provide retirement benefits for certain employees of the City of San José (City). The System is considered to be a part of the City's financial reporting entity and is included in the City's basic financial statements as a pension trust fund. The System is administered by the Director of Retirement, an employee of the City, under the direction of the Federated City Employees' Retirement System Board of Administration (Board of Administration). The contribution and benefit provisions and all other requirements are established by City ordinance. The System is responsible for all direct administrative costs, which are funded by investment earnings, except for certain support services, which are provided by the City.

All full-time and eligible part-time employees of the City, except employees who are members of the City's Police and Fire Department Retirement Plan, are required to be members of the System. Total payroll, except for Police and Fire employees, amounted to approximately $290,581,000 and $292,677,000 for 2006 and 2005, respectively. Covered payroll amounted to approximately $274,592,000 and $277,939,000 for 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 System was as follows:

| **Defined Benefit Pension Plan:** | **2006** | **2005** |
|---|---|---|
| Retirees and beneficiaries currently receiving benefits | 2,621 | 2,485 |
| Terminated vested members not yet receiving benefits | 458 | 448 |
| Active members | 4,066 | 4,155 |
| **Total** | **7,145** | **7,088** |

| **Postemployment Healthcare Plan:** | | |
|---|---|---|
| Retirees and beneficiaries currently receiving benefits | 1,963 | 1,839 |
| Terminated vested members not yet receiving benefits | 62 | 59 |
| Active members | 4,066 | 4,155 |
| **Total** | **6,091** | **6,053** |

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

### *(b) Pension Benefits*

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

If employees terminate employment 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 earnings thereon is refunded. Refunds are paid out on a lump-sum basis. The forfeited amount of the City's contributions remains in the

# NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

## NOTE 1 – DESCRIPTION OF THE PLAN *Continued*

System. In the case of reciprocity, the member may leave contributions in the System with less than five years of service.

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

### *(c) Death Benefits*

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

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

### *(d) Disability Benefits*

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

If an employee with at least five years of service suffers a non-service related disability, the annual disability benefit is equal to the greater of: (1) 2.5% of final compensation multiplied by the number of years of service, up to a maximum of 30 years; or (2) 40% of final compensation. The benefit is reduced by 0.5% of final compensation for each year an employee's age is under 55.

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

### *(e) Postemployment Healthcare Benefits*

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

# NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### *(a) Basis of Presentation*

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

### *(b) Basis of Accounting*

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

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

### *(c) Investments*

Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price on the last business day of the fiscal year at current exchange rates, if applicable. Investments that do not have an established market are reported at estimated fair value. The fair value of real estate investments is based on independent appraisals. 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: $362,225,000 in domestic equities, $99,311,000 in international equities, and $7,956,000 in private equities. As of June 30, 2005 the amounts were $382,596,000 in domestic equities, $96,457,000 in international equities, and $1,014,000 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 System is required by the City of San José Municipal Code to establish various reserves in the plan net assets. The Plan Net Assets are allocated between the Defined Benefit Pension Plan (which includes the Retirement Fund and the Cost-of-Living Fund) and the Postemployment Healthcare Plan. As of June 30, 2006 and 2005, the net assets, totaling $1,623,956,000 and $1,512,163,000, 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 | Total Defined Benefit Pension Plan | Post-employment Healthcare Plan | Total |
|---|---|---|---|---|---|
| *June 30, 2006:* | | | | | |
| Employee contributions | $ 166,028 | $ 46,944 | $ 212,972 | $ 11,844 | $ 224,816 |
| Supplemental retiree benefit | 16,488 | - | 16,488 | - | 16,488 |
| Unrealized gains (loss) on investments held | 120,458 | 70,794 | 191,252 | 8,593 | 199,845 |
| General reserve | 836,512 | 285,444 | 1,121,956 | 60,851 | 1,182,807 |
| **Total** | **$ 1,139,486** | **$ 403,182** | **$ 1,542,668** | **$ 81,288** | **$ 1,623,956** |
| *June 30, 2005:* | | | | | |
| Employee contributions | $ 160,816 | $ 47,028 | $ 207,844 | $ 11,985 | $ 219,829 |
| Supplemental retiree benefit | 15,324 | - | 15,324 | - | 15,324 |
| Unrealized gains (loss) on investments held | 77,995 | 56,848 | 134,843 | 5,813 | 140,656 |
| General reserve | 803,681 | 271,636 | 1,075,317 | 61,037 | 1,136,354 |
| **Total** | **$ 1,057,816** | **$ 375,512** | **$ 1,433,328** | **$ 78,835** | **$ 1,512,163** |

*Employee Contributions Reserve* represent the total accumulated employee contributions of current active and deferred members plus credited interest. The reserve is accounted for separately due to the possibility of their return to the member upon separation from City employment.

*Supplemental Retiree Benefit Reserve* represents 10% of total accumulated excess earnings plus credited interest.

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

*General Reserve* represents net earnings resulting from interest earnings, realized investment gains and losses. General Reserve also represents an accumulation of funds necessary to pay all accumulated vested retirement obligations.

### *(e) 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 System does not have a policy regarding interest rate risk. As of June 30, 2006, GNMAs in the amount of $1,321,000 and U.S. government agency securities in the amount $172,192,000 are backed by mortgage pass-throughs which are highly sensitive to interest rate changes. Therefore, if interest rates decline, the mortgages are subject to prepayment by borrowers. However, the System's intent is to hold all fixed maturity investments until maturity, and accordingly, fixed maturity investments are classified in the following tables as if they were held to maturity. As of June 30 2005, the GNMA's were in the amount of $3,035,000 and the amount for U.S. government agency securities were $123,696,000. In addition, as of June 30, 2006 $4,891,000 of the collateralized mortgage obligations ("CMO") are floating rate securities tied to the 1 to 12 month LIBOR plus 31–250 bps, and $2,062,000 of the FNMA's is a floating rate security tied to the one-year CMT plus 212.9 bps. In 2005, $4,025,000 of the CMO's and $991,000 of the FNMA's were floating rate securities tied to the LIBOR plus 27–250 bps.

***Custodial Credit Risk*** – Custodial credit risk is the risk that the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party if that outside party fails. The System's custodian holds all investments of the System in the System's nominee name except for the assets held in pooled funds, which are under custody of the 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. The System's assets shall generally be invested in investment grade, marketable, fixed-income securities. Domestic fixed maturity investment grade shall be defined as being rated Baa/BBB or better by two of the following three rating services; Moody's Investor Services (Moody's), Standard & Poor's Corporation (S&P) or Fitch Rating Services (Fitch's). In the event that ratings are provided by only two agencies and the third is non-rated, the most conservative (lowest) rating will be assigned. If only one agency assigns a rating, that rating will be used. Up to 15% investment in BB or B securities will be permitted with written authorization of the Board. The investment managers employed to manage domestic fixed-income securities will have discretion in the day-to-day management of the funds under their control. International fixed maturity must be at least Aa3/AA-. If the corresponding ratings assigned by S&P and Moody's are not equivalent, the higher rating will be used for purposes of measuring portfolio and security quality. If a security is not rated by S&P or Moody's, the equivalent rating determined by the investment manager's research department will be used. If bonds are downgraded below the minimum credit quality allowable in the guidelines at the time of purchase, the manager is permitted to hold up to 2% of the System's portfolio managed by the individual manager, using the lower of S&P, Moody's, and Fitch's rating in the event of a split-rated security. The System may hedge against the possible adverse effects of currency fluctuations on the System's portfolio of international fixed income obligations when it is considered appropriate. Short-term investments may consist of commercial paper rated at least A1 or P1, repurchase agreements, short-term U.S. securities, and other money market investments.

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

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

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

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

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

# NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

## NOTE 3 – INVESTMENTS *Continued*

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

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

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

Short-term investments includes certificates of deposit and the collective short-term investment fund, which is used for overnight investment of all excess cash in the System's funds. It is invested by the System's Custodian, and held in the System Custodian's name. This fund consists of high-grade money market instruments with short maturities, such as:

- Short-term fixed corporate and U. S. agency obligations;
- Commercial Paper;
- Certificates of Deposit;
- 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.

As of June 30, 2006, the System held $144,535,000 of investments issued by the Federal National Mortgage Association (including non-USD), which represents 8.9% of its plan net assets.

# NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

## NOTE 3 – INVESTMENTS *Continued*

The following tables provide information as of June 30, 2006, concerning the fair value of investments, interest rate risk, and international 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 | $ (26) | $ - | $ 1,985 | $ 60,672 | $ - | $ 6,520 | $ 69,151 | $ 70,467 |
| GNMA | - | - | - | - | - | 1,321 | 1,321 | 1,365 |
| Other U.S. Gov't Agency Securities | - | - | - | 554 | 1,085 | 4,396 | 6,035 | 6,119 |
| FHLMC | - | - | - | 206 | 5,567 | 25,977 | 31,750 | 32,830 |
| FNMA | 4,162 | - | 7,509 | 2,028 | 15,965 | 110,778 | 140,442 | 143,901 |
| Asset Backed Securities | - | - | - | 27,157 | 3,227 | 8,352 | 38,736 | 39,086 |
| Collateralized Mortgage Obligations | - | - | - | 1,271 | - | 45,633 | 46,904 | 48,650 |
| Corporate Bonds | 450 | 303 | 1,017 | 38,461 | 39,453 | 35,384 | 115,068 | 116,109 |
| Collective Short-Term Investments | 26,295 | - | 1,383 | 3,163 | - | - | 30,841 | 30,860 |
| **Total Domestic Fixed Maturity** | **30,881** | **303** | **11,894** | **133,512** | **65,297** | **238,361** | **480,248** | **489,387** |
| **International** | | | | | | | | |
| **Government Bonds** | | | | | | | | |
| British Pound | - | - | - | - | - | 1,276 | 1,276 | 1,306 |
| Colombian Peso | - | - | - | 113 | 359 | - | 472 | 522 |
| Euro Currency | 2,422 | - | - | 12,414 | 7,669 | 7,432 | 29,937 | 31,117 |
| Japanese Yen | - | 975 | - | 15,002 | 3,283 | - | 19,260 | 20,271 |
| Mexican Peso | - | - | - | - | 1,980 | 148 | 2,128 | 2,132 |
| New Zealand Dollar | - | - | - | - | 754 | - | 754 | 882 |
| Norwegian Krone | - | - | - | 968 | - | - | 968 | 908 |
| Singapore Dollar | - | - | 2,201 | 836 | - | - | 3,037 | 3,055 |
| South African Rand | - | - | - | 947 | - | - | 947 | 1,019 |
| Swedish Krona | - | - | - | 3,007 | - | - | 3,007 | 3,196 |
| United States Dollar Denominated | - | - | - | - | 253 | 2,551 | 2,804 | 2,691 |
| **Total International Government Bonds** | **2,422** | **975** | **2,201** | **33,287** | **14,298** | **11,407** | **64,590** | **67,099** |
| **Corporate Bonds** | | | | | | | | |
| Australian Dollar | - | - | - | 458 | 458 | - | 916 | 973 |
| Brazilian Real | - | - | - | 488 | - | - | 488 | 383 |
| British Pound | - | - | - | 1,854 | 1,430 | 813 | 4,097 | 4,215 |
| Canadian Dollar | - | - | - | - | 891 | - | 891 | 891 |
| Euro Currency | - | - | 457 | 3,011 | 3,815 | - | 7,283 | 7,565 |
| Indonesian Rupiah | - | - | - | 419 | - | - | 419 | 378 |
| Japanese Yen | - | - | - | 9,621 | - | - | 9,621 | 10,573 |
| Mexican Peso | - | - | - | - | 301 | - | 301 | 321 |
| New Zealand Dollar | - | - | - | 430 | 113 | - | 543 | 643 |
| South Korean Won | - | - | - | 1,460 | - | - | 1,460 | 1,398 |
| Thai Bhat | - | - | - | 973 | - | - | 973 | 930 |
| United States Dollar Denominated | - | - | - | 2,325 | 4,973 | 2,519 | 9,817 | 10,105 |
| **Total International Corporate Bonds** | **-** | **-** | **457** | **21,039** | **11,981** | **3,332** | **36,809** | **38,375** |
| **Total International Fixed Maturity** | **2,422** | **975** | **2,658** | **54,326** | **26,279** | **14,739** | **101,399** | **105,474** |
| **Total Fixed Maturity** | **$ 33,303** | **$ 1,278** | **$ 14,552** | **$ 187,838** | **$ 91,576** | **$ 253,100** | **$ 581,647** | **$ 594,861** |

# NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

## NOTE 3 – INVESTMENTS *Continued*

| Type of Investment | Total Fair Value | Cost |
|---|---|---|
| **Equity** | | |
| Domestic | $ 343,927 | $ 302,303 |
| Pooled Domestic Equity | 362,225 | 287,750 |
| **Total Domestic Equity** | **706,152** | **590,053** |
| **International** | | |
| Australian Dollar | 6,563 | 5,474 |
| Brazilian Real | 3,508 | 3,817 |
| British Pound | 22,046 | 18,574 |
| Canadian Dollar | 11,976 | 10,023 |
| Danish Krone | 618 | 507 |
| Euro Currency | 57,024 | 45,603 |
| Hong Kong Dollar | 2,053 | 1,701 |
| Hungarian Florint | 1,307 | 1,480 |
| Japanese Yen | 43,477 | 34,677 |
| Mexican Peso | 1,530 | 1,393 |
| Norwegian Krone | 7,536 | 5,955 |
| Polish Zloty | 823 | 964 |
| South African Rand | 4,211 | 3,935 |
| South Korean Won | 9,493 | 8,233 |
| Swedish Krona | 4,160 | 3,202 |
| Swiss Franc | 8,584 | 6,966 |
| USD Denominated | 7,833 | 5,330 |
| Pooled Foreign Equity | 99,311 | 43,368 |
| **Total Foreign Equity** | **292,053** | **201,202** |
| **Total Equities** | **998,205** | **791,255** |
| **Private Equity** | **7,956** | **8,674** |
| **Real Estate** | **54,584** | **47,821** |
| | **62,540** | **56,495** |
| **Forward International Currency Contracts, net** | **59** | **-** |
| **Securities Lending Collateral Investment Pool (see Note 4)** | **148,037** | **148,037** |
| **Total Investments** | **$ 1,790,488** | **$ 1,590,648** |

# NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

## NOTE 3 – INVESTMENTS *Continued*

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

*(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 | $ 20,459 | $ 6,962 | $ 17,769 | $ 53,192 | $ 8,904 | $ 21,096 | $ 128,382 | $ 128,067 |
| GNMA | - | - | - | - | - | 3,035 | 3,035 | 3,038 |
| U.S. Gov't Agency Securities | - | - | 611 | 11,535 | 27,883 | 100,882 | 140,911 | 138,393 |
| Asset Backed Securities | - | - | - | 1,476 | 7,324 | 7,016 | 15,816 | 15,433 |
| Collateralized Mortgage Obligations | - | - | - | - | 109 | 6,392 | 6,501 | 6,399 |
| Corporate Bonds | - | - | 304 | 47,704 | 44,988 | 55,643 | 148,639 | 142,938 |
| Municipals | - | - | - | 1,044 | - | - | 1,044 | 1,041 |
| Collective Short-Term Investment Fund | 32,772 | - | - | - | - | - | 32,772 | 32,812 |
| **Total Domestic Fixed Maturity** | **53,231** | **6,962** | **18,684** | **114,951** | **89,208** | **194,064** | **477,100** | **468,121** |
| **International** | | | | | | | | |
| **Government Bonds** | | | | | | | | |
| British Pound | - | - | - | - | 1,089 | 2,256 | 3,345 | 3,407 |
| Danish Krone | - | - | - | 1,679 | - | - | 1,679 | 1,785 |
| Euro Currency | - | - | - | 14,149 | 2,304 | 8,353 | 24,806 | 26,147 |
| Japanese Yen | - | - | - | 9,292 | - | - | 9,292 | 9,940 |
| Mexican Peso | - | - | - | 1,054 | 584 | - | 1,638 | 1,595 |
| New Zealand Dollar | - | - | - | - | 465 | - | 465 | 441 |
| Singapore Dollar | - | - | - | 2,115 | 3,682 | - | 5,797 | 5,996 |
| Swedish Krona | - | - | - | 1,784 | 1,831 | - | 3,615 | 4,123 |
| United States Dollar Denominated | - | - | - | - | 1,648 | 1,160 | 2,808 | 2,510 |
| **Total International Government Bonds** | **-** | **-** | **-** | **30,073** | **11,603** | **11,769** | **53,445** | **55,945** |
| **Corporate Bonds** | | | | | | | | |
| Australian Dollar | - | - | - | 1,459 | 489 | - | 1,948 | 1,966 |
| Brazilian Real | - | - | - | - | 944 | - | 944 | 937 |
| British Pound | - | - | - | 1,982 | 1,431 | - | 3,413 | 3,554 |
| Canadian Dollar | - | - | - | 1,218 | 692 | 576 | 2,486 | 2,444 |
| Euro Currency | - | - | - | 7,548 | 1,443 | - | 8,991 | 9,543 |
| Japanese Yen | 2,084 | 2,167 | - | 16,590 | - | - | 20,841 | 21,963 |
| New Zealand Dollar | - | - | - | 498 | - | - | 498 | 510 |
| United States Dollar Denominated | - | - | - | 2,328 | 4,022 | 1,233 | 7,583 | 7,514 |
| **Total International Corporate Bonds** | **2,084** | **2,167** | **-** | **31,623** | **9,021** | **1,809** | **46,704** | **48,431** |
| **Total International Fixed Maturity** | **2,084** | **2,167** | **-** | **61,696** | **20,624** | **13,578** | **100,149** | **104,375** |
| **Total Fixed Maturity** | **$ 55,315** | **$ 9,129** | **$ 18,684** | **$ 176,647** | **$ 109,832** | **$ 207,642** | **$ 577,249** | **$ 572,496** |

# Notes to Basic Financial Statements *Continued*

## NOTE 3 – INVESTMENTS *Continued*

| Type of Investment | Total Fair Value | Cost |
|---|---|---|
| **Equity** | | |
| Domestic | $ 231,309 | $ 195,809 |
| Pooled Domestic Equities | 428,475 | 382,596 |
| **Total Domestic Equity** | **659,784** | **578,405** |
| **International** | | |
| Australian Dollar | 5,532 | 5,503 |
| British Pound | 26,891 | 25,764 |
| Canadian Dollar | 5,391 | 5,471 |
| Euro Currency | 46,950 | 43,616 |
| Hong Kong Dollar | 4,418 | 4,303 |
| Japanese Yen | 26,732 | 26,454 |
| Mexican Peso | 751 | 750 |
| Norwegian Krone | 4,808 | 4,664 |
| South African Rand | 2,597 | 2,554 |
| South Korean Won | 3,552 | 3,457 |
| Swedish Krona | 1,890 | 1,872 |
| Swiss Franc | 10,433 | 8,209 |
| USD Denominated | 6,576 | 6,598 |
| Pooled Foreign Equity | 96,456 | 52,437 |
| **Total Foreign Equity** | **242,977** | **191,652** |
| **Total Equities** | **902,761** | **770,057** |
| **Private Equities** | **1,014** | **1,243** |
| **Real Estate** | **49,883** | **43,983** |
| **Forward International Currency Contracts, net** | **173** | **-** |
| **Securities Lending Collateral (see note 4)** | **167,350** | **163,371** |
| **Total Investments** | **$ 1,698,430** | **$ 1,551,150** |

# Notes to Basic Financial Statements *Continued*

## NOTE 3 – INVESTMENTS *Continued*

The following table provides information as of June 30, 2006, concerning credit 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 |
|---|---|---|
| Unrated Agency | $175,597 | 30.2% |
| AAA | 205,356 | 35.3% |
| AA | 25,506 | 4.4% |
| A | 41,756 | 7.2% |
| BBB | 42,594 | 7.3% |
| BB | 27,590 | 4.7% |
| B | 10,250 | 1.8% |
| CCC & Below | - | 0.0% |
| Unrated* | 52,998 | 9.1% |
| **TOTAL** | **$581,647** | **100.0%** |

** Includes Collective Short-Term Investment Fund*

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* | $378,513 | 65.6% |
| AA | 24,467 | 4.2% |
| A | 27,992 | 4.9% |
| BBB | 43,663 | 7.6% |
| BB | 41,815 | 7.2% |
| B | 2,467 | 0.4% |
| CCC & Below | - | 0.0% |
| Unrated** | 58,333 | 10.1% |
| **TOTAL** | **$577,249** | **100.0%** |

** Includes agency rated bonds guaranteed by the U.S. Government*
*** Includes Collective Short-Term Investment Fund*

**International Forward Currency Contracts** - The System has made investments in forward currency contracts, which are commitments to purchase or sell stated amounts of international currency. The System utilizes these contracts to control exposure and facilitate the settlement of international security purchase and sale transactions. At June 30, 2006 and 2005, the System's net position in these contracts is recorded at fair value as international forward currency contracts. The fair values of forward currency contracts are determined by quoted currency prices from national exchanges. The System's investments in forward currency contracts bear credit risk in that parties to the contracts may fail to perform according to the terms of the contract. As of June 30, 2006, total commitments in forward currency contracts to purchase and sell international currencies were $10,821,000 and $10,821,000, respectively, with market values of $10,867,000 and $10,808,000 respectively. As of June 30, 2005, total commitments in forward currency contracts to purchase and sell international currencies were $5,162,0000 and $5,162,000, respectively, with market values of $5,162,000 and $4,989,000, respectively. The System's commitments relating to forward currency contracts are settled on a net basis.

## NOTE 4 – SECURITIES LENDING PROGRAM

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

# NOTES TO BASIC FINANCIAL STATEMENTS *Continued*

## NOTE 4 – SECURITIES LENDING PROGRAM *Continued*

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

The System authorized The Northern Trust Company to invest and reinvest cash collateral in Northern Trust's pooled investment vehicle which must have weighted average life of 60 days or less. Securities with maturities of 13 months or more must have a rating of A or better. 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 $85.9 billion and the weighted average life of 41 days. The cash collateral investments included time deposits (19% of the pool), repurchase agreements (18%), asset backed securities (17%), certificates of deposit (15%), variable rate securities (14%) and other bank notes (2%). All of the underlying investments of the System's securities lending cash collateral are held by the counterparty, not in the name of the System.

In 2005, the System authorized the Bank of New York to invest and reinvest cash collateral in securities fully guaranteed by the United States government, high grade commercial paper registered under the Securities Act of 1933, certificates of deposit of U.S. banks, and repurchase agreements with respect to Government Securities. At June 30, 2005, the System's cash collateral was invested in repurchase agreements ($135,866,000), with a weighted average maturity of 1.49 days and certificates of deposit ($31,484,000), with a weighted average maturity of 325 days. The repurchase agreements held at June 30, 2005 were unrated by S&P and Moody's. Of the certificates of deposit held at June 30, 2005, 84% carried credit quality ratings of A-1 and P-1 and 16% carried credit quality ratings of AA and Aa2 by S&P and Moody's, respectively. All of the underlying investments of the System's securities lending cash collateral were held by the counterparty, not in the name of the System.

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

As of June 30, 2006, the underlying securities loaned by the System as a whole amounted to approximately $163,839,000. The cash collateral and the non-cash collateral totaled $148,037,000 and $18,573,000, respectively. As of June 30, 2005, the underlying securities loaned by the System as a whole amounted to approximately $215,227,000. The cash collateral and the non-cash collateral totaled $167,350,000 and $52,985,000, respectively. The System 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 101.67% of the fair value of the investments lent, thus did not meet the Plan's policy of 102% due to daily market fluctuations on the securities lent. The custodian marks to market the securities on loan at the end of the day and cash collateral for those securities are settled at the beginning of the next business day. As of July 3, 2006 the fair value of collateral was 102.03% 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** | | |
| U.S. government and agencies | $ - | $ 78,019 |
| Domestic corporate bonds | 17,909 | 14,731 |
| Domestic equity securities | 74,262 | 70,045 |
| U.S. treasury notes and bonds | 30,551 | - |
| International government bonds | 2,558 | 522 |
| International equity securities | 20,295 | - |
| **Total Lent for Cash Collateral** | **$ 145,575** | **$ 163,317** |
| **For Non-Cash Collateral** | | |
| Domestic corporate bonds | 1,940 | 86 |
| Domestic equity securities | 2,314 | - |
| U.S. government agency securities | - | 50,678 |
| U.S. treasury notes and bonds | 13,614 | - |
| International equity securities | 396 | 363 |
| International government bonds | - | 783 |
| **Total Lent for Non-Cash Collateral** | **18,264** | **51,910** |
| **Total Securities Lent** | **$ 163,839** | **$ 215,227** |

| TYPE OF COLLATERAL RECEIVED | 2006 | 2005 |
|---|---|---|
| **Cash Collateral** | $ 148,037 | $ 167,350 |
| **Non-cash Collateral** | | |
| For lent domestic corporate bonds | 1,972 | 99 |
| For lent domestic equity securities | 2,355 | - |
| For lent U.S. government agency securities | - | 51,861 |
| U.S. treasury notes and bonds | 13,834 | - |
| For lent international equity securities | 412 | 377 |
| For lent international government bonds | - | 648 |
| **Total Non-Cash Collateral** | **18,573** | **52,985** |
| **Total Collateral Received** | **$ 166,610** | **$ 220,335** |

# Notes to Basic Financial Statements *Continued*

## NOTE 5 – CONTRIBUTIONS - FUNDING POLICY

Contributions to the Defined Benefit Pension Plan for both the City and the participating employees are based upon an actuarially determined percentage of each employee's base salary sufficient to provide adequate assets to pay benefits when due. The significant actuarial assumptions used to compute the actuarially determined contribution requirement are the same as those used to compute the actuarial accrued liability shown in the Schedule of Funding Progress for the Defined Benefit Pension Plan (see page 40).

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

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

| | CITY | | EMPLOYEE | |
|---|---|---|---|---|
| **Period** | **Pension** | **Healthcare** | **Pension** | **Healthcare** |
| 7/01/05 – 6/30/06 | 14.96% | 2.16% | 4.26% | 1.80% |
| 7/04/04 – 6/30/05 | 14.96% | 2.16% | 4.26% | 1.80% |

## NOTE 6 – POSTEMPLOYMENT HEALTHCARE BENEFIT PLAN

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

## NOTE 7 – ACTUARIAL VALUATION (Unaudited)

The System completed a new actuarial valuation dated June 30, 2005 and the rates were adopted effective July 2, 2006. The new rates increase the contributions from the City from 17.12% to 21.98% and the employees from 6.06% to 7.58%. Funding status of the System was reduced from 97.6% to 80.9%. Funding status was reduced due to an increase in unfunded accrued actuarial liability ("UAAL") from $31 million to $327 million. This increase in UAAL is mainly due to experience losses, such as continued smoothed in investment losses from 2001 and 2002, and a greater number of retirements than anticipated; and assumption changes made to reflect longer life expectancies and earlier retirements.

# REQUIRED SUPPLEMENTARY INFORMATION

## SCHEDULE OF FUNDING PROGRESS - DEFINED BENEFIT PENSION PLAN

(Unaudited)

Funding Progress-GASB No. 25

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) | Unfunded AAL | Funded Ratio | Annual Covered Payroll (b) | Unfunded AAL as a Percentage of Annual Covered Payroll |
|---|---|---|---|---|---|---|
| 6/30/97 | $678,954,000 | $735,772,000 | $56,818,000 | 92.0% | $176,284,000 | 32% |
| 6/30/99 | $804,860,000 | $862,226,000 | $57,366,000 | 93.0% | $196,178,000 | 29% |
| 6/30/01 | $1,060,144,000 | $1,072,333,000 | $12,189,000 | 99.0% | $252,696,000 | 5% |
| 6/30/03 | $1,280,719,000 | $1,311,691,000 | $30,972,000 | 98.0% | $292,961,000 | 11% |

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

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

*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 | 30 years, open |
| Actuarial asset valuation method | 5 year smoothed market |
| **Actuarial assumptions:** | |
| Assumed rate of return on investments | 8.25% per annum |
| Postretirement mortality | The 1983 Group Annuity Mortality Table for males, with one-year setback is used for male members. The 1983 Group Annuity Mortality Table for females, with one year set forward, is used for female members. |
| Active service, withdrawal, death, disability service retirement | Tables based on current experience |
| Salary increases | Total System payroll is assumed to increase 4.5% per year. Graded increases ranging from 8.00% at age 25 to 5.0% at ages 65 and over. Of the total salary increases 4.50% is for inflation and merit and longevity. |
| Cost-of-living adjustments | 3.00% a year |

# 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 | $ 35,284 | 100% |
| 2002 | 41,011 | 100% |
| 2003 | 38,411 | 100% |
| 2004 | 39,534 | 100% |
| 2005 | 41,552 | 100% |
| 2006 | 41,267 | 100% |

