UNIVERSAL HEALTH REALTY INCOME TRUST
Form 10-Q
May 07, 2010
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2010

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 1-9321

UNIVERSAL HEALTH REALTY INCOME TRUST

(Exact name of registrant as specified in its charter)

MARYLAND	**23-6858580**
(State or other jurisdiction of incorporation or organization)	**(I. R. S. Employer Identification No.)**

UNIVERSAL CORPORATE CENTER

367 SOUTH GULPH ROAD

KING OF PRUSSIA, PENNSYLVANIA	**19406**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code (610) 265-0688

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated Filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Number of common shares of beneficial interest outstanding at April 30, 2010 12,091,730

Table of Contents

UNIVERSAL HEALTH REALTY INCOME TRUST

INDEX

	PAGE NO.
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
Condensed Consolidated Statements of Income Three Months Ended March 31, 2010 and 2009	3
Condensed Consolidated Balance Sheets March 31, 2010 and December 31, 2009	4
Condensed Consolidated Statements of Cash Flows Three Months Ended March 31, 2010 and 2009	5
Notes to Condensed Consolidated Financial Statements	6 through 14
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	15 through 24
Item 3. Quantitative and Qualitative Disclosures About Market Risk	24
Item 4. Controls and Procedures	24
PART II. Other Information	24
Item 1A. Risk Factors	24
Item 6. Exhibits	24
Signatures	25
EXHIBIT INDEX	26

Table of Contents

Part I. Financial Information

Universal Health Realty Income Trust

Condensed Consolidated Statements of Income

For the Three Months Ended March 31, 2010 and 2009

(amounts in thousands, except per share amounts)

(unaudited)

	Three Months Ended March 31, 2010	2009
Revenues:		
Base rental - UHS facilities	$ 3,292	$ 3,460
Base rental - Non-related parties	2,610	2,576
Bonus rental - UHS facilities	1,094	1,095
Tenant reimbursements and other - Non-related parties	616	714
Tenant reimbursements and other - UHS facilities	32	35
	7,644	7,880
Expenses:		
Depreciation and amortization	1,569	1,538
Advisory fees to UHS	437	390
Other operating expenses	1,352	1,506
	3,358	3,434
Income before equity in income of unconsolidated limited liability companies (LLCs) and interest expense	4,286	4,446
Equity in income of unconsolidated LLCs	736	807
Interest expense, net	(495)	(607)
Net income	$ 4,527	$ 4,646
Basic earnings per share	$ 0.37	$ 0.39
Diluted earnings per share	$ 0.37	$ 0.39
Weighted average number of shares outstanding - Basic	12,077	11,860
Weighted average number of share equivalents	2	12
Weighted average number of shares and equivalents outstanding - Diluted	12,079	11,872

See accompanying notes to condensed consolidated financial statements.

3

Table of Contents

Universal Health Realty Income Trust

Condensed Consolidated Balance Sheets

(dollar amounts in thousands, except share amounts)

(unaudited)

	March 31, 2010	December 31, 2009
Assets:		
Real Estate Investments:		
Buildings and improvements	$ 195,373	$ 207,597
Accumulated depreciation	(73,635)	(72,405)
	121,738	135,192
Land	19,348	19,348
Net Real Estate Investments	141,086	154,540
Investments in and advances to limited liability companies (LLCs)	71,734	61,934
Other Assets:		
Cash and cash equivalents	1,167	3,038
Base and bonus rent receivable from UHS	2,102	2,039
Rent receivable - other	896	980
Deferred charges, notes receivable and intangible and other assets, net	6,132	6,294
Total Assets	$ 223,117	$ 228,825
Liabilities:		
Line of credit borrowings	$ 59,900	$ 48,800
Mortgage notes payable, non-recourse to us	6,619	6,677
Mortgage, construction and other loans payable of consolidated LLCs, non-recourse to us	15,216	28,790
Accrued interest	120	142
Accrued expenses and other liabilities	1,960	2,251
Tenant reserves, escrows, deposits and prepaid rents	837	981
Total Liabilities	84,652	87,641
Equity:		
Preferred shares of beneficial interest, $.01 par value; 5,000,000 shares authorized; none issued and outstanding	-	-
Common shares, $.01 par value; 95,000,000 shares authorized; issued and outstanding: 2010 - 12,091,636; 2009 -12,089,474	121	121
Capital in excess of par value	195,241	195,209
Cumulative net income	361,821	357,294
Cumulative dividends	(418,916)	(411,662)
Total Universal Health Realty Income Trust Shareholders Equity	138,267	140,962

Third-party equity interests	198	222
Total Equity	138,465	141,184
Total Liabilities and Equity	$ 223,117	$ 228,825

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Universal Health Realty Income Trust

Condensed Consolidated Statements of Cash Flows

(amounts in thousands)

(unaudited)

	Three months ended March 31, 2010	Three months ended March 31, 2009
Cash flows from operating activities:		
Net income	$ 4,527	$ 4,646
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,569	1,538
Restricted/stock-based compensation expense	76	58
Changes in assets and liabilities:		
Rent receivable	(31)	(44)
Accrued expenses and other liabilities	21	(476)
Tenant reserves, escrows, deposits and prepaid rents	(108)	65
Accrued interest	-	(66)
Other, net	(2)	14
Net cash provided by operating activities	6,052	5,735
Cash flows from investing activities:		
Investments in LLCs	(2,414)	(5,831)
Repayments of advances made to LLCs	120	15
Advances made to LLCs	(7,693)	(1,613)
Cash distributions in excess of income from LLCs	554	506
Cash distributions of refinancing proceeds from LLCs	29	-
Additions to real estate investments	(215)	(2,577)
Decrease in cash and cash equivalents due to recording of LLC on unconsolidated basis	(1,938)	-
Net cash used in investing activities	(11,557)	(9,500)
Cash flows from financing activities:		
Net borrowings on line of credit	11,100	9,700
Repayments of mortgage notes payable of consolidated LLCs	(62)	(57)
(Repayments)/borrowings from loans payable of consolidated LLCs	(47)	2,208
Repayments of mortgage notes payable	(58)	(54)
Dividends paid	(7,254)	(7,001)
Partial settlement of dividends equivalent rights	-	(213)
Issuance of shares of beneficial interest, net	(45)	61
Capital contributions from non-controlling interests	-	33
Net cash provided by financing activities	3,634	4,677
(Decrease)/Increase in cash and cash equivalents	(1,871)	912
Cash and cash equivalents, beginning of period	3,038	618
Cash and cash equivalents, end of period	$ 1,167	$ 1,530

Supplemental disclosures of cash flow information:		
Interest paid	$ 451	$ 649
Supplemental disclosure of non-cash information:		
Deconsolidation of LLC:		
Net Real Estate Investments	12,169	-
Cash and cash equivalents	1,938	-
Other assets	144	-
Mortgage note payable	13,465	-
Other liabilities	370	-
Third-party equity interests	21	-
Investment in LLC	395	-

See accompanying notes to these consolidated financial statements.

UNIVERSAL HEALTH REALTY INCOME TRUST

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2010

(unaudited)

(1) General

This Quarterly Report on Form 10-Q is for the Quarterly Period ended March 31, 2010. In this Quarterly Report, we, us, our and the Trust refer to Universal Health Realty Income Trust.

You should carefully review all of the information contained in this Quarterly Report, and should particularly consider any risk factors that we set forth in this Quarterly Report and in other reports or documents that we file from time to time with the Securities and Exchange Commission (the SEC). In this Quarterly Report, we state our beliefs of future events and of our future financial performance. In some cases, you can identify those so-called forward-looking statements by words such as may, will, should, could, would, predicts, potential, continue, exp future, intends, plans, believes, estimates, appears, projects and similar expressions, as well as statements in future tense. You should b that those statements are only our predictions. Actual events or results may differ materially. In evaluating those statements, you should specifically consider various factors, including the risks outlined in Item 2- Management s Discussion and Analysis of Financial Condition and Results of Operations, under Forward Looking Statements and Certain Risk Factors as disclosed in this Quarterly Report on Form 10-Q for the period ended March 31, 2010 and as outlined in Item 1A-Risk Factors as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2009. Those factors may cause our actual results to differ materially from any of our forward-looking statements.

Our future results of operations could be unfavorably impacted by continued deterioration in general economic conditions which could result in increases in the number of people unemployed and/or uninsured. Should that occur, it may result in decreased occupancy rates at our medical office buildings as well as a reduction in the revenues earned by the operators of our hospital facilities which would unfavorably impact our future bonus rentals (on the UHS hospital facilities) and may potentially have a negative impact on the future lease renewal terms and the underlying value of the hospital properties. Additionally, the general real estate market has been unfavorably impacted by the deterioration in economic and credit market conditions which may adversely impact the underlying value of our properties.

In this Quarterly Report on Form 10-Q, the term revenues does not include the revenues of the unconsolidated limited liability companies (LLCs) in which we have various non-controlling equity interests ranging from 33% to 99%. We currently account for our share of the income/loss from these investments by the equity method (see Note 5). As of March 31, 2010, we had investments or commitments in thirty-two LLCs, thirty of which are accounted for by the equity method and two that are currently consolidated in our financial statements.

The financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the SEC and reflect all normal and recurring adjustments which, in our opinion, are necessary to fairly present results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although we believe that the accompanying disclosures are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the financial statements, the notes thereto and accounting policies included in our Annual Report on Form 10-K for the year ended December 31, 2009.

(2) Relationship with Universal Health Services, Inc. (UHS) and Related Party Transactions

Leases: We commenced operations in 1986 by purchasing the real property of certain subsidiaries from UHS and immediately leasing the properties back to the respective subsidiaries. Most of the leases were entered into at the time we commenced operations and provided for initial terms of 13 to 15 years with up to six additional 5-year renewal terms. The current base rentals and lease and rental terms for each facility are provided below. The base rents are paid monthly and each lease also provides for additional or bonus rents which are computed and paid on a quarterly basis based upon a computation that compares current quarter revenue to a corresponding quarter in the base year. The leases with subsidiaries of UHS are unconditionally guaranteed by UHS and are cross-defaulted with one another.

The revenues generated from the leases on the UHS hospital facilities accounted for approximately 54% and 52% of our consolidated revenue for the three months ended March 31, 2010 and 2009, respectively. Including 100% of the revenues generated at the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 99%, the leases on the UHS hospital facilities accounted for approximately 20% and 21% of the combined consolidated and unconsolidated revenue for the three month periods ended March 31, 2010 and

2009, respectively. In addition, twelve medical office buildings (MOBs), owned by an LLC in which we hold various non-controlling equity interests, include or will include tenants which are subsidiaries of UHS.

Pursuant to the Master Lease Document by and among us and certain subsidiaries of UHS, dated December 24, 1986 (the Master Lease), which governs the leases of all hospital properties with subsidiaries of UHS, UHS has the option to renew the leases at the

Table of Contents

lease terms described below by providing notice to us at least 90 days prior to the termination of the then current term. In addition, UHS has rights of first refusal to: (i) purchase the respective leased facilities during and for 180 days after the lease terms at the same price, terms and conditions of any third-party offer, or; (ii) renew the lease on the respective leased facility at the end of, and for 180 days after, the lease term at the same terms and conditions pursuant to any third-party offer. UHS also has the right to purchase the respective leased facilities at the end of the lease terms or any renewal terms at the appraised fair market value. In addition, the Master Lease, as amended during 2006, includes a change of control provision whereby UHS has the right, upon one month s notice should a change of control of the Trust occur, to purchase any or all of the four leased hospital properties at their appraised fair market value.

The table below details the renewal options and terms for each of the four UHS hospital facilities:

Hospital Name	Type of Facility	Annual Minimum Rent	End of Lease Term	Renewal Term (years)
McAllen Medical Center	Acute Care	$ 5,485,000	December, 2011	20(a)
Wellington Regional Medical Center	Acute Care	$ 3,030,000	December, 2011	20(b)
Southwest Healthcare System, Inland Valley Campus	Acute Care	$ 2,648,000	December, 2011	20(b)
The Bridgeway	Behavioral Health	$ 930,000	December, 2014	10(c)

(a) UHS has four 5-year renewal options at existing lease rates (through 2031).

(b) UHS has two 5-year renewal options at existing lease rates (through 2021) and two 5-year renewal options at fair market value lease rates (2022 through 2031).

(c) UHS has two 5-year renewal options at fair market value lease rates (2015 through 2024).

We are committed to invest up to a total of $8.6 million in equity and debt financing, of which $4.7 million has been funded as of March 31, 2010, in exchange for a 95% non-controlling equity interest in an LLC (Palmdale Medical Properties) that constructed, owns, and operates the Palmdale Medical Plaza, located in Palmdale, California, on the campus of a UHS hospital. This MOB has a triple net, 75% master lease commitment by UHS of Palmdale, Inc., a wholly-owned subsidiary of UHS, pursuant to the terms of which the master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and UHS of Palmdale, Inc. This MOB, tenants of which will include subsidiaries of UHS, was completed and opened during the third quarter of 2008 at which time the master lease commenced. As of March 31, 2010, the master lease threshold of 75% has not been met and is not expected to be met in the near future. The LLC has a third-party term loan commitment of $7.4 million, which is non-recourse to us, of which $7.0 million has been borrowed as of March 31, 2010. This LLC, which is deemed to be a variable interest entity, is consolidated in our financial statements as of March 31, 2010 since we are the primary beneficiary.

We are committed to invest up to $5.2 million in debt or equity, of which $237,000 has been funded as of March 31, 2010, in exchange for a 95% non-controlling equity interest in an LLC (Banburry Medical Properties) that developed, constructed, owns and operates the Summerlin Medical Office Building III, located in Las Vegas, Nevada, on the campus of a UHS hospital. Summerlin Hospital Medical Center (Summerlin Hospital), a majority-owned subsidiary of UHS, has committed to lease approximately 25% of this building pursuant to the terms of a 10-year flex lease. In addition, Summerlin Hospital has committed to a 50% master lease on the remaining 75% of the building (representing 37.5% of the building) pursuant to the terms of which the master lease for each suite was cancelled at such time that the suite was leased to another tenant acceptable to the LLC and Summerlin Hospital. This MOB, tenants of which will include subsidiaries of UHS, was completed and opened during the first quarter of 2009 at which time the master lease commenced. As a result of this master lease agreement, the LLC was considered a variable interest entity and since we were the primary beneficiary, the financial results of this MOB were included in our financial statements on a consolidated basis prior to January 1, 2010. During the first quarter of 2010, the master lease threshold was met and, as a result, this MOB is accounted for as an unconsolidated LLC under the equity method beginning on January 1, 2010. The LLC has a third-party term loan commitment of $13.5 million, which is non-recourse to us, all of which has been borrowed as of March 31, 2010.

We are committed to invest up to $4.8 million in equity and debt financing, of which $3.2 million has been funded as of March 31, 2010, in exchange for a 95% non-controlling equity interest in an LLC (Sparks Medical Properties) that owns and operates the Vista Medical Terrace and The Sparks Medical Building, located in Sparks, Nevada, on the campus of a UHS hospital. These MOBs were acquired by the LLC during the third quarter of 2008. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method.

We are committed to invest up to a total of $4.8 million in equity and debt financing, none of which has been funded as of March 31, 2010, in exchange for a 95% non-controlling equity interest in an LLC (Texoma Medical Properties) that developed, constructed, owns and operates the

Texoma Medical Plaza located in Denison, Texas, which was completed and opened during the first quarter of 2010. This MOB is located on the campus of a newly constructed and recently opened replacement UHS acute care hospital owned and operated by Texoma Medical Center (Texoma Hospital), a wholly-owned subsidiary of UHS. Texoma Hospital has committed to lease 75% of this building, pursuant to which the master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and Texoma Hospital. The master lease threshold has been met. This MOB will have tenants that include subsidiaries of UHS. This LLC has a third-party construction loan commitment of $13.3 million, which is non-recourse to us, of which $11.2 million has been borrowed as of March 31, 2010. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method.

Table of Contents

We are committed to invest up to a total of $4.7 million in equity and debt financing, of which $2.4 million has been funded as of March 31, 2010, in exchange for a 95% non-controlling equity interest in an LLC (Auburn Medical Properties) that developed constructed, owns and operates the Auburn Medical Office Building II, located in Auburn, Washington, on the campus of a UHS hospital. Auburn Regional Medical Center (Auburn Hospital), a wholly-owned subsidiary of UHS, has committed to lease 75% of this building, pursuant to which the master lease for each suite will be cancelled at such time that the suite is leased to another tenant acceptable to the LLC and Auburn Hospital. The master lease threshold on this MOB has been met. This MOB, tenants of which include subsidiaries of UHS, was completed and opened in the third quarter of 2009. This LLC has a third-party construction loan commitment of $8.4 million, which is non-recourse to us, of which $7.7 million has been borrowed as of March 31, 2010. As this LLC is not considered to be a variable interest entity, it is accounted for pursuant to the equity method.

Advisory Agreement: UHS of Delaware, Inc. (the Advisor), a wholly-owned subsidiary of UHS, serves as Advisor to us under an Advisory Agreement (the Advisory Agreement) dated December 24, 1986. Pursuant to the Advisory Agreement, the Advisor is obligated to present an investment program to us, to use its best efforts to obtain investments suitable for such program (although it is not obligated to present any particular investment opportunity to us), to provide administrative services to us and to conduct our day-to-day affairs. All transactions between us and UHS must be approved by the Trustees who are unaffiliated with UHS (the Independent Trustees). In performing its services under the Advisory Agreement, the Advisor may utilize independent professional services, including accounting, legal, tax and other services, for which the Advisor is reimbursed directly by us. The Advisory Agreement may be terminated for any reason upon sixty days written notice by us or the Advisor. The Advisory Agreement expires on December 31 of each year; however, it is renewable by us, subject to a determination by the Independent Trustees, that the Advisor s performance has been satisfactory. In December, 2009, based upon a review of our advisory fee and other general and administrative expenses, as compared to an industry peer group, the Advisory Agreement was renewed for 2010 and the fee was increased to 0.65% (from 0.60%) of our average invested real estate assets, as derived from our consolidated balance sheet.

The average real estate assets for advisory fee calculation purposes exclude certain items from our consolidated balance sheet such as, among other things, accumulated depreciation, cash and cash equivalents, base and bonus rent receivables, deferred charges and other assets. The advisory fee is payable quarterly, subject to adjustment at year-end based upon our audited financial statements. In addition, the Advisor is entitled to an annual incentive fee equal to 20% of the amount by which cash available for distribution to shareholders for each year, as defined in the Advisory Agreement, exceeds 15% of our equity as shown on our consolidated balance sheet, determined in accordance with generally accepted accounting principles without reduction for return of capital dividends. The Advisory Agreement defines cash available for distribution to shareholders as net cash flow from operations less deductions for, among other things, amounts required to discharge our debt and liabilities and reserves for replacement and capital improvements to our properties and investments. No incentive fees were paid during the first quarter of 2010 or 2009 since the incentive fee requirements were not achieved. Advisory fees incurred and paid (or payable) to UHS amounted to $437,000 and $390,000 for the three months ended March 31, 2010 and 2009, respectively, and were based upon average invested real estate assets of $269 million and $260 million for the three-month periods ended March 31, 2010 and 2009, respectively. Based upon our average invested real estate assets of $269 million during the first quarter of 2010, the increase in the advisory fee expense to 0.65% (beginning in 2010) from 0.60% amounts to $134,000 annually.

Officers and Employees: Our officers are all employees of UHS and although as of March 31, 2010 we had no salaried employees, our officers do receive stock-based compensation from time-to-time.

Share Ownership: As of March 31, 2010 and December 31, 2009, UHS owned 6.5% of our outstanding shares of beneficial interest.

SEC reporting requirements of UHS: UHS is subject to the reporting requirements of the SEC and is required to file annual reports containing audited financial information and quarterly reports containing unaudited financial information. Since the leases on the hospital facilities leased to wholly-owned subsidiaries of UHS comprised approximately 54% and 52% of our consolidated revenues for the three months ended March 31, 2010 and 2009, respectively, and since a subsidiary of UHS is our Advisor, you are encouraged to obtain the publicly available filings for Universal Health Services, Inc. from the SEC s website at www.sec.gov. These filings are the sole responsibility of UHS and are not incorporated by reference herein.

UHS Other Matters:

Southwest Healthcare System: UHS has advised us that, during the third quarter of 2009, Southwest Healthcare System (SWHCS), a wholly-owned subsidiary of UHS which operates Rancho Springs Medical Center (the real property of which is not owned by us) and Inland Valley Regional Medical Center (Inland Valley, the real property of which is owned by us) in Riverside County, California, entered into an agreement with the Center for Medicare and Medicaid Services (CMS). The agreement required SWHCS to engage an independent quality monitor to assist SWHCS in meeting all CMS s conditions of participation. Further, the agreement provided that during the last 60 days of the agreement CMS would conduct a full Medicare certification survey. That survey took place the week of January 11, 2010.

UHS has advised us that they received notification from CMS that it intends to effectuate the termination of SWHCS s Medicare provider agreement effective June 1, 2010. SWHCS has commenced discussions with officials from CMS regarding an agreement that will potentially rescind the provider agreement termination action. Should UHS be unable to reach an agreement with CMS, they intend to file an administrative appeal with the Department of Health and Human Services and/or pursue other such remedies that may be available to them.

Table of Contents

UHS has also informed us that they have also received notification from the California Department of Public Health (CDPH) indicating that they plan to initiate a process to revoke SWHCS s hospital license. UHS plans to appeal CDPH s action and SWHCS will remain operational pending the appeal. In that notice, CDPH has indicated its willingness to rescind this revocation should SWHCS demonstrate its ability to meet all state licensing requirements.

UHS has informed us that Rancho Springs Medical Center and Inland Valley Medical Center remain fully committed to providing high-quality healthcare to their patients and the communities they serve. UHS therefore intends to work expeditiously and collaboratively with both CMS and CDPH in an effort to resolve these matters although there can be no assurance they will be able to do so. Failure to resolve these matters may have a material adverse affect effect on UHS and, in turn, us. While the base rentals on Inland Valley are guaranteed by UHS through the end of the existing lease term (December, 2011), should this matter adversely impact the future revenues and/or operating results of SWHCS, the future bonus rental earned by us on Inland Valley, and the underlying value of the property, may be materially adversely impacted. At March 31, 2010, the book value of the property was $19.5 million. Bonus rental revenue earned by us from Inland Valley amounted to $291,000 during the quarter ended March 31, 2010 and $1.1 million during the year ended December 31, 2009.

(3) Dividends

A dividend of $0.60 per share or $7.3 million in the aggregate was declared by the Board of Trustees on March 9, 2010 and was paid on March 31, 2010 to shareholders of record as of March 19, 2010.

(4) Acquisitions and Dispositions

Three Months Ended March 31, 2010:

During the first quarter of 2010, we invested $5.2 million in debt financing and equity for a 95% non-controlling ownership interest in an LLC (3811 Bell Medical Properties) that purchased the North Valley Medical Plaza, a medical office building located in Phoenix, Arizona.

There were no dispositions during the first three months of 2010.

Three Months Ended March 31, 2009:

There were no acquisitions or dispositions during the first three months of 2009.

(5) Summarized Financial Information of Equity Affiliates

Our consolidated financial statements include the consolidated accounts of our controlled investments and those investments that meet the criteria of a variable interest entity where we are the primary beneficiary. In accordance with the FASB s standards and guidance relating to accounting for investments and real estate ventures, we account for our unconsolidated investments in LLCs which we do not control using the equity method of accounting. The third-party members in these investments have equal voting rights with regards to issues such as, but not limited to: (i) divestiture of property; (ii) annual budget approval, and; (iii) financing commitments. These investments, which represent 33% to 99% non-controlling ownership interests, are recorded initially at our cost and subsequently adjusted for our net equity in the net income, cash contributions to, and distributions from, the investments. Pursuant to certain agreements, allocations of profits and losses of some of the LLC investments may be allocated disproportionately as compared to ownership interests after specified preferred return rate thresholds have been satisfied.

At March 31, 2010, we have non-controlling equity investments or commitments in thirty-two LLCs which own medical office buildings (MOBs). As of March 31, 2010, we accounted for: (i) thirty of these LLCs on an unconsolidated basis pursuant to the equity method since they are not variable interest entities, and; (ii) two of these LLCs on a consolidated basis, as discussed below, since they are considered to be variable interest entities where we are the primary beneficiary by virtue of their master lease, lease assurance or lease guarantee arrangements with subsidiaries of Universal Health Services, Inc. (UHS), a related party to us.

The majority of these LLCs are joint-ventures between us and a non-related party that manages and holds minority ownership interests in the entities. Each LLC is generally self-sustained from a cash flow perspective and generates sufficient cash flow to meet its operating cash flow requirements and service the third-party debt (if applicable) that is non-recourse to us. Although there is typically no ongoing financial support required from us to these entities since they are cash-flow sufficient, we may, from time to time, provide funding for certain purposes such as, but not limited to, significant capital expenditures and/or leasehold improvements. Although we are not obligated to do so, if approved by us at our sole discretion, additional cash fundings are typically advanced as equity or short to intermediate term loans.

Two of these LLCs have master lease, lease assurance or lease guarantee arrangements with subsidiaries of UHS. Additionally, UHS of Delaware, a wholly-owned subsidiary of UHS, serves as advisor to us under the terms of an advisory agreement and manages our day-to-day affairs. All of our officers are officers or employees of UHS. As a result of our related-party relationship with UHS and the master lease, lease assurance or lease guarantee arrangements with subsidiaries of UHS, we account for these LLCs on a consolidated basis since they are variable interest entities and we are deemed to be the primary beneficiary.

Table of Contents

The two LLCs that we account for on a consolidated basis are as follows:

LLC	Facility Name	Ownership Interest	Date of Consolidation
653 Town Center Phase II	Summerlin Hospital MOB II	98%	First quarter of 2004(a)
Palmdale Medical Properties	Palmdale Medical Plaza	95%	Fourth quarter of 2007(b)

(a) This MOB has a master lease provision that is scheduled to expire on September 30, 2010; therefore, beginning in the fourth quarter of 2010, we anticipate this MOB will no longer be deemed a variable interest entity and will be accounted for on an unconsolidated basis pursuant to the equity method.

(b) Newly constructed facility that was completed and opened during the third quarter of 2008. The master lease threshold on this MOB has not yet been met and is not expected to be met in the near future.

The other LLCs in which we hold various non-controlling ownership interests are not variable interest entities and therefore are not subject to consolidation.

Summerlin Medical Office Building III, which is located in Las Vegas, Nevada on the campus of Summerlin Hospital Medical Center (a majority-owned subsidiary of Universal Health Services, Inc.), was completed and opened during the first quarter of 2009. In connection with this MOB, which is owned by an LLC (Banburry Medical Properties) in which we hold a majority, non-controlling ownership interest, Summerlin Hospital Medical Center committed to a master lease agreement for a specified portion of the space. As a result of this master lease agreement, the LLC was considered a variable interest entity. Since we were the primary beneficiary, the financial results of this MOB were included in our financial statements on a consolidated basis prior to January 1, 2010. During the first quarter of 2010, the master lease threshold was met and, as a result, this MOB is accounted for as an unconsolidated LLC under the equity method beginning on January 1, 2010. During the three-month period ended March 31, 2009, this property generated approximately $160,000 of revenue, $65,000 of other operating expenses and $60,000 of combined interest and depreciation and amortization expense. There was no material impact on our net income as a result of the deconsolidation of this LLC.

Below are the combined balance sheets (unaudited) for the two above-mentioned LLCs, as included in our consolidated balance sheets at March 31, 2010 and for the three LLCs (the two above-mentioned LLCs as well as Banburry Medical Properties), as included in our consolidated balance sheet at December 31, 2009:

	March 31, 2010	December 31, 2009
	(in thousands)	
Net property (a.)	$ 23,866	$ 36,193
Other assets	841	2,818
Total assets	$ 24,707	$ 39,011
Liabilities	$ 791	$ 1,089
Mortgage notes payable, non-recourse to us	15,216	28,790
Equity	8,700	9,132
Total liabilities and equity	$ 24,707	$ 39,011

(a.) Used as collateral for outstanding mortgage notes payable.

Rental income is recorded by our consolidated and unconsolidated MOBs relating to leases in excess of one year in length using the straight-line method under which contractual rents are recognized evenly over the lease term regardless of when payments are due. The amount of rental revenue resulting from straight-line rent adjustments is dependent on many factors, including the nature and amount of any rental concessions granted to new tenants, scheduled rent increases under existing leases, as well as the acquisition and sales of properties that have existing in-place leases with terms in excess of one year. As a result, the straight-line adjustments to rental revenue may vary from period-to-period.

The following tables represent summarized financial and other information related to the thirty LLCs which were accounted for under the equity method:

Name of LLC	Ownership	Property Owned by LLC
DSMB Properties	76%	Desert Samaritan Hospital MOBs
DVMC Properties (a.)	90%	Desert Valley Medical Center
Suburban Properties	33%	Suburban Medical Plaza II

Name of LLC	Ownership	Property Owned by LLC
Litchvan Investments	89%	Papago Medical Park
Paseo Medical Properties II	75%	Thunderbird Paseo Medical Plaza I & II
Willetta Medical Properties (a.)	90%	Edwards Medical Plaza
Santa Fe Scottsdale (a.)	90%	Santa Fe Professional Plaza
575 Hardy Investors (a.)	90%	Centinela Medical Building Complex
Brunswick Associates	74%	Mid Coast Hospital MOB
Deerval Properties (d.)	90%	Deer Valley Medical Office II
PCH Medical Properties	85%	Rosenberg Children s Medical Plaza
Gold Shadow Properties (b.)	98%	700 Shadow Lane & Goldring MOBs
Arlington Medical Properties	75%	Saint Mary s Professional Office Building
ApaMed Properties	85%	Apache Junction Medical Plaza
Spring Valley Medical Properties (b.)	95%	Spring Valley Medical Office Building
Sierra Medical Properties	95%	Sierra San Antonio Medical Plaza
Spring Valley Medical Properties II (b.)	95%	Spring Valley Hospital Medical Office Building II
PCH Southern Properties	95%	Phoenix Children s East Valley Care Center
Centennial Medical Properties (b.)	95%	Centennial Hills Medical Office Building I
Canyon Healthcare Properties	95%	Canyon Springs Medical Plaza
653 Town Center Investments (b.)(c.)	95%	Summerlin Hospital Medical Office Building
DesMed (b.)	99%	Desert Springs Medical Plaza
Deerval Properties II (d.)	95%	Deer Valley Medical Office Building III
Cobre Properties	95%	Cobre Valley Medical Plaza
Sparks Medical Properties (b.)	95%	Vista Medical Terrace & The Sparks Medical Building
Auburn Medical Properties II (b.)	95%	Auburn Medical Office Building II
Texoma Medical Properties (b.)(e.)	95%	Texoma Medical Plaza
BRB/E Building One (f.)	95%	BRB Medical Office Building
Banburry Medical Properties (b.)(g.)	95%	Summerlin Hospital MOB III
3811 Bell Medical Properties (h.)	95%	North Valley Medical Plaza

(a.) The membership interests of this entity are held by a master LLC in which we hold a 90% non-controlling ownership interest.

(b.) Tenants of this medical office buildings include or will include subsidiaries of UHS.

(c.) The membership interests of this entity are held by a master LLC in which we hold a 95% non-controlling ownership interest.

(d.) Deerval Parking Company, LLC, which owns the real property of a parking garage located near Deer Valley Medical Office Buildings II and III, is 50% owned by each of Deerval Properties and Deerval Properties II.

(e.) We have committed to invest up to $4.8 million in equity and debt financing, none of which has been funded as of March 31, 2010. This building, which is on the campus of a replacement UHS hospital and will have tenants that will include subsidiaries of UHS, was completed and opened during the first quarter of 2010. This LLC has a third-party construction loan commitment of $13.3 million, which is non-recourse to us, of which $11.2 million has been borrowed as of March 31, 2010.

