Overview of Municipal Market Conditions

presented to

Fairfax County Board of Supervisors

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Credit Crunch: Part 1

Dec ‘06

March ‘07

June ‘07

Sept ‘07

Dec ‘07

March ‘08

June ‘08

- Housing market stalls
- Subprime loan delinquency rates spike

- Auction Rate Bonds begin to fail

- Florida suspends withdrawals from LGIP
- Structured Investment defaults increase

- Several AAA insurers placed on negative outlook

- Fed cuts 125 bps in 10 days

- JP Morgan and Fed bail out Bear Stearns
- MBIA and AMBAC downgraded

- State of Connecticut, Congress, and the SEC take action against the rating agencies

- Subprime losses top $400 billion

- July 11th – Federal Regulators seize IndyMac bank, largest ever thrift to fail in the US

Credit Crunch: Part 2

September ‘08

- September 7th – Fannie Mae and Freddie Mac placed into conservatorship
- September 10th – Lehman puts itself up for sale
- September 14th – Bank of America announced acquisition of Merrill Lynch
- **September 15th – Lehman Brothers files for bankruptcy**
- **September 17th – The Reserve fund “breaks the buck,” price at 97 cents at close of business**
- September 17th – Fed forces AIG into liquidation
- September 29th – Dow plunges 9% ; U.S. House fails to pass bail-out plan
- Week of September 29th – Wachovia announces purchase by Wells Fargo (not Citigroup)