# Other Supplementary Information

## COMBINING SCHEDULE OF DEFINED BENEFIT PENSION PLAN NET ASSETS

*June 30, 2006*

| *(Dollars In Thousands)* | Retirement Fund | Cost-of-Living Fund | Total |
|---|---|---|---|
| **ASSETS:** | | | |
| **Receivables:** | | | |
| Employee contributions | $ 348 | $ 93 | $ 441 |
| Employer contributions | 1,312 | 305 | 1,617 |
| Brokers and others | 15,938 | 5,274 | 21,212 |
| Accrued investment income | 4,529 | 1,477 | 6,006 |
| **Total receivables** | **22,127** | **7,149** | **29,276** |
| **Investments, at fair value:** | | | |
| *Securities and other:* | | | |
| U.S. Treasury notes and bonds | 48,536 | 17,166 | 65,702 |
| U.S. government agency securities | 126,021 | 44,571 | 170,592 |
| International government bonds | 45,334 | 16,034 | 61,368 |
| Domestic corporate bonds | 140,873 | 49,824 | 190,697 |
| International corporate bonds | 25,836 | 9,137 | 34,973 |
| Domestic equity securities | 495,635 | 175,295 | 670,930 |
| International equity securities | 204,987 | 72,499 | 277,486 |
| Private market equity | 5,584 | 1,975 | 7,559 |
| International forward currency contracts | 41 | 15 | 56 |
| Collective short-term investment funds | 21,647 | 7,656 | 29,303 |
| Real estate | 38,312 | 13,550 | 51,862 |
| Securities lending cash collateral investment pool | 105,600 | 34,932 | 140,532 |
| **Total investments** | **1,258,406** | **442,654** | **1,701,060** |
| **Total assets** | **1,280,533** | **449,803** | **1,730,336** |
| **LIABILITIES:** | | | |
| Payable to brokers | 33,943 | 11,228 | 45,171 |
| Securities lending collateral due to borrowers | 105,600 | 34,932 | 140,532 |
| Other liabilities | 1,504 | 461 | 1,965 |
| **Total liabilities** | **141,047** | **46,621** | **187,668** |
| **Net assets held in trust for pension benefits** | **$1,139,486** | **$403,182** | **$1,542,668** |

# Other Supplementary Information *Continued*

## COMBINING SCHEDULE OF CHANGES IN DEFINED BENEFIT PENSION PLAN NET ASSETS

*For the Fiscal Year Ended June 30, 2006*

| *(Dollars in Thousands)* | Retirement Fund | Cost-of-Living Fund | Total |
|---|---|---|---|
| **ADDITIONS:** | | | |
| **Contributions:** | | | |
| Employee | $ 9,755 | $ 2,640 | $ 12,395 |
| Employer | 33,503 | 7,764 | 41,267 |
| **Total contributions** | **43,258** | **10,404** | **53,662** |
| **Investment income:** | | | |
| Net appreciation in fair value of investments | 77,853 | 25,711 | 103,564 |
| Interest income | 19,180 | 6,346 | 25,526 |
| Dividend income | 5,613 | 1,857 | 7,470 |
| Net rental income | 670 | 237 | 907 |
| Less investment expense | (3,754) | (1,203) | (4,957) |
| **Net investment income before securities lending income** | **99,562** | **32,948** | **132,510** |
| **Securities lending income:** | | | |
| Earnings | 4,962 | 1,641 | 6,603 |
| Rebates | (4,564) | (1,510) | (6,074) |
| Fees | (125) | (41) | (166) |
| **Net securities lending income** | **273** | **90** | **363** |
| **Net investment income** | **99,835** | **33,038** | **132,873** |
| **Total additions** | **143,093** | **43,442** | **186,535** |
| **DEDUCTIONS:** | | | |
| Retirement benefits | 55,392 | 13,046 | 68,438 |
| Death benefits | 3,618 | 2,103 | 5,721 |
| Refund of contributions | 996 | 250 | 1,246 |
| Administrative expenses and other | 1,417 | 373 | 1,790 |
| **Total deductions** | **61,423** | **15,772** | **77,195** |
| Net increase | 81,670 | 27,670 | 109,340 |
| **NET ASSETS HELD IN TRUST FOR PENSION BENEFITS:** | | | |
| Beginning of year | 1,057,816 | 375,512 | 1,433,328 |
| **End of year** | **$ 1,139,486** | **$ 403,182** | **$ 1,542,668** |

# Other Supplementary Information *Continued*

## SCHEDULES OF ADMINISTRATIVE EXPENSES AND OTHER

*For the Fiscal Year Ended June 30, 2006*

| | 2006 | | | 2005 |
|---|---|---|---|---|
| *(Dollars in Thousands)* | Original Budget | Actual | Variance Positive (Negative) | Actual |
| Personal services | $ 1,348,597 | $ 1,269,137 | $ 79,460 | $ 1,173,073 |
| Non-personal/equipment | 605,800 | 445,280 | 160,520 | 409,354 |
| Professional services | 239,200 | 179,025 | 60,175 | 100,652 |
| **Total administrative expenses and other** | **$ 2,193,597** | **$ 1,893,442** | **$ 300,155** | **$ 1,683,079** |

# OTHER SUPPLEMENTARY INFORMATION *Continued*

## SCHEDULES OF INVESTMENT EXPENSES

*For the Fiscal Years Ended June 30, 2006 and 2005*

| | 2006 | 2005 |
|---|---|---|
| **Equity:** | | |
| Domestic equity | $ 1,724,281 | $ 1,194,833 |
| International equity | 1,718,023 | 1,240,012 |
| **Total equity** | **3,442,304** | **2,434,845** |
| **Fixed income:** | | |
| Domestic fixed income | 863,208 | 841,357 |
| Global fixed income | 341,659 | 143,401 |
| International fixed income | - | 200,213 |
| **Total fixed income** | **1,204,867** | **1,184,971** |
| **Private Markets** | - | 24,218 |
| **Real estate** | 340,641 | 574,087 |
| **Total investment managers' fees** | **4,987,812** | **4,218,121** |
| **Other investment service fees:** | | |
| Investment consultant | 100,000 | 113,798 |
| Proxy voting | 6,100 | 7,375 |
| Real estate legal fees | 3,753 | 559 |
| Real estate appraisal | 5,250 | - |
| Custodian | 128,129 | 198,058 |
| **Total other investment service fees** | **243,232** | **319,790** |
| **TOTAL INVESTMENT EXPENSES** | **$ 5,231,044** | **$ 4,537,911** |

# 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 |
|---|---|---|---|
| CPS Human Resources | Human Resource Consultant | $ - | $ (2,026) |
| Levi, Ray & Shoup | Web Development, Maintenance and Hosting | 15,463 | 17,223 |
| Levi, Ray & Shoup | Document Imaging & Support and Maintenance | 7,500 | 3,125 |
| Macias Gini & O'Connell LLP | External Auditors | 31,380 | 24,332 |
| Avery, William, & Associate | Human Resource Consultant | 12,200 | - |
| Medical Director/Other Medical | Medical Consultant | 29,709 | 19,842 |
| Pension Benefit Information | Reports on Beneficiary Deaths | 2,261 | 1,966 |
| Saltzman & Johnson | Legal Counsel | 12,557 | 11,160 |
| Klausner & Kaufman | Legal - Attendance at Retreat | - | 4,715 |
| Gabriel, Roeder, Smith & Company | Actuarial Consultant | 67,955 | 20,315 |
| **Total** | | **$ 179,025** | **$ 100,652** |

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# Investment Section

# Report on Investment Activity

The Northern Trust Company
50 South La Salle Street
Chicago, Illinois 60603
(312) 630-6000

Northern Trust

August 7, 2006

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

Dear Mr. Overton:

The information contained within this letter includes a review of investment performance results for the Federated City Employees' Retirement System (System) of San José covering the fiscal year ending June 30, 2006 as well as a summary of financial markets activity during the aforementioned time period.

*Background*

The objectives of the System have been established in conjunction with a comprehensive review of the current and projected financial requirements. The Board ensures that good judgment will be applied in the construction of an investment program designed to meet pension liabilities into the future.

The Northern Trust Company, global custodian for the System, provides quarterly investment performance reviews based on plan accounting information. Northern Trust calculates rates of return and other measures in accordance with CFA Institute, GIPS and BAI standards.

*Financial Markets Review*

The fiscal year ending June 30, 2006 provided insight into factors leading to Federal Reserve tightening policy and the subsequent reaction by financial markets. The Fed raised short-term interest rates eight times during the year ending 6/30/06. The corresponding Fed Funds rate increased from 3.25% as of June 30, 2005 to 5.25% as of June 30, 2006.

U.S. Equities boasted double-digit returns across many sectors including value-oriented issues during the fiscal year ending June 30, 2006. Value issues (which generally comprise cyclical sectors such as materials, industrials and utilities) considerably outperformed their growth counterparts (i.e. information technology, consumer goods, etc.) over the aforementioned period. Additionally, small cap stocks continued their dominance over their larger capitalization counterparts for the year ending 6/30/06.

# REPORT ON INVESTMENT ACTIVITY *Continued*

The Northern Trust Company

Northern Trust

Fixed Income markets, with the exception of high yield and short-term issues, traded lower during the fiscal year ending 6/30/06 as longer-term yields moved higher throughout the period. Additionally, lower quality issues rose during the year as earnings growth pushed higher yielding bonds into positive territory.

International Equity markets, boosted by strong returns across financial sectors, performed well during the fiscal year ending June 30, 2006. The largest contributor to EAFE performance came from Japan (24.52% weighting as of 6/30/06), which provided a 35.96% return for the period ending June 30, 2006.**

***All returns expressed in U.S. Dollar terms.*

*Investment Results*

Investment performance for the Federated City Employees' Retirement System of San José could be described as "favorable" during the fiscal year ending June 30, 2006 relative to various metrics including the actuarial assumption rate (8.25%), passive management alternatives and peer group comparisons. Specifically, the system produced a return of 10.81% over the one year period, 12.11% over three years and 8.24% over the five years ending 6/30/06.

Peer group comparisons are based using Wilshire's Trust Universe Comparison Service (TUCS). TUCS is a cooperative effort among custodial banks and Wilshire Associates whereby custodians submit asset positions and performance information to Wilshire, which is then aggregated into various universes for comparison purposes. The Northern Trust Company maintains a membership in TUCS and provides clients TUCS data as an option with the performance measurement service.

For the System, comparisons at the total fund level are made versus several peer universes including TUCS' Public Fund Universe. As of 6/30/06, the System's one year return ranked in the 39th percentile (1st percentile being the highest, 99th percentile being the lowest) relative to peers within the Public Fund space. Longer term returns were comparatively strong as the three, five and seven year rankings of 40th percentile, 8th percentile and 7th percentile respectively, indicate.

The System's asset allocation employs a diversified mix of stocks, bonds, real estate and cash invested within the U.S. as well as across markets around the globe. Within the domestic equity strategy, the System implements a "core/satellite" approach in which the majority of assets are indexed to a broad-based, investable universe of stocks, (specifically, the Russell 3000 Index) and then "satellites" around this component using investment managers which specialize across large and small capitalization issues as well as across growth/value styles.

International equity investments have been accessed through investment managers who proxy their performance versus the Morgan Stanley All Country World (Ex-United States) Index (MS ACWI Ex-U.S.). Overseas equity markets demonstrated strength during the year ending June 30, 2006 as global economies grew at an above-average pace.

# Report on Investment Activity *Continued*

The Northern Trust Company

Northern Trust

Fixed Income assets can provide stability in that cash flows are more predictable and price movements are generally less volatile than equities. The System invests in bond instruments within the United States and internationally using a multiple investment manager platform.

The System's Real Estate portfolio has provided significant benefit over short and longer-term periods as cash flows and market appreciation from property holdings have resulted in double-digit returns over the one, three and five years ending June 30, 2006. Real Estate investments are primarily accessed through commingled fund vehicles managed by investment firms who allocate system assets across retail, industrial and residential properties diversified regionally across the United States.

In sum, the Federated Employees' Retirement System of San José has positioned its investment portfolio accordingly, in order to maximize the opportunity for long-term, risk-adjusted returns in accordance with investment objectives as outlined in the plan's Statement of Investment Policy.

Sincerely,

Steven R. Pines
Senior Investment Consultant
Investment Risk & Analytical Services

# Statement of Investment Policy

## GENERAL ENVIRONMENT

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

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

- Stating in a written document the Board's attitudes, expectations, objectives and guidelines for the investment of all the System's assets.
- Setting forth an investment structure for managing all the System's assets. This structure includes various asset classes, investment management styles, asset allocation and acceptable ranges that, in total, are expected to produce a sufficient level of overall diversification and total investment return over the long-term.
- Providing guidelines for the investment System that control the level of overall risk and liquidity assumed in that System, so that all the System's assets are managed in accordance with stated objectives.
- Encouraging effective communications between the Board, the investment consultant(s) and the money managers.
- Establishing formalized criteria to monitor, evaluate and compare the performance results achieved by the money managers on a quarterly basis, or as deemed appropriate.
- Complying with all applicable fiduciary, prudence and due diligence requirements that experienced investment professionals would utilize, and with all applicable laws, rules and regulations from various local, state, federal and international political entities that may impact the System's assets.

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

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

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

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

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

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

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

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

# Statement of Investment Policy *Continued*

## ASSET ALLOCATION POLICY

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

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

### Asset Allocation without Private Markets

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

The System will use the following asset allocation targets once the Private Markets asset class is funded to approximately 50% of its target allocation or 1.5% of the Plan's total assets.

### Asset Allocation with Private Markets

| *Asset Class* | *Minimum* | *Target* | *Maximum* |
|---|---|---|---|
| Domestic Equity | 30% | 35% | 40% |
| International Equity | 10% | 15% | 20% |
| Domestic Bonds | 29% | 34% | 39% |
| Global Bonds | 4% | 7% | 10% |
| Real Estate | 3% | 6% | 9% |
| Private Markets | 0% | 3% | 6% |

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

*(Procedure 620.2)*

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

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

## TIME HORIZON

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

## RISK TOLERANCES AND VOLATILITY

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

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

## REBALANCING OF STRATEGIC ALLOCATION

*(Procedure 620.3-F)*

The Plan's asset allocation will be reviewed relative to the targets on a semi-monthly basis and action will be taken to rebalance to within the target ranges by means of asset transfers among the categories.

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

# Statement of Investment Policy *Continued*

General guidelines for rebalancing the portfolio are as follows:

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

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

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

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

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

## ASSET ALLOCATION MODEL SECONDARY TARGETS WITHIN THE DOMESTIC EQUITY CLASS

| *Portfolio Category: Form of Investment Management* | *As a Percentage of the Domestic Equity Portfolio* | *As the Equivalent Percentage of the Total Portfolio* | *Allowable Variation from the Percentage of Equity Portfolio* |
|---|---|---|---|
| Index Fund | 50% | 17.4% | +/- 4.5% |
| Large Cap Value | 12% | 3.4% | +/- 2.5% |
| Large Cap Growth | 10% | 2.9% | +/- 2.5% |
| Small Cap Value | 7% | 3.6% | +/- 1.5% |
| Small Cap Growth | 6% | 3.1% | +/- 1.5% |
| All Cap Growth | 15% | 4.4% | +/- 2.5% |

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

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

# Statement of Investment Policy *Continued*

## LIQUIDITY

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

## DIVERSIFICATION

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

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

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

## SUPERVISION

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

## BROKERAGE POLICY

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

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

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

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

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

# STATEMENT OF INVESTMENT POLICY *Continued*

## PERFORMANCE OBJECTIVES

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

## TOTAL FUND INVESTMENTS

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

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

*(Procedure 610.2)*

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

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

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

# Statement of Investment Policy *Continued*

## FIXED-INCOME INVESTMENTS

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

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

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

## DOMESTIC EQUITY INVESTMENTS

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

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

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

## PASSIVE EQUITY INVESTMENT

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

## INTERNATIONAL EQUITY INVESTMENTS

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

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

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

## GLOBAL FIXED-INCOME INVESTMENTS

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

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

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

## REAL ESTATE INVESTMENTS

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

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

## PRIVATE MARKETS INVESTMENTS

The Private Markets portfolio is an illiquid investment with a 10 to 12 year investment horizon. It is expected to provide a S&P 500 Index return plus 300 basis points over time.

