Closed-End Fund Research
Industry Brief

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Comments on Auction-Rate Preferreds and Closed-End Funds

Drab equity markets, credit fears, and more recently leverage concerns have left little patience in closed-end fund investors. Another one-day free-fall, reminding us of those mid-August days, resulted in more than 95% of funds closing in the red. We believe yesterday's drop was mainly a result of the news surrounding the auction-rate securities market, which spurred panic selling throughout the entire closed-end fund universe. There are and may still be some misperceptions as to the relationship between the two markets, which we will discuss in more detail below. In addition, we will highlight a few of the well-known sectors that have had specific issues.

Auction-Rate Preferreds (ARPs)

Closed-end funds are well known for their attractive yields, often achieved through their use of leverage. More than 450 closed-end funds employ a leveraging strategy, representing over 70% of the closed-end fund market. Of those leveraged funds, approximately 70% utilize ARPs to some extent, including all municipal funds and a number of taxable income funds. As ARPs are issued, the additional capital raised is put to work in-line with the fund's investment requirements.

Many news articles have highlighted the illiquidity and "failed" auctions in the auction-rate market over the past few days. A failed auction occurs simply when there are fewer buyers than sellers. Below are many of the frequently asked questions related to ARPs that we've received throughout the past few days, as well as how the current environment affects closed-end funds.

Will funds be forced to liquidate assets and redeem preferred shares used for leverage?
Failed auctions do not lead to the de-leveraging of funds. They do not force the funds to liquidate assets to pay preferred shareholders and redeem shares. Rather, a failed auction reverts to a "maximum rate" paid to ARP shareholders by the fund.

What is the maximum rate?
There are several formulas to calculate the maximum rate and they vary by fund company. Typically it's a percentage over or set rate above a benchmark, or base, rate. For taxable ARPs, the benchmark rate tends to be either a comparable LIBOR rate or AA-rated comparable term commercial paper rate. The maximum rate could be 125% to 150% of the base rate or simply a stated amount like 150 basis points over the base rate. The maximum auction rate calculation is specified in the prospectus for the securities.

Please read disclosure/risk information on page 4-5 and Analyst Certification on page 5.

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While the maximum rate we've seen has been around 4.25% to 4.50%, under certain circumstances it is possible to see the rates exceed 5.0%. For municipal ARPs, often referred to as MuniPreferreds which is the Nuveen product, the maximum rate is typically 110% of the 30-day AA rated commercial paper rate or a similar yielding index. As of February 14, that rate was approximately 3.30%. Again, under certain circumstances, the rate may exceed this cap.

How do the maximum rate compare to rates over the past year?
This varies fund to fund, but speaking generally the current maximum rates are similar to the auction rates we saw prior to the Fed reducing the Fed funds rate late last year. The average daily rate in 2007 for the municipal ARPs issued by Nuveen's national municipal funds was approximately 3.65%. Additionally, we saw some municipal ARPs surpass 4.0% in December 2007 as LIBOR lagged in following the Fed rate cuts.

What affect will this have on dividends paid to common shareholders of closed-end funds?
There is no way for us to tell the immediate impact on each individual fund, but overall we believe there will be little reaction in the short-term. As mentioned above, the current maximum rates are still in-line or below where rates have been over the past year. Those funds that were having troubles meeting dividend rates last year may be forced to lower dividends, but again, this is fund by fund and not widespread.

So at what point in time would a fund be required to redeem ARPs?
Under the Investment Company Act of 1940, each fund must maintain asset coverage of at least 200% (50% leverage), calculated on the last business day of each month. If the asset coverage falls below this level, then funds would be subject to mandatory redemption of ARP shares. While we don't anticipate this to occur in the short run, if it were to happen, we believe this would have a more timely effect on taxable funds than the tax-free funds due to the heightened volatility in sectors such as REITs and below investment grade securities. But currently, the majority of funds in both areas have current leverage ratios of between 25% and 42%. Generally speaking, the net asset values (NAVs) of most funds would need to drop upwards of 20% to force liquidations.

Senior Loan Funds

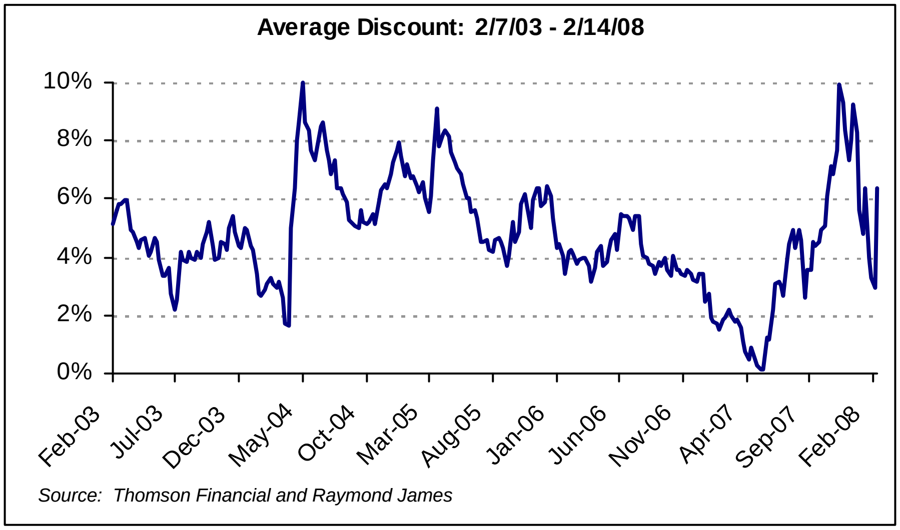
Senior loan funds have taken a beating over the past eight months, sparked by the sub-prime debacle which in turn has dried up demand for the product at a time when supply was well above historical levels. Over the past five years, there has been extreme growth in the asset class, driven by reasonable economic growth, low interest rates, and corporate acquisitions. The increased demand attracted institutional buyers, hedge funds, closed-end funds and collateralized loan obligations (CLOs), securities which own a package of loan obligations. CLOs accounted for a large part of the demand, but these products were purchased by many of the same investors that purchased structured finance products related to mortgage securities. Needless the say, CLO involvement has decreased significantly following the subprime debacle leaving a heavy imbalance of supply and demand. There is no direct subprime exposure in the asset class and at this time, no material fundamental issues with the asset class.