Credit Crunch: Continues

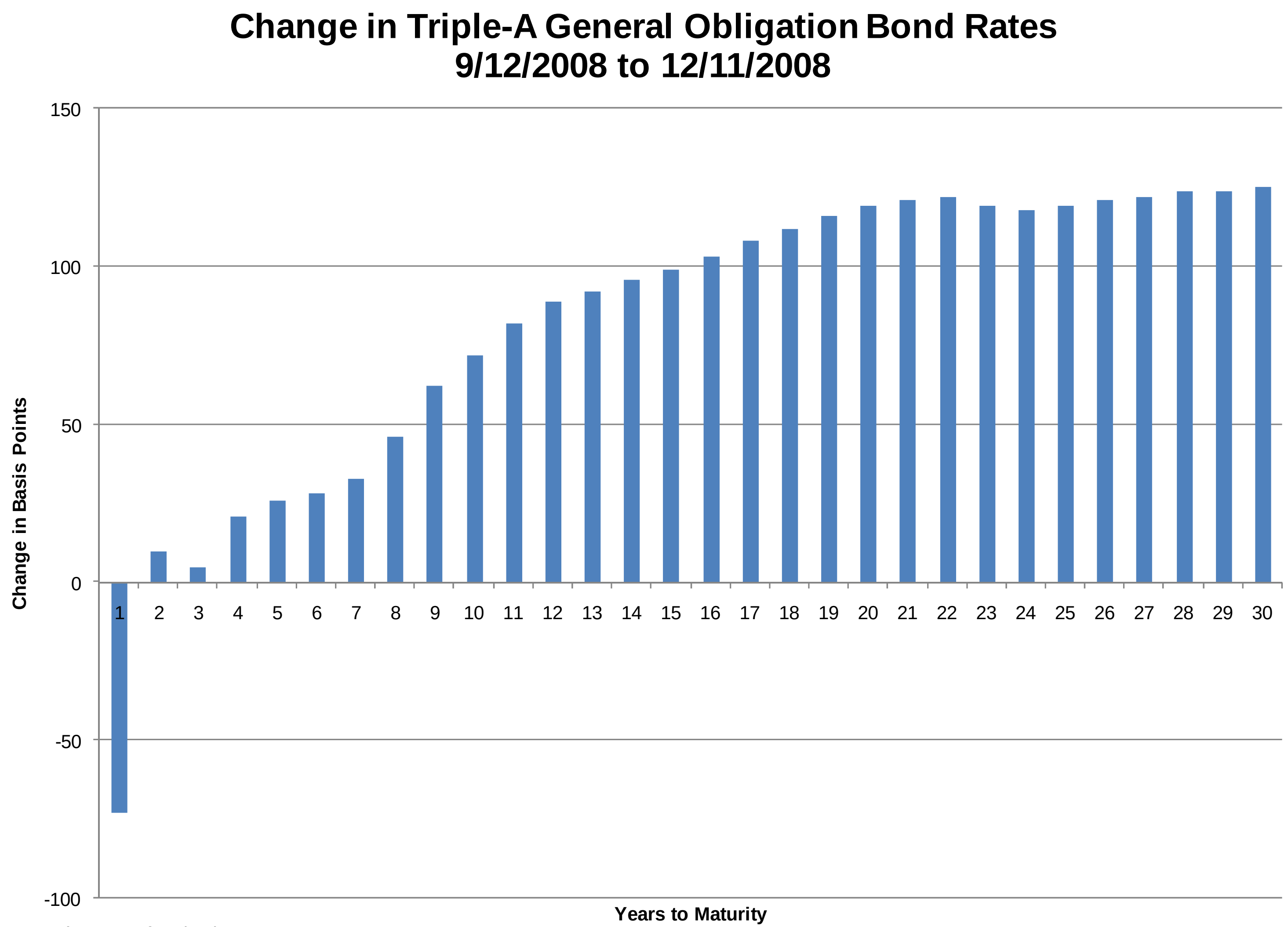
October '08

- October 3rd – Dow closes down 818 points for the week, its worst week in 7 years
- October 4th – President signs Emergency Economic Stabilization Act of 2008
- October 7th – Federal Reserves creates CP Funding Facility to buy CP from eligible companies
- October 7th – Fitch and Moody's defer recalibration of municipal ratings
- October 8th – Federal Reserve cuts Fed Funds target rate 50 bps
- October 13th – US announces plan to invest a portion of $700 billion facility in preferred stocks of US banks
- October 29th – Federal Reserves cuts 50 bps

November '08

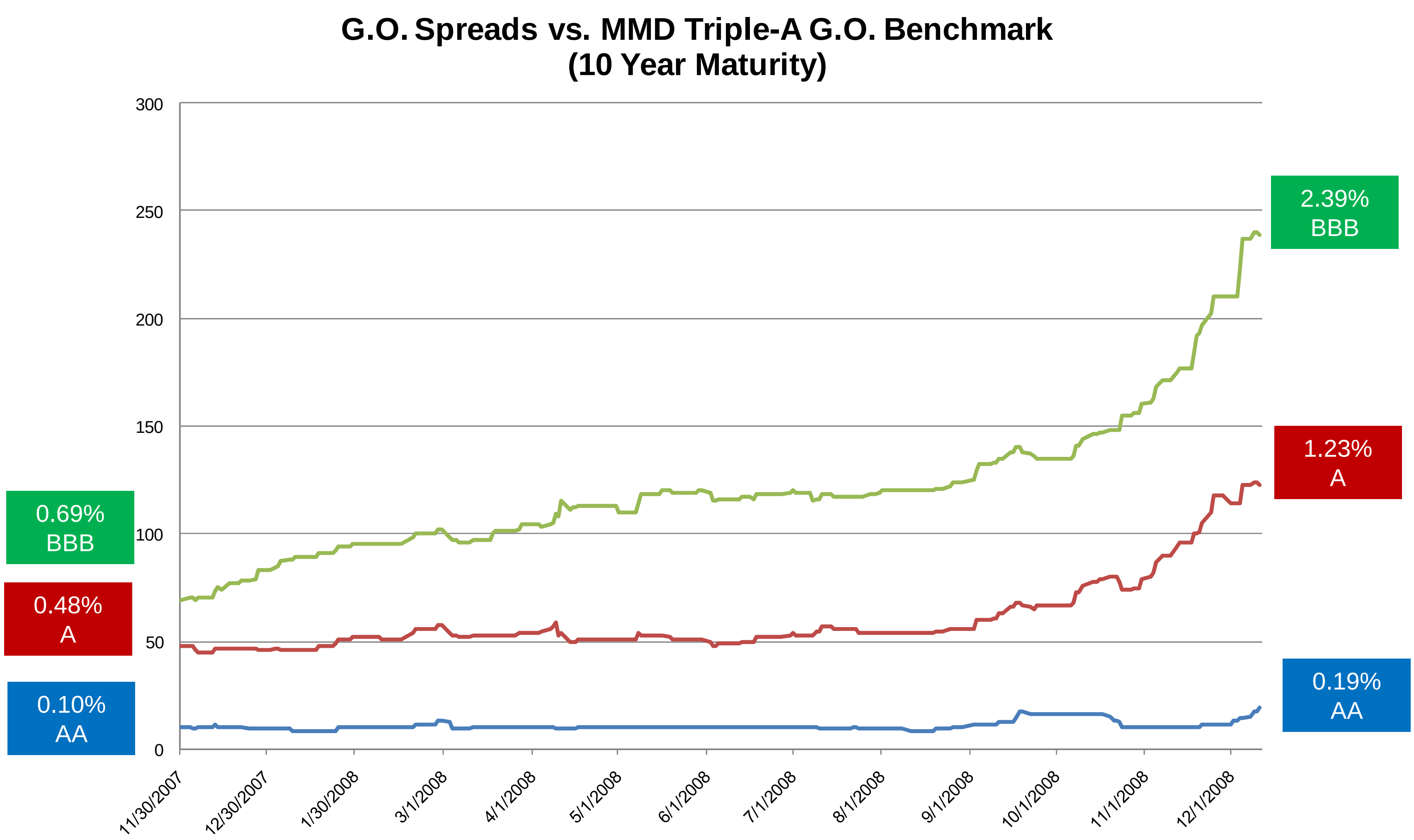
- November 4th – Senator Barack Obama elected 44th President

