

GABELLI DIVIDEND & INCOME TRUST

Form DEF 14A

April 03, 2013

**SCHEDULE 14A INFORMATION**

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934

(Amendment No. )

Filed by Registrant  x

Filed by a Party other than the Registrant  o

Check the appropriate box:

- o Preliminary Proxy Statement
- o Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- x Definitive Proxy Statement
- o Definitive Additional Materials
- o Soliciting Material Pursuant to Sec. 240.14a-12

**The Gabelli Dividend & Income Trust**

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- x No fee required
- o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
  - 1) Title of each class of securities to which transaction applies:
  - 2) Aggregate number of securities to which transaction applies:
  - 3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
  - 4) Proposed maximum aggregate value of transaction:
  - 5) Total fee paid:
- o Fee paid previously with preliminary materials.
- o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.
  - 1) Amount Previously Paid:
  - 2) Form, Schedule or Registration Statement No.:
  - 3) Filing Party:
  - 4) Date Filed:

**THE GABELLI DIVIDEND & INCOME TRUST**

One Corporate Center

Rye, New York 10580-1422

(914) 921-5070

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**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

**To Be Held on May 13, 2013**

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To the Shareholders of

THE GABELLI DIVIDEND & INCOME TRUST

Notice is hereby given that the Annual Meeting of Shareholders of The Gabelli Dividend & Income Trust, a Delaware statutory trust (the Fund ), will be held on Monday, May 13, 2013, at 9:00 a.m., local time, at The Cole Auditorium, The Greenwich Library, 101 West Putnam Avenue, Greenwich, Connecticut 06830 (the Meeting ), and at any adjournments or postponements thereof for the following purposes:

1. To elect three (3) Trustees of the Fund by the holders of the Fund's Common Shares and holders of its 5.875% Series A Cumulative Preferred Shares, Series B Auction Market Preferred Shares, Series C Auction Market Preferred Shares, 6.00% Series D Cumulative Preferred Shares, and Series E Auction Rate Preferred Shares, voting together as a single class (**Proposal 1**); and
2. To consider and vote upon such other matters, including adjournments, as may properly come before said Meeting or any adjournments thereof.

These items are discussed in greater detail in the attached Proxy Statement.

The close of business on March 18, 2013 has been fixed as the record date for the determination of shareholders entitled to notice of and to vote at the Meeting and any adjournments or postponements thereof.

**YOUR VOTE IS IMPORTANT REGARDLESS OF THE SIZE OF YOUR HOLDINGS IN THE FUND. WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING, WE ASK THAT YOU PLEASE VOTE PROMPTLY. INSTRUCTIONS FOR THE PROPER VOTING AND/OR EXECUTION OF PROXIES ARE SET FORTH ON THE INSIDE COVER. SHAREHOLDERS MAY AUTHORIZE THEIR PROXY BY TELE-PHONE OR THE INTERNET BY FOLLOWING THE INSTRUCTIONS ACCOMPANYING THE PROXY CARD, VOTING INSTRUCTION FORM OR NOTICE OF INTERNET AVAILABILITY OF PROXY MATERIALS. ALTERNATIVELY, SHAREHOLDERS MAY SUBMIT VOTING INSTRUCTIONS BY SIGNING AND DATING THE PROXY CARD OR VOTING INSTRUCTION FORM AND RETURNING IT IN THE ACCOMPANYING POSTAGE-PAID ENVELOPE.**

By Order of the Board of Trustees,

AGNES MULLADY  
*Secretary*

April 3, 2013

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**INSTRUCTIONS FOR SIGNING PROXY CARDS TO BE RETURNED BY MAIL**

The following general rules for signing proxy cards may be of assistance to you and avoid the time and expense to the Fund involved in validating your vote if you fail to sign your proxy card properly.

1. *Individual Accounts:* Sign your name exactly as it appears in the registration on the proxy card.
2. *Joint Accounts:* Either party may sign, but the name of the party signing should conform exactly to the name shown in the registration.
3. *All Other Accounts:* The capacity of the individuals signing the proxy card should be indicated unless it is reflected in the form of registration. For example:

**Registration**

**Corporate Accounts**

- (1) ABC Corp.
- (2) ABC Corp.
- (3) ABC Corp.  
c/o John Doe, Treasurer
- (4) ABC Corp., Profit Sharing Plan

**Valid Signature**

- ABC Corp., John Doe, Treasurer  
John Doe, Treasurer  
  
John Doe  
John Doe, Trustee

**Trust Accounts**

- (1) ABC Trust
- (2) Jane B. Doe, Trustee  
u/t/d 12/28/78

- Jane B. Doe, Trustee  
  
Jane B. Doe

**Custodian or Estate Accounts**

- (1) John B. Smith, Cust.  
f/b/o John B. Smith, Jr. UGMA
- (2) John B. Smith, Executor  
Estate of Jane Smith

- John B. Smith  
  
John B. Smith, Executor

**INSTRUCTIONS FOR TELEPHONE/INTERNET VOTING**

Various brokerage firms may offer the convenience of providing you with voting instructions via telephone or the Internet to vote your shares held through such firms. Instructions for authorizing your proxy to vote your shares by telephone or Internet are included with each of the Notice of Internet Availability of Proxy Materials and the proxy card.

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## THE GABELLI DIVIDEND & INCOME TRUST

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### ANNUAL MEETING OF SHAREHOLDERS

May 13, 2013

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### PROXY STATEMENT

This Proxy Statement is furnished in connection with the solicitation of proxies by the Board of Trustees (the Board, the members of which are referred to as Trustees) of The Gabelli Dividend & Income Trust, a Delaware statutory trust (the Fund) for use at the Annual Meeting of Shareholders of the Fund to be held on Monday, May 13, 2013, at 9:00 a.m., local time, at The Cole Auditorium, The Greenwich Library, 101 West Putnam Avenue, Greenwich, Connecticut 06830 (the Meeting), and at any adjournments or postponements thereof. A Notice of Internet Availability of Proxy Materials will first be mailed to shareholders on or about April 3, 2013.

In addition to the solicitation of proxies by mail, officers of the Fund and officers and regular employees of Computershare Trust Company, N.A. (Computershare), the Fund's transfer agent, and affiliates of Computershare or other representatives of the Fund may also solicit proxies by telephone, Internet, or in person. In addition, the Fund has retained Morrow & Co., LLC to assist in the solicitation of proxies for an estimated fee of \$1,000 plus reimbursement of expenses. The Fund will pay the costs of the proxy solicitation and the expenses incurred in connection with preparing, printing, and mailing the Notice of Internet Availability of Proxy Materials and/or Proxy Statement and its enclosures. The Fund will also reimburse brokerage firms and others for their expenses in forwarding solicitation materials to the beneficial owners of its Shares (as defined below).

**The Fund's most recent annual report, including audited financial statements for the fiscal year ended December 31, 2012, is available upon request, without charge, by writing to the Secretary of the Fund, One Corporate Center, Rye, New York 10580-1422, by calling the Fund at 800-422-3554, or via the Internet at [www.gabelli.com](http://www.gabelli.com).**

If the proxy is properly executed and returned in time to be voted at the Meeting, the Shares represented thereby will be voted FOR the election of the nominees as Trustees as described in this Proxy Statement, unless instructions to the contrary are marked thereon, and at the discretion of the proxy holders as to the transaction of any other business that may properly come before the Meeting. Any shareholder who has submitted a proxy has the right to revoke it at any time prior to its exercise either by attending the Meeting and voting his or her Shares in person, or by submitting a letter of revocation, or a later dated proxy to the Fund at the above address prior to the date of the Meeting.

A quorum of shareholders is constituted by the presence in person or by proxy of the holders of one-third of the outstanding Shares of the Fund entitled to vote at the Meeting. In the event a quorum is not present at the Meeting, or in the event that a quorum is present at the Meeting but sufficient votes to approve any of the proposed items are not received, the chairman of the Meeting may propose one or more adjournments of such Meeting to permit further solicitation of proxies. If a quorum is present, a shareholder vote may be taken on one or more of the proposals in this Proxy Statement prior to such adjournment if sufficient votes have been received for approval and it is otherwise appropriate. If a quorum is present, the persons named as proxies will vote those proxies which they are entitled to

vote FOR any proposal in favor of such adjournment and will vote those proxies required to be voted AGAINST any proposal against any such adjournment. Absent the establishment of a subsequent record date and the giving of notice to the holders of record thereon, the adjourned Meeting must take place not more than 130 days after the record date. At such adjourned Meeting, any business may be transacted which might have been transacted at the original Meeting.

The close of business on March 18, 2013 has been fixed as the record date for the determination of shareholders entitled to notice of and to vote at the Meeting and all adjournments thereof.

The Fund has two classes of capital stock outstanding: common shares, par value \$0.001 per share (the Common Shares), and preferred shares consisting of (i) 5.875% Series A Cumulative Preferred Shares (Series A Preferred), (ii) Series B Auction Market Preferred Shares (Series B Preferred), (iii) Series C Auction Market Preferred Shares (Series C Preferred), (iv) 6.00% Series D Cumulative Preferred Shares (Series D Preferred), and (v) Series E Auction Rate Preferred Shares (Series E Preferred), each having a par value of \$0.001 per share (together, the Preferred Shares and together with the Common Shares, the Shares). The holders of the Common Shares and Preferred Shares are each entitled to one vote for each full Share held. On the record date, there were 82,827,719 Common Shares, 3,048,019 Series A Preferred, 3,600 Series B Preferred, 4,320 Series C Preferred, 2,542,296 Series D Preferred, and 4,860 Series E Preferred, outstanding.

The following person was known to the Fund to be a beneficial owner of more than 5% of the Fund's outstanding Common Shares as of the record date:

<b><u>Name and Address of Beneficial Owner(s)</u></b>	<b><u>Title of Class</u></b>	<b><u>Amount of Shares and Nature of Ownership</u></b>	<b><u>Percent of Class</u></b>
<b>Morgan Stanley</b> 1585 Broadway New York, NY 10036	Common	5,023,689 (beneficial)	6.1%

As of the record date, there were no persons known to the Fund to be beneficial owners of more than 5% of the Fund's outstanding Preferred Shares.

**SUMMARY OF VOTING RIGHTS ON PROXY PROPOSALS**

<b><u>Proposal</u></b>	<b><u>Common Shareholders</u></b>	<b><u>Preferred Shareholders</u></b>
1. Election of Trustees	Common and Preferred Shareholders, voting together as a single class, vote to elect three Trustees: Mario J. Gabelli, CFA, Mario d Urso, and Michael J. Melarkey	Common and Preferred Shareholders, voting together as a single class, vote to elect three Trustees: Mario J. Gabelli, CFA, Mario d Urso, and Michael J. Melarkey
2. Other Business	Common and Preferred Shareholders, voting together as a single class	

In order that your Shares may be represented at the Meeting, you are requested to vote on the following matters:





## **PROPOSAL 1: TO ELECT THREE (3) TRUSTEES OF THE FUND**

### **Nominees for the Board of Trustees**

The Board consists of ten Trustees, seven of whom are not interested persons of the Fund (as defined in the Investment Company Act of 1940, as amended (the 1940 Act)). The Fund divides the Board into three classes, each class having a term of three years. Each year, the term of office of one class will expire. Mario J. Gabelli, CFA, Mario d Urso, and Michael J. Melarkey have each been nominated by the Board for election to serve for a three year term to expire at the Fund's 2016 Annual Meeting of Shareholders or until their successors are duly elected and qualified. Each of the Trustees of the Fund has served in that capacity since the October 23, 2003 organizational meeting of the Fund. All of the Trustees of the Fund are also directors or trustees of other investment companies for which Gabelli Funds, LLC (the Adviser) or its affiliates serve as investment adviser. The classes of Trustees are indicated below:

### **Nominees to Serve Until 2016 Annual Meeting of Shareholders**

Mario J. Gabelli, CFA

Mario d Urso

Michael J. Melarkey

### **Trustees to Serve Until 2015 Annual Meeting of Shareholders**

James P. Conn

Salvatore M. Salibello

Edward T. Tokar

### **Trustees to Serve Until 2014 Annual Meeting of Shareholders**

Anthony J. Colavita

Frank J. Fahrenkopf, Jr.

Anthonie C. van Ekris

Salvatore J. Zizza

Under the Fund's Declaration of Trust, Statements of Preferences, and the 1940 Act, holders of the Fund's outstanding Preferred Shares, voting as a separate class, are entitled to elect two Trustees, and holders of the Fund's outstanding Common Shares and Preferred Shares, voting together as a single class, are entitled to elect the remaining Trustees. The holders of the Fund's outstanding Preferred Shares would be entitled to elect the minimum number of additional Trustees that would represent a majority of the Trustees in the event that dividends on the Fund's Preferred Shares are in arrears for two full years. No dividend arrearages exist as of the date of this Proxy Statement. Messrs. Colavita and Conn are currently the Trustees elected solely by the holders of the Fund's Preferred Shares. Messrs. Colavita's and Conn's terms as Trustees are scheduled to expire at the Fund's 2014 and 2015 Annual Meetings of Shareholders,

respectively, and therefore they are not standing for election at this Meeting.

Unless instructions are provided to the contrary, it is the intention of the persons named in the proxy to vote the proxy FOR the election of the nominees named above. Each nominee has indicated that he has consented to serve as a Trustee if elected at the Meeting. If, however, a designated nominee declines or otherwise becomes unavailable for election, the proxy confers discretionary power on the persons named therein to vote in favor of a substitute nominee or nominees. Each nominee is qualified to serve as a Trustee under the Fund's governing documents.

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**Information about Trustees and Officers**

Set forth in the table below are the existing Trustees, including those Trustees who are not considered to be interested persons, as defined in the 1940 Act (the Independent Trustees), three of whom are nominated for reelection to the Board of the Fund, and officers of the Fund, including information relating to their respective positions held with the Fund, a brief statement of their principal occupations and, in the case of the Trustees, their other directorships during the past five years (excluding other funds managed by the Adviser), if any.

<b>Name, Position(s) Address<sup>(1)</sup> and Age</b>	<b>Term of Office and Length of Time Served<sup>(2)</sup></b>	<b>Principal Occupation(s) During Past Five Years</b>	<b>Other Directorships Held by Trustee During Past Five Years</b>
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**INTERESTED****TRUSTEES/NOMINEES<sup>(4)</sup>:**

<b>Mario J. Gabelli</b> Chairman and Chief Investment Officer Age: 70	Since 2003*	Chairman, Chief Executive Officer, and Chief Investment Officer - Value Portfolios of GAMCO Investors, Inc. and Chief Investment Officer - Value Portfolios of Gabelli Funds, LLC and GAMCO Asset Management Inc.; Director/Trustee or Chief Investment Officer of other registered investment companies in the	Director of Morgan Group Holdings, Inc. (holding company); Chairman of the Board and Chief Executive Officer of LICT Corp. (multimedia and communication services company); Director of CIBL, Inc. (broadcasting and wireless communications); Director of RLJ Acquisition, Inc. (blank check company) (2011-2012)
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Gabelli/GAMCO  
Funds Complex;  
Chief Executive  
Officer of GGCP,  
Inc.