(f.) We have committed to invest up to $2.9 million in equity and debt financing, $600,000 of which has been funded as of March 31, 2010, in an LLC that will develop, construct, own and operate this MOB which is scheduled to be completed and opened during the third quarter of 2010. This LLC obtained a third-party construction loan commitment of $6.2 million, which is non-recourse to us, $3.0 million of which has been borrowed as of March 31, 2010.

(g.) We have committed to invest up to $5.2 million in equity and debt financing, of which $237,000 has been funded as of March 31, 2010. This newly constructed facility was completed and opened during the first quarter of 2009 and was accounted for on a consolidated basis through December 31, 2009. During the first quarter of 2010, the master lease threshold at this facility was met; therefore, this LLC is no longer deemed to be a variable interest entity and is accounted for on an unconsolidated basis pursuant to the equity method beginning January 1, 2010.

(h.) We have committed to invest up to $6.2 million in equity and debt financing, $5.2 million of which has been funded as of March 31, 2010. This MOB was acquired during the first quarter of 2010.

Below are the combined statements of income (unaudited) for the LLCs accounted for under the equity method at March 31, 2010 and 2009:

	Three Months Ended March 31,	
	2010	2009

Revenues	$ 13,017	$ 11,963
Operating expenses	5,426	5,262
Depreciation and amortization	2,994	2,431

Table of Contents

	Three Months Ended March 31, 2010	2009
Interest, net	4,046	3,537
Net income	$ 551	$ 733
Our share of net income (a.)	$ 736	$ 807

(a.) Our share of net income for the three months ended March 31, 2010 and 2009 includes interest income earned by us on various advances made to LLCs of approximately $456,000 and $378,000, respectively.

Below are the combined balance sheets (unaudited) for the LLCs accounted for under the equity method:

	March 31, 2010	December 31, 2009
	(in thousands)	
Net property, including CIP	$ 318,619	$ 296,623
Other assets	24,968	21,666
Total assets	$ 343,587	$ 318,289
Liabilities	$ 13,582	$ 13,097
Mortgage notes payable, non-recourse to us	266,451	251,406
Notes payable to us	26,876	19,084
Equity	36,678	34,702
Total liabilities and equity	$ 343,587	$ 318,289
Our share of equity and notes receivable from LLCs	$ 71,734	$ 61,934

As of March 31, 2010, aggregate maturities of mortgage notes payable by the LLCs which are accounted for under the equity method and are non-recourse to us, are as follows (amounts in thousands):

2010	$ 38,613
2011	54,632
2012	24,588
2013	25,834
2014	28,822
Thereafter	93,962
Total	$ 266,451

Name of LLC	Mortgage Balance(a.)	Maturity Date
Deerval Properties(b.)(f.)	$ 6,950	06/10/2010

Suburban Properties(b.)	9,147	09/15/2010
DVMC Properties(b.)(g.)	4,438	09/30/2010
Banbury Medical Properties(b.)(c.)(h.)	13,402	12/31/2010
PCH Medical Properties	6,444	01/31/2011
Deerval Properties II	18,312	02/15/2011
Auburn Medical Properties(b.)(c.)(d.)	7,667	04/02/2011
Santa Fe Scottsdale	2,618	06/10/2011
Texoma Medical Properties(c.)	11,247	07/01/2011
ApaMed Properties	2,739	01/01/2012
575 Hardy Investors	9,615	02/01/2012
Gold Shadow Properties	6,670	04/10/2012
BRB/E Building One(c.)	3,010	11/01/2012
Sierra Medical Properties	3,992	12/31/2012
Centennial Medical Properties	12,255	01/31/2013
Sparks Medical Properties(b.)(e.)	7,100	04/12/2013
Litchvan Investments	7,895	10/01/2013
Paseo Medical Properties II	17,000	06/08/2014
653 Town Center Investments	9,892	07/01/2014
Brunswick Associates	8,448	01/01/2015
Spring Valley Medical Properties	5,789	02/10/2015
DSMB Properties	25,416	09/10/2015
Arlington Medical Properties	26,589	10/10/2015
Willetta Medical Properties	13,245	10/10/2016
Cobre Properties	2,547	11/01/2017
Canyon Healthcare Properties	16,987	12/01/2017
PCH Southern Properties	7,037	12/01/2017
	$ 266,451	

12

(a.) All mortgage loans, other than construction loans, require monthly principal payments through maturity and include a balloon principal payment upon maturity.

(b.) We believe the terms of these loans are within current market underwriting criteria. At this time, the LLC expects to refinance these loans on or before their 2010 maturity dates for three to ten year terms at the then current market interest rates. In the unexpected event that we are unable to refinance these loans on reasonable terms, we will explore other financing alternatives, including, among other things, potentially increasing our equity investment in the property utilizing funds borrowed under our revolving credit facility.

(c.) Construction loans.

(d.) The Auburn Medical Properties loan was scheduled to mature on April 2, 2010, however, the LLC exercised the first of two one- year extension periods extending the term to April 2, 2011.

(e.) The Sparks Medical Properties loan was scheduled to mature on April 12, 2010, however, the loan balance was reduced by $1.6 million during the second quarter of 2010, and the term was extended for three years to April 12, 2013.

(f.) The Deerval Properties loan is scheduled to mature on June 30, 2010, and can be extended, at the LLC s option, for three years to June 30, 2013.

(g.) The DVMC Properties loan is scheduled to mature on September 30, 2010, and can be extended, at the LLC s option, for three years to September 30, 2013.

(h.) The Banburry Medical Properties loan is scheduled to mature on December 31, 2010, and can be extended, at the LLC s option, for one year to December 31, 2011.

Pursuant to the operating agreements of the LLCs, the third-party member and the Trust, at any time, have the right to make an offer (Offering Member) to the other member(s) (Non-Offering Member) in which it either agrees to: (i) sell the entire ownership , interest of the Offering Member to the Non-Offering Member (Offer to Sell) at a price as determined by the Offering Member (Transfer Price), or; (ii) purchase the entire ownership interest of the Non-Offering Member (Offer to Purchase) at the equivalent proportionate Transfer Price. The Non-Offering Member has 60 days to either: (i) purchase the entire ownership interest of the Offering-Member at the Transfer Price, or; (ii) sell its entire ownership interest to the Offering Member at the equivalent proportionate Transfer Price. The closing of the transfer must occur within 60 days of the acceptance by the Non-Offering Member.

(6) Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued an amendment to the accounting and disclosure requirements for transfers of financial assets. This amendment requires greater transparency and additional disclosures for transfers of financial assets and the entity s continuing involvement with them and changes the requirements for derecognizing financial assets. In addition, this amendment eliminates the concept of a qualifying special-purpose entity (QSPE). This amendment became effective for us on January 1, 2010. This amendment did not have a material impact on our consolidated financial position or results of operations.

In June 2009, the FASB also issued an amendment to the accounting and disclosure requirements for the consolidation of variable interest entities (VIE s). The elimination of the concept of a QSPE, as discussed above, removes the exception from applying the consolidation guidance within this amendment. This amendment requires an enterprise to perform a qualitative analysis when determining whether or not it must consolidate a VIE. The amendment also requires an enterprise to continuously reassess whether it must consolidate a VIE. Additionally, the amendment requires enhanced disclosures about an enterprise s involvement with VIEs and

Table of Contents

any significant change in risk exposure due to that involvement, as well as how its involvement with VIEs impacts the enterprise s financial statements. Finally, an enterprise will be required to disclose significant judgments and assumptions used to determine whether or not to consolidate a VIE. This amendment became effective for us on January 1, 2010. This amendment did not have a material impact on our consolidated financial position or results of operations.

(7) Segment Reporting

Our primary business is investing in and leasing healthcare and human service facilities through direct ownership or through joint ventures, which aggregate into a single reportable segment. We actively manage our portfolio of healthcare and human service facilities and may from time to time make decisions to sell lower performing properties not meeting our long-term investment objectives. The proceeds of sales are typically reinvested in new developments or acquisitions, which we believe will meet our planned rate of return. It is our intent that all healthcare and human service facilities will be owned or developed for investment purposes. Our revenue and net income are generated from the operation of our investment portfolio.

Our portfolio is located throughout the United States however, we do not distinguish or group our operations on a geographical basis for purposes of allocating resources or measuring performance. We review operating and financial data for each property on an individual basis; therefore, we define an operating segment as our individual properties. Individual properties have been aggregated into one reportable segment based upon their similarities with regard to both the nature and economics of the facilities, tenants and operational processes, as well as long-term average financial performance.

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are a real estate investment trust (REIT) that commenced operations in 1986. We invest in healthcare and human service related facilities including acute care hospitals, behavioral healthcare facilities, rehabilitation hospitals, sub-acute facilities, surgery centers, childcare centers and medical office buildings. As of March 31, 2010, we have fifty-two real estate investments or commitments located in fifteen states consisting of:

seven hospital facilities consisting of three acute care, one behavioral healthcare, one rehabilitation and two sub-acute;

forty-one medical office buildings, including thirty-two owned by various LLCs, and;

four pre-school and childcare centers.

Forward Looking Statements and Certain Risk Factors

This report contains forward-looking statements that reflect our current estimates, expectations and projections about our future results, performance, prospects and opportunities. Forward-looking statements include, among other things, the information concerning our possible future results of operations, business and growth strategies, financing plans, expectations that regulatory developments or other matters will not have a material adverse effect on our business or financial condition, our competitive position and the effects of competition, the projected growth of the industry in which we operate, and the benefits and synergies to be obtained from our completed and any future acquisitions, and statements of our goals and objectives, and other similar expressions concerning matters that are not historical facts. Words such as may, will, should, could, would, predicts, potential, continue, expects, anticipates, future, intends, plans, believes, estimates, a expressions, as well as statements in future tense, identify forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, such performance or results will be achieved. Forward-looking information is based on information available at the time and/or our good faith belief with respect to future events, and is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements. Such factors include, among other things, the following:

a substantial portion of our revenues are dependent upon one operator, Universal Health Services, Inc. (UHS);

A number of legislative initiatives have recently been passed into law that may result in major changes in the healt these events and other market disruptions may have a greater impact on the prices and volatility of high yield securities than on investment grade fixed income securities. There can be no assurance that these events and other market disruptions may not have other material and adverse implications for the high yield securities markets.

Recent Events. The debt and equity capital markets in the United States have been negatively impacted by significant write-offs in the financial services sector relating to subprime mortgages and the repricing of credit risk in the broadly syndicated market, among other things. These events, along with the deterioration of the housing market, the failure of major financial institutions and the resulting United States federal government actions have led to worsening general economic conditions, which have materially and adversely impacted the broader financial and credit markets and have reduced the availability of debt and equity capital for the market as a whole and financial firms in particular.

These events have been adversely affecting the willingness of some lenders to extend credit, in general, which may make it more difficult for issuers of debt securities to obtain financings or refinancings for their investment or lending activities or operations. There is a risk that such issuers will be unable to successfully complete such financings or refinancings. In particular, because of the current conditions in the credit markets, issuers of debt securities may be subject to increased cost for debt, tightening underwriting standards and reduced liquidity for loans they make, securities they purchase and securities they issue.

These events may increase the volatility of the value of securities owned by a Fund and/or result in sudden and significant valuation increases or declines in its portfolio. These events also may make it more difficult for a Fund to accurately value its securities or to sell its securities on a timely basis. These events could adversely affect the ability of a Fund to borrow for investment purposes, if it chose to do so, and increase the cost of such borrowings, which would reduce returns to the holders of shares of common stock. A significant decline in the value of a Fund s portfolios would likely result in a significant decline in the value of your investment in a Fund.

These events have adversely affected the broader economy, and may continue to do so, which in turn may adversely affect the ability of issuers of securities owned by a Fund to make payments of principal and interest when due, lead to lower credit ratings and increase defaults. There is also a risk that developments in sectors of the credit markets in which a Fund does not invest may adversely affect the liquidity and the value of securities in sectors of the credit markets in which a Fund does invest, including securities owned by Fund. Such developments could, in turn, reduce the value of securities owned by a Fund and adversely affect the net asset value of a Fund s shares of common stock.

Prolonged continuation or further deterioration of current market conditions could adversely impact a Fund s portfolio.

Government Intervention in Financial Markets. The recent instability in the financial markets discussed above has led the U.S. Government to take a number of unprecedented actions designed to support certain financial institutions and segments of the financial markets that have experienced extreme volatility, and in some cases a lack of liquidity, including through direct purchases of equity in financial institutions. Federal, state, and other governments, their regulatory agencies or self-regulatory organizations may take actions that affect the regulation of the instruments in which a Fund invests, or the issuers of such instruments, in ways that are unforeseeable. Legislation or regulation may also change the way in which a Fund is regulated. Such legislation or regulation could limit or preclude a Fund s ability to achieve its investment objective.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which was signed into law in July 2010, is expected to result in a significant revision of the U.S. financial regulatory framework. The Dodd-Frank Act significantly revises and expands the rulemaking, supervisory and enforcement authority of federal bank, securities and commodities regulators. The Dodd-Frank Act, among other things, grants regulatory authorities such as the Commodity Futures Trading Commission and SEC broad rulemaking authority to implement various provisions of the Dodd-Frank Act including comprehensive regulation of the over-the-counter derivatives market. It is unclear how these regulators will exercise these revised and expanded powers and whether they will undertake rulemaking, supervisory or enforcement actions that would adversely affect the Funds or investments made by the Funds. Possible regulatory actions taken under these revised and expanded powers may include actions related to financial consumer protection, proprietary trading and derivatives. There can be no assurance that future regulatory actions authorized by the Dodd-Frank Act will not have a material adverse effect on a Fund or will not impair the ability of the Fund to achieve its investment objective.

The ultimate impact of the Dodd-Frank Act, and any resulting regulation, is not yet certain and a Fund and issuers of securities in which the Fund invests may be affected by the new legislation and regulation in ways that are currently unknown, unanticipated or unforeseeable. The regulation of various types of derivative instruments pursuant to the Dodd-Frank Act may adversely affect a Fund as well as issuers of securities in which the Fund invests that utilize derivatives strategies for hedging or other purposes. The implementation of the Dodd-Frank

Act could also adversely affect a Fund by increasing transaction and/or regulatory compliance costs. In addition, greater regulatory scrutiny may increase a Fund s and the Investment Advisor s exposure to potential liabilities. Increased regulatory oversight could also impose administrative burdens on a Fund and the Investment Advisor, including, without limitation, responding to investigations and implementing new policies and procedures. Any of these developments could reduce the profitability of a Fund by exposing it to additional costs, taxes, liabilities, enforcement actions and reputational risk.

Legislation Risk. At any time after the date of this Joint Proxy Statement/Prospectus, legislation may be enacted that could negatively affect the assets of a Fund or the issuers of such assets. Changing approaches to regulation may have a negative impact on the entities in which a Fund invests. Legislation or regulation may also change the way in which a Fund itself is regulated. There can be no assurance that future legislation, regulation or deregulation will not have a material adverse effect on a Fund or will not impair the ability of the Fund to achieve its investment objective.

EXPENSE TABLE FOR STOCKHOLDERS

Total Expenses Table for Stockholders of the Funds as of February 29, 2012

The table below illustrates the anticipated reduction in Total Expenses expected as a result of the Reorganizations. When we use the term Total Expenses, we mean a Fund s total annual operating expenses. When we use the term Total Expense Ratio, we mean a Fund s Total Expenses expressed as a percentage of its average net assets attributable to its shares of common stock. The table sets forth (i) the Total Expenses paid by each Fund for the 12-month period ended February 29, 2012 and (ii) the *pro forma* Total Expenses for the Combined Fund, assuming the Reorganization had taken place on February 29, 2012. As shown below, the Reorganizations of the Funds are expected to result in a lower Total Expense Ratio for stockholders of each Fund for the period covered.

	FRB	DVF	FRA	Combined Fund (All Funds)[a]	Combined Fund (FRB and Acquiring Fund)[a]	Combined Fund (DVF and Acquiring Fund)[a]
Stockholder Transaction Expenses						
Maximum Sales Load (as a percentage of the offering price) imposed on purchases of shares of common stock[b]	None	None	None	None	None	None
Dividend Reinvestment and Cash Purchase Plan Fees	None	None	None	None	None	None
Annual Total Expenses (as a percentage of average net assets attributable to shares of common stock)						
Investment Management Fees[c]	1.00%	1.02%	1.00%	1.01%	1.00%	1.01%
Other Expenses	0.36%	0.38%	0.35%	0.28%	0.30%	0.30%
Interest Expense	0.32%	0.34%	0.32%	0.33%	0.32%	0.33%
Total Annual Fund Operating Expenses (Including Interest Expense)[d][e]	1.68%	1.74%	1.67%	1.62%	1.62%	1.64%

(a) Assumes the Reorganizations had taken place on February 29, 2012.

(b) No sales load will be charged in connection with the issuance of the Acquiring Fund Shares as part of the Reorganizations. Common shares are not available for purchase from the Funds but may be purchased on the NYSE through a broker-dealer subject to individually negotiated commission rates. Common shares purchased in the secondary market may be subject to brokerage commissions or other charges.

(c) Each of the Funds currently pays the Investment Adviser a contractual management fee at an annual rate of 0.75% based on an aggregate of (i) the Combined Fund s average daily net assets (including proceeds from the issuance of any preferred stock) and (ii) the proceeds of any outstanding borrowings used for leverage (average daily managed assets). The contractual management fees will not increase following the Reorganizations as the Combined Fund will pay the Investment Adviser the same contractual management fee that each of the Funds currently pays the Investment Adviser. However, the effective management fee as a percentage of average net assets attributable to shares of common stock for the Combined Fund will increase by 0.01% for FRA and FRB because the Combined Fund utilizes a larger amount of leverage than FRA and FRB currently utilize.

(d) The Total Annual Fund Operating Expense (*excluding* interest expense) is 1.36% for FRB; 1.40% for DVF; 1.35% for FRA; 1.29% if all the Funds were combined; 1.30% if only FRB and FRA were combined; and 1.31% if only DVF and FRA were combined.

(e) For the fiscal year ended August 31, 2011, the Total Expense Ratios of FRA and DVF were 1.60% and 1.74%, respectively.

The following example is intended to help you compare the costs of investing in the shares of common stock of the Combined Fund *pro forma* if the Reorganization is completed with the costs of investing in FRB, DVF and the Acquiring Fund without the Reorganization. An investor in shares of common stock would pay the following expenses on a $1,000 investment, assuming (1) the Total Expense Ratio for each Fund set forth in the table above and (2) a 5% annual return throughout the period:

	1 Year	**3 Years**	**5 Years**	**10 Years**
FRB	$ 17	$ 53	$ 91	$ 199
DVF	$ 18	$ 55	$ 94	$ 205
Acquiring Fund	$ 17	$ 53	$ 91	$ 198
Combined Fund (All Target Funds into Acquiring Fund)	$ 16	$ 51	$ 88	$ 192
Combined Fund (FRB and Acquiring Fund)	$ 16	$ 51	$ 88	$ 192
Combined Fund (DVF and Acquiring Fund)	$ 17	$ 52	$ 89	$ 194

The examples set forth above assume shares of common stock of each Fund were owned as of the completion of the Reorganizations and the reinvestment of all dividends and distributions and uses a 5% annual rate of return as mandated by SEC regulations. The examples should not be considered a representation of past or future expenses or annual rates of return. Actual expenses or annual rates of return may be more or less than those assumed for purposes of the examples.

As shown above, for the 12-month period ended February 29, 2012, the Total Expense Ratios of FRB, DVF and FRA were 1.68%, 1.74% and 1.67%, respectively. The Funds estimate that the completion of the Reorganization would result in a Total Expense Ratio for the Combined Fund of 1.62% on a *pro forma* basis for the 12-month period ended February 29, 2012. See Reasons for the Reorganizations.

The Funds will bear expenses incurred in connection with the Reorganizations that are not reflected in Other Expenses, including, but not limited to, costs related to the preparation and distribution of materials distributed to each Fund s Board, expenses incurred in connection with the preparation of the Reorganization Agreements and the registration statement on Form N-14, the printing and distribution of this Joint Proxy Statement/Prospectus and any other materials required to be distributed to stockholders, SEC and state securities commission filing fees and legal and audit fees in connection with the Reorganizations, legal fees incurred preparing each Fund s Board materials, attending each Fund s Board meetings and preparing the minutes, auditing fees associated with each Fund s financial statements, stock exchange fees, transfer agency fees, portfolio transfer taxes (if any) and any similar expenses incurred in connection with the Reorganizations, which will be borne directly by the respective Fund incurring the expense or allocated among the Funds proportionately or on another reasonable basis, as appropriate.

Because each of the Funds has already incurred expenses solely and directly attributable to the Reorganizations and because each of the Target Funds is responsible for paying those expenses and FRA is responsible for paying its expenses in excess of $100,000, if such Fund s respective stockholders do not approve their Fund s respective Reorganization, such Fund will continue to be responsible for the expenses arising from its proposed Reorganization even though its proposed Reorganization will not occur and those expenses may be material. Because of the expected benefits outlined above for each Fund, and because, over time, the savings attributable to each Fund s participation in each Reorganization outweigh the costs associated with such Reorganization, the Investment Advisor recommended, and the Boards have approved, that DVF and FRB be responsible for their own Reorganization expenses and that FRA be responsible for its Reorganization expenses in excess of $100,000. See Reasons for the Reorganizations. Such expenses are estimated to be $930,000 in the aggregate, of which $300,000 is estimated to be attributable to FRB, $300,000 is estimated to be attributable to DVF, and $330,000 is estimated to be attributable to FRA, of which the Investment Advisor has agreed to pay $100,000. The actual costs associated with the proposed Reorganizations may be more or less than the estimated costs discussed herein. Neither the Funds nor the Investment Advisor will pay any expenses of stockholders arising out of or in connection with the Reorganizations.

REASONS FOR THE REORGANIZATIONS

The primary factors considered by the Board of each Fund with regard to the Reorganizations include, but are not limited to, the following:

1. The Combined Fund is expected to have a lower Total Expense Ratio than each of the Funds had prior to the Reorganization.

The Funds estimate that the completion of all of the Reorganizations would result in a Total Expense Ratio for the Combined Fund of 1.62% on a *pro forma* basis for the 12-month period ended February 29, 2012.

2. The expectation that, if the Reorganization of a Target Fund is not approved, the Investment Advisor may, in connection with ongoing management of the Funds and its product line, recommend alternative proposals to the Board of such Target Fund.

3. Each Fund s stockholders will remain invested in a diversified, NYSE-listed, closed-end management investment company that will have substantially greater net assets and either the same or substantially similar (but not identical) investment objectives and policies and, as a result, the style and risk/return profile of the Combined Fund will remain comparable to those of each Target Fund stockholders current investments, subject to the differences described in Comparison of the Funds.

Each Fund s stockholders would continue to own a closed-end fund that (i) has the same investment adviser and portfolio managers as FRA, (ii) has comparable risk-return attributes as FRA, (iii) similarly focuses its investments in floating rate debt securities and instruments and (iv) trades at market price on the NYSE. See Investment Objectives and Policies for additional information regarding the Funds investment objective(s) and policies.

4. Under current market conditions and all other things being equal, the earnings rate of the Combined Fund is expected to be higher than the current earnings rate of each of the Funds, which is expected to support a higher distribution level based on net asset value for the Combined Fund than each Fund prior to the Reorganization.

5. The common shares of each Fund have historically fluctuated between a discount and a premium. As of May 4, 2012, FRA, FRB and DVF each traded at a discount to their respective NAV. To the extent FRB and DVF are trading at a wider discount (or a narrower premium) than FRA at the time of the Reorganizations, FRB and DVF shareholders would have the potential for an economic benefit by the narrowing of the discount/premium. To the extent FRB and DVF are trading at a narrower discount (or wider premium) than FRA at the time of the Reorganizations, FRB and DVF shareholders may be negatively impacted if the Reorganizations are consummated. FRA shareholders would only benefit from a discount perspective to the extent the post-Reorganization discount (or premium) improves.

6. The Combined Fund is expected to achieve certain operating and administrative efficiencies from its larger net asset size. The larger net asset size of the Combined Fund could permit the Combined Fund to achieve certain economies of scale as certain fixed and variable costs can be spread over a larger asset base and the larger Combined Fund may realize greater investment flexibility and investment

30

options, greater diversification of portfolio investments, the ability to trade in larger positions, more favorable transaction terms, better trade execution, more consistent implementation of investment strategies, additional research coverage and greater liquidity.

7. The Combined Fund may experience potential benefits from having fewer closed-end funds in the market, including potential benefits from a more efficient secondary market and an increased focus by investors on the remaining funds in the market (including the Combined Fund), and fewer similar funds in the same fund complex, including potential benefits from easier product differentiation for stockholders (including stockholders of the Combined Fund).

8. The Combined Fund may provide greater secondary market liquidity for its shares of common stock as it would be larger than any of the Funds.

9. Stockholders will recognize no gain or loss for U.S. federal income tax purposes as a result of the Reorganizations (except with respect to cash received in lieu of fractional shares), as each Reorganization is intended to qualify as a reorganization within the meaning of Section 368(a) of the Code.

10. Stockholders will benefit from the continuing experience and expertise of the portfolio management team designated for the Combined Fund and the team s commitment to the investment style and strategies to be used in managing the assets of the Combined Fund. See Management of the Funds. The portfolio guidelines of the Combined Fund will either be the same or substantially similar (but not identical) to that of each Target Fund, as described in greater detail elsewhere in this Joint Proxy Statement/Prospectus. As a result, it is not anticipated that there will be significant disposition of the holdings in each Target Fund as a result of the Reorganization. In addition, nothing will require the Funds to dispose of holdings in the Target Funds portfolio if, in the reasonable judgment of the Boards or the Investment Advisor, such disposition would adversely affect the tax-free nature of the Reorganizations for U.S. federal income tax purposes.

11. The aggregate net asset value of the shares of the Combined Fund that the Target Fund stockholders will receive in the Reorganization is expected to equal the aggregate net asset value (not the market value) of the Target Fund shares that the Target Fund stockholders owned immediately prior to the Reorganization, and the net asset value of Target Fund shares will not be diluted as a result of the Reorganization.

12. While the capital loss carryforwards of the Combined Fund attributable to each Target Fund that participates in a Reorganization will be subject to tax loss limitation rules by reason of such Target Fund undergoing an ownership change in the Reorganization, the Boards of the Target Funds currently expect that such tax loss limitation rules should not have a material adverse effect on the Combined Fund s utilization of each Target Fund s capital loss carryforward as compared with what each Target Fund s utilization of its own capital loss carryforward would be without the Reorganization. The actual effect of the loss limitation rules depends on many variables and assumptions, including projected performance, and is, therefore, highly uncertain.

The Board of each Fund believes that the Reorganizations would benefit stockholders of the Funds, based on a number of factors, including: (i) that stockholders would not be diluted with respect to net asset value; (ii) the relative similarity of the investment strategies and policies of the Funds; (iii) the larger net asset base of the Combined Fund after the Reorganizations; (iv) the capabilities of the management team of the Combined Fund that would manage the Combined Fund; and (v) the possibility of achieving economies of scale going forward while promoting more efficient operations, administration and portfolio management while also enabling greater diversification of investments, lower expense ratios as a result of a larger asset base and greater shareholder liquidity. Considering these and other reasons, the Board of each Fund unanimously concluded that completion of the Reorganizations is in the best interests of each Fund and its stockholders and that the interests of the stockholders of each Fund will not be diluted with respect to net asset value as a result of the Reorganizations. This determination was made on the basis of each Director s business judgment after consideration of all of the factors taken as a whole with respect to each Fund and its stockholders, although individual Directors may have placed different weight on various factors and assigned different degrees of materiality to various factors, particularly if all of the Reorganizations are approved, which the Boards believe is the most likely result of all of the potential combinations of proposed reorganizations.

PROPOSAL 1: THE REORGANIZATIONS OF THE TARGET FUNDS

The Reorganizations seek to combine three funds that are either the same or substantially similar (but not identical) to achieve certain economies of scale and other operational efficiencies. Each Fund is registered as a diversified, closed-end management investment company under the 1940 Act. Each Fund s shares of common stock are listed on the NYSE. The Funds have the same investment adviser. Each of the investment objectives and the investment strategies and restrictions of the Funds are the same or substantially similar (but not identical). Each of the Funds has the investment objective to provide high current income; however, the Acquiring Fund and FRB also seek to provide such preservation of capital as is consistent with investment in a diversified, leveraged portfolio consisting primarily of floating rate debt securities and instruments. Each Fund s investment objective(s) is a fundamental policy and may not be changed without stockholder approval. Each Fund, under normal market conditions, invests at least 80% of its net assets in floating rate debt securities. DVF differs from the other Funds in that it may invest across a broader array of security types that are rated below investment grade including fixed rate securities that are purchased with a derivative instrument (a swap, for example) to make the securities floating rate.

The Board of each Fund, including the Independent Directors, has unanimously approved each Reorganization Agreement. In each Reorganization, each Target Fund will merge with and into the Merger Subsidiary, and each Target Fund will terminate its registration under the 1940 Act. Following the Reorganizations, the Merger Subsidiary will dissolve under Maryland law and be liquidated into the Acquiring Fund. The outstanding shares of common stock of each Target Fund will be exchanged for newly-issued Acquiring Fund Shares, par value $0.10 per share. The aggregate net asset value of Acquiring Fund Shares received by a Target Fund s stockholders in each Reorganization will equal the aggregate net asset value (not the market value) of Target Fund shares of common stock held immediately prior to that Reorganization, less the costs of that Reorganization (although stockholders may receive cash for their fractional shares of common stock). The Acquiring Fund will continue to operate as a registered, diversified, closed-end investment company with the investment objective and policies described in this Joint Proxy Statement/Prospectus.

The Boards have reviewed data presented by the Investment Advisor and believe that the Reorganizations generally would result in a reduced Total Expense Ratio for each of the Funds as certain fixed administrative costs would be spread across the Combined Fund s larger asset base. If the Reorganizations are approved, the Combined Fund will pay the Investment Advisor a monthly fee at an annual rate of 0.75% of the Combined Fund s average daily managed assets. Because each of the Funds borrows for investment purposes and the Combined Fund intends to borrow for investment purposes, the Combined Fund s managed assets will generally be equal to the total assets of the Combined Fund minus the sum of the accrued liabilities (other than the aggregate indebtedness constituting financial leverage).

For the fiscal year ended August 31, 2011, the Total Expense Ratios of FRA and DVF were 1.60% and 1.74%, respectively. For the fiscal year ended February 29, 2012, FRB s Total Expense Ratio was 1.68% and for the 12-month period ended February 29, 2012, FRA s and DVF s Total Expense Ratios were 1.67% and 1.74%, respectively. The Funds estimate that the completion of all of the Reorganizations would result in a Total Expense Ratio for the Combined Fund of 1.62% on a *pro forma* basis for the 12-month period ended February 29, 2012.

The table below shows the projected Total Expense Ratios on a *pro forma* basis for each possible combination of Funds for the 12-month period ended February 29, 2012.

	Pro Forma **Combined Fund (All Funds)**	***Pro Forma*** **Combined Fund (FRB and Acquiring Fund)**	***Pro Forma*** **Combined Fund (DVF Acquiring Fund)**
Total Expense Ratios	1.62%	1.62%	1.64%

In approving the proposed Reorganizations, the Board of each Fund, including the Independent Directors, determined that participation in the Reorganizations is in the best interests of each Fund and its stockholders and that the interests of each Fund s stockholders will not be diluted with respect to the net asset value of such Fund as a result of its Reorganization. Before reaching these conclusions, the Board of each Fund, including the Independent Directors, engaged in a thorough review process relating to the proposed Reorganizations. The Boards of the Funds also received a memorandum outlining, among other things, the legal standards and certain other considerations relevant to the Boards deliberations. The Boards of the Funds, including all of the Independent Directors, approved the Reorganization at a meeting held on May 22-23, 2012.

Considering these and other reasons, the Board of each Target Fund unanimously concluded that completion of the Reorganizations is in the best interests of each Target Fund and its stockholders and that the interests of the stockholders of each Target Fund will not be diluted as a result of the Reorganizations. This determination was made on the basis of each Director s business judgment after consideration of all of the factors taken as a whole with respect to each Target Fund and its stockholders, although individual Directors may have placed different weight and assigned different degrees of materiality to various factors. See Reasons for the Reorganization.

