

NEWTEK BUSINESS SERVICES, INC.

Form 10-Q

August 06, 2012

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012

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: 001-16123

NEWTEK BUSINESS SERVICES, INC.

(Exact name of registrant as specified in its charter)

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New York (State or other jurisdiction of incorporation or organization)	11-3504638 (I.R.S. Employer Identification No.)
212 West 35th Street 2nd Floor, New York, NY (Address of principal executive offices)	10001 (Zip Code)
Registrant's telephone number, including area code: (212) 356-9500	

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 past 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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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 (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer

Accelerated filer

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

As of July 30, 2012, there were 35,253,647 of the Company's Common Shares outstanding.

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Table of Contents**Item 1. Financial Statements.****NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)****FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2012 AND 2011****(In Thousands, except for Per Share Data)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Operating revenues	\$ 32,338	\$ 32,322	\$ 63,067	\$ 62,845
Net change in fair value of:				
SBA loans	(569)	(2,686)	(663)	(3,858)
Warrant liability	(111)		(111)	
Credits in lieu of cash and notes payable in credits in lieu of cash	5	1	41	76
Total net change in fair value	(675)	(2,685)	(733)	(3,782)
Operating expenses:				
Electronic payment processing costs	17,849	17,628	34,730	34,722
Salaries and benefits	5,437	5,524	11,113	10,709
Interest	1,136	804	1,973	1,859
Depreciation and amortization	711	1,029	1,512	2,059
Provision for loan losses	154	73	264	86
Other general and administrative costs	4,446	4,443	8,707	8,658
Total operating expenses	29,733	29,501	58,299	58,093
Income before income taxes	1,930	136	4,035	970
Provision for income taxes	726	447	1,522	803
Net income (loss)	1,204	(311)	2,513	167
Net income attributable to non-controlling interests	29	24	23	55
Net income (loss) attributable to Newtek Business Services, Inc.	\$ 1,233	\$ (287)	\$ 2,536	\$ 222
Weighted average common shares outstanding - basic	35,922	35,716	35,851	35,696
Weighted average common shares outstanding - diluted	36,881	35,716	36,536	36,350
Earnings (loss) per share - basic and diluted	\$ 0.03	\$ (0.01)	\$ 0.07	\$ 0.01

See accompanying notes to these unaudited condensed consolidated financial statements.

Table of Contents**NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****JUNE 30, 2012 AND DECEMBER 31, 2011****(In Thousands, except for Per Share Data)**

	June 30, 2012	December 31, 2011
	Unaudited	(Note 1)
<u>ASSETS</u>		
Cash and cash equivalents (includes \$2,850 and \$0, respectively, related to VIE)	\$ 23,061	\$ 11,363
Restricted cash	8,938	14,066
Broker receivable	5,643	4,911
SBA loans held for investment, net (includes \$14,120 and \$15,217, respectively, related to securitization trust VIE; net of reserve for loan losses of \$2,380 and \$2,900, respectively)	17,075	18,555
SBA loans held for investment, at fair value (includes \$24,004 and \$19,617, respectively, related to securitization trust VIE)	31,410	21,857
Accounts receivable (net of allowance of \$633 and \$308, respectively)	12,775	10,493
SBA loans held for sale, at fair value	1,783	2,198
Prepaid expenses and other assets, net (includes \$1,235 and \$1,211, respectively, related to securitization trust VIE)	9,285	11,762
Servicing asset (net of accumulated amortization and allowances of \$6,322 and \$5,964, respectively)	3,831	3,420
Fixed assets (net of accumulated depreciation and amortization of \$12,942 and \$16,463, respectively)	2,844	2,853
Intangible assets (net of accumulated amortization of \$13,585 and \$13,226, respectively)	1,088	1,420
Credits in lieu of cash	11,552	16,948
Goodwill	12,092	12,092
Deferred tax asset, net	1,617	72
Total assets	\$ 142,994	\$ 132,010
<u>LIABILITIES AND EQUITY</u>		
Liabilities:		
Accounts payable and accrued expenses	\$ 12,996	\$ 14,196
Notes payable	26,631	13,565
Note payable securitization trust VIE	24,253	26,368
Deferred revenue	1,484	1,634
Notes payable in credits in lieu of cash	11,552	16,948
Warrant liability	2,070	
Total liabilities	78,986	72,711
Commitments and contingencies		
Equity:		
Newtek Business Services, Inc. shareholders' equity:		
Preferred shares (par value \$0.02 per share; authorized 1,000 shares, no shares issued and outstanding)		
Common shares (par value \$0.02 per share; authorized 54,000 shares, 36,913 and 36,701 issued respectively; 35,200 and 35,702 outstanding, respectively, not including 83 shares held in escrow)	738	734
Additional paid-in capital	58,344	57,960
Retained earnings (includes \$1,466 and \$0, respectively, related to consolidation of VIE on January 1, 2012)	4,044	45
Treasury shares, at cost (1,713 and 999 shares, respectively)	(1,467)	(620)
Total Newtek Business Services, Inc. shareholders' equity	61,659	58,119

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Non-controlling interests	2,349	1,180
Total equity	64,008	59,299
Total liabilities and equity	\$ 142,994	\$ 132,010

See accompanying notes to these unaudited condensed consolidated financial statements.

Table of Contents**NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)****FOR THE SIX MONTHS ENDED JUNE 30, 2012 AND 2011****(In Thousands)**

	2012	2011
Cash flows from operating activities:		
Net income	\$ 2,513	\$ 167
Adjustments to reconcile net income to net cash provided by operating activities:		
Income from tax credits	(319)	(630)
Accretion of interest expense	360	706
Fair value adjustments on SBA loans	663	3,858
Fair value adjustment on warrant liability	111	
Fair value adjustment of credits in lieu of cash and notes payable in credits in lieu of cash	(41)	(76)
Deferred income taxes	(1,545)	(550)
Depreciation and amortization	1,512	2,059
Provision for loan losses	264	86
Other, net	451	222
Changes in operating assets and liabilities:		
Originations of SBA loans held for sale	(34,686)	(33,573)
Originations of SBA loans transferred, subject to premium recourse		(274)
Proceeds from sale of SBA loans held for sale	35,019	32,677
Proceeds from sale of SBA loans, achieving sale status		26,613
Liability on SBA loans transferred, subject to premium recourse		(29,391)
Broker receivable	(733)	3,262
Accounts receivable	(2,347)	(956)
Prepaid expenses, accrued interest receivable and other assets	3,390	(506)
Accounts payable, accrued expenses and deferred revenue	(1,218)	2,149
Other, net	(1,049)	(3,286)
Net cash provided by operating activities	2,345	2,557
Cash flows from investing activities:		
Return of investments in qualified businesses	101	245
Purchase of fixed assets and customer merchant accounts	(813)	(698)
SBA loans originated for investment, net	(10,923)	(8,623)
Payments received on SBA loans	2,086	1,692
Change in restricted cash	368	1,949
Purchase of non-controlling interest		(200)
Net cash used in investing activities	(9,181)	(5,635)

See accompanying notes to these unaudited condensed consolidated financial statements.

Table of Contents**NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)****FOR THE SIX MONTHS ENDED JUNE 30, 2012 AND 2011 (CONTINUED)**

	2012	2011
Cash flows from financing activities:		
Net borrowings on bank lines of credit	\$ 5,167	\$ 3,811
Increase in cash due to consolidation of VIE	2,763	
Proceeds from term loan	10,000	
Payments on bank term note payable	(208)	(208)
Change in restricted cash due to debt refinancing		(750)
Change in restricted cash related to securitization	5,041	3,058
Payments on senior notes	(2,228)	(1,209)
Additions to deferred financing costs	(1,257)	
Purchase of treasury shares	(926)	
Other	182	(305)
Net cash provided by financing activities	18,534	4,397
Net increase in cash and cash equivalents	11,698	1,319
Cash and cash equivalents beginning of period	11,363	10,382
Cash and cash equivalents end of period	\$ 23,061	\$ 11,701
Supplemental disclosure of cash flow activities:		
Reduction of credits in lieu of cash and notes payable in credits in lieu of cash balances due to delivery of tax credits to Certified Investors	\$ 6,167	\$ 11,101
Addition to assets and liabilities on January 1, 2012 as a result of consolidation of interests in Exponential of New York, LLC		
Assets	\$ 2,763	\$
Liabilities	\$ 7	
Equity	\$ 2,756	
Additions to additional paid in-capital for warrants expired previously attributable to non-controlling interests	\$ 330	\$
Additions to non-controlling interests as a result of consolidation of majority owned subsidiary	\$ 2,291	\$
Issuance of warrant	\$ 1,959	\$

See accompanying notes to these unaudited condensed consolidated financial statements.

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NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION:

Newtek Business Services, Inc. (Newtek or the Company) is a holding company for several wholly- and majority-owned subsidiaries, including twelve certified capital companies which are referred to as Capcos, and several portfolio companies in which the Capcos own non-controlling or minority interests. The Company provides a one-stop-shop for business services to the small- and medium-sized business market and uses state of the art web-based proprietary technology to be a low cost acquirer and provider of products and services. The Company partners with companies, credit unions, and associations to offer its services.

The Company's principal business segments are:

Electronic Payment Processing: Marketing third party credit card processing and check approval services to the small- and medium-sized business market under the name of Newtek Merchant Solutions.

Managed Technology Solutions: CrystalTech Web Hosting, Inc., d/b/a Newtek Technology Services (NTS), offers shared and dedicated web hosting, data storage and backup services, cloud computing plans and related services to the small- and medium-sized business market.

Small Business Finance: The segment is comprised of Newtek Small Business Finance, Inc. (NSBF), a nationally licensed, U.S. Small Business Administration (SBA) lender that originates, sells and services loans to qualifying small businesses, which are partially guaranteed by the SBA and CDS Business Services, Inc. d/b/a Newtek Business Credit (NBC) which provides receivable financing and management services.

All Other: Businesses formed from investments made through Capco programs and others which cannot be aggregated with other operating segments, including insurance and payroll processing.

Corporate Activities: Corporate implements business strategy, directs marketing, provides technology oversight and guidance, coordinates and integrates activities of the segments, contracts with alliance partners, acquires customer opportunities, and owns our proprietary NewTracker referral system. This segment includes revenue and expenses not allocated to other segments, including interest income, Capco management fee income and corporate operations expenses.

Capco: Twelve certified capital companies which invest in small- and medium-sized businesses. They generate non-cash income from tax credits and non-cash interest expense and insurance expenses in addition to cash management fees.

The condensed consolidated financial statements of Newtek, its subsidiaries and consolidated entities included herein have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America and include all wholly- and majority-owned subsidiaries, and several portfolio companies in which the Capcos own non-controlling minority interests, or those variable interest entities of which Newtek is considered to be the primary beneficiary. All inter-company balances and transactions have been eliminated in consolidation. Non-controlling interests (previously shown as minority interest) are reported below net income (loss) under the heading Net loss attributable to non-controlling interests in the unaudited condensed consolidated statements of operations and shown as a component of equity in the condensed consolidated balance sheets. See New Accounting Standards in Note 2 to the Condensed Consolidated Financial Statements for further discussion.

The Company determined that it was the primary beneficiary of an affiliated Capco company, Exponential of New York, LLC (Expo), resulting from an ownership change pursuant to operation of the LLC agreement and its ability to direct the activities of Expo that most significantly impact the entity's economic performance. The Company now includes Expo as a consolidated variable interest entity effective January 2012, and holds a 39% interest in Expo; the remaining 61% is held by non-affiliates and is accounted for as non-controlling interest. As a result of the consolidation, a cumulative effect adjustment to equity was required to recognize the previously recognized interest in the newly consolidated subsidiary. In addition, the Company's opening cash and accounts payable increased by \$2,763,000 and \$7,000, respectively, reflecting the opening balance of Expo's assets and liabilities. The opening equity was adjusted as follows:

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(In thousands)	Number				Number			Total
	of Common Shares	Common Shares (at par)	Additional Paid-in Capital	Retained Earnings	of Treasury Shares	Treasury Shares	Non- controlling Interest	
Balance at December 31, 2011	36,701	\$ 734	\$ 57,960	\$ 45	999	\$ (620)	\$ 1,180	\$ 59,299
Cumulative effect adjustment to opening equity as a result of Expo consolidation				1,466			2,290	3,756
Adjusted balance at January 1, 2012	36,701	\$ 734	\$ 57,960	\$ 1,511	999	\$ (620)	\$ 3,470	\$ 63,055

The accompanying notes to unaudited condensed consolidated financial statements should be read in conjunction with Newtek's 2011 Annual Report on Form 10-K. These financial statements have been prepared in accordance with instructions to Form 10-Q and Article 10 of Regulation S-X and, therefore, omit or condense certain footnotes and other information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States. In the opinion of management, all adjustments, consisting of normal recurring items, considered necessary for a fair presentation have been included. The results of operations for an interim period may not give a true indication of the results for the entire year. The December 31, 2011 condensed consolidated balance sheet has been derived from the audited financial statements of that date but does not include all disclosures required by accounting principles generally accepted in the United States of America.

All financial information included in the tables in the following footnotes is stated in thousands, except per share data.

