Annual Investment Guide

Palm Beach County, Florida

PREPARED BY THE CLERK & COMPTROLLER'S OFFICE FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2008

SHARON R. BOCK
Clerk & Comptroller
Palm Beach County

Dear Residents:

During Palm Beach County's last fiscal year, $1.7 billion in total revenue was collected from property taxes, charges for services and other sources. The majority of this income was received during the months of December and January and used to meet the County's financial obligations throughout the year.

As your independently elected Clerk & Comptroller, I am the treasurer and custodian of these funds. It is my fiduciary duty to invest and earn income on your tax dollars until the money is needed to pay the County's expenses. During Fiscal Year 2008, despite a volatile market and low interest rates, my highly skilled team of Accredited Investment Fiduciary® professionals invested and earned nearly $93 million, equal to a household tax savings of $195 per year. In addition to maximizing investment earnings, our diligent portfolio management strategy consistently protects your tax dollars.

This Annual Investment Guide will give you a better understanding of the County's investment portfolio and its performance during the last two fiscal years. This guide is derived from my office's *Comprehensive Annual Financial Report* (CAFR) for the fiscal year that ended on September 30, 2008. The CAFR includes more than 200 pages of detailed County investments, financial statements, notes, schedules and reports. A condensed and simplified version of this report is also made available in *Checks & Balances: Your Guide to County Finances*. Both publications, which have been honored for excellence in financial reporting by the Government Finance Officers Association, are available at www.mypalmbeachclerk.com along with other financial information.

Thank you for reading the *Annual Investment Guide* and learning how your tax dollars are invested. Please share your comments, questions or suggestions by e-mailing me at clerkweb@mypalmbeachclerk.com or calling (561) 355-2996.

It remains an honor and privilege to serve as your Clerk & Comptroller. By educating the public about County finances, I will continue my commitment to promoting transparency and accountability in County government.

Best regards,

Sharon R. Bock

Sharon R. Bock, Esq., Clerk & Comptroller, Palm Beach County

ABOUT THIS GUIDE

As County Treasurer, the Clerk & Comptroller is responsible for the investment of County funds. The Clerk and her staff of experienced investment professionals manage the investment program in accordance with the County Investment Policy and perform ongoing, in-depth research and analysis of portfolio holdings to protect the safety of the principal, ensure liquidity and earn a market rate of return.

The management of public funds is markedly different than that of private funds. The Clerk & Comptroller's investment management activities are restricted by specific investment policy guidelines related to investment types, risk diversification, maturity, investment quality, performance measurement, selection of qualified dealers and issuers, safekeeping of securities, and reporting requirements. A copy of the County Investment Policy is available under the Finance section of the Clerk's Web site at www.mypalmbeachclerk.com.

The Palm Beach County Investment Ordinance, adopted in 1987, built flexibility into the County's investment program by establishing a framework for a formalized investment policy that expanded investment alternatives and set standards beyond those as dictated by state statute. The ordinance also provided for the creation of the Palm Beach County Investment Policy Committee (IPC).

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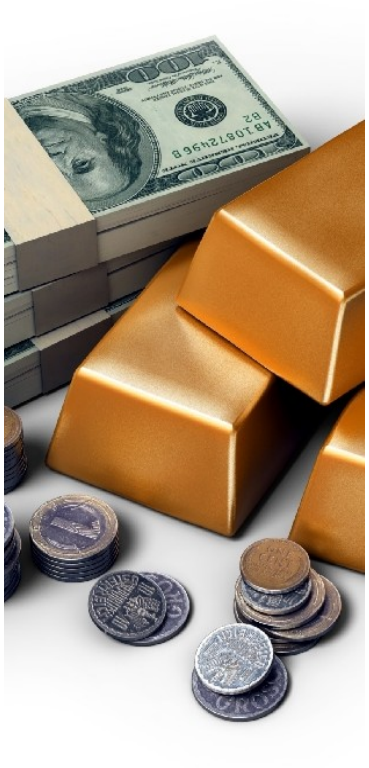
The Clerk & Comptroller's office is the first government agency in the country to have its entire investment staff earn the esteemed ***Accredited Investment Fiduciary***®*certification.*



Clerk & Comptroller

In addition to duties as Clerk of the Court, County Recorder, Clerk of the Board of County Commissioners and County Auditor, the Clerk & Comptroller is the Chief Financial Officer and Treasurer for Palm Beach County. As Chief Financial Officer, the Clerk monitors the County budget, revenue, debt and spending and maintains an accurate and complete set of financial records in order to produce all required financial statements and reports to comply with state and federal laws and generally accepted accounting principles. As Treasurer, the Clerk invests and earns interest income on County funds.