If a Reorganization is not approved by a Target Fund s stockholders, such Target Fund will continue to operate for the time being as a standalone Maryland corporation, and will continue to be advised by the Investment Advisor. However, if the Reorganization of a Target Fund is not approved, the Investment Advisor may, in connection with ongoing management of the Funds and its product line, recommend alternative proposals to the Board of such Target Fund. An unfavorable vote by one of the Target Funds or the Acquiring Fund with respect to one of the Reorganizations will not affect the implementation of the Reorganization by the other Funds.

The Target Fund Boards have determined that the Reorganizations are in the best interests of each Target Fund and the stockholders of each Target Fund and that the interests of such stockholders will not be diluted as a result of their Fund s Reorganization. Similarly, the Acquiring Fund Board has determined that each Reorganization is in the best interests of the Acquiring Fund and its stockholders and that the interests of such stockholders will not be diluted as a result of each Reorganization. As a result of the Reorganizations, however, stockholders of each Fund will hold a reduced percentage of ownership in the larger Combined Fund than they did in any of the individual Funds.

Each Reorganization is intended to qualify as a reorganization within the meaning of Section 368(a) of the Code. If a Reorganization so qualifies, in general, stockholders of a Target Fund will recognize no gain or loss for U.S. federal income tax purposes upon the exchange of their Target Fund shares of common stock for Acquiring Fund Shares pursuant to the Reorganization (except with respect to cash received in lieu of fractional shares). Additionally, the Target Funds will recognize no gain or loss for U.S. federal income tax purposes by reason of the Reorganization. Neither Acquiring Fund nor its stockholders will recognize any gain or loss for U.S. federal income tax purposes pursuant to each Reorganization. It is a condition to the closing of each Reorganization that the respective Target Fund and the Acquiring Fund receive an opinion from Skadden Arps, dated as of the Closing Date, regarding the characterization of the Reorganization as a reorganization within the meaning of Section 368(a) of the Code.

The Target Fund Boards request that stockholders of each Target Fund approve their Fund s proposed Reorganization at the Special Meeting to be held on Thursday, September 13, 2012 at 9:00 a.m. Stockholder approval of each Reorganization requires the affirmative vote by stockholders of each Target Fund representing a majority of the outstanding shares of common stock entitled to vote on the Reorganization. Subject to the requisite approval of the stockholders of each Target Fund with regard to each Reorganization, it is expected that the Closing Date will be after the close of business on or about October 12, 2012, but it may be at a different time as described herein.

For additional information regarding voting requirements, see Voting Information and Requirements.

Investing in the Combined Fund following the Reorganization involves risks. For additional information, see Risk Factors and Special Considerations.

The FRB Board recommends that stockholders of FRB vote **FOR** FRB s proposed Reorganization.

The DVF Board recommends that stockholders of DVF vote **FOR** DVF s proposed Reorganization.

INVESTMENT OBJECTIVES AND POLICIES

The structure, organization and investment policies of the Funds are substantially similar. Each Fund is a diversified, closed-end management investment company registered under the 1940 Act. Each Fund s shares of common stock are also listed for trading on the NYSE. The investment objectives of the Funds are substantially similar. Each of the Funds has the investment objective to provide high current income; however, the Acquiring Fund and FRB also seek to provide such preservation of capital as is consistent with investment in a diversified, leveraged portfolio consisting primarily of floating rate debt securities and instruments. The investment objective(s) of each Fund is a fundamental policy of such Fund and may not be changed without stockholder approval.

Each Fund seeks to achieve its investment objective by investing primarily in floating rate debt securities.

The Funds investment policies and restrictions are the same or substantially similar (but not identical). Under normal market conditions, the Funds invest at least 80% of such Fund s net assets in floating rate debt securities. DVF differs from the other Funds in that it may invest in a broader array of security types including fixed rate securities that are purchased with a derivative instrument (a swap, for example) to make the securities floating rate. For a comparison of the Funds, see Comparison of the Funds.

Each Fund currently utilizes leverage for investment purposes. At times, each Fund utilizes leverage through borrowings, the issuance of short term debt securities, the issuance of shares of preferred stock or a combination thereof. Each Fund has the ability to utilize leverage through borrowings or the issuance of short term debt securities in an amount up to $33^{1/3}$% of the value of its total assets (including the amount obtained from such borrowings or debt issuance). Each Fund also has the ability to utilize leverage through the issuance of shares of preferred stock in an amount up to 50% of the value of its total assets (including the amount obtained from such issuance).

Each Fund is classified as diversified within the meaning of the 1940 Act, which means that it is must satisfy the 5% and 10% requirements (described below) with respect to 75% of its total assets. Each Fund s investments will be limited so as to qualify the Fund as a regulated investment company for purposes of Federal tax laws. Requirements for qualification include limiting its investments so that, at the close of each quarter of the taxable year, (i) not more than 25% of the market value of the Fund s total assets will be invested in (A) the securities of a single issuer (other than U.S. Government securities and securities of other regulated investment companies), (B) the securities of two or more issuers (other than securities of other regulated investment companies) controlled by the Fund and engaged in the same, similar or related trades or businesses, or (C) the securities of one or more qualified publicly traded partnerships, and (ii) with respect to 50% of the market value of its total assets, not more than 5% of the market value of its total assets will be invested in the securities of a single issuer and the Fund will not own more than 10% of the outstanding voting securities of a single issuer (other than U.S. Government securities and securities of other regulated investment companies).

Floating Rate Debt Securities

Under normal market conditions each Fund will invest at least 80% of an aggregate of (i) such Fund s net assets (including proceeds from the issuance of any preferred stock) and (ii) the proceeds of any outstanding borrowings for investment purposes, in floating rate debt securities. Floating rate debt securities include floating or variable rate securities that pay interest at rates that adjust whenever a specified interest rate changes and/or which reset on predetermined dates (such as the last day of a month or calendar quarter). In addition to senior loans, these floating rate debt securities may include, without limitation, instruments such as catastrophe and other event linked bonds, bank capital securities, corporate bonds, notes, money market instruments and certain types of mortgage related and other asset backed securities. Due to their floating or variable rate features, these instruments will generally pay higher levels of income in a rising interest rate environment and lower levels of income as interest rates decline. For the same reason, the market value of a floating rate debt security is generally expected to have less sensitivity to fluctuations in market interest rates than a fixed rate debt instrument, although the value of a floating rate debt security may nonetheless decline as interest rates rise and due to other factors, such as real or perceived changes in credit quality or financial condition of the issuer or borrower, volatility in the capital markets or other adverse market conditions.

Senior Loans

Under normal market conditions each Fund anticipates investing a substantial portion of its floating rate debt assets in senior loans. The senior loans in which each Fund invests primarily consist of direct obligations of a borrower undertaken to finance the growth of the borrower s business, internally or externally, or to finance a capital restructuring. Senior loans may also include debtor in possession financings pursuant to Chapter 11 of the U.S. Bankruptcy Code and obligations of a borrower issued in connection with a restructuring pursuant to Chapter 11 of the U.S. Bankruptcy Code. A significant portion of such senior loans are highly leveraged loans such as leveraged buy-out loans, leveraged recapitalization loans and other types of acquisition loans. Such senior loans may be structured to include both term loans, which are generally fully funded at the time of each Fund s investment, and revolving credit facilities or delayed draw term loans, which would require such Fund to make additional investments in the senior loans as required under the terms of the credit facility. Such senior loans may also include receivables purchase facilities, which are similar to revolving credit facilities secured by a borrower s receivables. Senior loans generally are issued in the form of senior syndicated loans, but each Fund also may invest from time to time in privately placed notes, credit linked notes, structured notes or other instruments with credit and pricing terms which are, in the opinion of the Investment Adviser, consistent with investments in senior loan obligations.

Each Fund may invest without limitation in debt securities of issuers domiciled outside the United States. The Acquiring Fund, however, will not invest more than 10% of its total assets in debt securities of issuers located in emerging market countries. The Acquiring Fund will not invest more than 10% of its total assets in debt securities denominated in currencies other than the U.S. dollar or that do not provide for payment to the Acquiring Fund in U.S. dollars. Investments in foreign securities involve certain risks not involved in domestic investments. Loans to such non-U.S. borrowers involve risks not typically involved in domestic investment, including fluctuation in foreign exchange rates, future foreign political and economic developments, and the possible imposition of exchange controls or other foreign or U.S. governmental laws or restrictions applicable to such loans. With respect to certain foreign countries, there is the possibility of expropriation or confiscatory taxation, political or social instability, or diplomatic developments which could affect the Acquiring Fund s investments in those countries. Moreover, individual foreign economies may differ favorably or unfavorably from the U.S. economy in such respects as growth of gross national product, rate of inflation, capital reinvestment, resource self-sufficiency and balance of payment position. In addition, information with respect to non-U.S. borrowers may differ from that available with respect to U.S. borrowers, since foreign companies are not generally subject to uniform accounting, auditing and financial reporting standards, practices and requirements comparable to those applicable to U.S. borrowers.

The senior loans in which each Fund invests generally hold a senior position in the capital structure of the borrower. Such loans may include loans that hold the most senior position, loans that hold an equal ranking with other senior debt, or loans that are, in the judgment of the Investment Adviser, in the category of senior debt. A senior position in the borrower s capital structure generally gives the holder of the senior loan a claim on some or all of the borrower s assets that is senior to that of subordinated debt, preferred stock and common stock in the event the borrower defaults or becomes bankrupt. The senior loans in which each Fund invests may be wholly or partially secured by collateral, or may be unsecured. In the event of a default, the ability of an investor to have access to any collateral may be limited by bankruptcy and other insolvency laws. The value of the collateral also may decline subsequent to each Fund s investment in the senior loan. Under certain circumstances, the collateral may be released with the consent of the Agent Bank and Co-Lenders (each as defined below), or pursuant to the terms of the underlying credit agreement with the borrower. There is no assurance that the liquidation of the collateral will satisfy the borrower s obligation in the event of nonpayment of scheduled interest or principal, or that the collateral could be readily liquidated. As a result, a Fund might not receive payments to which it is entitled and thereby may experience a decline in the value of the investment, and possibly, its net asset value.

In the case of highly leveraged senior loans, a borrower is often required to pledge collateral that may include (i) working capital assets, such as accounts receivable and inventory, (ii) tangible fixed assets, such as real property, buildings and equipment, (iii) intangible assets, such as trademarks, copyrights and patent rights and/or (iv) security interests in securities of subsidiaries or affiliates. Collateral also may include guarantees or other credit support by subsidiaries or affiliates. In some cases the only collateral for the senior loan is the stock of the borrower and/or its subsidiaries and affiliates. To the extent a senior loan is secured by stock of the borrower and/or its subsidiaries and affiliates, such stock may lose all of its value in the event of a bankruptcy or insolvency of the borrower. In the case of senior loans to privately held companies, the companies owners may provide additional credit support in the form of guarantees and/or pledges of other securities that they own.

In the case of project finance loans, the borrower is generally a special purpose entity that pledges undeveloped land and other non-income producing assets as collateral and obtains construction completion guaranties from third parties, such as the project sponsor. Project finance credit facilities typically provide for payment of interest from escrowed funds during a scheduled construction period, and for the pledge of current and fixed assets after the project is constructed and becomes operational. During the construction period, however, the lenders bear the risk that the project will not be constructed in a timely manner, or will exhaust project funds prior to completion. In such an event, the lenders may need to take legal action to enforce the completion guaranties, or may need to lend more money to the project on less favorable financing terms, or may need to liquidate the undeveloped project assets. There can be no assurance in any of such cases that the lenders will recover all of their invested capital.

The rate of interest payable on senior floating rate loans is established as the sum of a base lending rate plus a specified margin. These base lending rates generally are the prime rate (Prime Rate) of a designated U.S. bank, London Interbank Offered Rate (LIBOR), the Certificate of Deposit (CD) rate or another base lending rate used by commercial lenders. The interest rate on Prime Rate-based senior loans floats daily as the Prime Rate changes, while the interest rate on LIBOR-based and CD-based senior loans is reset periodically, typically every one, two, three or six months. Certain of the senior floating rate loans in which each Fund invests permit the borrower to select an interest rate reset period of up to one year. A portion of each Fund s portfolio may be invested in senior loans with interest rates that are fixed for the term of the loan. Investment in senior loans with longer interest rate reset periods or fixed interest rates may increase fluctuations in each Fund s net asset value, and potentially the market price of each Fund s shares of common stock, as a result of changes in interest rates.

Each Fund may receive and/or pay certain fees in connection with its lending activities. These fees are in addition to interest payments received and may include facility fees, commitment fees, amendment and waiver fees, commissions and prepayment fees. In certain circumstances, each Fund may receive a prepayment fee on the prepayment of a senior loan by a borrower. In connection with the acquisition of senior loans or other debt securities, each Fund also may acquire warrants and other debt and equity securities of the borrower or issuer or its affiliates. The acquisition of such debt and equity securities will only be incidental to each Fund s purchase of an interest in a senior loan or other debt security. Each Fund may also acquire other debt and equity securities of the borrower or issuer in connection with an amendment, waiver, conversion or exchange of a senior loan or in connection with a bankruptcy or workout of the borrower or issuer.

In making an investment in a senior loan, the Investment Adviser will consider factors deemed by it to be appropriate to the analysis of the borrower and the senior loan. The Investment Adviser performs its own independent credit analysis of the borrower in addition to utilizing information prepared and supplied by the Agent Bank, Co-Lender or Participant (each defined below) from whom each Fund purchases its interest in a senior loan. Such factors include, but are not limited to, the legal/protective features associated with the securities (such as their position in the borrower s capital structure and any security through collateral), financial ratios of the borrower such as pre-tax interest coverage, leverage ratios, and the ratios of cash flows to total debts and the ratio of tangible assets to debt. In its analysis of these factors, the Investment Adviser also will be influenced by the nature of the industry in which the borrower is engaged, the nature of the borrower s assets and the Investment Adviser s assessments of the general quality of the borrower. The Investment Adviser s analysis continues on an ongoing basis for any senior loans in which each Fund has invested. Although the Investment Adviser uses due care in making such analysis, there can be no assurance that such analysis will disclose factors that may impair the value of the senior loan.

Senior loans made in connection with highly leveraged transactions are subject to greater credit risks than other senior loans in which each Fund may invest. These credit risks include a greater possibility of default or bankruptcy of the borrower and the assertion that the pledging of collateral to secure the loan constituted a fraudulent conveyance or preferential transfer which can be nullified or subordinated to the rights of other creditors of the borrower under applicable law.

The secondary market for trading of senior loans continues to develop and mature. One of the effects of a more active and liquid secondary market, however, is that a senior loan may trade at a premium or discount to the principal amount, or par value, of the loan. There are many factors that influence the market value of a senior loan, including technical factors relating to the operation of the loan market, supply and demand conditions, market perceptions about the credit quality or financial condition of the borrower or more general concerns about the industry in which the borrower operates. Each Fund participates in this secondary market for senior loans, purchasing and selling loans that may trade at a premium or discount to the par value of the loan.

The Acquiring Fund does not have a policy with regard to minimum ratings for senior loans in which it may invest, except that the Acquiring Fund may not invest more than 10% of its total assets in securities that are rated Caa1 or lower (if rated by Moody s) or CCC+ or lower (if rated by S&P) by each agency rating such security or, if unrated, are considered by the Investment Adviser to be of comparable quality or are otherwise considered to be Distressed Securities. Investments in senior loans are based primarily on the Investment Adviser s independent credit analyses of a particular borrower.

A borrower must comply with various restrictive covenants contained in any credit agreement between the borrower and the lending syndicate. Such covenants, in addition to requiring the scheduled payment of interest and principal, may include restrictions on dividend payments and other distributions to stockholders, provisions requiring the borrower to maintain specific financial ratios or relationships, limits on total debt and restrictions on the borrower s ability to pledge its assets. In addition, the loan agreement may contain a covenant requiring the borrower to prepay the senior loan with any excess cash flow. Excess cash flow generally includes net cash flow after scheduled debt service payments and permitted capital expenditures, among other things, as well as the proceeds from asset dispositions or sales of securities. A breach of a covenant (after giving effect to any cure period) which is not waived by the Agent Bank and the lending syndicate normally is an event of default (i.e., the Agent Bank has the right to call the outstanding senior loan).

It is expected that a majority of the senior loans will have stated maturities ranging from three to ten years. However, such senior loans usually require, in addition to scheduled payments of interest and principal, the prepayment of the senior loan from excess cash flow, as discussed above, and typically permit the borrower to prepay at its election. The degree to which borrowers prepay senior loans, whether as a contractual requirement or at their election, may be affected by general business conditions, the financial condition of the borrower and competitive conditions among lenders, among other factors. Accordingly, prepayments cannot be predicted with accuracy. Upon a prepayment, the Acquiring Fund may receive both a prepayment fee from the prepaying borrower and a facility fee on the purchase of a new senior loan with the proceeds from the prepayment of the former. Such fees may mitigate any adverse impact on the yield on the Acquiring Fund s portfolio which may arise as a result of prepayments and the reinvestment of such proceeds in senior loans bearing lower interest rates.

A senior loan in which the Acquiring Fund may invest typically is originated, negotiated and structured by a syndicate of lenders (Co-Lenders) consisting of commercial banks, thrift institutions, insurance companies, finance companies, investment banking firms, securities brokerage houses or other financial institutions or institutional investors, one or more of which administers the loan on behalf of the syndicate (the Agent Bank). Co-Lenders may sell senior loans to third parties (Participants). The Acquiring Fund invests in a senior loan either by participating in the primary distribution as a Co-Lender at the time the loan is originated or by buying an assignment or participation interest in the senior loan in the secondary market from a Co-Lender or a Participant. The Acquiring Fund will not act as an Agent Bank, guarantor, sole negotiator or sole structurer with respect to a senior loan.

The Acquiring Fund may invest in a senior loan at origination as a Co-Lender or by acquiring an assignment or participation interest in the secondary market from a Co-Lender or Participant. If the Acquiring Fund purchases an assignment, the Acquiring Fund typically accepts all of the rights of the assigning lender in a senior loan, including the right to receive payments of principal and interest and other amounts directly from the borrower and to enforce its rights as a lender directly against the borrower and assumes all of the obligations of the assigning lender, including any obligations to make future advances to the borrower. As a result, therefore, the Acquiring Fund has the status of a Co-Lender. In some cases, the rights and obligations acquired by a purchaser of an assignment may differ from, and may be more limited than, the rights and obligations of the assigning lender. The Acquiring Fund also may purchase a participation in a portion of the rights of a Co-Lender or Participant in a senior loan by means of a participation agreement. A participation is similar to an assignment in that the Co-Lender or Participant transfers to the Acquiring Fund all or a portion of an interest in a senior loan. Unlike an assignment, however, a participation does not establish any direct relationship between the Acquiring Fund and the borrower. In such a case, the Acquiring Fund is required to rely on the Co-Lender or Participant that sold the participation not only for the enforcement of the Acquiring Fund s rights against the borrower but also for the receipt and processing of payments due to the Acquiring Fund under the senior loans.

Because it may be necessary to assert through a Co-Lender or Participant such rights as may exist against the borrower, in the event the borrower fails to pay principal and interest when due, the Acquiring Fund may be subject to delays, expenses and risks that are greater than those that would be involved if the Acquiring Fund could enforce its rights directly against the borrower. Moreover, under the terms of a participation, the Acquiring Fund may be regarded as a creditor of the Co-Lender or Participant that sold the participation (rather than of the borrower), so that the Acquiring Fund may also be subject to the risk that the Co-Lender or Participant may become insolvent. Similar risks may arise with respect to the Agent Bank, as described below. Further, in the event of the bankruptcy or insolvency of the borrower, the obligation of the borrower to repay the senior loan may be subject to certain defenses that can be asserted by such borrower as a result of improper conduct by the Agent Bank, Co-Lender or Participant.

In a typical senior loan, the Agent Bank administers the terms of the credit agreement and is responsible for the collection of principal and interest and fee payments from the borrower and the apportionment of these payments to the credit of all lenders which are parties to the credit agreement. The Acquiring Fund generally relies on the Agent Bank (or the Co-Lender or Participant that sold the Acquiring Fund a participation interest) to collect its portion of the payments on the senior loan. Furthermore, the Acquiring Fund generally relies on the Agent Bank to use appropriate creditor remedies against the borrower. Typically, under credit agreements, the Agent Bank is given broad discretion in enforcing the credit agreement, and is obligated to use only the same care it would use in the management of its own property. The borrower compensates the Agent Bank for these services. Such compensation may include special fees paid on structuring and funding the senior loan and other fees paid on a continuing basis.

In the event that an Agent Bank becomes insolvent, or has a receiver, conservator, or similar official appointed for it by the appropriate bank regulatory authority or becomes a debtor in a bankruptcy proceeding, assets held by the Agent Bank under the credit agreement should remain available to holders of senior loans.

If, however, assets held by the Agent Bank for the benefit of the Acquiring Fund were determined by an appropriate regulatory authority or court to be subject to the claims of the Agent Bank s general or secured creditors, the Acquiring Fund might incur certain costs and delays in realizing payment on a senior loan or suffer a loss of principal and/or interest. In situations involving a Co-Lender or Participant that sold the Acquiring Fund a participation interest, similar risks may arise, as described above.

The Acquiring Fund may have certain obligations pursuant to a credit agreement, which may include the obligation to make future advances to the borrower in connection with revolving credit facilities in certain circumstances. These commitments may have the effect of requiring the Acquiring Fund to increase its investment in a borrower at a time it might not be desirable to do so (including at a time when the borrower s financial condition makes it unlikely that such amounts will be repaid). The Acquiring Fund currently intends to reserve against such contingent obligations by segregating sufficient investments in liquid assets. The Acquiring Fund will not invest in senior loans that would require the Acquiring Fund to make any additional investments in connection with such future advances if such commitments would cause the Acquiring Fund to fail to meet the diversification requirements described under Investment Restrictions.

High Yield Securities

The Acquiring Fund may invest without limit and generally intends to invest a substantial portion of its assets in high yield securities, including senior loans and other floating or fixed rate debt securities, that are rated below investment grade by the established rating services (Ba or lower by Moody s or BB or lower by S&P) or, if unrated, are considered by the Investment Adviser to be of comparable quality. The Acquiring Fund may not, however, invest more than 10% of its total assets (at the time of investment) in securities that are rated Caa1 or lower (if rated by Moody s) or CCC+ or lower (if rated by S&P) by each agency rating such security or, if unrated, are considered by the Investment Adviser to be of comparable quality or are otherwise considered to be Distressed Securities. High yield bonds commonly are referred to as junk bonds. See Appendix A Ratings of Securities for information concerning rating categories.

Selection and supervision of high yield securities by the Investment Adviser involves continuous analysis of individual issuers, general business conditions and other factors which may be too time-consuming or too costly for the average investor. The furnishing of these services does not, of course, guarantee successful results. The Investment Adviser s analysis of issuers includes, among other things, historic and current financial conditions, current and anticipated cash flow and borrowing requirements, value of assets in relation to historical costs, strength of management, responsiveness to business conditions, credit standing, and current and anticipated results of operations. Analysis of general conditions and other factors may include anticipated change in economic activity and interest rates, the availability of new investment opportunities and the economic outlook for specific industries. While the Investment Adviser considers as one factor in its credit analysis the ratings assigned by the rating services, the Investment Adviser performs its own independent credit analysis of issuers and, consequently, the Acquiring Fund may invest, without limit, in unrated securities. As a result, the Acquiring Fund s ability to achieve its investment objective may depend to a greater extent on the Investment Adviser s own credit analysis than investment companies which invest in investment grade securities. The Acquiring Fund may continue to hold securities that are downgraded after the Acquiring Fund purchases them and will sell such securities only if, in the Investment Adviser s judgment, it is advantageous to sell such securities.

Investments in high yield securities generally provide greater income than investments in investment grade securities, but they also typically entail greater price volatility and principal and income risk, including the possibility of issuer default and bankruptcy. High yield securities are regarded as being predominantly speculative as to the issuer s ability to make repayments of principal and payments of interest. Investment in such securities involves substantial risk. Issuers of high yield securities may be highly leveraged and may not have available to them more traditional methods of financing. Therefore, the risks associated with acquiring the securities of such issuers generally are greater than is the case with investment grade securities. For example, during an economic downturn or a sustained period of rising interest rates, issuers of high yield securities may be more likely to experience financial stress, especially if such issuers are highly leveraged. During periods of economic downturn, such issuers may not have sufficient revenues to meet their interest payment obligations. The issuer s ability to service its debt obligations also may be adversely affected by specific issuer developments, or the issuer s inability to meet specific projected business forecasts or the unavailability of additional financing. Therefore, there can be no assurance that in the future there will not exist a higher default rate relative to the rates currently existing in the high yield market. If an issuer of high yield securities defaults, in addition to risking non-payment of all or a portion of interest and principal, the Acquiring Fund may incur additional expenses to seek recovery. The market prices of high yield securities structured as zero-coupon, step-up or payment-in-kind securities will normally be affected to a greater extent by interest rate changes, and therefore tend to be more volatile than the prices of securities that pay interest currently and in cash. Other than with respect to Distressed Securities (which are discussed below), the high yield securities in which the Acquiring Fund may invest do not include securities which, at the time of investment, are in default or the issuers of which are in bankruptcy. However, there can be no assurance that such events will not occur after the Acquiring Fund purchases a particular security, in which case the Acquiring Fund may experience losses and incur costs.

High yield securities tend to be more volatile than investment grade securities, so that adverse events may have a greater impact on the prices of high yield securities than on investment grade securities. Factors adversely affecting the market value of such securities are likely to affect adversely the Acquiring Fund s net asset value, and potentially the market price of the Acquiring Fund s shares of common stock.

Like investment grade securities, high yield securities generally are purchased and sold through dealers who make a market in such securities for their own accounts. However, there are fewer dealers in the high yield market, which market may be less liquid than the market for investment grade securities, even under normal economic conditions. This is particularly the case in the senior loan market. Also, there may be significant disparities in the prices quoted for high yield securities by various dealers and the spread between the bid and asked price is generally much larger than for investment grade securities. As a result, the Acquiring Fund may experience difficulty acquiring appropriate high yield securities for investment.

Adverse conditions and investor perceptions thereof (whether or not based on economic fundamentals) may impair liquidity in the high yield market, and in particular the senior loan market, and may cause the prices the Acquiring Fund receives for its high yield securities to be reduced. In addition, the Acquiring Fund may experience difficulty in liquidating a portion of its portfolio when necessary to meet the Acquiring Fund s liquidity needs or in response to a specific economic event such as a deterioration in the creditworthiness of the issuer. Under such conditions, judgment may play a greater role in valuing certain of the Acquiring Fund s portfolio securities than in the case of securities trading in a more liquid market. In addition, the Acquiring Fund may incur additional expenses if it is forced to seek recovery upon a default of a portfolio holding or if it participates in the restructuring of the obligation.

The risk of loss due to default by an issuer is significantly greater for the holders of junk bonds because such securities are often unsecured and subordinated to other creditors of the issuer. In addition, junk bonds may have call or redemption features that permit an issuer to repurchase the securities from the Acquiring Fund. If a call were exercised by an issuer during a period of declining interest rates, the Acquiring Fund likely would have to replace such called securities with lower yielding securities, thus decreasing the net investment income to the Acquiring Fund and dividends to stockholders.

The high yield securities in which the Acquiring Fund invests may include credit linked notes, structured notes, credit linked trust certificates or other instruments evidencing interests in special purpose vehicles or trusts that hold interests in high yield securities.

Distressed Securities

Distressed Securities are high yield/high risk securities, including certain senior loans purchased in the secondary market, that are the subject of bankruptcy proceedings or otherwise in default as to the repayment of principal and/or payment of interest at the time of acquisition by the Acquiring Fund or are rated in the lowest rating categories (Ca or lower by Moody s or CC or lower by S&P) or, if unrated, are considered by the Investment Adviser to be of comparable quality. Investment in Distressed Securities is speculative and involves significant risk. Distressed Securities frequently do not produce income while they are outstanding and may require the Acquiring Fund to bear certain extraordinary expenses in order to protect and recover its investment. The Acquiring Fund also will be subject to significant uncertainty as to when and in what manner and for what value the obligations evidenced by the Distressed Securities will eventually be satisfied (e.g., through a liquidation of the obligor s assets, an exchange offer or plan of reorganization involving the distressed securities or a payment of some amount in satisfaction of the obligation). In addition, even if an exchange offer is made or a plan of reorganization is adopted with respect to Distressed Securities held by the Acquiring Fund, there can be no assurance that the securities or other assets received by the Acquiring Fund in connection with such exchange offer or plan of reorganization will not have a lower value or income potential than may have been anticipated when the investment was made. Moreover, any securities received by the Acquiring Fund upon completion of an exchange offer or plan of reorganization may be restricted as to resale. As a result of the Acquiring Fund s participation in negotiations with respect to any exchange offer or plan of reorganization with respect to an issuer of Distressed Securities, the Acquiring Fund may be restricted from disposing of such securities.

Other Investments

The Acquiring Fund may invest up to 20% of its total assets in securities other than floating rate debt securities. These securities include, but are not limited to, fixed rate debt securities such as convertible securities, bonds, notes, fixed rate loans and mortgage related and other asset backed securities issued on a public or private basis, collateralized debt obligations, preferred securities, commercial paper, U.S. government securities, structured notes, credit linked notes, credit linked trust certificates and other hybrid instruments.

To a limited extent, incidental to and in connection with its investment activities or pursuant to a convertible feature in a security, the Acquiring Fund may acquire warrants and other debt and equity securities. The Acquiring Fund may also acquire other debt and equity securities of a borrower or issuer in connection with an amendment, waiver, conversion or exchange of a senior loan or other debt security or in connection with a bankruptcy or workout of the borrower or issuer.

Bonds

The Acquiring Fund may invest in bonds of varying maturities issued by U.S. and non-U.S. corporations and other business or governmental entities. Bonds can be variable or fixed rate debt obligations, including bills, notes, debentures, money market instruments and similar instruments and securities. Bonds generally are used by corporations as well as governments and other issuers to borrow money from investors. The issuer pays the investor a variable or fixed rate of interest and normally must repay the amount borrowed on or before maturity. Certain bonds are perpetual in that they have no maturity date. The Acquiring Fund may also invest in catastrophe or other event linked bonds.

Zero-coupon bonds pay interest only at maturity rather than at intervals during the life of the security. Like zero-coupon bonds, step up bonds pay no interest initially but eventually begin to pay a coupon rate prior to maturity, which rate may increase at stated intervals during the life of the security. Payment-in-kind securities (PIKs) are debt obligations that pay interest in the form of other debt obligations, instead of in cash. Each of these instruments is normally issued and traded at a deep discount from face value. Zero-coupon bonds, step-ups and PIKs allow an issuer to avoid or delay the need to generate cash to meet current interest payments and, as a result, may involve greater credit risk than bonds that pay interest currently or in cash. The Acquiring Fund would be required to distribute the income on these instruments as it accrues, even though the Acquiring Fund will not receive the income on a current basis or in cash. Thus, the Acquiring Fund may have to sell other investments, including when it may not be advisable to do so, to make income distributions to its stockholders.

Preferred Securities

The Acquiring Fund may invest in preferred securities, including preferred securities that may be converted into common stock or other securities of the same or a different issuer. Generally, preferred securities receive dividends in priority to distributions on common stock and usually have a priority of claim over common stockholders if the issuer of the stock is liquidated. Preferred securities have certain characteristics of both debt and equity securities. Like debt securities, preferred securities rate of income is generally contractually fixed. Like equity securities, preferred securities do not have rights to precipitate bankruptcy filings or collection activities in the event of missed payments. Furthermore, preferred securities are generally in a subordinated position in an issuer s capital structure and their value is heavily dependent on the profitability of the issuer rather than on any legal claims to specific assets or cash flows. Certain preferred securities in which the Acquiring Fund may invest have a variable dividend, generally determined on a quarterly or other periodic basis, either according to a formula based upon a specified premium or discount to the yield on particular U.S. Treasury securities or based on an auction process, involving bids submitted by holders and prospective purchasers of such securities. Some preferred securities in which the Acquiring Fund may invest offer a fixed rate of return with no maturity date. Because they never mature, these preferred securities act like long term bonds, can be more volatile than other types of preferred securities and may have heightened sensitivity to changes in interest rates. Because preferred securities represent an equity ownership interest in a company, their value usually will react more strongly than bonds and other debt securities to actual or perceived changes in a company s financial condition or prospects, or to fluctuations in the equity markets. The types of preferred securities in which the Acquiring Fund may invest include trust preferred securities.

