MUNI INTERMEDIATE DURATION FUND INC
Form N-2/A
July 27, 2005
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As filed with the Securities and Exchange Commission on July 27, 2005

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-2

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933	x
Pre-Effective Amendment No. 1	x
Post-Effective Amendment No.	¨
and/or	
REGISTRATION STATEMENT UNDER THE INVESTMENT COMPANY ACT OF 1940	x
AMENDMENT NO. 6	x
(Check appropriate box or boxes)	

MUNI INTERMEDIATE DURATION FUND, INC.

(Exact Name of Registrant as Specified in Charter)

800 Scudders Mill Road

Plainsboro, New Jersey 08536

(Address of Principal Executive Offices)

(Registrant s Telephone Number, Including Area Code) (609) 282-2800

Robert C. Doll, Jr.

Muni Intermediate Duration Fund, Inc.

800 Scudders Mill Road, Plainsboro, New Jersey 08536

Mailing Address: P.O. Box 9011, Princeton, New Jersey 08543-9011

(Name and Address of Agent for Service)

Copies to:

Andrew J. Donohue, Esq.

FUND ASSET MANAGEMENT, L.P.

P.O. Box 9011

Princeton, New Jersey 08543-9011

Frank P. Bruno, Esq.

SIDLEY AUSTIN BROWN & WOOD LLP

787 Seventh Avenue

New York, New York 10019

Approximate date of proposed public offering:

As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended (the Securities Act), other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. ¨

CALCULATION OF REGISTRATION FEE UNDER THE SECURITIES ACT OF 1933

Title of Securities Being Registered	Amount being Registered	Proposed Maximum Offering Price Per Unit(1)	Proposed Maximum Aggregate Offering Price(1)	Amount of Registration Fee(2)
Auction Market Preferred Stock	1,400 shares	$ 25,000	$ 35,000,000	$ 4,120

(1) Estimated solely for the purpose of calculating the registration fee.
(2) Previously paid.

The Registrant hereby amends this Registration Statement on such date or dates as may become necessary to delay its effective date until the Registrant shall file a further amendment, which specifically states that this Registration Statement shall thereafter become

effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Subject to Completion

Preliminary Prospectus dated July 27, 2005

PROSPECTUS

$35,000,000

Muni Intermediate Duration Fund, Inc.

Auction Market Preferred Stock (AMPS)

1,400 Shares, Series TH28

Liquidation Preference $25,000 per Share

Muni Intermediate Duration Fund, Inc. is a non-diversified, closed-end fund. The investment objective of the Fund is to provide common stockholders with high current income exempt from Federal income taxes. The Fund seeks to achieve its investment objective by investing, as a fundamental policy, at least 80% of its net assets (including assets acquired from the sale of preferred stock), plus the amount of any borrowings for investment purposes, in a portfolio of municipal obligations the interest on which, in the opinion of bond counsel to the issuer, is excludable from gross income for Federal income tax purposes (except that the interest may be includable in taxable income for purposes of the Federal alternative minimum tax). Under normal market conditions, the Fund expects to invest at least 75% of its total assets in municipal obligations that are rated investment grade or, if unrated, are considered by the Fund s investment adviser to be of comparable quality. The Fund may invest up to 25% of its total assets in municipal obligations that are rated below investment grade (commonly known as junk bonds) or, if unrated, are considered by the Fund s investment adviser to possess similar credit characteristics. Under normal market conditions and after the initial investment period following this offering (expected to be approximately three months), the Fund will invest, as a non-fundamental policy, at least 80% of its net assets (including assets acquired from the sale of preferred stock), plus the amount of any borrowings for investment purposes, in municipal obligations with a duration, as calculated by the Fund s investment adviser, of three to ten years. The Fund expects to maintain, under normal market conditions, a dollar-weighted average portfolio duration, as calculated by the Fund s investment adviser, of three to ten years. The Fund may invest in certain tax exempt securities classified as private activity bonds, as discussed within, that may subject certain investors in the Fund to an alternative minimum tax. There can be no assurance that the Fund s investment objective will be realized.

This prospectus contains information you should know before investing, including information about risks. Please read it before you invest and keep it for future reference. The Fund s statement of additional information dated , 2005 contains further information about the Fund and is incorporated by reference (legally considered to be part of this prospectus) and the table of contents of the statement of additional information appears on page 56 of this prospectus. A copy of the statement of additional information and copies of the Fund s semi-annual and annual reports may be obtained without charge by writing to the Fund at its address at 800 Scudders Mill Road, Plainsboro, New Jersey 08536, or by calling the Fund at (800) 543-6217. In addition, you may request other information about the Fund or make stockholder inquiries by calling the Fund toll-free at (800) 543-6217. In addition, the Securities and Exchange Commission maintains a website (http://sec.gov) that contains the statement of additional information, material incorporated by reference and other information regarding registrants that file electronically with the Securities and Exchange Commission. The Fund does not maintain a website.

Certain capitalized terms used herein not otherwise defined in this prospectus have the meaning provided in the Glossary at the back of this prospectus.