SHARON R. BOCK, ESQ.
Clerk & Comptroller, Palm Beach County

SHANNON RAMSEY-CHESSMAN
Chief Operating Officer of Finance

DENISE COFFMAN, ESQ.
Legal Counsel & Ethics Officer

J. ANTHONY BEARD
Director of Compliance & Revenue

FELICIA LANDERMAN
Investments Manager

INVESTMENT POLICY COMMITTEE

The committee has seven members from the public and private sectors who are appointed by the Board of County Commissioners. The function of the committee is to work in conjunction with the Clerk & Comptroller to develop and evaluate the County's investment policies. For Fiscal Year 2008, membership of the committee was as follows:

BURT AARONSON, Chair
Palm Beach County Commissioner

LIZ BLOESER[1]
Director , Office of Financial Management & Budget, Palm Beach County

JIM DAVIS
Director of Administrative Services, Palm Beach County Sheriff's Office

RICHARD MILLER, ESQ.
Edwards, Angell, Palmer & Dodge, LLP

STEPHEN FREILICH
Treasurer, South Florida Water Management District

LARRY ZALKIN
Wescott Financial Advisory Group, LLC

BARRY WEISS, ESQ.[2]
Greenberg Traurig, LLP

[1] *Replaced Richard Roberts in January 2008*

[2] *Replaced James J. Derba in January 2008*

GOVT
Full faith and credit of U.S. government

GSE
Government-Sponsored Enterprise

MBS
Mortgage-Backed Security

ARM
Adjustable Rate Mortgage

CMO
Collateralized Mortgage Obligation

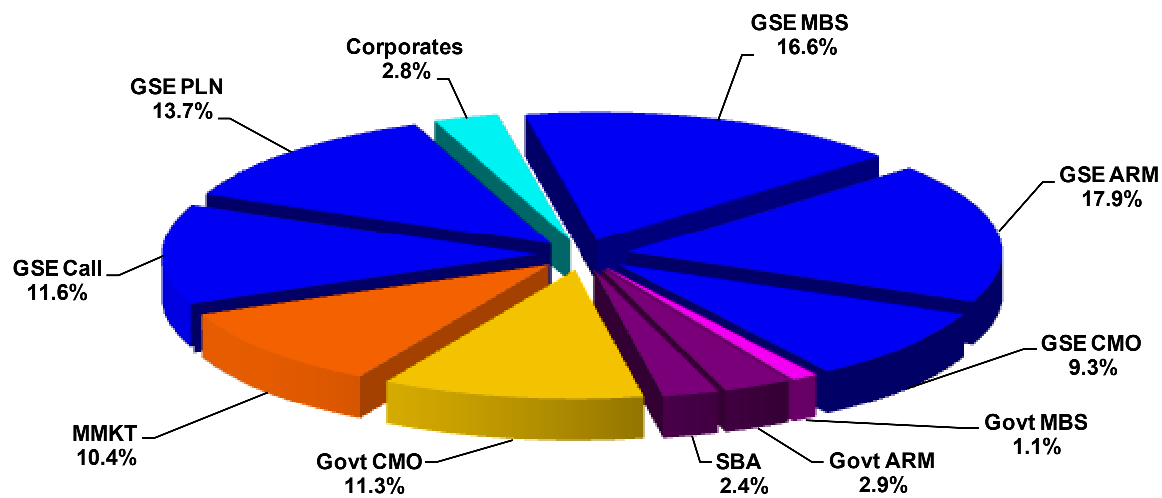
PLN
Prepayment-Linked Note

SBA
Small Business Administration Pool

PORTFOLIO SIZE & PERFORMANCE

At the end of Fiscal Year 2008, the County's investment portfolio totaled $1.8 billion. During the fiscal year, the yield averaged 4.75 percent, and the duration averaged 2.10 years. The portfolio earned approximately $92.7 million in interest income during the fiscal year, exclusive of any realized or unrealized gains or losses. Investment income during the fiscal year, which includes realized and unrealized gains and losses, totaled more than $92 million. The portfolio allocation at fiscal year -end is depicted in the chart below. Specific investment descriptions follow. A detailed listing of portfolio holdings as of Sept. 30, 2008 is available under the Finance section of the Clerk's Web site at www.mypalmbeachclerk.com.

PORTFOLIO ALLOCATION



INVESTMENT SECTOR DESCRIPTIONS

Government Sponsored Enterprise (GSE) Securities

GSEs are financing entities created by Congress to fund loans to certain groups of borrowers such as homeowners, farmers and students. GSEs are also sometimes referred to as federal agencies or federally sponsored agencies. The more common GSEs are Federal Home Loan Bank (FHLB), Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Federal Farm Credit Bank (FFCB).