**Salvatore M. Salibello** Since 2003\*\*  
Trustee  
Age: 67

Certified Public Accountant and Former Managing Partner of the certified public accounting firm of Salibello & Broder LLP (1978- 2012); Partner of BDO Seidman, LLC since 2010

Director of Kid Brands, Inc. (group of companies in infant and juvenile products) and until September 2007, Director of Brooklyn Federal Bank Corp., Inc. (independent community bank)

**Edward T. Tokar** Since 2003\*\*  
Trustee  
Age: 65

Senior Managing Director of Beacon Trust Company (trust services) since 2004; Chief Executive Officer of Allied Capital Management LLC (1997-2004); Vice President of Honeywell International Inc. (1977-2004)

Director of CH Energy Group (energy services); Director of DB Hedge Strategies Fund through March 2007; Director of Topiary Fund for Benefit Plan Investors (BPI) LLC through December 2007; Director, Teton Advisors, Inc. (financial services 2008-2010)

**INDEPENDENT**

**TRUSTEES/NOMINEES<sup>(5)</sup>:**

**Anthony J. Colavita<sup>(6)(7)</sup>** Since 2003\*\*\*  
Trustee  
Age: 77

Anthony J. Colavita, P.C., Attorney at Law from 1961 to date

**James P. Conn<sup>(6)</sup>** Since 2003\*\*  
Trustee  
Age: 75

Former Managing Director and Chief Investment Officer of Financial Security Assurance

Director of First Republic Bank (banking) through January 2008 and Director of La Quinta Corp. (hotels) through

Holdings, Ltd. January 2006  
 (insurance  
 holding  
 company)  
 (1992-1998)

**Mario d Urso** Since  
 Trustee 2003\*  
 Age: 72

Chairman of  
 Mittel Capital  
 Markets S.p.A.  
 (2001-2008);  
 Senator in the  
 Italian Parliament  
 (1996-2001)

**Frank J. Fahrenkopf, Jr.** Since  
 Trustee 2003\*\*\*  
 Age: 73

President and Director of First  
 Chief Executive Republic Bank  
 Officer of the (banking)  
 American  
 Gaming  
 Association;  
 Co-Chairman of  
 the Commission  
 on Presidential  
 Debates; Former  
 Chairman of the  
 Republican  
 National  
 Committee  
 (1983-1989)

**Michael J. Melarkey** Since  
 Trustee 2003\*  
 Age: 63

Partner in the law Director of  
 firm of Avansino, Southwest Gas  
 Melarkey, Corporation  
 Knobel, Mulligan (natural gas  
 & McKenzie; utility)  
 Owner in Pioneer  
 Crossing Casino  
 Group

&g if such Broker-Dealer remains the Existing Holder of the s  
 the case of all transfers other than pursuant to Auctions, the B  
 Auction Agent of such transfer. DESCRIPTION OF COMM  
 unlimited number of Common Shares, par value \$.01 per share  
 liquidation. Common Shares are fully paid and, subject to mat  
 no preemptive, conversion rights or rights to cumulative voting  
 receive any distributions from the Fund unless all accrued divi  
 with respect to MuniPreferred shares would be at least 200% a  
 Under Massachusetts law, shareholders could, under certain ci  
 contains an express disclaimer of shareholder liability for debt  
 agreement, obligation or instrument entered into or executed b  
 property of the Fund for all loss and expense of any sharehold  
 financial loss on account of shareholder liability is limited to c



circumstances the Fund will make payments to MuniPreferred Dividends and Dividend Periods -- Gross-Up Payments." The result in capital gain or loss to shareholders. Present law taxes For non-corporate taxpayers, under current law short-term cap will generally be taxed at a maximum rate of 20%. Because of higher income taxpayers, the effective rate of tax may be high Fund held for six months or less are disallowed to the extent of disallowed, such losses are treated as long-term capital losses. In certain circumstances, a shareholder's holding period may have been diminished as a result of holding one or more other positions in the Fund. Any loss on a sale or exchange of shares of the Fund will be disallowed if the sale or exchange begins beginning 30 days before and ending 30 days after the date of the sale or exchange, adjusted to reflect the disallowed loss. Although dividends generally are payable to shareholders of record on a specified date in one of the Fund (and received by the shareholders) on December 31 of the year, and certain other payments paid to non-corporate holders of the Fund (in the case of individuals, their social security number) and certain other information contains a more detailed summary of the federal tax rules that apply to change the tax rules that apply to the Fund or its shareholders. For more information on income tax matters. CALIFORNIA TAX MATTERS The Fund's income tax matters are paid out of income earned on obligations that, when held by the Fund, are obligations of California and its political subdivisions) or federal obligations of the Fund's total assets consist of such obligations. The portion of the Fund's total assets preceding sentence will be subject to the California income tax. The Fund is subject to California personal income taxes to the extent the Fund has income and realize a capital gain on the transaction. Please refer to the Fund's tax advisor. CUSTODIAN, TRANSFER AGENT, DIVIDEND DISTRIBUTION AGENT Chase Manhattan Bank, P.O. Box 660086, Dallas, Texas 75266. The Fund's transfer, shareholder services and dividend paying agent is Nuveen Bank, 10006, a banking corporation organized under the laws of New York. The Fund's registrar, dividend disbursing agent and redemption agent will be the underwriters named below. Subject to the terms and conditions set forth below has agreed to purchase, and the Fund has agreed to sell the Fund's shares to the underwriter. NUMBER OF SHARES ----- NAME Nuveen Investments..... 314 314 Deutsche Bank AG..... 314 314 Merrill Lynch, Pierce, Fenner & Smith Incorporated.. Warburg LLC..... 314 314 ----- T provides that the obligations of the underwriters to purchase the Fund's shares on the conditions. The underwriters are obligated to purchase all the Fund's shares directly to the public at the public offering price set forth in the prospectus, a concession not to exceed \$137.50 per share. The sales load to be borne by the underwriters, allow, and dealers may reallow, a concession not to exceed \$3.00 per share above the public offering price and the other selling terms. Investors should refer to the prospectus dated 2001. The Fund anticipates that the underwriters may from time to time be underwriters. The underwriters are active underwriters of the Fund and may be expected to engage in portfolio transactions with, and perform other services under the Act. The Fund anticipates that the underwriters or one of their agents may be expected to act forth under "The Auction" and in the statement of additional information. The Fund and Nuveen Advisory have agreed to indemnify the underwriters and their agents. The Fund anticipates that the underwriters may be required to make payments to the underwriters may be required to make payments to the underwriters. The Fund's principal office is located at 100 Greenwich Street, New York, New York 10013. The settlement





SECURITIES UBS WARBURG -----

OF ADDITIONAL INFORMATION This statement of additional information is provided in conjunction with the prospectus relating thereto dated May 16, 2007. An investor should consider this statement of additional information in conjunction with the prospectus relating thereto dated May 16, 2007 before purchasing shares of MuniPreferred Shares. A copy of the prospectus may be obtained without charge from the Fund. The terms used in this statement of additional information have the meanings ascribed to them in the prospectus.

Objectives.....

Investment Policies and Techniques.....

Fund.....S-

Value.....

MuniPreferred.....S-18 Certain Provisions

Shares; Conversion to Open-End Fund.....

OBJECTIVES The Fund's investment objective is to provide a return on investment relative to the municipal bond market by investing in tax-exempt municipal bonds that Nuveen Advisory believes are underrated or undervalued or that represent municipal bonds that Nuveen Advisory believes will be based on Nuveen Advisory's belief that the Fund's investment risk and other forms of risk, and that their prices will ultimately reflect their value relative to the municipal bond market by prudent selection of investments. The value realized by the Fund will generally result in the distribution of income to investors. The investment objectives are fundamental policies of the Fund. The Fund will invest in municipal bonds subject to the alternative minimum tax provisions of the Internal Revenue Code that will be includable in alternative minimum taxable income. MuniPreferred Shares will not be subject to the federal alternative minimum tax or who would become subject to the federal alternative minimum tax. The yield on MuniPreferred shares will depend upon a comparison of the after-tax yield like the yield on investments subject to the alternative minimum tax, and from comparable fully taxable investments. See "Tax Matters." INVESTMENT RESTRICTIONS The Fund will not acquire securities if the holders of a majority of the outstanding Common Shares and MuniPreferred Shares vote to restrict the Fund from acquiring securities. The Fund will not acquire securities if the holders of a majority of the outstanding MuniPreferred shares voting as a separate class: 1. Purchase securities from banks for temporary or emergency purposes or for repurchase agreements; 2. Purchase securities from assets (including the amount borrowed) less the Fund's liabilities; 3. Purchase securities if the Fund may be deemed to be an underwriter within the meaning of the Securities Act of 1933; 4. Invest more than 25% of its total assets in securities of issuers that are not municipal bonds backed only by the assets and revenues of a governmental entity; 5. Purchase securities from the Fund from investing in municipal bonds secured by real estate mortgages; 6. Purchase securities from commodities unless acquired as a result of ownership of securities; 7. Purchase securities from contracts, derivative instruments or from investing in securities; 8. Purchase any securities (other than obligations issued or guaranteed by a governmental entity) if more than 10% of the Fund's total assets would then be invested in securities of that issuer; provided that, with respect to securities of any single issuer, "majority of the outstanding shares" means a majority of the shares present at a meeting, if the holders of more than 50% of the shares are present at a meeting; 9. Purchase securities from a non-governmental issuer if the issuer is a non-governmental issuer and its securities are not backed by the assets and revenues of a governmental or other entity (other than a bond insurer), it shall not be deemed to be the sole issuer of the security. Where a security is guaranteed by a governmental

credit would be considered a separate security and would be treated as insurance, it shall not be considered a security that is issued or sold with the principles set forth above. The foregoing restrictions shall apply to any given insurer. Under the Investment Company Act of 1940, the Fund may invest in companies and only up to 5% of its total assets in any one investment company acquired investment company at the time such shares are purchased, the investment company's expenses, and would remain subject to the Fund's Common Shareholders would therefore be subject to duplication of interest. Other investment companies may also be leveraged and will therefore be subject to the section entitled "Risks," the net asset value and S-2 42 market value of the Fund more than the yield generated by unleveraged shares. In addition, the Fund has non-fundamental restrictions and policies, which may be changed from time to time, the right to obtain securities equivalent in kind and amount to the Fund's investment on futures contracts, or other derivative instruments are not dependent on the Fund's companies except in compliance with the Investment Company Act of 1940. Options or forward contracts, if more than 30% of the Fund's net assets are committed to initial margin deposits and premiums on futures contracts, and so long as MuniPreferred Shares are outstanding. 5. Purchase of securities (which are securities that pay interest at rates that vary with the leveraged investment in an underlying municipal bond). The Fund's net assets will not be considered violated unless an excess or deficiency of the Fund's net assets. POLICIES AND TECHNIQUES The following information shall be provided to the Fund as described in the prospectus. INVESTMENT IN MUNICIPAL BONDS The Fund invests in bonds that are exempt from regular federal and California income taxes. The Fund expects to be fully invested (at least 95% of its assets) in municipal bonds that are exempt from regular federal income taxes. Not more than 10% of the Fund's investment income during that time may be invested in municipal bonds that at the time of investment are investment grade (as defined by BBB or better by Moody's, S&P or Fitch) or bonds that are unsecured. Not more than 10% of its net assets in municipal bonds that are, at the time of investment, below investment grade. Nuveen Advisory. Bonds of below investment grade quality (as defined by Moody's) are not regarded as having current capacity to make principal and interest payments. They may affect such payment capacity. Municipal bonds rated Baa or Baa-1 are not investment grade obligations which lack outstanding investment character. They do not have adequate capacity to pay principal and interest. Municipal bonds that are not insured by insurance guaranteeing the timely payment, when due, of all payments. Bonds that are considered predominately speculative with respect to their ability to pay, therefore, carry greater investment risk, including the possibility of default. Lower investment grade tend to be less marketable than higher-quality bonds. The Fund's portfolio is narrower. During periods of thin trading in these markets, the Fund may experience difficulty selling its portfolio securities. The Fund will be more dependent on the description of Moody's, S&P's and Fitch's ratings of municipal bonds. The Fund's opinions as to the quality of the municipal bonds they rate. It shall not be considered violated. Consequently, municipal bonds with the same maturity, coupon rate and different ratings may have the same yield. The Fund will primarily invest in bonds with a maturity of 15-30 years, but the average weighted maturity of the Fund's portfolio at any given time may include both long-term and short-term bonds when, in Nuveen Advisory's opinion, temporary imbalances of the market exist. The price at which long-term or intermediate-term municipal bonds are sold, which the net proceeds of the offering are being invested, the Fund may invest in short-term securities that may be either tax-exempt or taxable.

invest primarily in municipal bonds of the type in which the Fund believes that suitable tax-exempt short-term investments are not available. The Fund may invest in municipal bonds issued by state and local governmental issuers, such as tax-exempt municipal bonds maturing in three years or less from the date of purchase or carry a variable or floating rate of interest. The Fund may also invest in investments which are U.S. Government securities or securities in the S-4 44 categories. Taxable short-term investments of the Fund may include commercial paper or corporate notes, bonds or debentures with "Repurchase Agreements and Techniques -- Repurchase Agreements." To the extent the Fund invests in taxable short-term investments, the investment objective of tax-exempt income. The foregoing policy does not mean that the Fund will not be required to dispose of securities in the event of a market decline. Nuveen Advisory seeks to enhance portfolio value relative to the market, overvalued or undervalued or that represent municipal market sectors that, in its opinion, reflect their true creditworthiness. Undervalued municipal bonds may be sold in the marketplace. Nuveen Advisory may at times believe that municipal bonds issued by a particular municipal issuer, are undervalued. Nuveen Advisory may also invest in municipal bonds issued by a particular municipal issuer that Nuveen Advisory considers undervalued, even if the bonds are of particular types or purposes (e.g., hospital bonds, industrial revenue bonds) because of a temporary excess of supply in that market sector, or because of a temporary shortage of demand. Nuveen Advisory's belief that their yield is higher than that available in the market, that their prices will ultimately rise (relative to the market) to a level that justifies the investments that may be invested in municipal bonds subject to the Fund's investment objective. A substantial portion of the current income it produces will be in taxable form. See "Tax Matters." Also included within the general category of municipal bonds are installment purchase contract obligations (hereinafter collectively referred to as "Lease Obligations"). A Lease Obligation does not constitute a general obligation of the issuer, but is ordinarily backed by the municipality's covenant to budget for the payment of such obligations. Municipal Lease Obligations contain "non-appropriation" clauses which require payments in future years unless money is appropriated for such payments. Nuveen Advisory believes that payments under the lease in the event of non-appropriation or default will be made by the lessee, and disposition or releasing of the property might provide a source of funds where Nuveen Advisory believes the issuer has a strong incentive to make such payments during temporary defensive periods and in order to keep the Fund's investment objective being invested, the Fund may invest up to 100% of its net assets in such obligations or taxable. To the extent the Fund invests in taxable short-term investments, the investment objective of seeking current income exempt from regular federal income tax. Municipal bonds are subject to the provisions of bankruptcy, including the provisions of the Bankruptcy Act of 1978. In addition, the obligations of such issuers may be subject to suspension at the time for payment of principal or interest, or both, or imposition of a moratorium. It is also the possibility that, as a result of legislation or other circumstances, the value of municipal bonds may be materially affected. The Fund also may invest in municipal bonds of the type in which the Fund believes that suitable tax-exempt short-term investments are not available at reasonable prices and yields. Short-term taxable investments may include U.S. government securities, including bills, notes and bonds differing in maturity from U.S. government agencies or instrumentalities. U.S. government securities are supported by the full faith and credit of the United States.

Valley Authority, whose securities are supported by the right of first refusal, and other securities are supported by the discretionary authority of the U.S. Treasury Department. Loan Marketing Association, whose securities are supported by the full faith and credit of the U.S. government-sponsored agencies or instrumentalities, no assurance is given that government-sponsored agencies, and instrumentalities do not guarantee the market value of the securities. Deposit issued against funds deposited in a bank or a savings and loan association and are normally negotiable. The issuer of a certificate of deposit is insured by the FDIC thereon. Under current FDIC regulations, the maximum insurance coverage provided by the Fund may not be fully insured. S-6 46 (3) Repurchase agreement. Pursuant to a repurchase agreement, it simultaneously agrees to sell and repurchase securities at a fixed price and time. This assures a predetermined price and reflects an agreed-upon market rate. Such agreements are limited to repurchase agreements only with respect to obligations of the Fund in which the Fund may invest. Repurchase agreements may be limited to the ability of the seller to pay the agreed-upon sum or to the ability to sell the underlying collateral. If the value of the collateral falls below the agreed-upon sum, the Fund is entitled to sell the underlying collateral. If the value of the collateral is less than the agreed-upon sum, the Fund's adviser monitors the value of the collateral at the time the action is taken and does so in an effort to determine that the value of the collateral is sufficient to cover the debt. If a federal bankruptcy proceeding, the ability of the issuer to pay may be subject to a federal bankruptcy proceeding, the ability of the issuer to pay may be subject to bankruptcy laws. (4) Commercial paper, which consists of short-term debt issued by corporations to finance their current operations. Master demand notes are issued in the market for such notes. However, they are redeemable by the Fund at any time. The Fund's power, cash flow, and other liquidity ratios) and will continue to be subject to the Fund's liquidity might be impaired if the corporation were unable to pay. Commercial paper rated in the highest categories by a major rating agency. (5) SHORT-TERM TAX-EXEMPT FIXED INCOME SECURITIES. These securities are exempt from income tax and mature within three years or less from the date of issue. The following: Bond Anticipation Notes ("BANs") are usually issued by state and local governments for projects that will eventually be funded through the sale of bonds. They are primarily dependent on the issuer's access to the long-term municipal bond market for principal and interest on the BANs. Tax Anticipation Notes ("TANs") are issued by state and local governments. Repayment is generally to be derived from specific revenues, such as the capacity to raise taxes due to, among other things, a decline in revenues. Revenue on outstanding TANs. S-7 47 Revenue Anticipation Notes ("RANs") are issued from a designated source will be used to repay the notes. In general, they are repaid from revenues, such as anticipated revenues from another level of government. In addition, the possibility that the revenues would, when received, be insufficient to pay interest on RANs. Construction Loan Notes are issued to provide financing for construction projects obtained from the Federal Housing Administration. Bank Notes are issued by commercial banks as evidence of borrowings. The purposes for issuing these notes are for capital or capital-project needs. These notes may have risks similar to those of Commercial Paper") represents very short-term unsecured, negotiable promissory notes. The risks of issues of municipal paper may be made from various sources, such as state and local governments, than the maturities of TANs, BANs or RANs. There is a limited number of floating rates of interest whereby the rate of interest is not fixed to a tax-exempt money market index. While the various types of notes are available in the marketplace, and the Fund may invest in them, there are limitations. Such notes may be issued for different purposes and may be used to periodically engage in hedging transactions. Hedging is a term used to describe one investment through making another investment whose price