Currently, senior loan funds are trading at an average discount of greater than 9% with many funds trading well over a 10% discount. With the underlying loans trading around $0.85 on the $1.00 and historical recovery rates from defaults of $0.70 to $0.80 on the $1.00, we believe the highly discounted closed-end funds provide exceptional value for patient investors. The main deterrents are continued oversupply in the senior loan market which could drive prices down further and the high probability of dividend reductions across most of the funds, due to the floating rate nature of their holdings. The funds themselves can be treated more as a long-term total return play than an income play at this time

Municipal Funds

Municipal funds had the most notable downward moves of any of the sectors, given the relative safety of the underlying asset class. On February 14, 2008, the national municipal sector posted an average one day loss of -3.65%. We believe this negative performance is directly linked to the happenings in the auction-rate preferred market combined with worries over credit quality in reference to bond insurers. Even non-leveraged funds were hit as investors moved out of the closed-end fund market. While we can't speak for every fund, we do not expect an immediate impact to the dividend levels on funds as a result of the failed auctions on ARPs. There are funds that have been stretching to maintain dividend levels and those may be forced to finally reduce their dividends. The current rates on municipal ARPs remain lower than most of the latter half of 2007 according to data we've seen for MuniPreferreds.

In the first few weeks of the new year, municipal funds traded extremely well and discounted valuations that expanded in the latter half of 2007, contracted significantly. Excessive price returns, over NAV returns, were a large contributor to the discount deterioration. The average discount for the national municipal fund group decreased from well over 8% to less than 2%, but has quickly risen to 6.38% in the past few days. We are seeing a reversal of what happened in January. The chart to the left represents the average weekly discount of the national municipal fund sector over the past five years.



Conclusion

As usual in the closed-end fund market, we believe the rash of recent selling has been based on the "sell first, ask questions later" theory. No forced liquidations of closed-end fund assets have occurred in order to redeem preferred shares closed-end funds issue for leveraging purposes. Certain funds may be forced to lower dividends, but we believe those that do have had that option in the works for some time now. We are seeing value in the senior loan asset class, particularly for those investors looking to hold long-term. There is no fundamental crisis in this asset class, but there has been heightened volatility over the past eight months due to the supply and demand imbalance. Finally, valuations on municipal funds have become more attractive after a quick contraction at the beginning of the year. With discounts shifted back towards historical averages, this may very well be an opportune time to add to positions.

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None

Risk Factors:

1. *Market Price of Shares:* Common shares may trade above (a premium) or below (a discount) the net asset value (NAV) of the trust/fund's portfolio. At times, discounts could widen or premiums could shrink, either diluting positive performance or compounding negative performance.

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3. *Interest Rate Risk:* Generally, when market interest rates rise, bond prices fall, and vice versa. Interest rate risk is the risk that the bonds and other fixed income instruments in a trust/fund's portfolio will decline in value because of increases in market interest rates. The prices of longer-term bonds tend to fluctuate more than prices of shorter-term bonds.

4. *Credit Risk:* One or more bonds in a trust/fund's portfolio could decline or fail to pay interest or principal when due. Fixed-income securities of below investment grade quality are predominately speculative with respect to the issuer's capacity to pay interest and repay principal when due and, therefore, involve a greater risk of default.

5. *Reinvestment Risk:* Income from the trust/fund's bond portfolio will decline if and when the trust/fund invests the proceeds from matured, traded, or called bonds at market interest rates that are below the portfolio's current earnings rate. A decline in income could affect the common shares' market price or their overall returns.

6. *Leverage Risk*: The use of leverage increases the volatility of net asset values of leveraged funds/trusts and could cause drops in net asset values during a period of rising interest rates. There is also the possibility that common share income will fall if the dividend rate on the trust/fund's preferred shares or the interest rate on any borrowings rises, or that common share income will fluctuate because the dividend rate on the fund's preferred shares or the interest rate on any borrowings varies.

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8. *Alternative Minimum Tax (AMT):* A trust/fund may invest in securities subject to the alternative minimum tax.

9. *The securities selected by Closed-End Fund Research could underperform comparable funds:* There is no assurance that the recommended funds will outperform their peer group.

10. *There is an inherent risk of capital loss associated with all closed-end funds.*

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