

November 5, 2002

Report to the Commission of Jefferson County

Contained herein is a projection of the Environmental Services Department's rate revenues and related income, its operations and maintenance (O&M) expenses, and its annual debt service and debt coverage through the fiscal year ending September 30, 2006. The objective of this undertaking is to evaluate the adequacy of the current sewer user fee structure in light of the requirements created as a result of what is generally referred to as the "Consent Decree" which was entered with the United States District Court in Birmingham, Alabama on December 9, 1996 and the Commission's long term plan for other needed capital improvements.

The Consent Decree calls for the development and implementation of a remedial plan over a twelve-year period to eliminate bypasses and other unlawful discharges of untreated sewage into receiving streams in Jefferson County. Because that plan requires the rehabilitation of an extensive amount of lateral and collector sewers throughout Jefferson County, the undertaking is currently estimated to cost approximately \$2.0 billion over the period which officially began in July 1995. While much has been accomplished during the first seven years of the twelve-year time frame set forth in the Decree, a considerable amount of work remains to be done. As compliance with the provisions of the Consent Decree continues to manifest itself through very substantial capital outlays by the County, it has become necessary to periodically increase the existing sewer user fee structure to accommodate the periodic financing of those improvements. Other needed improvements are currently projected to cost approximately \$1.1 billion.

Proposed changes in the sewer user fee structure have historically been based on usage by existing customers at prevailing rates during the most recent fiscal year. While there can be no assurance that those customers will continue to use the County's sewer facilities at that same rate as user fees rise, it has historically been the amount of rainfall during a fiscal year which has been the most significant factor influencing the amount of sewer usage experienced. The fiscal year ended September 30, 2000 was a very dry one, while the following fiscal year was a very wet one according to National Oceanic and Atmospheric Administration records for the Jefferson County area. In our opinion, neither year was satisfactory for purposes of modeling the probable user rate increases required to fund the County's planned capital improvements program. Accordingly, in projecting rates for the Series 2002-B and thereafter debt offerings, we attempted to minimize the influence of an event at either extreme by making our forecast using the development of an "average year" usage model which considered usage data for those two fiscal years. The fiscal year ended September 30, 2002 proved to be one in which rainfall closely approximated that on which the "average year" model was based. However, the quantity of sewer services demanded during that year declined somewhat when compared with the average year. As a consequence, we must assume that either the public has begun to use water more wisely as a result of the drought in 2000, or the price of sewer services is beginning to result in conservation practices in some segments of the county rate base. Please see a more complete discussion of this subject in the body of the report.

To position itself in such a manner as to provide the maximum flexibility which will be required to meet its normal needs and comply with the terms of the Consent Decree, the Commission proposes to borrow an additional \$475 million to maintain its rate of progress toward construction of projects mandated by the Consent Decree, other projects required to comply with the Clean Water Act, and discretionary projects which are necessary to meet the future needs of the system. This borrowing will finance the construction

objectives scheduled for completion over the next two fiscal years. Additional borrowing may be required during the remaining years of the period set by the Consent Decree.

Sewer user fees accounted for approximately 74 percent of the Environmental Services Department's total revenues in the most recently completed fiscal year, and that percentage is expected to rise steadily in future years. The rate currently in effect is \$3.53 per hundred cubic feet of water consumed. Residential customers receive a quantity exclusion equal to fifteen percent of their water usage, so the typical account in this customer group, assuming the use of 1,000 cubic feet of water per month, would currently receive a monthly bill of \$30.01. With the implementation of the automatic rate increase which is projected to take effect January 1, 2003 and based upon the financing plan currently proposed, the sewer user fee would rise from \$3.53 to \$5.05 per hundred cubic feet. This would result in an increase in a typical residential user's monthly bill from \$30.01 to \$42.93 or an increase of approximately 43 percent. Utilizing the County's automatic rate increase ordinance, the projected rate increases to \$6.26 per hundred cubic feet on January 1, 2004, to \$7.18 per hundred cubic feet on January 1, 2005, and to \$7.83 on January 1, 2006. All projections of sewer user fees contained in this report are contingent upon the actual implementation of the planned rate increases on the dates proposed herein.

Based on the financial and operating data available to us, it is our opinion that sewer rate revenues arising from the proposed sewer user charge system, when added to the other sewer operating revenues and resources which the Commission indicates are available to it, will be adequate to cover projected sewer operations and maintenance expenses, existing and currently proposed annual debt service, and debt service coverage as required by the governing indenture agreement. Projected annual net income available for debt service is \$82.6, \$104.1, \$123.1 and \$137.0 million for the fiscal years ending September 30, 2003, 2004, 2005, and 2006, respectively. A brief summary of projected revenues, operating expenses and annual debt service for these years may be seen in Exhibits A and B of this report.