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES:*Use of Estimates*

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expense during the reporting period. The level of uncertainty in estimates and assumptions increases with the length of time until the underlying transactions are complete. The most significant estimates are with respect to valuation of investments in qualified businesses, asset impairment valuation, allowance for loan losses, valuation of servicing assets, charge-back reserves, tax valuation allowances and the fair value measurements used to value certain financial assets and financial liabilities. Actual results could differ from those estimates.

During the six months ended June 30, 2012, the Company revised its estimate for the amortization period of the servicing asset. Please see Note 5 to the Condensed Consolidated Financial Statements for a full discussion.

Revenue Recognition

The Company operates in a number of different segments. Revenues are recognized as services are rendered and are summarized as follows:

Electronic payment processing revenue: Electronic payment processing and fee income is derived from the electronic processing of credit and debit card transactions that are authorized and captured through third-party networks. Typically, merchants are charged for these processing services on a percentage of the dollar amount of each transaction plus a flat fee per transaction. Certain merchant customers are charged miscellaneous fees, including fees for handling charge-backs or returns, monthly minimum fees, statement fees and fees for other miscellaneous services. Revenues derived from the electronic processing of MasterCard® and Visa® sourced credit and debit card transactions are reported gross of amounts paid to sponsor banks.

Web hosting revenue: Managed technology solutions revenue is primarily derived from monthly recurring service fees for the use of its web hosting, web design and software support services. Customer set-up fees are billed upon service initiation and are recognized as revenue over the estimated customer relationship period of 2.5 years. Payment for web hosting and related services, excluding cloud plans, is generally received one month to one year in advance. Deferred revenues represent customer payments for web hosting and related services in advance of the reporting period date. Revenue for cloud related services is based on actual consumption used by a cloud customer.

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Income from tax credits: Following an application process, a state will notify a company that it has been certified as a Capco. The state or jurisdiction then allocates an aggregate dollar amount of tax credits to the Capco. However, such amount is neither recognized as income nor otherwise recorded in the financial statements since it has yet to be earned by the Capco. The Capco is entitled to earn tax credits upon satisfying defined investment percentage thresholds within specified time requirements. Newtek has Capcos operating in five states and the District of Columbia. Each statute requires that the Capco invest a threshold percentage of certified capital (the funds provided by the insurance company investors) in businesses defined as qualified within the time frames specified. As the Capco meets these requirements, it avoids grounds under the statute for its disqualification for continued participation in the Capco program. Such a disqualification, or decertification as a Capco results in a permanent recapture of all or a portion of the allocated tax credits. The proportion of the possible recapture is reduced over time as the Capco remains in general compliance with the program rules and meets the progressively increasing investment benchmarks. As the Capco progresses in its investments in Qualified Businesses and, accordingly, places an increasing proportion of the tax credits beyond recapture, it earns an amount equal to the non-recapturable tax credits and records such amount as income, with a corresponding asset called credits in lieu of cash in the balance sheet.

The amount earned and recorded as income is determined by multiplying the total amount of tax credits allocated to the Capco by the percentage of tax credits immune from recapture (the earned income percentage) at that point. To the extent that the investment requirements are met ahead of schedule, and the percentage of non-recapturable tax credits is accelerated, the present value of the tax credit earned is recognized currently and the asset, credits in lieu of cash, is accreted up to the amount of tax credits deliverable to the certified investors. The obligation to deliver tax credits to the certified investors is recorded as notes payable in credits in lieu of cash. On the date the tax credits are utilizable by the certified investors, the Capco decreases credits in lieu of cash with a corresponding decrease to notes payable in credits in lieu of cash.

Sales and Servicing of SBA Loans: NSBF originates loans to customers under the SBA program that generally provides for SBA guarantees of 50% to 85% of each loan, subject to a maximum guarantee amount. This guaranteed portion is generally sold to a third party via an SBA regulated secondary market transaction utilizing SBA Form 1086 for a price equal to the guaranteed loan amount plus a premium that includes both an upfront cash payment and the fair value of future net servicing income. Prior to October 1, 2010, NSBF recognized the revenue item Premium on loan sales net of capitalized loan expenses and the discount on the retained unguaranteed portion; subsequent to the adoption of fair value of SBA 7(a) loans on October 1, 2010, NSBF recognizes premium on loan sales as equal to the cash premium plus the fair value of the servicing income. Revenue is recognized on the trade date of the guaranteed portion, except as described below.

Upon recognition of each loan sale, the Company retains servicing responsibilities and receives servicing fees of a minimum of 1% of the guaranteed loan portion sold. The Company is required to estimate its adequate servicing compensation in the calculation of its servicing asset. The purchasers of the loans sold have no recourse to the Company for failure of customers to pay amounts contractually due.

Subsequent measurements of each class of servicing assets and liabilities may use either the amortization method or the fair value measurement method. NSBF has chosen to apply the amortization method to its servicing asset, amortizing the asset in proportion to, and over the period of, the estimated future net servicing income on the underlying sold guaranteed portion of the loans and assessing the servicing asset for impairment based on fair value at each reporting date. In the event future prepayments are significant or impairments are incurred and future expected cash flows are inadequate to cover the unamortized servicing assets, additional amortization or impairment charges would be recognized. In evaluating and measuring impairment of servicing assets, NSBF stratifies its servicing assets based on year of loan and loan term which are the key risk characteristics of the underlying loan pools. The Company uses an independent valuation specialist to estimate the fair value of the servicing asset by calculating the present value of estimated future net servicing cash flows, using assumptions of prepayments, defaults, servicing costs and discount rates that NSBF believes market participants would use for similar assets. If NSBF determines that the impairment for a stratum is temporary, a valuation allowance is recognized through a charge to current earnings for the amount the amortized balance exceeds the current fair value. If the fair value of the stratum were to later increase, the valuation allowance may be reduced as a recovery. However, if NSBF determines that impairment for a stratum is other than temporary, the value of the servicing asset and any related valuation allowance is written-down.

Interest and SBA Loan Fees: Interest income on loans is recognized as earned. Loans are placed on non-accrual status if they exceed 90 days past due with respect to principal or interest and, in the opinion of management, interest or principal on individual loans is not collectible, or at such earlier time as management determines that the collectability of such principal or interest is unlikely. Such loans are designated as impaired non-accrual loans. All other loans are defined as performing loans. When a loan is designated as impaired non-accrual, the accrual of interest is discontinued, and any accrued but uncollected interest income is reversed and charged against current operations. While a loan is classified as impaired non-accrual and the future collectability of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding.

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The Company passes certain expenditures it incurs to the borrower, such as force placed insurance, insufficient funds fees, or fees it assesses, such as late fees, with respect to managing the loan. These expenditures are recorded when incurred. Due to the uncertainty with respect to collection of these passed through expenditures or assessed fees, any funds received to reimburse the Company are recorded on a cash basis as other income.

Insurance commissions: Revenues are comprised of commissions earned on premiums paid for insurance policies and are recognized at the time the commission is earned. At that date, the earnings process has been completed and the Company can estimate the impact of policy cancellations for refunds and establish reserves. The reserve for policy cancellations is based on historical cancellation experience adjusted by known circumstances.

Other income: Other income represents revenues derived from operating units that cannot be aggregated with other business segments. In addition, other income represents one time recoveries or gains on investments. Revenue is recorded when there is strong evidence of an agreement, the related fees are fixed, the service or product has been delivered, and the collection of the related receivable is assured.

Receivable fees: Receivable fees are derived from the funding (purchase) of receivables from finance clients. NBC recognizes the revenue on the date the receivables are purchased at a percentage of face value as agreed to by the client. The Company also has arrangements with certain of its clients whereby it purchases the client's receivables and charges a fee at a specified rate based on the amount of funds advanced against such receivables. The funds provided are collateralized and the interest income is recognized as earned.

Late fees: Late fees are derived from receivables NBC has purchased that have gone over a certain period (usually over 30 days) without payment. The client or the client's customer is charged a late fee according to the agreement with the client and NBC records the fees as income in the month in which such receivable becomes past due.

Billing fees: Billing fees are derived from billing-only (non-finance) clients. These fees are recorded when earned, which occurs when the service is rendered.

Other fees: These fees include annual fees, due diligence fees, termination fees, under minimum fees, and other fees including finance charges, supplies sold to clients, NSF fees, wire fees and administration fees. These fees are charged upon funding, takeovers or liquidation of finance clients. The Company also receives commission revenue from various sources.

The detail of total operating revenues included in the condensed consolidated statements of operations is as follows for the three and six months ended:

(In thousands):	Three months ended June 30:		Six months ended June 30:	
	2012	2011	2012	2011
Electronic payment processing	\$ 21,371	\$ 20,714	\$ 41,988	\$ 40,801
Web hosting and design	4,569	4,767	9,262	9,596
Premium income	2,414	4,258	4,804	7,272
Interest income	817	645	1,538	1,371
Servicing fee income NSBF portfolio	496	352	978	718
Servicing fee income external portfolios	1,475	377	2,075	652
Income from tax credits	129	317	319	630
Insurance commissions	319	269	630	525
Other income	748	623	1,473	1,280
Totals	\$ 32,338	\$ 32,322	\$ 63,067	\$ 62,845

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Electronic payment processing costs consist principally of costs directly related to the processing of merchant sales volume, including interchange fees, VISA® and MasterCard® dues and assessments, bank processing fees and costs paid to third-party processing networks. Such costs are recognized at the time the merchant transactions are processed or when the services are performed. Two of the most significant components of electronic processing expenses include interchange and assessment costs, which are set by the credit card associations. Interchange costs are passed on to the entity issuing the credit card used in the transaction and assessment costs are retained by the credit card associations. Interchange and assessment fees are billed primarily as a percent of dollar volume processed and, to a lesser extent, as a per transaction fee. In addition to costs directly related to the processing of merchant sales volume, electronic payment processing costs also include residual expenses. Residual expenses represent fees paid to third-party sales referral sources. Residual expenses are paid under various formulae as contracted. These are generally linked to revenues derived from merchants successfully referred to the Company and that begin using the Company for merchant processing services. Such residual expenses are recognized in the Company's condensed consolidated statements of operations.

Restricted Cash

Restricted cash includes cash collateral relating to a letter of credit; monies due on SBA loan-related remittances and insurance premiums received by the Company and due to third parties; cash held by the Capcos restricted for use in managing and operating the Capco, making qualified investments and for the payment of income taxes; cash held in a pre-funding account which will be used to purchase future unguaranteed portions of SBA 7(a) loans, cash reserves and prepaid interest associated with the securitization, and a cash account maintained as a reserve against chargeback losses. Following is a summary of restricted cash by segment:

(In thousands):	June 30, 2012	December 31, 2011
Electronic payment processing	\$ 382	\$ 284
Small business finance	4,338	9,107
All other	20	110
Corporate activities	1,064	1,064
Capcos	3,134	3,501
Totals	\$ 8,938	\$ 14,066

Broker Receivable

Broker receivable represents amounts due from third parties for loans which have been traded at year end but have not yet settled.

Purchased Receivables

For clients that are assessed fees based on a discount, purchased receivables are recorded at the point in time when cash is released to the seller. For clients that are on a Prime plus fee schedule, receivables are considered purchased when the invoices are submitted to NBC. A majority of the receivables purchased have recourse and are charged back to the seller if aged over 90 or 120 days, depending on contractual agreements. Purchased receivables are included in accounts receivable on the condensed consolidated balance sheets.

Investments in Qualified Businesses

The various interests that the Company acquires in its qualified investments are accounted for under three methods: consolidation, equity method and cost method. The applicable accounting method is generally determined based on the Company's voting interest or the economics of the transaction if the investee is determined to be a variable interest entity.

Consolidation Method. Investments in which the Company directly or indirectly owns more than 50% of the outstanding voting securities, those the Company has effective control over, or those deemed to be a variable interest entity in which the Company is the primary beneficiary are generally accounted for under the consolidation method of accounting. Under this method, an investment's financial position and results of operations are reflected within the Company's condensed consolidated financial statements. All significant inter-company accounts and transactions are eliminated, including returns of principal, dividends, interest received and investment redemptions. The results of operations and

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cash flows of a consolidated operating entity are included through the latest interim period in which the Company owned a greater than 50% direct or indirect voting interest,

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exercised control over the entity for the entire interim period or was otherwise designated as the primary beneficiary. Upon dilution of control below 50%, or upon occurrence of a triggering event requiring reconsideration as to the primary beneficiary of a variable interest entity, the accounting method is adjusted to the equity or cost method of accounting, as appropriate, for subsequent periods.

Equity Method. Investments that are not consolidated, but over which the Company exercises significant influence, are accounted for under the equity method of accounting. Whether or not the Company exercises significant influence with respect to an investee depends on an evaluation of several factors including, among others, representation on the investee's Board of Directors and ownership level, which is generally a 20% to 50% interest in the voting securities of the investee, including voting rights associated with the Company's holdings in common, preferred and other convertible instruments in the investee. Under the equity method of accounting, an investee's accounts are not reflected within the Company's condensed consolidated financial statements; however, the Company's share of the earnings or losses of the investee is reflected in the Company's condensed consolidated financial statements.

Cost Method. Investments not accounted for under the consolidation or the equity method of accounting are accounted for under the cost method of accounting. Under this method, the Company's share of the net earnings or losses of such investments is not included in the Company's condensed consolidated financial statements. However, cost method impairment charges are recognized, as necessary, in the Company's condensed consolidated financial statements. If circumstances suggest that the value of the investee has subsequently recovered, such recovery is not recorded until ultimately liquidated or realized.