## EXCEPTIONS

The Board may 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.

# Investment Professionals

## Investment Managers

### *Domestic Equities:*

Atlanta Capital Management
Large Cap Growth
Atlanta, GA

Brandywine Asset Management
Small Cap Value
Philadelphia, PA

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

Northern Trust Quantitative Advisors
Russell 3000 Index
Chicago, IL

Dodge & Cox
Large Cap Value
San Francisco, CA

Wellington Management
All Cap Growth
San Francisco, CA

### *Private Market Equities:*

Pathway Capital Management, LLC
Private Market Equities
Irvine, CA

### *International Equities:*

The Boston Company Asset Management, LLC
Boston, MA

Fisher Investments Institutional Group
Woodside, CA

McKinley Capital Management
Anchorage, AK

### *Domestic Fixed Income:*

Dodge & Cox
San Francisco, CA

BlackRock Financial Management
New York, NY

### *Global Fixed Income:*

Loomis Sayles
Boston, MA

### *Real Estate:*

DRA Advisors, Inc.
New York, NY

Fidelity Investments
Boston, MA

MIG Realty Advisors
Cleveland, OH

Prudential Real Estate Investors
Newark, NJ

## Consultants

The Northern Trust
Chicago, IL

Strategic Investment Solutions, Inc.
San Francisco, CA

## Custodian

The Northern Trust
Chicago, IL

## Proxy Voting

Institutional Shareholder Services, Inc.
Rockville, MD

# Schedule of Investment Results

## GROSS PERFORMANCE SUMMARY BY ASSET CLASS

*For Periods Ending June 30, 2006*

*Source: The Northern Trust Investment Performance Evaluation Report June 30, 2006.*
*Basis of Calculation: Time-weighted Rate of Return*

| | *One Year* | *Three Years* | *Five Years* |
|---|---|---|---|
| **TOTAL FUND** | **10.8%** | **12.1%** | **8.2%** |
| Benchmark | 9.3% | 11.3% | 6.9% |
| TUCS All Master Trust Median | 9.3% | 11.0% | 6.1% |
| TUCS Public Fund Universe Median | 9.4% | 11.4% | 6.3% |

| | *One Year* | *Three Years* | *Five Years* |
|---|---|---|---|
| **TOTAL DOMESTIC EQUITY** | **10.3%** | **13.5%** | **4.8%** |
| S&P 500 Index | 8.6% | 11.2% | 2.5% |
| TUCS Equity Median | 10.8% | 14.6% | 5.4% |
| **TOTAL INTERNATIONAL EQUITY** | **28.4%** | **24.3%** | **9.7%** |
| MSCI ACWI ex-US (Net Dividends) | 27.9% | 25.3% | 11.4% |
| MSCI ACWI ex-US | 28.4% | 25.8% | 11.9% |
| TUCS International Equity Median | 27.4% | 24.7% | 11.4% |
| **TOTAL DOMESTIC FIXED INCOME** | **0.7%** | **3.0%** | **5.4%** |
| Lehman Brothers Aggregate Bond Index | -0.8% | 2.1% | 5.0% |
| TUCS Domestic Fixed Income Median | 0.2% | 2.6% | 5.4% |

| | *One Quarter* | *One Year* | *(Inception 02/05)* |
|---|---|---|---|
| **TOTAL GLOBAL FIXED INCOME** | **3.5%** | **2.2%** | **-0.2** |
| Citigroup World Government Bond Index | 3.2% | -0.4% | -2.1 |
| TUCS Unhedged Global Fixed Income Median | 1.0% | 1.0% | N/A |

| | *One Year* | *Three Years* | *Five Years* |
|---|---|---|---|
| **TOTAL REAL ESTATE** | **16.0%** | **19.3%** | **16.0%** |
| NCREIF Property Index | 20.2% | 15.1% | 11.7% |
| TUCS Real Estate Median | 19.5% | 16.7% | 12.4% |

# 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: The Northern Trust Investment Performance Evaluation Report June 30, 2006.

*Basis of Calculation: Time-weighted Rate of Return*

| | *One Year* | *Three Years* | *Five Years* |
|---|---|---|---|
| **DOMESTIC EQUITY** | | | |
| **Northern Trust (Index)** | **9.6%** = | **12.6%** = | **3.5%** = |
| Russell 3000 Index | 9.6% | 12.6% | 3.5% |
| TUCS Equity Median | 10.8% | 14.6% | 5.4% |
| **Atlanta Capital (Large Cap Growth)** | **6.7%** + | **8.5%** + | **0.1%** + |
| Russell 1000 Growth Index | 6.1% | 8.4% | -0.8% |
| TUCS Large Cap Growth Median | 7.2% | 10.9% | 1.2% |
| TUCS Equity Median | 10.8% | 14.6% | 5.4% |
| **Eagle Asset Management (Small Cap Growth)** | **13.4%** + | **18.7%** +++ | **8.5%** +++ |
| Russell 2000 Growth Index | 14.6% | 16.3% | 3.5% |
| TUCS Small Cap Growth Median | 14.8% | 17.4% | 6.5% |
| TUCS Equity Median | 10.8% | 14.6% | 5.4% |
| **Brandywine (Small Cap Value)** | **6.2%** | **18.2%** + | **13.5%** ++ |
| Russell 2000 Value Index | 14.6% | 21.0% | 13.1% |
| TUCS Small Cap Value Universe Median | 13.1% | 20.8% | 14.1% |
| TUCS Equity Median | 10.8% | 14.6% | 5.4% |

| | *One Quarter* | *One Year* | *(Inception 07/04)* |
|---|---|---|---|
| **Dodge & Cox (Large Cap Value)** | **0.6%** =++ | **15.5%** +++ | **13.9%** + |
| Russell 1000 Value Index | 0.6% | 12.1% | 13.1% |
| TUCS Large Cap Value Median | 0.2% | 11.7% | N/A |
| TUCS Equity Median | -2.3% | 10.8% | N/A |

| | *One Quarter* | | *(Inception 09/05)* |
|---|---|---|---|
| **Wellington Management** | **-4.7%** + | | **4.4%** + |
| Russell 3000 Growth Index | -4.2% | | 3.0% |
| TUCS All Cap Growth Median | -4.9% | | N/A |
| TUCS Equity Median | -2.3% | | N/A |

| | *One Quarter* | *One Year* | *Three Years* |
|---|---|---|---|
| **INTERNATIONAL EQUITY** | | | |
| **Boston Company Asset Management, LLC** | **0.4%** ++ | **23.8%** | **24.6%** |
| MSCI ACWI ex-US Index | 0.0% | 27.9% | 25.3% |
| TUCS International Equity Median | -0.5% | 27.4% | 24.7% |

# SCHEDULE OF INVESTMENT RESULTS *Continued*

## NET PERFORMANCE SUMMARY BY INVESTMENT MANAGER *Continued*

*For Periods Ending June 30, 2006*

| | One Quarter | One Year | (Inception 07/05) |
|---|---|---|---|
| **INTERNATIONAL EQUITY** *Continued* | | | |
| **Fisher Investments Institutional Group** | **-3.8%** | **27.2%** | **27.2%** |
| MSCI ACWI ex-US Index | 0.0% | 27.9% | 27.9% |
| TUCS International Equity Median | -0.5% | 27.4% | N/A |
| **McKinley Capital Management** | **0.6% ++** | **34.2% ++** | **34.2% +** |
| MSCI ACWI ex-US Index | 0.0% | 27.9% | 27.9% |
| TUCS International Equity Median | -0.5% | 27.4% | N/A |

| | One Quarter | One Year | Three Years |
|---|---|---|---|
| **DOMESTIC FIXED INCOME** | | | |
| **BlackRock Financial Management, Inc.** | **0.2% ++** | **0.0% +** | **2.6% +=** |
| Lehman Brothers Aggregate Bond Index | -0.1% | -0.8% | 2.1% |
| TUCS Fixed Income Median | 0.1% | 0.2% | 2.6% |

| | One Year | Three Years | Five Years |
|---|---|---|---|
| **Dodge and Cox** | **0.8% ++** | **2.9% ++** | **5.7% ++** |
| Lehman Brothers Aggregate Bond Index | -0.8% | 2.1% | 5.0% |
| TUCS Fixed Income Median | 0.2% | 2.6% | 5.4% |

| | One Quarter | One Year | (Inception 02/05) |
|---|---|---|---|
| **GLOBAL FIXED INCOME** | | | |
| **Loomis Sayles** | **3.4% ++** | **2.0% ++** | **-0.3% +** |
| Citigroup World Government Bond Index | 3.2% | -0.4% | -2.1% |
| TUCS International Fixed Portfolio Median | 1.0% | 1.0% | N/A |

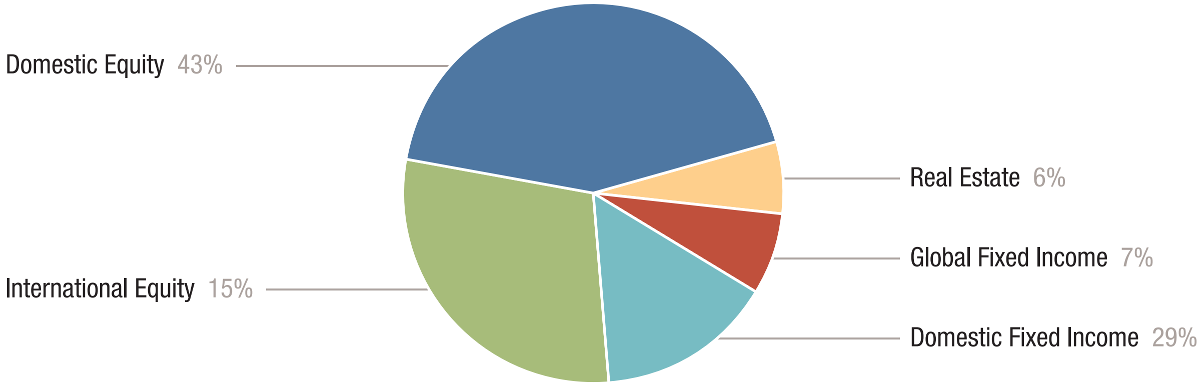
| | One Year | Three Years | Five Years |
|---|---|---|---|
| **REAL ESTATE** | | | |
| **MIG Realty Advisors** | **-2.9%** | **12.1%** | **14.0% ++** |
| **CIGNA (Formerly, TimesSquare)** | **1.6%** | **14.5%** | **9.3%** |
| **DRA II** | **24.4% ++** | **13.1%** | **11.9%** |
| **Fidelity** | **27.6% ++** | **27.7% ++** | **20.9% ++** |
| NCREIF Property Index | 20.2% | 15.1% | 11.7% |
| TUCS Real Estate Median | 19.5% | 16.7% | 12.4% |

| | One Quarter | One Year | (Inception 06/04) |
|---|---|---|---|
| **PRISA** | **3.5% +** | **20.1% +** | **18.1% =** |
| NCREIF Property Index | 3.6% | 20.2% | 18.1% |
| TUCS Real Estate Median | 2.8% | 19.5% | N/A |

| | One Quarter | | (Inception 09/05) |
|---|---|---|---|
| **DRA V** | **1.2%** | | **2.4%** |
| NCREIF Property Index | 3.6% | | 20.2% |
| TUCS Real Estate Median | 2.8% | | N/A |

# Investment Review

## TARGET ASSET ALLOCATION *As of June 30, 2006*

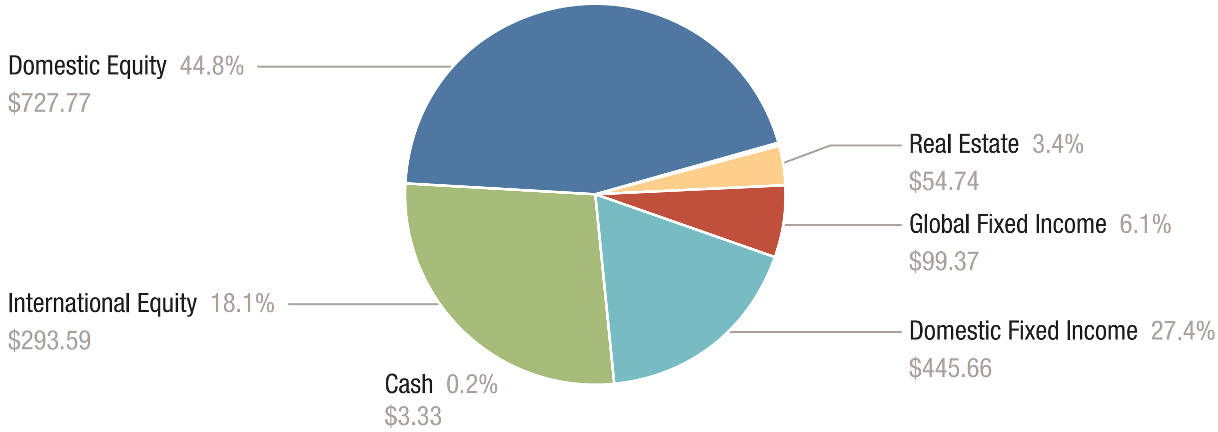



## ACTUAL ASSET ALLOCATION Non-GAAP Basis (In Millions)

*June 30, 2006*

| Asset Class | Actual |
|---|---|
| Domestic Equity | $727.77 |
| International Equity | 293.59 |
| Domestic Fixed Income | 445.66 |
| Global Fixed Income | 99.37 |
| Real Estate | 54.74 |
| Cash | 3.33 |
| **TOTAL** | **$1,624.46** |