Sources of information used to make rate revenue projections contained in this report included summary usage and billing data provided by the Water Works and Sewer Board of the City of Birmingham and the smaller municipal utilities in the Jefferson County sewer system. Other revenues and operating expenses are projected using historical financial information contained in the Commission's accounting system, operating expense budget data prepared by Commission professional staff, and other information provided by the professional engineers of the Environmental Services Department.

We appreciate very much the opportunity to serve the Commission on this project. If we can be of additional assistance, please do not hesitate to call on us.

Paul B. Krebs & Associates, Inc

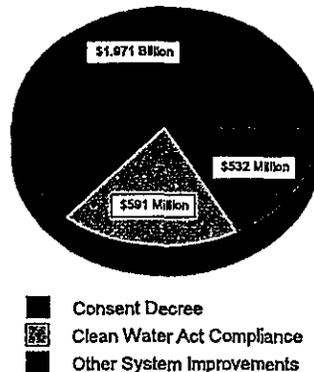
PROJECT OVERVIEW

This report is the fifth of a series arising out of the partial summary judgment granted in favor of the original plaintiff and the federal government by the District Court in December 1995. The case, which was brought against the Jefferson County Commission in 1993, alleged that the Commission violated certain provisions of the Clean Water Act of 1972, as amended. The District Court judgment mandated that the defendants in the litigation develop a plan of action now commonly known as the "Consent Decree", which set forth the manner in which the violations would be remedied. That plan was filed with the United States District Court, Northern District of Alabama, on December 9, 1996, and has provided the principal focus for the debt offerings which have followed the court ruling. Those bond offerings have also included funding for construction of some improvements which were deemed necessary by the Commission, but not required by the Consent Decree.

Engineering reports have been developed to support needed debt offerings in 1997, 1999, 2001 and earlier in 2002 in an effort to assist the Commission in complying with the terms of the Consent Decree and meeting other construction objectives, even though the total cost of the improvements to the system required had not yet been fully determined. As far as the Consent Decree is concerned, the Commission is obliged, within a twelve year time frame beginning in June 1995, to complete all of the improvements required to bring it into compliance with the Clean Water Act. The Series 1997, 1999, 2001, 2002-A and Series 2002-B debt offerings funded part of the needed improvements, but the Commission now seeks additional financing in the amount of \$475 million to continue with its construction improvements plan for the work contemplated. It is anticipated that, after issuance costs and the funding of the debt service reserve and other funds, approximately \$386 million will be available for use on planned sewer improvements. When this amount is combined with the proceeds made available from the Series 2002-B debt offering and funds on hand from prior financing efforts, it is projected that funds available for existing and proposed sewer projects will approach \$837 million. Work remaining on contracts awarded by the Environmental Services Department as of September 30, 2002 is valued at \$436 million, so approximately \$401 million of the funds currently available for construction work can be devoted to new projects. The proposed use by the Jefferson Count Environmental Services Department of the unencumbered amounts is outlined in more detail in the sections which follow. The Commission continues to develop more accurate estimates for the cost of the work remaining to be performed, to identify other projects which will have to be constructed to meet announced but not yet implemented Environmental Protection Agency ("EPA") discharge standards, to identify other projects required to serve new growth, and to maintain the construction schedule required to obtain information needed to measure compliance with the Consent Decree on or before the EPA's scheduled benchmark dates.

As of the date of this report, the best estimate for the cost to complete both the already constructed and the proposed work is approximately \$3.1 billion. This figure does not include approximately \$97 million which the Commission spent on essential improvements before the Consent Decree became effective. The cost of the work remaining to be performed should continue to be considered an approximation until bids on all

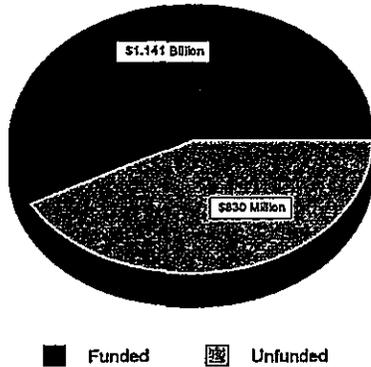
Total Projects



projects to be constructed have been received.

This estimate is subject to adjustment as additional information becomes available. The financing plan which brought about the need for this report calls for the borrowing of approximately \$475 million to be used to provide funding for projects during the next two years of planned construction activity for projects which can be classified into three groups: Consent Decree, Clean Water Act Compliance, and Other System Improvements.

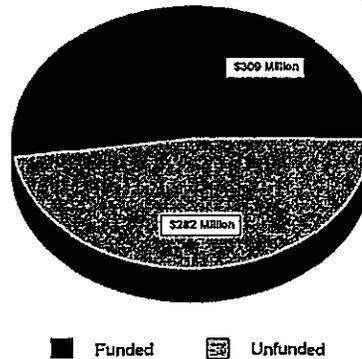
Consent Decree Projects



Consent Decree projects can be generally categorized as infiltration/inflow (I/I) program management, sewer rehabilitation and replacement projects, and the upgrading of some wastewater treatment plants to meet the discharge standards mandated in that document. The total cost of all Consent Decree projects is currently projected to be \$1.971 billion. Of this amount, approximately \$1.141 billion has been

funded. Of the \$830 million in projected remaining costs, it is anticipated that \$559 million will be constructed with funds now available, leaving approximately \$271 million to be funded from future resources as they become available.