The Company's debt and equity investments have substantially been made with funds available to Newtek through the Capco programs. These programs generally require that each Capco meet a minimum investment benchmark within five years of initial funding. In addition, any funds received by a Capco as a result of a debt repayment or equity return may, under the terms of the Capco programs, be reinvested and counted towards the Capcos' minimum investment benchmarks.

Securitization Activities

NSBF engaged in two securitization transactions of the unguaranteed portions of its SBA 7(a) loans in 2010 and 2011. Because the transfer of these assets to the Newtek Small Business Loan Trust 2010-1 (the Trust), a variable interest entity (VIE), did not meet the criteria of a sale, it was treated as a secured borrowing. NSBF continues to recognize the assets of the VIE in loans held for investment and the associated financing of the VIE in notes payable on the accompanying condensed consolidated balance sheets.

The liabilities recognized as a result of consolidating the VIE do not represent additional claims on the Company's general assets; rather, they represent claims against the specific assets of the VIE. Conversely, assets recognized as a result of consolidating the VIE do not represent additional assets that could be used to satisfy claims against the Company's general assets. All of the assets and the liabilities of the VIE are presented parenthetically on the accompanying condensed consolidated balance sheets.

Share - Based Compensation

All share-based payments to employees are recognized in the financial statements based on their fair values using an option-pricing model at the date of grant. The Company recognizes compensation on a straight-line basis over the requisite service period for the entire award. The Company has elected to adopt the alternative transition method for calculating the tax effects of share-based compensation. The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool related to the tax effects of employee share-based compensation, which is available to absorb tax deficiencies.

Fair Value

The Company adopted the methods of fair value to value its financial assets and liabilities. The Company carries its credits in lieu of cash, prepaid insurance and notes payable in credits in lieu of cash at fair value, as well as its warranty liability. In addition, the Company elected on October 1, 2010 to fair value its SBA loans held for investment and SBA loans held for sale. The Company also carries impaired loans and other real estate owned at fair value. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, the Company utilized a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

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- Level 1** Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain U.S. Government and agency mortgage-backed debt securities, corporate debt securities, derivative contracts and residential mortgage loans held-for-sale.
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly structured or long-term derivative contracts.

Income Taxes

Deferred tax assets and liabilities are computed based upon the differences between the financial statement and income tax basis of assets and liabilities using the enacted tax rates in effect for the year in which those temporary differences are expected to be realized or settled. If available evidence suggests that it is more likely than not that some portion or all of the deferred tax assets will not be realized, a valuation allowance is required to reduce the deferred tax assets to the amount that is more likely than not to be realized.

The Company's U.S. Federal and state income tax returns prior to fiscal year 2007 are closed and management continually evaluates expiring statutes of limitations, audits, proposed settlements, changes in tax law and new authoritative rulings.

Accounting for Uncertainty in Income Taxes

The ultimate deductibility of positions taken or expected to be taken on tax returns is often uncertain. In order to recognize the benefits associated with a tax position taken (i.e., generally a deduction on a corporation's tax return), the entity must conclude that the ultimate allowability of the deduction is more likely than not. If the ultimate allowability of the tax position exceeds 50% (i.e., it is more likely than not), the benefit associated with the position is recognized at the largest dollar amount that has more than a 50% likelihood of being realized upon ultimate settlement. Differences between tax positions taken in a tax return and recognized will generally result in (1) an increase in income taxes currently payable or a reduction in an income tax refund receivable or (2) an increase in a deferred tax liability or a decrease in a deferred tax asset, or both (1) and (2).

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash, cash equivalents and accounts receivable. The Company maintains its cash and cash equivalents with major financial institutions and at times, cash balances with any one financial institution may exceed Federal Deposit Insurance Corporation (FDIC) insured limits.

The Company sells its services to businesses throughout the United States. The Company performs ongoing credit evaluations of its customers financial condition and, generally, requires collateral, such as accounts receivable and/or other assets of the client, whenever deemed necessary. For the three and six months ended June 30, 2012 and 2011, no single customer accounted for 10% or more of the Company's revenue, or of total accounts receivable at June 30, 2012 and December 31, 2011.

Fair Value of Financial Instruments

As required by the Financial Instruments Topic of the FASB ASC, the estimated fair values of financial instruments must be disclosed. Excluding fixed assets, intangible assets, goodwill, and prepaid expenses and other assets (excluding as noted below), substantially all of the Company's assets and liabilities are considered financial instruments as defined under this standard. Fair value estimates are subjective in nature and are dependent on a number of significant assumptions associated with each instrument or group of similar instruments, including estimates of discount rates, risks associated with specific financial instruments, estimates of future cash flows and relevant available market information.

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The carrying values of the following balance sheet items approximate their fair values primarily due to their liquidity and short-term or adjustable-yield nature:

Cash and cash equivalents

Restricted cash

Broker receivable

Accounts receivable

Notes payable

Accrued interest receivable (included in prepaid expenses and other assets)

Accrued interest payable (included in accounts payable and accrued expenses)

Accounts payable and accrued expenses

The carrying value of investments in Qualified Businesses (included in prepaid expenses and other assets), credits in lieu of cash and notes payable in credits in lieu of cash as well as SBA loans held for investment, SBA loans held for sale, and warrants issued approximate fair value based on management's estimates.

New Accounting Standards

In January 2011, the FASB issued ASU No. 2011-01, *Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings* in Update No. 2010-20, which defers the effective date related to the disclosures required in ASU No. 2010-20, enabling creditors to provide such disclosures after the FASB completes their project clarifying the guidance for determining what constitutes a troubled debt restructuring. As the provisions of this ASU only defer the effective date of disclosure requirements related to troubled debt restructurings, the adoption of this ASU had no impact on the Company's condensed consolidated statements of operations and balance sheets.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements* in U.S. GAAP and IFRSs, which amends the current fair value measurement and disclosure guidance of ASC Topic 820 *Fair Value Measurement* to include increased transparency around valuation inputs and investment categorization. The guidance provided in ASU No. 2011-04 is effective prospectively for interim and annual periods beginning after December 15, 2011. The impact of adoption was not material to the Company's results of operations or financial position; additional disclosures required by this standard are located in Note 3 to the Condensed Consolidated Financial Statements *Fair Value Measurements*.

In September 2011, the FASB issued ASU No. 2011-08, *Intangibles - Goodwill and Other (Topic 350)*, to allow entities to use a qualitative approach to test goodwill for impairment and permit an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. This standard was effective for interim and annual reporting periods beginning on or after December 15, 2011, and has not had a material impact on the Company's condensed consolidated statements of operations and balance sheets.

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NOTE 3 FAIR VALUE MEASUREMENTS:

Fair Value Option Elections

Effective January 1, 2008, the Company adopted fair value accounting concurrent with the election of the fair value option. The accounting standard relating to the fair value measurements clarifies the definition of fair value and describes methods available to appropriately measure fair value in accordance with GAAP. The accounting standard applies whenever other accounting standards require or permit fair value measurements. The accounting standard relating to the fair value option for financial assets and financial liabilities allows entities to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities that are not otherwise required to be measured at fair value, with changes in fair value recognized in earnings as they occur. It also establishes presentation and disclosure requirements designed to improve comparability between entities that elect different measurement attributes for similar assets and liabilities.

On January 1, 2008, the Company elected the fair value option for valuing its Capcos credits in lieu of cash, notes payable in credits in lieu of cash and prepaid insurance.

On October 1, 2010, the Company elected the fair value option for valuing its SBA 7(a) loans funded on or after that date which are included in SBA loans held for investment and SBA loans held for sale.

The Company elected the fair value option in order to reflect in its financial statements the assumptions that market participants use in evaluating these financial instruments.

Table of Contents**Assets and Liabilities Measured at Fair Value on a Recurring Basis (In thousands):**

(In thousands):	Fair Value Measurements at June 30, 2012 Using:				Total Gains and (Losses)
	Total	Level 1	Level 2	Level 3	
Assets					
Credits in lieu of cash	\$ 11,552	\$	\$ 11,552	\$	\$
SBA loans held for investment	31,410			31,410	(581)
SBA loans held for sale	1,783		1,783		184
Total assets	\$ 44,745	\$	\$ 13,335	\$ 31,410	\$ (397)
Liabilities					
Notes payable in credits in lieu of cash	\$ 11,552	\$	\$ 11,552	\$	\$ 5
Warrant liability	2,070			2,070	(111)
Total liabilities	\$ 13,622	\$	\$ 11,552	\$ 2,070	\$ (106)

Assets and Liabilities Measured at Fair Value on a Recurring Basis as (in thousands):

(In thousands):	Fair Value Measurements at December 31, 2011 Using:				Total Gains and (Losses)
	Total	Level 1	Level 2	Level 3	
Assets					
Credits in lieu of cash	\$ 16,948	\$	\$ 16,948	\$	\$
SBA loans held for investment	21,857			21,857	(2,392)
SBA loans held for sale	2,198		2,198		265
SBA loans transferred, subject to premium recourse					(3,366)
Total assets	\$ 41,003	\$	\$ 19,146	\$ 21,857	\$ (5,493)
Liabilities					
Notes payable in credits in lieu of cash	\$ 16,948	\$	\$ 16,948	\$	\$ 41

Table of Contents**Credits in Lieu of Cash, Prepaid Insurance and Notes Payable in Credits in Lieu of Cash**

The Company elected to account for both credits in lieu of cash and notes payable in credits in lieu of cash at fair value in order to reflect in its condensed consolidated financial statements the assumptions that market participants use in evaluating these financial instruments.

Under the cost basis of accounting, the discount rates used to calculate the present value of the credits in lieu of cash and notes payable in credits in lieu of cash did not reflect the credit enhancements that the Company's Capcos obtained from Chartis, Inc. (Chartis) (the renamed property and casualty holdings of American International Group, Inc., AIG), namely its AA+ rating at such time, for their debt issued to certified investors. Instead the cost paid for the credit enhancements was recorded as prepaid insurance and amortized on a straight-line basis over the term of the credit enhancements.

With the adoption of the fair value measurement of financial assets and financial liabilities and the election of the fair value option, credits in lieu of cash and notes payable in credits in lieu of cash are valued based on the yields at which financial instruments would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. The accounting standards require the fair value of the assets or liabilities to be determined based on the assumptions that market participants use in pricing the financial instrument. In developing those assumptions, the Company identified characteristics that distinguish market participants generally, and considered factors specific to (a) the asset type, (b) the principal (or most advantageous) market for the asset group, and (c) market participants with whom the reporting entity would transact in that market.

Based on the aforementioned characteristics and in view of the Chartis credit enhancements, the Company believes that market participants purchasing or selling its Capcos debt, and therefore its credits in lieu of cash and notes payable in credits in lieu of cash, view nonperformance risk to be equal to the risk of Chartis nonperformance risk and as such both the fair value of credits in lieu of cash and notes payable in credits in lieu of cash should be priced to yield a rate equal to comparable U.S. Dollar denominated debt instruments issued by Chartis' parent, AIG. Because the value of notes payable in credits in lieu of cash directly reflects the credit enhancement obtained from Chartis, the unamortized cost relating to the credit enhancement will cease to be separately carried as an asset on the Company's condensed consolidated balance sheets and is incorporated in notes payable in credits in lieu of cash.

Fair value measurements:

The Company's Capcos debt, enhanced by Chartis insurance, effectively bears the nonperformance risk of Chartis. The closest trading comparators are the debt of Chartis' parent, AIG. Therefore the Company calculates the fair value of both the credits in lieu of cash and notes payable in credits in lieu of cash using the yields of various AIG notes with similar maturities to each of the Company's respective Capcos debt (the Chartis Note Basket). The Company elected to discontinue utilizing AIG's 7.70% Series A-5 Junior Subordinated Debentures because those long maturity notes began to trade with characteristics of a preferred stock after AIG received financing from the United States Government. The Company considers the Chartis Note Basket a Level 2 input under fair value accounting, since it is a quoted yield for a similar liability that is traded in an active exchange market. The Company selected the Chartis Note Basket as the most representative of the nonperformance risk associated with the Capco notes because they are Chartis issued notes, are actively traded and because maturities match credits in lieu of cash and notes payable in credits in lieu of cash.

After calculating the fair value of both the credits in lieu of cash and notes payable in credits in lieu of cash, the Company compares their values. This calculation is done on a quarterly basis. Calculation differences primarily due to tax credit receipt versus delivery timing may cause the value of the credits in lieu of cash to differ from that of the notes payable in credits in lieu of cash. Because the credits in lieu of cash asset has the single purpose of paying the notes payable in credits in lieu of cash and has no other value to the Company, Newtek determined that the credits in lieu of cash should equal the notes payable in credits in lieu of cash.

On December 31, 2011, the yield on the Chartis Note Basket was 5.53%. As of June 30, 2012, the date the Company revalued the asset and liability, the yields on the Chartis notes averaged 3.31% reflecting changes in interest rates in the marketplace. This decrease in yield decreased both the fair value of the credits in lieu of cash and the fair value of the notes payable in credits in lieu of cash. The Company increased the value of the credits in lieu of cash to equal the value of the notes payable in credits in lieu of cash because the credits in lieu of cash can only be used to satisfy the liability and must equal the value of the notes payable in credits in lieu of cash at all times. The net change in fair value reported in the Company's condensed consolidated statements of operations for the three and six months ended June 30, 2012 was a gain of \$5,000 and \$41,000, respectively.