Convertible Securities

The Acquiring Fund may invest in convertible securities. A convertible security is a bond, debenture, note or preferred security that may be converted into or exchanged for a prescribed amount of common stock or other securities of the same or a different issuer within a particular period of time at a specified price or formula. A convertible security entitles the holder to receive interest or dividends generally paid or accrued until the convertible security matures or is redeemed, converted or exchanged. Convertible securities, including convertible preferred securities, have several unique investment characteristics such as (i) higher yields than common stocks, but lower yields than comparable nonconvertible securities, (ii) a lesser degree of fluctuation in value than the underlying stock since they have fixed income characteristics and (iii) the potential for capital appreciation if the market price of the underlying common stock increases. Holders of convertible securities have a claim on the assets of the issuer prior to the common stockholders but may be subordinated to similar non-convertible securities of the same issuer. A convertible security may be subject to redemption at the option of the issuer at a price established in the convertible security s governing instrument. If a convertible security held by the Acquiring Fund is called for redemption, the Acquiring Fund may be required to permit the issuer to redeem the security, convert it into the underlying common stock or other securities or sell it to a third party.

Mortgage and Asset Backed Securities

Mortgage backed securities are pass through securities, meaning that principal and interest payments made by the borrower on the underlying mortgages are passed through to the Acquiring Fund. The value of mortgage backed securities, like that of traditional fixed rate securities, typically increases when interest rates fall and decreases when interest rates rise. However, mortgage backed securities differ from traditional fixed rate securities because of their potential for prepayment without penalty. The price paid by the Acquiring Fund for its mortgage backed securities, the yield the Acquiring Fund expects to receive from such securities and the average life of the securities are based on a number of factors, including the anticipated rate of prepayment of the underlying mortgages. In a period of declining interest rates, borrowers may prepay the underlying mortgages more quickly than anticipated, thereby reducing the yield to maturity and the average life of the mortgage backed securities. Moreover, when the Acquiring Fund reinvests the proceeds of a prepayment in these circumstances, it will likely receive a rate of interest that is lower than the rate on the security that was prepaid.

To the extent that the Acquiring Fund purchases mortgage backed securities at a premium, mortgage foreclosures and principal prepayments may result in a loss to the extent of the premium paid. If the Acquiring Fund buys such securities at a discount, both scheduled payments of principal and unscheduled prepayments will increase current and total returns and will accelerate the recognition of income which, when distributed to shareholders, will be taxable as ordinary income. In a period of rising interest rates, prepayments of the underlying mortgages may occur at a slower than expected rate, creating maturity extension risk. This particular risk may effectively change a security that was considered short or intermediate term at the time of purchase into a long term security. Since long term securities generally fluctuate more widely in response to changes in interest rates than short term securities, maturity extension risk could increase the inherent volatility of the Acquiring Fund.

The mortgage backed securities in which the Acquiring Fund may invest may be guaranteed by the Government National Mortgage Association (GNMA) or issued by the Federal National Mortgage Association (FNMA) or the Federal Home Loan Mortgage Corporation (FHLMC). Certain of the asset backed securities in which the Acquiring Fund will invest may be guaranteed by the Small Business Administration (SBA) or issued in programs originated by the Resolution Trust Corporation (RTC). GNMA, FNMA, FHLMC and SBA are agencies or instrumentalities of the United States.

The Acquiring Fund may invest in pass through mortgage backed securities that represent ownership interests in a pool of mortgages on single-family or multi-family residences. Such securities represent interests in pools of residential mortgage loans originated by U.S. governmental or private lenders and guaranteed, to the extent provided in such securities, by the U.S. Government, one of its agencies or instrumentalities or by private guarantors. Such securities, which are ownership interests in the underlying mortgage loans, differ from conventional debt securities, which provide for periodic payment of interest in fixed amounts (usually semiannually) and principal payments at maturity or on specified call dates. Mortgage pass through securities provide for monthly payments that pass through the monthly interest and principal payments (including any prepayments) made by the individual borrowers on the pooled mortgage loans, net of any fees paid to the guarantor of such securities and the servicer of the underlying mortgage loans. The Acquiring Fund may also invest in collateralized mortgage obligations (CMOs) which are debt obligations collateralized by mortgage loans or mortgage pass through securities.

Asset backed securities are pass through securities, meaning that principal and interest payments made by the borrower on the underlying assets (such as credit card receivables) are passed through to the Acquiring Fund. The value of asset backed securities, like that of traditional fixed rate securities, typically increases when interest rates fall and decreases when interest rates rise. However, asset backed securities differ from traditional fixed rate securities because of their potential for prepayment. The price paid by the Acquiring Fund for its asset backed securities, the yield the Acquiring Fund expects to receive from such securities and the average life of the securities are based on a number of factors, including the anticipated rate of prepayment of the underlying assets. In a period of declining interest rates, borrowers may prepay the underlying assets more quickly than anticipated, thereby reducing the yield to maturity and the average life of the asset backed securities. Moreover, when the Acquiring Fund reinvests the proceeds of a prepayment in these circumstances, it will likely receive a rate of interest that is lower than the rate on the security that was prepaid. To the extent that the Acquiring Fund purchases asset backed securities at a premium, prepayments may result in a loss to the extent of the premium paid. If the Acquiring Fund buys such securities at a discount, both scheduled payments and unscheduled prepayments will increase current and total returns and will accelerate the recognition of income which, when distributed to shareholders, will be taxable as ordinary income. In a period of rising interest rates, prepayments of the underlying assets may occur at a slower than expected rate, creating maturity extension risk. This particular risk may effectively change a security that was considered short or intermediate term at the time of purchase into a long term security. Since long term securities generally fluctuate more widely in response to changes in interest rates than shorter term securities, maturity extension risk could increase the inherent volatility of the Acquiring Fund.

Illiquid Securities

The Acquiring Fund may invest in floating rate debt securities, senior loans, high yield securities and other securities that lack a 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 upon disposition of the security, which may be less than would be obtained for a comparable more liquid security. Although senior loans are transferred among certain financial institutions, the senior loans in which the Acquiring Fund invests may not have the liquidity of conventional debt securities traded in the secondary market and may be considered illiquid. Although the market for senior loans has developed significantly during recent years, certain of the senior loans in which the Acquiring Fund invests may still not have the liquidity of conventional debt securities traded in the secondary market. The Acquiring Fund has no limitation on the amount of its investments that are not readily marketable or are subject to restrictions on resale. Illiquid securities may be subject to wide fluctuations in market value. The Acquiring Fund may be subject to significant delays in disposing of certain high yield securities. As a result, the Acquiring Fund may be forced to sell these securities at less than fair market value or may not be able to sell them when the Investment Adviser believes that it is desirable to do so. Illiquid securities also may entail registration expenses and other transaction costs that are higher than those for liquid securities. Such investments may affect the Acquiring Fund s ability to realize the net asset value in the event of a voluntary or involuntary liquidation of its assets.

Other Investment Policies

See Investment Objectives and Policies of the Funds Other Investment Policies in the Statement of Additional Information for a discussion of the Funds other investment policies.

COMPARISON OF THE FUNDS

Investment Objectives

The investment objectives of the Funds are substantially similar (but not identical). Each of the Funds has the investment objective to provide high current income; however, the Acquiring Fund and FRB also seek to provide such preservation of capital as is consistent with investment in a diversified, leveraged portfolio consisting primarily of floating rate debt securities and instruments. Each Fund s investment objective(s) is a fundamental policy and may not be changed without stockholder approval. Each Fund, under normal market conditions, invests at least 80% of its net assets in floating rate debt securities. DVF differs from the other Funds in that it may invest across a broader array of security types that are rated below investment grade including, fixed rate securities that are purchased with a derivative instrument (a swap, for example) to make the securities floating rate.

Investment Strategies and Restrictions

The Funds have either the same or substantially similar (but not identical) investment strategies and restrictions. A comparison of the significant investment strategies and operating policies used by the Funds is set forth in the table below. The investment strategies and significant operating policies of the Combined Fund will be those of FRA.

Acquiring Fund	Target Funds	
FRA	**FRB**	**DVF**
Total Assets Under Management	**Total Assets Under Management**	**Total Assets Under Management**
As of February 29, 2012: $350,651,890	As of February 29, 2012: $184,772,951	As of February 29, 2012: $172,399,987
Investment Objective(s)	**Investment Objective(s)**	**Investment Objective(s)**
The Fund s investment objective is to provide stockholders with high current income and such preservation of capital as is consistent with investment in a diversified, leveraged portfolio consisting primarily of floating rate debt securities and instruments.	Same as Acquiring Fund.	The Fund s investment objective is to provide stockholders with high current income.
Investment Policies	**Investment Policies**	**Investment Policies**
The Fund seeks to achieve its objective by investing primarily in floating rate debt securities and instruments (floating rate debt securities).	Same as Acquiring Fund.	The Fund seeks to achieve its objective by investing primarily in a diversified portfolio of floating rate debt securities and instruments (floating rate debt securities), including floating rate loans, bonds, certain preferred securities (including certain convertible preferred securities that may be converted into common stock or other securities of the same or a different issuer), notes or other debt securities or instruments which pay a floating or variable rate of interest until maturity.

Acquiring Fund FRA	Target Funds FRB	DVF
Floating Rate Debt Securities	**Floating Rate Debt Securities**	**Floating Rate Debt Securities**
Under normal market conditions, the Fund will invest at least 80% of an aggregate of (i) the Fund s net assets (including proceeds from the issuance of any preferred stock) and (ii) the proceeds of any outstanding borrowings for investment purposes, in floating rate debt securities.	Same as Acquiring Fund.	Under normal market conditions, the Fund intends to invest at least 80% of its net assets in floating rate debt securities, including floating rate loans, bonds, certain preferred securities (including certain convertible preferred securities that may be converted into common stock or other securities of the same or a different issuer), notes or other debt securities or instruments which pay a floating rate of interest until maturity.
Fixed Rate Debt Securities	**Fixed Rate Debt Securities**	**Fixed Rate Debt Securities**
The Fund may invest up to 20% of its total assets in securities other than floating rate debt securities, including, but not limited to, fixed rate debt securities such as convertible securities, bonds, notes, fixed rate loans and mortgage related and other asset backed securities issued on a public or private basis, collateralized debt obligations, preferred securities, commercial paper, U.S. government securities, structured notes, credit linked notes, credit linked trust certificates and other hybrid instruments.	Same as Acquiring Fund.	The Fund also may invest up to 20% of its total assets in certain fixed rate debt securities, including fixed rate senior loans, bonds, certain preferred securities (including certain convertible preferred securities that may be converted into common stock or other securities of the same or a different issuer), notes or other debt securities or instruments which pay a fixed rate of interest until maturity. The Fund does not consider such securities to include fixed rate debt securities where the Fund has entered into certain derivative transactions, discussed above, in an attempt to convert the fixed rate payments into floating rate payments.
Senior Loans	**Senior Loans**	**Senior Loans**
Under normal market conditions, the Fund anticipates investing a substantial portion of its floating rate debt assets in senior loans.	Same as Acquiring Fund.	The Fund s investments in floating rate debt securities may include senior loans.

Acquiring Fund FRA	Target Funds FRB	 DVF
High Yield Securities	**High Yield Securities**	**High Yield Securities**
The Fund may invest without limit and generally intends to invest a substantial portion of its assets in high yield securities, including senior loans and other floating or fixed rate debt securities, that are rated below investment grade by the established rating services (Ba or lower by Moody s or BB or lower by S&P) or, if unrated, are considered by the Investment Adviser to be of comparable quality.	Substantially the same as Acquiring Fund.	Substantially the same as Acquiring Fund.
Distressed Securities	**Distressed Securities**	**Distressed Securities**
The Fund may not, however, invest more than 10% of its total assets (at the time of investment) in securities that are rated Caa1 or lower (if rated by Moody s) or CCC+ or lower (if rated by S&P) by each agency rating such security or, if unrated, are considered by the Investment Adviser to be of comparable quality or are otherwise considered to be distressed securities.	Same as Acquiring Fund.	The Fund also may invest without limit in securities that are rated Caa1 or lower (if rated by Moody s) or CCC+ or lower (if rated by S&P) by each agency rating such security or, if unrated, are considered by the Investment Adviser to be of comparable quality or are otherwise considered to be distressed securities.
Foreign Investments	**Foreign Investments**	**Foreign Investments**
The Fund may invest without limitation in debt securities of issuers domiciled outside the United States. The Fund, however, will not, invest more than 10% of its total assets in debt securities of issuers located in emerging market countries. The Fund will invest primarily in U.S. dollar denominated debt securities. The Fund will not invest more than 10% of its total assets in debt securities denominated in currencies other than the U.S. dollar or that do not provide for payment to the Fund in U.S. dollars.	Same as Acquiring Fund.	The Fund may invest without limitation in debt securities of issuers domiciled outside the United States, including emerging market countries. Although the Fund intends to invest primarily in U.S. dollar-denominated debt securities, the Fund also may invest in debt securities denominated in currencies other than the U.S. dollar or that do not provide for payment to the Fund in U.S. dollars.

Acquiring Fund FRA	Target Funds FRB	DVF
Other Investments	**Other Investments**	**Other Investments**
The Fund may invest up to 20% of its total assets in securities other than floating rate debt securities. These securities include, but are not limited to, fixed rate debt securities such as convertible securities, bonds, notes, fixed rate loans and mortgage related and other asset backed securities issued on a public or private basis, collateralized debt obligations, preferred securities, commercial paper, U.S. government securities, structured notes, credit linked notes, credit linked trust certificates and other hybrid instruments.	Same as Acquiring Fund.	The Fund may invest in various other types of floating rate or fixed rate debt securities. These securities include, but are not limited to, convertible securities, mortgage related and other asset backed securities issued on a public or private basis, collateralized debt obligations, commercial paper, U.S. government securities, structured notes, credit linked notes, credit linked trust certificates and other hybrid instruments.
To a limited extent, incidental to and in connection with its investment activities or pursuant to a convertible feature in a security, the Fund may acquire warrants and other debt and equity securities. The Fund may also acquire other debt and equity securities of a borrower or issuer in connection with an amendment, waiver, conversion or exchange of a senior loan or other debt security or in connection with a bankruptcy or workout of the borrower or issuer.	Same as Acquiring Fund.	Same as Acquiring Fund.
Bonds	**Bonds**	**Bonds**
The Fund may invest in bonds of varying maturities issued by U.S. and non-U.S. corporations and other business or governmental entities.	Same as Acquiring Fund.	Same as Acquiring Fund.
Preferred Securities	**Preferred Securities**	**Preferred Securities**
The Fund may invest in preferred securities, including preferred securities that may be converted into common stock or other securities of the same or a different issuer.	Same as Acquiring Fund.	Same as Acquiring Fund.

Acquiring Fund FRA	Target Funds FRB	DVF
Convertible Securities	**Convertible Securities**	**Convertible Securities**
The Fund may invest in convertible securities. A convertible security is a bond, debenture, note or preferred security that may be converted into or exchanged for a prescribed amount of common stock or other securities of the same or a different issuer within a particular period of time at a specified price or formula.	Same as Acquiring Fund.	Same as Acquiring Fund.
Leverage	**Leverage**	**Leverage**
At times, the Fund expects to utilize leverage through borrowings, the issuance of short term debt securities, the issuance of shares of preferred stock or a combination thereof. The Fund has the ability to utilize leverage through borrowings or the issuance of short term debt securities in an amount up to $33^{1/3}$% of the value of its total assets (including the amount obtained from such borrowings or debt issuance). The Fund also has the ability to utilize leverage through the issuance of shares of preferred stock in an amount up to 50% of the value of its total assets (including the amount obtained from such issuance).	Substantially the same as Acquiring Fund.	Substantially the same as Acquiring Fund.
Investment Grade Securities	**Investment Grade Securities**	**Investment Grade Securities**
The Fund may also invest in investment grade securities.	Same as Acquiring Fund.	Same as Acquiring Fund.
Maturity of Investments	**Maturity of Investments**	**Maturity of Investments**
The Fund may invest in securities of any maturity.	Same as Acquiring Fund.	Substantially the same as Acquiring Fund.
Dividends	**Dividends**	**Dividends**
The Fund intends to distribute dividends from its net investment income monthly to holders of common stock.	Same as Acquiring Fund.	Same as Acquiring Fund.

Acquiring Fund FRA	Target Funds FRB	Target Funds DVF
Investment Advisor and Sub-Advisor	**Investment Advisor and Sub-Advisor**	**Investment Advisor and Sub-Advisor**
Investment Advisor: BlackRock Advisors, LLC.	Same as Acquiring Fund.	Same as Acquiring Fund.
Sub-Advisor: BlackRock Financial Management, Inc.	Same as Acquiring Fund.	Same as Acquiring Fund.
Advisory and Sub-Advisory Fee	**Advisory and Sub-Advisory Fee**	**Advisory and Sub-Advisory Fee**
Advisory Fee: 0.75% of the Fund s average daily managed assets.	Same as Acquiring Fund.	Same as Acquiring Fund.
Sub-Advisory Fee: Equal to 59.0% of the advisory fee received by the Investment Advisor.	Same as Acquiring Fund.	Same as Acquiring Fund.
Portfolio Management Team	**Portfolio Management Team**	**Portfolio Management Team**
Leland Hart and C. Adrian Marshall.	Same as Acquiring Fund.	Leland Hart, James E. Keenan and C. Adrian Marshall.
Fiscal Year End	**Fiscal Year End**	**Fiscal Year End**
August 31.	February 28.	Same as Acquiring Fund.

The fundamental investment restrictions of the Funds are identical and may not be changed without the approval of the holders of a majority of a Fund s outstanding shares of common stock (which for this purpose and under the 1940 Act means the lesser of (i) 67% of the shares of common stock represented at a meeting at which more than 50% of the outstanding shares of common stock are represented, or (ii) more than 50% of the outstanding shares). The following investment restrictions of the Acquiring Fund will apply to the Combined Fund. Under the fundamental investment restrictions, the Acquiring Fund may not:

(1) make any investment inconsistent with the Fund s classification as a diversified company under the 1940 Act;

(2) make investments for the purpose of exercising control or management;

(3) purchase or sell real estate, commodities or commodity contracts, except that, to the extent permitted by applicable law, the Fund may invest in securities directly or indirectly secured by real estate or interests therein or issued by entities that invest in real estate or interests therein, and the Fund may purchase and sell financial futures contracts and options thereon;

(4) issue senior securities or borrow money except as permitted by Section 18 of the 1940 Act or otherwise as permitted by applicable law;

(5) underwrite securities of other issuers, except insofar as the Fund may be deemed an underwriter under the Securities Act of 1933, as amended, in selling portfolio securities;

(6) make loans to other persons, except (i) to the extent that the Fund may be deemed to be making loans by purchasing senior loans, as a Co-Lender or otherwise, or other debt securities or enters into repurchase agreements or any similar instruments and (ii) the Fund may lend its portfolio securities in an amount not in excess of $33^{1/3}$% of its total assets, taken at market value, provided that such loans shall be made in accordance with the guidelines set forth in this prospectus; and

(7) invest more than 25% of its total assets (taken at market value at the time of each investment) in the securities of issuers in any one industry; provided that this limitation shall not apply with respect to obligations issued or guaranteed by the U.S. government or by its agencies or instrumentalities. For purposes of this restriction, the term issuer includes both a borrower and any lender selling a participation interest (as described under Investment Objectives and Policies Description of Senior Loans above) to the Fund together with any other person interpositioned between the lender selling such participation interest and the Fund with respect to such participation interest.

Additional investment restrictions adopted by the Acquiring Fund, which may be changed by the Board of the Acquiring Fund without stockholder approval, provide that the Acquiring Fund may not:

(1) purchase securities of other investment companies, except to the extent that such purchases are permitted by applicable law;

(2) mortgage, pledge, hypothecate or in any manner transfer, as security for indebtedness, any securities owned or held by the Fund except as may be necessary in connection with borrowings mentioned in investment restriction (4) above or except as may be necessary in connection with transactions described under Other Investment Policies above;

(3) purchase any securities on margin, except that the Fund may obtain such short term credit as may be necessary for the clearance of purchases and sales of portfolio securities (the deposit or payment by the Fund of initial or variation margin in connection with financial futures contracts and options thereon is not considered the purchase of a security on margin);

(4) change its policy of investing, under normal circumstances, at least 80% of an aggregate of (i) the Fund s net assets (including proceeds from the issuance of preferred stock) and (ii) the proceeds of any outstanding borrowings for investment purposes, in floating rate debt securities, unless the Fund provides its stockholders with at least 60 days prior written notice;

(5) invest more than 10% of its total assets (at the time of investment) in securities that are rated Caa1 or lower (if rated by Moody s) or CCC+ or lower (if rated by S&P) by each agency rating such security or, if unrated, are considered by the Investment Adviser to be of comparable quality or are otherwise considered to be distressed securities; and

(6) invest more than 10% of its total assets in debt securities of issuers located in emerging market countries or in debt securities denominated in currencies other than the U.S. dollar or that do not provide for payment to the Fund in U.S. dollars.

In addition, to comply with U.S. federal income tax requirements for qualification as a regulated investment company, the Acquiring Fund s investments will be limited in a manner such that at the close of each quarter of each taxable year, (a) no more than 25% of the value of the Acquiring Fund s total assets are invested (i) in the securities (other than U.S. Government securities or securities of other regulated investment companies) of a single issuer or two or more issuers controlled by the Acquiring Fund and engaged in the same, similar or related trades or businesses, or (ii) in the securities of one or more qualified publicly traded partnerships (as defined under Section 851(h) of the Code), and (b) with regard to at least 50% of the Acquiring Fund s total assets, no more than 5% of its total assets are invested in the securities (other than U.S. Government securities or securities of other regulated investment companies) of a single issuer and no investment represents more than 10% of the outstanding voting securities of such issuer. These tax-related limitations may be changed by the Directors to the extent appropriate in light of changes to applicable tax requirements.

Each Target Fund s fundamental investment restrictions are the same as the Acquiring Fund s fundamental restrictions (1) through (7). FRB s non-fundamental investment restrictions also are the same as the Acquiring Fund s non-fundamental restrictions (1) through (6). DVF s non-fundamental investment restrictions are substantially the same as the Acquiring Fund s non-fundamental restrictions except that DVF does not have non-fundamental restrictions (4) through (6) above.

If a percentage restriction on the investment or use of assets set forth above is adhered to at the time a transaction is effected, later changes in percentages resulting from changing values will not be considered a violation.

Any policies of the Acquiring Fund not described as fundamental in this Joint Proxy Statement/Prospectus may be changed by its Board without stockholder approval.

Leverage

At times, each Fund utilizes leverage through borrowings, the issuance of short term debt securities, the issuance of shares of preferred stock or a combination thereof.

Each Fund may borrow money and issue debt securities in amounts up to $33^{1/3}$%, and may issue shares of preferred stock in amounts up to 50%, of the value of its total assets to finance additional investments. These practices are known as leverage. Each Fund may borrow from banks and other financial institutions and may also borrow additional funds using such investment techniques as BlackRock may from time to time determine. Changes in the value of each Fund s investment portfolio, including securities bought with the proceeds of the leverage, will be borne entirely by the holders of shares of common stock. If there is a net decrease, or increase, in the value of each Fund s investment portfolio, the leverage will decrease, or increase (as the case may be), the net asset value per common share to a greater extent than if each Fund were not leveraged. During periods in which each Fund is using leverage, the fees paid to BlackRock for advisory and sub-advisory services will be higher than if each Fund did not use leverage because the fees paid will be calculated on the basis of the Fund s total assets, including the proceeds from the issuance of preferred shares and other leverage.

Under the 1940 Act, each Fund is not permitted to (i) issue preferred stock, unless immediately after such issuance the value of the Fund s total assets is at least 200% of the liquidation value of the outstanding preferred stock, or (ii) issue any senior security representing indebtedness of the Fund, unless immediately after such issuance the value of the Fund s total assets is at least 300% of the face amount of such indebtedness. In addition, in the event that each Fund does issue any preferred stock or senior securities representing indebtedness, the Fund will not be able to (i) pay dividends or declare any other distribution on any such preferred stock or the shares of common stock unless at the time of declaration of any such dividend or other distribution the value of the Fund s total assets is at least 200% of the liquidation value of the outstanding preferred stock after giving effect to such dividend or other distribution, or (ii) pay dividends or declare any other distribution on any such senior security representing indebtedness or the shares of common stock unless at the time of declaration of any such dividend or other distribution the value of the Fund s total assets is at least 300% of the face amount of such indebtedness after giving effect to such dividend or other distribution.

MANAGEMENT OF THE FUNDS

The Boards

The Board of each Fund is responsible for the overall supervision of the operations of its respective Fund and performs the various duties imposed on the directors of investment companies by the 1940 Act and under Maryland law. A list of the directors, a brief biography for each director and additional information relating to the Boards are included in the Statement of Additional Information.

The Advisors

BlackRock Advisors, LLC acts as the investment adviser for each Fund. Pursuant to an investment management agreement between BlackRock Advisors, LLC and each Fund, each Fund pays the Investment Advisor a monthly fee at an annual rate of 0.75% of the respective Fund s average daily managed assets.

BlackRock Financial Management, Inc. acts as the sub-advisor for each Fund (the Sub-Advisor and together with the Investment Advisor, the Advisors). BlackRock Advisors, LLC has entered into a separate sub-advisory agreement with BlackRock Financial Management, Inc., under which the BlackRock Advisors, LLC pays BlackRock Financial Management, Inc. for services it provides, a monthly fee that is a percentage of the investment advisory fees paid by each Fund to BlackRock Advisors, LLC.

A discussion regarding the basis for the approval of the investment management agreements by the Boards of the Funds are available in (i) the Acquiring Fund s and DVF s annual report and (ii) FRB s semi-annual report to stockholders for the period ending August 31, 2011.

BlackRock Advisors, located at 100 Bellevue Parkway, Wilmington, Delaware 19809, and the Sub-Advisor, located at 55 East 52nd Street, New York, New York 10055, are wholly owned subsidiaries of BlackRock, Inc. (BlackRock). BlackRock is one of the world s largest publicly-traded investment management firms. As of June 30, 2012, BlackRock s assets under management were approximately $3.560 trillion. BlackRock has over 20 years of experience managing closed-end products and, as of June 30, 2012 advised a registered closed-end family of 92 exchange-listed active funds with approximately $42.7 billion in assets. In addition, BlackRock advised six non-exchange-listed closed-end funds with approximately $303.8 million in assets.

BlackRock offers products that span the risk spectrum to meet clients needs, including active, enhanced and index strategies across markets and asset classes. Products are offered in a variety of structures including separate accounts, mutual funds, iShares® (exchange-traded funds), and other pooled investment vehicles. BlackRock also offers risk management, advisory and enterprise investment system services to a broad base of institutional investors through BlackRock Solutions®. Headquartered in New York City, as of June 30, 2012, the firm has approximately 9,900 employees in 27 countries and a major presence in key global markets, including North and South America, Europe, Asia, Australia and the Middle East and Africa.

Portfolio Management

The Investment Advisor serves as the investment adviser for each of the Funds and is expected to continue to serve as investment adviser for the Combined Fund. Each Fund is managed by a team of investment professionals comprised of Leland Hart and C. Adrian Marshall. DVF is also managed by James E. Keenan. Leland Hart and C. Adrian Marshall are jointly responsible for the day-to-day management of FRA s and FRB s portfolio, which includes setting such Fund s overall investment strategy, overseeing the management of such Fund and/or selection of its investments. Leland Hart, C. Adrian Marshall and James E. Keenan are jointly responsible for the day-to-day management of DVF s portfolio, which includes setting DVF s overall investment strategy, overseeing the management of DVF and/or selection of its investments. Leland Hart and C. Adrian Marshall are expected to be jointly responsible for the day-to-day management of the Combined Fund s portfolio, which includes setting the Combined Fund s overall investment strategy, overseeing the management of the Combined Fund and/or selection of its investments.

Leland Hart, Managing Director, is a member of the Corporate Credit Group within BlackRock Fundamental Fixed Income. He is a portfolio manager on the Leveraged Finance Portfolio Team. Mr. Hart is also a member of the BlackRock Kelso Investment Committee.

Prior to joining BlackRock in 2009, Mr. Hart was a Partner and head of Europe Leveraged Loans at R3 Capital Partners. Previously, he spent eight years with Lehman Brothers, most recently as a Managing Director in Leveraged Capital Markets focused on the origination, structuring, and distribution of leveraged loans, mezzanine debt, high yield bonds and equity-linked securities. Earlier, Mr. Hart was in the firm s Leveraged Finance Group. Before joining Lehman Brothers, Mr. Hart was with Bank of America s High Yield Group and the Private Placement Group of Continental Bank, a predecessor firm.

Mr. Hart earned a BA degree, cum laude, from Middlebury College in 1991 and an MBA degree from the University of Chicago Graduate School of Business in 1997. He also serves as a board member of the Loan Syndications and Trading Association.

James E. Keenan, CFA, Managing Director, is a portfolio manager in the Corporate Credit Group within BlackRock Fundamental Fixed Income. He is head of Leveraged Finance Portfolios and Investments overseeing global high yield, leveraged loans, and distressed products. Mr. Keenan is also a member of the BlackRock Kelso Investment Committee.

Prior to joining BlackRock in 2004, Mr. Keenan was a senior high yield trader at Columbia Management Group. Mr. Keenan began his investment career at UBS Global Asset Management where he held roles as a trader and research analyst from 1998 through 2003.

Mr. Keenan earned a BBA degree in finance from the University of Notre Dame in 1998.

C. Adrian Marshall, CFA, Director, is a member of the Corporate Credit Group within BlackRock Fundamental Fixed Income. He is a portfolio manager on the Leveraged Finance Portfolio Team.

Mr. Marshall moved into his current position in 2007; he was previously a sector specialist on the investment grade corporate bond team. Prior to moving to portfolio management in 2003, he spent two years in Tokyo as a member of the product development and investment management groups at Nomura BlackRock Asset Management Co., Ltd., BlackRock s former Tokyo-based joint venture. Mr. Marshall began his career at BlackRock in 1999 as an account manager for institutional clients in the US and internationally.

Mr. Marshall earned a BA degree in political science from Williams College in 1999.

The Statement of Additional Information provides additional information about the portfolio managers compensation, other accounts managed by the portfolio managers, and the portfolio managers ownership of securities in each Fund.

Portfolio Transactions with Affiliates

The Advisors may place portfolio transactions, to the extent permitted by law, with brokerage firms affiliated with the Funds and the Advisors, if they reasonably believe that the quality of execution and the commission are comparable to that available from other qualified brokerage firms.

Legal Proceedings

There are no material pending legal proceedings against the Funds or the Advisors.

Other Service Providers

The professional service providers for the Funds are as follows:

Service	**Service Providers to the Funds**
Investment Advisor	BlackRock Advisors, LLC
Sub-Advisor	BlackRock Financial Management, Inc.
Custodian	State Street Bank and Trust Company
Transfer Agent, Dividend Disbursing Agent and Registrar	Computershare Trust Company N.A.
Accounting Services Provider	State Street Bank and Trust Company
Independent Registered Public Accounting Firm	Deloitte & Touche LLP
Fund Counsel	Skadden, Arps, Slate, Meagher & Flom LLP
Counsel to the Independent Directors	Debevoise & Plimpton LLP

All securities owned by the Funds and all cash, including proceeds from the sale of securities in each Fund s investment portfolio, are held by State Street Bank and Trust Company, 1 Lincoln Street, Boston, Massachusetts 02111, as custodian. Computershare Trust Company N.A. 250 Royall Street, Canton, Massachusetts 02021 serves as each Fund s transfer agent with respect to the Funds shares of common stock.