Investing in the AMPS involves certain risks that are described in the Risk Factors and Special Considerations section beginning on page 10 of this prospectus. The minimum purchase amount for the AMPS is $25,000.

	Per Share	Total
Public offering price	$ 25,000	$ 35,000,000
Underwriting discount	$250	$350,000
Proceeds, before expenses, to the Fund (1)	$ 24,750	$ 34,650,000

(1) The estimated offering expenses payable by the Fund are $150,000.

The public offering price per share will be increased by the amount of accumulated dividends, if any, from the date the shares are first issued.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

One certificate for the AMPS will be ready for delivery to the nominee of The Depository Trust Company on or about , 2005.

Merrill Lynch & Co.

The date of this prospectus is , 2005.

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Information about the Fund can be reviewed and copied at the Securities and Exchange Commission s Public Reference Room in Washington, D.C. Call 1-202-942-8090 for information on the operation of the public reference room. This information is also available on the Securities and Exchange Commission s Internet site at http://www.sec.gov and copies may be obtained upon payment of a duplicating fee by writing to the Public Reference Section of the Securities and Exchange Commission, Washington, D.C. 20549-0102.

You should rely only on the information contained in this prospectus. We have not, and the underwriter has not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriter is not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus is accurate only as of the date on the front cover of this prospectus. Our business, financial condition, results of operations and prospects may have changed since that date.

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PROSPECTUS SUMMARY

This summary is qualified in its entirety by reference to the detailed information included in this prospectus and the statement of additional information.

The Fund Muni Intermediate Duration Fund, Inc. is a non-diversified, closed-end management investment company.

The Offering The Fund is offering a total of 1,400 shares of Auction Market Preferred Stock, Series TH28, at a purchase price of $25,000 per share plus accumulated dividends, if any, from the date the shares are first issued. The shares of AMPS are being offered by Merrill Lynch, Pierce, Fenner & Smith Incorporated (Merrill Lynch), as underwriter.

The Series TH28 AMPS will be shares of preferred stock of the Fund that entitle their holders to receive cash dividends at an annual rate that may vary for the successive dividend periods. In general, except as described below, each dividend period following the initial dividend period will be 28 days. The applicable dividend for a particular dividend period will be determined by an auction conducted on the business day next preceding the start of that dividend period.

Investors and potential investors in shares of Series TH28 AMPS may participate in auctions for the AMPS through their broker-dealers.

Generally, AMPS investors will not receive certificates representing ownership of their shares. Ownership of AMPS will be maintained in book-entry form by the securities depository (The Depository Trust Company) or its nominee for the account of the investor s agent member (generally the investor s broker-dealer). The investor s agent member, in turn, will maintain records of such investor s beneficial ownership of AMPS.

Investment Objective and Policies The investment objective of the Fund is to provide common stockholders with high current income exempt from Federal income taxes. The Fund seeks to achieve its investment objective by investing, as a fundamental policy, at least 80% of its net assets (including assets acquired from the sale of preferred stock), plus the amount of any borrowings for investment purposes, in a portfolio of municipal obligations issued by or on behalf of states, territories and possessions of the United States and their political subdivisions, agencies or instrumentalities, each of which pays interest that, in the opinion of bond counsel to the issuer, is excludable from gross income for Federal income tax purposes (Municipal Bonds). In general, the Fund does not intend for its investments to earn a large amount of interest income that is not exempt from Federal income tax, except that the interest may be includable in taxable income for purposes of the Federal alternative minimum tax. There can be no assurance that the Fund s investment objective will be realized.

Duration. Under normal market conditions, and after the initial investment period following this offering (expected to be approximately three months), the Fund will invest, as a non-fundamental policy, at least 80% of its net assets (including assets acquired from the sale of preferred stock), plus the amount of any borrowings for investment purposes, in Municipal Bonds with a duration, as calculated by Fund Asset Management, L.P. (the Investment Adviser), of three to ten years. The Fund expects to maintain, under normal market conditions, a dollar-weighted average portfolio duration, as calculated by the Investment Adviser, of three to ten years. There is no limit on the remaining maturity of each individual Municipal Bond investment by the Fund.

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Investment Grade Municipal Bonds. Under normal market conditions, the Fund invests at least 75% of its total assets in Municipal Bonds that are rated investment grade by one or more nationally recognized statistical rating organizations (NRSROs) (Baa or higher by Moody s Investors Service, Inc. (Moody s) or BBB or higher by Standard & Poor s (S&P) or Fitch Ratings (Fitch)) or in unrated bonds considered by the Investment Adviser to be of comparable quality. In assessing the quality of Municipal Bonds, the Investment Adviser takes into account any letters of credit or similar credit enhancement to which particular Municipal Bonds are entitled and the creditworthiness of the financial institution that provided such credit enhancement.