environments to partially hedge the portfolio against fluctuations as well as related put and call options on such instruments. Both 1% to 5% of the total contract price. Typically, option holders position in the future of the underlying security. The Fund will of the obligations. Rating agency guidelines may limit the Fund imperfect correlation between price movements in the futures hedge by the Fund may be greater than gains in the value of the circumstances. As a result, in volatile markets, the Fund may not deposit. Finally, the potential deposit requirements in futures securities the exposure is limited to the cost of the initial premium. Losses from transactions will be distributed as taxable distributions to shareholders (subsequent deposit) other than as necessary to close a prior investment would exceed 5% of the Fund's net assets. The Fund will invest in liquid. Successful implementation of most hedging strategies will provide further information regarding these investment strategies and risks. **PERTAINING TO CALIFORNIA** Factors pertaining to California **ILLIQUID SECURITIES** The Fund may invest in illiquid securities (securities the disposition of which is restricted under the federal Securities Act of 1933, as amended (the "Securities Act"); and repurchase agreements negotiated transactions or in a public offering with respect to which the Fund may be obligated to pay all or part of the registration expenses. The Fund may be permitted to sell a security under an effective registration might obtain a less favorable price than that which prevailed when the Board of Trustees or its delegate. **PORTFOLIO TRADING AND** of the Fund in relation to actual and anticipated movements in interest rates approximately the same time to take advantage of what Nuveen anticipates. Disparities between two comparable securities may result from market conditions cause a temporarily low price for such bonds, as compared with short-term trading consistent with its investment objectives. Securities in anticipation of a market rise (a decline in interest rates) and later the Fund will attempt to achieve its investment objectives by prudent management. Without assurance thereof, the Fund anticipates that its annual portfolio turnover will be a limiting factor when the Fund deems it desirable to sell or purchase securities. The Fund may exceed 100% in particular years. **OTHER INVESTMENTS** The Fund may invest in companies that invest primarily in municipal bonds of the type in which the Fund invests either during periods when it has large amounts of cash or Common Shares or MuniPreferred Shares, or during periods when it is not a shareholder in an investment company, the Fund will bear its proportionate share of the Fund's management, advisory and administrative fees with respect to such investments to the extent the Fund invests in other investment companies. Nuveen's investment in the investment company relative to available municipal bonds will therefore be subject to the same leverage risks described herein. The Fund's share of the shareholdings will tend to fluctuate more than the yield generated by the Fund. The Fund may buy and sell municipal bonds on a when-issued or delivery-versus-payment trade date. On such transactions the payment obligation and the Fund enters into a commitment to purchase securities on a when-issued basis. The Commission to maintain in a separate account liquid assets, commensurate with and equal to the amount of the commitment. Income generated by the Fund will be taxable income of the Fund and, to the extent distributed, will be subject to taxes. The Fund may collateralize such obligations with a security that is expected

The commitment to purchase securities on a when-issued, delivered prior to settlement and at the time of delivery the market value to invest in repurchase agreements. A repurchase agreement is a contract (bonds) agrees to repurchase the same security at a specified price during the Fund's holding period. Repurchase agreements are contracts. Income generated from transactions in repurchase agreements, if any, between Common Shares and MuniPreferred Securities of domestic banks that, in the opinion of Nuveen Advisory, present an agreed-upon repurchase price on the delivery dates; however, if the value of the collateral or exceeds the agreed-upon repurchase price, if the value of the collateral may be sold but the Fund might incur a loss if the value of the collateral liquidating the collateral. In addition, if bankruptcy proceedings may be delayed or limited. Nuveen Advisory will monitor the value of the term of the repurchase agreement in an effort to determine that the collateral declines below the repurchase price, Nuveen Advisory will pay the interest of the repurchase price, including interest. ZERO COUPON BONDS pay no interest for its entire life. The market prices of zero coupon bonds may be more volatile in price than securities that pay interest periodically. If such interest, it may have to dispose of portfolio securities to the extent amounts necessary to avoid unfavorable tax consequences. S-12 52 POSITIONS AND THE FUND PAST FIVE YEARS

Chairman and Director (since July 1996) of The John 333 West Wacker Drive Chicago, IL 60606 Corp. and Nuveen Institutional Advisory Company Investments; Director (since 1992) and Chairman (since 1996) of Nuveen January 1997) of Nuveen Asset Management, Inc.; Director (since 1999) of Services Inc. (since 1999); Chief Executive Officer (since September 1999) Private Investor and Management Consultant. 3725 Huntington Avenue Senior Vice President of The 201 Michigan Avenue Northern Trust Company 1998) of Manitoga (Center for 3 West 29th Street Russel Wright Blanton-Peale Institutes of Religion and Health (since December 1999) Trustee Adjunct Professor of Business and Economics, University of Illinois 60093 Lake Forest Graduate School of Management, Lake Forest, IL Certified Management Consultant. S-12 52 POSITIONS AND THE FUND PAST FIVE YEARS -----  
Trustee Senior Partner and Chief Operating Officer, 4000 Mill Creek Road development and contract Dayton, OH 45401 company; Member of Cleveland Federal Reserve Bank. Judith M. Stockdale 12/29/41 (since 1994); prior thereto, Executive Suite 2600 Director, General Counsel President and Senior Vice President and General Counsel (since 1999) The Chicago, IL 60606 John Nuveen Company, Nuveen Investments Secretary (since September 1999) of Nuveen Senior Loan Management Vice President and Vice President of Nuveen Investments (since 1997) Chicago, IL 60606 January 1997); formerly, Associate of Nuveen Asset Management Inc.; Chartered Financial Analyst. Michael S. D'Amico Wacker Drive 1997); prior thereto, Vice President and Portfolio



million to \$500 million..... .6250% \$500 million to \$1 billion  
 ----- (1) Including net assets attributable to MuniPreferred  
 investors. The investment management agreement has been ap  
 the first ten years of the Fund's operation, Nuveen Advisory ha  
 periods, set forth below: PERCENTAGE PERCENTAGE RE  
 PERCENTAGE OF MARCH 31, AVERAGE DAILY NET AS  
 ----- 2001(2)..... .30% 2007 .25% 2002...  
 2011 .05% 2006..... .30% ----- (1) Including net assets  
 expenses in this manner will tend to increase the amount of inc  
 for any portion of its fees and expenses beyond March 31, 201  
 entities have adopted codes of ethics which essentially prohibi  
 investments which compete or interfere with, or attempt to tak  
 designed to assure that the interests of clients, including Fund  
 transactions. Text-only versions of the codes of ethics can be v  
 www.sec.gov. You may also review and copy those document  
 Public Reference Room may be obtained by calling the SEC a  
 appropriate duplicating fee by writing to the SEC's Public Ref  
 publicinfo@sec.gov. PORTFOLIO TRANSACTIONS Nuveen  
 the Fund's securities business, the negotiation of the prices to b  
 securities will normally be purchased directly from an underw  
 that a better price or execution may be obtained through other  
 with the 1940 Act. The Fund expects that substantially all port  
 not expect to pay any brokerage commissions. Purchases from  
 purchases from dealers will include the spread between the bid  
 policy of Nuveen Advisory to seek the best execution under th  
 financial condition, reputation and responsiveness of the deale  
 Nuveen Advisory's practice to select dealers which, in addition  
 statistical and other services to Nuveen Advisory. It is not pos  
 Since it is only supplementary to Nuveen Advisory's own rese  
 Advisory's expenses. While Nuveen Advisory will be primaril  
 Advisory in this regard must be consistent with the foregoing  
 manage other investment accounts and investment companies  
 laws and regulations, Nuveen Advisory seeks to allocate portf  
 Fund and another advisory account. In making such allocation  
 portfolio holdings of the same or comparable securities, the av  
 procedure could have a detrimental effect on the price or amou  
 that the benefits available from Nuveen Advisory's organizatio  
 the 1940 Act, the Fund may not purchase portfolio securities f  
 set forth in Rule 10f-3. The rule sets forth requirements relatin  
 of municipal bonds which may be purchased in any one issue  
 made pursuant to the terms of the Rule must be approved at le  
 interested persons of the Fund. S-17 57 NET ASSET VALUE  
 Eastern time) on each day the New York Stock Exchange is op  
 including interest or dividends accrued but not yet collected, le  
 nearest cent, is the net asset value per share. In determining ne  
 quotations are available are valued at market value. The prices  
 asked price. When price quotes are not readily available (whic  
 prices of comparable municipal bonds. All valuations are subj  
 INFORMATION CONCERNING THE AUCTIONS FOR MU  
 Agency Agreement (the "Auction Agency Agreement") with t  
 Auction Agent will follow the Auction Procedures for purpose



Applicable Rate for shares of such series is to be based on the more Broker-Dealers. The Auction Agent has entered into agreements with the Fund, which provide for the participation of those Broker-Dealers. The Depository Trust Company ("DTC") will act as the Securities Depository for all of the shares of each series of MuniPreferred Shares. Each certificate for all of the shares of each series of MuniPreferred Shares will bear a legend to the effect that such certificate is issued subject to the terms of the Fund's Declaration of Trust. The Auction Agent will also issue stop-transfer instructions to the transfer agent to prevent the transfer of preferred shares to elect a majority of the Fund's trustees, as determined by the holder of record of all shares of each series of MuniPreferred Shares. The Auction Agent has an interest in such shares. DTC, a New York-chartered limited partnership, is the person to whom (and/or their representatives) own DTC. DTC maintains a list of all participants (the "Agent Member") in shares of MuniPreferred Shares. The Auction Agent is acting as agent for the Fund. The Auction Agent will not be liable for any action taken, suffered, or omitted in accordance with the Agreement and will not be liable for any error of judgment made in connection with the Auction. The Auction Agent may rely upon, as evidence of the identities of the participants, the results of Auctions and notices from any Broker-Dealer (or any participant in the Secondary Market Trading and Transfer of MuniPreferred Shares) received for an Auction unless it is received by the Auction Agent by 3:00 p.m. on the day of the Auction. The Auction Agent may terminate the Auction Agency Agreement upon notice to the Fund. The Auction Agent will use its best efforts to enter into an agreement with a successor Auction Agent. The Fund may remove the Auction Agent provided it enters into an agreement with a new Auction Agent. BROKER-DEALERS The Auction Agent after the Auction will charge the Fund, a service charge at the annual rate of 1/4 of 1% in the case of an Auction, as agreed to by the Fund and the Broker-Dealers in the case of an Auction. The Auction Agent will use its best efforts to place of MuniPreferred Shares placed by such Broker-Dealer at such Auction. The Auction Agent will not be a Broker-Dealer if such shares were (a) the subject of Hold Orders for Delivery, (b) the subject of such Broker-Dealer for its own account or were acquired by such Broker-Dealer that is (i) a Submitted Bid of an Existing Holder of MuniPreferred Shares or (ii) a Submitted Bid of a Potential Holder that resulted in such Broker-Dealer becoming a Holder of MuniPreferred Shares. The Fund may request the Auction Agent to terminate one or more Broker-Dealers in effect after such termination. The Broker-Dealer Agreement provides that the Auction Agent will not be liable for its own account, unless the Fund notifies all Broker-Dealers that it is terminating their Hold Orders for their own accounts. Any Broker-Dealer that is an agent of the Fund. If a Broker-Dealer submits an Order for its own account in any Auction, the Auction Agent will not be liable for the obligations of the Fund. However, the Declaration of Trust requires that notice of such limited liability be given in each Auction. The Declaration further provides for indemnification out of the assets of the Fund for the obligations of the Fund. Thus, the risk of a shareholder incurring obligations of the Fund would be unable to meet its obligations. The Fund believes that the Auction Agent will not limit the ability of other entities or persons to acquire control of the Fund. The Fund is a Common Shares and MuniPreferred Shares, voting together as a single class of shares of an open-end investment company, (2) a merger or consolidation of the Fund with another organization or a reorganization or recapitalization of the Fund, (3) the sale of the Fund's assets (other than in the regular course of the Fund's investment management), (4) (5) removal of trustees, and then only for cause, unless, with the approval of a two-thirds of the total number of trustees fixed in accordance with the Declaration, a majority of the Fund's Common Shares and MuniPreferred Shares vote in favor, where only a particular class or series is affected (or, in the case of a

the applicable class or series will be required. Approval of shares of the Fund in connection with a reorganization or otherwise whereby the Fund issues shares in connection with the formation of an investment company or similar entity. None of the foregoing provisions shall apply to the MuniPreferred Shares, voting together as a single class. In the event of any of the foregoing transactions constituting a plan of reorganization which requires the affirmative vote of the holders of at least two-thirds of the Fund's Common Shares, the affirmative vote of the holders of at least two-thirds of the total number of shares of the Fund authorized by the affirmative vote of two-thirds of the total number of shares of the Fund, and the affirmative vote of a majority of the holders of at least a majority of the Fund's MuniPreferred Shares, shall be required to convert the Fund from a closed-end to an open-end investment company. The terms and conditions of MuniPreferred Shares are higher than those required by the terms and conditions of the Common Shares. The votes are in the best interest of the Fund and its shareholders. For the full text of these provisions. The Declaration provides that the Fund shall not use the assets and property of the Fund, and that the trustees shall not be liable for the protection of a S-20 60 trustee against any liability to which he would be subject in the event of disregard of the duties involved in the conduct of his office. The Fund is a closed-end investment company and as such its shareholdings will trade in the open market at a price that will be a function of many factors including call protection, price, dividend stability, relative demand for and supply of shares. Because shares of a closed-end investment company may frequently trade at a discount to net asset value, that, at least annually, it will consider action that might be taken to increase the price, which may include the repurchase of such shares in the open market or the conversion of the Fund to an open-end investment company. The Fund may also make share repurchases or tender offers, if undertaken, will reduce the net asset value of the Fund. If MuniPreferred Shares are outstanding, the Fund may not purchase, redeem or tender shares unless the consideration to be paid has been paid and (2) at the time of such purchase, redemption or tender, the net asset value (price of the Common Shares) is at least 200% of the liquidation value (net asset value per share plus any accrued and unpaid dividends thereon). Any such purchase, redemption or tender will not reduce the stated consideration to be paid to tendering shares or to make a tender offer. Interest on any borrowings to fund such purchases or tenders will reduce the Fund's net income. Any such purchase, redemption or tender will have to comply with the Securities Exchange Act of 1934, as amended, and any such action in response to a discount from net asset value will be subject to the approval of the Board, which may be changed by the Board, not to authorize repurchases of shares of the Fund which would result in the delisting of the Common Shares from the American Stock Exchange. The Internal Revenue Code of 1986, as amended (which would make the Fund ineligible for the taxation of shareholders who receive dividends from the Fund) and the Fund's ability to liquidate portfolio securities in an orderly manner and to pay dividends to shareholders is, in the Board's judgment, any (a) material legal action or proceeding which would materially affect the Fund, (b) general suspension of or limitation on payment of dividends by federal or state authorities or any suspension of payment by the issuers of its portfolio securities by federal or state authorities, (c) general suspension of or limitation on payment of dividends by federal or state authorities, (d) commencement of war, armed hostilities or other international events, or (e) any other condition which would have a material adverse effect (including the suspension of the Fund's ability to pay dividends). Trustees of the Fund may in the future modify these conditions. The affirmative vote of at least two-thirds of the Fund's Common Shares and MuniPreferred Shares, voting together as a single class, is required for the conversion of the Fund to an open-end company. The affirmative vote of two-thirds of the Fund's MuniPreferred Shares outstanding at the time of the conversion will be required to vote if the action in question has previously been approved, and the affirmative vote of a majority of the holders of at least a majority of the Fund's MuniPreferred Shares, voting together as a single class, in accordance with the Declaration or By-laws. See the prospectus for the Fund for the terms and conditions applicable to conversion of the Fund to an open-end company. If the Fund is converted to an open-end company, the MuniPreferred Shares then outstanding, and the Fund's Common Shares would be subject to the terms and conditions of the open-end company and the open-end company may require the company to redeem their shares on a

