

February 4, 2008

Jefferson County Alabama School District Bonds: Questions and Answers Update

Jefferson County School District Warrants (ARS Series 2005 A-1 through A-4)

CUSIPS Affected:

472653BA1
472653BB9
472653BC7
472653BD5

What is the current credit rating on the Warrants?

The Warrants remain insured by AMBAC. Due to this insurance the bonds are rated:

Moody's: BAA1 with a Developing Outlook
S & P: A with a Negative Outlook

Underlying Ratings (Ratings exclusive of insurance) are as follows:

Moody's: B3 with Negative Outlook
S & P: BBB with Negative Outlook

Does the recent downgrade of Ambac affect the Maximum Rate on the Warrants?

The formula for the Warrant in a failed auction currently is 1 MONTH LIBOR X 2.50%. So if 1 MO LIBOR is at 0.43750% (Feb 2009), the formula would look like this:

$0.43750\% \times 2.50\% = 1.093750\%$ (rounded to the third decimal, so the printed rate here would be 1.094%).

Summarize the original transaction and the credit supporting the debt?

The warrants were issued with \$650 million fixed rate 2004-A bonds, \$200 million Auction Rate 2005-A and \$200 million 2005-B Variable Rate Demand Notes. To our knowledge, no interest rate swap was executed in connection with these bonds. The warrants are payable from a 1% sales tax collected in the County that, according to state law, is to be used exclusively for public school purposes including capital improvements or repayment of debt used for such purposes. The School District warrants have completely different pledged revenues than the Jefferson County Sewer warrants.

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Are the ARS Warrants in Default?

NO. The County continues to make timely interest payments on their School District ARS Warrants. However, the auctions themselves continue to fail (no liquidity).

Section 16.1 of the Indenture requires the County to furnish the Trustee with a copy of an Audit of the receipts and disbursements of the Education Tax Proceeds (the "Annual Audit") no later than 180 days after the end of the Fiscal Year. Under 17.1(b) of the Indenture, the County's failure to comply with Section 16.1 of the Indenture will constitute an Event of Default after 30 days written notice (such notice, a "Notice of Default") by the Trustee, unless "the County has commenced and is diligently pursuing appropriate corrective action."

On September 19, 2008, the Trustee received a second letter certifying that the County was continuing to diligently pursue corrective action. However, the County has still not filed its Annual Audit.

What happens to the excess sales tax revenue? Can it be used to pay for the sewer bonds?

The school district warrants were originally structured to generate excess sales tax revenues, providing a cushion against declines in the tax revenues. The excess has been used to redeem the 2005-A bond on an annual basis. \$12 million Series 2005- A bonds are scheduled to be called on March 1, 2009 from the 2008 excess revenue. After the March redemption, \$110.9 million of the original \$200mm series 2005 A bonds will remain outstanding.

The specific 1% sales tax revenues are dedicated solely to the school warrants. However, the Official Statement does cite, as a risk, the possibility that a Court might be able to reallocate the excess tax revenue.

What is the status of the Jefferson Sewer System's potential restructuring?

The forbearance agreement between the County and creditors has been extended through February 20, 2009 providing for more time to resolve the situation. The Governor has been assisting in negotiations to resolve the dispute between the County and its creditors.

On November 19, 2008 the Court appointed Special Masters to make recommendations with respect to the dispute as well as assist in the mediation. The Special Masters filed their recommendations with the Court on January 19, 2009. In general terms, their recommendations include:

- Pursue the possibility of federal or state government assistance;
- Consider implementing non-user fees;
- Target revenue, expense and operating efficiencies of the system;
- Continue consensual efforts to resolve the dispute;
- Sewer rate increases would be dependent on possible federal assistance or state legislative solutions.

What happens to my ARS Warrants if the County Files for Bankruptcy?

If the County files for bankruptcy we would expect an automatic stay to be issued. This is an injunction that is automatically issued by the bankruptcy court when a debtor files for bankruptcy. The automatic stay prohibits most creditor collection activities. Though we cannot guarantee it, we believe such an injunction should not interrupt payments on the School district warrants because they are secured by specific, special sales tax revenues.

There is limited case law on Chapter 9 bankruptcy filings. In general, it gives the Court broad discretion to resolve the problems. As a result, the rating agencies cannot get 100% comfort that a bankruptcy filing would not negatively affect the Jefferson GO debt or the School Warrants. This is why they have lowered the ratings on the debt. We would expect the trustee to use all available legal defenses on behalf of bondholders, if needed.

If revenues were insufficient to make full principal and interest payments on the School Warrants, the reserve funds would be used to make the payments. The reserve fund is partially funded with an Ambac policy with the rest in cash and high quality investments. Ambac insures payment of principal and interest on the VRDN and the auction rate bonds. They therefore would be required to make principal and interest payments, as they become due, in the event that other revenues and the debt service reserve funds become insufficient.