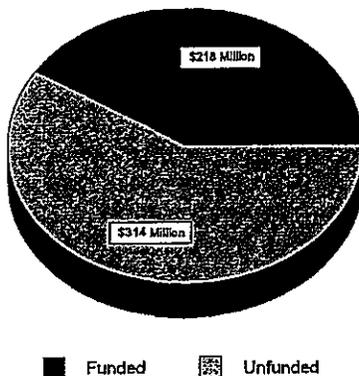
Clean Water Act Compliance Projects



Clean Water Act Compliance projects include projects which, while not specifically mandated in the Consent Decree, must be constructed in the near term if the County is to bring some recently acquired facilities into compliance with existing EPA standards as well as modify others to meet the evolving discharge standards which may have been announced by the EPA but which are not yet effective. Such projects include sewer replacements, relief sewer construction, upgrades to wastewater pumping stations, and upgrades to wastewater treatment plants. The projected cost for all projects in this group as of the date of this report is \$591 million. Of this amount, approximately \$309 million has already been funded. Of the \$283 million in remaining costs, it is anticipated that \$190 million will be constructed with funds now available, leaving \$93 million to be funded from future resources as they become available.

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Other System Improvements



Other System Improvements include projects such as sanitary sewer extensions, new sewer pumping stations, and wastewater treatment plant expansions. All projects in this category are constructed for the purpose of providing additional capacity to serve new accounts. The projected cost for all projects included in this group is \$532 million, and \$218 million of this amount has already been funded, leaving \$314 million to be funded. Of the \$314 million in remaining projected costs, \$89 million will be constructed with funds now available. The remaining projects, estimated at \$225 million, will be funded from future resources as they become available.

REVENUE REQUIREMENTS

General

To develop a rate structure which should provide the Commission with the system revenues required to discharge its responsibilities, it is necessary to consider the following requirements: (1) the amount of operating and maintenance (O&M) expenses to be incurred in a fiscal year, (2) the amount of debt service which the Commission will be required to satisfy during that period, and (3) the terms for the debt service as specified in the Trust Indenture.

After the revenue requirements for each major group have been properly identified, the total of those requirements may then be compared with revenues anticipated to be generated from the existing customer base under the Commission's current rate structure and other operating revenues. If the revenues generated are found to be inadequate, a new rate structure which will help satisfy the projected revenue requirements is then proposed. The current rate for sewer service is \$3.53 per hundred cubic feet and has been in force since January 1, 2002. To meet its ongoing operating and capital needs, an increase in the sewer user fee will be required. The currently projected rate increase, scheduled for implementation on January 1, 2003, will increase the current volumetric charge to \$5.05 for that same quantity. To comply with the Revenue Forecast provisions of the Trust Indenture, the \$5.05 rate is proposed to rise again to \$6.26 on January 1, 2004, to \$7.18 on January 1, 2005, and to \$7.83 on January 1, 2006.

O&M Expense

Starting points for determining an estimate of this revenue requirement are the Commission's unaudited financial statement for the most recently completed fiscal year and the budget for the current year. The Commission has an experienced professional staff that maintains a well-developed financial reporting system which both accumulates current financial information each month and compares current operating performance against budget on year-to-date basis. The budget and financial reporting system contains a great deal of data about actual financial performance in prior years as well as budget information on its various operating segments for the current fiscal year. The fiscal year for the Commission ends on September 30.

For the fiscal year ended September 30, 2002, total operating expense (as defined in the Trust Indenture) for the Environmental Services Department amounted to \$44.6 million. For the fiscal year ending September 30, 2003, operations and maintenance expenses are budgeted at \$56.6 million, or 27 percent higher than those in the preceding fiscal year largely because the County continues to increase its staffing and expenses to meet the requirements of the Consent Decree. Historically, the Environmental Services Department has underrun its operating budget by a considerable margin. For the most recently completed fiscal year, actual expenses were approximately 85 percent of budgeted amounts. However, we must assume that the budget for the current fiscal year will closely approximate what will ultimately be incurred.