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On December 31, 2010, the yield on the Chartis Note Basket was 4.38%. As of June 30, 2011, the date the Company revalued the asset and liability, the yields on the Chartis notes averaged 4.44% reflecting changes in interest rates in the marketplace. This increase in yield decreased both the fair value of the credits in lieu of cash and the fair value of the notes payable in credits in lieu of cash. The Company increased the value of the credits in lieu of cash to equal the value of the notes payable in credits in lieu of cash because the credits in lieu of cash can only be used to satisfy the liability and must equal the value of the notes payable in credits in lieu of cash at all times. The net change in fair value reported in the Company's condensed consolidated statements of operations for the three and six months ended June 30, 2011 was a gain of \$1,000 and \$76,000, respectively.

Changes in the future yield of the Chartis Note Basket will result in changes to the fair values of the credits in lieu of cash and notes payable in credits in lieu of cash when calculated for future periods; these changes will be reported through the Company's condensed consolidated statements of operations.

SBA 7(a) Loans

On October 1, 2010, the Company elected to utilize the fair value option for SBA 7(a) loans funded on or after that date. Management believed that doing so would promote its effort to both simplify and make more transparent its financial statements by better portraying the true economic value of this asset on its balance sheet and statement of income. NSBF originates, funds, and services government guaranteed loans under section 7(a) of the Small Business Act. The SBA does not fully guarantee the SBA 7(a) Loans: An SBA 7(a) Loan is bifurcated into a guaranteed portion and an unguaranteed portion, each accruing interest on the principal balance of such portion at a per annum rate in effect from time to time. NSBF originates variable interest loans, usually set at a fixed index to the Prime rate that resets quarterly. Primarily, NSBF has made SBA 7(a) loans carrying guarantees of 75% and 85%; from 2009 through early 2011 under a special program, most of the loans NSBF originated carried a guarantee of 90%. NSBF, both historically and as a matter of its business plan, sells the guaranteed portions via SBA Form 1086 into the secondary market when the guaranteed portion becomes available for sale upon the closing and fully funding of the SBA 7(a) loan and retains the unguaranteed portions. Management recognized that the economic value in the guaranteed portion did not inure to NSBF at the time of their sale but rather when the guaranty attached at origination; amortization accounting by its nature does not recognize this increase in value at the true time when it occurred. Under the fair value option, the value of the guarantee is recorded when it economically occurs at the point of the creation and funding of the loan, and is not delayed until when the sale occurs. Contemporaneously, the value of the unguaranteed portion will also be determined to reflect the full, fair value of the loan.

Although the fair value election is for the entire SBA 7(a) loan, the Company primarily sells the guaranteed portions at the completion of funding. The need to record the fair value for the guaranteed portion of the loan will primarily occur when a guaranteed portion is not traded at period end (SBA loans held for sale). The unguaranteed portion retained is recorded under SBA loans held for investment.

SBA Loans Held for Investment

For loans that completed funding before October 1, 2010, SBA loans held for investment are reported at their outstanding unpaid principal balances adjusted for charge-offs, net deferred loan origination costs and the allowance for loan losses. For loans that completed funding on or after October 1, 2010, management elected to fair value SBA loans held for investment within the fair value hierarchy that prioritizes observable and unobservable inputs utilizing Level 3 unobservable inputs which reflect the Company's own expectations about the assumptions that market participants would use in pricing the asset (including assumptions about risk). The Company considers its Securitization pricing model to be the best indicator of the fair value discount used to measure loans held for investment. As discussed in the Company's 2011 10K, the Company was able to securitize its unguaranteed portions of its SBA 7(a) loans and issued notes to an investor with a S&P rating of AA.

The fair value measurement, currently recorded as a 9.5% upfront discount of the unguaranteed principal balance of SBA loans held for investment, is based upon the investor price paid for the senior interest in our unguaranteed loans with respect to our two securitized transactions, and adjusted for the estimated servicing and interest income retained by the trust over an estimated repayment term of three years. This was further adjusted to reflect the estimated default rate on the senior notes based on the default rate on our loan portfolio, assuming a worst case scenario of no recoveries. Should the performance of the underlying loans to the senior notes change, this could impact the assumptions used in the estimated repayment term as well as the estimated default rate and thus result in a higher or lower discount rate taken in the future; management reviews these assumptions regularly. If a loan measured at fair value is subsequently impaired, then the fair value of the loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the loan is collateral dependent. The significant unobservable inputs used in the fair value measurement of the impaired loans involve management's judgment in the use of market data and third party estimates regarding collateral values. Such estimates are further discounted by 20% - 80% to reflect the cost of liquidating the various assets under collateral. Any subsequent increases or decreases in any of the inputs would result in a corresponding decrease or increase in the reserve for loan loss. Because the loans bear interest at a variable rate, NSBF does not have to factor in interest rate risk.

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Below is a summary of the activity in SBA loans held for investment, at fair value for the six months ended June 30, 2012 and the year ended December 31, 2011, respectively, (in thousands):

	June 30, 2012	December 31, 2011
Balance, beginning of period	\$ 21,857	\$ 2,310
SBA loans held for investment, originated	10,824	22,385
Payments received	(690)	(446)
Fair value loss	(581)	(2,392)
Balance, end of period	\$ 31,410	\$ 21,857

SBA Loans Held For Sale

For guaranteed portions funded, but not yet traded at each measurement date, management elected to fair value SBA loans held for sale within the fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value utilizing Level 2 assets. These inputs include debt securities with quoted prices that are traded less frequently than exchange-traded instruments or have values determined using a pricing model with inputs that are observable in the market. The secondary market for the guaranteed portions is extremely robust with broker dealers acting as primary dealers. NSBF sells regularly into the market and can quickly price its loans for sale. The Company values the guaranteed portion based on market prices equal to the guaranteed loan amount plus a premium that includes both an upfront cash payment (utilizing quoted prices) and the value of a stream of payments representing servicing income received in excess of NSBF's servicing cost (valued using a pricing model with inputs that are observable in the market).

SBA Loans Transferred, Subject to Premium Recourse

In 2010, a new accounting standard codified into ASC Topic 860, Transfers and Servicing, required for the guaranteed portions transferred that the Company, due to the premium warranty formerly incorporated in SBA Form 1086 (the warranty ceased as part of the form on February 7, 2011), establish a new asset related to the guaranteed portion of SBA 7(a) loans contractually sold but subject to premium recourse. Prior to October 1, 2010, guaranteed loans transferred in the secondary market are carried at cost. For guaranteed portions funded on or after October 1, 2010, management elected to fair value SBA loans transferred, subject to premium recourse within the fair value hierarchy that prioritizes observable and unobservable inputs utilizing Level 2 assets. The Company valued the guaranteed portion based on market prices equal to the guaranteed loan amount plus a premium that includes both an upfront cash payment (utilizing quoted prices) and the value of a stream of payments representing servicing income received in excess of NSBF's servicing cost (valued using a pricing model with inputs that are observable in the market).

Warrant Liability

Warrant liability represents warrants issued in connection with a financing transaction in April 2012. Due to anti-dilution provisions, the warrants are considered a derivative liability and are revalued at each reporting date with changes in the fair value reported in the statements of operations. The fair value of the warrants is determined using the Black-Scholes option valuation model and is subject to fluctuations based on changes in the Company's stock price, expected volatility, remaining contractual life, and the risk-free interest rate. At June 30, 2012, the fair value of the equity-based warrants was \$2,070,000. There were no corresponding liabilities at December 31, 2011.

	June 30, 2012
Balance, beginning of period, January 1, 2012	\$
Establishment of warrant liability upon closing of April 2012 financing	1,959
Fair value adjustment through June 30, 2012	111
Balance, end of period	\$ 2,070

Table of Contents**Other Fair Value Measurements**

Assets Measured at Fair Value on a Non-recurring Basis are as follows (In thousands):

	Fair Value Measurements at June 30, 2012 Using:				Total Losses
	Total	Level 1	Level 2	Level 3	
Assets					
Impaired loans	\$ 6,730	\$	\$	\$ 6,730	\$ (134)
Other real-estate owned	179		179		(119)
Total assets	\$ 6,909	\$	\$ 179	\$ 6,730	\$ (253)

	Fair Value Measurements at December 31, 2011				Total Losses
	Total	Level 1	Level 2	Level 3	
Assets					
Impaired loans	\$ 6,978	\$	\$	\$ 6,978	\$ (751)
Other real-estate owned	469		469		(43)
Total assets	\$ 7,447	\$	\$ 469	\$ 6,978	\$ (794)

Impaired loans

Impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the loan is collateral dependent. Impaired loans for which the carrying amount is based on fair value of the underlying collateral are included in assets and reported at estimated fair value on a non-recurring basis, both at initial recognition of impairment and on an on-going basis until recovery or charge-off of the loan amount. The significant unobservable inputs used in the fair value measurement of the impaired loans involve management's judgment in the use of market data and third party estimates regarding collateral values. Such estimates are further discounted by 20% - 80% to reflect the cost of liquidating the various assets under collateral. Valuations in the level of impaired loans and corresponding impairment affect the level of the reserve for loan losses. Any subsequent increases or decreases in any of the inputs would result in a corresponding decrease or increase in the reserve for loan loss.

Other real-estate owned (included in Prepaid expenses and other assets)

The estimated fair value of other real-estate owned is calculated using observable market information, including bids from prospective purchasers and pricing from similar market transactions where available. The value is generally discounted between 20-25% based on market valuations as well as expenses associated with securing the Company's interests. Where bid information is not available for a specific property, the valuation is principally based upon recent transaction prices for similar properties that have been sold. These comparable properties share comparable demographic characteristics. Other real estate owned is generally classified within Level 2 of the valuation hierarchy.

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SBA loans are geographically concentrated in Florida (13% of the portfolio), New York (11% of the portfolio) and Texas (9% of the portfolio). Below is a summary of the activity in the SBA loans held for investment, net of SBA loan loss reserves for the six months ended June 30, 2012 (in thousands):

Balance at December 31, 2011	\$ 40,412
SBA loans funded for investment	10,824
Fair value adjustment	(581)
Payments received	(2,076)
Provision for SBA loan losses	(275)
Discount on loan originations, net	181
Balance at June 30, 2012	\$ 48,485

Below is a summary of the activity in the reserve for loan losses for the six months ended June 30, 2012 (in thousands):

Balance at December 31, 2011	\$ 2,900
SBA loan loss provision	275
Recoveries	9
Loan charge-offs	(804)
Balance at June 30, 2012	\$ 2,380

Below is a summary of the activity in the SBA loans held for sale for the six months ended June 30, 2012 (in thousands):

Balance at December 31, 2011	\$ 2,198
Originations of SBA Loans held for sale	34,686
Fair value adjustment	(82)
SBA loans sold	(35,019)
Balance at June 30, 2012	\$ 1,783

All loans are priced at the Prime interest rate plus approximately 2.75% to 3.75%. The only loans with a fixed interest rate are defaulted loans of which the guaranteed portion sold is repurchased from the secondary market by the SBA, while the unguaranteed portion of the loans still remains with the Company. As of June 30, 2012 and December 31, 2011, net SBA loans receivable held for investment with adjustable interest rates amounted to \$49,191,000 and \$40,475,000, respectively.

For the six months ended June 30, 2012 and 2011, the Company funded approximately \$45,511,000 and \$42,622,000 in loans and sold and transferred approximately \$35,019,000 and \$31,997,000 of the guaranteed portion of the loans, respectively. Receivables from loans traded but not settled of \$5,643,000 and \$4,911,000 as of June 30, 2012 and December 31, 2011, respectively, are presented as broker receivable in the accompanying condensed consolidated balance sheets.

The outstanding balances of loans past due ninety days or more and still accruing interest as of June 30, 2012 and December 31, 2011 amounted to \$191,000 and \$516,000, respectively.

At June 30, 2012 and December 31, 2011, total impaired non-accrual loans amounted to \$6,730,000 and \$6,978,000, respectively. For the six months ended June 30, 2012 and for the year ended December 31, 2011, the average balance of impaired non-accrual loans was \$6,836,000 and

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\$7,995,000, respectively. Approximately \$1,943,000 and \$2,428,000 of the allowance for loan losses were allocated against such impaired non-accrual loans, respectively.

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The following is a summary of SBA loans held for investment as of:

(In thousands):	June 30, 2012		December 31, 2011	
	Fair Value	Cost Basis	Fair Value	Costs Basis
Due in one year or less	\$	\$ 25	\$	\$ 1,033
Due between one and five years		4,396		3,390
Due after five years	34,669	16,235	24,535	18,413
Total	34,669	20,656	24,535	22,836
Less : Allowance for loan losses		(2,380)		(2,900)
Less: Deferred origination fees, net		(1,201)		(1,381)
Less: Fair value adjustment	(3,259)		(2,678)	
Balance (net)	\$ 31,410	\$ 17,075	\$ 21,857	\$ 18,555

NOTE 5 SERVICING ASSET:

Servicing rights are recognized as assets when SBA loans are accounted for as sold and the rights to service those loans are retained. The Company measures all separately recognized servicing assets initially at fair value, if practicable. The Company reviews capitalized servicing rights for impairment which is performed based on risk strata, which are determined on a disaggregated basis given the predominant risk characteristics of the underlying loans. The predominant risk characteristics are loan term and year of loan origination.