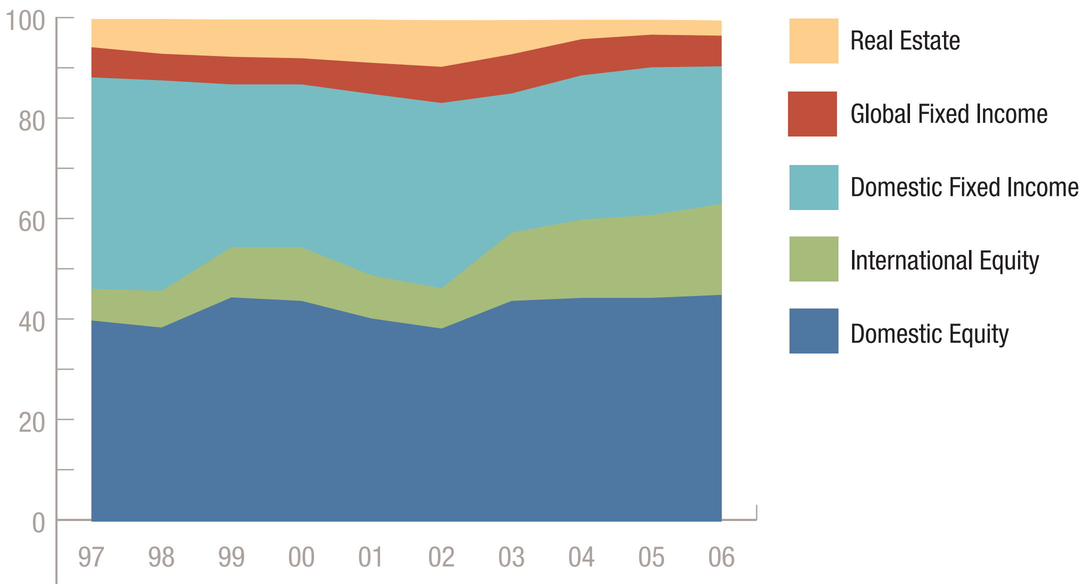
## ACTUAL ASSET ALLOCATION (In Millions) *As of June 30, 2006*



# Investment Review *Continued*

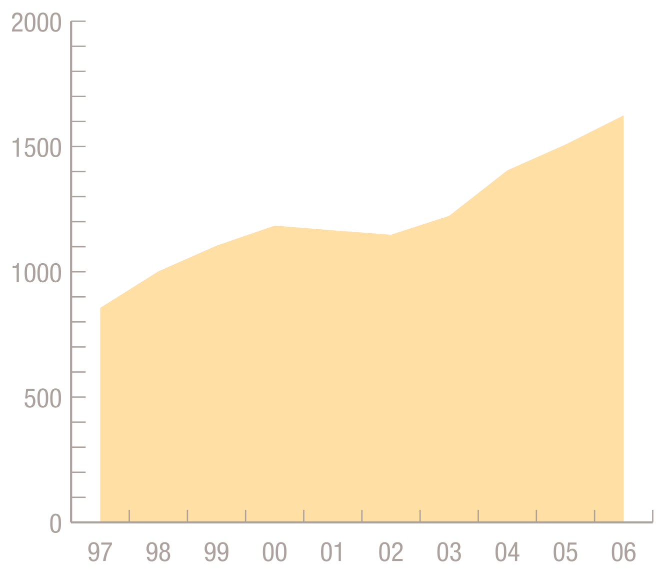
## HSTORICAL ASSET ALLOCATION (ACTUAL)

*June 30, 1997 – June 30, 2006*



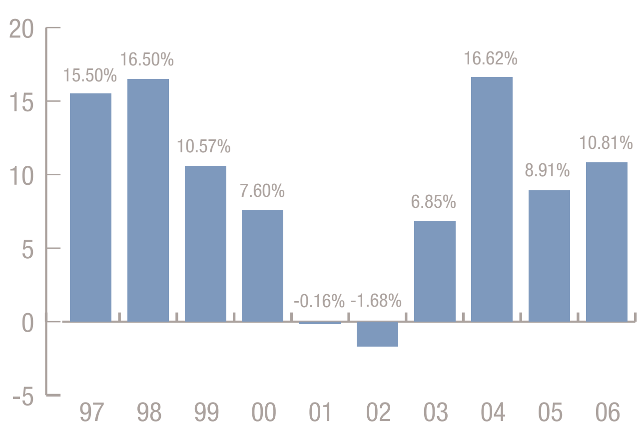

## MARKET VALUE GROWTH OF PLAN ASSETS

*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 |
|---|---|---|---|
| 116,430 | UNITED STATES | MEDTRONIC INC COM | $5,462,896 |
| 240,300 | UNITED KINGDOM | BHP BILLITON PLC USD0.50 | 4,662,247 |
| 123,280 | UNITED STATES | NETWORK APPLIANCE INC DEL | 4,351,784 |
| 32,970 | FRANCE | GROUPE DANONE EUR0.50 | 4,188,307 |
| 213,280 | UNITED STATES | CISCO SYS INC COM | 4,165,358 |
| 288 | JAPAN | MITSUBISHI UFJ FIN NPV | 4,030,967 |
| 139,115 | UNITED KINGDOM | GLAXOSMITHKLINE ORD GBP0.25 | 3,887,805 |
| 64,630 | UNITED KINGDOM | ADR ASTRAZENECA PLC SPONSORED | 3,866,167 |
| 77,280 | FRANCE | ADR SANOFI-AVENTIS SPONSORED | 3,763,536 |
| 111,970 | UNITED STATES | GENERAL ELEC CO COM | 3,690,531 |

## LARGEST BOND HOLDINGS (By Market Value)

*June 30, 2006*

| Description | Country | Maturity Date | Par Value | Market Value in $US |
|---|---|---|---|---|
| US TREAS NTS DTD 11/16/1998 4.75 11-15-2008 | UNITED STATES | 11/15/2008 | 12,500,000 | $12,388,188 |
| UNITED STATES TREAS NTS NT 4.875% 05-31-2008 | UNITED STATES | 5/31/2008 | 11,000,000 | 10,938,554 |
| UNITED STATES TREAS NTS DTD 00013 3% 11-15-2007 | UNITED STATES | 11/15/2007 | 11,000,000 | 10,679,878 |
| UNITED STATES TREAS NTS DTD 08/15/1999 6% 08-15-2009 | UNITED STATES | 8/15/2009 | 8,000,000 | 8,199,688 |
| FNMA POOL #735503 6% 04-01-2035 | UNITED STATES | 4/1/2035 | 7,694,650 | 7,597,020 |
| UNITED STATES TREAS NTS NT 4.875% 04-30-2008 | UNITED STATES | 4/30/2008 | 6,475,000 | 6,439,841 |
| FNMA POOL #821697 FLTG RT 5.031% 06-01-2035 | UNITED STATES | 6/1/2035 | 5,555,684 | 5,455,515 |
| FNMA POOL #735224 5.5% 02-01-2035 | UNITED STATES | 2/1/2035 | 5,593,467 | 5,396,018 |
| FNMA POOL #725721 4.219% 06-01-2034 | UNITED STATES | 6/1/2034 | 5,466,124 | 5,316,789 |
| FNMA POOL #555783 4.5% 10-01-2033 | UNITED STATES | 10/1/2033 | 5,826,958 | 5,309,524 |

*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 | $ 727,771,749 | $ 1,724,281 | 24 |
| International Equity Managers | 293,586,564 | 1,718,023 | 59 |
| Domestic Fixed Income Managers | 445,663,684 | 863,208 | 19 |
| Global/Int'l. Fixed Income Managers | 99,369,717 | 341,659 | 34 |
| Real Estate Managers | 54,739,815 | 340,641 | 62 |
| Cash | 3,332,600 | - | N/A |
| **TOTAL** | **$ 1,624,464,129** | **$ 4,987,812** | **31** |
| **OTHER INVESTMENT SERVICE FEES** | | | |
| Investment Consultant | N/A | $ 100,000 | N/A |
| Proxy Voting | N/A | 6,100 | N/A |
| Custodian | N/A | 128,129 | N/A |
| Real Estate Legal Fees | N/A | 3,753 | N/A |
| Real Estate Appraisals | N/A | 5,250 | N/A |
| **TOTAL** | | **$ 243,232** | |

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

# Schedule of Commissions

*For the Year Ending June 30, 2006*

| Brokerage Firm | Number of Shares Traded | Total Commissions | Commission Per Share |
|---|---|---|---|
| 508 SECURITIES LLC | 8,800 | $ 176.00 | $ 0.02000 |
| ABEL NOSER CORPORATION | 26,800 | 1,072.00 | 0.04000 |
| ABG SECURITIES, OSLO | 62,925 | 1,465.00 | 0.02328 |
| ADAMS HARKNESS & HILL, INC | 20,895 | 849.55 | 0.04066 |
| ADP CLEARING & OUTSOURCING INC | 53,620 | 1,321.76 | 0.02465 |
| ASSENT | 32,680 | 228.79 | 0.00700 |
| AVONDALE PARTNERS | 2,100 | 63.00 | 0.03000 |
| B TRADE SERVICES | 117,281 | 2,257.72 | 0.01925 |
| BAIRD ROBERT W & CO INC | 56,250 | 2,564.00 | 0.04558 |
| BANC AMERICA SECUR MONTGOMERY DIV | 374,995 | 13,332.90 | 0.03555 |
| BANCO SANTANDER C HISPANO NY | 2,800 | 112.00 | 0.04000 |
| BANCOVAL, MADRID | 15,200 | 640.00 | 0.04211 |
| BANK J.VONTOBEL UND CO. AG ZURICH | 3,710 | 2,151.12 | 0.57982 |
| BAYPOINT TRADING LLC | 31,200 | 1,138.00 | 0.03647 |
| BEAR STEARNS & CO INC | 271,995 | 10,847.10 | 0.03988 |
| BEAR STEARNS CO SECS NEW YORK | 429,705 | 5,134.00 | 0.01195 |
| BEAR STEARNS NEW YORK DTC 352 | 1,177,960 | 3,756.39 | 0.00319 |
| BEAR, STEARNS, SECURITIES CORP | 60,670 | 2,337.90 | 0.03853 |
| BERNSTEIN, SANFORD C & CO | 117,140 | 2,339.10 | 0.01997 |
| BLAIR WILLIAM & COMPANY LLC | 16,235 | 794.00 | 0.04891 |
| BMO NESBITT BURNS CORP | 2,900 | 116.00 | 0.04000 |
| BNY BROKERAGE INC | 296,597 | 9,070.00 | 0.03058 |
| BNY ESI SECURITIES CO | 49,563 | 589.93 | 0.01190 |
| BOENNING AND SCATTERGOOD | 27,990 | 629.78 | 0.02250 |
| BRIDGE TRADING COMPANY | 23,075 | 1,044.00 | 0.04524 |
| BROADCORT CAPITAL CORP | 9,800 | 392.00 | 0.04000 |
| BROCKHOUSE & COOPER LONDON | 11,190 | 242.00 | 0.02163 |
| B-TRADE SERVICES LLC | 293,961 | 5,991.00 | 0.02038 |
| BUNTING WARBURG TORONTO | 42,100 | 1,986.75 | 0.04719 |
| CANTOR FITZGERALD CO. LONDON | 31,200 | 929.96 | 0.02981 |
| CANTOR FITZGERALD EUROPE | 92,900 | 1,556.00 | 0.01675 |
| CANTOR FITZGERALD & CO., INC | 571,700 | 13,135.68 | 0.02298 |
| CAP INSTITUTIONAL SERVICES INC | 173,100 | 8,008.10 | 0.04626 |
| CHEUVREUX DE VIRIEU PARIS | 22,550 | 2,657.54 | 0.11785 |
| CIBC WORLD MARKETS CORP NEW YORK | 74,070 | 3,170.35 | 0.04280 |
| CITATION GROUP | 12,500 | 562.50 | 0.04500 |
| CITIGROUP GLOBAL MARKETS INC | 151,050 | 5,727.00 | 0.03791 |

# SCHEDULE OF COMMISSIONS *Continued*

*For the Year Ending June 30, 2006*

| Brokerage Firm | Number of Shares Traded | Total Commissions | Commission Per Share |
|---|---|---|---|
| CITIGROUP GLOBAL MARKETS INC/SMITH BARNEY | 180,608 | $ 5,565.61 | $ 0.03082 |
| CITIGROUP GLOBAL MARKETS UK EQUITY | 6,400 | 125.94 | 0.01968 |
| CITIGROUP GLOBAL MKTS INC/SMITH BARNEY | 4,200 | 126.00 | 0.03000 |
| CLSA GUERNSEY LIMITED, GUERNSEY | 5,696 | 39.00 | 0.00685 |
| CLSA SINGAPORE PTE LTD | 90 | 1,163.00 | 12.92222 |
| COLLINS STEWART INC | 835 | 41.75 | 0.05000 |
| CREDIT AGRICOLE INDO CHEUVREUX | 30,765 | 3,516.00 | 0.11429 |
| CREDIT AGRICOLE INDOSUEZ, MILAN | 38,100 | 1,156.50 | 0.03035 |
| CREDIT LYONNAIS SECS SINGAPORE | 193,600 | 5,851.31 | 0.03022 |
| CREDIT SUISSE FIRST BOSTON CORPORATION | 462,085 | 11,131.70 | 0.02409 |
| CROWELL WEEDON AND CO | 2,600 | 104.00 | 0.04000 |
| CRUTTENDEN AND COMPANY | 3,280 | 164.00 | 0.05000 |
| DAIWA SECS AMERICA NEW YORK | 12,900 | 1,269.60 | 0.09842 |
| DAIWA SECURITIES AMERICA | 27,540 | 3,042.00 | 0.11046 |
| DAVIS MENDEL AND REGENSTEIN INC | 4,200 | 204.50 | 0.04869 |
| DEMATTED MONNESS LLC | 4400 | 176.00 | 0.04000 |
| DESJARDINS SECURITIES INC | 3,850 | 192.00 | 0.04987 |
| DEUTSCHE BANC/ALEX BROWN | 64,055 | 2,705.00 | 0.04223 |
| DEUTSCHE BANK AG (CUST SVS) (TRANS) | 46,700 | 1,147.93 | 0.02458 |
| DEUTSCHE BANK SECURITIES INC | 551,765 | 12,005.68 | 0.02176 |
| DONALDSON LUFKIN AND JENRETTE SECS | 181,400 | 7,256.00 | 0.04000 |
| E*TRADE CLEARING LLC | 1,010 | 40.00 | 0.03960 |
| EDWARDS, A.G., & SONS, INC. | 61,400 | 2,899.00 | 0.04721 |
| EMP RESEARCH PTRNS LLC | 2,500 | 100.00 | 0.04000 |
| FIDELITY CAPITAL MARKETS | 4,800 | 144.00 | 0.03000 |
| FIRST ALBANY CORPORATION | 52,160 | 2,100.65 | 0.04027 |
| FIRST ANALYSIS SECURITIES CORP | 1,000 | 40.00 | 0.04000 |
| FIRST CLEARING, LLC | 148,490 | 3,634.94 | 0.02448 |
| FRIEDMAN, BILLINGS & RAMSEY | 100,015 | 4,190.60 | 0.04190 |
| FUJI SECURITIES NEW YORK | 14,216 | 679.62 | 0.04781 |
| FULCRUM GLOBAL PARTNERS LLC | 31,857 | 1,370.00 | 0.04300 |
| FUTURETRADE SECURITIES LLC | 3,200 | 32.00 | 0.01000 |
| GOLDMAN EXECUTING & CLEARING | 275,320 | 1,379.60 | 0.00501 |
| GOLDMAN SACHS & CO NW YK DTC 005 | 384,200 | 7,833.52 | 0.02039 |
| GOLDMAN SACHS & COMPANY | 411,660 | 14,768.90 | 0.03588 |
| GOLDMAN SACHS CO, NY | 141,682 | 3,380.00 | 0.02386 |
| GOLDMAN SACHS EXECUTION & CLEA | 194,895 | 1,913.00 | 0.00982 |