High Yield or Junk Bonds. The Fund may invest up to 25% of its total assets in high yield Municipal Bonds (commonly known as junk bonds) that are rated below investment grade by the NRSROs (Ba or lower by Moody s or BB or lower by S&P or Fitch) or are unrated securities that are considered by the Investment Adviser to possess similar credit characteristics. Although junk bonds generally pay higher rates of interest than investment grade bonds, they are high risk investments that may cause income and principal losses for the Fund. Junk bonds generally are less liquid and experience more price volatility than higher rated debt securities. The issuers of junk bonds may have a larger amount of outstanding debt relative to their assets than issuers of investment grade bonds. In the event of an issuer s bankruptcy, claims of other creditors may have priority over the claims of junk bond holders, leaving few or no assets available to repay junk bond holders. Junk bonds may be subject to greater call and redemption risk than higher rated debt securities.

Indexed and Inverse Floating Rate Securities. The Fund may invest in securities whose potential returns are directly related to changes in an underlying index or interest rate, known as indexed securities. The return on indexed securities will rise when the underlying index or interest rate rises and fall when the index or interest rate falls. The Fund may also invest in securities whose return is inversely related to changes in an interest rate (inverse floaters). In general, income on inverse floaters will decrease when short term interest rates increase and increase when short term interest rates decrease. Investments in inverse floaters may subject the Fund to the risks of reduced or eliminated interest payments and loss of principal. In addition, certain indexed securities and inverse floaters may increase or decrease in value at a greater rate than the underlying interest rate, which effectively leverages the Fund s investment. As a result, the market value of such securities will generally be more volatile than that of fixed rate, tax exempt securities. Both indexed securities and inverse floaters are derivative securities and can be considered speculative.

Hedging Transactions. The Fund may seek to hedge its portfolio against changes in interest rates using options and financial futures contracts or swap transactions. The Fund s hedging transactions are designed to reduce volatility, but come at some cost. For example, the Fund may try to limit its risk of loss from a decline in price of a portfolio security by purchasing a put option. However, the Fund must pay for the option, and the price of the security may not in fact drop. In large part, the success of the Fund s hedging activities depends on its ability to forecast movements in securities prices and interest rates. The Fund is not required to hedge its portfolio and may choose not to do so. The Fund cannot guarantee that any hedging strategies it uses will work.

Swap Agreements. The Fund is authorized to enter into swap agreements, which are over-the-counter contracts in which one party agrees to make periodic payments based on

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the change in the market value of a specific bond, basket of bonds or index in return for periodic payments based on a fixed or variable interest rate or the change in market value of a different bond, basket of bonds or index. Swap agreements may be used to obtain exposure to a bond or market without owning or taking physical custody of securities.

Tax Considerations. While exempt-interest dividends are excluded from gross income for Federal income tax purposes, they may be subject to the Federal alternative minimum tax in certain circumstances. Distributions of any capital gain or other taxable income will be taxable to stockholders. The Fund may not be a suitable investment for investors subject to the Federal alternative minimum tax or who would become subject to such tax by investing in the Fund. See Taxes.

Risk Factors *Set forth below is a summary of the main risks of investing in the Fund s Series TH28 AMPS. For a more detailed description of the main risks as well as certain other risks associated with investing in the Fund s Series TH28 AMPS, see Risk Factors and Special Considerations.*

The credit ratings of the AMPS could be reduced or terminated while an investor holds the AMPS, which could affect liquidity.

Neither broker-dealers nor the Fund are obligated to purchase shares of AMPS in an auction or otherwise, nor is the Fund required to redeem shares of AMPS in the event of a failed auction.

If sufficient bids do not exist in an auction, the applicable dividend rate will be the maximum applicable dividend rate, and in such event, owners of AMPS wishing to sell will not be able to sell all, and may not be able to sell any, AMPS in the auction. As a result, investors may not have liquidity of investment.

As a result of bidding by broker-dealers in an auction for their own account, the dividend rate that would apply at the auction may be higher or lower than the rate that would have prevailed had the broker-dealer not bid.

A broker-dealer may bid in an auction in order to prevent what would otherwise be (i) a failed auction, (ii) an all-hold auction, or (iii) an applicable dividend rate that the broker-dealer believes, in its sole discretion, does not reflect the market for the AMPS at the time of the auction.

The relative buying and selling interest of market participants in AMPS and in the auction rate securities market as a whole will vary over time, and such variations may be affected by, among other things, news relating to the issuer, the attractiveness of alternative investments, the perceived risk of owning the security (whether related to credit, liquidity or any other risk), the tax treatment accorded the instruments, the accounting treatment accorded auction rate securities, including recent clarifications of U.S. generally accepted principles relating to the treatment of auction rate securities, reactions to regulatory actions or press reports, financial reporting cycles and market sentiment generally. Shifts of demand in response to any one or simultaneous particular events cannot be predicted and may be short-lived or exist for longer periods.