It is not anticipated that the Reorganization will result in any change in the organizations providing services to FRA as set forth above. As a result of the Reorganization, the service providers to FRA are anticipated to be the service providers to the Combined Fund.

Capitalization

The Board of each Fund may authorize separate classes of shares together with such designation of preferences, rights, voting powers, restrictions, limitations, qualifications or terms as may be determined from time to time by the Board of such Fund. The tables below set forth the capitalization of the Funds as of February 29, 2012 and the *pro forma* capitalization of the Combined Fund as if the proposed Reorganizations had occurred on that date.

Capitalization as of February 29, 2012 (Unaudited)

	FRA	FRB	DVF	Adjustments	*Pro Forma* Combined Fund (All Funds)
Net Assets(a)	$ 272,651,890	$ 143,772,951	$ 132,399,987	$ (830,000)(b)	$ 547,994,828
Shares of Common Stock Outstanding	18,467,299	10,574,327	12,401,086	(4,294,502)(c)	37,148,210
Net Asset Value Per Share of Common Stock	$ 14.76	$ 13.60	$ 10.68		$ 14.75

(a) Based on the number of outstanding shares of common stock listed in Outstanding shares of common stock table below.

(b) Reflects non-recurring aggregate estimated reorganization expenses of $830,000 of which $300,000 was attributable to FRB, $300,000 was attributable to DVF, and $230,000 was attributable to FRA. Since the cost savings of FRA are expected to be less than those of the Target Funds, the Investment Advisor has decided to cover $100,000 of FRA s costs of the Reorganizations. Therefore, only a portion of FRA s costs associated with the Reorganizations will be borne directly by FRA. Because of the expected benefits outlined above for each Fund, and because, over time, the savings attributable to each Fund s participation in each Reorganization outweigh the costs associated with such Reorganization, the Investment Advisor recommended, and the Boards have approved, that DVF and FRB be responsible for their own Reorganization expenses and that FRA be responsible for its Reorganization expenses in excess of $100,000. See Reasons for the Reorganizations. The actual costs associated with the proposed Reorganizations may be more or less than the estimated costs discussed herein.

(c) Reflects adjustments of $848,389 for FRB shares of common stock and $3,446,113 for DVF shares of common stock due to differences in per share NAV.

	FRA	FRB	Adjustments	*Pro Forma* Combined Fund (FRB and Acquiring Fund)
Net Assets(a)	$ 272,651,890	$ 143,772,951	$ (530,000)(b)	$ 415,894,841
Shares of Common Stock Outstanding	18,467,299	10,574,327	(848,389)(c)	28,193,237
Net Asset Value Per Share of Common Stock	$ 14.76	$ 13.60		$ 14.75

(a) Based on the number of outstanding shares of common stock listed in Outstanding shares of common stock table below.

(b) Reflects non-recurring aggregate estimated reorganization expenses of $530,000 of which $300,000 was attributable to FRB and $230,000 was attributable to FRA, respectively. Since the cost savings of FRA are expected to be less than those of the Target Funds, the Investment Advisor has decided to cover $100,000 of FRA s costs of the Reorganizations. Therefore, only a portion of FRA s costs associated with the Reorganizations will be borne directly by FRA. Because of the expected benefits outlined above for each Fund, and because, over time, the savings attributable to each Fund s participation in each Reorganization outweigh the costs associated with such Reorganization, the Investment Advisor recommended, and the Boards have approved, that FRB be responsible for its own Reorganization expenses and that FRA be responsible for its Reorganization expenses in excess of $100,000. See Reasons for the Reorganizations. The actual costs associated with the proposed Reorganization may be more or less than the estimated costs discussed herein.

(c) Reflects adjustments due to differences in per share NAV.

55

	FRA	DVF	Adjustments	*Pro Forma* Combined Fund (DVF and Acquiring Fund)
Net Assets(a)	$ 272,651,890	$ 132,399,987	$ (530,000)(b)	$ 404,521,877
Shares of Common Stock Outstanding	18,467,299	12,401,086	(3,446,113)(c)	27,422,272
Net Asset Value Per Share of Commons Stock	$ 14.76	$ 10.68		$ 14.75

(a) Based on the number of outstanding shares of common stock listed in Outstanding shares of common stock table below.

(b) Reflects non-recurring aggregate estimated reorganization expenses of $530,000 of which $300,000 was attributable to DVF and $230,000 was attributable to FRA, respectively. Since the cost savings of FRA are expected to be less than those of the Target Funds, the Investment Advisor has decided to cover $100,000 of FRA s costs of the Reorganizations. Therefore, only a portion of FRA s costs associated with the Reorganizations will be borne directly by FRA. Because of the expected benefits outlined above for each Fund, and because, over time, the savings attributable to each Fund s participation in each Reorganization outweigh the costs associated with such Reorganization, the Investment Advisor recommended, and the Boards have approved, that DVF be responsible for its own Reorganization expenses and that FRA be responsible for its Reorganization expenses in excess of $100,000. See Reasons for the Reorganizations. The actual costs associated with the proposed Reorganization may be more or less than the estimated costs discussed herein.

(c) Reflects adjustments due to differences in per share NAV.

ADDITIONAL INFORMATION ABOUT THE SHARES OF COMMON STOCK OF THE FUNDS

General

Stockholders of a Fund are entitled to share equally in dividends declared by the Fund s Board as payable to holders of the Fund s shares of common stock and in the net assets of the Fund available for distribution to holders of the shares of common stock. Stockholders do not have preemptive or conversion rights and a Fund s shares of common stock are not redeemable. The outstanding shares of common stock of each Fund are fully paid and nonassessable.

Purchase and Sale

Purchase and sale procedures for the shares of common stock of each of the Funds are identical. Investors typically purchase and sell shares of common stock of the Funds through a registered broker-dealer on the NYSE, thereby incurring a brokerage commission set by the broker-dealer. Alternatively, investors may purchase or sell shares of common stock of the Funds through privately negotiated transactions with existing stockholders.

Outstanding Shares of Common Stock as of February 29, 2012

Fund	Title of Class	Amount Authorized	Amount Held by Fund for its Own Account	Amount Outstanding Exclusive of Amount Shown in Previous Column
FRB	Common Stock	200 million		10,574,327
DVF	Common Stock	200 million		12,401,086
FRA	Common Stock	200 million		18,467,299

Share Price Data

The following tables set forth the high and low market prices for shares of common stock of each Fund on the NYSE, for each full quarterly period within each Fund s two most recent fiscal years and each full quarter since the beginning of each Fund s current fiscal year, along with the net asset value and discount or premium to net asset value for each quotation.

FRB Period Ended	Market Price High	Market Price Low	Net Asset Value High	Net Asset Value Low	Premium/(Discount) to Net Asset Value High	Premium/(Discount) to Net Asset Value Low
May 31, 2012	$ 13.95	$ 13.15	$ 13.76	$ 13.48	2.27%	(2.81%)
February 29, 2012	$ 13.33	$ 11.85	$ 13.60	$ 13.10	(1.62%)	(9.68%)
November 30, 2011	$ 12.70	$ 11.46	$ 13.36	$ 12.66	(3.61%)	(9.55%)
August 31, 2011	$ 14.51	$ 11.86	$ 14.03	$ 12.73	3.42%	(8.11%)
May 31, 2011	$ 14.79	$ 14.13	$ 14.12	$ 13.89	5.34%	0.64%
February 28, 2011	$ 14.40	$ 13.34	$ 14.07	$ 13.62	2.49%	(2.41%)
November 30, 2010	$ 14.71	$ 13.16	$ 13.75	$ 13.28	9.86%	(3.45%)
August 31, 2010	$ 14.61	$ 13.27	$ 13.34	$ 13.03	11.10%	0.15%
May 31, 2010	$ 15.58	$ 13.20	$ 13.52	$ 13.09	15.69%	(0.15%)
February 28, 2010	$ 15.01	$ 12.91	$ 13.21	$ 12.68	14.06%	1.81%

DVF Period Ended	Market Price High	Market Price Low	Net Asset Value High	Net Asset Value Low	Premium/(Discount) to Net Asset Value High	Premium/(Discount) to Net Asset Value Low
May 31, 2012	$ 10.40	$ 9.82	$ 10.80	$ 10.57	(2.89%)	(7.45%)
February 29, 2012	$ 10.19	$ 9.22	$ 10.68	$ 10.28	(4.41%)	(10.40%)
November 30, 2011	$ 9.89	$ 8.97	$ 10.51	$ 9.95	(3.61%)	(11.26%)
August 31, 2011	$ 12.01	$ 9.13	$ 11.02	$ 10.05	8.98%	(12.38%)
May 31, 2011	$ 11.92	$ 10.91	$ 11.09	$ 10.89	8.17%	(0.91%)
February 28, 2011	$ 11.70	$ 10.89	$ 11.06	$ 10.71	6.91%	(0.09%)
November 30, 2010	$ 10.84	$ 10.25	$ 10.80	$ 10.49	1.69%	(4.03%)
August 31, 2010	$ 11.34	$ 10.19	$ 10.56	$ 10.33	8.83%	(1.83%)
May 31, 2010	$ 11.96	$ 10.13	$ 10.89	$ 10.33	11.88%	(5.21%)
February 28, 2010	$ 10.68	$ 9.27	$ 10.36	$ 9.90	3.89%	(7.49%)
November 30, 2009	$ 9.74	$ 8.77	$ 9.87	$ 8.75	2.13%	(7.68%)

FRA Period Ended	Market Price High	Market Price Low	Net Asset Value High	Net Asset Value Low	Premium/(Discount) to Net Asset Value High	Premium/(Discount) to Net Asset Value Low
May 31, 2012	$ 15.02	$ 14.17	$ 14.94	$ 14.63	0.94%	(3.20%)
February 29, 2012	$ 14.59	$ 12.88	$ 14.76	$ 14.20	(0.88%)	(9.35%)
November 30, 2011	$ 13.71	$ 12.42	$ 14.49	$ 13.74	(4.03%)	(9.67%)
August 31, 2011	$ 16.31	$ 12.95	$ 15.21	$ 13.80	(7.30%)	(8.21%)
May 31, 2011	$ 16.30	$ 15.23	$ 15.31	$ 14.88	7.10%	0.13%
February 28, 2011	$ 15.60	$ 14.32	$ 15.26	$ 14.75	2.36%	(3.24%)
November 30, 2010	$ 15.75	$ 14.22	$ 14.88	$ 14.37	8.47%	(3.66%)
August 31, 2010	$ 15.50	$ 13.57	$ 14.43	$ 14.11	7.64%	(4.77%)
May 31, 2010	$ 16.94	$ 13.48	$ 14.67	$ 14.17	15.55%	(5.80%)
February 28, 2010	$ 15.64	$ 13.92	$ 14.30	$ 13.75	9.85%	(0.21%)
November 30, 2009	$ 13.84	$ 12.21	$ 13.73	$ 12.94	0.95%	(9.43%)

As of May 31, 2012, the net asset value per common share of FRB was $13.48 and the market price per common share was $13.42, representing a discount to net asset value of (0.45%), the net asset value per common share of DVF was $10.57 and the market price per common share was $9.95, representing a discount to net asset value of (5.87%) and the net asset value per common share of FRA was $14.63 and the market price per common share was $14.17, representing a discount to net asset value of (3.14%). Common shares of FRA, FRB and DVF have historically traded at both a premium and discount to net asset value.

Performance Information

The performance table below illustrates the past performance of an investment in shares of common stock of each Fund by setting forth the average total returns for the Funds for the periods indicated. A Fund s past performance does not necessarily indicate how its shares of common stock will perform in the future.

Average Annual Total Returns as of February 29, 2012

Fund	Trailing 12-month Distribution Yield based on February 29, 2012 NAV	One Year ended February 29, 2012 based on NAV	One Year ended February 29, 2012 based on Market Price	Life of Fund ended February 29, 2012 based on NAV	Life of Fund ended February 29, 2012 based on Market Price	Inception Date
FRB	6.47%	3.41%	(0.61)%	4.01%	2.99%	07/30/04
DVF	6.70%	4.11%	(2.24)%	2.26%	0.82%	01/31/05
FRA	6.24%	3.36%	0.76%	4.74%	3.96%	10/31/03

DIVIDENDS AND DISTRIBUTIONS

The dividend and distribution policy of the Acquiring Fund will be the dividend and distribution policy for the Combined Fund. The dividend and distribution policies of the Target Funds are substantially the same as those of the Acquiring Fund. The Acquiring Fund intends to make regular monthly cash distributions of all or a portion of its net investment income to holders of the Fund s shares of common stock. The Acquiring Fund s net investment income consists of all interest income accrued on portfolio assets less all expenses of the Fund. The Acquiring Fund is required to allocate net capital gains and other taxable income, if any, received by the Fund among its stockholders on a *pro rata* basis in the year for which such capital gains and other income are realized.

The tax treatment and characterization of the Acquiring Fund s distributions may vary significantly from time to time because of the varied nature of the Fund s investments. The Acquiring Fund will indicate the proportion of its capital gains distributions that constitute long-term and short-term gains annually. The ultimate tax characterization of the Acquiring Fund s distributions made in a calendar or fiscal year cannot finally be determined until after the end of that fiscal year. As a result, there is a possibility that the Acquiring Fund may make total distributions during a calendar or fiscal year in an amount that exceeds the Acquiring Fund s earnings and profits (as determined for U.S. federal income tax purposes), if any, for the relevant fiscal year and its previously undistributed earnings and profits from prior years, if any. In such situations, the amount by which the Acquiring Fund s total distributions exceed its earnings and profits generally will be treated as a tax-free return of capital reducing the amount of a stockholder s tax basis in such stockholder s shares, with any amounts exceeding such basis treated as gain from the sale of shares.

Various factors will affect the level of the Acquiring Fund s net investment income, such as its asset mix, its level of retained earnings, the amount of leverage utilized by the Fund and the effects thereof and the movement of interest rates for debt securities. These factors, among others, may result in the Combined Fund s level of net investment income being different from the level of net investment income for any of the Target Funds or the Acquiring Fund if the Reorganization were not completed. To permit the Acquiring Fund to maintain more stable monthly distributions and to the extent consistent with the distribution requirements imposed on regulated investment companies by the Code, the Fund may from time to time distribute less than the entire amount earned in a particular period. The income would be available to supplement future distributions. As a result, the distributions paid by the Acquiring Fund for any particular month may be more or less than the amount actually earned by the Fund during that month. Undistributed earnings will increase the Acquiring Fund s net asset value and, correspondingly, distributions from undistributed earnings and from capital, if any, will reduce the Fund s net asset value. Holders of the Acquiring Fund s shares of common stock will automatically have all dividends and distributions reinvested in shares of common stock issued by the Fund or shares of common stock of the

Fund purchased in the open market in accordance with the Fund s Automatic Dividend Reinvestment Plan, unless an election is made to receive cash. For information concerning the manner in which dividends and distributions to holders of a Fund s shares of common stock may be reinvested automatically in such Fund s shares of common stock, see Automatic Dividend Reinvestment Plan below.

AUTOMATIC DIVIDEND REINVESTMENT PLAN

The automatic dividend reinvestment plan (the Plan) of the Acquiring Fund will be the automatic dividend reinvestment plan of the Combined Fund. The automatic dividend reinvestment plan of the Target Funds is the same as the Acquiring Fund s Plan. Stockholders of the Acquiring Fund are automatically enrolled to have all distributions of dividends and capital gains reinvested by Computershare Trust Company, N.A. (the Plan Agent), agent for stockholders in administering the Plan, in the Acquiring Fund s Shares. Stockholders who do not participate in the Plan receive all distributions in cash paid by check and mailed directly to the stockholders of record (or if the shares are held in street or other nominee name, then to the nominee) by the Plan Agent.

After the Acquiring Fund declares a dividend or determines to make a capital gain distribution, the Plan Agent will acquire shares for the participants accounts, depending upon the circumstances described below, either (i) through receipt of unissued but authorized shares from the Fund (newly issued shares), or (ii) by purchase of outstanding shares on the open market or on the Fund s primary exchange (open-market purchases). If, on the dividend payment date, the net asset value per share (NAV) is equal to or less than the market price per share plus estimated brokerage commissions (such condition being referred to herein as market premium), the Plan Agent will invest the dividend amount in newly issued shares on behalf of the participants. The number of newly issued shares to be credited to each participant s account will be determined by dividing the dollar amount of the dividend by the NAV on the dividend payment date. However, if the NAV is less than 95% of the market price on the dividend payment date, the dollar amount of the dividend will be divided by 95% of the market price on the dividend payment date. If, on the dividend payment date, the NAV is greater than the market value per share plus estimated brokerage commissions (such condition being referred to herein as market discount), the Plan Agent will invest the dividend amount in shares acquired on behalf of the participants in open market purchases.

In the event of a market discount on the payment date for any dividend, the Plan Agent will have until the last business day before the next date on which the shares of common stock trade on an ex-dividend basis or 30 days after the payment date for such dividend, whichever is sooner (the last purchase date), to invest the dividend amount in shares of common stock acquired in open-market purchases. It is contemplated that the Combined Fund will pay monthly dividends. Therefore, the period during which open-market purchases can be made will exist only from the payment date on the dividend through the date before the next ex-dividend date, which typically will be approximately ten days. If the Plan Agent is unable to invest the full dividend amount in open market purchases, or if the market discount shifts to a market premium during the purchase period, the Plan Agent will invest any un-invested portion in newly issued shares. Investments in newly issued shares made in this manner would be made pursuant to the same process described above and the date of issue for such newly issued shares will substitute for the dividend payment date.

Participation in the Plan is completely voluntary and may be terminated or resumed at any time without penalty by notice if received and processed by the Plan Agent prior to the dividend record date. Additionally, the Plan Agent seeks to process notices received after the record date but prior to the payable date and such notices often will become effective by the payable date. Where late notices are not processed by the applicable payable date, such termination or resumption will be effective with respect to any subsequently declared dividend or distribution.

The Plan Agent s fees for the handling of the reinvestment of dividends are paid by the Acquiring Fund. However, each participant will pay a *pro rata* share of brokerage commissions incurred with respect to the Plan Agent s open-market purchases in connection with the reinvestment of dividends and distributions. The automatic reinvestment of dividends and distributions will not relieve participants of any U.S. federal income tax that may be payable on such dividends or distributions. Participants should consult their own tax advisors regarding the U.S. federal income tax consequences of the automatic reinvestment of dividends and distributions, as well as the effects of state, local and non-U.S. tax laws, including possible changes in tax laws.

The Acquiring Fund reserves the right to amend or terminate its Plan. There is no direct service charge to participants in its Plan; however, the Acquiring Fund reserves the right to amend its Plan to include a service charge payable by the participants. Participants who request a sale of shares through the Plan Agent are subject to a $2.50 sales fee and a $0.15 per share sold brokerage commission.

All correspondence concerning the Plan, including any questions about the Plan, should be directed to the Plan Agent at Computershare Trust Company, N.A., P.O. Box 43078, Providence, RI 02940-3078, Telephone: (800) 699-1BFM. All overnight correspondence should be directed to the Reinvestment Plan Agent at 250 Royall Street, Canton, MA 02021.

CERTAIN PROVISIONS OF THE CHARTER

Each Fund s charter includes provisions that could have the effect of limiting the ability of other entities or persons to acquire control of the Fund or to change the composition of its Board. This could have the effect of depriving stockholders of an opportunity to sell their shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control over the Fund. Such attempts could have the effect of increasing the expenses of the Fund and disrupting the normal operation of the Fund.

The Board of each Fund consists of 11 Board Members, nine of whom are not interested persons of the Funds (as defined in the 1940 Act) (the Independent Board Members). At each annual meeting, Stockholders elect all 11 Board Member nominees for one year terms. With respect to each Fund, a director elected by the stockholders may be removed (with or without cause), but only by action taken by the stockholders of at least sixty-six and two-thirds percent ($66^{2/3}$%) of the shares of common stock then entitled to vote in an election to fill that directorship.

In addition, the Charter requires the favorable vote of the holders of at least $66^{2/3}$% of the Fund s shares to approve, adopt or authorize the following:

- a merger or consolidation or statutory share exchange of the Fund with any other corporation;
- a sale of all or substantially all of the Fund s assets (other than in the regular course of the Fund s investment activities); or
- a liquidation or dissolution of the Fund;

unless such action has been approved, adopted or authorized by the affirmative vote of at least two-thirds of the total number of Directors fixed in accordance with the Bylaws, in which case the affirmative vote of a majority of the Fund s shares of common stock is required.

The Charter and Bylaws provide that the Board of Directors has the power, to the exclusion of stockholders, to make, alter or repeal any of the Bylaws (except for any Bylaw specified not to be amended or repealed by the Board), subject to the requirements of the 1940 Act. Neither this provision of the Charter, nor any of the foregoing provisions of the Charter requiring the affirmative vote of $66^{2/3}$% of shares of common stock of the Fund, can be amended or repealed except by the vote of such required number of shares.

In addition, conversion of a Fund to an open-end investment company would require an amendment to such Fund s Charter. The amendment would have to be declared advisable by the Board of Directors prior to its submission to stockholders. Such an amendment would require the favorable vote of the holders of at least

$66^{2/3}$% of the Fund s outstanding shares of common stock (including any preferred stock) entitled to be voted on the matter, voting as a single class (or a majority of such shares if the amendment was previously approved, adopted or authorized by two-thirds of the total number of Directors fixed in accordance with the Bylaws), and, assuming preferred stock is issued, the affirmative vote of a majority of outstanding shares of preferred stock of the Fund, voting as a separate class. Such a vote also would satisfy a separate requirement in the 1940 Act that the change be approved by the stockholders. Stockholders of an open-end investment company may require the company to redeem their shares of common stock at any time (except in certain circumstances as authorized by or under the 1940 Act) at their net asset value, less such redemption charge, if any, as might be in effect at the time of a redemption. All redemptions will be made in cash. If the Fund is converted to an open-end investment company, it could be required to liquidate portfolio securities to meet requests for redemption, and the common stock would no longer be listed on a stock exchange.

The Board of each Fund has determined that the voting requirements described above, which are greater than the minimum requirements under the 1940 Act or, in certain circumstances, Maryland law, are in the best interests of stockholders generally. Reference should be made to the charter of each Fund on file with the SEC for the full text of these provisions.

Each Fund s Bylaws generally require that advance notice be given to the Fund in the event a stockholder desires to transact any business, including business from the floor, at an annual meeting of stockholders, including the nomination of Board Members. Notice of any such business or nomination must be in writing, comply with the requirements of the Bylaws and be received by the Fund not less than 120 calendar days nor more than 150 calendar days prior to the anniversary date of the prior year s annual meeting. In the event a Fund moves the date of its annual meeting by more than 25 days from the anniversary of its immediately preceding annual meeting, stockholders who wish to submit a proposal or nomination for consideration at the annual meeting in accordance with the advance notice provisions of the Bylaws of a Fund must deliver such proposal or nomination not later than the close of business on the tenth day following the day on which such notice of the date of the meeting was mailed or such public disclosure of the meeting date was made, whichever comes first.

GOVERNING LAW

Each Fund is organized as a Maryland corporation pursuant to its charter governed by the laws of the State of Maryland. BlackRock Floating Rate Income Strategies Fund II, Inc. was formed under the laws of the State of Maryland on November 6, 2003 and commenced operations on July 30, 2004. BlackRock Floating Rate Income Strategies Fund II, Inc. was known as Floating Rate Income Strategies Fund II, Inc. prior to September 29, 2006. BlackRock Diversified Income Strategies Fund, Inc. was formed under the laws of the State of Maryland on September 20, 2004 and commenced operations on January 31, 2005. BlackRock Diversified Income Strategies Fund, Inc. was known as Diversified Income Strategies Portfolio, Inc. prior to June 8, 2007. BlackRock Floating Rate Income Strategies Fund, Inc. was formed under the laws of the State of Maryland on August 14, 2003 and commenced operations on October 31, 2003. BlackRock Floating Rate Income Strategies Fund, Inc. was known as Floating Rate Income Strategies Fund, Inc. prior to September 29, 2006.

CONVERSION TO OPEN-END FUND

To convert each of FRB, DVF and FRA to an open-end investment company, each such Fund s Charter requires an amendment to the Fund s Charter. The amendment would have to be declared advisable by the Board of Directors prior to its submission to stockholders. Such an amendment would require the favorable vote of the holders of at least $66^{2/3}$% of the Fund s outstanding shares of common stock (including any preferred stock) entitled to be voted on the matter, voting as a single class (or a majority of such shares if the amendment was previously approved, adopted or authorized by two-thirds of the total number of Directors fixed in accordance with the Bylaws), and, assuming preferred stock is issued, the affirmative vote of a majority of outstanding shares of preferred stock of the Fund, voting as a separate class.

The foregoing votes would satisfy a separate requirement in the 1940 Act that any conversion of a Fund to an open-end investment company be approved by the stockholders. If approved in the foregoing manners, we anticipate conversion of a Fund to an open-end investment company might not occur until 90 days after the stockholders meeting at which such conversion was approved and would also require at least 10 days prior notice to all stockholders. Following any such conversion, it is possible that certain of the Fund s investment policies and strategies would have to be modified to assure sufficient portfolio liquidity. In the event of conversion, the shares of common stock would cease to be listed on the NYSE. Stockholders of an open-end investment company may require the company to redeem their shares at any time, except in certain circumstances as authorized by or under the 1940 Act, at their net asset value, less such redemption charge, if any, as might be in effect at the time of redemption. An open-end investment company expects to pay all such redemption requests in cash, but reserves the right to pay redemption requests in a combination of cash and securities. If such partial payment in securities were made, investors may incur brokerage costs in converting such securities to cash. If a Fund were converted to an open-end investment company, it is likely that new shares would be sold at net asset value plus a sales load. The Boards believe, however, that the Funds closed-end structure is desirable in light of the Funds investment objectives and policies. Therefore, stockholders should assume that it is not likely that the Boards would vote to convert any of the Funds to an open-end fund.

VOTING RIGHTS

Voting rights are identical for the stockholders of each Fund. The stockholders of each Fund are entitled to one vote for each share held by them. The stockholders of each Fund do not have any preemptive or preferential right to purchase or subscribe to any shares of such Fund.

Each Fund s shares of common stock do not have cumulative voting rights, which means that the holders of more than 50% of a Fund s shares of common stock voting for the election of directors can elect all of the directors standing for election by such holders, and, in such event, the holders of the Fund s remaining shares of common stock will not be able to elect any directors.

APPRAISAL RIGHTS

Common stockholders of each Target Fund do not have appraisal rights.

FINANCIAL HIGHLIGHTS

BlackRock Floating Rate Income Strategies Fund II, Inc. (FRB)

The Financial Highlights table is intended to help you understand FRB s financial performance for the periods shown. Certain information reflects the financial results for a single Fund share. The total returns in the table represent the rate an investor would have earned or lost on an investment in FRB (assuming reinvestment of all dividends and/or distributions, if applicable). The information for the periods shown has been audited by Deloitte & Touche LLP, FRB s independent registered public accounting firm. Financial statements for the fiscal year ended February 29, 2012 and the Report of the Independent Registered Public Accounting Firm thereon appear in FRB s Annual Report for the fiscal year ended February 29, 2012, which is available upon request.

BlackRock Floating Rate Income Strategies Fund II, Inc. (FRB)	Year Ended February 29, 2012[1]	Year Ended February 28, 2011	2010	2009	Year Ended February 29, 2008	Year Ended February 28, 2007	2006	For the Period July 30, 2004[2] to February 28, 2005
Per Share Operating Performance								
Net asset value, beginning of period	$ 14.07	$ 13.16	$ 8.92	$ 16.06	$ 19.28	$ 19.39	$ 19.74	$ 19.10
Net investment income[3]	0 .89	0.87	0.86	1.37	1.55	1.55	1.33	0.58
Net realized and unrealized gain (loss)	(0.48)	0.94	4.44	(6.98)	(3.27)	(0.12)	(0.31)	0.57
Net increase (decrease) from investment operations	$ 0 .41	$ 1.81	$ 5.30	$ (5.61)	$ (1.72)	$ 1.43	$ 1.02	$ 1.15
Dividends and distributions from:								
Net investment income	(0.88)	(0.83)	(0.98)	(1.53)	(1.50)	(1.54)	(1.27)	(0.47)
Tax return of capital		(0.07)	(0.08)				(0.10)	(0.01)
Total dividends and distributions	(0.88)	(0.90)	(1.06)	(1.53)	(1.50)	(1.54)	(1.37)	(0.48)
Capital charges with respect to issuance of shares								(0.03)
Net asset value, end of period	$ 13.60	$ 14.07	$ 13.16	$ 8.92	$ 16.06	$ 19.28	$ 19.39	$ 19.74
Market price, end of period	$ 13.21	$ 14.22	$ 15.01	$ 8.28	$ 14.75	$ 18.50	$ 17.76	$ 19.44
Total Investment Return[4]								
Based on net asset value	3.41%	14.20%	62.08%	(36.46)%	(8.98)%	8.31%	6.07%	5.97%[5]
Based on market price	(0.61)%	1.19%	99.15%	(35.78)%	(12.88)%	13.47%	(1.35)%	(0.34)%[5]
Ratios to Average Net Assets								

Total expenses	1.68%	1.56%	1.50%	2.48%	2.78%	2.87%	2.46%	1.48%[6]
Total expenses after fees waived and paid indirectly	1.68%	1.56%	1.50%	2.48%	2.78%	2.87%	2.46%	1.30%[6]
Total expenses after fees waived and paid indirectly and excluding interest expense	1.36%	1.30%	1.27%	1.38%	1.20%	1.22%	1.25%	0.92%[6]
Net investment income	6.61%	6.48%	7.40%	10.08%	8.39%	8.03%	6.88%	5.11%[6]
Supplemental Data								
Net assets, end of period (000)	$ 143,773	$ 148,552	$ 138,371	$ 93,656	$ 168,553	$ 202,364	$ 203,557	$ 207,255
Borrowings outstanding, end of period (000)	$ 41,000	$ 36,000	$ 24,000	$ 26,000	$ 50,000	$ 47,000	$ 61,400	$ 60,300
Average borrowings outstanding, during the period (000)	$ 48,292	$ 29,101	$ 22,225	$ 45,165	$ 55,269	$ 61,022	$ 63,725	$ 29,072
Portfolio turnover	57%	100%	92%	47%	65%	65%	72%	30%
Asset coverage, end of period per $1,000	$ 4,507	$ 5,126	$ 6,765	$ 4,602	$ 4,371	$ 5,306	$ 4,315	$ 4,437

1 Consolidated Financial Highlights.
2 Commencement of operations.
3 Based on average shares outstanding.
4 Total investment returns based on market value, which can be significantly greater or lesser than the net asset value, may result in substantially different returns. Where applicable, total investment returns exclude the effects of any sales charges and include the reinvestment of dividends and distributions.
5 Aggregate total investment return.
6 Annualized.

BlackRock Diversified Income Strategies Fund, Inc. (DVF)

The Financial Highlights table is intended to help you understand DVF s financial performance for the periods shown. Certain information reflects the financial results for a single Fund share. The total returns in the table represent the rate an investor would have earned or lost on an investment in DVF (assuming reinvestment of all dividends and/or distributions, if applicable). The information for the six months ended February 29, 2012 is unaudited. The information for the remaining periods shown has been audited by Deloitte & Touche LLP, DVF s independent registered public accounting firm. Financial statements for the fiscal year ended August 31, 2011 and the Report of the Independent Registered Public Accounting Firm thereon appear in DVF s Annual Report for the fiscal year ended August 31, 2011, which is available upon request.