Increase in Triple-A Yield Curve



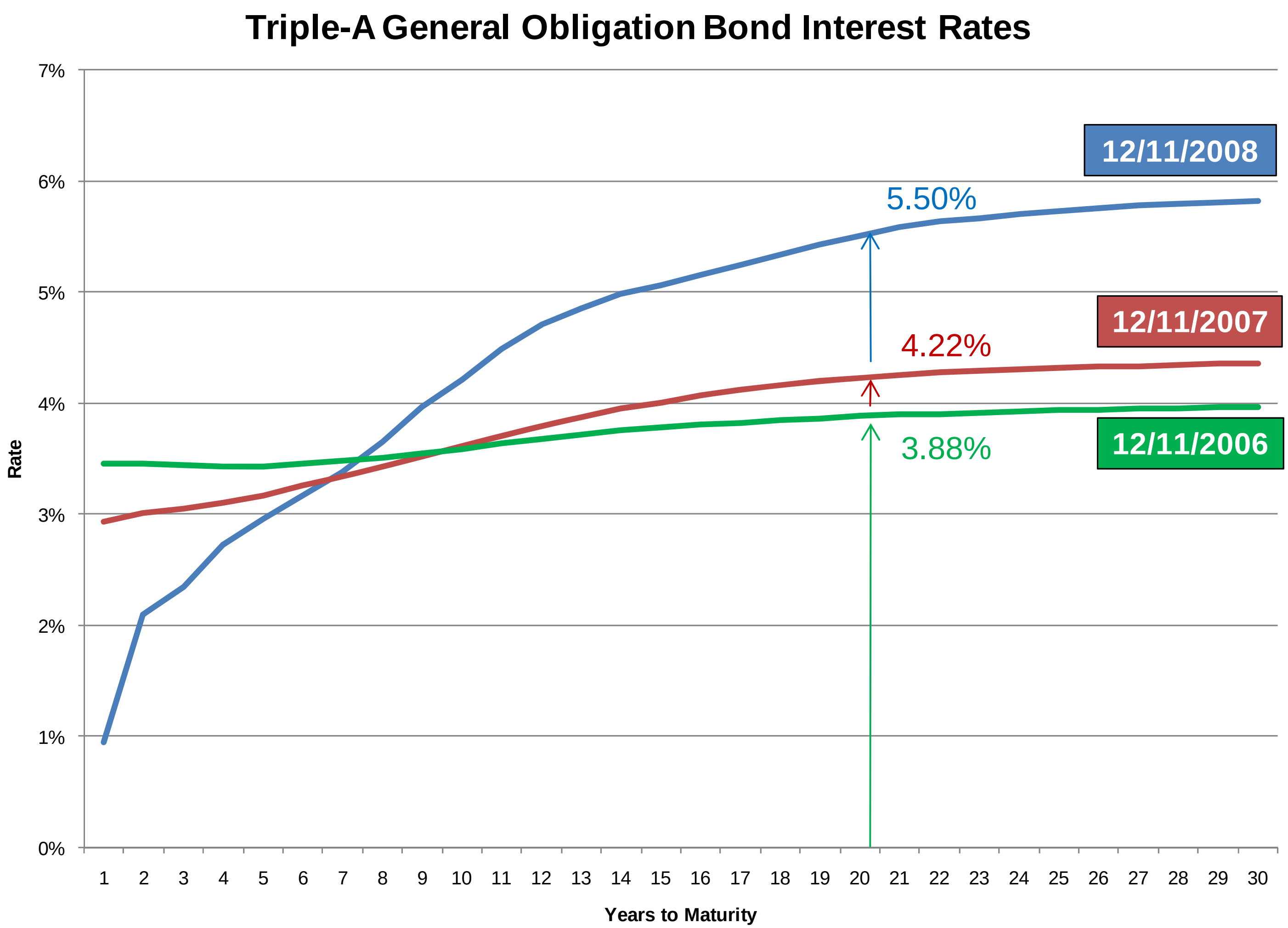
Source: TM3, data as of 12/11/2008.

Credit Spreads Widen



Data shown from 11/30/2007 to 12/11/2008
Source: TM3, as of 12/11/2008.