Merrill Lynch, Pierce, Fenner & Smith Incorporated (Merrill Lynch) has advised the Fund that it and various other broker-dealers and other firms that participate in the auction rate securities market received letters from the staff of the Securities and Exchange Commission last spring. The letters requested that each of these firms voluntarily conduct an investigation regarding its respective practices and procedures in that market. Pursuant to this request, Merrill Lynch conducted its own voluntary review and reported its findings to the Securities and Exchange Commission staff. At the Securities and Exchange Commission staff s request, Merrill Lynch is engaging in discussions with the Securities and Exchange Commission staff concerning its inquiry. Neither Merrill Lynch nor the Fund can predict the ultimate outcome of the inquiry or how that outcome will affect the market for the AMPS or the auctions.

Broker-dealers have no obligation to maintain a secondary trading market in the AMPS outside of auctions and there can be no assurance that a secondary market for the AMPS will develop or, if it does develop, that it will provide holders with a liquid trading market. An increase in the level of interest rates likely will have an adverse effect on the secondary market price of the AMPS, and a selling stockholder may have to sell AMPS between auctions at a price per share of less than $25,000.

The Fund will issue the AMPS only if the AMPS have received a rating of Aaa from Moody s and AAA from S&P. Under certain circumstances, the Fund may voluntarily terminate compliance with Moody s or S&P guidelines, or both, in which case the AMPS may no longer be rated by Moody s or S&P, as applicable, but will be rated by at least one rating agency.

The Fund issues shares of AMPS, which generally pay dividends based on short term interest rates. The Fund generally will purchase Municipal Bonds that pay interest at fixed or adjustable rates. If market interest rates rise, this could negatively impact the value of the Fund s investment portfolio, reducing the amount of assets serving as asset coverage for the AMPS. If the asset coverage becomes too low, the Fund may be required to redeem some or all of the shares of AMPS.

The Fund is registered as a non-diversified investment company, the Fund may invest a greater percentage of its assets in a single issuer than a diversified investment company. Since the Fund may invest a relatively high percentage of its assets in a limited number of issuers, the Fund may be more exposed to any single economic, political or regulatory occurrence than a more widely diversified fund.

The amount of public information available about Municipal Bonds in the Fund s portfolio is generally less than that for corporate equities or bonds, and the investment performance of the Fund may, therefore, be more dependent on the analytical abilities of the Investment Adviser than the performance of a stock fund or taxable bond fund.

The Fund s investments in Municipal Bonds are subject to interest rate and credit risk. Interest rate risk is the risk that prices of Municipal Bonds generally increase when interest rates decline and decrease when interest rates increase. Credit risk is the risk that the issuer will be unable to pay the interest or principal when due. Changes in an issuer s credit rating or the market s perception of an issuer s creditworthiness may affect the value of the Fund s investment in that issuer.

Investments in junk bonds entail a higher level of credit risk (loss of income and/or principal) and a corresponding greater risk of loss than investments in investment grade Municipal Bonds. Municipal Bonds rated in the lower rating categories are considered to be predominantly speculative with respect to capacity to pay interest and dividend income and repay principal.

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Investment Adviser The Investment Adviser provides investment advisory and administrative services to the Fund. For its services, the Fund pays the Investment Adviser a monthly fee at the annual rate of 0.55% of the Fund s average daily net assets (including any proceeds from the issuance of preferred stock), plus the proceeds of any outstanding borrowings used for leverage. The Investment Adviser has contractually agreed to waive a portion of its fee during the first seven years of the Fund s operations, which began August 1, 2003, ending July 31, 2010, as follows:

	Fee Waiver (as a percentage of average daily net assets)
Years 1 through 5	0.15%
Year 6	0.10%
Year 7	0.05%
Year 8 and thereafter	0.00%

Dividends and Dividend Periods Dividends on the Series TH28 AMPS will be cumulative from the date the shares are first issued and payable at the annualized cash dividend rate for the initial dividend period on the initial dividend payment date as follows:

AMPS Series	Initial Dividend Rate	Initial Dividend Period Ending	Initial Dividend Payment Date
Series TH28	%	, 2005	, 2005

After the initial dividend period, each dividend period for the Series TH28 AMPS will generally consist of 28 days; provided however, that before any auction, the Fund may decide, subject to certain limitations and only if it gives notice to holders, to declare a special dividend period of up to five years.

After the initial dividend period, in the case of dividend periods that are not special dividend periods, dividends generally will be payable on each succeeding fourth Friday.

Dividends for the Series TH28 AMPS will be paid through the securities depository (The Depository Trust Company) on each dividend payment date for the AMPS.

For each subsequent dividend period, the auction agent (The Bank of New York) will hold an auction to determine the cash dividend rate on the shares of the Series TH28 AMPS.