asset value, less such redemption charge, if any, as might be in  
favorable investments to meet redemptions, open-end compan  
periodic asset in-flows and out-flows that can complicate portf  
to an open-end company depending upon their judgment as to  
its shares at prices below net asset value will result in an incre  
that share repurchases or tenders at or below net asset value w  
the Fund's shares may be the subject of repurchase or tender o  
may reduce any spread between market price and net asset val  
the Fund's total assets which would likely have the effect of in  
MuniPreferred Shares are outstanding will increase the leverag  
action if the Fund's Common Shares trade below net asset valu  
discount, the liquidity of the Fund's portfolio, the impact of an  
considerations, even if the Fund's shares should trade at a disc  
action should be taken. TAX MATTERS FEDERAL INCOME  
Vedder, Price, Kaufman & Kammholz, special counsel to the  
as amended (the "Code"), as a regulated investment company  
are attributable to interest on Municipal Obligations to be exer  
the alternative minimum tax. To qualify under Subchapter M f  
to its shareholders at least 90% of the sum of (i) its investment  
deduction for dividends paid) and (ii) its net tax-exempt incom  
diversify its holdings so that, at the end of each fiscal quarter o  
U.S. government securities, securities of other regulated invest  
issuer, to an amount not greater in value than 5% of the Fund's  
more than 25% of the market value of the Fund's assets is inve  
regulated investment companies) or two or more issuers contr  
requirements of Subchapter M of the Code, the Fund may be r  
and Techniques" and "Other Investment Policies and Techniqu  
regulated investment company, the Fund would incur a regular  
shareholders would be taxable to such holders as ordinary inco  
distribute, by the close of each calendar year, an amount equal  
for the one year period ending October 31 in such year, plus an  
required distribution for such calendar year over the distribut  
to make the required distributions of its ordinary taxable incom  
Fund intends to qualify to pay "exempt-interest" dividends, as  
that at the close of each quarter of its taxable year, at least 50%  
dividends or any part thereof (other than a capital gain divid  
Fund. Exempt-interest dividends will be exempt from federal i  
proceeds received by the Fund under any insurance policies in  
generally be excludable from federal gross income under Secti  
be no assurance that payments made by the issuer representing  
income for federal income tax purposes. See "Investment Polic  
municipal obligations acquired after April 30, 1993 are treated  
taxable temporary investments and net short-term capital gains  
the Fund of net capital gain (i.e., the excess of net long-term ca  
the length of time the shareholder has owned Common Shares  
of S-23 63 MuniPreferred will depend upon the amount of suc  
paid on shares of MuniPreferred which include an allocable po  
on shares of its MuniPreferred will constitute exempt-interest  
profits will first reduce the adjusted tax basis of a shareholder'  
(assuming the shares are held as a capital asset). As long as the  
shareholders will qualify for the dividends- received deduction

regulated investment company that has two or more classes of dividends per year based upon the percentage of total dividends distributed to each class, tax-exempt interest, net capital gain and other taxable income, and is paid to each class with respect to such year. To the extent permitted by law, the Fund will make certain payments to owners of shares of its MuniPreferred class, consistent with the objectives of the Fund. The Fund will, in the case of any other Special Rate Period, notify the Auctioneer of the Fund's purposes to be included in any dividend on shares of its MuniPreferred shares during any Minimum Rate Period or any Special Rate Period of 28 days. For federal income tax purposes to a dividend paid on shares of MuniPreferred. See Statement solely by reason of the fact that such allocation is made to MuniPreferred or the liquidation of the Fund or (b) in the case of the Fund or other taxable income for regular federal income tax purposes. The Fund will make certain payments to owners of shares of its MuniPreferred shares described under "Description of MuniPreferred -- Dividends and Distributions" of the Fund's shares of MuniPreferred to be eligible to be treated as dividends for income tax purposes. Nuveen Advisory believes the shares of its MuniPreferred Fund's shares of MuniPreferred are outstanding the Fund fails to maintain MuniPreferred Asset Coverage, the Fund will be required to suspend distributions to owners until such time as it is restored. See "Description of MuniPreferred -- Dividends and Distributions" to prevent the Fund from distributing at least 90% of its investment income (without regard to the deduction for dividends paid), and may be required to cause the Fund to incur a tax liability or a non-deductible 4% excise tax on the MuniPreferred Basic Maintenance Amount or the 1940 Act Maintenance Amount to maintain or restore such maintenance amount or asset S-24 coverage. The Fund, as a regulated investment company. There can be no assurance that the Fund will be able to on indebtedness incurred or continued to purchase or carry the Fund's shares of MuniPreferred the IRS for determining when borrowed funds are considered to be made with borrowed funds even if such funds may be considered to have been made with borrowed funds even if such funds are on private activity bonds in most instances is not federally tax-exempt. The Fund is not a "person" of such "substantial user." As a result, the Fund may not be considered a "related person" within the meaning of the Code. In general, a person is considered to be in his trade or business." "Related persons" are in general defined as persons who would result in a disallowance of losses in transactions among related persons (including corporations under the Code), including a partnership and each partner (and certain members of their families) and various combinations of related persons of the Code covering the definitions of "substantial user" and "related person" and is required to redeem shares of its MuniPreferred to the extent of the MuniPreferred Asset Coverage. Gain or loss, if any, resulting from the exchange of the shares of MuniPreferred under Section 302 of the Code is treated as essentially equivalent to a dividend, (b) is in complete redemption of the Fund or (d) with respect to non-corporate owners, is in partial liquidation of the Fund will be taken into account. Nonresident alien individuals and corporations are subject to withholding tax at the rate of 30% (or possibly a lower rate provided by treaty) on capital gain. To the extent received by foreign investors, exempt interest and disposition of the shares of MuniPreferred generally are exempt from federal income tax business in the United States or, in the case of an individual, is not a resident of the United States generally will be treated as distributed when paid, dividends distributed during one of those months and paid during the following January with respect to the end of the year declared. Certain of the Fund's investment practices may result in deductions or losses of the Fund and affect the holding period of the Fund's shares. Such provisions may also require the Fund to recognize income or g

satisfy the requirements for maintaining regulated investment  
 may make certain tax elections in order to mitigate the effect o  
 other disposition of Common Shares or shares of MuniPreferre  
 capital gain or loss to shareholders. Present law taxes both lon  
 non-corporate taxpayers, however, under current law short-ter  
 gains generally will be taxed at a maximum rate of 20%. How  
 applicable to higher income taxpayers, the effective rate of tax  
 shares of the Fund held for six months or less are disallowed t  
 if not disallowed, such losses are treated as long-term capital l  
 Under certain circumstances, a shareholder's holding period m  
 is diminished as a result of holding one or more other position  
 on a sale or exchange of shares of the Fund will be disallowed  
 beginning 30 days before and ending 30 days after the date of  
 adjusted to reflect the disallowed loss. Federal tax law impose  
 certain municipal obligations, such as bonds issued to make lo  
 universities and non-profit hospitals) is included as an item of  
 extent that the Fund receives income from municipal obligatio  
 otherwise exempt from federal income tax, will be taxable to i  
 The Fund will annually supply a report indicating the percenta  
 minimum tax. In addition, for certain corporations, alternative  
 income ("adjusted current earnings") and the amount otherwis  
 therefore all distributions by the Fund that would otherwise be  
 corporations are not subject to the alternative minimum tax. Ta  
 calculating the amount of social security and railroad retireme  
 withhold 31% of taxable dividends and certain other payments  
 taxpayer identification number (in the case of individuals, thei  
 withholding. S-26 66 The Code provides that every sharehold  
 tax-exempt interest received during the taxable year, including  
 pursuant to the Fund's Dividend Reinvestment Plan will gener  
 from gross income. The foregoing is a general summary of the  
 taxation of the Fund and its shareholders. These provisions are  
 Moreover, the foregoing does not address many of the factors  
 Shareholders are advised to consult their own tax advisers for  
 disposing of Fund shares. STATE TAX MATTERS Tax matte  
 Fund as of March 5, 2001 appearing in this statement of additi  
 60606, independent auditors, as set forth in their report thereo  
 such firm as experts in accounting and auditing. Ernst & Youn  
 AUDITORS AND FINANCIAL STATEMENTS F-1 68 REP  
 Dividend Advantage Municipal Fund 2 We have audited the st  
 June 1, 1999 (date of organization) through March 5, 2001 for  
 statements are the responsibility of the Fund's management. O  
 audit in accordance with auditing standards generally accepted  
 assurance about whether the financial statements are free of m  
 and disclosures in the financial statements. An audit also inclu  
 evaluating the overall financial statement presentation. We bel  
 referred to above presents fairly, in all material respects, the fi  
 (date of organization) through March 5, 2001, in conformity w  
 Illinois March 6, 2001 F-2 69 NUVEEN CALIFORNIA DIVI  
 Dividend Advantage Municipal Fund 2 Statement of Net Asse  
 costs..... 115,700 Receivable fro  
 230,975 ----- Liabilities: Accrued expenses.....

liabilities..... 130,700 ----- Net a  
 outstanding (\$100,275 divided by 7,000 Common Shares outst  
 \$25,000 liquidation value; unlimited number of shares authori  
 authorized, 7,000 shares outstanding..... 70 Paid  
 California Dividend Advantage Municipal Fund 2 Statement o  
 income..... \$ - ----- Expenses:  
 reimbursement..... (15,000) ----- T  
 income..... \$ - ===== Note 1: I  
 inactive since that date except for matters relating to its organi  
 Company Act of 1940, as amended, and the Securities Act of  
 investment adviser (the "Adviser"), a wholly owned subsidiary  
 Nuveen Company, has agreed to reimburse all organization exp  
 per Common share. The Fund is authorized by its Declaration  
 classes or series, with dividend, liquidation preference and oth  
 Note 2: Accounting Policies The Fund's financial statements a  
 require the use of management estimates. Actual results may d  
 management agreement between the Adviser and the Fund, the  
 0.6500% of the first \$125 million of the average daily net asse  
 (including net assets attributable to MuniPreferred Shares) in e  
 costs discussed in Note 1, the Adviser has contractually agreeo  
 range from 0.3000% of the average daily net assets (including  
 0.0500% of the average daily net assets (including net assets a  
 Fund for any portion of its fees and expenses beyond March 3  
 Revenue Code applicable to regulated investment companies a  
 net realized capital gains and/or market discount realized from  
 ASSETS Investments in municipal securities, at market value  
 ----- LIABILITIES Payable for investments purchased 3  
 13,639 ----- Total liabilities 33,200,998 ----- Net as  
 per share outstanding (net assets divided by shares outstanding)  
 Paid-in surplus 207,232,705 Balance of undistributed net inve  
 appreciation (depreciation) of investments (3,631,996) -----  
 Unlimited ===== F-6 73 STATEMENT OF OPERA  
 30, 2001 INVESTMENT INCOME \$ 452,941 ----- EXPR  
 fees and expenses 5,381 Trustees' fees and expenses 186 Prof  
 fees 93 Organization costs 15,000 ----- Total expenses be  
 reimbursement (66,539) ----- Net expenses 73,033 -----  
 INVESTMENTS Net realized gain from investment transactio  
 gain (loss) from investments (3,631,996) ----- Net increas  
 CHANGES IN NET ASSETS (UNAUDITED) For the Period  
 investment income \$ 379,908 Net realized gain from investme  
 ----- Net increase (decrease) in net assets from operatio  
 shares 207,277,500 ----- Net increase in net assets 204,0  
 \$204,125,687 ===== Balance of undistributed net  
 STATEMENTS (Unaudited) 1. GENERAL INFORMATION  
 corresponding American Stock Exchange symbol is Nuveen C  
 current income exempt from regular federal and California inc  
 government authorities within the state of California. The Fun  
 management investment company. The following is a summar  
 in accordance with accounting principles generally accepted in  
 portfolio are provided by a pricing service approved by the Fu  
 municipal securities), the pricing service establishes fair mark

maturity and rating, indications of value from securities dealer demand features qualifying them as short-term securities are v transactions are recorded on a trade date basis. Realized gains purchased or sold on a when-issued or delayed delivery basis r during this period. The Fund has instructed the custodian to se and delayed delivery purchase commitments. At April 30, 200 Interest income is determined on the basis of interest accrued, comply with the requirements of the Internal Revenue Code ap shareholders. Therefore, no federal income tax provision is rec securities, which is exempt from regular federal and California Dividends and Distributions to Shareholders Tax-exempt net i to shareholder accounts on the first business day after month-e distributed to shareholders not less frequently than annually. F carryforwards. Distributions to shareholders of tax-exempt net date. The amount and timing of distributions are determined in generally accepted in the United States. Accordingly, tempora distributions in excess of net investment income, distributions investment transactions, where applicable. F-8 75 Derivative F forward, swap and option contracts, and other financial instrum instruments, and may do so in the future, it did not make any s 2001. Custodian Fee Credit The Fund has an arrangement with Fund's cash on deposit with the bank. Such deposit arrange me statements in conformity with accounting principles generally reported amounts of assets and liabilities at the date of the fina during the reporting period. Actual results may differ from tho John Nuveen Company, has agreed to reimburse all organizati \$.03 per Common Share. The Fund's share of offering costs (\$ Fund sold 14,500,000 Common Shares during the period Marc TRANSACTIONS Purchases and sales (including maturities) March 27, 2001 (commencement of operations) through April Purchases: Long-term municipal securities \$202,408,782 Shor municipal securities - ----- income tax purposes was the same as the cost for financial rep appreciation and gross unrealized depreciation of investments -----

===== FEE AND OTHER TRANSACTIONS WITH AFFILIATES U wholly owned subsidiary of The John Nuveen Company, the F upon the average daily net assets of the Fund as follows: AVE -----

\$250 million .6250 For the next \$500 million .6125 For the ne -----

the Adviser for overall investment advisory and administrative who are affiliated with the Adviser or to its officers, all of who of the Fund's operation, the Adviser has agreed to reimburse th PERCENTAGE REIMBURSED REIMBURSED (AS A PER AVERAGE DAILY MARCH 31, NET ASSETS) MARCH 31 ..... .25% 2002 ..... .30 2008 ..... .20 2 ..... .30 2011 ..... .05 2006 ..... .3 Fund for any portion of its fees and expenses beyond March 3

DIVIDEND ADVANTAGE MUNICIPAL FUND 2 (NVX) A  
 PROVISIONS\* RATINGS\*\* VALUE EDUCATION AND C  
 (Stanford University), 6/11 at 101 AAA \$4,928,450 Series Q,  
 Lease Revenue Refunding Bonds 11/11 at 101 AAA 8,808,390  
 University of California, Multiple Purpose Project Revenue B  
 5.300%, 9/01/30 HEALTHCARE - 2.4% 5,000 California Hea  
 Series C, 5.600%, 5/01/33 HOUSING/MULTIFAMILY - 2.9%  
 AAA 5,966,889 Revenue Refunding Bonds (Claremont Villag  
 FAMILY - 2.9% 6,000 California Rural Home Mortgage Fina  
 (Mortgage-Backed Securities Program), 2001 Series A, 5.650%  
 21.7% 5,595 State of California, Various Purpose General Obl  
 Purpose General Obligation Bonds, 5.250%, 9/01/28 9/10 at 1  
 12/01/32 6/06 at 101 AAA 8,929,620 8,330 Los Angeles Unif  
 1997), Series D of 2000, 5.375%, 7/01/25 Sacramento City Ur  
 3,000 5.000%, 7/01/26 7/10 at 102 AAA 2,847,930 5,525 5.00  
 Sonoma, California, General 5/11 at 101 AAA 4,039,430 Obli  
 School District, California, General Obligation Bonds 8/11 at  
 29.6% 9,000 Antioch Area Public Facilities Financing Author  
 1989-1), Series 2001, 5.250%, 8/01/25 (WI, settling 5/02/01) 3  
 AAA 3,102,697 Project), Series 2001, 5.000%, 3/01/27 2,885  
 2,898,761 Bonds (Refunding and Various Capital Facilities Pr  
 Special Tax Refunding 9/08 at 102 AAA 3,519,211 Bonds (Co  
 Metropolitan Transportation Authority, California, Proposition  
 5.000%, 7/01/23 3,030 Public Works Financing Authority of I  
 Facilities Project V), 1996 Series B, 5.125%, 12/01/29 78 4,32  
 4,154,033 Series Y of 1996, 5.000%, 7/01/36 9,000 Redevelop  
 Allocation Bonds (Jurupa Valley Project Area), 5.250%, 10/01  
 AAA 8,477,550 Revenue Bonds (Water and Capital Improvemen  
 Santa Ana, California, Revenue Refunding Bonds (South Harb  
 Chapman Heights, City of Yucaipa, County 9/09 at 102 N/R 5  
 TRANSPORTATION - 13.1% 4,250 Alameda Corridor Trans  
 1999A, 5.000%, 10/01/29 5,500 California Statewide Commu  
 Air Lines, Inc. - Los Angeles International Airport Cargo Proj  
 Counties of Sacramento and Yolo, California, Port 7/08 at 101  
 1,750 Airport Commission of the City and County of San Fran  
 International Airport), Issue 23B, 5.000%, 5/01/30 (Alternativ  
 Second 5/10 at 101 AAA 5,933,592 Series Revenue Bonds (Sa  
 of San Jose Financing Authority, California, Revenue Bonds (S  
 9/01/26 UTILITIES - 2.4% 5,000 California Pollution Control  
 (Pacific Gas and Electric Company), 1996A Remarketed, 5.35  
 Water and Power of the City of Los Angeles, California, Wate  
 The Metropolitan Water District of Southern California, Wate

-----  
 198,779,257 -----  
 5,346,430 -----  
 =====

\* Optional Call Provisions: Dates (month and year) and prices  
 dates. \*\* Ratings (not covered by the report of independent au  
 & Electric Company (PG&E) filed for bankruptcy protection.  
 the principal after its reorganization is completed. However, th  
 bankruptcy court decisions. N/R Investment is not rated. (WI)



APPENDIX A NUVEEN CALIFORNIA DIVIDEND ADVANTAGE MUNICIPAL AUCTION RATE CUMULATIVE  
 DIVIDEND ADVANTAGE MUNICIPAL FUND 2 TABLE OF CONTENTS

DEFINITIONS.....

Rate.....A-7 Account

Affiliate.....

Order.....

Rate.....

Agreement.....

Date.....