The changes in the value of the Company's servicing rights for the six months ended June 30, 2012 were as follows:

(In thousands):	
Balance at December 31, 2011	\$ 3,420
Servicing rights capitalized	769
Servicing assets amortized	(358)
Balance at June 30, 2012	\$ 3,831

During the six months ended June 30, 2012, the Company revised its estimate for the amortization period of the servicing asset from 3.94 years to 5.00 years. Variables supporting this change in the rate of amortization included a decrease in loan prepayment speeds, an extended weighted average maturity date of the loan portfolio, and improvements in the credit standing of its loan customers. The effect of this change resulted in a \$83,000 reduction in servicing asset amortization for the six months ended June 30, 2012.

The estimated fair value of capitalized servicing rights was \$3,831,000 and \$3,420,000 at June 30, 2012 and December 31, 2011, respectively. The estimated fair value of servicing assets at both balance sheet dates was determined using a discount rate of 14%, weighted average prepayment speeds ranging from 1% to 12%, depending upon certain characteristics of the loan portfolio, weighted average life of 3.94 years, and an average default rate of 6%. The Company uses an independent valuation specialist to estimate the fair value of the servicing asset.

The unpaid principal balances of loans serviced for others are not included in the accompanying condensed consolidated balance sheets. The unpaid principal balances of loans serviced for others within the NSBF originated portfolio were \$309,458,000 and \$286,113,000 as of June 30, 2012 and December 31, 2011, respectively. The unpaid principal balances of loans serviced for others which were not originated by NSBF and are outside of the Newtek portfolio were \$566,467,000 and \$136,971,000 as of June 30, 2012 and December 31, 2011, respectively.

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At June 30, 2012 and December 31, 2011, the Company had long-term debt outstanding comprised of the following (in thousands):

	June 30, 2012	December 31, 2011
Notes payable:		
Capital One lines of credit (NSBF)		
Guaranteed line	\$ 6,429	\$ 5,355
Unguaranteed line	5,465	3,009
Summit Partners Credit Advisors, L.P. (NBS)	8,108	
Sterling National line of credit (NBC)	5,414	3,777
Capital One term loan (NTS)	1,215	1,424
Total notes payable:	26,631	13,565
Note payable Securitization trust	24,253	26,368
Total notes payable	\$ 50,884	\$ 39,933

On April 26, 2012, the Company closed a \$15,000,000 Second Lien Credit Facility (the Facility) issued by Summit Partners Credit Advisors, L.P. (Summit), comprised of a \$10,000,000 term loan, which was drawn at closing, and a \$5,000,000 delayed draw term loan to be made upon the satisfaction of certain conditions. The funds were used primarily for general corporate purposes including the origination of SBA 7(a) loans. The loan bears interest at 12.5% per annum on the amount outstanding plus payment-in-kind interest at 2.5%, which can either be paid quarterly in arrears or added to the outstanding loan amount. The Facility will mature in 5.5 years and can be prepaid without penalty at any time following the second anniversary of the closing date.

In addition to a second lien on all of the Company's assets behind the first lien held by Capital One, N.A., the principal lender to the Company's SBA lender, NSBF, Summit was given second-lien secured guarantees by each of the Company's principal subsidiaries: NTS and Universal Processing Services of Wisconsin, LLC, as well as certain other smaller subsidiaries. The Company has also committed to attempt to obtain the approval of the SBA for NSBF to provide a guaranty to Summit of the Company's obligations; the ability of the Company to achieve this approval is the precondition to the Company obtaining the \$5,000,000 delayed draw.

Total closing fees were approximately \$1,011,000 which included a 3% fee paid to Summit on the aggregate amount of the Facility, as well as legal, accounting and other closing related costs which will be recorded as deferred financing costs and amortized over the life of the facility. The majority of these fees were paid at closing and netted against the initial draw down. Net cash proceeds received at closing were \$9,353,000.

In addition, the Company issued to Summit a warrant representing the right to purchase 1,696,810 common shares, or 4.4% of the Company's current outstanding common equity. The warrant is exercisable at \$0.02 per share, included registration rights and will have anti-dilution protection for future issuances of equity and equity-linked securities of the Company issued to officers, directors and employees. Summit is prohibited from selling any common shares it receives on exercise of the warrant for a period of 24 months following the closing; provided, however, that if the Company's common shares trade at or above \$2.25 per share for a period of fifteen consecutive days, Summit will have the ability to sell the common shares. Any sales by Summit will be subject to a right of first refusal in favor of the Company. The Facility calls for financial covenants such as minimum EBITDA, maximum capital expenditures, minimum unrestricted cash and cash equivalents, minimum tangible net worth and maximum leverage.

In accordance with ASC 470 and ASC 815 the accounting for these warrants reflects the notion that the consideration received upon issuance must be allocated between the debt and warrant liability components based on the relative fair values of the debt instrument without the warrants and of the warrants themselves at time of issuance. The warrant liability, due to the anti-dilution provision, is considered a derivative liability, and will therefore be marked to market each reporting period. The remainder of the proceeds was allocated to the debt instrument portion of the transaction. As such, the note was initially valued at \$8,041,000, and the difference of \$1,959,000 was allocated to the value of the warrant liability and recorded as debt discount, which is being amortized over the life of the note using the interest method. Debt discount amortization for both the three and six months ended

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June 30, 2012 was \$66,000 and is included in interest expense in the Company's condensed consolidated statements of operations. The Company determined the fair value of the warrant as of the date of grant was \$1.44 per share by utilizing the Black-Scholes model and utilized the following inputs: closing price per share of common stock of \$1.45, \$0.02 exercise price, volatility of 72.50%, expected term of 10 years, risk-free interest rate of 2.01% and dividend yield of zero.

Through June 30, 2012, the Company has capitalized \$1,011,000 of deferred financing costs attributable to the Summit facility of which \$34,000 has been amortized and included in interest expense. The net balance of \$977,000 is included in prepaid expenses and other assets in the Company's condensed consolidated balance sheet.

Total interest expense for both the three and six months ended June 30, 2012 was approximately \$379,000, which includes interest, payment-in-kind interest, discount on the valuation of the warrant and amortization of deferred financing costs.

NOTE 7 TREASURY STOCK:

Shares of common stock repurchased by us are recorded at cost as treasury stock and result in a reduction of equity in our consolidated balance sheet. From time-to-time, treasury shares may be reissued as part of our stock-based compensation programs. When shares are reissued, we use the weighted average cost method for determining cost. The difference between the cost of the shares and the issuance price is added or deducted from additional paid in-capital.

In November 2011, the Company's Board of Directors adopted a stock buy-back program authorizing management to enter the market to re-purchase up to 1,000,000 of the Company's common shares. This 1,000,000 share authorization replaced the unexercised portions of two previous authorizations and terminates in one year. As of June 30, 2012, the Company has purchased a total of 794,339 treasury shares under this authorization with 780,920 shares being repurchased during the first six months of 2012. Total shares repurchased under all three authorizations aggregated 1,437,098 as of June 30, 2012. Since 2007, the Company reissued 196,887 shares in connection with the Company's 401(k) match program. In addition, 472,814 shares that were held by an affiliate were issued to the Company in 2008 as settlement of an outstanding liability and are being held as treasury shares.

In connection with the Company's 401(k) plan, at December 31, 2011, the Company elected to make a matching contribution in the form of Company shares equal to 50% of the first 2% of employees' 2011 contributions, up to a maximum match of 1%. In April 2012, in connection with this match, 66,760 treasury shares were transferred to the Company's 401(k) plan at a value of \$1.555 per share.

NOTE 8 STOCK OPTIONS AND RESTRICTED STOCK:

The Company had three share-based compensation plans as of June 30, 2012 and 2011, respectively. Shareholders of the Company approved a new share-based plan at the annual meeting during the second quarter of 2011. For the six months ended June 30, 2012 and 2011, compensation cost charged to operations for those plans was \$260,000 and \$193,000, respectively, of which \$203,000 and \$164,000 are included in salaries and benefits, and \$57,000 and \$29,000 are included other general and administrative costs in the Company's condensed consolidated statements of operations for the six months ended June 30, 2012 and 2011, respectively.

In March 2011, Newtek granted certain employees, executives and board of directors an aggregate of 1,142,000 restricted shares valued at \$1,941,000. The grants vest on July 1, 2014. The fair value of these grants was determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee. Upon vesting, the grantee will receive one common share for each restricted share vested. Under the terms of the plan, these share awards do not include voting rights until the shares vest. The Company charged \$105,000 and \$244,000 to share-based compensation expense during the three and six months ended June 30, 2012, respectively, in connection with the vesting period associated with these grants.

In the second quarter of 2012, Newtek granted certain employees and executives an aggregate of 124,000 restricted shares valued at \$184,000. The grants vest on July 1, 2014. The fair value of these grants was determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee. Upon vesting, the grantee will receive one common share for each restricted share vested. Under the terms of the plan, these share awards do not include voting rights until the shares vest. The Company charged \$15,000 to share-based compensation expense during both the three and six months ended June 30, 2012 in connection with the vesting period associated with these grants.

There were no options granted during the six months ended June 30, 2012.

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As of June 30, 2012 and December 31, 2011, there was \$1,254,000 and \$1,426,000 of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the 2000, 2003 and 2010 plans. That cost is expected to be recognized ratably through July 2014.

NOTE 9 INCOME TAXES:

The Company's provision (benefit) for income taxes for the six months ended June 30, 2012 and 2011 is as follows (in thousands):

	2012	2011
Current:		
Federal	\$ 2,587	\$ 827
State	456	526
	3,043	1,353
Deferred:		
Federal	(1,293)	(468)
State and local	(228)	(82)
	(1,521)	(550)
Provision for income taxes	\$ 1,522	\$ 803

NOTE 10 INCOME (LOSS) PER SHARE:

Basic income (loss) per share is computed based on the weighted average number of common shares outstanding (excluding treasury shares) during the period. The effect of common share equivalents is included in the calculation of diluted loss per share only when the effect of their inclusion would be dilutive.

The calculations of income (loss) per share were:

(In thousands except per share data):	Three months ended June 30:		Six months ended June 30:	
	2012	2011	2012	2011
Numerator for basic and diluted EPS income (loss) available to common shareholders	\$ 1,233	\$ (287)	\$ 2,536	\$ 222
Denominator for basic EPS weighted average shares	35,922	35,716	35,851	35,696
Effect of dilutive securities	959		685	654
Denominator for diluted EPS weighted average shares	36,881	35,716	36,536	36,350
Earnings (loss) per share: Basic and diluted	\$ 0.03	\$ (0.01)	\$ 0.07	\$ 0.01

The amount of anti-dilutive shares/units excluded from above is as follows:

Stock options and restricted shares	772	888	777	0
Warrants	5,050	50	5,050	50
Contingently issuable shares	8,383	83	8,383	83

NOTE 11 COMMITMENTS AND CONTINGENCIES:

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In the ordinary course of business, the Company may from time to time be party to lawsuits and claims. The Company evaluates such matters on a case by case basis and its policy is to contest vigorously any claims it believes are without compelling merit. The Company is currently involved in various contract claims and litigation matters. Management has reviewed all claims against

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the Company with counsel and has taken into consideration the views of such counsel as to the outcome of the claims, and on that basis the Company has determined that it is reasonably possible that claims will result in a loss in the near term which it estimates to be between \$100,000 and \$500,000.

NOTE 12 SEGMENT REPORTING:

Operating segments are organized internally primarily by the type of services provided. The Company has aggregated similar operating segments into six reportable segments: Electronic payment processing, Managed technology solutions, Small business finance, All other, Corporate and Capcos.

The Electronic payment processing segment is a processor of credit card transactions, as well as a marketer of credit card and check approval services to the small- and medium-sized business market. Expenses include direct costs (included in a separate line captioned electronic payment processing costs), professional fees, salaries and benefits, and other general and administrative costs, all of which are included in the respective caption on the condensed consolidated statements of operations.

The Managed technology solutions segment consists of NTS, acquired in July 2004. NTS's revenues are derived primarily from web hosting services and consist of web hosting and set up fees. NTS generates expenses such as professional fees, payroll and benefits, and depreciation and amortization, which are included in the respective caption on the accompanying condensed consolidated statements of operations, as well as licenses and fees, rent, and general office expenses, all of which are included in other general and administrative costs in the respective caption on the condensed consolidated statements of operations.

The Small business finance segment consists of Small Business Lending, Inc., a lender that primarily originates, sells and services government guaranteed SBA 7(a) loans to qualifying small businesses through NSBF, its licensed SBA lender; the Texas Whitestone Group which manages the Company's Texas Capco; and NBC which provides accounts receivable financing, billing and accounts receivable maintenance services to businesses. NSBF generates revenues from sales of loans, servicing income for those loans retained or contracted to service by NSBF and interest income earned on the loans themselves. The lender generates expenses for interest, professional fees, salaries and benefits, depreciation and amortization, and provision for loan losses, all of which are included in the respective caption on the condensed consolidated statements of operations. NSBF also has expenses such as loan recovery expenses, loan processing costs, and other expenses that are all included in the other general and administrative costs caption on the condensed consolidated statements of operations.