Determination of Maximum Dividend Rates Generally, the applicable dividend rate for any dividend period for the Series TH28 AMPS will not be more than the maximum applicable rate attributable to such shares. The maximum applicable rate for the Series TH28 AMPS will be the higher of (A) the applicable percentage of the reference rate on the auction date or (B) the applicable spread plus the reference rate on the auction date. The reference rate is (A) the higher of the applicable LIBOR Rate (as defined in the Glossary) and the Taxable Equivalent of the Short-Term Municipal Bond Rate (as defined in the Glossary) (for a dividend period or special dividend period of 364 or fewer days), or (B) the applicable Treasury Index Rate (as defined in the Glossary) (for a special dividend period of 365 days or more). The applicable percentage and the applicable spread as so determined may be subject to

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upward but not downward adjustment in the discretion of the Board of Directors of the Fund after consultation with the broker-dealers participating in the auction for the AMPS. The maximum applicable rate for the AMPS will depend on the credit rating assigned to the shares, the length of the dividend period and whether or not the Fund has given notification prior to the auction for the dividend period that any taxable income will be included in the dividend on the AMPS for that dividend period. The applicable percentage and applicable spread are as follows:

Credit Ratings		Applicable Percentage of Reference Rate No Notification	Applicable Percentage of Reference Rate Notification	Applicable Spread Over Reference Rate No Notification	Applicable Spread Over Reference Rate Notification
Moody s	S&P				
Aaa	AAA	110%	125%	1.10%	1.25%
Aa3 to Aa1	AA- to AA+	125%	150%	1.25%	1.50%
A3 to A1	A- to A+	150%	200%	1.50%	2.00%
Baa3 to Baa1	BBB- to BBB+	175%	250%	1.75%	2.50%
Below Baa3	Below BBB-	200%	300%	2.00%	3.00%

The applicable percentage and the applicable spread as so determined may be subject to upward but not downward adjustment in the discretion of the Board of Directors of the Fund after consultation with the broker-dealers participating in the auction for the AMPS.

There is no minimum applicable dividend rate for any dividend period.

Other AMPS The Fund has outstanding 11,400 shares of five other series of Auction Market Preferred Stock, each with a liquidation preference of $25,000 per share, plus accumulated but unpaid dividends, for an aggregate initial liquidation preference of $285,000,000 (the Other AMPS). The Other AMPS are as follows: 2,000 shares of Auction Market Preferred Stock, Series M7; 2,700 shares of Auction Market Preferred Stock, Series T7; 2,000 shares of Auction Market Preferred Stock, Series W7; 2,700 shares of Auction Market Preferred Stock, Series TH7; and 2,000 shares of Auction Market Preferred Stock, Series F7. The Series TH28 AMPS offered hereby rank on a parity with the Other AMPS with respect to dividends and liquidation preference.

Asset Maintenance Under the Fund s Articles Supplementary creating the Series TH28 AMPS (the Articles Supplementary), the Fund must maintain:

asset coverage of the AMPS and Other AMPS as required by the rating agencies rating the AMPS, and

asset coverage of the AMPS and Other AMPS of at least 200% as required by the Investment Company Act of 1940 (the 1940 Act).

The Fund estimates that, based on the composition of its portfolio at May 31, 2005, asset coverage of the AMPS and Other AMPS as required by the 1940 Act would be approximately 284% immediately after the Fund issues the shares of AMPS offered by this prospectus representing approximately 35% of the Fund s capital, or approximately 54% of the Fund s common stock equity, immediately after the issuance of such AMPS.

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Mandatory Redemption	If the required asset coverage is not maintained or, when necessary, restored, the Fund must redeem shares of the Series TH28 AMPS at the price of $25,000 per share plus accumulated but unpaid dividends thereon (whether or not earned or declared). The provisions of the 1940 Act may restrict the Fund s ability to make such a mandatory redemption.
Optional Redemption	The Fund may, at its option, choose to redeem all or a portion of the shares of AMPS on any dividend payment date at the price of $25,000 per share, plus accumulated but unpaid dividends thereon (whether or not earned or declared) plus any applicable premium.
Liquidation Preference	The liquidation preference (that is, the amount the Fund must pay to holders of AMPS if the Fund is liquidated) of each share of AMPS will be $25,000, plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared).
Ratings	The AMPS will be issued with a rating of Aaa from Moody s and AAA from S&P.
Voting Rights	The 1940 Act requires that the holders of AMPS and any other preferred stock, including the Other AMPS, voting as a separate class, have the right to elect at least two directors at all times and to elect a majority of the directors at any time when dividends on the AMPS or any other preferred stock, including the Other AMPS, are unpaid for two full years. The Fund s Charter, the 1940 Act and the General Corporation Laws of the State of Maryland require holders of AMPS and any other preferred stock, including the Other AMPS, to vote as a separate class on certain other matters.

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RISK FACTORS AND SPECIAL CONSIDERATIONS

An investment in the Fund s AMPS should not constitute a complete investment program.

Set forth below are the main risks of investing in the Fund s AMPS.

Investment Considerations. Investors in AMPS should consider the following factors:

The credit ratings of the AMPS could be reduced or terminated while an investor holds the AMPS, which could affect liquidity.

Neither broker-dealers nor the Fund are obligated to purchase shares of AMPS in an auction or otherwise, nor is the Fund required to redeem shares of AMPS in the event of a failed auction.