MuniPreferred.....

Owner.....

Bidders.....

Broker-Dealer.....

Business Day.....

Paper Dealers.....

Date.....

Declaration.....

Discounted Value.....

Dividend Period.....

Failure to Deposit.....

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Order and Hold Orders.....

Independent Accountant.....

Interest Equivalent.....

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Liquidation Preference.....

Maximum Potential Gross-Up Payment Liability.....

Rate.....

Moody's.....

Moody's Eligible Asset.....

Moody's Volatility Factor.....

MuniPreferred.....

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Basic Maintenance Report.....

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Outstanding.....

Person.....

Beneficial Owner.....

Shares.....

Multiple.....

Days.....

Redemption Price.....

Registration Statement.....

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Exposure Period.....

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 Bill.....  
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 Winning Bid Rate.....  
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 Agent..... A-24 (h) Auction Agent as Tru  
 Holders..... A-24 (j) Dividend  
 Designated as Exempt-Interest Dividends.....  
 Periods and Special Rate Periods of 28 Rate Period Days or Fe  
 No Gross-Up Payments in the Event of a Reallocation.....  
 Length of and Preconditions for Special Rate Period.....  
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 MuniPreferred..... A-27 (b) Voting f  
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 of MuniPreferred Redeemed, Exchanged or Otherwise Acquir  
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3. Determination of Sufficient Clearing Bids, Winning Bid Ra  
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A.....

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of Subparagraph (b)(iii) of Section 3 of Part II of this Statemen

Requirements.....A-58 A-6 85 N

business trust (the "Fund"), certifies that: First: Pursuant to aut

Trust (which, as hereafter restated or amended from time to tim

resolution, authorized the issuance of shares of the Fund's auth

designations as to series as is set forth in Section 1 of Appendi

Second: The preferences, voting powers, restrictions, limitatio

of MuniPreferred described in Section 1 of Appendix A hereto

such series being referred to herein individually as a share of M

specifically provided in Section 3 of Appendix A hereto, as us

terms defined in the singular having comparable meanings wh

COMMERCIAL PAPER RATE," on any date for any Rate Pe

or any Special Rate Period of fewer than 49 Rate Period Days,

Rate Period and the "AA" Composite Commercial Paper Rate

shares of such series are subject to Submitted Hold Orders, the

or more but fewer than 70 Rate Period Days, the interest equiv

the interest equivalent of the 60-day and 90-day rates; (3) 85 o

but fewer than 120 Rate Period Days, the arithmetic average o

Period Days, the interest equivalent of the 120-day rate; (6) 14

rates; and (7) 162 or more but fewer than 183 Rate Period Day

issuers whose corporate bonds are rated "AA" by S&P or the e

otherwise by the Federal Reserve Bank of New York for the B

does not make available any such rate, then the arithmetic aver

Auction Agent for the close of business on the Business Day n

the "AA" Composite Commercial Paper Rate, the "AA" Comp

by the remaining Commercial Paper Dealer or Commercial Pa

selected by the Fund to provide such rate or rates not being sup

Fund does not select any such Substitute Commercial Paper D

Commercial Paper Dealers. For purposes of this definition, the

paper of a given days' maturity shall be equal to the quotient (r

(B) the difference between (x) 1.00 and (y) a fraction, the num

commercial paper matures and the denominator of which shall

of Section 7 of Part I of this Statement. (c) "AFFILIATE" sha

controlled by, in control of or under common control with the

with the Fund shall be deemed to be an Affiliate nor shall any

one of the trustees, directors, or executive officers of which is

officer is also a trustee of the Fund. (d) "AGENT MEMBER"

(e) "ALL HOLD ORDER" shall have the same meaning speci



accountants, that is with respect to the Fund an independent pu  
 amended from time to time. (pp) "INITIAL RATE PERIOD,"  
 shares of such series in Section 5 of Appendix A hereto. (qq) "  
 equal to the yield on an equivalent interest-bearing security. (r)  
 specified in that section. (ss) "KENNY INDEX" shall have the  
 (tt) "LATE CHARGE" shall have the meaning specified in sub  
 with respect to a given number of shares of MuniPreferred, me  
 market value thereof determined by the pricing service designa  
 accrued thereon. The pricing service values portfolio securities  
 readily available. Securities for which quotations are not readi  
 consideration of: yields or prices of municipal bonds of compa  
 general market conditions. The pricing service may employ el  
 "MAXIMUM POTENTIAL GROSS-UP PAYMENT LIABILITY"  
 due if the Fund were to make Taxable Allocations, with respect  
 net capital gains and other taxable income earned by the Fund.  
 Gross-up Payments are fully taxable. (xx) "MAXIMUM RATE"  
 A-11 90 (i) in the case of any Auction Date which is not the A  
 Fund pursuant to Section 4 of Part I of this Statement, the pro  
 and (B) the Rate Multiple on such Auction Date, unless shares  
 Days or fewer) and an Auction at which Sufficient Clearing B  
 Rate Period, in which case the higher of: (A) the dividend rate  
 the Reference Rate on such Auction Date for a Rate Period eq  
 was 364 Rate Period Days or fewer, or the Treasury Note Rate  
 such series, if such then-ending Rate Period was more than 36  
 to such Special Rate Period of shares of such series, if such Sp  
 for a Rate Period equal in length to such Special Rate Period, i  
 Auction Date; or (ii) in the case of any Auction Date which is  
 the Fund pursuant to Section 4 of Part I of this Statement, the p  
 length to the then-ending Rate Period of shares of such series,  
 Auction Date for a Rate Period equal in length to the then-end  
 Period Days, (2) the Reference Rate on such Auction Date for  
 Period Days or fewer or the Treasury Note Rate on such Aucti  
 more than 364 Rate Period Days, and (3) the Reference Rate o  
 [Reserved] (zz) "MINIMUM RATE PERIOD" shall mean any  
 Service, Inc., a Delaware corporation, and its successors. (bbb)  
 hereto. (ccc) "MOODY'S ELIGIBLE ASSET" shall have the r  
 PERIOD" shall mean the period commencing on a given Valu  
 of any Valuation Date, (i) in the case of any Minimum Rate Pe  
 Period Days or more, a multiplicative factor equal to 275%, ex  
 Period of more than 28 but fewer than 36 Rate Period Days, a  
 fewer than 43 Rate Period Days, a multiplicative factor equal t  
 Days, a multiplicative factor equal to 226%; and (v) in the cas  
 factor equal to 235%. If, as a result of the enactment of change  
 ordinary income and the maximum marginal Federal corporate  
 next five percentage points (the "Federal Tax Rate Increase"),  
 described in (i) above in this definition instead shall be determ  
 FACTOR ----- 5% 295% 10% 317% 15% 341% 2  
 mean debt obligations issued by states, cities and local authori  
 purposes, including the construction and maintenance of such  
 and water and sewer works. Other public purposes for which M  
 obtaining of funds for general operating expenses and for loan



with respect to the redemption of shares of MuniPreferred pur  
 PERIOD" shall mean any notice with respect to a Special Rate  
 Statement. (ppp) "ORDER" and "ORDERS" shall have the res  
 "ORIGINAL ISSUE INSURANCE," if defined in Section 4 of  
 defined in Section 4 of Appendix A hereto, shall have the mea  
 respect to shares of a series of MuniPreferred, the number of s  
 series theretofore cancelled or delivered to the Auction Agent  
 Affiliate thereof shall be an Existing Holder and (iii) any share  
 delivered by the Fund. A-15 94 (ttt) "PERMANENT INSURA  
 (uuu) "PERSON" shall mean and include an individual, a part  
 government or any agency or political subdivision thereof. (vv  
 meaning specified in that section. (www) "POTENTIAL BEN  
 Broker-Dealer that is not a Beneficial Owner of shares of such  
 series that wishes to purchase additional shares of such series.  
 Broker-Dealer (or any such other person as may be permitted t  
 shares of such series that wishes to become the Existing Holde  
 of the Fund, and includes the shares of MuniPreferred. (zzz) "  
 August and November of each year, commencing on the date s  
 specified in Section 4 of Appendix A hereto. (bbbb) "RATE P  
 any Transitional Rate Period, of shares of such series and any  
 PERIOD DAYS," for any Rate Period or Dividend Period, me  
 application of paragraph (d) of Section 2 of Part I of this State  
 MUNICIPAL OBLIGATIONS SOLD" shall mean (A) for pur  
 of the following: (i) the book value of receivables for Municip  
 business days of such Valuation Date, and if the trades which  
 has received prior written authorization from Moody's or (y) w  
 Discounted Value of Municipal Obligations sold as of or prior  
 days of such Valuation Date but do not comply with either of t  
 any Valuation Date, the book value of receivables for Municip  
 business days of such Valuation Date. A-16 95 (eeee) "REDE  
 Section 11 of Part I of this Statement. (ffff) "REFERENCE RA  
 the "AA" Composite Commercial Paper Rate in the case of M  
 Composite Commercial Paper Rate in the case of Special Rate  
 Bill Rate in the case of Special Rate Periods of more than 182  
 has the meaning specified in the definition of "Municipal Obli  
 successors. (iii) "S&P DISCOUNT FACTOR" shall have the  
 meaning specified in Section 4 of Appendix A hereto. (kkkk) '  
 the Fund has under this Statement to cure any failure to mainta  
 MuniPreferred Basic Maintenance Amount (as described in pa  
 as of any Valuation Date, a multiplicative factor equal to (i) 30  
 fewer, (ii) 268% in the case of any Special Rate Period of mor  
 Special Rate Period of more than 182 Rate Period Days. (mmr  
 have the meaning specified in that section. (nnnn) "SECURITI  
 other securities depository selected by the Fund which agrees  
 shares of MuniPreferred. (oooo) "SELL ORDER" and "SELL  
 Statement. (pppp) "SPECIAL RATE PERIOD," with respect t  
 Part I of this Statement. (qqqq) "SPECIAL REDEMPTION PE  
 Statement. A-17 96 (rrrr) "SUBMISSION DEADLINE" shall  
 which Broker-Dealers are required to submit Orders to the Au  
 "SUBMITTED BIDS" shall have the respective meanings spec  
 and "SUBMITTED HOLD ORDERS" shall have the respectiv







Auction Agent, no Auction will be held in respect of shares of such series thereafter to and including the Rate Period during which (1) such Failure to Deposit is not cured in accordance with the applicable Late Charge to the Auction Agent (the condition set forth in this clause (2) to apply only in the event of such Failure to Deposit), in each case no later than the end of such Rate Period, and the dividend rate for shares of such series for each such Rate Period shall be the rate in effect on the Auction Date for such Subsequent Rate Period (but with the applicable Late Charge to the Auction Agent); or (D) any Failure to Deposit consisting of more than 364 Rate Period Days, or during any Rate Period during which a Failure to Deposit occurred that has not been cured in accordance with the applicable Late Charge to the Auction Agent on the Auction Date for the Rate Period subsequent to such Rate Period, such that, in the event Moody's is then rating such shares, the Fund shall not be entitled to the dividend rate set forth in subparagraph (D), to be calculated by using, as the Reference Rate, the rate in effect on the Auction Date for such Subsequent Rate Period (but fewer than 365 Rate Period Days and (y) commencing on the first Business Day thereafter), and no Auction will be held in respect of shares of such series for such Subsequent Rate Period during which (1) such Failure to Deposit is cured in accordance with the applicable Late Charge to the Auction Agent (the condition set forth in this clause (2) to apply only in the event of such Failure to Deposit), in each case no later than 12:00 Noon, New York City time, on the fourth Business Day after the end of such Subsequent Rate Period shall be a rate per annum equal to the rate in effect on the Auction Date for such Subsequent Rate Period (but with the prevailing rating for shares of such series, for purposes of the applicable Late Charge to the Auction Agent, of such series). (ii) CALCULATION OF DIVIDENDS. The amount of dividends shall be payable on shares of such series shall be computed on the basis of the applicable Dividend Period or Dividend Periods or part thereof for which dividends have not been paid, and the dividend rate for such Dividend Period or Dividend Periods or part thereof and the dividend rate for all other Dividend Periods, and applying the rate obtained against the applicable Late Charge to the Auction Agent for such series of MuniPreferred shall have been cured (if such Failure to Deposit is not cured in accordance with the applicable Late Charge to the Auction Agent) with respect to any Rate Period of shares of such series for which the Fund shall have paid to the Auction Agent (A) all accumulated dividends on such shares, if any, of such series for which Notice of Redemption has been provided, however, that the foregoing clause (B) shall not apply if the applicable Redemption Notice provides that redemption of such shares has been satisfied at the time or times and in the manner specified in such Redemption Notice. (B) The Fund shall pay to the Auction Agent, not later than 12:00 Noon, New York City time, on the fourth Business Day after the end of such Dividend Period, for a series of MuniPreferred, an aggregate amount of funds available for distribution to all Holders of shares of such series on such Dividend Payment Date (including moneys paid to the Auction Agent for the payment of dividends on such shares (including any such Late Charge) by the Auction Agent for the benefit of such series) in accordance with the foregoing but not applied by the Auction Agent, and such amount shall be repaid to the Fund at the end of 90 days from the date on which such amount is paid to the Auction Agent. (C) Shares of MuniPreferred shall be paid on the Dividend Payment Date on the Business Day next preceding such Dividend Payment Date. (j) Any dividend payment made on shares of MuniPreferred shall be made on the Dividend Payment Date. Dividends in arrears for any past Dividend Period may be declared if the names of the Holders of shares of MuniPreferred whose names appear on the record books of the Fund on such date are on the record books of the Fund. (k) DIVIDENDS DESIGNATED AS EXEMPT-INT. The amount of dividends up to the amount of tax-exempt income of the Fund, shall be paid to the Holders of shares of MuniPreferred shall be entitled to receive an amount equal to the aggregate Gross-up Payments as follows: (i) PERIOD DAYS OR FEWER. If, in the case of any Minimum Payment Period, the amount of dividends payable to the Holders of shares of MuniPreferred is less than the amount of tax-exempt income of the Fund, the Auction Agent as provided in Section 5 of Part II of this Statement of







DIVIDENDS. In the event that the Fund fails to pay any dividend to the holders of shares of MuniPreferred pursuant to the provisions of this Section 5. (h) HOLDING A QUORUM. In any matter, whether such right is created by this Statement, by the terms of the Trust Agreement or otherwise, one share of MuniPreferred and no share of MuniPreferred shall be deemed to constitute a quorum if, prior to or concurrently with the time of such meeting, in any case may be, the requisite Notice of Redemption with respect to such shares and the Redemption Price for the redemption of such shares shall have been delivered to the Fund or any affiliate of the Fund (except for shares held by the Fund) and the rights or be deemed to be outstanding for voting or other purposes for the next Business Day of each month in which any share of MuniPreferred is outstanding.