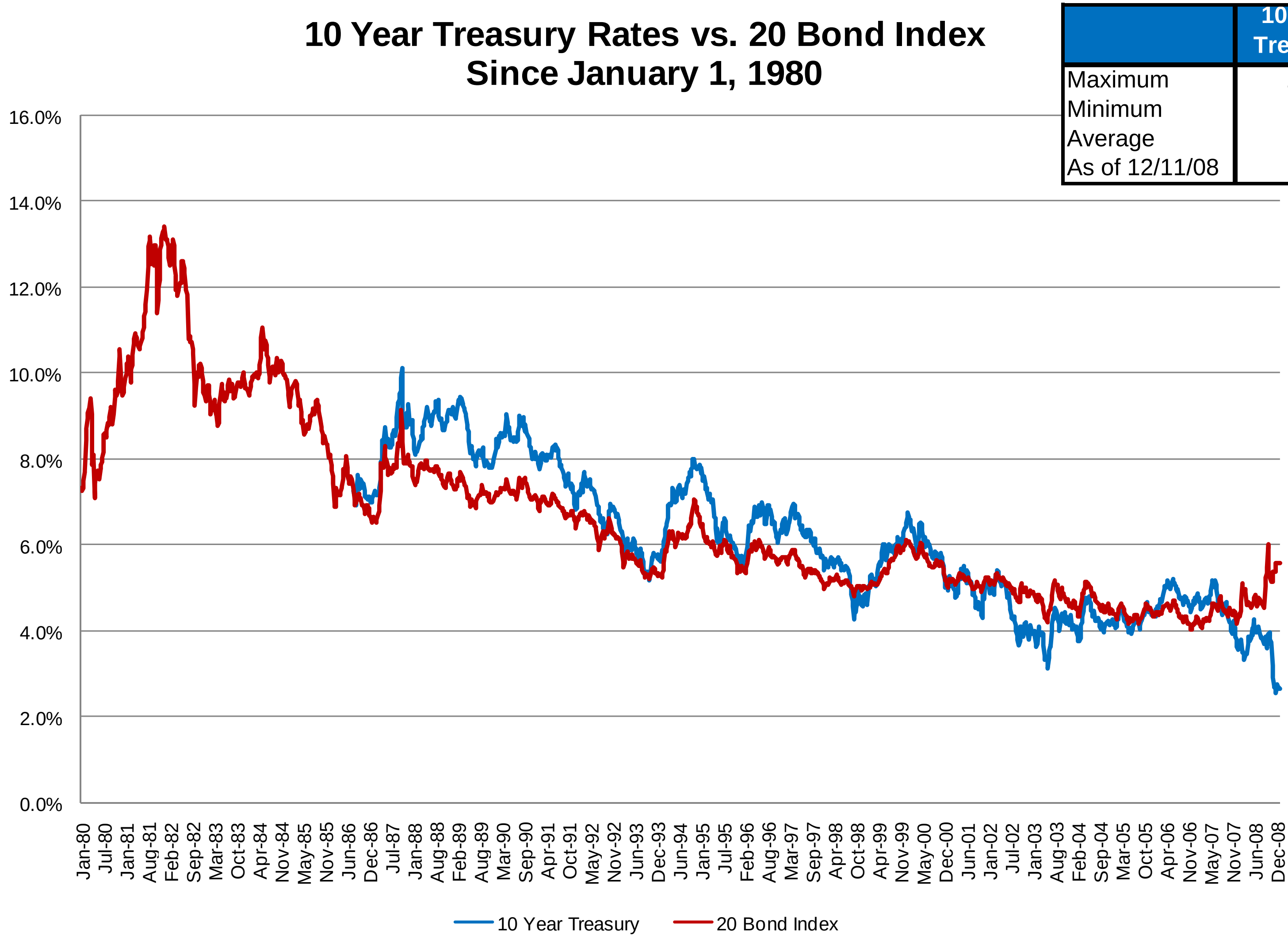
Change in Triple-A Yield Curve



Source: TM3, data as of 12/11/2008.