Most of the operating expense groupings reflect moderate increases for the current fiscal year, but the largest single item in terms of both percentage and dollar increase is expected to be experienced in the Sanitary Administration expense grouping. This increase is largely due to the anticipated filling of additional positions in the that area. However, liquidity and remarketing fees arising out of the Series 2002-C refunding now constitute about 4.5 percent of projected operating expenses which the Environmental Service Department must also address in addition to regular operating expenses. For the fiscal years beginning October 1, 2003 and continuing through the fiscal year ending September 30, 2007, the professional staff of the Environmental Services Department has projected operating expenses to rise at an annual rate of between four and five percent. Accordingly, Operations & Maintenance (O&M) expense is projected to rise at a rate of approximately 4.5 percent per year for those fiscal years. For the fiscal years beginning October 1, 2007 and thereafter, however, it is the opinion of the professional staff of the Environmental Services

Department that there will be a decrease in the annual rate of growth in operating expense as construction spending winds down and emphasis can be placed on operating efficiencies. More specifically, those efficiencies are expected to include a leveling of or decrease in sewer line maintenance expense currently budgeted at \$6.38 million, the significant reduction in the maintenance expense on the more than 100 sewer pumping stations acquired from surrounding municipalities once those facilities have been upgraded to county standards or taken out of service due to more efficient system operating configurations, and the implementation of a SCADA system for remote monitoring of certain operating facilities which will minimize the need for additional personnel. A more detailed examination of the components of projected O&M expense may be seen in Exhibit B of this report.

Debt Service

The Commission currently has sewer debt obligations outstanding which total approximately \$2.55 billion. The County plans to issue additional parity indebtedness of approximately \$475 million to continue with the System's construction during this year and subsequent years. A major portion of that amount will be used to construct the estimated \$830 million in remaining construction required for compliance with the Consent Decree, while the remainder will be used to fund other sewer improvements already under contract. After issuance of the additional parity indebtedness, the County will have approximately \$3.03 billion in sewer revenue debt outstanding. Maximum annual debt service (MADS) is projected to be approximately \$171.9 million. Annual debt service numbers reflected in Exhibit A have been provided by J.P. Morgan Securities, Inc. The MADS figure has been provided by Sterne, Agee & Leach, Inc.

Debt Service Coverage

Debt service coverage is usually thought of in terms of the amount by which the bond documents require that annual net revenues available for debt service (NRADS) must exceed annual debt service. Under the terms of the Trust Indenture, there is a specific debt service standard which defines both the NRADS and Prior Years' Surplus (PYS) funds required to issue parity debt. For purposes of that Revenue Forecast, until the fiscal year beginning October 1, 2007, the required combined coverage test is 1.05 times maximum annual debt service (MADS). At least .75 of that coverage must be provided by NRADS, while the remaining .30 coverage requirement may be provided by certain resources, hereinafter referred to as Prior Years' Surplus (PYS) funds, which the County has accumulated from its operation of the Environmental Services Department in recent years. In the fiscal year beginning October 1, 2007, it will be necessary for NRADS to equal or exceed 1.05 times MADS.

SOURCES OF REVENUE

The major sources of revenue available to the Environmental Services Department, are: (1) sewer user fees, (2) sewer impact fees, (3) ad valorem taxes, (4) waste surcharges, (5) interest income, and (6) miscellaneous income. Of these, sewer user fees is by far the most important, contributing from 77 to 88 percent of projected total revenues during the years for which a forecast has been made. The Commission has undertaken a study of the adequacy and equity of all of its sources of operating revenue, and that report is scheduled for completion by the end of calendar year 2002.

Sewer User Fees

Most of the sewer user fees are collected for the Commission by the Water Works and Sewer Board of the City of Birmingham (the "Board") and are based on water meter readings. In exchange for collection services, the Commission pays that entity a handling fee equal to the cost of collections as defined in the agreement between the Commission and the Board dated November 29, 1994. Billings through this entity

accounted for about 87 percent of the sewer user fees billed in the fiscal year ended September 30, 2002. The County also provides sewer service to a smaller number of customers not served through the Water Works and Sewer Board of the City of Birmingham. Those entities are the boards or municipal governments of the cities of Bessemer, Graysville, Irondale, Leeds, Mulga, Roupes Valley and Trussville. The City of Bessemer both bills and collects for sewer service on the Commission's behalf, while the remaining six municipalities submit water usage data for their customers individually to Jefferson County, which then bills customers for their usage.

The customer base of the Environmental Services Department is currently composed of almost 141,000 residential, commercial and industrial accounts. Based on data available from the Birmingham Water Works & Sewer Board, the Commission's Finance - Sewer Services Department and the City of Bessemer, the distribution of and contribution to rate revenues by those groups for the fiscal year ended September 30, 2002 is reflected in the table which follows:

Customer	No. of Accounts	Percent of Revenue
Residential	127,600	41.8%
Commercial	13,133	56.1%
Industrial	90	2.1%
Total	140,823	100.0%