# Schedule of Commissions *Continued*

*For the Year Ending June 30, 2006*

| Brokerage Firm | Number of Shares Traded | Total Commissions | Commission Per Share |
|---|---|---|---|
| GOODBODY STOCKBROKERS DUBLIN | 6,400 | $ 140.00 | $ 0.02188 |
| GREEN STREET ADVISORS 443 | 100 | 4.00 | 0.04000 |
| HEFLIN & CO, LLC | 13,100 | 524.00 | 0.04000 |
| I P S BROKERAGE INC. | 23,300 | 1,165.00 | 0.05000 |
| ING FINANCIAL MARKETS LLC | 6,900 | 138.00 | 0.02000 |
| INSTINET - NEW YORK (CORPORATION) | 6,500 | 130.00 | 0.02000 |
| INSTINET CLEARING SERVICES INC | 2,100 | 42.00 | 0.02000 |
| INSTINET CORPORATION | 53,955 | 1,054.70 | 0.01955 |
| INSTINET EUROPE LTD, LONDON | 487,350 | 998.00 | 0.00205 |
| INSTINET PACIFIC LTD | 36,000 | 253.00 | 0.00703 |
| INSTINET PACIFIC LTD HK | 4,000 | 26.14 | 0.00654 |
| INSTINET U.K LIMITED LONDON | 77,000 | 2,090.48 | 0.02715 |
| INVESTMENT TECHN GROUP, DUBLIN | 131,985 | 2,610.47 | 0.01978 |
| INVESTMENT TECHNOLOGY GROUP INC | 1,104,515 | 16,680.83 | 0.01510 |
| IPS BROKERAGE INC | 88,900 | 4,078.00 | 0.04587 |
| ISI GROUP INC | 10,600 | 507.50 | 0.04788 |
| ITG CANADA CORP, TORONTO | 20,200 | 775.75 | 0.03840 |
| IVY SECURITIES, INC | 9,400 | 414.00 | 0.04404 |
| J P MORGAN SECURITIES INC | 127,050 | 4,638.10 | 0.03651 |
| JAMES CAPEL SECURITIES, INC | 34,400 | 1,382.17 | 0.04018 |
| JEFFERIES & COMPANY, INC. | 149,935 | 6,241.60 | 0.04163 |
| JMP SECURITIES | 17,260 | 691.40 | 0.04006 |
| JONES & ASSOCIATES, INC | 210,930 | 7,260.27 | 0.03442 |
| JONES AD | 600 | 24.00 | 0.04000 |
| JP MORGAN SECURITIES LIMITED LONDON | 14,711 | 776.17 | 0.05276 |
| KALB VOORHIS & CO | 14,690 | 367.25 | 0.02500 |
| KAUFMAN BROTHERS | 12,370 | 494.80 | 0.04000 |
| KAUPTHING BANK SVERIGE AB | 13,985 | 373.00 | 0.02667 |
| KEEFE BRUYETTE AND WOODS INC | 5,335 | 257.40 | 0.04825 |
| KELLOGG PARTNERS | 25,180 | 630.00 | 0.02502 |
| KINNARD JOHN G & COMPANY | 2,100 | 63.00 | 0.03000 |
| KNIGHT SECURITIES L P | 107,250 | 4,289.75 | 0.04000 |
| KV EXECUTION SERVICES LLC | 25,990 | 649.00 | 0.02497 |
| LA BRANCHE FINANCIAL #2 | 17,430 | 694.75 | 0.03986 |
| LEERINK SWANN & CO /IPO | 8,810 | 428.80 | 0.04867 |
| LEERINK SWANN AND COMPANY | 25,160 | 1,091.00 | 0.04336 |
| LEGG MASON WOOD WALKER, INC | 7,075 | 353.00 | 0.04989 |

# Schedule of Commissions *Continued*

*For the Year Ending June 30, 2006*

| Brokerage Firm | Number of Shares Traded | Total Commissions | Commission Per Share |
|---|---|---|---|
| LEHMAN BROS INC NEW YORK DTC 074 | 412,700 | $ 2,787.41 | $ 0.00675 |
| LEHMAN BROS INTL (EUROPE) | 389,900 | 4,577.37 | 0.01174 |
| LEHMAN BROTHERS INC | 451,540 | 14,847.90 | 0.03288 |
| LEHMAN BROTHERS INC NEW YORK | 78,800 | 820.00 | 0.01041 |
| LEHMAN BROTHERS INTL EUROPE LDN | 99,900 | 1,539.00 | 0.01541 |
| LEHMAN BROTHERS SECS ASIA LTD HK | 38,400 | 71.30 | 0.00186 |
| LIQUIDNET INC | 329,180 | 7,541.10 | 0.02291 |
| LOOP CAPITAL MARKETS/BROADCORT CAPITAL | 310 | 12.40 | 0.04000 |
| LYNCH JONES & RYAN INC | 4,997,126 | 103,385.67 | 0.02069 |
| MACQUARIE EQUITIES LTD SYDNEY | 118,450 | 5,694.00 | 0.04807 |
| MACQUARIE EQUITIES NY, US | 18,000 | 889.00 | 0.04939 |
| MAGNA SECURITIES CORPORATION | 500 | 20.00 | 0.04000 |
| MAXCOR FINANCIAL GROUP | 51,020 | 1,531.00 | 0.03001 |
| MAXCOR FINANCIAL INC | 33,520 | 781.94 | 0.02333 |
| MCDONALD AND COMPANY | 22,645 | 998.35 | 0.04409 |
| MCDONALD INVESTMENTS INC(KEYBA | 22,700 | 1,102.00 | 0.04855 |
| MELVIN SECURITIES | 6,000 | 240.00 | 0.04000 |
| MERRILL LYNCH AMSTERDAM | 219,320 | 7,378.14 | 0.03364 |
| MERRILL LYNCH AND CO INC NEW YORK | 1,850 | 92.00 | 0.04973 |
| MERRILL LYNCH CO INC (AGS), NY | 25,500 | 2,328.00 | 0.09129 |
| MERRILL LYNCH FENNER & SMITH INC | 2,495,995 | 31,885.73 | 0.01277 |
| MERRILL LYNCH INTERNATIONAL, LONDON | 69,950 | 442.90 | 0.00633 |
| MERRILL LYNCH INTL BANK NEW YORK | 1,350 | 68.00 | 0.05037 |
| MERRILL LYNCH INTL LTD EQUITIES | 1,828,200 | 34,949.55 | 0.01912 |
| MERRILL LYNCH PFS MCUR CDS, NY | 22,100 | 884.00 | 0.04000 |
| MERRILL LYNCH PIERCE FENNER & SMITH | 799,987 | 29,630.90 | 0.03704 |
| MERRILL LYNCH PROFESSIONAL | 56,135 | 2,433.00 | 0.04334 |
| MERRILL PROFESSIONAL CLEARING CORP | 72,100 | 1,595.40 | 0.02213 |
| MERRIMAN CURHAN FORD & CO | 2,050 | 82.00 | 0.04000 |
| MIDWEST RESEARCH SECURITIES | 800 | 32.00 | 0.04000 |
| MILLER TABAK & CO LLC | 11,080 | 443.00 | 0.03998 |
| MIZUHO SECURITIES USA INC, NY | 148,430 | 5,836.00 | 0.03932 |
| MORGAN KEEGAN & COMPANY, INC. | 22,025 | 1,022.50 | 0.04642 |
| MORGAN STANLEY & CO | 298,030 | 5,208.00 | 0.01747 |
| MORGAN STANLEY & CO INC NEW YORK | 481,875 | 13,305.15 | 0.02761 |
| MORGAN STANLEY AND CO NW YK DTC 050 | 469,850 | 8,425.94 | 0.01793 |
| MORGAN STANLEY EUROPE | 9,200 | 368.00 | 0.04000 |

# Schedule of Commissions *Continued*

*For the Year Ending June 30, 2006*

| Brokerage Firm | Number of Shares Traded | Total Commissions | Commission Per Share |
|---|---|---|---|
| MORGAN STANLEY INT. LDN (CST 50701) | 31,700 | $ 447.69 | $ 0.01412 |
| MR BEAL AND COMPANY | 3,610 | 144.40 | 0.04000 |
| NATIONAL FINANCIAL SERVICES | 1500 | 45.00 | 0.03000 |
| NBC CLEARING SERVICE TWO | 3,400 | 136.00 | 0.04000 |
| NBC CLEARING SERVICES INC. | 2,000 | 80.00 | 0.04000 |
| NEEDHAM & COMPANY | 42,320 | 1,896.80 | 0.04482 |
| NOMURA SECURITIES INTL INC NY | 33,550 | 1,770.00 | 0.05276 |
| NYFIX CLG CORP | 2,200 | 42.50 | 0.01932 |
| NYFIX TRANSACTION SERVICES #2 | 4,100 | 73.00 | 0.01780 |
| ODDO PARIS | 4,480 | 478.07 | 0.10671 |
| PACIFIC AMERICAN SECURITIES LLC | 7,500 | 300.00 | 0.04000 |
| PENSON FINANCIAL SERV CANADA INC | 35,200 | 1,351.43 | 0.03839 |
| PERSHING & COMPANY | 12,000 | 510.00 | 0.04250 |
| PERSHING DIV/DONALDSON LUFKIN/JE | 100 | 4.00 | 0.04000 |
| PERSHING LLC - JERSEY CITY | 633,515 | 17,114.65 | 0.02702 |
| PERSHING LLC FORMERLY DLJ\ | 28,420 | 1,224.85 | 0.04310 |
| PERSHING NOMS | 33,145 | 308.00 | 0.00929 |
| PERSHING SECURITIES LONDON | 90,625 | 1,146.00 | 0.01265 |
| PERSHING, JERSEY CITY | 1,358,607 | 15,434.00 | 0.01136 |
| PIPELINE TRADING SYSTEMS LLC | 45,380 | 691.20 | 0.01523 |
| PIPER JAFFRAY INC | 103,850 | 4,683.40 | 0.04510 |
| PRINCETON SECURITIES | 10,900 | 324.00 | 0.02972 |
| PRUDENTIAL EQUITY GROUP | 52,240 | 2,241.70 | 0.04291 |
| PULSE TRADING LLC | 75,980 | 1,847.74 | 0.02432 |
| PXP SECURITIES CORP | 7,850 | 392.50 | 0.05000 |
| QUANTEX, NEW YORK DTC 019 | 3,250 | 65.00 | 0.02000 |
| RAYMOND JAMES | 26,280 | 1,084.20 | 0.04126 |
| RBC CAPITAL MARKETS INC | 41,270 | 1,687.90 | 0.04090 |
| RBC DAIN RAUSCHER | 2,300 | 92.00 | 0.04000 |
| RBC DOMINION SECURITIES,CORP. | 19,240 | 423.00 | 0.02199 |
| ROBBINS AND HENDERSON LLC | 14,800 | 370.00 | 0.02500 |
| ROBERT W BAIRD & COMPANY INC MILWAUKEE | 54,615 | 2,463.85 | 0.04511 |
| ROTH CAPITAL PARTNERS, LLC | 5,180 | 259.00 | 0.05000 |
| ROYAL BANK OF CANADA TORONTO | 1,500 | 75.00 | 0.05000 |
| RTX SECURITIES CORP | 16,880 | 675.20 | 0.04000 |
| S.G. COWEN & CO., LLC | 40,640 | 1,772.00 | 0.04360 |
| SANDLER O'NEILL & PARTNERS LP | 3,500 | 172.00 | 0.04914 |

# SCHEDULE OF COMMISSIONS *Continued*

*For the Year Ending June 30, 2006*

| Brokerage Firm | Number of Shares Traded | Total Commissions | Commission Per Share |
|---|---|---|---|
| SANFORD C BERNSTEIN & CO.,LLC | 49,080 | $ 932.00 | $ 0.01899 |
| SANTANDER INVESTMENT SECS | 3,300 | 132.00 | 0.04000 |
| SBK-BROOKS INVESTMENT CORP | 2,000 | 100.00 | 0.05000 |
| SCOTIA CAP MARKETS USA INC NY | 16,990 | 680.00 | 0.04002 |
| SCOTIA MCLEOD INC | 16,250 | 650.00 | 0.04000 |
| SCOTT & STRINGFELLOW INVESTMENT | 14,380 | 709.00 | 0.04930 |
| SCOTT & STRINGFELLOW, INC | 280 | 11.00 | 0.03929 |
| SG AMERICAS SECURITIES LLC | 3,900 | 117.00 | 0.03000 |
| SG COWEN SECURITIES | 75,685 | 3,080.65 | 0.04070 |
| SIDOTI & COMPANY LLC | 12,025 | 490.50 | 0.04079 |
| SIMMONS & COMPANY INTL | 4,600 | 189.50 | 0.04120 |
| SKANDINAVISKA ENSKILDA BK, STOCKHOL | 20,790 | 559.00 | 0.02689 |
| SOCIETE GENERALE LONDON | 1,288,750 | 15,981.14 | 0.01240 |
| SOLEIL SECURITIES CORP | 2,400 | 108.00 | 0.04500 |
| SOUTHWEST SECURITIES INC, NY | 7,810 | 78.00 | 0.00999 |
| STANDFORD GROUP CO | 3,970 | 189.50 | 0.04773 |
| STATE ST BROKERAGE SERVICE INC | 21,820 | 655.10 | 0.03002 |
| STEPHENS, INC. | 6,100 | 281.00 | 0.04607 |
| STERNE AGEE AND LEACH INC | 11,950 | 540.55 | 0.04523 |
| SUNTRUST CAPITAL MARKETS, INC | 50,450 | 2,420.00 | 0.04797 |
| SUNTRUST ROBINSON HUMPHREY | 15,200 | 686.50 | 0.04516 |
| THE WILLIAMS CAPITAL GROUP LP | 2,500 | 125.00 | 0.05000 |
| THOMAS WEISEL PARTNERS LLC | 169,585 | 7,189.25 | 0.04239 |
| UBS AG, (LONDON EQUITIES) | 306,950 | 7,567.50 | 0.02465 |
| UBS AUSTRALIA GROUP LTD. SYDNEY | 54,300 | 1,476.17 | 0.02719 |
| UBS SECURITIES ASIA | 227,896 | 5,072.66 | 0.02226 |
| UBS SECURITIES LLC | 172,990 | 6,375.00 | 0.03685 |
| UBS WARBURG LLC | 169,557 | 7,139.48 | 0.04211 |
| UBS/WARBURG SECURITIES LLC NEW YORK\ | 25,340 | 1,019.70 | 0.04024 |
| UNION BANK OF SWIT NEW YK DTC 642 | 500 | 418.14 | 0.83628 |
| UNTERBERG HARRIS | 2,850 | 114.00 | 0.04000 |
| VERITAS SECURITIES | 55,800 | 1,674.00 | 0.03000 |
| WACHOVIA CAPITAL MARKETS LLC | 53,740 | 2,538.00 | 0.04723 |
| WACHOVIA SECS CAPITAL MARKET | 74,305 | 3,676.00 | 0.04947 |
| WATERHOUSE SECURITIES INC | 17,690 | 708.00 | 0.04002 |
| WAVE SECURITIES LLC | 20,200 | 404.00 | 0.02000 |
| WEDBUSH MORGAN SECURITIES, INC | 27,650 | 1,102.50 | 0.03987 |