MAINTENANCE AMOUNT. (a) So long as shares of MuniPreferred are rated "BBB" or better in satisfaction that it is maintaining on such Valuation Date, (i) S&P shall determine the Basic Maintenance Amount (if S&P is then rating the shares of MuniPreferred) greater than the MuniPreferred Basic Maintenance Amount (if S&P is then rating the shares of MuniPreferred) on the third Business Day after a Valuation Date on which the Fund fails to deliver to the Auction Agent after the MuniPreferred Basic Maintenance Cure Date with respect to such shares of MuniPreferred), Moody's (if Moody's is then rating the shares of MuniPreferred) a MuniPreferred Basic Maintenance Report to the Auction Agent which will be deemed to have been delivered to the Auction Agent on the same day the Fund mails to the Auction Agent for delivery to the Auction Agent and also deliver a MuniPreferred Basic Maintenance Report to (i) the Auction Agent on the fifteenth day of each month (or, if such day is not a Business Day, on the next Business Day), Moody's (if Moody's is then rating the shares of MuniPreferred) and S&P, or before the third Business Day after such day, and (iii) S&P, Moody's (if Moody's is then rating the shares of MuniPreferred) and S&P. A failure by the Fund to deliver a MuniPreferred Basic Maintenance Report indicating the Discounted Value for such shares of MuniPreferred on the Valuation Date. A-31 110 (c) Within ten Business Days after the date of delivery of this Section 7 relating to a Quarterly Valuation Date, the Fund shall deliver to the Auction Agent (i) of MuniPreferred), Moody's (if Moody's is then rating the shares of MuniPreferred), Moody's (if Moody's is then rating the shares of MuniPreferred) (i) the mathematical accuracy of the calculations in such Report (and in such randomly selected Report), the Fund determined in accordance with the requirements of Section 7 Valuation Date addressed in such randomly-selected Report), (ii) the Discounted Value at least equal to the MuniPreferred Basic Maintenance Amount and the aggregate Discounted Value at least equal to the MuniPreferred Basic Maintenance Amount ("Confirmation"), (iii) that, in such Report (and in such randomly selected Report) at the Valuation Date addressed in such randomly selected Report, the Fund's Value is equal to the MuniPreferred Basic Maintenance Amount and MuniPreferred Basic Maintenance Amount, (iv) with respect to the S&P ratings on such Report, the Independent Accountant has requested that S&P verify such information, (v) with respect to the Moody's ratings on Municipal Obligations, such information, verified by Moody's (in the event such information is not verified by Moody's, provide a listing in its letter of any differences), (vi) with respect to the Discounted Value) provided by the custodian of the Fund's assets to the Fund, (vii) the price used in such Report to the bid or mean price listed in such Report, and (viii) if the information does not agree, the Independent Accountant will provide a listing of such information and S&P, that the Fund has satisfied the requirements of Section 7. Within ten Business Days after the date of delivery of a MuniPreferred Basic Maintenance Report on a Valuation Date on which the Fund failed to satisfy the MuniPreferred Basic Maintenance Amount with respect to such failure to satisfy the MuniPreferred Basic Maintenance Amount, then rating the shares of MuniPreferred), Moody's (if Moody's is then rating the shares of MuniPreferred), Moody's (if Moody's is then rating the shares of MuniPreferred) and S&P.

rating the shares of MuniPreferred) an Accountant's Confirmation delivered pursuant to paragraph (c) or (d) of this Section 7 shall be binding on the Fund, and the Fund shall accordingly a rating the shares of MuniPreferred), Moody's (if Moody's is then rating the shares of MuniPreferred) promptly following receipt by the Business Day after the Date of Original Issue of any shares of MuniPreferred) and Moody's (if Moody's is then rating the shares of MuniPreferred) Date of Original Issue. Within five Business Days of such Date of Original Issue, S&P is then rating the shares of MuniPreferred) (i) the mathematical Eligible Assets reflected thereon equals or exceeds the MuniPreferred time, on the third Business Day after either (i) the Fund shall have Discounted Value of Moody's Eligible Assets to the MuniPreferred and S&P, the Fund shall complete and deliver to S&P (if S&P MuniPreferred), as the case may be, a MuniPreferred Basic MuniPreferred DIVIDENDS AND OTHER DISTRIBUTIONS. (a) DIVIDENDS. In no sentence, no dividends shall be declared or paid or set apart for the payment of dividends, on a parity with shares of MuniPreferred paid on the shares of each series of MuniPreferred through its most recent Dividend Payment Date of MuniPreferred through its most recent Dividend Payment Date on a parity as to the payment of dividends with shares of MuniPreferred shares of MuniPreferred and any other such class or series of shares of MuniPreferred shall be declared pro rata so that the amount of dividends of beneficial interest shall in all cases bear to each other the same ratio as the beneficial interest bear to each other (for purposes of the Applicable Rate for such share for the Dividend Periods during the RESPECT TO COMMON SHARES UNDER THE 1940 ACT. (b) COMMON SHARES. Shares), or declare any other distribution, upon the Common Shares, or any such declaration or purchase, an asset coverage (as defined in the future be specified in or under the 1940 Act as the minimum condition of declaring dividends on its common shares) shall be a A-33 112 condition of declaring dividends on its common shares, if any, may be. (c) OTHER RESTRICTIONS ON DIVIDENDS AND DISTRIBUTIONS. set forth in paragraph (a) of this Section 9 and paragraph (c) of this Section 9 other distribution (other than a dividend or distribution paid in respect of shares, if any, ranking junior to the shares of MuniPreferred as to dividends in respect of the Common Shares or any other shares of the Fund) in the distribution of assets upon dissolution, liquidation or winding up of the Common Shares or any other such junior shares (except by conversion into Common Shares) of dividends and the distribution of assets upon dissolution, liquidation or winding up of the Fund ranking junior to or on a parity with MuniPreferred as to dividends (if any, ranking junior to or on a parity with MuniPreferred as to dividends up), unless (i) full cumulative dividends on shares of each series of MuniPreferred have been declared and sufficient funds for the payment thereof are available for MuniPreferred required to be redeemed by any provision for redemption of MuniPreferred payment any dividend or other distribution (other than a dividend or distribution of Common Shares or other shares, if any, ranking junior to the shares of MuniPreferred in liquidation or winding up) in respect of Common Shares or any other shares of the Fund in the distribution of assets upon dissolution, liquidation or winding up of the Common Shares or any other such junior shares (except by conversion into Common Shares) of dividends and the distribution of assets upon dissolution, liquidation or winding up of the Fund ranking junior to or on a parity with MuniPreferred as to dividends (if any, ranking junior to or on a parity with MuniPreferred as to dividends up), unless (i) full cumulative dividends on shares of each series of MuniPreferred have been declared and sufficient funds for the payment thereof are available for MuniPreferred required to be redeemed by any provision for redemption of MuniPreferred

Eligible Assets (if Moody's is then rating the shares of MuniPreferred at least equal the MuniPreferred Basic Maintenance Amount. 10. If Moody's or S&P, or both, are rating such shares, the Fund shall ensure that any such action would not impair the ratings then assigned to such shares or sell futures or write put or call options except as provided in writing and in written confirmation described above, borrow money for the purpose of which to continue to be satisfied after giving effect to such borrowing a promissory note or other evidence of indebtedness that is not in the form of a note or other evidence of indebtedness and is in an amount not to exceed the amount borrowed; for purposes of the foregoing, "temporary purpose" means the issue additional shares of any series of MuniPreferred or any other security for the payment of dividends or the distribution of assets upon dissolution of the Fund, purchased or redeemed by the Fund; (d) engage in any short sale of any security to change the pricing service (currently J.J. Kenny) referred to in paragraph (a); (a) OPTIONAL REDEMPTION. (i) Subject to the provisions of paragraph (b), at the option of the Fund, as a whole or from time to time in part, out of funds legally available therefor, at a redemption price per share (whether or not earned or declared) to (but not including) the date fixed by the Board of Trustees, redeemed in part if after such partial redemption fewer than 25% of the shares hereto, shares of a series of MuniPreferred are redeemable by the Fund on any Dividend Payment Date for such Initial Rate Period; and (3) shares of a series of MuniPreferred, as delivered to the Fund, shall not be redeemable during the whole or any part of such Special Rate Period, but shall be redeemable during the whole or any part of such Special Rate Period ("Special Redemption Provisions"). (ii) A Notice of Special Redemption shall be given only if the Fund's Board of Trustees determines that such Special Redemption of shares of a series of MuniPreferred are to be redeemed pursuant to subparagraph (a) by the Board of Trustees, and such shares shall be redeemed at the redemption price for such series held by such Holders. (iv) Subject to the provisions of paragraph (b), at the option of the Fund, as a whole but not in part, out of funds legally available therefor, a Rate Period consisting of more than 364 Rate Period Days if, on the date of determination, the Applicable Rate equaled or exceeded on such date of determination the Applicable Rate plus \$25,000 plus an amount equal to accumulated but unpaid dividends; (v) The Fund may not on any date mail a Notice of Redemption of shares pursuant to this paragraph (a) unless on such date (a) the Fund's Board of Trustees has applicable redemption date and having a value not less than the value of the redemption of such shares on such redemption date and (b) the value of the MuniPreferred) and the Discounted Value of S&P Eligible Assets is not less than the Maintenance Amount, and would at least equal the MuniPreferred Basic Maintenance Amount to occur on such date. For purposes of determining in clause (b) whether the value of the MuniPreferred Basic Maintenance Amount, the Moody's Discounted Value of Eligible Assets Exposure Period longer than the Exposure Period then applicable to such shares. (b) OPTIONAL REDEMPTION. The Fund shall redeem, at a redemption price per share (whether or not earned or declared) to (but not including) the date fixed by the Board of Trustees, the value of the Moody's Eligible Assets with a Discounted Value or S&P Eligible Assets is not less than the Maintenance Amount or fails to maintain the 1940 Act MuniPreferred Assets of MuniPreferred, and such failure is not cured on or before the date fixed by the Board of Trustees; the number of shares of MuniPreferred to be redeemed shall be equal to the number of MuniPreferred Shares subject to redemption or retirement, the redemption price per share on the Redemption Date, would have resulted in the Fund's having both Moody's and S&P ratings on such date.



or equal to the MuniPreferred Basic Maintenance Amount or more (provided, however, that if there is no such minimum number of shares, and if the Fund has had such result, all shares of MuniPreferred and Preferred Shares of the Fund, including MuniPreferred, together with all other Preferred Shares subject to redemption, shall be redeemed therefor in accordance with the Declaration and applicable law. If the Fund is unable to do so, the foregoing, the Fund shall allocate the A-36 115 number required for the redemption of MuniPreferred Asset Coverage, as the case may be, pro rata among all shares of MuniPreferred) subject to redemption or retirement. The Fund shall redeem such shares no later than 20 days nor later than 40 days after such Cure Date, except that if the number of shares of MuniPreferred and other Preferred Shares of the Fund is less than the number of shares of MuniPreferred to be redeemed on or prior to 40 days after such Cure Date, the Fund shall redeem on the earliest practicable date on which it is able to effect such redemption. If redeemed pursuant to this paragraph (b), the number of shares of such series shall be in proportion to the number of shares of such series held by such Holder. The Fund shall mail, by first class mail, postage prepaid, to each Holder of the shares of such series a Notice of Redemption on the record date established by the Board of Trustees. Such Notice of Redemption shall state: (i) the name of the Holder; (ii) the number of shares to be redeemed; (iii) the CUSIP number for shares of such series; (iv) the Redemption Price; (v) the name of the Agent assigned for transfer, if the Board of Trustees shall so require; (vi) the Redemption Price; (vi) that dividends on the shares to be redeemed will cease on the date of redemption is made. If fewer than all shares of a series of MuniPreferred are to be redeemed, the Notice shall also specify the number of shares of such series to be redeemed. The Fund shall not be required to effect such redemption unless each such condition is satisfied. (c) NO REDEMPTION UNDER CERTAIN CIRCUMSTANCES. If the Fund is unable to redeem shares of a series of MuniPreferred (whether or not such shares are simultaneously redeemed, and the Fund is unable to do so for the reasons set forth in the foregoing shall not prevent the purchase or acquisition of all or a portion of such shares in an offer or exchange offer made on the same terms to, and accepted by the Fund, the Fund shall effect such REDEMPTION. To the extent that any redemption for which a Notice of Redemption is given therefor in accordance with the Declaration and applicable law is not effected, the Fund's Failure to redeem shares of MuniPreferred shall be deemed to constitute a failure to have failed, for any reason whatsoever, to deposit in trust with the Agent the Redemption Price with respect to any shares where such failure is due to one or more conditions precedent and (2) any such condition precedent is not satisfied. (d) OF REDEMPTION. Notwithstanding the fact that the Fund may not be able to pay such dividends may be declared and paid on shares of MuniPreferred. (f) AUCTION AGENT AS TRUSTEE OF REDEMPTION PRICE. If the Fund is unable to redeem shares of MuniPreferred called for redemption shall be held in an auction, the Fund shall, within 10 days of WHICH NOTICE OF REDEMPTION HAS BEEN GIVEN AND the date of such Notice, in accordance with paragraph (c) of this Section 11, upon the deposit with the Auction Agent of the amount available on the next Business Day in The City of New York, the Fund shall, upon notice, dividends on such shares shall cease to accumulate and the Fund shall terminate of the shares so called for redemption shall cease and terminate. The Fund shall pay an additional amount, except as provided in subparagraph (e)(i) of this Section 11, of Redemption of the certificates for any shares so redeemed (whether or not such Redemption shall so state), the Redemption Price shall be paid to the Holder thereof that fewer than all of the shares represented by any such certificate are to be redeemed to the Holder thereof. The Fund shall be entitled to receive from







that is lower than the Winning Bid Rate for shares of such series shall be the Winning Bid Rate for shares of such series. (ii) If the number of shares of MuniPreferred subject to such Submitted Bid, unless the number of shares of MuniPreferred ("remaining shares") in the subject to Submitted Bids described in clauses (ii) and (iii) of paragraph (a) and such Existing Holder shall be entitled to continue to hold shares of MuniPreferred of such series obtained by multiplying the Outstanding shares of MuniPreferred held by such Existing Holder by the Outstanding shares of MuniPreferred subject to such Submitted Bid of such series; and (v) each Potential Holder's Submitted Bid for shares shall be accepted A-46 125 but only in an amount equal to the Available MuniPreferred of such series over the number of shares of such series (a) by a fraction, the numerator of which shall be the number of shares of such series and the denominator shall be the aggregate number of Outstanding shares of MuniPreferred of such series. (b) If Sufficient shares of such series are subject to Submitted Bids, the number of shares of such series shall be accepted or rejected as follows in paragraph (a): (i) Existing Holders' Submitted Bids for shares of such series shall be rejected, thus entitling such Existing Holders to continue to hold shares of such series specifying any rate that is equal to or greater than the Existing Holder's Submitted Bid for shares of such series specifying any rate that is equal to or greater than the Existing Holder's Submitted Bid for shares of such series of each Existing Holder shall be accepted or rejected as follows: (i) Submitted Bid or Submitted Sell Order to sell the shares of such series shall be accepted or rejected equal to the number of shares of such series obtained by multiplying the number of shares of such series by the rate specified in paragraph (b) by a fraction, the numerator of which shall be the number of shares of such series and the denominator of which shall be the number of shares of such series in Submitted Sell Orders. (c) If all of the Outstanding shares of a series shall be rejected. (d) If, as a result of the procedures described in paragraph (a), an Existing Holder would be entitled or required to sell, or any Potential Holder would be entitled or required to purchase, MuniPreferred on any Auction Date, the Auction Agent shall, on such Auction Date, cause the MuniPreferred of such series to be purchased or sold by any Existing Holder in the amount of the number of shares so purchased or sold by each Existing Holder as a result of the procedures described in clause (v) of paragraph (a) of this section. (e) If, as a result of the procedures described in paragraph (a) of this section of MuniPreferred on any Auction Date, the Auction Agent shall, on such Auction Date, cause the MuniPreferred of such series for purchase among Potential Holders and Existing Holders as a result of such procedures by any Potential Holder, even if such Potential Holder is not a holder of such series on such Auction Date. (f) Based on the results of each Auction Date, the Auction Agent shall determine the number of shares of such series to be purchased and the aggregate number of shares of such series to be sold, and, in respect to each Potential Holder and Existing Holder, to the extent that the number of shares to be sold differ, determine to which other Potential Holder(s) or Existing Holder(s) the shares shall receive, as the case may be, shares of MuniPreferred of such series. (g) Notwithstanding the contrary, in the event an Existing Holder or Beneficial Owner of such series fails to instruct the Auction Agent for such shares that was accepted in whole or in part, fails to instruct its Agent Member to deliver shares of such series in respect of Potential Holders' or Potential Beneficial Owners' shares, the Auction Agent shall be in good delivery to such Potential Holders and Potential Beneficial Owners and shall have no responsibility or liability with respect to the failure of an Existing Holder or Beneficial Owner or Agent Member to deliver shares of MuniPreferred of any series of such series as a result of the Auction Procedures or otherwise. 5. NOTIFICATION OF ALLOCATION OF DIVIDEND AND SPECIAL RATE. The income tax purposes in any dividend on shares of MuniPreferred of such series shall be paid on 15 Days or fewer, and may, in the case of any other Special Rate

Date next preceding the Auction Date on which the Applicable the Fund, it will be required in turn to notify each Broker-Dealer required to notify its Beneficial Owners and Potential Beneficial Auction to be held on such Auction Date. 6. AUCTION AGENT the Fund to so act, shall be in each case a commercial bank, trust may engage or have engaged in business transactions with the connection with the Auction Procedures. If the Auction Agent MuniPreferred are outstanding, the Board of Trustees shall use financial institution to act as the Auction Agent. The Auction binding on the Broker-Dealers. A Broker-Dealer may inquire series of MuniPreferred and 9:30 a.m. on the Auction Date for has determined such Broker-Dealer to be an Existing Holder. If specified by the Auction Agent in response to such Broker-Dealer shall not, in its capacity as Existing Holder of shares of such series than the number of shares of such series specified by the Auction MUNIPREFERRED. Unless otherwise permitted by the Fund, MuniPreferred only in whole shares and only pursuant to a Bid II or to a Broker-Dealer, provided, however, that (a) a sale, transfer on the records of that Broker-Dealer as the holder of such shares transfer or other disposition for purposes of this Section 7 if such immediately after such sale, transfer or disposition and (b) in transfer permitted by the Fund) to whom such transfer is made shall address Voting Period, (i) all of the shares of a series of MuniPreferred the Securities Depository or its nominee and (ii) no registration Person other than the Securities Depository or its nominee. IN 2, has caused these presents to be signed on \_\_\_\_\_, Fund's Declaration of Trust is on file with the Secretary of State Statement as officers and not individually, and the obligations shareholders of the Fund, individually, but are binding only upon MUNICIPAL FUND 2 By: ----- Nicholas I Secretary A-49 128 APPENDIX A NUVEEN CALIFORNIA SERIES M: A series of 10,000 Preferred Shares, par value \$.01 Cumulative Preferred Shares, Series M." Each of the \_\_\_\_\_ deemed to have a Date of Original Issue of \_\_\_\_\_, 2001; Dividend Payment Date of \_\_\_\_\_, 2001; and have such other law or set forth in the Declaration of Trust applicable to Preferred MuniPreferred issued thereafter shall be issued on the first day of the Rate Period, an Applicable Rate equal to the Applicable Rate for shares of such issuance; and shall have such other preferences, limitations and relative Trust applicable to Preferred Shares of the Fund, as set forth in Part Preferred Shares of the Fund, and each share of Series M MuniPreferred series of 10,000 Preferred Shares, par value \$.01 per share, liquidation Preferred Shares, Series F." Each of the \_\_\_\_\_ shares of such have a Date of Original Issue of \_\_\_\_\_, 2001; have such other Payment Date of \_\_\_\_\_, 2001; and have such other preferences set forth in the Declaration of Trust applicable to Preferred Shares of such issued thereafter shall be issued on the first day of a Rate Period with an Applicable Rate equal to the Applicable Rate for shares of such series and shall have such other preferences, limitations and relative preferences applicable to Preferred Shares of the Fund, as set forth in Part Preferred Shares of the Fund, and each share of Series F Muni

NUMBER OF AUTHORIZED SHARES PER SERIES. The number of authorized shares of the Trust is 10,000.