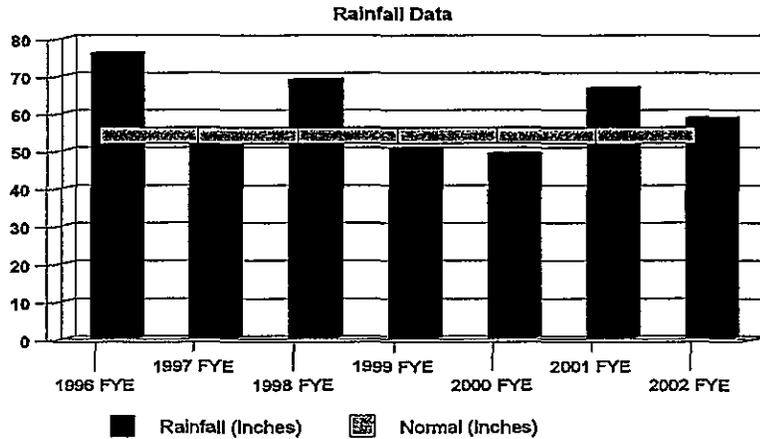
Source: Jefferson County Sewer Services Billing Department

To properly project the amount of additional revenue to be generated by the implementation of a proposed rate increase, it is important to have both actual cubic feet of sewer usage billed by customer class and the current dollar amount earned at the existing rate. Both usage and revenue data must be accumulated because the Commission permits certain discounts and allowances among various groups of customers, and knowledge of those discounts and allowances must be taken into consideration when forecasting the additional revenue to be generated by a change in the billing rate per hundred cubic feet. Revenue and usage data by customer class has been provided by the Water Works and Sewer Board of the City of Birmingham since 1991, and more recently by the smaller utilities within the Jefferson County system. As a result, it is possible to make some reasonable assumptions as to what can be expected in the way of additional revenues arising from a change in the billing rate, assuming no change in price elasticity of demand.

For a typical residential customer using perhaps 1,000 cubic feet per month, the change from the existing rate of \$3.53 to the proposed rate of \$5.05 per hundred cubic feet on January 1, 2003 will raise his or her monthly bill from \$30.01 to \$42.93. Actual and projected monthly bills for a typical residential customer from 2003 through 2006 may be seen in Exhibit A, however, the possible impact of the projected increase in rates on usage is difficult to predict.

It appears that the amount of rainfall experienced in a fiscal year is an influential factor in the level of billable sewer usage, and it is the intent of the rate model to attempt to project probable rate increases in what might be defined as a year in which a normal amount of rainfall could be expected to occur. A normal year is defined as the average amount of annual rainfall for the Jefferson County area from 1961 to 1990 as determined by the National Oceanic and Atmospheric Administration. During the two fiscal years ending September 30, 2000 and 2001, normal rainfall conditions did not occur. Billable sewer usage dropped approximately 15% from the 2000 to the 2001 fiscal year, while rainfall for the area was 36% higher in the 2001 fiscal year when compared with the 2000 fiscal year. As shown in the Rainfall Data exhibit, for the 2000 fiscal year, the rainfall total was approximately 10% lower than a normal year for Jefferson County.

In the following fiscal year, however, the rainfall total was 22% higher than for a normal year. We used customer data in the two fiscal years just discussed to create what we believed to be a representative usage year, and we also found that in the normal year, the rainfall amount for the Jefferson County sewer service area could be expected to be 57.8 inches. For the fiscal year ending September 30, 2002, the rainfall amount for the area was 58.5 inches. As a consequence, we believe that usage actually experienced during the "normal" year for the rate model is appropriate for forecasting purposes.



This average year was used in the Series 2002-B forecast for all classes of users to project growth in rate revenues for future years. Based on usage data now available for the fiscal year ended September 30, 2002, however, we have now elected to consider average usage by customer class during the three most recent fiscal years as a basis in our current model to forecast usage. This average year has been used for all classes of users to forecast growth in rate revenues for future years.

Residential units and apartment dwellers currently account for almost 42 percent of all billable usage, so an increase in cost of sewer service may not result in any meaningful reduction in usage from this group, but there may be a point at which this assumption is no longer valid. Commercial and industrial customers, particularly the latter, could be a different matter. However, because industrial accounts represent only about 2.1 percent of rate revenues in the fiscal year ended September 30, 2002, it can be assumed that any action that a customer in this class might take would probably not seriously endanger the revenue generating capability of the proposed rate increase. Nevertheless, the impact of possible action by the commercial customers responsible for the remaining 56 percent of the annual rate revenues cannot be entirely discounted. However, it is our opinion that if conservation action was taken by customers in this group, such action would probably be confined to the larger users.

Over the years during which usage and account growth data has now been available, it has been calculated that the annual compound growth rate in billing units chargeable has been approximately 0.25 percent. However, based on the preliminary data for the fiscal year ended September 30, 2002 available as of the date of this report, we are obliged to assume that the factor of price elasticity of demand may be beginning to have some effect on usage. We currently do not have sufficient historical data to quantify the possible extent of that factor, but we believe that it would be prudent to assume no additional growth in usage until the influence of this variable can be more accurately ascertained. Projections made are predicated upon the continuance of the Commission's existing policies relating to credits and allowances for the various customer classes as we understand them. Any material change in the Commission's policy on credits and allowances could have a significant impact on rate revenues.