BlackRock Diversified Income Strategies Fund, Inc. (DVF)	Six Months Ended February 29, 2012 (Unaudited)[1]	Year Ended August 31, 2011	2010	2009	2008	2007	2006	For the Period January 31, 2005[2] to August 31, 2005
Per Share Operating Performance								
Net asset value, beginning of period	$ 10.19	$ 10.47	$ 8.74	$ 13.94	$ 17.50	$ 18.70	$ 18.38	$ 19.10
Net investment income[3]	0.33	0.75	0.80	1.06	1.61	1.83	1.77	0.84
Net realized and unrealized gain (loss)	0.51	(0.28)	1.78	(4.88)	(3.41)	(1.23)	0.25	(0.77)
Net increase (decrease) from investment operations	0.84	0.47	2.58	(3.82)	(1.80)	0.60	2.02	0.07
Dividends and distributions from:								
Net investment income	(0.35)	(0.69)	(0.80)	(1.14)	(1.72)	(1.80)	(1.70)	(0.75)
Tax return of capital		(0.06)	(0.05)	(0.24)	(0.04)			
Total dividends and distributions	(0.35)	(0.75)	(0.85)	(1.38)	(1.76)	(1.80)	(1.70)	(0.75)
Capital charges with respect to issuance of shares							(0.00)[4]	(0.04)
Net asset value, end of period	$ 10.68	$ 10.19	$ 10.47	$ 8.74	$ 13.94	$ 17.50	$ 18.70	$ 18.38
Market price, end of period	$ 10.12	$ 9.84	$ 10.45	$ 8.80	$ 12.77	$ 17.16	$ 18.85	$ 17.53
Total Investment Return[5]								
Based on net asset value	8.73%[6]	4.30%	30.27%	(23.82)%	(10.17)%	3.00%	11.99%	0.42%[6]
Based on market price	6.70%[6]	0.91%	29.13%	(16.27)%	(16.08)%	0.19%	18.36%	(8.53)%[6]
Ratios to Average Net Assets								
Total expenses	1.66%[7]	1.74%	1.53%	2.47%	2.77%	3.66%	3.17%	2.48%[7]

Total expenses after fees waived and paid indirectly	1.66%[7]	1.74%	1.53%	2.47%	2.77%	3.66%	3.17%	2.20%[7]
Total expenses after fees waived and paid indirectly and excluding interest expense	1.35%[7]	1.39%	1.26%	1.57%	1.23%	1.30%	1.29%	1.00%[7]
Net investment income	6.43%[7]	6.99%	7.86%	13.63%	10.40%	9.63%	9.57%	7.88%[7]
Supplemental Data								
Net assets, end of period (000)	$ 132,400	$ 126,307	$ 129,385	$ 107,556	$ 169,707	$ 212,792	$ 224,156	$ 219,748
Borrowings outstanding, end of period (000)	$ 40,000	$ 47,000	$ 29,000	$ 18,000	$ 65,500	$ 72,000	$ 88,800	$ 101,400
Average borrowings outstanding, during the period (000)	$ 41,599	$ 43,553	$ 25,074	$ 28,247	$ 64,335	$ 95,465	$ 86,132	$ 75,543
Portfolio turnover	21%	93%	105%	45%	41%	72%	64%	17%
Asset coverage, end of period per $1,000	$ 4,310	$ 3,687	$ 5,462	$ 6,975	$ 3,591	$ 3,955	$ 3,524	$ 3,167

1 Consolidated Financial Highlights.
2 Commencement of operations.
3 Based on average shares outstanding.
4 Amount is less than $(0.01) per share.
5 Total investment returns based on market value, which can be significantly greater or lesser than the net asset value, may result in substantially different returns. Where applicable, total investment returns exclude the effects of any sales charges and include the reinvestment of dividends and distributions.
6 Aggregate total investment return.
7 Annualized.

BlackRock Floating Rate Income Strategies Fund, Inc. (FRA)

The Financial Highlights table is intended to help you understand FRA s financial performance for the periods shown. Certain information reflects the financial results for a single Fund share. The total returns in the table represent the rate an investor would have earned or lost on an investment in FRA (assuming reinvestment of all dividends and/or distributions, if applicable). The information for the six months ended February 29, 2012 is unaudited. The information for the remaining periods shown has been audited by Deloitte & Touche LLP, FRA s independent registered public accounting firm. Financial statements for the fiscal year ended August 31, 2011 and the Report of the Independent Registered Public Accounting Firm thereon appear in FRA s Annual Report for the fiscal year ended August 31, 2011, which is available upon request.

BlackRock Floating Rate Income Strategies Fund, Inc. (FRA)	Six Months Ended February 29, 2012 (Unaudited)[1]	Year Ended August 31,							For the Period October 31, 2003[2] to August 31, 2004
		2011	2010	2009	2008	2007	2006	2005	
Per Share Operating Performance									
Net asset value, beginning of period	$ 14.04	$ 14.36	$ 12.93	$ 16.12	$ 18.25	$ 19.32	$ 19.35	$ 19.16	$ 19.10
Net investment income[3]	0.48	0.96	0.91	1.14	1.45	1.54	1.40	1.23	0.66
Net realized and unrealized gain (loss)	0.70	(0.36)	1.48	(3.04)	(2.03)	(1.07)	(0.06)	0.08	0.02
Net increase (decrease) from investment operations	1.18	0.60	2.39	(1.90)	(0.58)	0.47	1.34	1.31	0.68
Dividends and distributions from:									
Net investment income	(0.46)	(0.86)	(0.94)	(1.29)	(1.55)	(1.54)	(1.37)	(1.11)	(0.60)
Tax return of capital		(0.06)	(0.02)					(0.01)	
Total dividends and distributions	(0.46)	(0.92)	(0.96)	(1.29)	(1.55)	(1.54)	(1.37)	(1.12)	(0.60)
Capital charges with respect to issuance of shares									(0.02)
Net asset value, end of period	$ 14.76	$ 14.04	$ 14.36	$ 12.93	$ 16.12	$ 18.25	$ 19.32	$ 19.35	$ 19.16
Market price, end of period	$ 14.52	$ 13.33	$ 14.61	$ 12.26	$ 14.49	$ 16.70	$ 17.49	$ 17.85	$ 19.44
Total Investment Return[4]									
Based on net asset value	8.76%[5]	4.04%	18.91%	(8.88)%	(2.56)%	2.74%	7.92%	7.27%	3.50%[5]
Based on market price	12.69%[5]	(2.91)%	27.59%	(3.88)%	(4.28)%	3.85%	5.91%	(2.47)%	0.29%[5]
Ratios to Average Net Assets									
Total expenses	1.60%[6]	1.60%	1.45%	1.96%	2.61%	3.33%	2.54%	2.18%	1.08%[6]
Total expenses after fees waived and paid indirectly	1.60%[6]	1.60%	1.45%	1.96%	2.60%	3.33%	2.54%	2.18%	0.87%[6]
Total expenses after fees waived and paid indirectly and excluding interest expense	1.30%[6]	1.30%	1.22%	1.31%	1.18%	1.20%	1.14%	1.22%	0.71%[6]

Net investment income	6.68%[6]	6.44%	6.43%	10.18%	8.49%	7.88%	7.30%	6.34%	3.80%[6]
Supplemental Data									
Net assets, end of period (000)	$ 272,652	$ 259,205	$ 264,379	$ 237,160	$ 295,005	$ 334,065	$ 353,713	$ 354,114	$ 350,254
Borrowings outstanding, end of period (000)	$ 78,000	$ 93,000	$ 53,000	$ 38,000	$ 101,500	$ 107,000	$ 135,200	$ 123,600	$ 123,225
Average borrowings outstanding, during the period (000)	$ 83,484	$ 79,195	$ 48,258	$ 50,591	$ 102,272	$ 133,763	$ 101,916	$ 117,702	$ 38,654
Portfolio turnover	21%	91%	96%	58%	49%	69%	57%	48%	43%
Asset coverage, end of period per $1,000	$ 4,496	$ 3,787	$ 5,988	$ 7,241	$ 3,906	$ 4,122	$ 3,616	$ 3,865	$ 3,842

1 Consolidated Financial Highlights.
2 Commencement of operations.
3 Based on average shares outstanding.
4 Total investment returns based on market value, which can be significantly greater or lesser than the net asset value, may result in substantially different returns. Where applicable, total investment returns exclude the effects of any sales charges and include the reinvestment of dividends and distributions.
5 Aggregate total investment return.
6 Annualized.

INFORMATION ABOUT THE REORGANIZATIONS

General

Under the Reorganization Agreements (a form of which is attached as Appendix A to the Statement of Additional Information), each Target Fund will merge with and into the Merger Subsidiary. Target Fund shares of common stock will be exchanged for Acquiring Fund Shares pursuant to each Reorganization. The Acquiring Fund Shares issued to the Target Funds common stockholders will have an aggregate net asset value equal to the aggregate net asset value (not the market value) of the Target Funds shares of common stock, less the direct costs of the Reorganizations (though cash may be paid in lieu of any fractional shares of common stock). In connection with the Reorganizations, the Acquiring Fund will issue to the Target Funds common stockholders book entry interests for the Acquiring Fund Shares registered in the name of such stockholder. As soon as practicable after the Closing Date for the Reorganizations, the Target Funds will deregister as investment companies under the 1940 Act and the Merger Subsidiary will dissolve under Maryland law and be liquidated into the Acquiring Fund.

Acquiring Fund Shares will be distributed pro rata to the holders of record of the Target Funds shares of common stock, as applicable. Such distribution of Acquiring Fund Shares to the Target Funds stockholders will be accomplished by opening new accounts on the books of Acquiring Fund in the names of the stockholders of the Target Funds and transferring to those stockholder accounts Acquiring Fund Shares. Each newly-opened account on the books of the Acquiring Fund for the former stockholders of the Target Funds will represent the respective pro rata number of Acquiring Fund Shares (rounded down, in the case of fractional shares of common stock held other than in a Plan account, to the next largest number of whole shares of common stock) due such stockholder. No fractional Acquiring Fund Shares will be issued (except for shares of common stock held in a Plan account). In the event there are fractional shares of common stock in an account other than a Plan account, the Acquiring Fund s transfer agent will aggregate all such fractional Acquiring Fund Shares and sell the resulting whole shares of common stock on the NYSE, for the account of all holders of such fractional interests, and each such holder will be entitled to the pro rata share of the proceeds from such sale upon surrender of Target Fund common share certificates. See Terms of the Reorganization Agreement Surrender and Exchange of Share Certificates below for a description of the procedures to be followed by the Target Funds stockholders to obtain their Acquiring Fund Shares (and cash in lieu of fractional shares of common stock, if any).

As a result of the Reorganizations, each stockholder of a Target Fund will own Acquiring Fund Shares that (except for cash payments received in lieu of fractional shares of common stock) will have an aggregate net asset value immediately after the Closing Date equal to the aggregate net asset value (not the market value) of that stockholder s Target Fund shares of common stock immediately prior to the Closing Date. Since the Acquiring Fund Shares will be issued at net asset value in exchange for the shares of common stock of each Target Fund having a value equal to the aggregate net asset value of those Acquiring Fund Shares, the net asset value per share of Acquiring Fund Shares should remain virtually unchanged by the Reorganizations except for its share of the costs of the Reorganizations. Thus, the Reorganizations will result in no dilution of the net asset value of the Acquiring Fund Shares, other than to reflect the costs of the Reorganization. However, as a result of the Reorganizations, a stockholder of any of the Funds will hold a reduced percentage of ownership in the Combined Fund than he or she did in any of the Target Funds. No sales charge or fee of any kind will be charged to stockholders of the Target Funds in connection with their receipt of Acquiring Fund Shares in the Reorganizations.

TERMS OF THE REORGANIZATION AGREEMENT

The following is a summary of the significant terms of the Reorganization Agreement. This summary is qualified in its entirety by reference to the Form of Reorganization Agreement attached as Appendix A to the Statement of Additional Information.

Valuation of Assets and Liabilities

The respective assets of each of the Funds will be valued on the business day prior to the Closing Date (the Valuation Time). The valuation procedures are the same for each Fund: The net asset value per common share of each Fund will be determined after the close of business on the NYSE (generally, 4:00 p.m., Eastern Time) at the Valuation Time. For the purpose of determining the net asset value of a common share of each Fund, the value of the securities held by the issuing Fund plus any cash or other assets (including interest accrued but not yet received) minus all liabilities (including accrued expenses) of the issuing Fund is divided by the total number of shares of common stock of the issuing Fund outstanding at such time. Daily expenses, including the fees payable to the Investment Adviser, will accrue at the Valuation Time.

Amendments and Conditions

The Reorganization Agreements may be amended at any time prior to the Closing Date with respect to any of the terms therein upon mutual agreement. The obligations of each Fund pursuant to the Reorganization Agreements are subject to various conditions, including a registration statement on Form N-14 being declared effective by the SEC, approval of the Reorganization Agreements by the stockholders of the Target Funds, approval of the issuance of additional Acquiring Fund Shares by the stockholders of the Acquiring Fund, receipt of an opinion of counsel as to tax matters, receipt of an opinion of counsel as to corporate and securities matters and the continuing accuracy of various representations and warranties of the Funds being confirmed by the respective parties.

Postponement; Termination

Under the Reorganization Agreements, the Board of any Fund or the Merger Subsidiary may cause a Reorganization to be postponed or abandoned under certain circumstances should such Board determine that it is in the best interests of the stockholders of its respective Fund or the Merger Subsidiary to do so. The Reorganization Agreements may be terminated, and the Reorganizations abandoned at any time (whether before or after adoption thereof by the stockholders of either of the Funds) prior to the Closing Date, or the Closing Date may be postponed: (i) by mutual consent of the Boards of the Funds and (ii) by the Board of either Fund or the Board of the Merger Subsidiary if any condition to that Fund s or the Merger Subsidiary s obligations set forth in the pertinent Reorganization Agreement has not been fulfilled or waived by such Board.

Surrender and Exchange of Share Certificates

The Acquiring Fund will issue to Target Fund stockholders book entry interests for the Acquiring Fund Shares registered in the name of on the basis of each holder s proportionate interest in the aggregate net asset value (not the market value) of Target Fund shares of common stock. With respect to any Target Fund stockholder holding certificates evidencing ownership of Target Fund shares as of the Closing Date, and subject to the Acquiring Fund being informed thereof in writing by the Target Fund, the Acquiring Fund will not permit such stockholder to receive new certificates evidencing ownership of the Acquiring Fund Shares, until notified by the Target Fund or its agent that such stockholder has surrendered his or her outstanding certificates evidencing ownership of Target Fund shares or, in the event of lost certificates, posted adequate bond. The Target Fund, at its own expense, will request its stockholders to surrender their outstanding certificates evidencing ownership of Target Fund shares or post adequate bond.

Please do not send in any share certificates at this time. Upon consummation of the Reorganizations, stockholders of the Target Funds will be furnished with instructions for exchanging their share certificates for Acquiring Fund share certificates and, if applicable, cash in lieu of fractional shares of common stock.

From and after the Closing Date, there will be no transfers on the stock transfer books of the Target Funds. If, after the Closing Date, certificates representing shares of common stock of the Target Funds are presented to the Acquiring Fund, they will be cancelled and exchanged for certificates representing Acquiring Fund Shares and cash in lieu of fractional shares of common stock, if applicable, distributable with respect to the Target Funds shares of common stock in the Reorganization.

Expenses of the Reorganization

The Funds will bear expenses incurred in connection with the Reorganization, including, but not limited to, costs related to the preparation and distribution of materials distributed to each Fund s Board, expenses incurred in connection with the preparation of the Reorganization Agreements and the registration statement on Form N-14, the printing and distribution of this Joint Proxy Statement/Prospectus and any other materials required to be distributed to stockholders, SEC and state securities commission filing fees and legal and audit fees in connection with the Reorganization, legal fees incurred preparing each Fund s Board materials, attending each Fund s Board meetings and preparing the minutes, auditing fees associated with each Fund s financial statements, stock exchange fees, transfer agency fees, rating agency fees, portfolio transfer taxes (if any) and any similar expenses incurred in connection with the Reorganization, which will be borne directly by the respective Fund incurring the expense or allocated among the Funds proportionately or on another reasonable basis, as appropriate. Because of the expected benefits outlined above for each Fund, and because, over time, the savings attributable to each Fund s participation in each Reorganization outweigh the costs associated with such Reorganization, the Investment Advisor recommended, and the Boards have approved, that DVF and FRB be responsible for their own Reorganization expenses and that FRA be responsible for its Reorganization expenses in excess of $100,000. See Reasons for the Reorganizations. Neither the Funds nor the Investment Advisor will pay any expenses of stockholders arising out of or in connection with the Reorganization. The expenses of the Reorganizations are estimated to be $930,000 in the aggregate, of which $300,000 is estimated to be attributable to FRB, $300,000 is estimated to be attributable to DVF and $330,000 is estimated to be attributable to FRA, of which the Investment Advisor has agreed to pay $100,000. The actual costs associated with the proposed Reorganizations may be more or less than the estimated costs discussed herein.

MATERIAL FEDERAL INCOME TAX CONSEQUENCES OF THE REORGANIZATIONS

The following is a summary of certain U.S. federal income tax consequences of the Reorganizations. The discussion is based upon the Code, Treasury regulations, court decisions, published positions of the Internal Revenue Service (IRS) and other applicable authorities, all as in effect on the date hereof and all of which are subject to change or differing interpretations (possibly with retroactive effect). The discussion is limited to U.S. persons who hold shares of common stock of a Target Fund as capital assets for U.S. federal income tax purposes (generally, assets held for investment). This summary does not address all of the U.S. federal income tax consequences that may be relevant to a particular stockholder or to stockholders who may be subject to special treatment under U.S. federal income tax laws. No ruling has been or will be obtained from the IRS regarding any matter relating to the Reorganizations. No assurance can be given that the IRS would not assert, or that a court would not sustain, a position contrary to any of the tax aspects described below. This summary of U.S. federal income tax consequences is for general information only. The Funds stockholders should consult their own tax advisers regarding the U.S. federal income tax consequences of the Reorganizations, as well as the effects of state, local and non-U.S. tax laws, including possible changes in tax law.

It is a condition to the closing of each Reorganization that the respective Target Fund and the Acquiring Fund each receive an opinion from Skadden Arps, dated as of the Closing Date, regarding the characterization of the Reorganization as a reorganization within the meaning of Section 368(a) of the Code. The opinion of Skadden Arps will be based on U.S. federal income tax law in effect on the Closing Date. In rendering its opinion, Skadden Arps will also rely upon certain representations of the management of the respective Target Fund and the Acquiring Fund and assume, among other things, that the Reorganization will be consummated in accordance with the applicable Reorganization Agreement and other operative documents and as described herein. An opinion of counsel is not binding on the IRS or any court.

As a reorganization, the U.S. federal income tax consequences of each Reorganization can be summarized as follows:

No gain or loss will be recognized by a Target Fund or the Acquiring Fund by reason of the Reorganization.

No gain or loss will be recognized by a stockholder of a Target Fund who exchanges all of its Target Fund Stock solely for Acquiring Fund Shares pursuant to the Reorganization (except with respect to cash received in lieu of a fractional Acquiring Fund Share, as discussed below).

The aggregate tax basis of Acquiring Fund Shares received by a stockholder of a Target Fund pursuant to the Reorganization will be the same as the aggregate tax basis of the stockholder s Target Fund shares of common stock surrendered in exchange therefor (reduced by any amount of tax basis allocable to a fractional Acquiring Fund common share for which cash is received).

The holding period of Acquiring Fund Shares received by a stockholder of a Target Fund pursuant to the Reorganization will include the holding period of the stockholder s Target Fund shares of common stock surrendered in exchange therefor.

A stockholder of a Target Fund that receives cash in lieu of a fractional Acquiring Fund common share in connection with the Reorganization will be treated as having received cash in redemption of such fractional Acquiring Fund common share. A Target Fund stockholder that receives cash in lieu of a fractional Acquiring Fund common share will recognize capital gain or loss equal to the difference between the amount of cash deemed received for the fractional Acquiring Fund common share and the Target Fund stockholder s tax basis in Target Fund shares of common stock allocable to the fractional Acquiring Fund common share. The capital gain or loss will be a long-term capital gain or loss if the Target Fund stockholder s holding period for Target Fund shares of common stock is more than one year as of the date the Reorganization is consummated.

The Acquiring Fund s tax basis in a Target Fund s assets received by the Acquiring Fund pursuant to the Reorganization will, in each instance, equal the tax basis of such assets in the hands of such Target Fund immediately prior to the Reorganization, and the Acquiring Fund s holding period for such assets will, in each instance, include the period during which the assets were held by a Target Fund.

The Acquiring Fund intends to continue to be taxed under the rules applicable to regulated investment companies as defined in Section 851 of the Code, which are the same rules currently applicable to each Fund and its stockholders.

None of the Funds intend to sell any assets in connection with the Reorganizations other than in the ordinary course of business. If, however, assets of the Target Funds were to be sold in connection with the Reorganization, or if such assets were required to be marked to market as a result of the termination of the Target Fund s taxable year or as a result of the transfer of certain assets in the Reorganization, the tax impact of any such sales (or deemed sales) would depend on the difference between the price at which such portfolio assets are sold and the Target Fund s basis in such assets. Any capital gains recognized in these sales (or deemed sales) on a net basis will be distributed to the Target Fund stockholders as capital gain dividends (to the extent of net realized long-term capital gains) and/or ordinary dividends (to the extent of net realized short-term capital gains) during or with respect to the year of sale (or deemed sale) and prior to or on the date of the Reorganization, and such distributions will be taxable to stockholders of the Target Fund.

Prior to the Closing Date, each Target Fund will declare and pay a distribution to its stockholders, which together with all previous distributions, will have the effect of distributing to the stockholders of such Target Fund all of such Target Fund s investment company taxable income (computed without regard to the deduction for dividends paid), if any, through the Closing Date, net capital gains, if any, through the Closing Date, and all of its net tax-exempt interest income, if any, through Closing Date. Such distribution will be taxable to stockholders for U.S. federal income tax purposes.

The Acquiring Fund will succeed to capital loss carryforwards (and certain unrealized built-in losses, if any) of each of the acquired Target Funds, which will be subject to the tax loss limitation rules described below because each acquired Target Fund will undergo an ownership change for U.S. federal income tax purposes, and such limitations might be significant. If both Reorganizations are consummated, the Acquiring Fund s own capital loss carryforwards (and certain unrealized built-in losses, if any) may also be subject to the tax loss limitation rules described below because the Acquiring Fund may also undergo an ownership change for U.S. federal income tax purposes, and such limitation might be significant. For each Fund that undergoes an ownership change, the Code generally limits the amount of pre-ownership change losses that may be used to offset post-ownership change gains to a specific annual loss limitation amount (generally the product of (i) the fair market value of the stock of such Fund, with certain adjustments, immediately prior to the Reorganization and (ii) a rate established by the IRS). Subject to certain limitations, any unused portion of these losses may be available in subsequent years, subject to the remaining portion of any applicable capital loss carryforward limit, as measured from the date of recognition.

Although the capital loss carryforwards of the Combined Fund attributable to each Target Fund that participates in a Reorganization (and to the Acquiring Fund, if it undergoes an ownership change as a result of the Reorganizations) are subject to tax loss limitation rules (as outlined above), it is currently expected that such tax loss limitation rules should not have a material adverse effect on the Combined Fund s utilization of each such Fund s capital loss carryforward as compared with what each such Fund s utilization of its own capital loss carryforward would be without the Reorganization. The ability of each Fund (and the Combined Fund) to utilize any capital loss carryforwards now or in the future depends on many variables and assumptions, including but not limited to, projected performance of a Fund, the unrealized gain/loss position of a Fund, the types of securities held by a Fund, the current and future market environment (including the level of interest rates), portfolio turnover and applicable law (including the requirement that capital loss carry forwards without expiration dates be utilized before capital loss carryforwards that have expiration dates), and is, therefore, highly uncertain. Current information with respect to the Funds capital loss carryforwards is set forth below:

-FRA-

Expiration	Capital Loss Amount*
8/31/2013	691,829
8/31/2016	475,453
8/31/2017	20,954,032
8/31/2018	43,990,722
8/31/2019	2,206,081
No Expiration	5,579,844
	73,897,961

-FRB-

Expiration	Capital Loss Amount*
2/28/2014	100,800
2/28/2015	1,315,945
2/28/2017	12,168,927
2/28/2018	38,830,450
2/28/2020	1,757,611
	54,173,733

-DVF-

Expiration	Capital Loss Amount*
8/31/2014	1,755,694
8/31/2015	2,237,399
8/31/2016	1,444,704
8/31/2017	20,249,830
8/31/2018	52,502,532
8/31/2019	7,153,981
No Expiration	3,789,054
	89,133,194

* The Target Funds anticipate that approximately $81.5 million of capital loss carryforwards will be lost/forfeited as a result of the tax loss limitation rules described above. No assurances can be given, however, that this estimate will be correct and the actual amount of forfeited capital loss carryforwards could be higher or lower than such estimate, depending on the circumstances. The Funds believe that the potential loss of capital loss carryforwards as a result of the Reorganizations is not a material factor in evaluating the Reorganizations in light of several factors including, (1) the difficulty of projecting the likelihood of utilization of some or all of the capital loss carryforwards prior to their expiration and (2) the potentially limited opportunity for capital gains in light of the Funds investment policy of investing primarily in floating rate debt securities and instruments.

Due to the operation of these tax loss limitation rules, it is possible that stockholders of the Target Funds and stockholders of the Acquiring Fund (if the Acquiring Fund undergoes an ownership change as described in the preceding paragraph) would receive taxable distributions of short-term and long-term capital gains earlier than they would have in the absence of the Reorganizations. Such taxable distributions will be treated either as ordinary income (and not as favorably taxed qualified dividend income) if such capital gains are short term or as favorably taxed capital gain dividends if such capital gains are long term. The actual financial effect of the loss limitation rules on a stockholder of a Fund whose losses are subject to the loss limitation rules would depend on many variables, including such Fund s expected growth rate if the relevant Reorganization were not to occur (i.e., whether, in the absence of the Reorganization, the Fund would generate sufficient capital gains against which to utilize its capital loss carryforwards prior to their expiration (and certain realized built-in losses), in excess of what would have been the annual loss limitation amount had the relevant Reorganization occurred), the timing and amount of future capital gains recognized by the Combined Fund if the relevant Reorganization were to occur, and the timing of a historic Fund stockholder s disposition of its shares (the tax basis of which might, depending on the facts, reflect that stockholder s share of such Fund s capital losses). Stockholders of all of the Funds should consult their own tax advisors in this regard.

In addition, for five years beginning on the Closing Date of a Reorganization, the Combined Fund will not be allowed to offset certain pre-Reorganization built-in gains attributable to a Fund that is a gain corporation with capital loss carryforwards (and certain built-in losses) attributable to another Fund.

PROPOSAL 2: ISSUANCES OF ADDITIONAL SHARES OF ACQUIRING FUND COMMON STOCK

Pursuant to the Reorganization Agreements, which are described more fully under Proposal 1: Reorganizations of the Target Funds above, the Acquiring Fund will issue Acquiring Fund Shares and list them for trading on the NYSE. The Acquiring Fund will issue to the Target Funds common stockholders book entry interests for the Acquiring Fund Shares registered in the name of such stockholder. Each Target Fund will then terminate its registration under the 1940 Act. The Acquiring Fund Board, based upon its evaluation of all relevant information, anticipates that each Reorganization will benefit the holders of Acquiring Fund Shares.

The aggregate net asset value of Acquiring Fund Shares issued in each Reorganization will equal the aggregate net asset value (not the market value) of the Target Fund s shares of common stock held immediately prior to the Reorganization, less the costs of the Reorganization (although stockholders may receive cash for their fractional shares of common stock). The Reorganizations will result in no reduction of the net asset value of the Acquiring Fund Shares, other than to reflect the costs of each Reorganization, as applicable. No gain or loss for U.S. federal income tax purposes will be recognized by the Acquiring Fund or its stockholders in connection with either Reorganization. The Acquiring Fund will continue to operate as a registered, diversified, closed-end investment company with the investment objective and policies described in this Joint Proxy Statement/Prospectus.

In connection with the Reorganizations and as contemplated by the Reorganization Agreements, the Acquiring Fund will issue additional Acquiring Fund Shares and list such shares of common stock on the NYSE. While applicable state and federal law does not require the stockholders of the Acquiring Fund to approve the Reorganizations, the NYSE Listed Company Manual requires the common stockholders of the Acquiring Fund to approve the issuance of additional Acquiring Fund Shares to be issued in connection with the Reorganizations. All other things being equal, the Reorganizations will result in no reduction of the net asset value of the Acquiring Fund Shares, other than to reflect the costs of the Reorganizations.

No gain or loss for U.S. federal income tax purposes will be recognized by Acquiring Fund or its stockholders pursuant to the Reorganizations. The Acquiring Fund Board, based upon its evaluation of all relevant information, anticipates that the Reorganizations will benefit stockholders of the Acquiring Fund. In particular, the Acquiring Fund Board reviewed data presented by the Investment Advisor showing that the Acquiring Fund will experience a reduced Total Expense Ratio as a result of the proposed Reorganizations.

The Acquiring Fund Board requests that stockholders of the Acquiring Fund approve the Issuances at the Special Meeting to be held on Thursday, September 13, 2012 at 9:00 a.m. (Eastern time). The affirmative vote of stockholders representing at least a majority of votes cast on a proposal, provided that the total votes cast on the proposal represents over 50% of all securities entitled to vote on the proposal, is required to approve the Issuances of additional shares of common stock for the Reorganizations. Subject to the requisite approval of the stockholders of each Fund with regard to the Reorganization, it is expected that the Closing Date will be after the close of business on or about October 12, 2012, but it may be at a different time as described herein. For additional information regarding voting requirements, see Voting Information and Requirements.

Investing in the Combined Fund following the Reorganization involves risks. For additional information, see Risk Factors and Special Considerations.

The Acquiring Fund Board recommends that stockholders of you vote **FOR** the issuance of additional Acquiring Fund Shares in connection with each Reorganization.

VOTING INFORMATION AND REQUIREMENTS

General

A list of the Funds stockholders of record as of the Record Date will be available at the stockholder meeting.

Record Date

The Funds have fixed the close of business on July 16, 2012 as the record date (the Record Date) for the determination of stockholders entitled to notice of, and to vote at, the Special Meeting or any adjournment thereof. Stockholders on the Record Date will be entitled to one vote for each share held, with no shares having cumulative voting rights.

At the Record Date, the Funds had outstanding the following amount of shares of common stock:

Title of Class	FRB	DVF	FRA
Common Stock	10,577,054	12,401,086	18,472,917

Proxies

Stockholders may vote by appearing in person at the Special Meeting, by returning the enclosed proxy card or by casting their vote via telephone or the Internet using the instructions provided on the enclosed proxy card and more fully described below. Stockholders of each Fund have the opportunity to submit their voting instructions via the Internet by utilizing a program provided by Georgeson Inc., or by touch-tone telephone voting. The giving of such a proxy will not affect your right to vote in person should you decide to attend the Special Meeting. To use the Internet, please access the Internet address found on your proxy card. To record your voting instructions by automated telephone, please call the toll-free number listed on your proxy card. The Internet and automated telephone voting instructions are designed to authenticate stockholder identities, to allow stockholders to give their voting instructions, and to confirm that stockholders instructions have been recorded properly. Stockholders submitting their voting instructions via the Internet should understand that there may be costs associated with Internet access, such as usage charges from Internet access providers and telephone companies that must be borne by the stockholders. Any person giving a proxy may revoke it at any time prior to its exercise by giving written notice of the revocation to the Secretary of the Fund at the address indicated above, by delivering a duly executed proxy bearing a later date, by recording later-dated voting instructions via the Internet or automated telephone or by attending the Special Meeting and voting in person. The giving of a proxy will not affect your right to vote in person if you attend the Special Meeting and wish to do so.

Votes cast by proxy or in person at the Special Meeting will be tabulated by the inspectors of election appointed for the Special Meeting. With respect to each proposal, one-third of the outstanding shares entitled to vote on the proposal must be present in person or by proxy to have a quorum to conduct business at the Special Meeting. The inspectors of election, who may be employees of BlackRock, will determine whether or not a quorum is present at the Special Meeting. The inspectors of election will generally treat abstentions and broker non-votes (i.e., shares held by brokers or nominees, typically in street name, as to which proxies have been returned but (a) instructions have not been received from the beneficial owners or persons entitled to vote and (b) the broker or nominee does not have discretionary voting power or elects not to exercise discretion on a particular matter) as present for purposes of determining a quorum, subject to any applicable rules of the stock exchange on which a Fund s shares are listed.