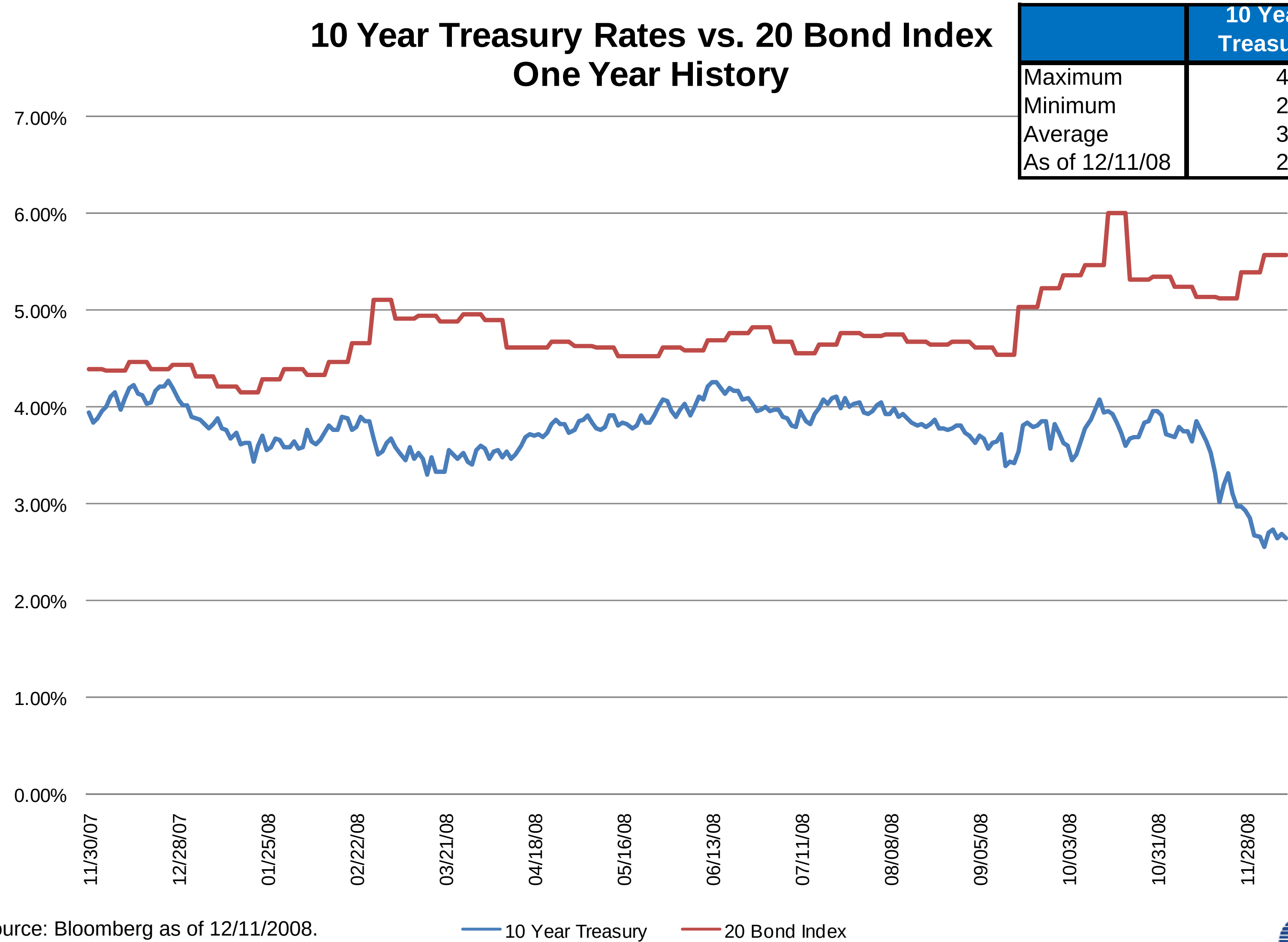
Municipal Bond Rates vs. Treasury Rates

	10 Year Treasury	20 Bond Index
Maximum	10.13%	13.44%
Minimum	2.55%	4.03%
Average	6.07%	6.68%
As of 12/11/08	2.65%	5.58%



Source: Bloomberg as of 12/11/2008.