With the considerations outlined in the preceding paragraph in mind, a rate model has been developed calling for a user fee per hundred cubic feet of \$5.05 to be implemented on January 1, 2003, \$6.26 on January 1, 2004, \$7.18 on January 1, 2005, and to \$7.83 on January 1, 2006 to meet the projected revenue requirements determined in this report. Rate revenues of approximately \$108.4, \$138.3, \$161.4 and \$178.1 million are projected for the fiscal years ending September 30, 2003, 2004, 2005, and 2006, respectively. In our opinion, the foregoing projected rates, while at the higher end of sewer user fee structures currently being experienced by publicly operated treatment works, would be reasonable for sanitary sewer systems similar in size and character to the system which may be operating under similar legal and regulatory

constraints. In assessing the character of the Jefferson County system, we considered historical usage data, composition of the customer base, operational requirements, and regulatory and legal requirements.

Sewer Impact Fees

Impact fee revenues have varied somewhat in recent years, ranging from approximately \$3.6 to \$4.4 million. The current impact or system development charge fee system has been in effect for many years. Impact fees are influenced by a number of factors including, but not limited to, interest rates, employment conditions, regulatory considerations and the possibility of an increase in amount, although the last of these factors normally has more of a one time rather than an ongoing impact. In Jefferson County the basis for impact fees is, as a general rule, an assessment per plumbing fixture unit, but there are variations of this rule for certain establishments such as restaurants or other higher use facilities. There may also be a nominal amount for connection of an existing structure to a new sewer service line installed where service did not previously exist. Because we believe that this source of revenue may be significantly impacted by changing economic conditions, it is appropriate to be conservative when projecting revenue from impact fees. The Commission has forecasted \$3.7 million for impact fee revenues for the current fiscal year. Future growth is projected at 2 percent annually to allow for the unpredictability of this source of revenue. While it is not expected that such a move would generate a significant increase in the amount of revenue earned from this source, the methodology for developing the amount of the impact fee to be charged to a new customer should be periodically reviewed to ensure both adequacy of the charge and equity to the existing customer base.

Ad Valorem Taxes

Ad valorem tax revenues allocable to the Environmental Services Department has ranged from \$2.9 to \$4.5 million over the past five fiscal years. This source has experienced some variability in its most recent fiscal year due to changes in funding percentages both at the state and county levels. The Commission has recently revised its estimate for ad valorem revenues allocable to sewer operations to be \$3.9 million for the current fiscal year to reflect the influence of both recurring and non-recurring adjustments which took place in the last fiscal year. One of those adjustments will also be reflected in the current fiscal year. Beyond the influence of those adjustments, we have assumed an annual compound growth rate of 2 percent per year. It is also our understanding that while revenues from ad valorem taxes allocable to the sewer operations may be counted for purposes of debt service coverage, they cannot be pledged toward the payment of the debt itself.

Waste Surcharges

Industrial waste surcharges earned in the fiscal year ended September 30, 2002 amounted to \$1.9 million, up from \$1.7 million in the preceding fiscal year. The schedule for these charges was revised in January 1996, and that schedule is undergoing review at the time of this report. Revenues from this source are largely dependent on Commission policy. Future revenues from this source are uncertain. The Commission anticipates \$1.9 million from this source for the current fiscal year. In the interest of conservatism it is projected that this item will grow at an annual rate of 2 percent. Potential revenues from this source will be examined again when the Commission completes its review of its current charge methodology.

Interest Income

The projection amount of interest income to be earned by an entity is an approximation due to the volatility of short term interest rates. Such a forecast involves estimating interest earnings on the various indenture funds and on various other funds of the System. Those funds include interest earned on operating funds,

all special purpose funds, debt service reserve funds, construction funds, and other related interest earning sources. Interest earnings for the fiscal years ending September 30, 2003, 2004, 2005, and 2006 are projected to be \$20.2, \$14.3, \$12.5 and \$12.1 million, respectively. The Construction Fund is projected to be spent in monthly installments through May 2004, and capitalized interest funds are scheduled to fund interest until six months after the construction fund is depleted. We believe that it is appropriate to assume an interest rate that corresponds to the one-year average life of these assets, which is 1.52% under market conditions as of October 2002. Debt service reserve funds, however, will remain in place through the final maturity of the warrants for which they were established. For example, the Series 1999-A Debt Service Reserve Fund will remain in place until the final maturity of February 1, 2039, and the Series 2002-B and 2002-D Debt Service Reserve funds will remain in place until the final maturity of February 1, 2042.. Due to the long average lives of these assets, it is assumed that the Series 2002-B Debt Service Reserve will earn the allowable yield of 5.03%, while the Series 2002-D fund will earn at the allowable yield of 5.19%. An interest rate of 5.25% is assumed on the 1997 and 1999 Debt Service Reserve Funds. The County has historically earned higher rates of return on its investments.

