

# Porter, White & Company

## Swap Portfolio Report

January 23, 2007

Valuation as of December 31, 2006

### Jefferson County, Alabama

Jefferson County's swap portfolio had a *negative mark-to-market value of \$151.7 million as of December 31, 2006.*<sup>1</sup> There are eleven swaps, four cancellable swaps, and two swaptions with four different counterparties in the portfolio.<sup>2</sup> Please refer to Table 1 for details on each position.

**Table 1: Jefferson County Swap Portfolio (Amounts in \$ Million)**

Counterparty	Notional Amount (1)	Transaction Date	Maturity Date	Type	Mark-to-Market Value		Dollar Value Basis Point (DV01) (4)
					At Inception (2)	12/31/2006 (3)	
<i>2001 B GO Warrants</i>							
JP Morgan Chase	120	4/26/2001	4/1/2011	Canc. Swap	(1.41)	(4.72)	(0.04)
<i>2002 C Sewer Revenue Refunding Warrants</i>							
JP Morgan Chase	539	10/23/2002	2/1/2040	Swap	(14.26)	(33.59)	(0.51)
Bank of America	110	10/23/2002	2/1/2040	Swap	(2.91)	(6.85)	(0.10)
Lehman Brothers	190	10/23/2002	2/1/2040	Swap	(5.02)	(11.83)	(0.18)
<i>2003 B Sewer Revenue Refunding Warrants</i>							
JP Morgan Chase	1,036	3/28/2003	2/1/2042	Swap	(28.44)	(30.03)	(0.93)
<i>2003 C Sewer Revenue Refunding Warrants</i>							
JP Morgan Chase	789	7/14/2003	2/1/2042	Swap	(23.65)	(13.86)	(0.73)
Bank of America	263	7/14/2003	2/1/2042	Swap	(7.88)	(4.62)	(0.24)
<i>Other Transactions</i>							
JP Morgan Chase	200	1/10/2001	1/1/2016	Swaption	(4.74)	(1.40)	0.01
JP Morgan Chase	175	1/10/2001	1/1/2016	Swaption	(2.84)	(1.02)	0.01
JP Morgan Chase	70	2/5/2001	2/1/2031	Canc. Swap	(3.48)	1.16	0.02
JP Morgan Chase	70	5/24/2001	2/1/2007	Canc. Swap	(0.18)	(0.93)	(0.00)
JP Morgan Chase	110	9/18/2001	2/1/2042	Swap	(3.36)	(19.62)	(0.20)
JP Morgan Chase	112	11/7/2003	2/1/2024	Canc. Swap	(2.97)	0.87	0.03
Bear Stearns	633	6/10/2004	2/1/2042	Swap	(9.30)	(5.03)	0.05
Bear Stearns	825	6/10/2004	2/1/2040	Swap	(14.19)	(7.33)	0.08
Bear Stearns	110	6/10/2004	2/1/2042	Swap	(15.52)	(9.91)	0.07
Bank of America	380	6/10/2004	2/1/2042	Swap	(5.58)	(3.02)	0.03
<b>Total (\$ million)</b>	<b>5,732</b>				<b>(145.7)</b>	<b>(151.7)</b>	<b>(2.6)</b>

Notes to Table 1:

- (1) Subject to amortization.
- (2) "Mark-to-Market Value at Inception" refers to the settlement required to terminate the swap at mid market on end of business day on the transaction date. It reflects intra-day changes in rates, counterparties' expense and profit, payments to advisers, and upfront payments to the County. The County received a total of \$25.488 million upfront for the four swaps transacted in 2004.
- (3) "Mark-to-Market Value" refers to the value of the swap portfolio on the close of business day on or before the valuation date of the report, based on mid market quotes.
- (4) "DV01" refers to the change in Mark-to-Market Value resulting from a one basis point decrease (-0.01%) in all reference rates used in valuation.

<sup>1</sup>If valuation date is a non-business day, market data from last business day preceding valuation date is used in valuation.

<sup>2</sup> Swaptions and cancellable swaps are exercisable by Counterparty.

The mark-to-market value shows the estimated mid-market value of the County's net obligations under the contracts. There are no current payments required related to the mark-to-market value as long as the indebtedness of the County and the sewer revenue program continues to be rated investment grade. The mark-to-market value as of December 31, 2006 reflects the present value, to the County, of the expected future payment streams as of the valuation date. The mark-to-market value at inception is not equivalent to a fair market determination, which requires an assessment of the reasonableness of spreads and consideration of payments to the County at inception (which aggregated \$25.488 million).

The valuation of interest rate derivatives is based on market traded reference rates; movements in these rates cause the valuation of a derivative to change. Dollar value of one basis point ("DV01") is used as a risk measure and measures the sensitivity of the valuation due to a one basis point change applied to reference rates uniformly, i.e. a vertical shift in the yield curve. The DV01 column in Table 1 displays the expected change in valuation due to a one basis point *decrease* in reference rates. A uniform fall (rise) of one basis point (0.01%) would result in a decrease (increase) in the County's swap portfolio value of \$2.6 million.

Alabama law and negotiated credit support documents require swap providers to post collateral when the mark-to-market value of positions, by swap provider, is in the County's favor. Table 2 shows Jefferson County's asset (liability) by swap provider. Since no cumulative position is an asset to the County, there are no collateral postings required.