All GSE debt is sponsored but not guaranteed by the U.S. Government. To conduct their lending business, GSEs have significant funding requirements. While many are stockholder-owned companies that can raise equity capital, most GSEs rely primarily on debt financing to fund their day-to-day operations. Some GSEs have explicit, though limited, lines of credit from the U.S. Treasury. In general, debt securities issued by GSEs are considered to be of high credit quality. The County only holds senior debt of the GSEs, which is rated AAA/Aaa.

As a group, GSEs benefit from a perceived backing of the federal government, as institutions established under federal legislation. However, debt securities issued by GSEs are solely the obligation of their issuer, and do not carry any guarantee by the U.S. government unless explicitly stated. Thus, they are considered to carry greater credit risk when compared to U.S. Treasury-issued debt. In light of recent developments in the U.S. markets, the government has more expressly stated their backing of GSE debt, particularly FNMA and FHLMC, but has stopped short of making the explicit backing permanent.

Despite the backing of the U.S. Government, GSE debt obligations often pay a higher yield to investors than "full faith and credit" U.S. government securities with comparable maturities. The premium varies with market volatility, structure, maturity, and general supply and demand for the particular security. The County portfolio consists of both callable GSE securities as well as stated maturity (bullet) GSE securities.

Mortgage–Backed Securities (GSE guaranteed)

Mortgage-backed securities represent ownership interests in mortgage loans made by financial institutions to finance borrowers' purchases of homes or other real estate. Mortgage-backed securities are created when these loans are packaged, or "pooled" by issuers or servicers for sale to investors. As the underlying mortgage loans are paid off by the homeowners, the investors receive payments of interest and principal. As of the end of the fiscal year, Palm Beach County held three types of mortgage backed securities, including:

Fixed-Rate Mortgages

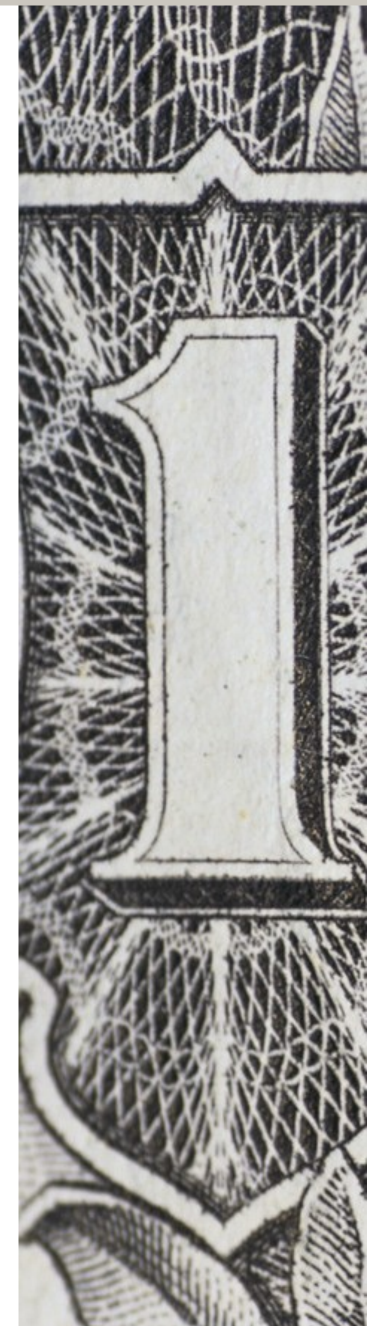
Fixed-rate mortgage-backed securities are pooled groups of mortgage loans that have a fixed interest rate. Maturities vary from 5 to 30 years with principal and interest payments paid to investors, typically monthly.

Adjustable-Rate Mortgages

Adjustable-rate mortgage-backed securities are groups of mortgage loans in which the interest rate changes at regular intervals to reflect fluctuations in general market interest rates. The adjustments are based on an index that cannot be controlled by the lending institution, such as the interest rate of U.S. Treasury bills or the London Interbank Offered Rate (LIBOR). There are often limitations on the interest rate change from one period to the next with rate caps for either the period, the life of the loan, or both.

Collateralized Mortgage Obligation

Collateralized Mortgage Obligations are pools of mortgage-backed securities that are structured and separated into short, medium and long-term positions called tranches. Tranches are designed to pay different rates of interest to investors depending upon their maturity and priority of cash flows. Interest payments are usually paid monthly. The County Investment Policy specifically addresses the classes of tranches that may and may not be purchased.



Small Business Administration (SBA) Pools

SBA pools represent ownership interests in assembled pools of small business loans guaranteed by the SBA. The U.S. Government guaranteed portion is bought and sold on the secondary market to form these pools. Pools adjust either monthly or quarterly to the prime rate published in the Wall Street Journal, providing excellent interest rate sensitivity. SBA pools are guaranteed by the full faith and credit of the U. S. Government.