Miscellaneous Income

Sources of revenue making up this revenue grouping include other sanitation charges, septic tank dumpings, delinquency fees, developer assessments, and recovery of charged off balances. Although this source of revenue amounted to approximately \$980,000 for the most recent fiscal year, revenues from this source have historically ranged from \$700,000 to \$900,000 annually. These items constitute less than 1 percent of total projected revenues of the Environmental Services Department. Little change in the size of the revenue stream is expected to occur. The County forecasts \$1.0 million in miscellaneous revenues for the current fiscal year, and the growth rate used in projecting future revenue estimates arising from this source is 2 percent.

SUMMARY OBSERVATIONS

We have worked with the Commission on sewer revenue forecasts on several occasions in the last ten years, and that continuing relationship has afforded us the opportunity to become increasingly familiar with the financial reporting systems providing the information which is the basis for this report. We are confident that this information provided represents a good framework for both evaluating the resources currently available to the Environmental Services Department and projecting that department's future revenues and requirements.

Based on the information available to us, it is our opinion that the currently adopted and the proposed rate increases raising the rate from a level of \$3.53 to \$5.05 per hundred cubic feet effective January 1, 2003, to \$6.26 on January 1, 2004, to \$7.18 on January 1, 2005, and to \$7.83 on January 1, 2006 will be sufficient to adequately fund the operations of the Environmental Services Department, provide for the orderly retirement of its debt for the period modeled and meet the other terms of the trust indenture, assuming that there is no material change in the economic or regulatory environment in which the Commission must operate. However, it should also be recognized that increasing conservation on the part of sewer system users may be expected as the cost of sewer service becomes more expensive, but the dollar value of potential conservation efforts is not quantifiable at this time.

The exhibits which follow provide an overview of projected revenues, operating expenses and debt service requirements which the Commission's Environmental Services Department can reasonably expect to experience over the years discussed herein, assuming implementation of the proposed change in sewer user fees as projected.

Exhibit A
Jefferson County Commission
Environmental Services Department
Proforma Income Statement and Debt Coverage
(thousands)

	Fiscal Years Ending September 30			
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
	(forecast)	(forecast)	(forecast)	(forecast)
Revenues:				
Sewer service fees(1)	\$108,393	\$138,311	\$161,376	\$178,054
Impact fees	3,745	3,819	3,896	3,974
Ad valorem taxes	3,887	3,965	4,044	4,125
Waste surcharges	1,944	1,984	2,023	2,064
Interest income(2)	20,218	14,255	12,526	12,173
Miscellaneous	984	1,004	1,024	1,044
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Total Revenues	139,171	163,338	184,889	201,434
Operating Expense:				
O & M Expense(3)	56,606	59,226	61,767	64,423
	<hr/>	<hr/>	<hr/>	<hr/>
Excess of Revenues over Expenses	<u>\$82,565</u>	<u>\$104,112</u>	<u>\$123,122</u>	<u>\$137,011</u>
Current & Projected Annual Debt Service(4)(5)	\$92,236	\$105,097	\$147,114	\$149,518
Historic debt coverage	0.90	0.99	0.84	0.92
Prospective debt coverage (6)	0.79	0.71	0.82	0.92
Prospective w/PYS coverage(7)	1.71	1.37	1.32	1.34
Operation of Prior Years' Surplus funds (8)				
Beginning Balance	\$106,513	\$97,555	\$97,292	\$74,035
Contributions	0	0	0	0
Earnings	1,619	1,483	1,478	1,125
Transfers to Revenue Fund	(10,577)	(1,746)	(24,735)	(12,886)
	<hr/>	<hr/>	<hr/>	<hr/>
Ending Balance	<u>\$97,555</u>	<u>\$97,292</u>	<u>\$74,035</u>	<u>\$62,274</u>
Rate per 100 cf	\$5.05	\$6.26	\$7.18	\$7.83
Implementation date	01/01/03	01/01/04	01/01/05	01/01/06
Average monthly resi- dential bill (1000 cf) (after 15 % non-sewer allowance)	\$42.93	\$53.21	\$61.03	\$66.56

IMPORTANT : The accompanying notes are an integral part of this exhibit.
Please see Trust Indenture for details.

1. Projected rate revenues assume no annual growth in billable wastewater units and the continued application of the existing rate structure in its current form. Actual growth experienced may differ from projected. Rate revenues and interest income projected from rate model.
2. Interest income includes interest earnings on all Trust Indenture funds (including the Construction Fund) and on various other funds of the System. Interest income earned is projected using appropriate interest rates currently available. See report for discussion of interest rate assumptions.
3. Operations and Maintenance (O & M) expenses are those expenses incurred to carry on the normal day-to-day operation of the System. The projections included herein reflect budgeted O&M expense for FYE 09/03 and normal growth. However, actual operating expenses could vary significantly from budgeted. See report for discussion of recent historical and budgeted O & M expenses.
4. For purposes of the Revenue Forecast as set forth in the Indenture, net revenues available for debt service (NRADS) in the Test Year (09/30/2006) must equal or exceed .75 times the maximum annual debt service (MADS) for the System. It is assumed that MADS will be approximately \$171.9 million and will occur subsequent to the Test Year.