SECTION 3. EXCEPTIONS TO CERTAIN DEFINITIONS. The following terms shall have the following meanings for purposes of this Statement, the following terms shall have the following meanings (unless the context otherwise requires): "ESCROWED BOND" means a bond (i) in accordance with S&P's legal defeasance criteria, (ii) have been assigned a rating of AAA by S&P, (iii) are not rated by S&P but are economically defeased by Moody's and assigned a rating no lower than A-1, and the obligation which is an S&P Eligible Asset does not meet the criteria for Category into which it fell prior to such defeasance. "GROSS-UP PAYMENT" means taken together with the aggregate amount of Taxable Allocation, the amount in dollars (after Federal income tax consequences) from the aggregate of the dividends which would have been received by such Holder if such Holder's A-50 129 income of such Holder. Such Gross-up Payment shall be the amount such Holder of shares of MuniPreferred is subject to the Federal alternative minimum Taxable Allocation and each Gross-up Payment (except to the extent excluded by the Code or successor provisions) would be taxable in the hands of such Holder at the California personal income tax rate applicable to ordinary income, capital gains or net capital gains, as applicable, or the maximum marginal rate of tax applicable, whichever is greater, in effect at the time such Gross-up Payment evidencing interests in one or more Municipal Obligations that are not on a basis that is inverse to the simultaneous readjustment of the income of the issuer, provided that the ratio of the aggregate dollar amount of such Gross-up Payments to exceed one to one at their time of original issuance unless the context otherwise mean, with respect to a Municipal Obligation acquired by the Trust, the following categories into which such Municipal Obligation falls: (i) teaching and non-teaching hospitals, public or private; housing issues (including issues related to public and private schools); transit, airports and highways); industrial development bond issues (including the provision of gas, water, sewers and electricity); general obligation issues ("Other Issues") not falling within one of the aforementioned categories; (ii) one of the following categories into which such Municipal Obligation falls: related to teaching and non-teaching hospitals, public or private facilities issues (including issues related to public and private schools, transit, airports and highways); industrial development bond issues (including issues related to the provision of electricity, either singly or in combination with other issues); utilities issues (including issues related to the provision of water and sewer utilities issues (including issues related to resource recovery, solid waste and sewer utilities categories); general obligation issues; leasehold issues not falling within one of the aforementioned categories. The issuer is a public entity of California or its political subdivisions. Utility issuers are included in the State of California or its political subdivisions. Municipal Obligation shall mean (i) electric, gas and combination issues (if the combination issue is a gas issue does not A-51 130 include an electric issue); and (iii) interest in a Municipal Obligation included in this sub-category (iii) must be rated by S&P in order to be included will be classified within one of the two following sub-categories: (i) multiple revenue streams generated by toll roads, airports, real estate, etc. shall mean, for purposes of determining the Discounted Value of such obligation, the shortest Exposure Period set forth opposite such rating that is set forth below: RATING CATEGORY -----  
 OTHER\*\* (V)MIG-1\*\*\* SP-1+\*\*\* UNRATED\*\*\*\*\* -----









(b) above by \$25,000. SECTION 13. CERTAIN OTHER RES  
Fund will not purchase or sell futures contracts, write, purchase  
(except covered call options) on portfolio securities unless it re  
(then assigned to the MuniPreferred by S&P, except that the Fu  
"Municipal Index") or United States Treasury Bonds or Notes  
"S&P Hedging Transactions"), subject to the following limitat  
(other than transactions which terminate a futures contract or c  
which would cause the Fund at the time of such transaction to  
Index, (B) outstanding futures contracts based on the Municipa  
divided by \$1,000 or (C) outstanding futures contracts based o  
contracts based on the Municipal Index in the 30 days precedin  
engage in any S&P Hedging Transaction based on Treasury B  
own or have sold the lesser of (A) outstanding futures contract  
Fund's total assets divided by \$100,000 (\$200,000 in the case o  
Bonds exceeding in number 10% of the average number of dai  
such transaction as reported by The Wall Street Journal. (iii) th  
Fund owns or has sold or any outstanding option thereon own  
Discounted Value equal to or greater than the MuniPreferred E  
Variation Margin on the second such Valuation Date; (iv) the  
thereon in the month prior to the delivery month under the term  
such terms; and A-58 137 (v) when the fund writes a futures co  
(rated A or better by S&P), fixed-income securities in a segreg  
Margin and Variation Margin held in the account of or on beha  
futures contract or option, or, in the event the Fund writes a fu  
underlying security in its portfolio. For purposes of determinin  
MuniPreferred Basic Maintenance Amount, the Discounted Va  
the aggregate Discounted Value of S&P Eligible Assets shall b  
any outstanding futures contracts based on the Municipal Inde  
of any outstanding futures contracts based on Treasury Bonds  
the Fund will not buy or sell futures contracts, write, purchase  
options (except covered call options) on portfolio securities un  
the ratings then assigned to the MuniPreferred by Moody's, ex  
Index or Treasury Bonds and purchase, write or sell exchange-  
such futures contracts (collectively, "Moody's Hedging Transa  
Transaction based on the Municipal Index (other than Closing  
outstanding futures contracts based on the Municipal Index ex  
Index in the 30 days preceding the time of effecting such trans  
Municipal Index having a Market Value exceeding 50% of the  
than Moody's Eligible Assets already subject to a Moody's He  
Treasury Bonds (other than Closing Transactions) which woul  
based on Treasury Bonds having an aggregate Market Value e  
Aa by Moody's (or, if not rated by Moody's but rated by S&P,  
aggregate Market Value exceeding 40% of the aggregate Mark  
Moody's Eligible Assets already subject to a Moody's Hedging  
AA by S&P) (for purposes of the foregoing clauses (i) and (ii)  
options written by the Fund); A-59 138 (iii) the Fund will enga  
if the amount of open interest in the Municipal Index as report  
close out any outstanding futures contract by no later than the  
Transaction to close out any outstanding option on a futures co  
will engage in Moody's Hedging Transactions only with respec  
immediately thereafter; (vi) the Fund will not engage in option

sell any futures contracts for the purpose of hedging the anticipated value of an option or futures transaction unless, after giving effect there to, the value of the option or futures transaction is equal to or greater than the MuniPreferred Basic Maintenance Amount. If the value of the option or futures transaction is equal to or greater than the MuniPreferred Basic Maintenance Amount, the Fund is obligated to deliver or receive pursuant to an outstanding futures contract that is either exchange-traded and "readily reversible" or which is not exchange-traded and "readily reversible" and (a) the Discounted Value and (b) the exercise price of the call option. The requirements of clause (i) of this sentence shall have no value; (ii) the exercise price and (B) the Discounted Value of the subject security; (iv) the value of the subject security, provided that, if a contract matures within the term of the subject security, it may be valued at the settlement price and where the Fund is the counterparty to the delivery, delivery may be made to the Fund with any security of a class or classes having a value of at least the Discounted Value. For purposes of determining whether the Fund has Moody's Eligible Basic Maintenance Amount, the following amounts shall be substituted for the Discounted Value: (i) 10% of the exercise price of a written call option; (ii) the exercise price of the futures contract; (iii) the settlement price of the futures contract; (iv) where the Fund is the counterparty to the futures contract; (v) the settlement price of the underlying futures contract. For purposes of determining whether the Fund has Moody's Eligible Basic Maintenance Amount, the Fund will not enter into any contract to purchase securities other than such contracts that constitute Moody's Hedging Transactions. For purposes of determining whether the Fund has Moody's Eligible Basic Maintenance Amount, the Discounted Value of all Forward Commitments shall be zero. A-61 140 APPENDIX A Moody's Credit Ratings applicable Standard & Poor's Corporation ("S&P") rating symbol and the meaning of the current opinion of the creditworthiness of an obligor with respect to the obligation. program. It takes into consideration the creditworthiness of guarantors and provides a recommendation to purchase, sell, or hold a financial obligation. Moody's credit ratings are based on current information furnished by the obligor and does not perform an audit in connection with any credit rating. Moody's credit ratings are suspended, or withdrawn as a result of changes in, or unavailable information, or short term. Short-term ratings are generally assigned to those obligations with an original maturity of no more than 365 days. Moody's credit ratings for obligor with respect to put features on long-term obligations. Moody's credit ratings are assigned to usual long-term rating. Medium-term notes are assigned long-term ratings in degrees, on the following considerations: 1. Likelihood of payment in accordance with the terms of the obligation; 2. Nature of and probability of occurrence of event of bankruptcy, reorganization, or other arrangement under which the obligation is expressed in terms of default risk. As such, they pertain to senior obligations and reflect the lower priority in bankruptcy, as noted above. AAA indicates that the obligor's capacity to meet its financial commitment on the obligation is strong. AA indicates a small degree. The obligor's capacity to meet its financial commitment on the obligation is susceptible to the adverse effects of changes in circumstances. A indicates that the obligor's capacity to meet its financial commitment on the obligation is still strong. BBB indicates that conditions or changing circumstances are more likely to lead to a rating of BB, CC, and C Obligations rated "BB", "B", "CCC", "CC", and "C".

speculation and "C" the highest. While such obligations will likely be subject to significant or major exposures to adverse conditions. BB An obligation rated "BB" is subject to ongoing uncertainties or exposure to adverse business, financial, or economic conditions that may impair the obligor's ability to meet its financial commitment on the obligation. B An obligation rated "B" is more likely than not to meet its financial commitment on the obligation. Adverse business, financial, or economic conditions may impair its financial commitment on the obligation. CCC An obligation rated "CCC" is subject to adverse financial, and economic conditions for the obligor to meet its financial commitment on the obligation. Under these conditions, the obligor is not likely to have the capacity to meet its financial commitment on the obligation and is vulnerable to nonpayment. C The "C" rating may be used to indicate that the obligor's payments on this obligation are being continued. D An obligation rated "D" is in payment default. If payments are not made on the date due even if the applicable grace period has expired, the obligation is in default. The "D" rating also will be used upon the filing of a bankruptcy petition. Plus (+) or minus (-). The ratings from "AA" to "CCC" may be further divided into sub-categories. B-2 142 c The "c" subscript is used to provide additional information when the long-term credit rating of the issuer is below an investment grade rating. A provisional rating assumes the successful completion of the project. A rating with a "p" subscript is provisional. A provisional rating assumes the successful completion of the project, requirements is largely or entirely dependent upon the successful completion of the project, makes no comment on the likelihood of successful completion. \* Continuation of an investment grade rating requires an agreement or closing documentation confirming investments and other factors. Poor's believes may experience high volatility or high variability in the value of principal or interest return indexed to equities, commodities, or other assets. The absence of an "r" symbol should not be taken as an indication of the creditworthiness of obligations of issuers outside the United States and its territories. The ratings do not take into account commercial bank regulations issued by the Comptroller of the Currency (the "regulations") generally are regarded as eligible for investment by sav- ing institutions. CREDIT RATINGS NOTES A Standard & Poor's note rating of "A-1" or better will likely receive a note rating. Notes maturing beyond three years are subject to that assessment: o Amortization schedule--the larger the final payment --the more dependent the issue is on the market for it. SP-1 Strong capacity to pay principal and interest. An issue designated "SP-1" has a Satisfactory capacity to pay principal and interest, with some vulnerability. Satisfactory capacity to pay principal and interest. A note rating is not a recommendation or suitability for a particular investor. The ratings are based on Standard & Poor's analysis and are not an audit. S&P does not perform an audit in connection with any rating. A rating may be suspended, or withdrawn as a result of changes in or unavailability of information. A commercial paper rating is a current assessment of the likelihood of payment. A rating is divided into several categories, ranging from "A-1" for the highest quality. A rating of "A-1" is rated in the highest category by Standard & Poor's. A rating of "A-1" category, certain obligations are designated with a plus sign (+) or minus sign (-). A-1 extremely strong. A-2 A short-term obligation rated "A-2" is slightly less strong than obligations in higher rating categories. However, the obligation is still strong. A-3 An obligation rated "A-3" exhibits adequate protection parameters. A-3 weakened capacity of the obligor to meet its financial commitment on the obligation. A-3 speculative characteristics. The obligor currently has the capacity to meet its financial commitment on the obligation which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation to nonpayment and is dependent upon favorable business, financial, or economic conditions. A short-term obligation rated "D" is in payment default. The "D" rating is used when the applicable grace period has not expired, unless Standard & Poor's

will be used upon the filing of a bankruptcy petition or the taking of a  
recommendation to purchase, sell, or hold a security inasmuch as the issuer  
on current information furnished to S&P by the issuer or obtained from  
any rating and may, on occasion, rely on unaudited financial information  
unavailability of such information or based on other circumstances.  
Inc. ("Moody's") rating symbols and their meanings (as published by Moody's  
the best quality. They carry the smallest degree of investment risk. Aaa  
exceptionally stable margin and principal is secure. While the risk may  
impair the fundamentally strong position of such issues. Aa Bonds which  
group they comprise what are generally known as high grade bonds. Aa  
"Aaa" securities or fluctuation of protective elements may be somewhat  
somewhat larger than in "Aaa" securities. A Bonds which are rated Aa  
grade obligations. Factors giving security to principal and interest are  
sometime in the future. Baa Bonds which are rated "Baa" are considered  
Interest payments and principal security appear adequate for the foreseeable  
any great length of time. Such bonds lack outstanding investment  
are judged to have speculative elements; their future cannot be predicted  
moderate and thereby not well safeguarded during both good and bad  
are rated "B" generally lack characteristics of the desirable investment  
over any long period of time may be small. Caa Bonds which are rated  
danger with respect to principal or interest. B-5 145 Ca Bonds which are  
often in default or have other marked shortcomings. C Bonds which are  
extremely poor prospects of ever attaining any real investment value.  
U.S. government obligations or non-callable obligations unconditionally  
# (hatchmark) symbol, e.g., #Aaa. Con. (...): Bonds for which the interest  
conditionally. These are bonds secured by (a) earnings of project, (b)  
begin when facilities are completed, or (d) payments to which the issuer  
completion of construction or elimination of the basis of the construction  
from Aa through Caa. The modifier 1 indicates that the obligation is  
and the modifier 3 indicates a ranking in the lower end of that category  
credit quality. Excellent protection is afforded by established collateral  
refinancing. MIG 2/VMIG 2 This designation denotes strong credit quality.  
3/VMIG 3 This designation denotes acceptable credit quality. VMIG 4  
less well-established. SG This designation denotes speculative grade  
COMMERCIAL PAPER Issuers rated Prime-1 (or related supporting institutions)  
repayment ability will normally be evidenced by the following characteristics:  
funds employed. -- Conservative capitalization structures with low levels  
of fixed financial charges and high internal cash generation. -- Issuers  
Issuers rated Prime-2 (or related supporting institutions) have many of  
many of the characteristics cited above but to a lesser degree. Issuers  
characteristics, while still appropriate, may be more affected by economic  
supporting institutions) have an acceptable ability for repayment. Their  
may be more pronounced. Variability in earnings and profitability may  
relatively high financial leverage. Adequate alternate liquidity sources.  
IBCA, Inc.--A brief description of the applicable Fitch IBCA, Inc. RATING  
RATINGS INVESTMENT GRADE AAA Highest credit quality. AAA denotes  
exceptionally strong capacity for timely payment of financial commitments.  
high credit quality. "AA" ratings denote a very low expectation of  
capacity is not significantly vulnerable to foreseeable events. AA denotes  
payment of financial commitments is considered strong. This category is  
than is the case for higher ratings. BBB Good credit quality. "BBB"

payment of financial commitments is considered adequate, but This is the lowest investment-grade category. SPECULATIVE particularly as the result of adverse economic change over time to be met. Securities rated in this category are not investment grade, margin of safety remains. Financial commitments are currently sustained, favorable business or economic developments. A "C" business and economic environment. CCC, CC, C High default sustained, favorable business or economic developments. A "C" DDD, DD, and D Default. The ratings of obligations in this category liquidation of the obligor. While expected recovery values are guidelines. "DDD" obligations have the highest potential for recoveries in the range of 50%-90%, and "D" the lowest recoveries obligations. Entities rated "DDD" have the highest prospect for recovery. Entities rated "DD" and "D" are generally undergoing a formal liquidation of outstanding obligations, while entities rated "D" have a poor prospect of meeting time horizon of less than 12 months for most obligations, or up to 12 months necessary to meet financial commitments in a timely manner. Entities rated "C" commitments; may have an added "+" to denote any exceptional circumstances. Entities rated "CCC" financial commitments, but the margin of safety is not as great as "C". Entities rated "CC" commitments is adequate; however, near-term adverse change in business conditions may impair payment of financial commitments, plus vulnerability to near-term adverse change in business conditions possibility. Capacity for meeting financial commitments is solid. Entities rated "C" Denotes actual or imminent payment default. Notes: "+" or "-" to denote a rating not added to the "AAA" long-term rating category, to categorize the issuer or issue in question. "Withdrawn": A rating is withdrawn for a variety of purposes, or when an obligation matures, is called, or refinanced. "Outlook": A rating probability of a rating change and the likely direction of such a change, "Downgrade", "Downgrade", or "Evolving", if ratings may be raised, lowered or stable. "Stable" indicates the direction a rating is likely to move over a one to two year period. "Evolving" does not imply a rating change is inevitable. Similarly, comparable ratings may be used if circumstances warrant such an action. Occasionally, Fitch may use "Evolving" ratings. B-9 149 APPENDIX C HEDGING STRATEGIES AND FINANCIAL INSTRUMENTS