The All other segment includes revenues and expenses primarily from qualified businesses that received investments made through the Company's Capcos which cannot be aggregated with other operating segments. The two largest entities in the segment are Newtek Insurance Agency, LLC, an insurance sales operation, and Business Connect, LLC, a provider of sales and processing services.

Corporate activities represent revenue and expenses not allocated to our segments. Revenue includes interest income and management fees earned from Capcos (and included in expenses in the Capco segment). Expenses primarily include corporate operations related to broad-based sales and marketing, legal, finance, information technology, corporate development and additional costs associated with administering the Capcos.

The Capco segment, which consists of the twelve Capcos, generates non-cash income from tax credits, interest income and gains from investments in qualified businesses which are included in other income. Expenses primarily include non-cash interest and insurance expense, management fees paid to Newtek (and included in the Corporate activities revenues), legal, and auditing fees and losses from investments in qualified businesses. Exponential of New York, LLC, an entity determined to be a subsidiary on January 1, 2012, is also included in this segment.

Management has considered the following characteristics when making its determination of its operating and reportable segments:

the nature of the product and services;

the type or class of customer for their products and services;

the methods used to distribute their products or provide their services; and

the nature of the regulatory environment (for example, banking, insurance, or public utilities).

The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

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The following table presents the Company's segment information for the three and six months ended June 30, 2012 and 2011 and total assets as of June 30, 2012 and December 31, 2011 (In thousands):

	For the three months ended June 30, 2012	For the three months ended June 30, 2011	For the six months ended June 30, 2012	For the six months ended June 30, 2011
Third Party Revenue				
Electronic payment processing	\$ 21,373	\$ 20,717	\$ 41,991	\$ 40,805
Managed technology solutions	4,570	4,767	9,263	9,597
Small business finance	5,963	6,299	10,801	11,353
All other	451	347	883	701
Corporate activities	205	304	455	639
Capcos	141	324	455	663
Total reportable segments	32,703	32,758	63,848	63,758
Eliminations	(365)	(436)	(781)	(913)
Consolidated Total	\$ 32,338	\$ 32,322	\$ 63,067	\$ 62,845
Inter-Segment Revenue				
Electronic payment processing	\$ 414	\$ 277	\$ 789	\$ 552
Managed technology solutions	198	133	399	298
Small business finance	13	15	24	35
All other	314	268	622	539
Corporate activities	755	406	1,266	812
Capcos	206	195	414	388
Total reportable segments	1,900	1,294	3,514	2,624
Eliminations	(1,900)	(1,294)	(3,514)	(2,624)
Consolidated Total	\$	\$	\$	\$
Income (loss) before income taxes				
Electronic payment processing	\$ 1,904	\$ 1,344	\$ 3,970	\$ 2,547
Managed technology solutions	1,114	997	2,216	2,228
Small business finance	1,478	1,036	2,944	2,308
All other	(238)	(342)	(558)	(638)
Corporate activities	(1,930)	(2,414)	(3,730)	(4,379)
Capcos	(398)	(485)	(807)	(1,096)
Totals	\$ 1,930	\$ 136	\$ 4,035	\$ 970
Depreciation and amortization				
Electronic payment processing	\$ 169	\$ 380	\$ 410	\$ 762
Managed technology solutions	303	355	601	730
Small business finance	206	224	426	416
All other	2	20	16	41
Corporate activities	29	47	55	105
Capcos	2	3	4	5
Totals	\$ 711	\$ 1,029	\$ 1,512	\$ 2,059

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	As of June 30, 2012	As of December 31, 2011
Identifiable assets		
Electronic payment processing	\$ 12,357	\$ 10,722
Managed technology solutions	11,191	10,838
Small business finance	90,808	80,797
All other	2,214	2,878
Corporate activities	6,179	3,281
Capco	20,245	23,494
Consolidated total	\$ 142,994	\$ 132,010

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. Introduction and Certain Cautionary Statements

The following discussion and analysis of our financial condition and results of operations is intended to assist in the understanding and assessment of significant changes and trends related to the results of operations and financial position of the Company together with its subsidiaries. This discussion and analysis should be read in conjunction with the condensed consolidated financial statements and the accompanying notes.

The statements in this Quarterly Report on Form 10-Q may contain forward-looking statements relating to such matters as anticipated future financial performance, business prospects, legislative developments and similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, we note that a variety of factors could cause our actual results to differ materially from the anticipated results expressed in the forward-looking statements such as intensified competition and/or operating problems in its operating business projects and their impact on revenues and profit margins or additional factors as described in Newtek Business Services' previously filed registration statements as more fully described under "Risk Factors" above.

Our Capcos operate under a different set of rules in each of the six jurisdictions which place varying requirements on the structure of our investments. In some cases, particularly in Louisiana, we don't control the equity or management of a qualified business but that cannot always be presented orally or in written presentations.

Executive Overview

For the quarter ended June 30, 2012, the Company reported income before income taxes of \$1,930,000, an increase of \$1,794,000 from \$136,000 for the same quarter of 2011. The Company had net income of \$1,233,000 compared to a net loss of \$(287,000) for the second quarter of 2011, a \$1,520,000 improvement over the same quarter of 2011. Each of our segments reported improvements in profitability: In Electronic payment processing, the segment had a gain in the dollar margin on core business and a decrease in depreciation and amortization; the improvement in Managed technology solutions was related to a 2011 one-time charge to earnings related to the settlement of a license dispute, which did not recur in 2012, and the increase in Small business finance was primarily related to the expansion of the servicing portfolio and corresponding servicing income. Each of the remaining segments realized reductions in their respective losses reported compared with the prior quarter: Corporate had a decrease in salaries and benefits related to staff reductions and a one-time severance pay accrual recognized in June 2011; All other recorded an increase in insurance commission revenue and the loss in the Capcos decreased as a result of reductions in related party management fees paid. While total revenues increased modestly between periods, Electronic payment processing recorded 3% growth for the quarter, and current period growth in premium income and servicing income in the lending segment was sufficient to offset a \$1,700,000 reversal in the current period of the fair value adjustment associated with SBA loans transferred, subject to premium recourse, which increased premium income for the same amount in the year ago period.

In April 2012, the Company closed a \$15,000,000 credit facility with Summit comprised of a \$10,000,000 term loan, which was drawn at closing, and a \$5,000,000 delayed draw term loan to be made upon the satisfaction of certain conditions. The funds will be used primarily for general corporate purposes including the origination of SBA 7(a) loans. The terms of this financing agreement are discussed more fully in Note 6 to the Condensed Consolidated Financial Statements - Notes Payable.

Also in the second quarter 2012, the Company launched a new marketing campaign that included national exposure focusing on generating awareness of our products and services to qualified small business owners. Our direct media advertising campaign under our banner, NEWTEK® *The Small Business Authority*, will include national television commercials, online display and search media parameters. We will continue with our production of our *The Small Business Authority Index* and *The SBA Market Sentiment Survey* reflecting our polling and assessment of business conditions for small businesses; the active use of social media marketing; and perform an update our web site, www.thesba.com, expected to be completed in the second half of 2012.

The increase in the Company's cash and cash equivalents from \$11,363,000 at December 31, 2011 to \$23,061,000 at June 30, 2012 is primarily due to the \$9,353,000 in proceeds received during the current quarter in connection with the \$15,000,000 financing from Summit. This additional source of funds, together with the Company's existing lines of credit, has positioned us to handle an anticipated increase in loan funding throughout the remainder of 2012 as well as the continued investment in NEWTEK® *The Small Business Authority*.

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The results of the Company's reportable segments for the three and six months ended June 30, 2012 and 2011 are discussed below:

Electronic Payment Processing

(In thousands):	Three months ended June 30:		\$ Change	% Change
	2012	2011		
Revenue:				
Electronic payment processing	\$ 21,371	\$ 20,714	\$ 657	3%
Interest income	2	3	(1)	(33)%
Total revenue	21,373	20,717	656	3%
Expenses:				
Electronic payment processing costs	17,849	17,628	221	1%
Salaries and benefits	1,022	988	34	3%
Professional fees	56	61	(5)	(8)%
Depreciation and amortization	169	380	(211)	(55)%
Other general and administrative costs	373	316	57	18%
Total expenses	19,469	19,373	96	1%
Income before income taxes	\$ 1,904	\$ 1,344	\$ 560	42%

Three Months Ended June 30, 2012 and 2011

Electronic payment processing (EPP) revenue increased \$657,000 or 3% between years due to organic growth. Revenue increased due to a combination of growth in processing volumes, selective fee increases and additions to services provided to our merchants. Processing volumes were favorably impacted by an increase in the average number of processing merchants under contract between periods of 3%. In addition, growth in revenue between periods increased due to an increase of approximately 9% in the average monthly processing volume per merchant. The increase in the average monthly processing volume per merchant is due in part to the addition of several larger volume processing merchants as well as year-over-year growth in processing volumes from existing merchants. Total revenue in 2012 was adversely impacted by approximately 9% due to the effect of lower pass-through pricing on debit card transactions due to government mandated limits on underlying interchange costs for such transactions as well as the overall pricing mix of merchant sales volumes realized between periods.

Electronic payment processing costs increased \$221,000 or 1% between years. Beginning in the fourth quarter of 2011, the EPP Segment began experiencing lower EPP Costs as interchange costs on debit card transactions were reduced for interchange plus priced merchants as well as others. Processing revenues less electronic payment processing costs (margin) increased from 14.9% in 2011 to 16.5% in 2012. The increase in margin is due to the impact on revenues and EPP Costs resulting from the debit card pricing and interchange cost changes noted above net of higher residual payments to sales agents which increased \$882,000 or 51% between years as well as changes in the mix of merchant sales volumes processed. Overall, the increase in margin dollars was \$436,000 between years.

Excluding electronic payment processing costs, other costs decreased \$125,000 or 7% between years. Depreciation and amortization decreased \$211,000 between periods as the result of a previously acquired portfolio of intangible assets becoming fully amortized between periods. Remaining costs, which increased \$86,000 between years, included approximately \$50,000 in office relocation costs during 2012.

Income before income taxes increased \$560,000 to \$1,904,000 in 2012 from \$1,344,000 in 2011. The increase in income before income taxes was due to the increase in the dollar margin of operating revenues less electronic payment processing costs of \$436,000 due to the reasons noted above and the decrease in depreciation and amortization cost between years.

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(In thousands):	Six months ended June 30:		\$ Change	% Change
	2012	2011		
Revenue:				
Electronic payment processing	\$ 41,988	\$ 40,801	\$ 1,187	3%
Interest income	3	4	(1)	(25)%
Total revenue	41,991	40,805	1,186	3%
Expenses:				
Electronic payment processing costs	34,730	34,722	8	%
Salaries and benefits	2,087	2,052	35	2%
Professional fees	120	119	1	1%
Depreciation and amortization	410	762	(352)	(46)%
Other general and administrative costs	674	603	71	12%
Total expenses	38,021	38,258	(237)	(1)%
Income before income taxes	\$ 3,970	\$ 2,547	\$ 1,423	56%

Six Months Ended June 30, 2012 and 2011

Electronic payment processing (EPP) revenue increased \$1,187,000 or 3% between years due to organic growth. Revenue increased due to a combination of growth in processing volumes, selective fee increases and additions to services provided to our merchants. Processing volumes were favorably impacted by an increase in the average number of processing merchants under contract between periods of 3%. In addition, growth in revenue between periods increased due to an increase of approximately 8% in the average monthly processing volume per merchant. The increase in the average monthly processing volume per merchant is due in part to the addition of several larger volume processing merchants as well as year-over-year growth in processing volumes from existing merchants. Total revenue in 2012 was adversely impacted by approximately 8% due to the effect of lower pass-through pricing on debit card transactions due to government mandated limits on underlying interchange costs for such transactions as well as the overall pricing mix of merchant sales volumes realized between periods.

Electronic payment processing costs increased only \$8,000 between years. Beginning in the fourth quarter of 2011, the EPP Segment began experiencing lower EPP Costs as interchange costs on debit card transactions were reduced for interchange plus priced merchants as well as others. Processing revenues less electronic payment processing costs (margin) increased from 14.9% in 2011 to 17.3% in 2012. The increase in margin is due to the impact on revenues and EPP Costs resulting from the debit card pricing and interchange cost changes noted above net of higher residual payments to sales agents which increased \$1,812,000 or 52% between years, as well as changes in the mix of merchant sales volumes processed. Overall, the increase in margin dollars was \$1,179,000 between years.

Excluding electronic payment processing costs, other costs decreased \$245,000 or 7% between years. Depreciation and amortization decreased \$352,000 between periods as the result of previously acquired portfolio intangible assets becoming fully amortized between periods. Remaining costs increased \$107,000 or 4% between years. During 2012, office relocation costs of approximately \$50,000 were incurred.

Income before income taxes increased \$1,423,000 to \$3,970,000 in 2012 from \$2,547,000 in 2011. The increase in income before income taxes was due to the increase in the dollar margin of operating revenues less electronic payment processing costs of \$1,179,000 due to the reasons noted above and the decrease in depreciation and amortization cost between years.