The county has also begun to selectively invest in SBA fixed-rate debentures that provide attractive fixed coupon/ yield returns, monthly cash flows, short stated final maturities compared to fixed-coupon MBS, and diversification within the full faith and credit sector of the market.

Prepayment-Linked Note (PLN)

PLNs are issued by GSEs and pay principal and interest to the investor monthly, similar to certain mortgage-backed securities. The rate at which interest is paid is typically set by a fixed-rate coupon. The rate at which principal is paid is determined by a “reference pool” of mortgages established by the issuing agency at the time of PLN creation. As the reference pool prepays, the PLN will receive principal cash flows in accordance with a predetermined schedule. PLNs typically have stated final maturities ranging from five to 15 years and are classified as debentures since there is no direct mortgage ownership involved.

State Pool

Funds required for liquidity purposes may be invested in the Local Government Surplus Funds Trust Fund (LGSFTF), administered by the Florida State Board of Administration. This is a pool of local government surplus funds that is state managed, similar to a money market account. The fund strives to maintain a net asset value of $1, and funds are available to depositors on a daily basis, while earning a competitive overnight interest rate. As of fiscal year end, no county funds were invested in the LGSFTF.

Money Market Fund (MMKT)

Used in conjunction with the State Pool for liquidity purposes, MMKTs are easily accessible low-risk, cash-equivalent assets. Portfolios are comprised of short-term (less than 1 year) securities of high-quality debt and monetary instruments allowable by the investment policy. The fund strives to maintain a net asset value of $1, and cash is accessible on a daily basis while earning a competitive overnight interest rate.

SOURCES OF COUNTY FUNDS

The County's overall investment portfolio contains monies that come from a variety of sources. During Fiscal Year 2008, 52.4 percent of the County's total revenue came from property taxes, also known as ad valorem taxes. Other sources included charges for services (16.5 percent), grants (7.7 percent) and investment income (5.1 percent).

"Funds" are fiscal and accounting entities that record cash and other financial resources as well as related liabilities and equities. When revenues come in, they are recorded into individual funds. Funds are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations. Funds are split into various types according to their purpose. The investment portfolio is comprised of fund types including Governmental Funds, Enterprise Funds, Agency Funds, and Internal Service Funds.

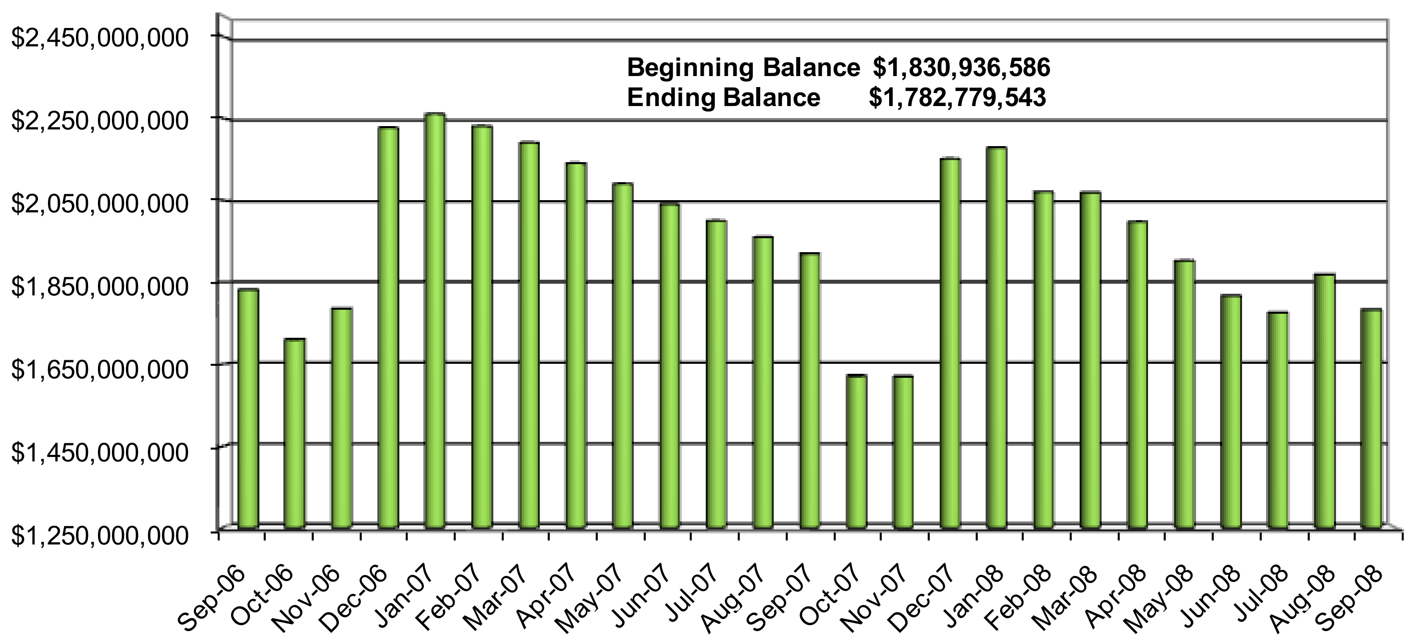
Governmental Funds have the largest share of the investment portfolio and include the General Fund (County's main operating fund), Debt Service Funds, Special Revenue Funds, and Capital Project Funds. Enterprise Funds include the Department of Airports and the Water Utilities Department. Agency Funds from constitutional officers include the Clerk & Comptroller, Tax Collector and Property Appraiser. Internal Service Funds include risk management insurance funds.