If you hold your shares directly (not through a broker-dealer, bank or other financial institution) and if you return a properly executed proxy card that does not specify how you wish to vote on a proposal, your shares will be voted FOR each Proposal on which you are entitled to vote.

Broker-dealer firms holding shares of a Fund in street name for the benefit of their customers and clients will request the instructions of such customers and clients on how to vote their shares on Proposals 1 and Proposal 2 before the Special Meeting. Proposals 1 and 2 are not routine matters and stockholder instructions are required for broker-dealers to vote a beneficial owner s shares.

If you hold shares of a Fund through a bank or other financial institution or intermediary (called a service agent) that has entered into a service agreement with the Fund or a distributor of the Fund, the service agent may be the record holder of your shares. At the Special Meeting, a service agent will vote shares for which it receives instructions from its customers in accordance with those instructions. A properly executed proxy card or other authorization by a stockholder that does not specify how the stockholder s shares should be voted on a proposal may be deemed to authorize a service provider to vote such shares in favor of the proposal. Depending on its policies, applicable law or contractual or other restrictions, a service agent may be permitted to vote shares with respect to which it has not received specific voting instructions from its customers. In those cases, the service agent may, but may not be required to, vote such shares in the same proportion as those shares for which the service agent has received voting instructions. This practice is commonly referred to as echo voting.

All properly executed proxies received prior to the Special Meeting will be voted in accordance with the instructions marked thereon or otherwise as provided therein. Unless instructions to the contrary are marked, proxies will be voted FOR the approval of each proposal. Abstentions and broker non-votes are not treated as votes FOR a proposal.

With respect to Proposal 1, abstentions and broker non-votes will have the same effect as votes AGAINST the proposal.

With respect to Proposal 2, abstentions will be counted as votes cast and will therefore have the same effect as votes AGAINST the proposal and broker non-votes will have the same effect as votes AGAINST the proposal; provided, that, if more than 50% of all securities entitled to vote on the proposal cast votes, than broker non-votes will not have any effect on the result of the vote.

Voting Requirement for Proposal 1: The Reorganizations of the Target Funds

Target Fund	Proposals	Required Approval
FRB	Proposal 1(A): The stockholders of FRB are being asked to approve an Agreement and Plan of Reorganization among FRB, FRA and FRA Merger Subsidiary and the termination of FRB s registration under the 1940 Act.	An affirmative vote by stockholders of each Target Fund representing a majority of the outstanding shares of common stock entitled to vote on the Reorganization.
DVF	Proposal 1(B): The stockholders of DVF are being asked to approve an Agreement and Plan of Reorganization among DVF, FRA and FRA Merger Subsidiary and the termination of DVF s registration under the 1940 Act.	

Voting Requirement for Proposal 2: Issuances of Additional Shares of Acquiring Fund Common Stock

Acquiring Fund	Proposals	Required Approval
FRA	Proposal 2(A): The stockholders of FRA are being asked to approve the issuance of additional shares of common stock of FRA in connection with an Agreement and Plan of Reorganization among FRB, FRA and FRA Merger Subsidiary.	A majority of votes cast, provided that the total votes cast on each proposal represents over 50% in interest of all shares entitled to vote on the proposal.
FRA	Proposal 2(B): The stockholders of FRA are being asked to approve the issuance of additional shares of common stock of FRA in connection with an Agreement and Plan of Reorganization among DVF, FRA and FRA Merger Subsidiary.	

74

As of June 30, 2012, the officers and directors of each Fund, as a group, beneficially owned less than 1% of the outstanding shares of common stock of each such Fund, and no person owned of record or, to the knowledge of each such Fund, beneficially 5% or more of the outstanding shares of common stock of each such Fund.

STOCKHOLDER PROPOSALS

To be considered for presentation at a stockholder s meeting, rules promulgated by the SEC generally require that, among other things, a stockholder s proposal must be received at the offices of the relevant Fund a reasonable time before solicitation is made. In addition, each Fund s bylaws provide for advance notice provisions, which require stockholders to give timely notice in proper written form to the Secretary of the Fund. Stockholders should review each Fund s bylaws for additional information regarding the Funds advance notice provisions. Each Fund s bylaws were filed with the SEC on September 21, 2010 as part of the Funds 8-Ks, and stockholders may obtain copies of such documents as described on page ii of this Joint Proxy Statement/Prospectus.

Timely submission of a proposal does not necessarily mean that such proposal will be included. Any stockholder who wishes to submit a proposal for consideration at a meeting of such stockholder s Fund should send such proposal to the relevant Fund at Park Avenue Plaza, 55 East 52nd Street, New York, New York 10055, Attention: Janey Ahn.

SOLICITATION OF PROXIES

Solicitation of proxies is being made primarily by the mailing of this Notice and Joint Proxy Statement/Prospectus with its enclosures on or about July 30, 2012. Stockholders of the Funds whose shares are held by nominees such as brokers can vote their proxies by contacting their respective nominee. In addition to the solicitation of proxies by mail, employees of the Advisors and their affiliates as well as dealers or their representatives may solicit proxies by mail, telephone, e-mail, fax or the Internet. The Funds and the Advisors have retained Georgeson Inc., a proxy solicitation firm, to assist in the distribution of proxy materials and the solicitation and tabulation of proxies. The anticipated cost of Georgeson s services in connection with the proxy is approximately $19,200, $20,000 and $33,500 for FRB, DVF and FRA, respectively. In addition, Broadridge Financial Solutions, Inc. (Broadridge), will assist the Funds in the printing and distribution of proxy materials. The cost of services in connection with the proxy is approximately $35,000, $37,000 and $70,300 for FRB, DVF and FRA, respectively.

LEGAL MATTERS

Certain legal matters concerning the U.S. federal income tax consequences of the Reorganization will be passed upon by Skadden, Arps, Slate, Meagher & Flom LLP, which serves as special counsel to the Funds. Certain legal matters concerning the issuance of Acquiring Fund Common Shares will be passed upon by Miles & Stockbridge P.C., which serves as special Maryland counsel to the Funds.

OTHER MATTERS WITH RESPECT TO THE MEETING

A representative of the Independent Registered Public Accounting Firm may attend the Special Meeting and will have the opportunity to make a statement if he or she desires to do so and will be available to answer appropriate questions.

A list of stockholders entitled to be present and to vote at the meeting will be available at the offices of the Funds, 1 University Square Drive Princeton, NJ 08540-6455, for inspection by any stockholder during regular business hours beginning ten days prior to the date of the meeting.

Stockholders who want to communicate with the Board or any individual director should write the Fund to the attention of the Secretary, Park Avenue Plaza, 55 East 52nd Street, New York, New York 10055. Stockholders may communicate with the Board electronically by sending an email to closedendfundsbod@blackrock.com. The communication should indicate that you are a Fund stockholder. If the communication is intended for a specific director and so indicates, it will be sent only to that director. If a communication does not indicate a specific director, it will be sent to the Chair of the Governance and Nominating Committee and the outside counsel to the Independent Directors for further distribution as deemed appropriate by such persons.

Additionally, stockholders with complaints or concerns regarding accounting matters may address letters to the Fund s Chief Compliance Officer, Park Avenue Plaza, 55 East 52nd Street, New York, New York 10055. Stockholders who are uncomfortable submitting complaints to the Chief Compliance Officer may address letters directly to the Chair of the Audit Committee of the Board. Such letters may be submitted on an anonymous basis.

PRIVACY PRINCIPLES OF THE FUNDS

The Funds are committed to maintaining the privacy of its current and former stockholders and to safeguarding their non-public personal information. The following information is provided to help you understand what personal information the Funds collect, how the Funds protect that information and why, in certain cases, the Funds may share such information with select parties.

The Funds obtain or verify personal non-public information from and about you from different sources, including the following: (i) information the Funds receive from you or, if applicable, your financial intermediary, on applications, forms or other documents; (ii) information about your transactions with the Funds, their affiliates or others; (iii) information the Funds receive from a consumer reporting agency; and (iv) from visits to the Funds or their affiliates websites.

The Funds do not sell or disclose to non-affiliated third parties any non-public personal information about their respective current and former stockholders, except as permitted by law or as is necessary to respond to regulatory requests or to service stockholder accounts. These non-affiliated third parties are required to protect the confidentiality and security of this information and to use it only for its intended purpose.

The Funds may share information with their respective affiliates to service your account or to provide you with information about other BlackRock products or services that may be of interest to you. In addition, the Funds restrict access to non-public personal information about their respective current and former stockholders to those BlackRock employees with a legitimate business need for the information. The Funds maintain physical, electronic and procedural safeguards that are designed to protect the non-public personal information of their respective current and former stockholders, including procedures relating to the proper storage and disposal of such information.

If you are located in a jurisdiction where specific laws, rules or regulations require the Funds to provide you with additional or different privacy-related rights beyond what is set forth above, then the Funds will comply with those specific laws, rules or regulations.

OTHER INFORMATION

BlackRock is independent in ownership and governance, with no single majority stockholder and a majority of independent directors. As of May 29, 2012, the PNC Financial Services Group, Inc. (PNC) owned 21.7% of BlackRock and institutional investors, employees and the public held economic interest of 78.3%. With regard to voting stock, PNC owned 21% and institutional investors, employees and the public owned 79% of voting shares.

Prior to the May 29, 2012 closing of the secondary stock offering and repurchase of Barclays plc s (Barclays) ownership interest in BlackRock, PNC owned 20.9% of BlackRock, Barclays owned 19.6% and institutional investors, employees and the public held economic interest of 59.5%. With regard to voting stock, PNC owned 23.8%, Barclays owned 2.2%, and institutional investors, employees and the public owned 74.0% of voting shares.

If you cannot be present in person at the Special Meeting, please fill in, sign and return the enclosed proxy card or please record your voting instructions by telephone or via the Internet promptly. No postage is necessary if the enclosed proxy card is mailed in the United States.

John M. Perlowski

President and Chief Executive Officer

BlackRock Floating Rate Income Strategies Fund II, Inc.

BlackRock Diversified Income Strategies Fund, Inc.

BlackRock Floating Rate Income Strategies Fund, Inc.

July 25, 2012

THE INFORMATION IN THIS STATEMENT OF ADDITIONAL INFORMATION 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 STATEMENT OF ADDITIONAL INFORMATION IS NOT AN OFFER TO SELL THESE SECURITIES AND IS NOT SOLICITING AN OFFER TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED. THIS STATEMENT OF ADDITIONAL INFORMATION IS NOT A PROSPECTUS.

SUBJECT TO COMPLETION, DATED July 25, 2012

STATEMENT OF ADDITIONAL INFORMATION

RELATING TO THE REORGANIZATION OF

BLACKROCK FLOATING RATE INCOME STRATEGIES FUND II, INC.

BLACKROCK DIVERSIFIED INCOME STRATEGIES FUND, INC.

AND

BLACKROCK FLOATING RATE INCOME STRATEGIES FUND, INC.

Dated July 25, 2012

This Statement of Additional Information is available to the stockholders of BlackRock Floating Rate Income Strategies Fund II, Inc. (FRB) and BlackRock Diversified Income Strategies Fund, Inc. (DVF) (each, a Target Fund and, collectively, the Target Funds) in connection with the proposed reorganizations (each, a Reorganization) whereby each Target Fund will merge with and into a new direct, wholly-owned subsidiary of BlackRock Floating Rate Income Strategies Fund, Inc. (FRA or the Acquiring Fund, and together with the Target Funds, the Funds) (the Merger Subsidiary). Following the Reorganizations, the Merger Subsidiary will dissolve under Maryland law and be liquidated into FRA. The Target Funds will then terminate their registrations under the Investment Company Act of 1940 (the 1940 Act). In each Reorganization, the outstanding shares of common stock of each Target Fund will be exchanged for newly-issued shares of common stock of the Acquiring Fund, par value $0.10 per share (Acquiring Fund Shares). The aggregate net asset value of Acquiring Fund Shares received by the stockholders of the Target Fund in each Reorganization will equal the aggregate net asset value (not the market value) of Target Fund shares of common stock held by such stockholders immediately prior to such Reorganization, less the direct costs of such Reorganization, as applicable (although stockholders may receive cash for their fractional shares of common stock). A copy of a form of the Agreement and Plan of Reorganization among each Target Fund, the Acquiring Fund and the Merger Subsidiary is attached hereto as Appendix A. Unless otherwise defined herein, capitalized terms have the meanings given to them in the Joint Proxy Statement/Prospectus.

This Statement of Additional Information is not a prospectus and should be read in conjunction with the Joint Proxy Statement/Prospectus dated July 25, 2012 relating to the proposed Reorganizations. A copy of the Joint Proxy Statement/Prospectus may be obtained, without charge, by writing to the Fund at 1 University Square Drive Princeton, NJ 08540-6455, or by calling (800) 882-0052.

The Acquiring Fund will provide, without charge, upon the written or oral request of any person to whom this Statement of Additional Information is delivered, a copy of any and all documents that have been incorporated by reference in the registration statement of which this Statement of Additional Information is a part.

TABLE OF CONTENTS

INVESTMENT OBJECTIVES AND POLICIES OF THE FUNDS	S-3
RISK FACTORS AND SPECIAL CONSIDERATIONS	S-16
DIRECTORS AND OFFICERS	S-20
INVESTMENT MANAGEMENT AGREEMENTS	S-40
FUND MANAGEMENT	S-42
CONFLICTS OF INTEREST	S-46
OTHER INFORMATION	S-52
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM	S-53
FINANCIAL STATEMENTS	S-53
PRO FORMA FINANCIAL STATEMENTS	S-54
APPENDIX A FORM OF AGREEMENT AND PLAN OF REORGANIZATION	A-1
APPENDIX B *PRO FORMA* CONDENSED COMBINED FINANCIAL STATEMENTS	B-1
APPENDIX C PROXY VOTING POLICIES FOR THE BLACKROCK U.S. REGISTERED FUNDS	C-1
APPENDIX D GENERAL CHARACTERISTICS AND RISKS OF STRATEGIC TRANSACTIONS	D-1

INVESTMENT OBJECTIVES AND POLICIES OF THE FUNDS

The following information supplements the discussion of the Funds investment objectives, policies and techniques that are described in the Joint Proxy Statement/Prospectus.

Leverage

At times, each Fund expects to utilize leverage through borrowings, the issuance of short term debt securities, the issuance of shares of preferred stock or a combination thereof. Each Fund has the ability to utilize leverage through borrowings or the issuance of short term debt securities in an amount up to $33^{1/3}$% of the value of its total assets (including the amount obtained from such borrowings or debt issuance). Each Fund also has the ability to utilize leverage through the issuance of shares of preferred stock in an amount up to 50% of the value of its total assets (including the amount obtained from such issuance). There can be no assurance, however, that each Fund will borrow in order to leverage its assets or if it does what percentage of such Fund s assets such borrowings will represent. Following the investment of the net proceeds of the offering, each Fund may, depending on market conditions and the relative costs and benefits associated with other types of leverage, choose to leverage through the issuance of preferred stock rather than through borrowings or each Fund may choose to leverage through a combination of both. Each Fund generally will not utilize leverage if it anticipates that each Fund s leveraged capital structure would result in a lower return to common stockholders than that obtainable if the common stock were unleveraged for any significant amount of time. Each Fund also may borrow money as a temporary measure for extraordinary or emergency purposes, including the payment of dividends and the settlement of securities transactions which otherwise might require untimely dispositions of Fund securities. Each Fund at times may borrow from affiliates of the Investment Adviser, provided that the terms of such borrowings are no less favorable than those available from comparable sources of funds in the marketplace for borrowings for leverage and the issuance of preferred stock. When each Fund is utilizing leverage, the fees paid to the Investment Adviser for investment advisory and management services will be higher than if each Fund did not utilize leverage because the fees paid will be calculated based on an aggregate of (i) the Fund s net assets (including the proceeds from the issuance of any preferred stock) and (ii) the proceeds of any outstanding borrowings used for leverage.

Each Fund s use of leverage is premised upon the expectation that the cost of the leverage used to purchase additional assets will be lower than the return such Fund achieves on its investments with the proceeds of the borrowings or the issuance of preferred stock. Such difference in return may result from the short term nature of each Fund s borrowing compared to the longer term nature of its investments. Because the total assets of each Fund (including the assets obtained from leverage) will generally be invested in the higher yielding portfolio investments, the holders of common stock will be the beneficiaries of the incremental return. Should the differential between the underlying assets and cost of leverage narrow, the incremental return pick up will be reduced.

Leverage creates certain risks for holders of common stock, including the likelihood of greater volatility of net asset value and market price of shares of common stock or fluctuations in dividends paid on common stock, the risk that fluctuations in interest rates on borrowings and short term debt or in the dividend rates on any preferred stock may affect the return to the holders of common stock and increased operating costs which may reduce each Fund s total return. To the extent the total return derived from securities purchased with funds received from leverage exceeds the cost of leverage, each Fund s return will be greater than if leverage had not been used. Conversely, if the total return from the securities purchased with such funds is not sufficient to cover the cost of leverage, the return of such Fund will be less than if leverage had not been used, and therefore the amount available for distribution to stockholders as dividends and other distributions will be reduced. In the latter case, the Investment Adviser in its best judgment nevertheless may determine to maintain such Fund s leveraged position if it expects that the benefits to such Fund s stockholders of maintaining the leveraged position will outweigh the current reduced return. Capital raised through leverage will be subject to interest costs or dividend payments that may or may not exceed the total return on the assets purchased. Each Fund also may be required to maintain minimum average balances in connection with borrowings or to pay a commitment or other fee to maintain a line of credit. Either of these requirements will increase the cost of borrowing over the stated interest rate. The issuance of classes of preferred stock involves offering expenses and other costs and may limit each Fund s freedom to pay dividends on shares of common stock or to engage in other activities. Borrowings and the issuance of a class of preferred stock create an opportunity for greater return per share of common stock, but at the same time such borrowing is a speculative technique in that it will increase each Fund s exposure to capital risk. Unless the total return on assets acquired with borrowed funds or preferred stock offering proceeds exceed the cost of borrowing or issuing classes of preferred securities, the use of leverage will diminish the investment performance of each Fund compared with what it would have been without leverage.

Certain types of borrowings may result in each Fund being subject to covenants in credit agreements, including those relating to asset coverage, borrowing base and portfolio composition requirements and additional covenants that may affect each Fund s ability to pay dividends and distributions on the common stock in certain instances. Each Fund also may be required to pledge its assets to the lenders in connection with certain types of borrowings. The Investment Adviser does not anticipate that these covenants or restrictions will adversely affect its ability to manage each Fund s portfolio in accordance with each Fund s investment objective and policies. However, due to these covenants or restrictions, each Fund may be forced to liquidate investments at times and at prices that are not favorable to each Fund, or such Fund may be forced to forgo investments that the Investment Adviser otherwise views as favorable. Each Fund may be subject to certain restrictions on investments imposed by guidelines of one or more nationally recognized rating organizations which may issue ratings for the short term debt securities or preferred stock issued by such Fund. These guidelines may impose asset coverage or portfolio composition requirements that are more stringent than those imposed by the 1940 Act. It is not anticipated that these covenants or guidelines will impede the Investment Adviser from managing each Fund s portfolio in accordance with such Fund s investment objective and policies.

Under the 1940 Act, the Funds are not permitted to incur indebtedness unless immediately after such incurrence each Fund has an asset coverage of at least 300% of the aggregate outstanding principal balance of indebtedness (i.e., such indebtedness may not exceed $33^{1/3}$% of the value of the Fund s total assets). Additionally, under the 1940 Act, each Fund may not declare any dividend or other distribution upon any class of its capital stock, or purchase any such capital stock, unless the aggregate indebtedness of each Fund has, at the time of the declaration of any such dividend or distribution or at the time of any such purchase, an asset coverage of at least 300% after deducting the amount of such dividend, distribution, or purchase price, as the case may be. Under the 1940 Act, each Fund is not permitted to issue shares of preferred stock unless immediately after such issuance the net asset value of such Fund s portfolio is at least 200% of the liquidation value of the outstanding preferred stock (i.e., such liquidation value may not exceed 50% of the value of the Fund s total assets). In addition, each Fund is not permitted to declare any cash dividend or other distribution on its common stock unless, at the time of such declaration, the net asset value of such Fund s portfolio (determined after deducting the amount of such dividend or distribution) is at least 200% of such liquidation value. In the event shares of preferred stock are issued, each Fund intends, to the extent possible, to purchase or redeem shares of preferred stock from time to time to maintain coverage of any preferred stock of at least 200%.

Each Fund s willingness to borrow money and issue debt securities or preferred stock for investment purposes, and the amount it will borrow or issue, will depend on many factors, the most important of which are investment outlook, market conditions and interest rates. Successful use of a leveraging strategy depends on the Investment Adviser s ability to predict correctly interest rates and market movements, and there is no assurance that a leveraging strategy will be successful during any period in which it is employed.

As discussed under Investment Advisory and Management Arrangements herein, during periods when each Fund has outstanding borrowings for leverage or preferred stock outstanding, the fees paid to the Investment

Adviser for investment advisory and management services will be higher than if each Fund did not borrow or issue preferred stock because the fees paid will be calculated on the basis of an aggregate of (i) each Fund s average daily net assets (including proceeds from the sale of preferred stock) and (ii) the proceeds of any outstanding borrowings used for leverage. Consequently, each Fund and the Investment Adviser may have differing interests in determining whether to leverage such Fund s assets. The Board of Directors will monitor this potential conflict.

Assuming the utilization of leverage by borrowings in the amount of approximately 30% of each Fund s total assets, and an annual interest rate of 1.049% payable on such leverage based on market rates as of the date of this prospectus, the annual return that each Fund s portfolio must experience (net of expenses) in order to cover such interest payments would be 0.315%.

The following table is designed to illustrate the effect on the return to a holder of common stock of the leverage obtained by borrowings in the amount of approximately 30% of each Fund s total assets, assuming hypothetical annual returns on each Fund s portfolio of minus 10% to plus 10%. As the table shows, leverage generally increases the return to stockholders when portfolio return is positive and greater than the cost of leverage and decreases the return when portfolio return is negative or less than the cost of leverage. The figures appearing in the table are hypothetical and actual returns may be greater or less than those appearing in the table.

Assumed Portfolio Return (net of expenses)	(10)%	(5)%	0%	5%	10%
Corresponding Common Stock Return	(15)%	(8)%	(1)%	6%	14%

Until each Fund borrows or issues shares of preferred stock, each Fund s common stock will not be leveraged, and the risks and special considerations related to leverage described in this prospectus will not apply. Such leveraging of the common stock cannot be fully achieved until the proceeds resulting from the use of leverage have been invested in accordance with each Fund s investment objective and policies.

Indexed and Inverse Floating Obligations

Each 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. Each Fund also may invest in securities whose return is inversely related to changes in an interest rate (inverse floaters). In general, inverse floaters change in value in a manner that is opposite to most bonds that is, interest rates on inverse floaters will decrease when short term rates increase and increase when short term rates decrease. Investments in indexed securities and inverse floaters may subject each Fund to the risk of reduced or eliminated interest payments. Investments in indexed securities also may subject each Fund to 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 each Fund s investment. Regardless of the effect, inverse floaters represent a leveraged investment. As a result, the market value of such securities will generally be more volatile than that of fixed rate securities. Both indexed securities and inverse floaters can be derivative securities and can be considered speculative.

Interest Rate Transactions

In order to seek to hedge the value of each Fund s portfolio against interest rate fluctuations or to seek to enhance each Fund s return, each Fund may enter into various interest rate transactions such as interest rate swaps and the purchase or sale of interest rate caps and floors. Each Fund may enter into these transactions to seek to preserve a return or spread on a particular investment or portion of its portfolio, to seek to protect against any increase in the price of securities each Fund anticipates purchasing at a later date or to seek to enhance its return. However, each Fund also may invest in interest rate swaps to seek to enhance income or to seek to increase the Fund s yield, for example, during periods of steep interest rate yield curves (i.e., wide differences between short term and long term interest rates). Each Fund is not required to pursue these portfolio strategies and may choose not to do so. Each Fund cannot guarantee that any strategies it uses will work.

In an interest rate swap, each Fund exchanges with another party their respective commitments to pay or receive interest (e.g., an exchange of fixed rate payments for floating rate payments). For example, if each Fund holds a debt instrument with an interest rate that is reset only once each year, it may swap the right to receive interest at this fixed rate for the right to receive interest at a rate that is reset every week. This would enable each Fund to offset a decline in the value of the debt instrument due to rising interest rates but would also limit its ability to benefit from falling interest rates. Conversely, if each Fund holds a debt instrument with an interest rate that is reset every week and it would like to lock in what it believes to be a high interest rate for one year, it may swap the right to receive interest at this variable weekly rate for the right to receive interest at a rate that is fixed for one year. Such a swap would protect each Fund from a reduction in yield due to falling interest rates and may permit each Fund to enhance its income through the positive differential between one week and one year interest rates, but would preclude it from taking full advantage of rising interest rates.

Each Fund usually will enter into interest rate swaps on a net basis (i.e., the two payment streams are netted out with each Fund receiving or paying, as the case may be, only the net amount of the two payments). The net amount of the excess, if any, of each Fund s obligations over its entitlements with respect to each interest rate swap will be accrued on a daily basis, and an amount of cash or liquid instruments having an aggregate net asset value at least equal to the accrued excess will be segregated by each Fund. If the interest rate swap transaction is entered into on other than a net basis, the full amount of each Fund s obligations will be accrued on a daily basis, and the full amount of each Fund s obligations will be segregated by such Fund.

Each Fund also may engage in interest rate transactions in the form of purchasing or selling interest rate caps or floors. The purchase of an interest rate cap entitles the purchaser, to the extent that a specified index exceeds a predetermined interest rate, to receive payments of interest equal to the difference of the index and the predetermined rate on a notional principal amount (i.e., the reference amount with respect to which interest obligations are determined although no actual exchange of principal occurs) from the party selling such interest rate cap. The purchase of an interest rate floor entitles the purchaser, to the extent that a specified index falls below a predetermined interest rate, to receive payments of interest at the difference of the index and the predetermined rate on a notional principal amount from the party selling such interest rate floor. Each Fund will not enter into caps or floors if, on a net basis, the aggregate notional principal amount with respect to such agreements exceeds the net assets of such Fund.

Typically, the parties with which each Fund will enter into interest rate transactions will be broker dealers and other financial institutions. Each Fund will not enter into any interest rate swap, cap or floor transaction unless the unsecured senior debt or the claims paying ability of the other party thereto is rated investment grade quality by at least one nationally recognized statistical rating organization at the time of entering into such transaction or whose creditworthiness is believed by the Investment Adviser to be equivalent to such rating. If there is a default by the other party to such a transaction, such Fund will have contractual remedies pursuant to the agreements related to the transaction. The swap market has grown substantially in recent years with a large number of banks and investment banking firms acting both as principals and as agents utilizing standardized swap documentation. As a result, the swap market has become relatively liquid in comparison with other similar instruments traded in the interbank market. Caps and floors, however, are more recent innovations and are less liquid than swaps. Certain Federal income tax requirements may limit each Fund s ability to engage in interest rate swaps. Payments from transactions in interest rate swaps generally will be taxable as ordinary income to stockholders. See Taxes.

Credit Default Swap Agreements

Each Fund may enter into credit default swap agreements for hedging purposes or to seek to enhance its returns. The credit default swap agreement may have as reference obligations one or more securities that are not currently held by each Fund. The protection buyer in a credit default contract may be obligated to pay the protection seller an upfront or a periodic stream of payments over the term of the contract provided that no credit event on a reference obligation has occurred. If a credit event occurs, the seller generally must pay the buyer the par value (full notional value) of the swap in exchange for an equal face amount of deliverable obligations of the reference entity described in the swap, or the seller may be required to deliver the related net cash amount, if the swap is cash settled. Each Fund may be either the buyer or seller in the transaction. If each Fund is a buyer and no credit event occurs, each Fund may recover nothing if the swap is held through its termination date. However, if a credit event occurs, the buyer generally may elect to receive the full notional value of the swap in exchange for an equal face amount of deliverable obligations of the reference entity that may have little or no value. As a seller, each Fund generally receives an upfront payment or a fixed rate of income throughout the term of the swap, which typically is between six months and five years, provided that there is no credit event. If a credit event occurs, generally the seller must pay the buyer the full notional value of the swap in exchange for an equal face amount of deliverable obligations of the reference entity that may have little or no value. As a seller, each Fund generally receives an upfront payment or a fixed rate of income throughout the term of the swap, which typically is between six months and five years, provided that there is no credit event. If a credit event occurs, generally the seller must pay the buyer the full notional value of the swap in exchange for an equal face amount of deliverable obligations of the reference entity that may have little or no value. As the seller, each Fund would effectively add leverage to its portfolio because, in addition to its total net assets, each Fund would be subject to investment exposure on the notional amount of the swap.

Credit default swap agreements involve greater risks than if each Fund had invested in the reference obligation directly since, in addition to general market risks, credit default swaps are subject to illiquidity risk, counterparty risk and credit risks. Each Fund will enter into credit default swap agreements only with counterparties who are rated investment grade quality by at least one nationally recognized statistical rating organization at the time of entering into such transaction or whose creditworthiness is believed by the Investment Adviser to be equivalent to such rating. A buyer generally also will lose its investment and recover nothing should no credit event occur and the swap is held to its termination date. If a credit event were to occur, the value of any deliverable obligation received by the seller, coupled with the upfront or periodic payments previously received, may be less than the full notional value it pays to the buyer, resulting in a loss of value to the seller. Each Fund s obligations under a credit default swap agreement will be accrued daily (offset against any amounts owing to such Fund). In connection with each such transaction, each Fund will at all times segregate unencumbered liquid securities or cash with a value at least equal to such Fund s exposure (any accrued but unpaid net amounts owed by such Fund to any counterparty), on a marked-to-market basis (as calculated pursuant to requirements of the Commission). Such segregation will ensure that the Fund has assets available to satisfy its obligations with respect to the transaction and will limit any potential leveraging of each Fund s portfolio. Such segregation will not limit each Fund s exposure to loss.

Total Return Swap Agreements

Each Fund may enter into total return swap agreements. Total return swap agreements are contracts in which one party agrees to make periodic payments based on the change in market value of the underlying assets, which may include a specified security, basket of securities or securities indices during the specified period, in return for periodic payments based on a fixed or variable interest rate or the total return from other underlying assets. Total return swap agreements may be used to obtain exposure to a security or market without owning or taking physical custody of such security or market. Total return swap agreements may effectively add leverage to each Fund s portfolio because, in addition to its total net assets, such Fund would be subject to investment exposure on the notional amount of the swap.

Total return swap agreements entail the risk that a party will default on its payment obligations to each Fund thereunder. Swap agreements also bear the risk that each Fund will not be able to meet its obligation to the counterparty. Generally, each Fund will enter into total return swaps on a net basis (i.e., the two payment streams are netted out with such Fund receiving or paying, as the case may be, only the net amount of the two payments). The net amount of the excess, if any, of each Fund s obligations over its entitlements with respect to each total return swap will be accrued on a daily basis, and an amount of cash or liquid instruments having an aggregate net asset value at least equal to the accrued excess will be segregated by each Fund. If the total return swap transaction is entered into on other than a net basis, the full amount of each Fund s obligations will be accrued on a daily basis, and the full amount of each Fund s obligations will be segregated by each Fund in an amount equal to or greater than the market value of the liabilities under the total return swap agreement or the amount it would have cost each Fund initially to make an equivalent direct investment, plus or minus any amount such Fund is obligated to pay or is to receive under the total return swap agreement.

Credit Linked Trust Certificates

Among the income producing securities in which each Fund may invest are credit linked trust certificates, which are investments in a limited purpose trust or other vehicle which, in turn, invests in a basket of derivative instruments, such as credit default swaps, interest rate swaps and other securities, in order to provide exposure to the high yield or another fixed income market. For instance, each Fund may invest in credit linked trust certificates as a cash management tool in order to gain exposure to the high yield markets and/or to remain fully invested when more traditional income producing securities are not available, including during the period when the net proceeds of this offering and any borrowings or offering of preferred stock are being invested.