If sufficient bids do not exist in an auction, the applicable dividend rate will be the maximum applicable dividend rate, and in such event, owners of AMPS wishing to sell will not be able to sell all, and may not be able to sell any, AMPS in the auction. As a result, investors may not have liquidity of investment.

Broker-dealers may submit orders in auctions for the AMPS for their own account. If a broker-dealer submits an order for its own account in any auction, it may have knowledge of orders placed through it in that auction and therefore have an advantage over other bidders, but such broker-dealer would not have knowledge of orders submitted by other broker-dealers in that auction. As a result of bidding by a broker-dealer in an auction, the dividend rate that would apply at the auction may be higher or lower than the rate that would have prevailed had the broker-dealer not bid.

A broker-dealer may bid in an auction in order to prevent what would otherwise be (i) a failed auction, (ii) an all-hold auction, or (iii) an applicable dividend rate that the broker-dealer believes, in its sole discretion, does not reflect the market for the AMPS at the time of the auction. A broker-dealer may, but is not obligated to, advise owners of AMPS that the dividend rate that would apply in an all-hold auction may be lower than would apply if owners submit bids and such advice, if given, may facilitate the submission of bids by owners that would avoid the occurrence of an all-hold auction.

The relative buying and selling interest of market participants in AMPS and in the auction rate securities market as a whole will vary over time, and such variations may be affected by, among other things, news relating to the issuer, the attractiveness of alternative investments, the perceived risk of owning the security (whether related to credit, liquidity or any other risk), the tax treatment accorded the instruments, the accounting treatment accorded auction rate securities, including recent clarifications of U.S. generally accepted principles relating to the treatment of auction rate securities, reactions to regulatory actions or press reports, financial reporting cycles and market sentiment generally. Shifts of demand in response to any one or simultaneous particular events cannot be predicted and may be short-lived or exist for longer periods.

Merrill Lynch has advised the Fund that it and various other broker-dealers and other firms that participate in the auction rate securities market received letters from the staff of the Securities and Exchange Commission last spring. The letters requested that each of these firms voluntarily conduct an investigation regarding its respective practices and procedures in that market. Pursuant to this request, Merrill Lynch conducted its own voluntary review and reported its findings to the Securities and Exchange

Commission staff. At the Securities and Exchange Commission staff s request, Merrill Lynch is engaging in discussions with the Securities and Exchange Commission staff concerning its inquiry. Neither Merrill Lynch nor the Fund can predict the ultimate outcome of the inquiry or how that outcome will affect the market for the AMPS or the auctions.

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Secondary Market. Broker-dealers have no obligation to maintain a secondary trading market in the AMPS outside of auctions and there can be no assurance that a secondary market for the AMPS will develop or, if it does develop, that it will provide holders with a liquid trading market. The AMPS will not be registered on any stock exchange or on any automated quotation system. An increase in the level of interest rates likely will have an adverse effect on the secondary market price of the AMPS, and a selling stockholder may have to sell AMPS between auctions at a price per share of less than $25,000.

Rating Agencies. The Fund will issue the AMPS only if the AMPS have received a rating of Aaa from Moody s and AAA from S&P. As a result of such ratings the Fund will be subject to guidelines of Moody s, S&P or another substitute NRSRO that may issue ratings for its preferred stock. These guidelines may impose asset coverage or portfolio composition requirements that are more stringent than those imposed by the 1940 Act and may prohibit or limit the use by the Fund of certain portfolio management techniques or investments. The Fund does not expect these guidelines to prevent the Investment Adviser from managing the Fund s portfolio in accordance with the Fund s investment objective and policies. Also, under certain circumstances, the Fund may voluntarily terminate compliance with Moody s or S&P s guidelines, or both, in which case the AMPS may no longer be rated by Moody s or S&P, as applicable, but will be rated by at least one rating agency.

Non-Diversification. The Fund is registered as a non-diversified investment company. This means that the Fund may invest a greater percentage of its assets in a single issuer than a diversified investment company. Since the Fund may invest a relatively high percentage of its assets in a limited number of issuers, the Fund may be more exposed to any single economic, political or regulatory occurrence than a more widely diversified fund. Even as a non-diversified fund, the Fund must still meet the diversification requirements applicable to regulated investment companies under the Federal income tax laws.

Interest Rate Risk and AMPS. The Fund issues shares of AMPS, which generally pay dividends based on short-term interest rates. The Fund generally will purchase Municipal Bonds that pay interest at fixed or adjustable rates. If short-term interest rates rise, dividend rates on the shares of AMPS may rise so that the amount of dividends paid to the holders of shares of AMPS exceeds the income from the Fund s portfolio securities. Because income from the Fund s entire investment portfolio (not just the portion of the portfolio purchased with the proceeds of the AMPS offering) is available to pay dividends on the shares of AMPS, dividend rates on the shares of AMPS would need to greatly exceed the Fund s net portfolio income before the Fund s ability to pay dividends on the shares of AMPS would be jeopardized. If market interest rates rise, this could negatively impact the value of the Fund s investment portfolio, reducing the amount of assets serving as asset coverage for the AMPS. If the asset coverage becomes too low, the Fund may be required to redeem some or all of the shares of AMPS.