PORTFOLIO GROWTH

The graph below illustrates the growth of the County investment portfolio during the past two fiscal years. Over the fiscal year the portfolio grew and ended Fiscal Year 2008 with a balance of more than $1.8 billion. Fluctuations from month to month reflect net cash flow as well as growth due to investment income.

PALM BEACH COUNTY INVESTMENT PORTFOLIO

FY2006—FY2008



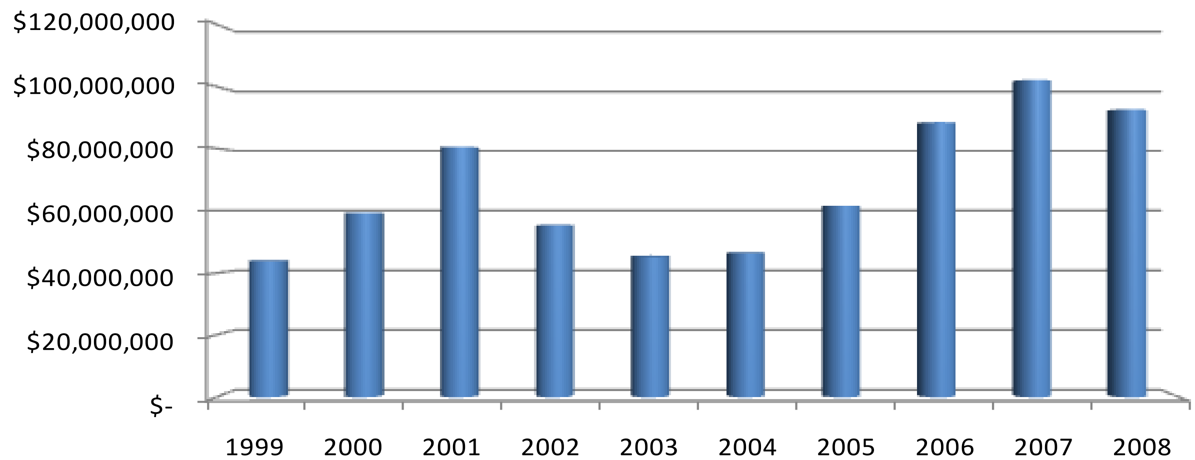
PORTFOLIO INCOME

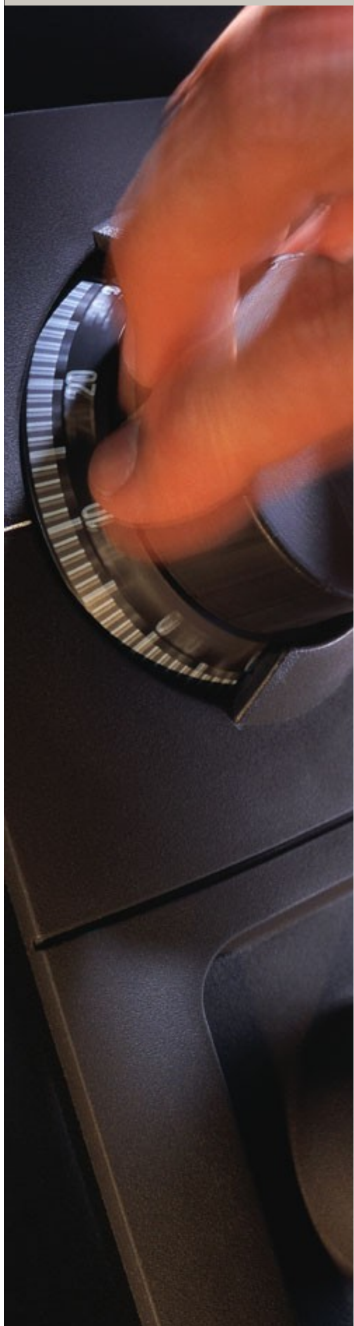
The Clerk's office invests County funds that are not needed for immediate use to maximize earnings potential until they are needed. Interest income on the portfolio helps reduce the tax burden on Palm Beach County residents. In Fiscal Year 2008, interest income on investments totaled more than $92.7 million, the equivalent tax savings of approximately $195 per year per county household.