Like an investment in a bond, investments in these credit linked trust certificates represent the right to receive periodic income payments (in the form of distributions) and payment of principal at the end of the term of the certificate. However, these payments are conditioned on the trust s receipt of payments from, and the trust s potential obligations to, the counterparties to the derivative instruments and other securities in which the trust invests. For instance, the trust may sell one or more credit default swaps, under which the trust would receive a stream of payments over the term of the swap agreements provided that no event of default has occurred with respect to the referenced debt obligation upon which the swap is based. If a default occurs, the stream of payments may stop and the trust would be obligated to pay to the counterparty the par (or other agreed upon value) of the referenced debt obligation. This, in turn, would reduce the amount of income and principal that each Fund would receive as an investor in the trust. Each Fund s investments in these instruments are indirectly subject to the risks associated with derivative instruments, including, among others, credit risk, default or similar event risk, counterparty risk, interest rate risk, leverage risk and management risk. It is also expected that the certificates will be exempt from registration under the Securities Act of 1933. Accordingly, there may be no established trading market for the certificates and they may constitute illiquid investments.

Options

Call Options. Each Fund may purchase call options on any of the types of securities or instruments in which it may invest. A purchased call option gives each Fund the right to buy, and obligates the seller to sell, the underlying security at the exercise price at any time during the option period. Each Fund also may purchase and sell call options on indices. Index options are similar to options on securities except that, rather than taking or making delivery of securities underlying the option at a specified price upon exercise, an index option gives the holder the right to receive cash upon exercise of the option if the level of the index upon which the option is based is greater than the exercise price of the option.

Each Fund also is authorized to write (i.e., sell) covered call options on the securities or instruments in which it may invest and to enter into closing purchase transactions with respect to certain of such options. A covered call option is an option in which each Fund, in return for a premium, gives another party a right to buy specified securities owned by such Fund at a specified future date and price set at the time of the contract. The principal reason for writing call options is the attempt to realize, through the receipt of premiums, a greater return than would be realized on the securities alone. By writing covered call options, each Fund gives up the opportunity, while the option is in effect, to profit from any price increase in the underlying security above the option exercise price. In addition, each Fund s ability to sell the underlying security will be limited while the option is in effect unless each Fund enters into a closing purchase transaction. A closing purchase transaction cancels out such Fund s position as the writer of an option by means of an offsetting purchase of an identical option prior to the expiration of the option it has written. Covered call options also serve as a partial hedge to the extent of the premium received against the price of the underlying security declining. Each Fund also is authorized to write (i.e., sell) uncovered call options on securities or instruments in which it may invest but that are not currently held by such Fund. The principal reason for writing uncovered call options is to realize income without committing capital to the ownership of the underlying securities or instruments. When writing uncovered call options, each Fund must deposit and maintain sufficient margin with the broker dealer through which it made the uncovered call option as collateral to ensure that the securities can be purchased for delivery if and when the option is exercised. In addition, in connection with each such transaction each Fund will segregate unencumbered liquid securities or cash with a value at least equal to the Fund s exposure (the difference between the unpaid amounts owed by such Fund on such transaction minus any collateral deposited with the broker dealer), on a marked-to-market basis (as calculated pursuant to requirements of the Commission). Such segregation will ensure that each Fund has assets available to satisfy its obligations with respect to the transaction and will avoid any potential leveraging of each Fund s portfolio. Such segregation will not limit each Fund s exposure to loss. During periods of declining securities prices or when prices are stable, writing uncovered calls can be a profitable strategy to increase each Fund s income with minimal capital risk. Uncovered calls are riskier than covered calls because there is no underlying security held by each Fund that can act as a partial hedge. Uncovered calls have speculative characteristics and the potential for loss is unlimited. When an uncovered call is exercised, a Fund must purchase the underlying security to meet its call obligation. There is also a risk, especially with less liquid preferred and debt securities, that the securities may not be available for purchase. If the purchase price exceeds the exercise price, a Fund will lose the difference.

Put Options. Each Fund is authorized to purchase put options to seek to hedge against a decline in the value of its securities or to enhance its return. By buying a put option, each Fund acquires a right to sell such underlying securities or instruments at the exercise price, thus limiting such Fund s risk of loss through a decline in the market value of the securities or instruments until the put option expires. The amount of any appreciation in the value of the underlying securities or instruments will be partially offset by the amount of the premium paid for the put option and any related transaction costs. Prior to its expiration, a put option may be sold in a closing sale transaction and profit or loss from the sale will depend on whether the amount received is more or less than the premium paid for the put option plus the related transaction costs. A closing sale transaction cancels out each Fund s position as the purchaser of an option by means of an offsetting sale of an identical option prior to the expiration of the option it has purchased. Each Fund also may purchase uncovered put options.

Each Fund also has authority to write (i.e., sell) put options on the types of securities or instruments that may be held by such Fund, provided that such put options are covered, meaning that such options are secured by segregated, liquid instruments. Each Fund will receive a premium for writing a put option, which increases such Fund s return. Each Fund will not sell puts if, as a result, more than 50% of such Fund s assets would be required to cover its potential obligations under its hedging and other investment transactions.

Each Fund is also authorized to write (i.e., sell) uncovered put options on securities or instruments in which it may invest but that such Fund does not currently have a corresponding short position or has not deposited cash equal to the exercise value of the put option with the broker dealer through which it made the uncovered put option as collateral. The principal reason for writing uncovered put options is to receive premium income and to acquire such securities or instruments at a net cost below the current market value. Each Fund has the obligation to buy the securities or instruments at an agreed upon price if the securities or instruments decrease below the exercise price. If the securities or instruments price increases during the option period, the option will expire worthless and such Fund will retain the premium and will not have to purchase the securities or instruments at the exercise price. In connection with such transaction, each Fund will segregate unencumbered liquid securities or cash with a value at least equal to such Fund s exposure, on a marked-to-market basis (as calculated pursuant to requirements of the Commission). Such segregation will ensure that each Fund has assets available to satisfy its obligations with respect to the transaction and will avoid any potential leveraging of each Fund s portfolio. Such segregation will not limit such Fund s exposure to loss.

Financial Futures and Options Thereon

Each Fund is authorized to engage in transactions in financial futures contracts (futures contracts) and related options on such futures contracts either as a hedge against adverse changes in the market value of its portfolio securities or to seek to enhance such Fund s income. A futures contract is an agreement between two parties which obligates the purchaser of the futures contract to buy and the seller of a futures contract to sell a security for a set price on a future date or, in the case of an index futures contract, to make and accept a cash settlement based upon the difference in value of the index between the time the contract was entered into and the time of its settlement. A majority of transactions in futures contracts, however, do not result in the actual delivery of the underlying instrument or cash settlement, but are settled through liquidation (i.e., by entering into an offsetting transaction). Futures contracts have been designed by boards of trade which have been designated contract markets by the Commodities Futures Trading Commission (the CFTC). Transactions by each Fund in futures contracts and financial futures are subject to limitations as described below under Restrictions on the Use of Futures Transactions.

Each Fund may sell financial futures contracts in anticipation of an increase in the general level of interest rates. Generally, as interest rates rise, the market values of securities that may be held by such Fund will fall, thus reducing the net asset value of such Fund. However, as interest rates rise, the value of each Fund s short position in the futures contract also will tend to increase, thus offsetting all or a portion of the depreciation in the market value of such Fund s investments which are being hedged. While each Fund will incur commission expenses in selling and closing out futures positions, these commissions are generally less than the transaction expenses which such Fund would have incurred had that Fund sold portfolio securities in order to reduce its exposure to increases in interest rates. Each Fund also may purchase financial futures contracts in anticipation of a decline in interest rates when it is not fully invested in a particular market in which it intends to make investments to gain market exposure that may in part or entirely offset an increase in the cost of securities it intends to purchase. It is anticipated that, in a substantial majority of these transactions, each Fund will purchase securities upon termination of the futures contract.

Each Fund also has authority to purchase and write call and put options on futures contracts. Generally, these strategies are utilized under the same market and market sector conditions (i.e., conditions relating to specific types of investments) in which such Fund enters into futures transactions. Each Fund may purchase put options or write call options on futures contracts rather than selling the underlying futures contract in anticipation of a decrease in the market value of securities or an increase in interest rates. Similarly, each Fund may purchase call options, or write put options on futures contracts, as a substitute for the purchase of such futures to hedge against the increased cost resulting from an increase in the market value or a decline in interest rates of securities which such Fund intends to purchase.

Each Fund may engage in options and futures transactions on exchanges and options in the over-the-counter markets (OTC options). In general, exchange-traded contracts are third-party contracts (i.e., performance of the parties obligation is guaranteed by an exchange or clearing corporation) with standardized strike prices and expiration dates. OTC options transactions are two-party contracts with price and terms negotiated by the buyer and seller. See Restrictions on OTC Options below for information as to restrictions on the use of OTC options.

Under regulations of the CFTC, the futures trading activity described herein will not result in the Fund being deemed a commodity pool and the Fund need not be operated by a person registered with the CFTC as a commodity pool operator.

When a Fund purchases a futures contract or writes a put option or purchases a call option thereon, an amount of cash or liquid instruments will be segregated so that the amount so segregated, plus the amount of variation margin held in the account of its broker, equals the market value of the futures contract, thereby ensuring that the use of such futures is unleveraged.

Each Fund will engage in transactions in OTC options only with banks or dealers which have capital of at least $50 million or whose obligations are guaranteed by an entity having capital of at least $50 million. OTC options and assets used to cover OTC options written by each Fund are considered by the staff of the Commission to be illiquid. The illiquidity of such options or assets may prevent a successful sale of such options or assets, result in a delay of sale, or reduce the amount of proceeds that might otherwise be realized.

Risk Factors in Interest Rate Transactions and Options and Futures Transactions

The use of interest rate transactions is a highly specialized activity that involves investment techniques and risks different from those associated with ordinary portfolio securities transactions. Interest rate transactions involve the risk of an imperfect correlation between the index used in the hedging transaction and that pertaining to the securities that are the subject of such transaction. If the Investment Adviser is incorrect in its forecasts of market values, interest rates and other applicable factors, the investment performance of each Fund would diminish compared with what it would have been if these investment techniques were not used. In addition, interest rate transactions that may be entered into by each Fund do not involve the delivery of securities or other underlying assets or principal. Accordingly, the risk of loss with respect to interest rate swaps is limited to the net amount of interest payments that each Fund is contractually obligated to make. If the security underlying an interest rate swap is prepaid and such Fund continues to be obligated to make payments to the other party to the swap, that Fund would have to make such payments from another source. If the other party to an interest rate swap defaults, a Fund s risk of loss consists of the net amount of interest payments that such Fund contractually is entitled to receive. In the case of a purchase by such Fund of an interest rate cap or floor, the amount of loss is limited to the fee paid. Since interest rate transactions are individually negotiated, the Investment Adviser expects to achieve an acceptable degree of correlation between each Fund s rights to receive interest on securities and its rights and obligations to receive and pay interest pursuant to interest rate swaps.

Utilization of options and futures transactions to hedge the portfolio involves the risk of imperfect correlation in movements in the price of options and futures and movements in the prices of the securities that are the subject of the hedge. If the price of the options or futures moves more or less than the price of the subject of the hedge, each Fund will experience a gain or loss which will not be completely offset by movements in the price of the subject of the hedge. The risk particularly applies to each Fund s use of futures and options thereon when it uses such instruments as a so-called cross-hedge, which means that the security that is the subject of the futures contract is different from the security being hedged by the contract. Utilization of options and futures and options thereon through uncovered call options and uncovered put options are highly speculative strategies. If the price of the uncovered option moves in the direction not anticipated by each Fund, such Fund s losses will not be limited.

Prior to exercise or expiration, an exchange-traded option position can only be terminated by entering into a closing purchase or sale transaction. This requires a secondary market on an exchange for call or put options of the same series. Each Fund intends to enter into options and futures transactions, on an exchange or in the over-the-counter market, only if there appears to be a liquid secondary market for such options and futures. However, there can be no assurance that a liquid secondary market will exist at any specific time. Thus, it may not be possible to close an options or futures position. The inability to close options and futures positions also could have an adverse impact on each Fund s ability to effectively hedge its portfolio. There is also the risk of loss by each Fund of margin deposits or collateral in the event of bankruptcy of a broker with whom such Fund has an open position in an option, a futures contract or an option related to a futures contract.

Short Sales

Each Fund may make short sales of securities. A short sale is a transaction in which a Fund sells a security it does not own in anticipation that the market price of that security will decline. Each Fund may make short sales both as a form of hedging to offset potential declines in long positions in similar securities and in order to seek to enhance return.

When a Fund makes a short sale, it must borrow the security sold short and deliver collateral to the broker dealer through which it made the short sale to cover its obligation to deliver the security upon conclusion of the sale. Each Fund may have to pay a fee to borrow particular securities and is often obligated to pay over any payments received on such borrowed securities.

Each Fund s obligation to replace the borrowed security will be secured by collateral deposited with the broker dealer, usually cash, U.S. government securities or other liquid securities similar to those borrowed. Each Fund also will be required to segregate similar collateral with its custodian to the extent, if any, necessary so that the value of both collateral amounts in the aggregate is at all times equal to at least 100% of the current market value of the security sold short. Depending on arrangements made with the broker dealer from which it borrowed the security regarding payment over of any payments received by such Fund on such security, such Fund may not receive any payments (including interest) on its collateral deposited with such broker dealer.

If the price of the security sold short increases between the time of the short sale and the time such Fund replaces the borrowed security, the Fund will incur a loss. Conversely, if the price declines, such Fund will realize a gain. Any gain will be decreased, and any loss increased, by the transaction costs described above. Although each Fund s gain is limited to the price at which it sold the security short, its potential loss is theoretically unlimited.

Each Fund also may make short sales against the box. These transactions will involve either short sales of securities retained in such Fund s portfolio or securities which it has the right to acquire without the payment of further consideration.

Foreign Exchange Transactions

Each Fund may engage in spot and forward foreign exchange transactions and currency swaps, purchase and sell options on currencies and purchase and sell currency futures and related options thereon (collectively, Currency Instruments) for purposes of hedging against the decline in the value of currencies in which its portfolio holdings are denominated against the U.S. dollar.

Forward Foreign Exchange Transactions. Forward foreign exchange transactions are OTC contracts to purchase or sell a specified amount of a specified currency or multinational currency unit at a price and future date set at the time of the contract. Spot foreign exchange transactions are similar but require current, rather than future, settlement. Each Fund will enter into foreign exchange transactions only for purposes of hedging either a specific transaction or a portfolio position. Each Fund may enter into a foreign exchange transaction for purposes of hedging a specific transaction by, for example, purchasing a currency needed to settle a security transaction or selling a currency in which such Fund has received or anticipates receiving a dividend or distribution. Each Fund may enter into a foreign exchange transaction for purposes of hedging a portfolio position by selling forward a currency in which a portfolio position of such Fund is denominated or by purchasing a currency in which such Fund anticipates acquiring a portfolio position in the near future. Each Fund may also hedge portfolio positions through currency swaps, which are transactions in which one currency is simultaneously bought for a second currency on a spot basis and sold for the second currency on a forward basis. Forward foreign exchange transactions involve substantial currency risk, and also involve credit and liquidity risk.

Currency Futures. Each Fund may also hedge against the decline in the value of a currency against the U.S. dollar through use of currency futures or options thereon. Currency futures are similar to forward foreign exchange transactions except that futures are standardized, exchange-traded contracts. See Financial Futures and Options Thereon above. Currency futures involve substantial currency risk, and also involve leverage risk.

Currency Options. Each Fund may also hedge against the decline in the value of a currency against the U.S. dollar through the use of currency options. Currency options are similar to options on securities, but in consideration for an option premium the writer of a currency option is obligated to sell (in the case of a call option) or purchase (in the case of a put option) a specified amount of a specified currency on or before the expiration date for a specified amount of another currency. Each Fund may engage in transactions in options on currencies either on exchanges or OTC markets. See Options above. Currency options involve substantial currency risk, and may also involve credit, leverage or liquidity risk.

Limitations on Currency Hedging. No Fund will speculate in Currency Instruments. Accordingly, no Fund will hedge a currency in excess of the aggregate market value of the securities which it owns (including receivables for unsettled securities sales), or has committed to or anticipates purchasing, which are denominated in such currency. Each Fund may, however, hedge a currency by entering into a transaction in a Currency Instrument denominated in a currency other than the currency being hedged (a cross-hedge). Each Fund will only enter into a cross-hedge if the Manager believes that (i) there is a demonstrable high correlation between the currency in which the cross-hedge is denominated and the currency being hedged, and (ii) executing a cross-hedge through the currency in which the cross-hedge is denominated will be significantly more cost-effective or provide substantially greater liquidity than executing a similar hedging transaction by means of the currency being hedged.

Investments in Foreign Securities

Each Fund may invest without limitation in debt securities of issuers domiciled outside the United States. No Fund will, however, invest more than 10% of its total assets in debt securities of issuers located in emerging market countries. Each Fund will invest primarily in U.S. dollar-denominated debt securities. No Fund will invest more than 10% of its total assets in debt securities denominated in currencies other than the U.S. dollar or that do not provide for payment to such Fund in U.S. dollars. The Investment Adviser generally considers emerging market countries to be any country that is defined as having an emerging or developing economy by the World Bank or its related organizations or the United Nations or its subsidiaries. Investments in foreign securities involve certain risks not involved in domestic investments.

Public Information. Many of the foreign securities held by each Fund will not be registered with the Commission nor will the issuers thereof be subject to the reporting requirements of such agency. Accordingly, there may be less publicly available information about the foreign issuer of such securities than about a U.S. issuer, and such foreign issuers may not be subject to accounting, auditing and financial reporting standards and requirements comparable to those of U.S. issuers. Traditional investment measurements, such as price/earnings ratios, as used in the United States, may not be applicable to such securities, particularly those issued in certain smaller, emerging foreign capital markets. Foreign issuers, and issuers in smaller, emerging capital markets in particular, generally are not subject to uniform accounting, auditing and financial reporting standards or to practices and requirements comparable to those applicable to domestic issuers.

Trading Volume, Clearance and Settlement. Foreign financial markets, while often growing in trading volume, have, for the most part, substantially less volume than U.S. markets, and securities of many foreign companies are less liquid and their prices may be more volatile than securities of comparable domestic companies. Foreign markets also have different clearance and settlement procedures, and in certain markets there have been times when settlements have failed to keep pace with the volume of securities transactions, making it difficult to conduct such transactions. Further, satisfactory custodial services for investment securities may not be available in some countries having smaller, emerging capital markets, which may result in each Fund incurring additional costs and delays in transporting and custodying such securities outside such countries. Delays in settlement could result in periods when assets of each Fund are uninvested and no return is earned thereon. The inability of a Fund to make intended security purchases due to settlement problems or the risk of intermediary counterparty failures could cause such Fund to miss attractive investment opportunities. The inability to dispose of a portfolio security due to settlement problems could result either in losses to each Fund due to subsequent declines in the value of such portfolio security or, if such Fund has entered into a contract to sell the security, could result in possible liability to the purchaser.

Government Supervision and Regulation. There generally is less governmental supervision and regulation of exchanges, brokers and issuers in foreign countries than there is in the United States. For example, there may be no comparable provisions under certain foreign laws to insider trading and similar investor protection securities laws that apply with respect to securities transactions consummated in the United States. Further, brokerage commissions and other transaction costs on foreign securities exchanges generally are higher than in the United States.

Restrictions on Foreign Investment. Some countries prohibit or impose substantial restrictions on investments in their capital markets, particularly their equity markets, by foreign entities such as each Fund. As illustrations, certain countries require governmental approval prior to investments by foreign persons, or limit the amount of investment by foreign persons in a particular company, or limit the investment by foreign persons in a company to only a specific class of securities that may have less advantageous terms than securities of the company available for purchase by nationals. Certain countries may restrict investment opportunities in issuers or industries deemed important to national interests.

A number of countries have authorized the formation of closed-end investment companies to facilitate indirect foreign investment in their capital markets. In accordance with the 1940 Act, each Fund may invest up to 10% of its total assets in securities of closed-end investment companies, not more than 5% of which may be invested in any one such company. This restriction on investments in securities of closed-end investment companies may limit opportunities for each Fund to invest indirectly in certain smaller capital markets. Shares of certain closed-end investment companies may at times be acquired only at market prices representing premiums to their net asset values. If each Fund acquires shares in closed-end investment companies, stockholders would bear both their proportionate share of such Fund s expenses (including investment advisory fees) and, indirectly, the expenses of such closed-end investment companies. Each Fund also may seek, at its own cost, to create its own investment entities under the laws of certain countries.

Foreign Sub-Custodians and Securities Depositories. Rules adopted under the 1940 Act permit each Fund to maintain its foreign securities and cash in the custody of certain eligible non-U.S. banks and securities depositories. Certain banks in foreign countries may not be eligible sub-custodians for each Fund, in which event such Fund may be precluded from purchasing securities in certain foreign countries in which it otherwise would invest or such Fund may incur additional costs and delays in providing transportation and custody services for such securities outside of such countries. Each Fund may encounter difficulties in effecting on a timely basis portfolio transactions with respect to any securities of issuers held outside their countries. Other banks that are eligible foreign sub-custodians may be recently organized or otherwise lack extensive operating experience. In addition, in certain countries there may be legal restrictions or limitations on the ability of each Fund to recover assets held in custody by foreign sub-custodians in the event of the bankruptcy of the sub-custodian.

Other Investment Strategies

Repurchase Agreements and Purchase and Sale Contracts. Each Fund may invest in securities pursuant to repurchase agreements and purchase and sale contracts. Repurchase agreements and purchase and sale contracts may be entered into only with a member bank of the Federal Reserve System or primary dealer in U.S. government securities. Under such agreements, the bank or primary dealer agrees, upon entering into the contract, to repurchase the security at a mutually agreed upon time and price, thereby determining the yield during the term of the agreement. This results in a fixed rate of return insulated from market fluctuations during such period. In the case of repurchase agreements, the prices at which the trades are conducted do not reflect accrued interest on the underlying obligations; whereas, in the case of purchase and sale contracts, the prices take into account accrued interest. Such agreements usually cover short periods, such as under one week. Repurchase agreements may be construed to be collateralized loans by the purchaser to the seller secured by the securities transferred to the purchaser. In the case of a repurchase agreement, each Fund will require the seller to provide additional collateral if the market value of the securities falls below the repurchase price at any time during the term of the repurchase agreement; each Fund does not have the right to seek additional collateral in the case of purchase and sale contracts. In the event of default by the seller under a repurchase agreement construed to be a collateralized loan, the underlying securities are not owned by such Fund but only constitute collateral for the seller s obligation to pay the repurchase price. Therefore, each Fund may suffer time delays and incur costs or possible losses in connection with the disposition of the collateral. A purchase and sale contract differs from a repurchase agreement in that the contract arrangements stipulate that the securities are owned by each Fund. In the event of a default under such a repurchase agreement or a purchase and sale contract, instead of the contractual fixed rate of return, the rate of return to each Fund shall be dependent upon intervening fluctuations of the market value of such security and the accrued interest on the security. In such event, each Fund would have rights against the seller for breach of contract with respect to any losses arising from market fluctuations following the failure of the seller to perform.

Reverse Repurchase Agreements. Each Fund may enter into reverse repurchase agreements with respect to its portfolio investments subject to the investment restrictions set forth herein. Reverse repurchase agreements involve the sale of securities held by such Fund with an agreement by the Fund to repurchase the securities at an agreed upon price, date and interest payment. The use by each Fund of reverse repurchase agreements involves many of the same risks of leverage described under Risk Factors and Special Considerations Leverage and Leverage above since the proceeds derived from such reverse repurchase agreements may be invested in additional securities. At the time each Fund enters into a reverse repurchase agreement, it may segregate liquid instruments having a value not less than the repurchase price (including accrued interest). If the Fund segregates such liquid instruments, a reverse repurchase agreement will not be considered a borrowing by each Fund, however, under circumstances in which such Fund does not segregate such liquid instruments, such reverse repurchase agreement will be considered a borrowing for the purpose of such Fund s limitation on borrowings. Reverse repurchase agreements involve the risk that the market value of the securities acquired in connection with the reverse repurchase agreement may decline below the price of the securities each Fund has sold but is obligated to repurchase. Also, reverse repurchase agreements involve the risk that the market value of the securities retained in lieu of sale by each Fund in connection with the reverse repurchase agreement may decline in price. In the event the buyer of securities under a reverse repurchase agreement files for bankruptcy or becomes insolvent, such buyer or its trustee or receiver may receive an extension of time to determine whether to enforce each Fund s obligation to repurchase the securities, and each Fund s use of the proceeds of the reverse repurchase agreement may effectively be restricted pending such decision. Also, each Fund would bear the risk of loss to the extent that the proceeds of the reverse repurchase agreement are less than the value of the securities subject to such agreement.

Lending of Portfolio Securities. Each Fund may lend securities with a value not exceeding $33^{1/3}$% of its total assets or the limit prescribed by applicable law to banks, brokers and other financial institutions. In return, each Fund receives collateral in cash or securities issued or guaranteed by the U.S. government, which will be maintained at all times in an amount equal to at least 100% of the current market value of the loaned securities. Each Fund maintains the ability to obtain the right to vote or consent on proxy proposals involving material events affecting securities loaned. Each Fund receives the income on the loaned securities. Where each Fund receives securities as collateral, such Fund receives a fee for its loans from the borrower and does not receive the income on the collateral. Where each Fund receives cash collateral, it may invest such collateral and retain the amount earned, net of any amount rebated to the borrower. As a result, each Fund s yield may increase. Loans of securities are terminable at any time and the borrower, after notice, is required to return borrowed securities within the standard time period for settlement of securities transactions. Each Fund is obligated to return the collateral to the borrower at the termination of the loan. Each Fund could suffer a loss in the event such Fund must return the cash collateral and there are losses on investments made with the cash collateral. In the event the borrower defaults on any of its obligations with respect to a securities loan, each Fund could suffer a loss where there are losses on investments made with the cash collateral or, where the value of the securities collateral falls below the market value of the borrowed securities. Each Fund could also experience delays and costs in gaining access to the collateral. Each Fund may pay reasonable finders, lending agent, administrative and custodial fees in connection with its loans. Each Fund has received an exemptive order from the Commission permitting it to lend portfolio securities to Merrill Lynch, Pierce, Fenner & Smith Incorporated (Merrill Lynch) or its affiliates and to retain an affiliate of each Fund as lending agent. See Portfolio Transactions.

When-Issued and Forward Commitment Securities. Each Fund may purchase interests in senior loans and other portfolio securities on a when-issued basis and may purchase or sell such interests or securities on a forward commitment basis. When such transactions are negotiated, the price, which generally is expressed in yield terms, is fixed at the time the commitment is made, but delivery and payment for such interests or securities take place at a later date. When-issued securities and forward commitments may be sold prior to the settlement date, but each Fund will enter into when-issued and forward commitment transactions only with the intention of actually receiving or delivering such interests or securities, as the case may be. If each Fund disposes of the right to acquire a when-issued security prior to its acquisition or disposes of its right to deliver or receive against a forward commitment, it can incur a gain or loss. At the time each Fund enters into a transaction on a when-issued or forward commitment basis, it will segregate cash or other liquid instruments with a value not less than the value of the when-issued or forward commitment securities. The value of these assets will be monitored daily to ensure that their marked-to-market value at all times will exceed the corresponding obligations of each Fund. There is always a risk that such interests or securities may not be delivered, and each Fund may incur a loss. Settlements in the ordinary course, which may take substantially more than five business days for mortgage related securities, are not treated by each Fund as when-issued or forward commitment transactions and accordingly are not subject to the foregoing restrictions.

Standby Commitment Agreements. Each Fund from time to time may enter into standby commitment agreements. Such agreements commit each Fund, for a stated period of time, to purchase a stated amount of a fixed income security that may be issued and sold to each Fund at the option of the issuer. The price and coupon of the security is fixed at the time of the commitment. At the time of entering into the agreement each Fund may be paid a commitment fee, regardless of whether or not the security ultimately is issued. Each Fund will enter into such agreements only for the purpose of investing in the security underlying the commitment at a yield and price which is considered advantageous to such Fund. Each Fund at all times will segregate cash or other liquid instruments with a value equal to the purchase price of the securities underlying the commitment.

There can be no assurance that the securities subject to a standby commitment will be issued and the value of the security, if issued, on the delivery date may be more or less than its purchase price. Since the issuance of the security underlying the commitment is at the option of the issuer, each Fund may bear the risk of decline in the value of such security and may not benefit from an appreciation in the value of the security during the commitment period.

The purchase of a security subject to a standby commitment agreement and the related commitment fee will be recorded on the date on which the security reasonably can be expected to be issued and the value of the security thereafter will be reflected in the calculation of each Fund s net asset value. The cost basis of the security will be adjusted by the amount of the commitment fee. In the event the security is not issued, the commitment fee will be recorded as income on the expiration date of the standby commitment.

RISK FACTORS AND SPECIAL CONSIDERATIONS

The following information supplements the discussion of the Funds risk factors that are described in the Joint Proxy Statement/Prospectus and the preceding discussion of the Funds investment objective, policies and techniques.

Leverage Risk. If each Fund borrows for investment purposes and/or issues preferred shares, such Fund will be subject to leverage risk. Although the use of leverage by each Fund may create an opportunity for higher total return for the shares of common stock, it also results in additional risks and can magnify the effect of any losses. If the income and gains earned on securities purchased with leverage proceeds are greater than the cost of leverage, each Fund s return on its shares of common stock will be greater than if leverage had not been used. Conversely, if the income or gains from the securities purchased with such proceeds does not cover the cost of leverage, the return on each Fund s shares of common stock will be less than if leverage had not been used. In such circumstances, the Advisors in their best judgment nevertheless may determine to continue to use leverage if they expect that the benefits to each Fund s stockholders of maintaining the leveraged position will outweigh the current reduced return. There is no assurance that a leveraging strategy will be successful. Leverage involves risks and special considerations for common stockholders including:

- the likelihood of greater volatility of net asset value, market price and dividend rate of the shares than a comparable portfolio without leverage;
- the risk that fluctuations in interest rates on borrowings and short term debt or in the dividend rates on any preferred stock that the Fund must pay will reduce the return to the common stockholders;
- the effect of leverage in a declining market, which is likely to cause greater decline in the net asset value of the shares of common stock than if each Fund were not leveraged, which may result in a greater decline in the market price of the shares of common stock;
- when each Fund uses financial leverage, the investment advisory fees payable to the Advisors will be higher than if such Fund did not use leverage; and
- leverage may increase operating costs, which may reduce a Fund s total return.

Certain types of borrowings by each Fund may result in such Fund being subject to covenants in credit agreements relating to asset coverage and Fund composition requirements. Each Fund may be subject to certain restrictions on investments imposed by guidelines of one or more rating agencies, which may issue ratings for the short-term corporate debt securities or preferred stock issued by a Fund. These guidelines may impose asset coverage or Fund composition requirements that are more stringent than those imposed by the 1940 Act. The Advisors do not believe that these covenants or guidelines will impede the Advisors from managing each Fund s portfolio in accordance with such Fund s investment objectives and policies.

Risks Related to Preferred Securities. To the extent each Fund invests in preferred securities, there are special risks associated with investing in preferred securities, including:

Deferral. Preferred securities may include provisions that permit the issuer, at its discretion, to defer distributions for a stated period without any adverse consequences to the issuer. If a Fund owns a preferred security that is deferring its distributions, that Fund may be required to report income for tax purposes although it has not yet received such income.

Subordination. Preferred securities are subordinated to bonds and other debt instruments in a company s capital structure in terms of priority to corporate income and liquidation payments, and therefore will be subject to greater credit risk than more senior debt instruments.

Liquidity. Preferred securities may be substantially less liquid than many other securities, such as common stocks or U.S. Government securities.

Limited Voting Rights. Generally, preferred security holders (such as the Funds) have no voting rights with respect to the issuing company unless preferr