# Schedule of Commissions *Continued*

*For the Year Ending June 30, 2006*

| Brokerage Firm | Number of Shares Traded | Total Commissions | Commission Per Share |
|---|---|---|---|
| WEEDEN AND & CO | 60,830 | $ 2,449.20 | $ 0.04026 |
| WESTMINSTER RES ASOC/BROADCORT/MERR161 | 4,600 | 207.00 | 0.04500 |
| WESTMINSTER RESEARCH | 8,200 | 410.00 | 0.05000 |
| WILLIAMS CAPITAL GROUP | 4,500 | 225.00 | 0.05000 |
| WR HAMBRECHT & CO | 26,805 | 1,231.65 | 0.04595 |
| **TOTAL** | **31,399,910** | **$ 707,003.02** | **$ 0.02252** |

# Investment Summary

Non-GAAP Basis

*As of June 30, 2006*

**(In Thousands)**

| **EQUITIES** | **Market Value** | **% of Portfolio** |
|---|---|---|
| Consumer Discretionary | $ 55,727 | 3.43% |
| Consumer Staples | 13,713 | 0.84% |
| Energy | 25,530 | 1.57% |
| Financials | 59,295 | 3.65% |
| Health Care | 53,268 | 3.28% |
| Industrials | 39,457 | 2.43% |
| Materials | 9,698 | 0.60% |
| Technology/Telecommunication | 76,502 | 4.71% |
| Utilities | 10,737 | 0.66% |
| Commingled | 362,225 | 22.30% |
| Foreign Equities | 292,053 | 17.98% |
| **TOTAL EQUITIES** | **$ 998,205** | **61.45%** |
| **FIXED INCOME** | | |
| U.S. Treasury | $ 69,151 | 4.26% |
| U.S. Government Agency | 179,548 | 11.05% |
| Domestic Corporate Bonds | 200,708 | 12.35% |
| State and Local Obligations | - | 0.00% |
| Foreign Government | 64,590 | 3.98% |
| Foreign Corporate | 36,809 | 2.27% |
| **TOTAL FIXED INCOME** | **$ 550,806** | **33.91%** |
| **OTHER INVESTMENTS** | | |
| Short Term | $ 32,089 | 1.97% |
| Real Estate | 54,584 | 3.36% |
| Private Market Equities | 7,956 | 0.49% |
| **TOTAL OTHER INVESTMENTS** | **$ 94,629** | **5.82%** |
| **PENDINGS** | **$ (19,175)** | **-1.18%** |
| **TOTAL** | **$1,624,465** | **100.00%** |

# Investment Property

**MILPITAS WAREHOUSE**

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

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# Actuarial Section

# ACTUARY CERTIFICATION LETTER

GRS
Gabriel Roeder Smith & Company
Consultants & Actuaries
9171 Towne Centre Drive
Suite 440
San Diego, CA 92122-1238
858.535.1300 phone
858.535.1415 fax
www.gabrielroeder.com

August 11, 2004

Board of Administration
City of San José - Federated City Employees' Retirement System
1737 N First Street, Suite 580
San José, CA 95112-4505

**RE: ACTUARIAL VALUATION CERTIFICATION**

**Members of the Board:**

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

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

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

**Gabriel, Roeder, Smith & Company**

# ACTUARY CERTIFICATION LETTER *Continued*

GRS Gabriel Roeder Smith & Company
Consultants & Actuaries

Board of Administration -2-
City of San José - Federated City Employees' Retirement System
August 11, 2004

**The Funding Objective of the Plan**

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

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

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

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

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

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

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

**Supporting Schedules**

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

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

**Gabriel, Roeder, Smith & Company**

# ACTUARY CERTIFICATION LETTER *Continued*

**GRS** Gabriel Roeder Smith & Company
Consultants & Actuaries

Board of Administration -3-
City of San José - Federated City Employees' Retirement System
August 11, 2004

**Trend Data Schedules in the Financial Section**

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

**Actuarial Assumptions and Methods Used for Funding Purposes**

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

* * *

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

Sincerely,

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

CML

**Gabriel, Roeder, Smith & Company**

# Summary of Assumptions and Funding Method

*Adopted November 2003*

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

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

*Sample rates*

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

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

**Mortality:** *A. For Pensioners on Service Retirement and Beneficiaries*

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

*Sample rates*

Deaths per 1,000

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

*B. For Pensioners on Disability Retirement:*

1981 Disability Mortality Table

*Sample rates*

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

**Rehire for Former Employees:** All former employees are assumed not to be rehired.

# Summary of Assumptions and Funding Method *Continued*

*Adopted November 2003*

**Disability:** Valuation of disability benefits are assumed to not be offset by Worker's Compensation.

**Prior Service Benefits:** The liability for benefits attributed to pre-1975 service is assumed in proportion to its liability as of June 30, 1997, adjusted for changes in demographics.

**Proportion of Members with Spouses at Retirement:** 85% of male employees and 60% of female employees are assumed married at retirement. Wives are assumed three years younger than husbands.

**Asset Valuation Method:** The Actuarial Value of Assets recognizes 20% of total return in excess of (or less than) the investment return assumption for each of the last five years. This method has the effect of smoothing volatility in investment returns as they affect the cost of benefits provided by the system.

## HEALTH SUBSIDY BENEFITS

**Increase in Retiree Population:** The covered Retiree population is assumed to increase 6.10% per year.

**Covered Payroll Increase:** 4.5% per year.

# Rates of Separation from Active Service — Males

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

# Rates of Separation from Active Service — Females

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

# Schedule of Active Member Valuation Data

*June 30,1993 to June 30, 2003*

| *Valuation Date* | *Number* | *Annual Payroll* | *Annual Average Pay* | *% Increase in Average Pay** |
|---|---|---|---|---|
| June 30, 2003 | 4,479 | $292,961,000 | $65,408 | 15.6% |
| June 30, 2001 | 4,466 | $252,696,000 | $56,582 | 7.9% |
| June 30, 1999 | 3,694 | $193,650,000 | $52,423 | 8.3% |
| June 30, 1997 | 3,642 | $176,284,000 | $48,403 | 6.8% |
| June 30, 1995 | 3,397 | $153,918,000 | $45,310 | 4.4% |
| June 30, 1993 | 3,360 | $145,781,000 | $43,387 | - |

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

# Changes In Retirants (Including Beneficiaries)

*July 1,1993 to June 30, 2003*

| | Beginning of Period | | Added to Rolls | | Removed from Rolls[1] | | End of Period | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| *Two-Year Period* | *Count* | *Annual Allowances* | *Count* | *Annual Allowances* | *Count* | *Annual Allowances* | *Count* | *Annual Allowances* | *% Increase in Annual Allowances* | *Average Annual Allowances* |
| 2001–2003 | 2,030 | $45,208,000 | 313 | $10,152,000 | 171 | $504,000 | 2,172 | $54,687,000 | 21.0% | $25,178 |
| 1999–2001 | 1,824 | $37,137,000 | 230 | $6,655,000 | 24 | $268,000 | 2,030 | $45,208,000 | 21.7% | $22,270 |
| 1997–1999 | 1,745 | $32,630,000 | 202 | $4,642,000 | 123 | $1,514,000 | 1,824 | $37,137,000 | 13.8% | $20,360 |
| 1995–1997 | 1,636 | $29,029,000 | 190 | $4,143,000 | 81 | $946,000 | 1,745 | $32,630,000 | 12.4% | $18,699 |
| 1993–1995 | 1,497 | $25,642,000 | 210 | $4,420,000 | 71 | $801,000 | 1,636 | $29,029,000 | 13.2% | $17,744 |

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

# Actuarial Analysis of Financial Experience

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

# Solvency Test

*July 1,1993 to June 30, 2003*

| Year Ended | (1) Active Members Contributions | (2) Retirants and Beneficiaries Accrued Liability | (3) Active Members Accrued Liability (Employer Portion) | Actuarial Value of Assets | Portion of Accrued Liabilities Covered by Reported Assets | | |
|---|---|---|---|---|---|---|---|
| | | | | | (1) | (2) | (3) |
| 2003 | $224,875,000 | $635,092,000 | $451,724,000 | $1,280,719,000 | 100% | 100% | 93% |
| 2001 | $210,377,000 | $529,853,000 | $332,103,000 | $1,060,144,000 | 100% | 100% | 96% |
| 1999 | $196,887,000 | $441,573,000 | $223,766,000 | $804,860,000 | 100% | 100% | 74% |
| 1997 | $167,837,000 | $383,574,000 | $184,361,000 | $678,954,000 | 100% | 100% | 69% |
| 1995 | $133,805,000 | $364,159,000 | $160,211,000 | $566,102,000 | 100% | 100% | 43% |
| 1993 | $104,098,000 | $308,922,000 | $170,099,000 | $489,865,000 | 100% | 100% | 45% |

# Summary of Key Provisions

## SUMMARY OF RETIREMENT BENEFITS

**1. Eligibility:** Members are eligible on their first day of City employment.

**2. Final Compensation:** Highest 12-month average salary

**3. Service Retirement:**

*A) Eligibility:* Age 55 with five years of service, or any age with 30 years of service.

*B) Benefit:* 2.5% of Final Compensation for each year of service.
Maximum benefit is 75% of Final Compensation.

*C) Form of Payment:* Monthly benefit payable for the life of the member.

**4. Disability Retirement:**

*A) Eligibility:* Physically or mentally incapacitated so unable to perform duties of position.

If disability is not service connected, then the member must have at least five years of City service.

*B) Benefit:* 2.5% of Final Compensation per year of service.
The maximum benefit is 75% and the minimum benefit is 40% of Final Compensation. Any Workers' Compensation benefits are offset from the benefits under this system. If the disability was not service-connected, then the benefit is reduced by .5% of Final Compensation for each year of age under 55.

*C) Form of Payment:* Monthly benefit payable for the life of the member.

**5. Deferred Service Retirement:**

*A) Eligibility:* Five years of membership prior to termination of City service.
Member must leave contributions on deposit until retirement.

*B) Benefit:* Same as Service Retirement, payable anytime after age 55.

*C) Form of Payment:* Same as Service Retirement.

**6. Pre-Retirement Death Benefits:** Member's beneficiary or estate receives (i), and (ii) where:

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

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

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

# Summary of Key Provisions *Continued*

## SUMMARY OF RETIREMENT BENEFITS *Continued*

**7. Post-Retirement Death Benefits:**

Member's eligible survivor receives (i) and (ii), where:
(i) = 50% continuance to surviving eligible spouse; if there is no surviving spouse, certain benefits are paid to the children.
(ii) = $500 death benefit allowance for burial expenses at death of retired member.

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

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

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

**9. Employee Contributions:**

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

## SUMMARY OF HEALTH SUBSIDY BENEFITS

**1. Eligibility:**

*A) Medical*

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

*B) Dental*

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

**2. Benefit:**

*A) Medical*

The Retirement System pays the premium for the lowest cost medical plan offered by the City for single and family coverage. Members and eligible survivors pay for the difference in the premium for their selected plan and the portion paid by the Retirement System.

*B) Dental*

The Retirement System pays the entire cost of dental insurance coverage.

**3. Contributions:**

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

# Statistical Section

# Statistical Review

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

### Pension Benefits (Schedule 1a)

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Additions** | | | | | | | | | | |
| Member contributions | $7,810 | $9,078 | $8,812 | $10,804 | $10,306 | $11,071 | $11,776 | $12,394 | $12,393 | $12,395 |
| Employer contributions | 27,162 | 30,367 | 30,139 | 34,146 | 35,284 | 41,011 | 38,411 | 39,534 | 41,552 | 41,267 |
| Investment Income (net of expenses) | 106,158 | 130,414 | 93,491 | 73,839 | (2,934) | (24,140) | 71,179 | 192,373 | 115,618 | 132,873 |
| Total additions to plan net assets | **141,130** | **169,859** | **132,442** | **118,789** | **42,656** | **27,942** | **121,366** | **244,301** | **169,563** | **186,535** |
| **Deductions (See Schedule 2a)** | | | | | | | | | | |
| Benefit payments | 29,979 | 32,035 | 34,846 | 44,655 | 43,761 | 48,235 | 46,814 | 53,578 | 60,438 | 68,438 |
| Death benefits | 20 | 84 | 47 | 20 | 105 | 22 | 4,752 | 5,454 | 5,437 | 5,721 |
| Refunds | 789 | 1,980 | 646 | 1,386 | 1,886 | 1,207 | 714 | 1,188 | 927 | 1,246 |
| Administrative expenses and other | 682 | 782 | 682 | 1,059 | 1,322 | 1,378 | 1,532 | 1,799 | 1,588 | 1,790 |
| Total deductions from plan net assets | **31,470** | **34,881** | **36,221** | **47,120** | **47,074** | **50,842** | **53,812** | **62,019** | **68,390** | **77,195** |
| **Change in Net Assets** | **$109,660** | **$134,978** | **$96,221** | **$71,669** | **$(4,418)** | **$(22,900)** | **$67,554** | **$182,282** | **$101,173** | **$109,340** |