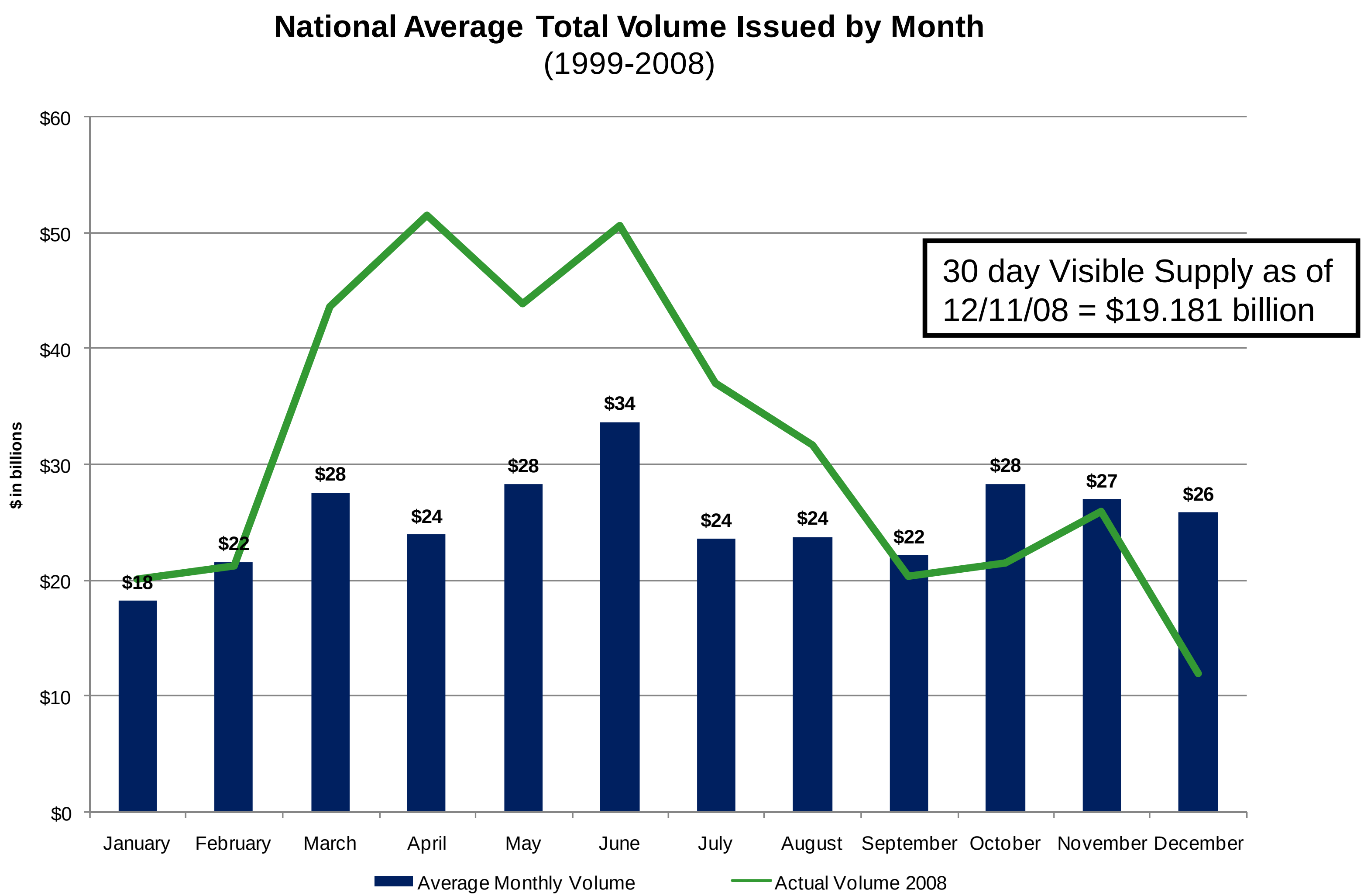
Municipal Bond Rates vs. Treasury Rates



	10 Year Treasury	20 Bond Index
Maximum	4.28%	6.01%
Minimum	2.55%	4.15%
Average	3.75%	4.78%
As of 12/11/08	2.65%	5.58%

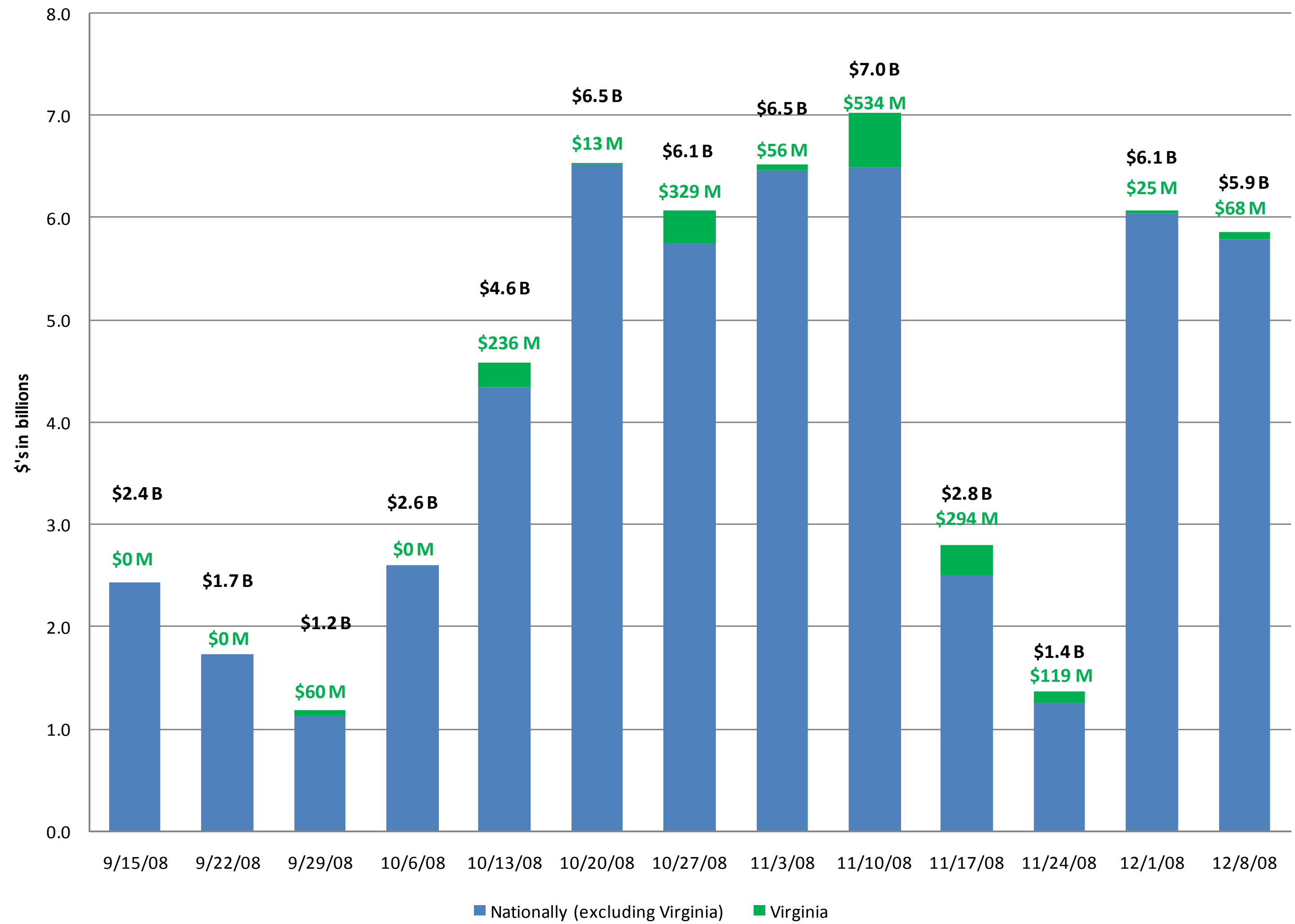
Source: Bloomberg as of 12/11/2008.