Income generated by County investments is dependent upon many factors, such as the interest rate environment, economy and size of the portfolio. This graph illustrates the amount generated throughout the past ten fiscal years.

INTEREST INCOME

FY1999—FY2008



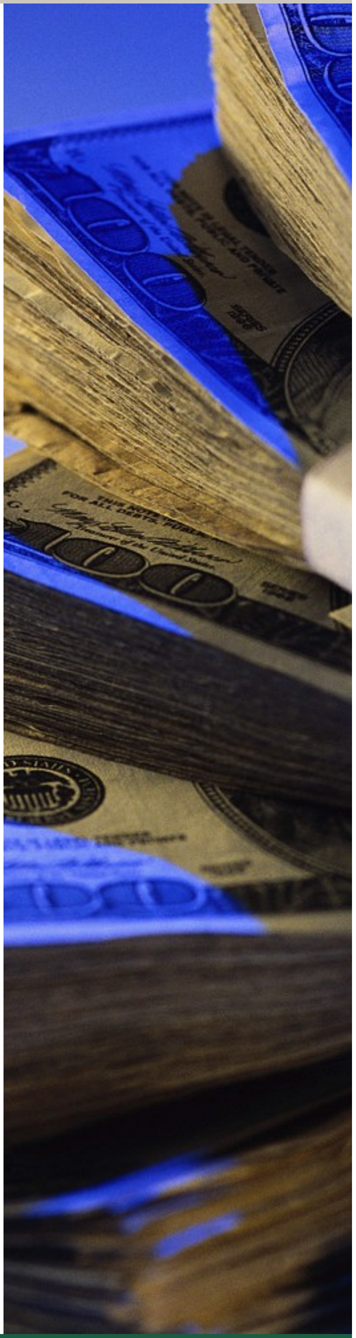


STRATEGIC INVESTMENT CHOICES

The Clerk & Comptroller's office has a staff of experienced professionals that actively manage County investments and are devoted to the development and implementation of an investment plan that effectively meets County objectives. Investment strategies fall within the guidelines of the County Investment Policy, a formal document approved by the Board of County Commissioners that addresses issues such as authorized instruments, risk diversification methods, internal controls, program monitoring, performance measurement, qualified dealers and competitive bidding.

Investment Policy

The County Investment Policy is very specific in terms of its stated investment objectives. These objectives in order of priority are safety of principal, liquidity of funds and earning a market rate of return. The primary objective of the County Investment Policy is to prevent any loss of principal; secondarily, to meet the County's needs to pay budgeted expenses as they are due throughout the year. After meeting these two objectives, the Clerk consistently and actively seeks opportunities to maximize interest income in order to reduce the financial burden on the taxpayers of Palm Beach County.



Investment Tools

While implementing industry best practices, the Clerk's office utilizes numerous tools in order to effectively implement strategies. The office subscribes to Bloomberg, which is a state-of-the-art financial system that allows access to real-time financial, market, and economic information. The system is a tool to perform complex and detailed analyses of investment securities of all classes.

The Clerk's investment staff also uses other complex software and systems that provide for dynamic cash flow modeling to "shock" the investment portfolio and measure the resulting effects of upward/downward movements in interest rates. Portfolio optimization models are likewise employed to analyze which securities perform best, considering risk tolerance and policy constraints. A brief explanation of relevant investment risks and how the Clerk's office addresses these risks follow on page 16.

Low Interest Rates

During Fiscal Year 2008, the Clerk's investment strategy was to structure the portfolio to perform best in a lower interest rate environment. The county began the fiscal year with an easing policy implemented by the Fed, beginning on September 18, 2007, due to the continual deterioration in the U.S. economy and tighter credit conditions, along with increasing uncertainty among consumers. During the fiscal year, this easing policy continued, resulting in a decrease of 2.75% in the Federal Funds rate from 4.75% to 2.00% by September 16, 2008.

In anticipation of a decline in interest rates, the Clerk's investment decisions considered future cash flows, portfolio duration, yield, interest rate sensitivity and overall portfolio performance. The Clerk's approach to managing investments in a lower rate environment includes extending the portfolio's duration profile and rebalancing the portfolio's asset classes. In rebalancing, specific securities are sold and others immediately purchases in order to improve the yield and duration profile of the portfolio. Ultimately, overall net earnings are higher due to these actions.