Market Risk and Selection Risk. Market risk is the risk that the bond market will go down in value, including the possibility that the market will go down sharply and unpredictably. Selection risk is the risk that the securities that Fund management selects will underperform the bond market, the market relevant indices, or other funds with similar investment objectives and investment strategies.

Tax Exempt Securities Market Risk. The amount of public information available about Municipal Bonds in the Fund s portfolio is generally less than that for corporate equities or bonds, and the investment performance of the Fund may therefore be more dependent on the analytical abilities of the Investment Adviser than that of a stock fund or taxable bond fund.

Interest Rate and Credit Risk. The Fund invests in Municipal Bonds, which are subject to interest rate and credit risk. Interest rate risk is the risk that prices of Municipal Bonds generally increase when interest rates decline and decrease when interest rates increase. Prices of longer term securities generally change more in response to interest rate changes than prices of shorter term securities. The Fund s use of leverage by the

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issuance of preferred stock and its investment in inverse floating obligations, as discussed below, may increase interest rate risk. Because market interest rates are currently near their lowest levels in many years, there is a greater risk that the Fund s portfolio will decline in value if interest rates increase in the future. Changes in an issuer s credit rating or the market s perception of an issuer s creditworthiness may affect the value of the Fund s investment in that issuer. Credit risk is the risk that the issuer will be unable to pay the interest or principal when due. The degree of credit risk depends on both the financial condition of the issuer and the terms of the obligation.

Risks Associated with Non-Investment Grade Securities. Under normal market conditions, the Fund expects to invest at least 75% of its total assets in Municipal Bonds that are rated investment grade by Moody s, S&P or Fitch, or in unrated Municipal Bonds that are considered by the Investment Adviser to possess similar credit characteristics. Obligations rated in the lowest investment grade category may have certain speculative characteristics. The Fund may invest up to 25% of its total assets in Municipal Bonds that are rated below investment grade or are unrated securities that are considered by the Investment Adviser to possess similar credit characteristics. Securities rated below investment grade, also known as junk bonds, generally entail greater interest rate and credit risks than investment grade securities. For example, their prices are more volatile, economic downturns and financial setbacks may affect their prices more negatively, and their trading market may be more limited.

Set forth below are certain other risks associated with investing in the Fund s AMPS.

Call and Redemption Risk. A Municipal Bond s issuer may call the bond for redemption before it matures. If this happens to a Municipal Bond that the Fund holds, the Fund may lose income and may have to invest the proceeds in Municipal Bonds with lower yields.

Rating Categories. The Fund intends to invest primarily in Municipal Bonds that are rated investment grade by S&P, Moody s or Fitch, or in unrated Municipal Bonds that are considered by the Investment Adviser to possess similar credit characteristics. Obligations rated in the lowest investment grade category may have certain speculative characteristics. For example, their prices are more volatile, economic downturns and financial setbacks may affect their prices more negatively, and their trading market may be more limited.

Reinvestment Risk. Reinvestment risk is the risk that income from the Fund s Municipal Bond portfolio will decline if and when the Fund invests the proceeds from matured, traded or called bonds at market interest rates that are below the portfolio s current earnings rate. A decline in income could negatively affect the Fund s yield, return or the market price of the common stock.

Sector Risk. The Fund may invest 25% or more of its total assets in tax exempt securities of issuers in the industries comprising the same economic sector, such as hospitals or life care facilities and transportation-related issuers. However, the Fund will not invest 25% or more of its total assets in any one of the industries comprising an economic sector. In addition, a substantial part of the Fund s portfolio may be comprised of securities credit enhanced by banks, insurance companies or companies with similar characteristics. Emphasis on these sectors may subject the Fund to certain risks.

Private Activity Bonds. The Fund may invest in certain tax exempt securities classified as private activity bonds. These bonds may subject certain investors in the Fund to the Federal alternative minimum tax.

Liquidity of Investments. Certain Municipal Bonds in which the Fund invests may lack an established secondary trading market or are otherwise considered illiquid. Liquidity of a security relates to the ability to easily dispose of the security and the price to be obtained and does not generally relate to the credit risk or likelihood of receipt of cash at maturity. Illiquid securities may trade at a discount from comparable, more liquid investments.

Portfolio Strategies. The Fund may engage in various portfolio strategies both to seek to increase the return of the Fund and to seek to hedge its portfolio against adverse effects from movements in interest rates and in the securities markets. These portfolio strategies include the use of derivatives, such as indexed securities, inverse securities, options, futures, options on futures, interest rate swap transactions, credit default swaps, and the use of short sales. Such strategies subject the Fund to the risk that, if the Investment Adviser incorrectly forecasts market values, interest rates or other applicable factors, the Fund s performance could suffer. Certain of these strategies such as investments in inverse securities, credit default swaps and short sales may provide investment leverage to the Fund s portfolio. The Fund is not required to use derivatives or other portfolio strategies to seek to increase return or to seek to hedge its portfolio and may choose not to do so. There can be no assurance that the Fund s portfolio strategies will be effective. Some of the derivative strategies that the Fund may use to seek to increase its return are riskier than its hedging transactions and have speculative characteristics. Such strategies do not attempt to limit the Fund s risk of loss.