### Postemployment Healthcare Benefits (Schedule 1b)

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Additions** | | | | | | | | | | |
| Member contributions | $3,566 | $2,051 | $1,921 | $1,679 | $1,462 | $2,787 | $3,032 | $3,191 | $5,219 | $5,226 |
| Employer contributions | 4,279 | 2,326 | 2,248 | 1,596 | 1,750 | 4,127 | 3,866 | 3,948 | 5,996 | 5,961 |
| Investment Income (net of expenses) | 6,881 | 10,514 | 6,416 | 4,132 | (536) | (1,558) | 4,193 | 11,066 | 6,539 | 7,273 |
| Total additions to plan net assets | **14,726** | **14,891** | **10,585** | **7,407** | **2,676** | **5,356** | **11,091** | **18,205** | **17,754** | **18,460** |
| **Deductions (See Schedule 2b)** | | | | | | | | | | |
| Healthcare insurance premiums | 4,145 | 4,161 | 4,711 | 5,236 | 6,530 | 7,804 | 9,191 | 11,438 | 13,393 | 15,904 |
| Administrative expenses and other | 44 | 59 | 44 | 77 | 98 | 94 | 99 | 114 | 95 | 103 |
| Total deductions from plan net assets | **4,189** | **4,220** | **4,755** | **5,313** | **6,628** | **7,898** | **9,290** | **11,552** | **13,488** | **16,007** |
| **Change in Net Assets** | **$10,537** | **$10,671** | **$5,830** | **$2,094** | **$(3,952)** | **$(2,542)** | **$1,801** | **$6,653** | **$4,266** | **$2,453** |

# STATISTICAL REVIEW *Continued*

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

### Pension Benefits (Schedule 2a)

| Type of Benefit | | 2006 |
|---|---|---|
| *Age and Service Benefits* | | |
| Retirees – Service | $ | 59,390 |
| Retirees – Deferred Vested | | 4,134 |
| Survivors – Service | | 3,195 |
| Survivors – Deferred Vested | | 87 |
| *Death in Service Benefits* | | 1,751 |
| *Disability Benefits* | | |
| Retirees – Service-Connected | | 2,702 |
| Retirees – Non-Service-Connected | | 1,640 |
| Survivors – Service-Connected | | 187 |
| Survivors – Non-Service-Connected | | 502 |
| *Ex-Spouse Benefits* | | 571 |
| **Total Benefits** | **$** | **74,159** |
| **Type of Refund** | | |
| *Separation* | $ | 1,246 |
| **Total Refunds** | **$** | **1,246** |

### Postemployment Healthcare Benefits (Schedule 2b)

| Type of Benefit | | 2006 |
|---|---|---|
| *Age and Service Benefits* | | |
| Retirees – Service | | |
| Medical | $ | 10,341 |
| Dental | | 1,870 |
| Retirees – Deferred Vested | | |
| Medical | | 652 |
| Dental | | |
| Survivors – Service | | |
| Medical | | 628 |
| Dental | | 235 |
| Survivors – Deferred Vested | | |
| Medical | | 11 |
| Dental | | - |
| *Death in Service Benefits* | | |
| Medical | | 293 |
| Dental | | 71 |
| *Disability Benefits* | | |
| Retirees – Service-Connected | | |
| Medical | | 956 |
| Dental | | 131 |
| Retirees – Non-Service-Connected | | |
| Medical | | 433 |
| Dental | | 73 |
| Survivors – Service-Connected | | |
| Medical | | 59 |
| Dental | | 17 |
| Survivors – Non-Service-Connected | | |
| Medical | | 103 |
| Dental | | 31 |
| *Ex-Spouse Benefits* | | |
| Medical | | - |
| Dental | | - |
| **Total Benefits** | **$** | **15,904** |

*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 | 6.70 | 18.59 |
| 1998* | 5.31 | 16.52 |
| 1999 | 5.31 | 16.52 |
| 2000 | 5.31 | 16.52 |
| 2001 | 4.76 | 16.09 |
| 2002 | 4.96 | 17.40 |
| 2003 | 5.08 | 15.20 |
| 2004 | 5.08 | 15.20 |
| 2005 | 6.06 | 17.12 |
| 2006 | 6.06 | 17.12 |

**multiple rates this year*

*Source: Pension Administration System*

# Retired Members by Type of Benefit

*As of June 30, 2006*

## PENSION BENEFITS

| | | Type of Retirement | | | | | | Option Selected | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *Amount Monthly Benefit* | *Number of Retirees & Beneficiaries* | *1* | *2* | *3* | *4* | *5* | *6* | *A* | *B* | *C* | *Total* |
| $ 1 - 500 | 172 | 61 | 46 | 2 | - | 10 | 53 | 84 | 17 | 71 | 172 |
| 501 - 1000 | 312 | 117 | 95 | 7 | 5 | 24 | 64 | 146 | 14 | 59 | 219 |
| 1001 - 1500 | 388 | 153 | 119 | 26 | 24 | 8 | 58 | 202 | 26 | 160 | 388 |
| 1501 - 2000 | 356 | 217 | 47 | 39 | 23 | 6 | 24 | 227 | 23 | 106 | 356 |
| 2001 - 2500 | 314 | 223 | 30 | 31 | 12 | | 18 | 215 | 25 | 74 | 314 |
| 2501 - 3000 | 260 | 215 | 10 | 12 | 11 | 2 | 10 | 187 | 17 | 149 | 353 |
| 3001 - 3500 | 209 | 179 | 8 | 5 | 3 | 1 | 13 | 151 | 19 | 39 | 209 |
| 3501 - 4000 | 171 | 156 | 6 | 3 | - | - | 6 | 134 | 12 | 25 | 171 |
| 4001 - 4500 | 133 | 125 | 2 | 1 | - | - | 5 | 95 | 13 | 25 | 133 |
| 4501 - 5000 | 121 | 116 | 1 | 1 | - | - | 3 | 85 | 9 | 27 | 121 |
| Over $5000 | 185 | 180 | - | 2 | - | - | 3 | 147 | 11 | 27 | 185 |
| **Total** | **2621** | **1742** | **364** | **129** | **78** | **51** | **257** | **1673** | **186** | **762** | **2621** |

**Retirement Codes**

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

**Option Descriptions**

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

## POSTEMPLOYMENT HEALTHCARE BENEFITS

| | Type of Subsidy | |
|---|---|---|
| *Amount Monthly Benefit* | *Health* | *Dental* |
| Ineligible/Deferred | 693 | 386 |
| $ 1 - 60 | - | 66 |
| 61 - 250 | 4 | 2169 |
| 251 - 500 | 897 | - |
| 501 - 750 | 209 | - |
| 751 - 1000 | 818 | - |
| **Total** | **2621** | **2621** |

*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** | | | | | | | |
| Period 7/1/2005 to 6/30/2006 | | | | | | | |
| Average Monthly Benefit* | $665 | $981 | $1,638 | $2,252 | $2,971 | $4,142 | $4,673 |
| Average Final Average Salary | $3,073 | $3,413 | $3,704 | $4,123 | $4,067 | $4,755 | $5,324 |
| Number of Retired Members** | 116 | 294 | 337 | 449 | 322 | 536 | 100 |

* Includes Cost of Living Increases
** 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** | | | | | | | |
| Period 7/1/2005 to 6/30/2006 | | | | | | | |
| Average Health Subsidy | $616 | $635 | $613 | $614 | $615 | $670 | $641 |
| Number of Health Participants* | 24 | 49 | 189 | 416 | 305 | 520 | 98 |
| Average Dental Subsidy | $95 | $94 | $94 | $94 | $94 | $94 | $94 |
| Number of Dental Participants* | 62 | 191 | 280 | 397 | 297 | 521 | 99 |

* 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*

ALDANA, LUCIANO S
ALLEN, GERALD E
AMARILLAS, HENRY G
ANDREWS-LITTLE, AUDRAY
ARANDA, AMELITA
ARIMURA, KENNETH M
ASFARI, DARIUSH
BAJAJ, POONAM
BALLEJO, ROBERT M
BARRETT, DENNIS W
BARRETT, WILLIAM J
BAUTISTA-TAMAYO, THERESA H
BECK, KENNETH J
BECK, VIRGINIA
BEGIL, RICHARD
BLANKENSHIP, MARIA E
BORGSDORF, DEL D
BORREGO, DIANA
BOURGEOIS, MARIANNE
BROOKS, DEBBIE D
BURTON, MARK
CANO, CARLOS C
CASAREZ, JOHN A
CASTELLANOS, JOSE C
CASTILLO, ANGIE M
CAVAZOS, GLORIA O
CHASE, CLARA R
CLARK, DAVID T
COMBS, LLOYD N
CORDOVA, ROBERT
CUSHING, ROBERT L
DANCE, GAIL
DAVILA, ESTHER
DEBOLT, ANNE
DOODY, DAVID J
DURAN, MONTE R
EBY, SUSAN G
EDWARDS, FRANCES L
ELA, TOM F
ESCOBEDO, MICHAEL J
ESTRADA, DANIEL
FARRELL, CONNIE M
FEURY, CLAIRE A
FLETCHER, THOMAS S
GALLAGHER, ROBERT J
GARCIA, JOSE L
GIBBONS, PATRICIA E
GOLDEN, SABLE G
GRIFFIN, MELBA M
GUCHO, GABRIEL G
HADE, SHALAH A
HARRIS, ORA L
HEALY, JOSEPH R
HELLMAN, RONALD L
HENDRY, JAMES
HERRON, STEVE
HILL, MATTIE L
HOUDA, MICHAEL
HUTCHINSON, GEORGE D
IIDA, MIKE C
JACK, EILEEN L
JACQUEZ, MARGARET
JOHNSON, DELLA M
JOHNSTON, SUE A
KALIN, BRUCE E
KEECH, BARRY F
KLASS, STEVEN K
KOMROSKY, MARLENE J
KOSANOVIC, CATHI J
KUROTSUCHI, CHARLEEN H
KWOK, PATRICK S
LABOUFF, SHARON L
LANDRETH, LINDA L
LANT, RICHARD A
LAYMAN, H MICHAEL
LINGOFELTER, SHARON R
LOWNSBERY, MARILYN C
LYONS, GREGORY
MARQUEZ, MARGARET R
MATTEONI, MARY LOU
MATTHIAS, EDWARD D
MC VEY, FRANCIS B
MELLO, JAMES H
MEYDBRAY, MARA F
MILLER, GLEN A
MORALES, ELENA
MUNOZ, KATHLEEN A
NIEMANN, MICHAEL J
NIETO, EVA A
NIVER, MARK
PACHECO, RALPH
POLETTI, CATHERINE A
POYADUE, TURHAN M
RENSFIELD, KENNETH V
ROBERTS, TERRY E
ROGERS, MICHAEL L
ROQUE, ANGELITO B
ROXAS, ARTEMIO B
SAENZ, ALBERT A
SALINAS, JOHN
SANCHEZ, AGERICO K
SATMARY, WAYNE C
SCHICK, DAVID A
SEEBACH, FLORENCE M
SEGELIN, LINDA
SEMORAD, LISA
SEYMOUR, JAMES G
SHIRAMIZU, BRENT T
SMALLWOOD, JANICE L
SMITH, PHILIP E
SNYDER, LARRY L
SODHA, BHARATI
SOLIS, RUBEN
SUM, HENRY K
SVINDAL, SHIRLEY M
TALBOT, KENNETH
TELLEFSON, HAROLD J
THOMAS-SMALLSHIRE, KATHLEEN M
TISCHLER, WARREN J
TRANTOW, PATTI A
TROYER, ALAN S
TRUMBULL, THAI CHUNG
TUCKER, NANCY G
UHROWCZIK, THEODORA
ULRICH, FREDRICK G
WANG, LARRY L
WEISE, EDWIN W
WILSON, EVERETT
WILSON, SAMPSON
WOLFF, CONNIE
WORTHY, ACEY L
YOUNG, DEBORAH M

*Source: Pension Administration System*

# Retirements During Fiscal Year 2005–06 *Continued*

### *Deferred Vested Retirements*

ALEXANDER, IRENE A
ANDERSON, CHRYSTEEN
ANZALDUA, LINDA E
BERGER, ROBERT A
BRYAN, ANDREA YVETTE
CRAIG, RICHARD R
ESPARZA, CONNIE L
GALIOS, KATHRYN ANNE
GARCIA, ALICIA F
HOLGERSSON, JAMES N
MAYFIELD, WILLIAM B
MOSHER, CARLOS
OPPENHEIM, ELLEN
PAK, TAE YONG
SIEBERT, GORDON S
STOUGH, DANIEL
THEIN, SUSAN
UNDERWOOD, PAUL E
URIBES, STEVEN R

### *Service-Connected Disability Retirements*

AVITIA, CONSUELO C
CASTRO, GEORGE
CHAVEZ, FRANCISCO
COULTER, DONALD R
GARCIA, CLARA FRANCES
GARCIA, WILLIAM A
GERARDO, GUSTAVO
HERNANDEZ, JOHN A
HERRERA, ARTURO
LUCERO, KENNETH
MELO, ROBYN E
RECKAS, KIMBERLIE
ROBERTS, RONALD
ROONEY, PAUL A
WILLIAMS, TERRI L
ZAMORA, MIKE

### *Non-Service-Connected Disability Retirements*

BAGNE, DEBRA J
FLORENDO, DAISY G
HIGA, JAMES M
HOLMES, JAMES P
WILKIE, AUDIE W

# Deaths During Fiscal Year 2005–06

### *Deaths After Retirement*

AMIN, SURENDRA N
ANDREWS, MARTHA E
BAKER, DORIS E
BALLENBERG, EDNA P
BARRAZA, ISABEL S
CARTER, WILLIAM G
CROTHERS, LEONARD C
DEWHURST, DEAN H
DOINE, MAURICE E
FREELING, JACK F
GEPHART, JANET L
HAAN, STANLEY K
HARRIS, ORA L
HERNANDEZ, PHILIP R
JOHNSON, ROBERT L
KANN, MARY JANE
KIMBERLIN, CHARLES W
KIZIS, CLIFFORD
LEAF, ERNEST R
LONERO, PIETRO
LYONS, THAYER D
MATTHIESEN, ARTHUR R
MC DONALD, EDWARD J
MENNING, ROY KURT
MILLER, NORMAN G
MOORE, SYLVESTER B
MURPHY, WILLARD I
NIEMANN, ROBERT F
PLANT, JOSEPH W
ROBERTS, J C
SANBORN, HUGH W
SHEELY, WILLIAM E
SHIGEMOTO, KATHERINE N
SWAN, LYMAN C
WALLIS, CARL W
WETHERFORD, MAR JEAN M

### *Deaths Before Retirement*

CASILLAS, JAVIER
ELIX, JANICE M
FIGUEROA, ROBERT
HARRIS, KATHLEEN F
JUNG, DOROTHY
RIVAS, AUGUSTINE C
SCHRECK, RONALD E
WOODWORTH, MARTIN

*Source: Pension Administration System*

# Other Reports

# Independent Auditor's 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

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

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

We have audited the financial statements of the City of San José Federated Employees' Retirement System (System), a pension trust fund of the City of San José, California, as of and for the fiscal years ended June 30, 2006 and 2005, and have issued our report thereon dated October 2, 2006. We conducted our audit 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 audit, we considered the System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control 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 System'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,

# Independent Auditor's 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*

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

we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the System 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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