Crisis in the Financial Markets

During 2008, liquidity concerns produced major credit market dislocations which threatened the survival of major financial firms. In March, 2008 federal regulators supported Bear Stearns by engineering its merger into JP Morgan Chase. In September, 2008, the U.S. Government put mortgage giants Fannie Mae and Freddie Mac into conservatorship and, to prevent failure, extended an $85 billion line of credit to insurance giant AIG. Lehman Brothers went bankrupt, while Bank of America took over Merrill Lynch.

The U.S. Treasury and Federal Reserve acted quickly to calm markets. Lower interest rates, new Federal Reserve borrowing facilities, and capital injections helped weakened financial firms survive the credit market turmoil. The turbulence created opportunities to buy high quality fixed income securities at bargains.

State Pool

At the beginning of the fiscal year, the Clerk made the strategic decision to pull out all County funds invested with the State Pool (see page 8 for description), prior to the run on the pool that caused the trustees to freeze all assets. Ultimately, the pool was split into two funds—Fund A and Fund B. The securities considered at-risk, including those that defaulted or were illiquid, were placed into Fund B and those participants with money remaining in the pool when it was frozen on November 29, 2007, are slowly recovering their principal investment as these investments pay off. Although no County funds were lost, accrued interest for the month of November, 2007, totaling approximately $60,000 is being withheld by the trustees as a reserve to Fund B. It is unknown when and if participants in Fund B will be able to recoup their entire principal investment. Only then will the participants who had November interest withheld be paid.

Fund A continues to operate as a money market fund and is being managed by an independent external manager. At the end of fiscal year 2008, the County had no funds invested in Fund A or Fund B.

Money Market Fund

As part of our normal due diligence and especially in light of the unprecedented illiquidity across all markets and financial sectors during the fiscal year, the Clerk reexamined the money funds utilized to hold short-term cash. The money market fund utilized throughout the fiscal year – the AIM Government and Agency Portfolio – is invested only in U.S. Government and Agency securities, or repurchase agreements backed by these assets. At no point in time was, or will, the fund be invested in volatile and illiquid securities at the forefront of the financial crisis, such as structured investment vehicles and subprime residential mortgage backed securities. The fund maintains the highest credit rating of the major rating agencies and demonstrates our conservative investment philosophy and commitment to safety, liquidity, and yield (in that order).

STRATEGIC RISK MANAGEMENT

The Clerk & Comptroller's office achieves a balance between certain types of risk and portfolio return. These different risks fall into four basic categories:

Credit Risk

Credit risk is the risk that the security issuer defaults and does not return the investor's principal. The Clerk addresses credit risk by primarily focusing on either U.S. government guaranteed debt or the highest rated Government-Sponsored Enterprise (GSE) debt. In addition, the portfolio may contain minimum exposure to corporations that are rated Aa/AA, at a minimum. As of the fiscal year end, all corporate exposure met these guidelines.

Diversification Risk

Diversification risk is the risk of loss resulting from over-concentration of investments in a specific maturity, issuer, instrument, or a class of instruments. The Clerk spreads exposures broadly between all of the following Government/GSE issuers: U.S. Treasury, Government National Mortgage Association (GNMA), Small Business Administration (SBA), Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC), Federal Home Loan Bank (FHLB) and Federal Farm Credit Bank (FFCB). In addition, diversification exists within these issuing entities by varying the maturity and other characteristics of the structures to include stated final maturities, callable securities and amortizing structures that pay back principal and interest on a monthly basis.

Interest Rate Risk

Interest rate risk comes from the market price volatility that fixed-income investments experience due to changing market interest rates. In managing this risk, the Clerk & Comptroller structures the County's portfolio to maintain an average effective duration of approximately two years. The effective duration is a measurement of the price sensitivity of the principal value of investments due to changes in interest rates. Over time, the two-year duration has provided value to investors by generating a favorable ratio of income vs. risk.

Liquidity Risk

Liquidity risk is the risk that cash flows from the portfolio will not be available when needed. The Clerk works with the County's Office of Financial Management and Budget to lower this possibility by effectively forecasting cash flow needs. Having a broad mix of fixed maturity and callable bonds, monthly amortizing fixed-rate mortgage securities, and adjustable-rate mortgage products within the portfolio also provides for necessary liquidity by ensuring a steady flow of cash into the portfolio. The adjustable-rate mortgage holdings are diversified among quarterly, annual and term (hybrid) adjusting pools that reset to any changes in respective interest rate levels. In addition, a pre-determined level of cash is invested in money market accounts to address any unanticipated liquidity needs that may arise during the fiscal year.