Municipal Bond Issuance



Source: *The Bond Buyer*.

Bond Issuance since September 15th



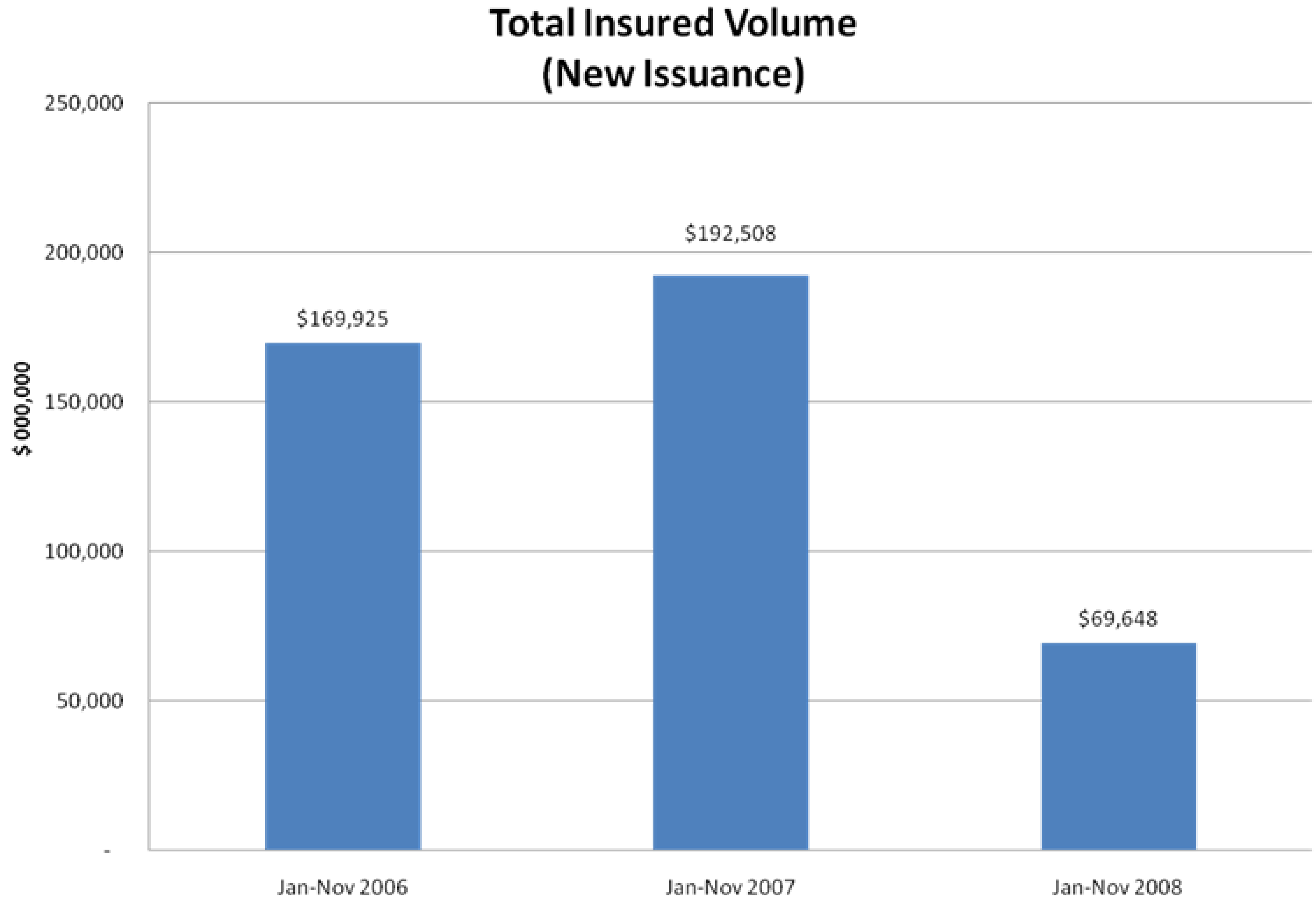
Note: Black numbers indicate total volume, green numbers indicate Virginia volume.
Source: TM3.

Demise of Triple-A Bond Insurers

	Moody's	S & P	Fitch
Ambac	Baa1 Watch Developing	A Negative	Withdrawn
Assured Guaranty[1]	Aa2 Stable	AAA Stable	AAA Stable
Berkshire Hathaway	Aaa Stable	AAA Stable	Not rated
CIFG	B3 Watch Developing	B Developing Watch	Withdrawn
FGIC	B1 Negative Watch	BB Negative Watch	CCC Evolving Watch
FSA[1]	Aa3 Watch Developing	AAA Negative Watch	AAA Negative Watch
MBIA	Baa1 Watch Developing	AA Negative	Withdrawn
Syncora[2]	Caa1 Watch Developing	B Negative Watch	Withdrawn

Data as of 12/11/2008.
1.Pending acquisition of FSA by Assured Guaranty, announced 11-14-08.
2.Formerly XL Capital.