Table of Contents**Managed Technology Solutions**

(In thousands):	Three months ended June 30:			
	2012	2011	\$ Change	% Change
Revenue:				
Web hosting and design	\$ 4,570	\$ 4,767	\$ (197)	(4)%
Expenses:				
Salaries and benefits	1,264	1,213	51	4%
Interest	21	27	(6)	(22)%
Professional fees	81	204	(123)	(60)%
Depreciation and amortization	303	355	(52)	(15)%
Other general and administrative costs	1,787	1,971	(184)	(9)%
Total expenses	3,456	3,770	(314)	(8)%
Income before income taxes	\$ 1,114	\$ 997	\$ 117	12%

Three months ended June 30, 2012 and 2011:

Revenue is derived primarily from recurring fees from hosting websites, including monthly contracts for shared hosting, dedicated servers and cloud instances (the "plans"). In addition, revenues are derived from contracted services to design web sites. Revenue between periods decreased \$197,000, or 4%, to \$4,570,000 in 2012. The decrease in revenues included a decrease in web design revenues of \$135,000 to \$18,000 in 2012 due to the timing of the completion of such project contracts between years and a decrease in web hosting revenue of \$63,000 or 1%. The decrease in web hosting revenue is the result of a decrease in the average monthly number of total plans by 5,592 or 10% between periods to 51,438 plans in 2012 from 57,030 plans in 2011. Substantially offsetting the decrease in web hosting revenue resulting from the decline in the number of plans was an increase in the average monthly revenue per plan of slightly less than 10% to \$29.26 in 2012 from \$26.70 in 2011. The increase in the average revenue per plan reflects a growth in cloud instances and customers purchasing higher-cost plans including additional options and services. The average number of cloud instances increased by 303 to an average of 626 from 323 in 2011 reflecting the Company's introduction of a customer scalable cloud offering in 2011. The decrease in the average total plans occurred in the shared and dedicated segments. The average monthly number of dedicated server plans for 2012, which generate a higher monthly fee versus shared hosting plans, decreased by 354 between periods, or 19%, to an average of 1,535 from an average of 1,889 in 2011. The average monthly number of shared hosting plans in 2012 decreased by 5,540, or 10%, to an average of 49,278 from 54,818 in 2011. Competition from other web hosting providers as well as alternative website services continues to have a negative effect on web hosting plan count and revenue growth.

It continues to be management's intent to increase revenues and margin per plan through higher-priced service offerings to customers, although this may result in some loss of customers and a lower number of plans in place overall. In addition, management plans to lessen its dependency on the Microsoft® web platform by broadening its platform capabilities to include more open source web applications which have become increasingly more attractive to web developers and resellers.

Total expenses of \$3,456,000 in 2012 declined \$314,000 or 8% from \$3,770,000 in 2011. Salaries and benefits increased \$51,000 or 4% between periods to \$1,264,000. The growth in salaries and benefits is principally due to additional staffing in executive management as well as wage rate increases between periods. Depreciation and amortization decreased \$52,000 between periods to \$303,000 due to reduced capital expenditures in recent years as a result of lower replacement costs for new equipment overall, more efficient use of existing equipment within the data center for shared and dedicated plans and the utilization of cloud architecture to more efficiently provide services to customers. The decrease of \$123,000 in professional fees was primarily due to a decrease in web design development costs as a result of a decrease in web design revenues between periods. Other general and administrative costs decreased \$184,000 or 9% between periods. Included in other expenses in 2011 was an expense of \$190,000 resulting from the resolution of a licensing dispute. Increases in domain costs of \$43,000 and hardware maintenance and support of \$47,000, principally due to the restructuring of previous contracts in those areas, were substantially offset by reductions in lease expense of \$18,000, utility costs of \$40,000 and bad debt expense of \$54,000.

Income before income taxes increased 12% or \$117,000 to \$1,114,000 in 2012 from \$997,000 in the same period of 2011. The increase is principally due to lower earnings in 2011 resulting from a \$190,000 licensing settlement partially offset by a decline in web hosting revenue

between years as increases in revenue per site have not offset an overall decline in revenue due to site attrition.

Table of Contents**Six months ended June 30, 2012 and 2011:**

(In thousands):	Six months ended June 30:		\$ Change	% Change
	2012	2011		
Revenue:				
Web hosting and design	\$ 9,263	\$ 9,597	\$ (334)	(3)%
Expenses:				
Salaries and benefits	2,554	2,398	156	7%
Interest	43	54	(11)	(20)%
Professional fees	250	388	(138)	(36)%
Depreciation and amortization	601	730	(129)	(18)%
Other general and administrative costs	3,599	3,799	(200)	(5)%
Total expenses	7,047	7,369	(322)	(4)%
Income before income taxes	\$ 2,216	\$ 2,228	\$ (12)	(1)%

Revenue is derived primarily from recurring fees from hosting websites, including monthly contracts for shared hosting, dedicated servers and cloud instances (the plans). In addition, revenues are derived from contracted services to design web sites. Revenue between years decreased by \$334,000 to \$9,263,000 in 2012. The decrease in revenues included a decrease in web design revenues of \$178,000 to \$142,000 in 2012 due to the timing of completion of projects between years and a decrease in web hosting revenue of \$156,000 or less than 2%. The decrease in web hosting revenue is the result of a decrease in the average monthly number of total plans by 5,338 or 10% between years to 52,222 plans in 2012 from 57,560 plans in 2011. Partially offsetting the decrease in web hosting revenue resulting from the decline in plans was an increase in the average monthly revenue per plan of slightly less than 9% to \$28.86 in 2012 from \$26.58 in 2011. The increase in the average revenue per plan reflects a growth in cloud instances and customers purchasing higher cost plans including additional options and services. The average number of cloud instances increased by 318 to an average of 599 from 281 in 2011 reflecting the Company's introduction of a customer scalable cloud offering in 2011. The decrease in the average total plans occurred in the shared and dedicated segments. The average monthly number of dedicated server plans for 2012, which generate a higher monthly fee versus shared hosting plans, decreased by 373 between years, or 19%, to an average of 1,567 from an average of 1,940 in 2011. The average monthly number of shared hosting plans in 2012 decreased by 5,284, or 10%, to an average of 50,055 from 55,339 in 2011. Competition from other web hosting providers as well as alternative website services continues to have a negative effect on web hosting plan count and revenue growth.

Total expenses of \$7,047,000 in 2012 declined 4% from \$7,369,000 in 2011. Salaries and benefits increased \$156,000 or 7% between years to \$2,554,000. The growth in salaries and benefits is principally due to adding additional staffing in the areas of customer service and executive management as well as wage rate increases between periods. Depreciation and amortization decreased \$129,000 between years to \$601,000 due to reduced capital expenditures in recent years as a result of lower replacement costs for new equipment overall, more efficient use of existing equipment within the data center for shared and dedicated plans and the utilization of cloud architecture to more efficiently provide services to customers. The decrease of \$138,000 in professional fees was primarily due to a decrease in web design development costs as a result of a decrease in web design revenues between years. Other general and administrative costs decreased \$200,000 or 5% between years. Included in other expenses in 2011 was an expense of \$190,000 resulting from the resolution of a licensing dispute. Increases in domain costs of \$43,000 and hardware maintenance and support of \$38,000, principally due to the restructuring of previous contracts in those areas, were substantially offset by a reduction in bad debt expense of \$84,000.

Income before income taxes decreased 1% or \$12,000 to \$2,216,000 in 2012 from \$2,228,000 in 2011. A decrease in profitability due to the decline in web hosting revenue between years where increases in revenue per site have not offset an overall decline in revenue due to site attrition was substantially offset by an overall decrease in costs including the impact of a \$190,000 licensing settlement cost in 2011.

Table of Contents**Small Business Finance**

(In thousands):	Three months ended June 30:			
	2012	2011	\$ Change	% Change
Revenue:				
Premium income	\$ 2,414	\$ 4,258	\$ (1,844)	(43)%
Servicing fee	1,971	729	1,242	170%
Interest income	807	618	189	31%
Management fees related party	146	146		%
Other income	625	548	77	14%
Total revenue	5,963	6,299	(336)	(5)%
Net change in fair value of:				
SBA loans transferred, subject to premium recourse		(1,703)	1,703	(100)%
SBA loans held for sale	(130)	(370)	240	(65)%
SBA loans held for investment	(439)	(613)	174	(28)%
Warrant liability	(111)		(111)	100%
Total net change in fair value	(680)	(2,686)	2,006	(75)%
Expenses:				
Salaries and benefits	1,439	1,116	323	29%
Interest	969	451	518	115%
Professional fees	153	70	83	119%
Depreciation and amortization	206	224	(18)	(8)%
Provision for loan losses	155	74	81	109%
Other general and administrative costs	883	642	241	38%
Total expenses	3,805	2,577	1,228	48%
Income before income taxes	\$ 1,478	\$ 1,036	\$ 442	43%

Business Overview

The Newtek Business lending segment is comprised of NSBF which is a non-bank SBA lender that originates, sells and services loans for its own portfolio as well as portfolios of other institutions, and NBC which provides accounts receivable financing and billing services to business. Revenue is derived primarily from premium income generated by the sale of the guaranteed portions of SBA loans, interest income on SBA loans held for investment and held for sale, servicing fee income on the guaranteed portions of SBA loans sold, servicing income for loans originated by other lenders for which NSBF is the servicer, and financing and billing services, classified as other income above, provided by NBC. Most SBA loans originated by NSBF charge an interest rate equal to the Prime rate plus an additional percentage amount; the interest rate resets to the current Prime rate on a monthly or quarterly basis, which will result in changes to the amount of interest accrued for that month and going forward and a re-amortization of a loan's payment amount until maturity.

Accounting Policy

Prior to February 7, 2011, guaranteed portions of SBA loans sold in the secondary market included a premium warranty which precluded sale treatment until the end of the expiration of a warranty period, 90 to 270 days subsequent to the date of loan transfer. Such loans were classified on the Balance Sheet as SBA loans transferred, subject to premium recourse with a matching liability, Liability on SBA loans transferred, subject to premium recourse. The fair value of the associated premium was recorded as SBA loans transferred, subject to premium recourse. At the expiration of the warranty period, the resulting gain on sale was recognized into premium income, the asset and liability eliminated, and the associated fair value adjustment reversed. Effective February 7, 2011, the SBA removed the warranty provision allowing the Company to recognize premium income concurrent with the date of sale and eliminating additions to the SBA loans transferred asset and liability. The net

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effect of this change resulted in NSBF being able to recognize as premium income, in the quarter ended June 30, 2011, \$1,703,000 from 2010 loan sales coming off of warranty as well as premium from loan sales during the three months ended June 30, 2011.

On October 1, 2010, the Company elected to utilize the fair value option for SBA 7(a) loans funded on or after that date. For these fair value loans, premium on loan sales equals the cash premium and servicing asset paid by the purchaser in the secondary market, the discount created on the unguaranteed portion from the sale which formerly reduced premium income is now included

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in the fair value line item, and, by not capitalizing various transaction expenses, the salaries and benefits and loan processing expense lines portray a value closer to the cash cost to operate the lending business. The fair value measurement, currently recorded as a 9.5% upfront discount of the unguaranteed principal balance of SBA loans held for investment, is based upon the investor price paid for the senior interest in our unguaranteed loans with respect to our two securitization transactions, and adjusted for the estimated servicing and interest income retained by the trust over an estimated repayment term of three years. This was further adjusted to reflect the estimated default rate on the senior notes based on the default rate on our loan portfolio, assuming a worst case scenario of no recoveries. Should the performance of the underlying loans to the senior notes change, this could impact the assumptions used in the estimated repayment term as well as the estimated default rate and thus result in a higher or lower discount rate taken in the future; management reviews these assumptions regularly. If a loan measured at fair value is subsequently impaired, then the fair value of the loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the loan is collateral dependent. The significant unobservable inputs used in the fair value measurement of impaired loans involve management's judgment in the use of market data and third party estimates regarding collateral values. Such estimates are further discounted by 20% - 80% to reflect the cost of liquidating the various assets under collateral. Any subsequent increases or decreases in any of the inputs would result in a corresponding decrease or increase in the reserve for loan loss. Because the loans bear interest at a variable rate, NSBF does not have to factor in interest rate risk.

Consideration in arriving at the provision for loan loss includes past and current loss experience, current portfolio composition, future estimated cash flows, and the evaluation of real estate and other collateral as well as current economic conditions. For all loans originated on or prior to September 30, 2010, management performed a loan-by-loan review for the estimated uncollectible portion of non-performing loans; subsequent to September 30, 2010, management began recording all loan originations on a fair value basis which requires a valuation reduction of the unguaranteed portion of loans held for investment to a level that takes into consideration future losses. This valuation reduction is reflected in the line item above: Net Change in Fair Value of SBA Loans Held for Investment.