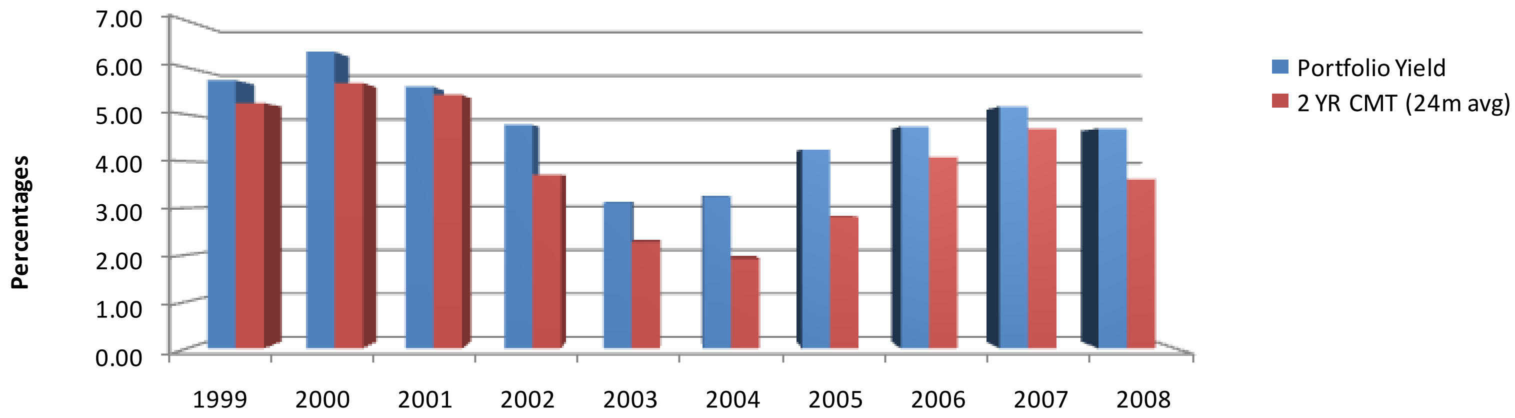
BENCHMARK COMPARISON

State statute and the County Investment Policy require that investment performance is measured. By measuring performance, the Clerk's office is able to gauge how effective they have been in their investment choices. The policy states that the measurement focus shall be on the portfolio as a whole, and that the portfolio shall be designed to attain a market rate of return taking into account risk constraints and cash flow requirements.

During Fiscal Year 2008, the performance benchmark selected by the Board of County Commissioners was the 24-month moving average of the two-year Constant Maturity Treasury (CMT) note. This benchmark is considered to measure an appropriate market rate of return on investments. Performance of the County's portfolio vs. the benchmark over the last ten years is shown in the following graph. As of fiscal year end, the County's portfolio yielded 4.70 percent, which was higher than the benchmark at 3.62 percent.

BOOK YIELD VS. BENCHMARK

FY1999—FY2008



DEPOSITORY BANKING

Just as individuals use banks to deposit monies and earn interest until the funds are withdrawn to pay expenses, the County has a similar need. When the County takes in revenue such as property taxes or parks and recreation fees, it is temporarily deposited into a main bank account until the Clerk's office invests it into higher yielding assets. County funds are consolidated into one account in order to gain economies of scale for banking and investing activities. When the County pays its expenses, such as payroll or vendor payments, the Clerk's office transfers cash from the investment portfolio to the bank so the County's checks will clear.

A large percentage of local governments that lack the professional staff, skill and sophistication to implement an effective investment program will invest most, if not all, of their funds in the local depository or the State Pool. Unfortunately, these local governments do not maximize the earnings potential on idle funds.

In order to maximize interest earnings on very short-term cash, the Clerk invests only minimal overnight County funds in the bank, and the remainder is placed in either the state investment pool or a competitive money market account.

Wachovia Bank, N.A. serves as Palm Beach County's depository bank, including the safekeeping of County investments. In accordance with Florida Statute 280.03, all public deposits must be secured in Qualified Public Depositories (QPD). Wachovia is a QPD, and all deposits are collateralized pursuant to state law. The collateral requirement for QPDs is determined by the Chief Financial Officer of the State of Florida.

The Clerk's office periodically sends out requests for proposals in order to ensure that the County is getting the best prices and most value on its banking services.

SHARON R. BOCK

Clerk & Comptroller
Palm Beach County

www.mypalmbeachclerk.com

As the third largest of the 67 Clerk's offices in Florida, this independent office serves a local population of nearly 1.3 million residents from six locations and online at www.mypalmbeachclerk.com.

ONLINE SERVICES:

- County Financial Information
- Court & Official Records Searches
- Traffic Ticket Payments
- *my*Minutes
- *my*VAB
- Self Service Court Forms
- Low-Cost Marriage Information
- Passport Information & Photos
- Domestic Partnership Registry