IMPORTANT : The accompanying notes are an integral part of this exhibit.
Please see Trust Indenture for details.

5. It is anticipated that the Commission may issue additional debt in a future year to continue with its projected plan for funding proposed capital improvements. The actual date for and the amount of the proposed financing has not yet been finalized. Such debt, if issued, would result in an increase in sewer rates on January 1 of the following year.
6. Annual debt service for the fiscal year ending 09/30/2007 is \$149,171,504.
7. Prior Year Surplus (PYS) Funds as defined in the Trust Indenture.
8. See the table below for a more detailed presentation of the operation of the Prior Years' Surplus Funds.

**Operation of Prior Years' Surplus funds
(thousands)**

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Rate Stabilization Fund				
Beginning balance	\$59,659	\$49,989	\$49,003	\$25,012
Contributions to RSF Acct.	0	0	0	0
RSF earnings (1)	907	760	744	380
Transfers to Revenue Fund	<u>(10,577)</u>	<u>(1,746)</u>	<u>(24,735)</u>	<u>(12,886)</u>
Ending balance	49,989	49,003	25,012	12,506
Depreciation Account Fund				
Beginning balance	\$46,854	\$47,566	\$48,289	\$49,023
Contributions to DA Fund.	0	0	0	0
DA Fund earnings (1)	712	723	734	745
Capital improv. withdrawals	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Ending balance	47,566	48,289	49,023	49,768
 Ending PYS Fund balance	 <u>\$97,555</u>	 <u>\$97,292</u>	 <u>\$74,035</u>	 <u>\$62,274</u>

1. A rate of 1.52% is assumed for all Prior Year Surplus funds.

Exhibit B
Jefferson County Commission
Environmental Services Department
Projected Operations & Maintenance Expenses

O & M EXPENSES:

	<u>2003</u> (Budget)	<u>2004</u> (Forecast)	<u>2005</u> (Forecast)	<u>2006</u> (Forecast)
Finance - Sewer Services	\$3,652,724	3,817,097	3,988,866	4,168,365
Provision for Bad Debts	1,955,195	2,043,179	2,135,122	2,231,202
Liquidity/Remarketing/Rating	2,563,973	2,752,403	2,752,403	2,752,403
Non - Departmental	3,432,563	3,587,028	3,748,445	3,917,125
Supplemental Environmental	276,475	288,916	301,918	315,504
Sanitary Administration	5,218,967	5,453,821	5,699,242	5,955,708
Administrative Engr. & Const.	402,126	420,222	439,132	458,893
Surveying Engr. & Const.	1,047,368	1,094,500	1,143,752	1,195,221
Inspection Engr. & Const.	1,945,797	2,033,358	2,124,859	2,220,478
Sewer Line Reconstruction	1,395,315	1,458,104	1,523,719	1,592,286
Administrative Line Maint.	1,292,664	1,350,834	1,411,621	1,475,144
Village Line Maintenance	1,385,787	1,448,147	1,513,314	1,581,413
Shades Line Maintenance	2,303,080	2,406,719	2,515,021	2,628,197
TV Inspection & Grouting	1,466,964	1,532,977	1,601,961	1,674,050
Cahaba River WWTP	2,873,964	3,003,292	3,138,441	3,279,670
Five Mile Creek WWTP	2,234,199	2,334,738	2,439,801	2,549,592
Leeds WWTP	874,415	913,764	954,883	997,853
Trussville WWTP	845,338	883,378	923,130	964,671
Turkey Creek WWTP	619,953	647,851	677,004	707,469
Valley Creek WWTP	5,473,135	5,719,426	5,976,800	6,245,756
Village Creek WWTP	5,459,704	5,705,391	5,962,133	6,230,429
Five Mile Creek Maint. Shop	285,996	298,866	312,315	326,369
Valley Maintenance Shop	373,951	390,779	408,364	426,740
Village Maintenance Shop	500,438	522,958	546,491	571,083
Village Electrical Shop	955,674	998,679	1,043,620	1,090,583
Instrument Shop	438,478	458,210	478,829	500,376
Package Plants/Pump Statns.	4,043,956	4,225,934	4,416,101	4,614,826
Biosolids Handling	1,015,568	1,061,269	1,109,026	1,158,932
Barton Lab	2,271,941	2,374,178	2,481,016	2,592,662
	<u>\$56,605,708</u>	<u>\$59,226,016</u>	<u>\$61,767,329</u>	<u>\$64,423,000</u>