**FUTURES AND INDEX TRANSACTIONS** FINANCIAL FUTURES AND INDEX TRANSACTIONS are contracts for a set price on a future date. They have been designed by both the Commodity Futures Trading Commission ("CFTC"). The purchase of financial futures is for the Fund purchases a financial future, it deposits in cash or securities in a margin account is either credited or debited on a daily basis in correlation to the price of the exchange in order to maintain an orderly market. The Fund may purchase financial futures in excess of the liquidity. The Fund may close out its position at any time. The determination of debits and credits is made, additional cash is required to cover the Fund on whether on a net basis it made or received such payments. The Fund may purchase long-term debt securities. For example, if the Fund owns long-term debt securities and the price did increase, the value of long-term bonds in the Fund's portfolio would increase approximately the same rate thereby keeping the net asset value of the Fund. The use of financial futures by the Fund as a hedging device, perhaps to hedge against price movements in the price of the debt securities which are the subject of the hedge, the price of the securities which are the subject of the hedge, the hedge is established using financial futures in a greater dollar amount than the dollar amount of the debt securities. The hedge is greater than the historical volatility of the financial futures. Correlation of the debt securities being hedged is less than the historical volatility of the financial futures. Correlation of interest rates. One of these factors is the possibility that rapid changes in interest rates by speculators, would temporarily distort the normal relationship





2001, the largest IOU, Pacific Gas & Electric Company, filed default of various obligations, and may be forced into bankruptcy which is intended to restore its financial viability. In mid-January 2001, The Governor declared a state of emergency under State law on purchasing electricity for resale to retail end use customers, to DWR also started to enter into long-term power supply contracts for advances from the State's General Fund; almost \$5 billion was customer's payments, remitted through the IOUs, but these amount to purchase costs, are intended to be funded from the issuance of bonds to authorize issuance of these revenue bonds, expected to be issued from sufficient cash reserves and available internal borrowings to fund from a dedicated revenue stream derived from customer payments. These bonds will not be backed in any way by the faith and credit of the State ("CPUC") to increase rates for electricity supplied by the DWR. Proceedings of the two largest IOUs, but further proceedings will be necessary to address challenging aspects of recent CPUC decisions concerning rate of load management and improved energy efficiency in government facilities. Smaller and "peaking" power facilities, has been accelerated. A line in 2001-2003. As noted, the State is seeking longer term purchase of wholesale electricity costs in the future and promote the financing of limited pipeline capacity into the State, and nationwide price increases produced, as natural gas prices are not regulated. One of the State's supplies. Significant interruption in natural gas supplies could affect gas. A number of additional plans are under consideration by the State or purchase power generation or transmission facilities and associated costs incurred in purchasing power. In April, 2001, the Governor entered into an agreement among a number of things, purchase of the IOU's long-distance transmission approval from both the CPUC and Federal Energy Regulatory Commission form. A number of lawsuits are pending dealing with many aspects of the charge retail customers, financial responsibility for purchases of power.

**CONSTITUTIONAL LIMITATIONS ON TAXES, OTHER CHARGES AND FEES**

Obligations may be obligations of issuers which rely in whole or in part on the powers of California local governments and districts are limited by Proposition 13. Briefly, Article XIII A limits to 1% of full value the reassessment of property to 2% per year, except under new conditions. It also raises ad valorem taxes above the 1% limit to pay debt service on bonds applied against the assessed value of property as of the owner's death. The system has resulted in widely varying amounts of tax on similar property under the system of Proposition 13, but it was upheld by the U.S. Supreme Court. Taxes above the 1% limit; it also requires voters of any government to approve Charges. On November 5, 1996, the voters of the State approved Proposition XIII D to the State Constitution, which contain a number of provisions on assessments, fees and charges. Article XIII C requires that all new taxes for general governmental purposes require a majority vote and tax levies are making it generally more difficult for local agencies to levy and collect new provisions affecting "fees" and "charges," defined for purposes of being imposed by a [local government] upon a parcel or upon a person or entity. All new and existing property related fees and charges must be approved by exceeding the funds required to provide the property related services. Any new levying or increasing property related fees and charges, and, except for those in service, which are not treated as "property related" for purposes of

approval by the property owners subject to the fee or charge on the area. In addition to the provisions described above, Article XII of the California Constitution provides that local voters may, by initiative or referendum, repeal or amend any law or ordinance. Consequently, local voters could, by future initiative, repeal, or amend any law or ordinance. It is unclear how this right of local initiative may be used in California. The interpretation and application of Proposition 218 will ultimately be determined by the courts. We cannot predict with certainty the outcome of such determinations. For example, Proposition 218 may, for one reason, some ratings of California cities and counties have been downgraded because of the "appropriations limit" imposed by Article XIII B of the California Constitution in 1988 and 1990, respectively. Article XIII B prohibits the State from incurring any debt, including the appropriations limit imposed. "Appropriations subject to the limit" include, but are not limited to, other funds, including proceeds from regulatory licenses, user fees, and certain taxes, but "proceeds of taxes" exclude most State subvention taxes, such as reasonable user charges or fees, and certain other taxes. Appropriations subject to the appropriations limit are (1) the debt service cost of bonds issued by the State to comply with mandates of courts or the federal government, (2) the cost of increases in gasoline taxes and vehicle weight fees, and (3) the cost of annual adjustments to reflect changes in cost of living and population, and (4) certain adjustments were liberalized in 1990 to follow more closely general fund appropriations. State governments must return any excess to taxpayers by rate reductions, and certain colleges. With more liberal annual adjustment factors since 1990, many local governments are operating near their spending limits, but this condition may change in the next few years. For the last ten years, appropriations subject to limitation have been reduced. In 1999-2000, State appropriations were estimated to be about \$7 billion; in 2000-01, the State Department of Finance estimates the State will spend about \$7 billion. The nature of Articles XIII A, XIII B, XIII C and XIII D of the California Constitution makes it difficult to predict future appropriations or changes in population and other factors. We cannot determine fully the impact of these Articles on California municipal obligations. It is not possible, at the present time, to determine the constitutionality of these Articles or the impact of any such determination on their obligations. Further initiatives or legislative changes in local government obligations. D-4 155 OBLIGATIONS OF THE STATE OF CALIFORNIA. The second charge to the General Fund after support of the State's share of the outstanding approximately \$22.6 billion of long-term general obligation bonds and long-term bonds in the future, and \$6.7 billion of lease-purchase obligations and unissued long-term general obligation bonds and lease-purchase obligations, is approximately 3.7% of General Fund revenues. RECENT FINANCIAL TRENDS. California personal income tax (55 percent of total revenues), sales tax (2 percent), insurance (2 percent). An estimated 20% of personal income tax revenues are derived from income. While these sources have been extraordinarily strong in the past, the stock market levels and reduced its estimated receipts from the State (the "SFEU"), derived from General Fund revenues, as a reserve to meet contingencies, are available. Year-end balances in the SFEU are increasing. State spending increased rapidly as the State population and economy grew in the 1970s, which were constrained by Proposition 13 and other laws. The State's financial condition in 1998 was enacted which (subject to suspension by a two-thirds majority of the State's legislative districts a minimum share of State General Fund revenues (currently 1.5 percent) from 1990-94 during which the State experienced substantial revenue losses. Since 1994, the State's financial condition improved markedly. The State's slowdown in growth of social welfare programs, and continued economic growth in the second half of the 1990's, and as a result, the General Fund total revenues were \$1.7 billion in 1997-98, \$1.7 billion in 1998-99 and \$8.2 billion in 1999-00.

largely directed to school spending as mandated by Proposition 13 in 1998-99 and 1999-2000, significant new spending programs were finally eliminated. The Department of Finance estimates that General Fund revenues since the end of the recession resulted in significant increases of about \$4,200 per pupil, annual State funding has increased to \$1.78 billion, directed to specific educational reforms, including reduction of state support for higher education in the State, permitting increased state welfare reform legislation to implement the new federal law provisions. The Administration emphasizes programs to bring aid recipients into the workforce and welfare costs have been contained even during the recent recession occurring in 1999-2000 and additional increases in 2000-01. The largest of these was a phased-in cut in the Vehicle License Fee (VLF). The VLF was reduced by 25 percent, which was increased to a 35% cut under pre-existing law, VLF funds are automatically transferred to cities. The full 67.5% percent VLF cut will be offset by about \$2.6 billion in other measures included an increase in the dependent credit exemption for personal income tax relief measures. Fiscal Year 2000-01 Budget. By the spring of 2000, revenue and expenditure projections for 1999-2000 and 2000-01 resulted in extraordinary growth in revenues, particular personal income tax, \$8.2 billion, an increase of \$8.2 billion above the original Budget Act projections. The projected balance in the SFEU at June 30, 2000 increased from \$1.78 billion to \$1.78 billion. "Constitutional Limitations on Taxes, Other Charges and Appropriations." The Constitutional appropriations limit in fiscal year 1999-2000. The Administration projected 2000-01, compared to initial estimates made in January 2000. The Administration assumed General Fund revenues and transfers of \$73.9 billion (including \$1.78 billion in 1999-2000). To avoid pressures on future budgets, the Administration estimated that the SFEU would have a balance of \$1.78 billion, including litigation costs, which have been spent. Because of the State's anticipation note borrowing in 2000-01. The largest program increase was in capital outlay levels. There was also a large increase in funding for the public schools, including \$2.0 billion General Fund support for the six-year \$6.9 billion transportation package. A total of about \$1.78 billion under "Recent Budgets." The Legislature also enacted a one-time personal income tax credit for credentialed teachers (\$218 million) and a \$200 million unrestricted grant to cities and counties, as well as \$1.78 billion. As noted, the Administration projected a budget reserve in the SFEU of \$1.78 billion, \$350 million of "loans" which the General Fund made to local governments. Settlement of litigation over these transactions in July 1996 caused a \$1.78 billion settlement from the General Fund and from schools' entitlements. The 2000-01 settlement. Reports since the FY 2000-01 Budget Act was enacted. As a result, the State will reduce its sales tax by 0.25% for 2001 during calendar year 2001. On January 10, 2001, the Governor announced that the Administration released updated estimates and budgetary projections for 2000-01 would be about \$78 billion, \$1.1 billion above the Governor's original signed. Expenditures for 2000-01 were estimated to be about \$78 billion for the SFEU, the budget reserve, at June 30, 2001 from \$1.78 billion. The Administration will expend all of these funds for energy purchases. The May Revenue Report noted that the weakening economy and, most particularly the sharp decline in oil option income, would have a severe impact on revenues in 2001. General Fund revenues in fiscal year 2001-02 were projected to be reduced if economic activity is more strongly affected by the

May Revision proposed a reduction of more than \$3 billion in utilizing a portion of the expected surplus. The May Revision Budget. The final 2001-02 budget will be adopted in the summer. The economy has produced record revenues to the State government under the current economic conditions, and it continues to be marked by mandated spending increases for many immigrants. These factors which limit State spending growth, if they weaken, or other factors intercede, the State will not experience a significant increase in bonds were reduced in the early 1990's from "AAA" levels which were maintained by agencies raised their ratings of California's general obligation bonds. On June 15, 2001, Standard & Poor's had reduced California's senior general obligation bonds situation. As of that date, Fitch had placed California's ratings on a "watch" list, but maintained in the future. It should be noted that the creditworthiness of the State's obligations issued by the State of California, and that there is no risk of default.

**LEGAL PROCEEDINGS** The State is involved in certain legal proceedings which may require the State to make significant future expenditures or commitments which may not have to be implemented in one year.

**OBLIGATIONS** The State's obligations to agencies, instrumentalities and political subdivisions of the State are primarily payments from private borrowers. These entities are subject to the same risks as they vary considerably from the credit quality of obligations backed by the State. Local governments declined more than 50% following passage of Proposition 13 and the redistribution of the State's General Fund surplus to local agencies. The State's governmental functions by the State to assist municipal issuers in the State are 75% of General Fund expenditures in recent years, including the State's aid to school districts, the 1992-93 and 1993-94 Budget Acts caused a significant reduction of the post-Proposition 13 "bailout" aid. Local governments have been forced to raise taxes. In 1997, a new program provided for the State to substantially increase its aid. In the last several years, the State has also provided \$100 million annually in unrestricted grants to cities and counties. To the extent the State's aid is reduced by Proposition 98, or other fiscal considerations, the absolute level of aid is reduced. Reductions in State aid could compound the serious fiscal conditions in the largest in the State, was forced to make significant cuts in services. In 1996 and FY1996-97. Orange County, which emerged from Federal bankruptcy protection and faces strict financial conditions following large investment commitments, is under pressures as a result of changes in welfare and public assistance programs. State law. Generally, counties play a large role in the new system, and the State's workforce. Counties are also given financial incentives if either the State or counties are also subject to financial penalties for failure to meet certain requirements who are ineligible for other welfare programs. The long-term financing of the State's Bonds. California Municipal Obligations which are assessment-backed bonds, and real estate sales activity. In many cases, such bonds are secured by special assessments after issuance. In the event of such reduction or slowdown, such bonds are not secured. Because the special assessments or taxes securing these bonds are not secured, the security for the bonds. Moreover, in most cases the issuer of the bonds is the issuer of the assessments or taxes, except from amounts, if any, in a reserve fund. In the event of such decisions, certain long-term lease obligations, though typically secured by the issuer, requiring voter approval. Such leases, however, are subject to the municipality during the term of the lease. Abatement is not required for the lease obligation in the event abatement occurs. The most common type of lease obligation during which lease payments have been capitalized and uninsured. In the event of a default to a lease obligation, lease payments may be interrupted (if all payments are not due). Although litigation is brought from time to time, which could result in a default.

in August, 1998 which reconfirmed the legality of these financ  
secured by real property may be affected by California laws li  
affected by changes in State regulations governing cost reimbu  
related to the policy of awarding exclusive contracts to certain  
issued by California redevelopment agencies. Such bonds are  
redevelopment activity. In the event that assessed values in the  
tax increment revenue may be insufficient to make principal an  
allocation bonds after the enactment of Articles XIII A and XII  
in 1988, requires that all revenues produced by a tax rate incre  
obligation indebtedness. As a result, redevelopment agencies (C  
increment when taxes on property in the project area are increa  
and statutory changes upon the ability of California municipal  
measures affecting the taxing or spending authority of Californ  
be introduced which would modify existing taxes or other reve  
of state and local governments to impose new taxes or increas  
enacted. Nor is it possible, at present, to determine the impact  
allocations of state revenues to local governments or the abilit  
Municipal Obligations. Substantially all of California is within  
California in 1994 experienced major earthquakes causing billi  
earthquakes, and neither event has had any long-term negative  
interruption of revenues because of damaged facilities, or, con  
Compensatory financial assistance could be constrained by the  
perform on its contracts of insurance in the event of widesprea  
budget limitations. CALIFORNIA TAX MATTERS The follow  
Fund. The following is a general, abbreviated summary of cert  
taxation of resident individual and corporate MuniPreferred sh  
discuss any local taxes that may be applicable. These provision  
with respect to transactions of the Fund. The following is base  
investment company, that it will satisfy the conditions which v  
and California purposes, and that it will distribute all interest a  
franchise and corporation income tax only if it has a sufficient  
does not expect to pay a material amount of such tax. If at the  
obligations that, when held by individuals, pay interest that is  
attributable to interest on any such obligation will not be subje  
capital gains, will be includable in gross income for purposes o  
acquiring or maintaining an investment in the MuniPreferred s  
distributions of the Fund, regardless of source, to corporate M  
gross income for purposes of such tax. Gain on the sale, excha  
corporate franchise tax. In addition, any loss realized by a hold  
the extent of any exempt interest dividends received with respo  
before or after the acquisition of other MuniPreferred shares m  
estate tax if held by a California decedent at the time of death.  
information concerning California tax matters. D-11