Reduction in Triple-A Insured Paper

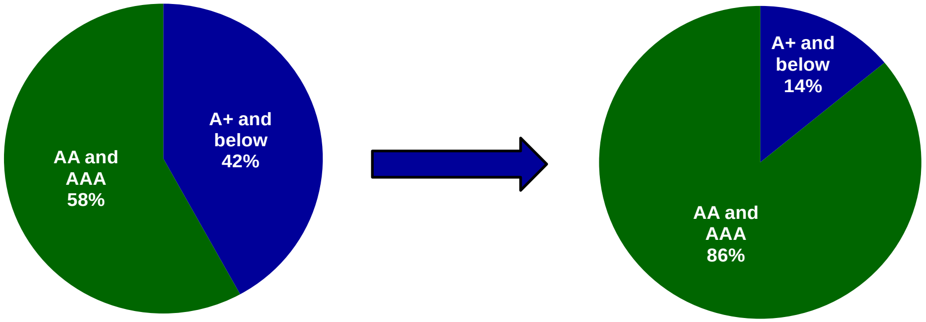


Source: *The Bond Buyer.*

Changes at Credit Agencies

- Municipal bonds default less often than corporate bonds
- Moody's & Fitch proposing single rating scale for corporate & municipal bonds
- New approach would drive most public finance ratings upward, on average
  - On average, GO bond ratings could move 2 notches higher
  - On average, enterprise sector bonds could move 1 notch higher
- On October 7, 2008, Moody's & Fitch placed recalibration of ratings on hold due to market turmoil
- S&P has, in the past, and will continue to use, the same rating scale across sectors
- S&P reaffirmed their methodology in May 2008

Fitch Ratings
State and Local G.O. Ratings Expected Shift



Potential Impacts of Rating Agency Changes

- More difficult than ever to predict “what do rating agencies think?”
- Scrutiny of ratings process could continue to drive changes to their methodologies and internal processes
- Revised rating methodology diminishes the need for and role of bond insurance market
- Investors will still value bonds based on relative credit risk
- Potential for increased due diligence by investors
  - Greater reliance on in-house credit assessments
  - Potential for greater, systematic & direct investor outreach by borrowers

“Hot Button” Issues with Rating Agencies

- Stress to residential real property tax base, revenue & collections as a result of foreclosures & economic downturn
- Slowdown in non-residential property tax base & other economically sensitive revenue sources
- Northern Virginia is experiencing a more severe real estate decline vs. other regions & the state
- Maintenance of financial flexibility
- Tapping of revenue stabilization fund
- Management initiatives to address budgetary pressures, budget monitoring & controls & resultant financial performance vs. expectations
- Continued compliance with reserve & other policies through current downturn
- Maintaining debt affordability

Overview of 2009A Bonds

- The County plans to sell bonds in January to finance $204 million of projects
- Monitoring a refunding opportunity on the Series 1999A Bonds
  - Based on current market conditions, could refund $33.5 million of bonds and generate savings of approximately $1.3 million, or 4.0% of the refunded par amount
- Based on current market conditions, a competitive sale is viable
  - Anticipate multiple bidders
  - Anticipate a relatively low True Interest Cost
- Based on current market conditions, the County should maintain flexibility in its approach to selling bonds

Competitive Sale Methodology

- Historically, the County's general obligation bonds have been sold via competitive sale process
- Advantages
  - Maintains a well-established, transparent process for pricing the bonds
  - Bonds are awarded based solely on lowest interest rate
  - Efficient and cost effective process
- Disadvantages
  - Targets institutional investors (nearly exclusively), which is a limitation in the current market
  - Retail investors have limited access to bonds sold via this methodology
  - Marketing effort is short and focused on institutions
  - The size of the County's bond sale (approx. $204 million) is relatively large in comparison to recent competitive bond sales
  - If investors cannot be identified for all bonds, underwriters may decline to risk their capital and not submit a bid

Types of Bond Investors

Two major categories of municipal bond investors:

Institutional Investors	Retail Investors
• Includes insurance companies, corporations, mutual funds, and money market funds	• Includes high wealth individuals, investment advisors, and trust accounts
• Historically, have been the predominant buyer of the County's G.O. bonds	• Limited access to bonds sold via competitive sale
• More price-sensitive than retail investors	• Less price-sensitive than institutional investors
• Require lower underwriter's compensation to market bonds	• Require higher underwriter's compensation to market bonds
• Fewer buyers needed to underwrite a large issue	• Many buyers needed to underwrite a large issue
• More sensitive to call provisions than retail investors	• Less sensitive to call provisions than institutional investors
• Very specific demands for coupons and bond prices	• Typically buy bonds at par
• Limited, in some cases, in the current market	• Active buyers in the current market

Summary of Potential Approaches

1
- Sell the full amount using a traditional competitive sale

2
- Break the full amount into separate bond series and sell each series using a traditional competitive sale

3
- Sell a portion of the bonds using a traditional competitive sale; and
- Sell a portion of the bonds targeting retail investors

4
- Sell all or a portion using a traditional negotiated sale

"Plan B"
- Sell Bond Anticipation Notes
- Use County Line of Credit

Questions?