General Risks Related to Derivatives. Derivatives are financial contracts or instruments whose value depends on, or is derived from, the value of an underlying asset, reference rate or index (or relationship between two indices). The Fund may invest in a variety of derivative instruments for investment purposes, hedging purposes or to seek to increase its return, such as options, futures contracts and swap agreements, and may engage in short sales. The Fund may use derivatives as a substitute for taking a position in an underlying security or other asset and/or as part of a strategy designed to reduce exposure to other risks, such as interest rate risk. The Fund also may use derivatives to add leverage to the portfolio and/or to hedge against increases in the Fund s costs associated with the dividend payments on the preferred stock, including the AMPS. The Fund also may invest in certain derivative products that pay tax exempt income interest via a trust or partnership through which the Fund holds interests in one or more underlying long term municipal securities. The Fund s use of derivative instruments involves risks different from, and possibly greater than, the risks associated with investing directly in securities and other traditional investments. Derivatives are subject to a number of risks such as liquidity risk, interest rate risk, credit risk, leverage risk and management risk. They also involve the risk of mispricing or improper valuation and correlation risk (*i.e.*, the risk that changes in the value of the derivative may not correlate perfectly with the underlying asset, rate or index). If the Fund invests in a derivative instrument it could lose more than the principal amount invested. Moreover, derivatives raise certain tax, legal, regulatory and accounting issues that may not be presented by investments in Municipal Bonds, and there is some risk that certain issues could be resolved in a manner that could adversely impact the performance of the Fund and/or the tax exempt nature of the dividends paid by the Fund.

Also, suitable derivative transactions may not be available in all circumstances and there can be no assurance that the Fund will engage in these transactions to reduce exposure to other risks when that would be beneficial.

Swaps. Swap agreements are types of derivatives. In order to seek to hedge the value of the Fund s portfolio, to hedge against increases in the Fund s cost associated with the interest payments on its outstanding borrowings or to seek to increase the Fund s return, the Fund may enter into interest rate or credit default swap transactions. In interest rate swap transactions, there is a risk that yields will move in the direction opposite of the direction anticipated by the Fund, which would cause the Fund to make payments to its counterparty in the transaction that could adversely affect Fund performance. In addition to the risks applicable to swaps generally, credit default swap transactions involve special risks because they are difficult to value, are highly susceptible to liquidity and credit risk, and generally pay a return to the party that has paid the premium only in the event of an actual default by the issuer of the underlying obligation (as opposed to a credit downgrade or other indication of financial difficulty). The Fund is not required to enter into interest rate or credit default swap transactions for hedging purposes or to enhance its return and may choose not to do so.

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Taxability Risk. The Fund intends to minimize the payment of taxable income to stockholders by investing in Municipal Bonds and other tax exempt securities in reliance on an opinion of bond counsel to the issuer that the interest paid on those securities will be excludable from gross income for Federal income tax purposes. Such securities, however, may be determined to pay, or to have paid, taxable income subsequent to the Fund s acquisition of the securities. In that event, the Internal Revenue Service may demand that the Fund pay taxes on the affected interest income, and, if the Fund agrees to do so, the Fund s yield on its common stock could be adversely affected. A determination that interest on a security held by the Fund is includable in gross income for Federal income tax purposes retroactively to its date of issue may, likewise, cause a portion of prior distributions received by stockholders, including holders of AMPS, to be taxable to those stockholders in the year of receipt. The Fund will not pay an Additional Dividend (as defined herein) to a holder of AMPS under these circumstances.

Antitakeover Provisions. The Fund s Charter, By-laws and the General Corporation Law of the State of Maryland include provisions that could limit the ability of other entities or persons to acquire control of the Fund or to change the composition of its Board of Directors. Such provisions could limit the ability of stockholders to sell their shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control of the Fund. See Description of Capital Stock Certain Provisions of the Charter and By-laws.

Market Disruption. The terrorist attacks in the United States on September 11, 2001 had a disruptive effect on the securities markets, some of which were closed for a four-day period. The continued threat of similar attacks and related events, including U.S. military actions in Iraq and continued unrest in the Middle East, have led to increased short term market volatility and may have long term effects on U.S. and world economies and markets. Similar disruptions of the financial markets could adversely affect the market prices of the Fund s portfolio securities, interest rates, auctions, secondary trading, ratings, credit risk, inflation and other factors relating to the Fund s AMPS. Non-investment grade securities tend to be more volatile than investment grade fixed income securities so that these events and other market disruptions may have a greater impact on the prices and volatility of non-investment grade securities than on investment grade fixed income securities. There can be no assurance that these events and other market disruptions will not have other material and adverse implications for the non-investment grade securities markets.

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FINANCIAL HIGHLIGHTS