**Table 2: Counterparty Credit Ratings (Amounts in \$ million)**

Counterparty	Credit Rating Agency			Value	Notional Amount
	Fitch	Moody's	S&P		
Bank of America	AA-	Aa1	AA	(14.5)	753
Bear Stearns	A+	A1	A+	(22.3)	1,568
JP Morgan Chase	A+	Aa2	AA-	(103.1)	3,221
Lehman Brothers	A+	A1	A+	(11.8)	190
<i>Total (\$ million)</i>				<i>(151.7)</i>	<i>5,732</i>

The floating rate payments received on several of Jefferson County's swaps are based on 67% of one-month LIBOR (a taxable rate), whereas the variable rate payments on the bonds underlying the swaps are reset to rates that are unique to the bonds and the tax exempt market. The BMA Index is calculated weekly to reflect reset rates in the tax exempt market and Jefferson County's variable rate bonds that are tied to the BMA Index can reasonably be expected to have rates reset relatively close to the BMA Index. The percentage of one-month LIBOR that has created enough cash flows, on average, to offset payment based on the BMA Index since 1989 is 67%.

There is, however, no assurance that this historical relationship will continue into the future and careful monitoring of this relationship is therefore necessary. If the future relationship between one-month LIBOR and the BMA Index diverges from their historical relationship, the intended purpose of some of the swaps, which was to hedge floating payments on the bonds, may not perform as initially intended. The risk of a mismatch between two floating rates is referred to as *basis risk*. Table 3 shows refunding positions where the County receives 67% of one-

month LIBOR and the BMA/LIBOR ratio since the swaps became effective and over the last twelve months respectively.

**Table 3: BMA / One-Month LIBOR Ratio**

Sewer Revenue Refunding Warrants	Notional Amount (\$ million)	Since Inception*	Since 12/31/2005
2002 B	840	72%	67%
2003 B	1,036	70%	67%
2003 C	1,052	69%	67%

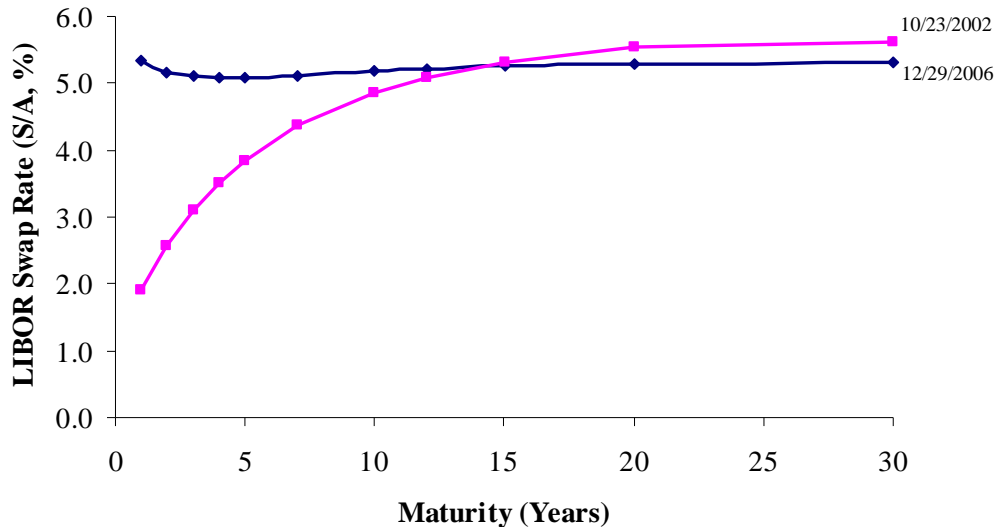
\*Inception of 67% of one-month LIBOR Payments under swap contracts.  
Warrants include Auction Rate Securities where rates may be reset less frequently than weekly.

*Additional Information*

Swaps are contracts to exchange cash flows and are often used for managing different types of risk but can be used for any financial purpose. In its most common form, a swap is a contract to exchange payments based on a fixed rate of interest for a payment based on a floating rate of interest, but it can also be a contract to exchange a floating rate for another floating rate, known as basis swaps. Swaps, where a borrower pays a fixed rate of interest in exchange for a floating rate of interest, are often used in combination with variable rate debt to create *synthetic fixed rate* debt. The rate is synthetically fixed from the perspective that if the floating rate received under the swap completely offsets the variable rate due on the debt, the only remaining obligation is the fixed rate under the swap.

Swap contracts increase or decrease in value as market conditions and expectations about the future change. A mark-to-market report provides information about how the market values these contracts as of a specific date. The value of swaps and options on swaps, referred to as swaptions, depends on the term structure of interest rates and expected volatility of future interest rates. The term structure of LIBOR swap rates for two dates is shown in Figure 1.

**Figure 1: LIBOR Swap Rates**



The term structure of interest rates, also referred to as the yield curve, provides information about the market's expectation about future interest rates since it is the fixed rate the market is willing to accept, for a given maturity, in exchange for a floating rate. Note that the shape of the current yield curve is relatively flat or even inverted, that is, swap rates of long maturities are less than those of short maturities. This shape occurs relatively rarely but arises from market expectations about a decrease in short rates in the future. This is in contrast to the yield curve in effect on October 23, 2002, which was much more upward sloping and considered a more normal shape. The valuation of swaps and other interest rate derivatives is dependent not only on vertical shifts in the yield curve, but also on "twists" in its shape.

The method used by Porter, White & Company to value swaps is commonly referred to as the zero coupon method, which assumes that future floating rates are those predicted by the current term structure of interest rates. Expected future cash flows are then discounted to a present value using discount factors derived from current interest rates. Valuation of swaptions also takes into account the market estimated probability of deviation of future rates from the current term structure. The sources of data used in Porter, White & Company valuations are Bloomberg and Thomson Financial Municipal Market Data. Values represent end of business day and do not account for intra-day variation in rates.

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