Small Business Finance Summary

(In thousands):	Three months ended June 30, 2012		Three months ended June 30, 2011	
	# Loans	\$ Amount	# Loans	\$ Amount
Loans sold in quarter	25	\$ 16,732	32	\$ 19,781
Loans originated in quarter	28	\$ 21,025	34	\$ 23,209
Loans that achieved sale status in quarter, originated in prior period		\$	23	\$ 14,670
Premium income recognized (1)		\$ 2,414		\$ 4,258
Average sale price		114.16		110.93

- (1) Of the total premium recognized in the second quarter of 2011, \$1,703,000 was from previously originated loans that achieved sale status as a result of the warranty period expiring.

For the three months ended June 30, 2012, the Company recognized \$2,414,000 of premium income from 25 loans sold aggregating \$16,732,000. During the three months ended June 30, 2011, the Company recognized \$4,258,000 in premium income from 32 loans sold totaling \$19,781,000 not subject to the premium warranty, and 23 loans aggregating \$14,670,000 previously subject to the premium warranty that achieved sale status during the quarter. The decrease in premium income for the three months ended June 30, 2012 as compared with the prior period, was due primarily to the reversal of the fair value adjustment of \$1,703,000 associated with SBA loans transferred, subject to premium recourse, which increased premium income for the same amount in the three months ended June 30, 2011. The additional decrease was attributable to the reduction in the number of loans sold quarter over quarter, offset by an increase in premium pricing. Premiums on guaranteed loan sales averaged 114.16 with 1% servicing for the quarter ended June 30, 2012 compared with 110.93 with 1% servicing for the quarter ended June 30, 2011.

Table of Contents**Servicing Portfolios and related Servicing Income**

(In thousands):	Three months ended June 30:			
	2012	2011	\$ Change	% Change
Total NSBF originated servicing portfolio (1)	\$ 309,457	\$ 249,565	\$ 59,892	24%
Third party servicing portfolio	257,009	75,880	181,129	239%
Aggregate servicing portfolio	\$ 566,466	\$ 325,445	\$ 241,021	74%
Total servicing income earned	\$ 1,971	\$ 729	\$ 1,242	170%

(1) Of this amount, total average NSBF originated portfolio earning servicing income was \$234,431,000 and \$184,458,000 for the three months ended June 30, 2012 and 2011, respectively.

The \$1,242,000 improvement in total servicing fee income was essentially due to the addition of third party loan servicing, which increased by \$1,130,000 for the three months ended June 30, 2012 compared with the three months ended June 30, 2011. The average third party servicing portfolio increased from \$76,055,000 to \$240,897,000 for the 2011 and 2012 three month period, respectively. The remaining increase of \$112,000 was attributable to the expansion of the NSBF portfolio, in which we earn servicing income, which increased from an average of \$184,458,000 for the three month period ending June 30, 2011 to an average of \$234,431,000 for the three months ended June 30, 2012. This increase was the direct result of increased loan originations throughout 2011 and the first six months of 2012.

Interest income increased by \$189,000 for the three months ended June 30, 2012 as compared to the same period in 2011. The second quarter of 2012 added \$246,000 of interest income as a result of the average outstanding performing portfolio of SBA loans held for investment increasing from \$26,247,000 to \$46,993,000 for the quarters ended June 30, 2011 and 2012, respectively. Interest income for the three months ended June 30, 2011 included \$55,000 in interest earned from SBA loans transferred, subject to recourse; all transferred loans achieved sales status at December 31, 2011.

Other income increased by \$77,000 primarily due to a \$15,000 increase in fees earned on receivables purchased and a \$69,000 increase in annual and upfront fees on financing clients earned by NBC offset by a decrease in other fees of \$8,000 from NSBF during the three months ended June 30, 2012 as compared with the three months ended June 30, 2011 attributable to recognizing fewer prepayment and packaging fees period over period.

The increase in the net change in fair value associated with SBA loans transferred, subject to premium recourse is the direct result of all previously transferred loans having achieved sale status during 2011 as well as the SBA removing the warranty provision (as discussed above) allowing the Company to recognize premium income concurrently with the date of sale. During the three months ended June 30, 2011, as a result of the elimination of the premium warranty, 23 previously transferred loans were recognized as sales, thereby reducing the corresponding fair value adjustment by \$1,703,000. The change in fair value associated with SBA loans held for sale is related to the total amount of loans converted from partially funded to fully funded status during a given period. During the three months ended June 30, 2011 and 2012, the Company converted \$2,368,000 in partially funded loans compared with \$729,000, respectively. The increase in the change in fair value on SBA loans held for investment is a result of reducing the upfront discount taken on unguaranteed loans, from 11% to 9.5% during the first quarter of 2012. This reduction was determined based on the investor price paid for the senior interest in our unguaranteed loans with respect to our two securitized transactions, adjusted for the estimated servicing and interest income retained by the trust over an estimated repayment term of three years and further adjusted to reflect the estimated default rate on the senior notes based on the default rate on our loan portfolio, assuming a worst case scenario of no recoveries. During the three months ended June 30, 2012, loans originated and held for investment aggregated \$5,015,000 resulting in a corresponding fair value loss of \$439,000, representing an improvement of \$174,000 over the second quarter of 2011. In connection with the Summit financing transaction which closed in April 2012, the Company adjusted its warrant liability to fair value at period end resulting in a fair value loss of \$111,000 for the three months ended June 30, 2012.

Salaries and benefits increased by \$323,000 primarily due to the addition of staff in the originating, servicing and liquidation departments, as well as additional staff to service third party contracts. Combined headcount increased by 30% from 50 at June 30, 2011 to 65 at June 30, 2012.

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Interest expense increased by \$518,000 for the three months ended June 30, 2012 compared with the same period in 2011, due primarily to \$379,000 of interest expense associated with the Summit financing transaction which closed in April 2012. The

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\$379,000 includes interest, payment-in-kind interest, discount on the valuation of the warrant and amortization of deferred financing costs. Additionally, interest at NBC increased by \$6,000 as the average debt outstanding at NBC increased from \$4,981,000 to \$5,336,000 for the three months ended June 30, 2011 and 2012, respectively and NSBF experienced an increase in interest expense of \$177,000 in connection with the closing of the second securitization transaction in December 2011 and an increase of \$11,000 related to the Capital One line of credit increase in June 2011. The remaining decrease is attributable to a reduction of \$55,000 attributable to the liability for SBA loans transferred, subject to premium recourse, which was reduced to zero in 2011.

Professional fees for the three months ended June 30, 2012 increased by \$83,000 when compared with the three months ended June 30, 2011 primarily due to consulting and accounting expenses, as well as fees associated with the trustee for the loan portfolio securitization.

Loan Loss Reserves and Fair Value Discount

(In thousands):	Three months ended June 30:		\$ Change	% Change
	2012	2011		
Total reserves and discount, beginning of period	\$ 5,623	\$ 4,077	\$ 1,546	38%
Provision for loan loss	155	74	81	109%
Discount, loans held for investment at fair value (1)	439	613	(174)	(28)%
Charge offs (net of recoveries)	(589)	(263)	(326)	(124)%
Total reserves and discount, end of period	\$ 5,628	\$ 4,501	\$ 1,127	25%
Gross portfolio balance, end of period	\$ 55,024	\$ 37,728	\$ 17,296	46%
Total impaired nonaccrual loans, end of period	\$ 6,519	\$ 8,334	\$ (1,815)	(22)%

- (1) Based on the investor price paid for the senior interest in our unguaranteed loans with respect to our two securitized transactions, adjusted for the estimated servicing and interest income retained by the trust over an estimated repayment term of three years and further adjusted to reflect the estimated default rate on the senior notes based on the default rate on our loan portfolio, assuming a worst case scenario of no recoveries, the upfront discount taken on unguaranteed loans was reduced from 11% to 9.5% during the first quarter of 2012.

The increase in loan loss provision of \$81,000 was offset by the \$174,000 net change in fair value of SBA loans held for investment for loans originated subsequent to September 30, 2010. The combined provision for loan loss and net change in fair value decreased from \$687,000 for the three months ended June 30, 2011 to \$594,000 for the same period in 2012, a net decrease of \$93,000 period over period. The allowance for loan loss, together with the cumulative fair value adjustment related to the SBA loans held for investment, increased from \$4,501,000 or 12.0% of the gross portfolio balance of \$37,728,000 at June 30, 2011 to \$5,628,000 or 10.2% of the gross portfolio balance of \$55,024,000 at June 30, 2012. This decrease in reserve percentage also reflects the positive performance of the portfolio. Total impaired non-accrual loans decreased from \$8,334,000 or 22.0% of the total portfolio at June 30, 2011 to \$6,519,000 or 11.8% at June 30, 2012 with \$2,507,000 or 30.1% and \$1,943,000 or 29.8% of the allowance for loan losses being allocated against such impaired non-accrual loans, respectively. The year over year reduction in non-performing loans results from an improvement in the overall economic climate. The year over year reduction in the specific reserve reflects both the overall collateralization on the non-performing portfolio as well as the increase in the portion of that portfolio making periodic payments pending return to performing status reducing the need for a specific reserve at this time.

Other general and administrative costs increased by \$241,000 due primarily to the increase in loan originating, processing and servicing costs as a result of the increase in loans originated and serviced during the current quarter as well as an increase in loan recovery costs of \$114,000 during the second quarter of 2012 as compared with the same quarter in 2011.

The increase of the loan portfolio, combined with improvements in servicing and interest, generated by the addition to and enhanced performance of the portfolio, and an increase in third party servicing, offset additional salaries, servicing and origination expenses. The resulting pretax income of \$1,478,000 for the three months ended June 30, 2012 was a 43% improvement over the pretax income of \$1,036,000 for the three months ended June 30, 2011.

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(In thousands):	Six months ended June 30:		\$ Change	% Change
	2012	2011		
Revenue:				
Premium income	\$ 4,804	\$ 7,272	\$ (2,468)	(34)%
Servicing fee	3,052	1,368	1,684	123%
Interest income	1,516	1,310	206	16%
Management fees related party	293	293		%
Other income	1,136	1,110	26	2%
Total revenue	10,801	11,353	(552)	(5)%
Net change in fair value of:				
SBA loans transferred, subject to premium recourse		(3,216)	3,216	(100)%
SBA loans held for sale	(82)	296	(378)	(128)%
SBA loans held for investment	(581)	(938)	357	(38)%
Warrant liability	(111)		(111)	%
Total net change in fair value	(774)	(3,858)	3,084	(80)%
Expenses:				
Salaries and benefits	2,852	2,220	632	28%
Interest	1,546	1,082	464	43%
Professional fees	351	232	119	51%
Depreciation and amortization	426	416	10	2%
Provision for loan losses	265	86	179	208%
Other general and administrative costs	1,643	1,151	492	43%
Total expenses	7,083	5,187	1,896	37%
Income before income taxes	\$ 2,944	\$ 2,308	\$ 636	28%

Small Business Finance Summary

(In thousands):	Six months ended June 30, 2012		Six months ended June 30, 2011	
	# Loans	\$ Amount	# Loans	\$ Amount
Loans sold in period	44	\$ 35,019	58	\$ 31,997
Loans originated in period	47	\$ 45,511	59	\$ 42,622
Loans that achieved sale status, originated in prior period		\$	46	\$ 29,219
Premium income recognized (1)		\$ 4,804		\$ 7,272
Average sale price		113.06		111.21

- (1) Of the total premium recognized in the first half of 2011, \$3,216,000 was from previously originated loans that achieved sale status as a result of the warranty period expiring.

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For the six months ended June 30, 2012, the Company recognized \$4,804,000 of premium income from 44 loans sold aggregating \$35,019,000. During the six months ended June 30, 2011, the Company recognized \$4,056,000 of premium income from 58 loans sold totaling \$31,997,000 not subject to the premium warranty, and \$3,216,000 from 46 loans aggregating \$29,219,000 previously subject to the premium warranty that achieved sale status during the six months. The decrease in premium income for the six months ended June 30, 2012 as compared with the prior period was due entirely to the reversal of the fair value adjustment of \$3,216,000 associated with SBA loans transferred, subject to premium recourse, which increased premium income for the same amount in the six months ended June 30, 2011. Premium prices on guaranteed loan sales averaged 113.06 with 1% servicing for the six months ended June 30, 2012 compared with 111.21 with 1% servicing for the six months ended June 30, 2011.

Servicing Portfolios and related Servicing Income

(In thousands):	Six months ended June 30:		\$ Change	% Change
	2012	2011		
Total NSBF originated servicing portfolio (1)	\$ 309,457	\$ 249,565	\$ 59,892	24%
Third party servicing portfolio	257,009	75,880	181,129	239%
Aggregate servicing portfolio	\$ 566,466	\$ 325,445	\$ 241,021	74%
Total servicing income earned	\$ 3,052	\$ 1,368	\$ 1,684	123%

(1) Of this amount, total average NSBF originated portfolio earning servicing income was \$226,073,000 and \$179,244,000 for the six month period ended June 30, 2012 and 2011, respectively.

The \$1,684,000 improvement in total servicing fee income was attributable primarily to third party loan servicing, which increased by \$1,358,000 for the six months ended June 30, 2012 compared to the six months ended June 30, 2011. The average third party servicing portfolio increased from \$76,055,000 to \$143,337,000 for the 2011 and 2012 six month period, respectively. In addition, servicing fees received from the SBA on repurchased loans increased by \$67,000 and the remaining increase of \$259,000 was attributable to the expansion of the NSBF portfolio, in which we earn servicing income, which increased from an average of \$179,244,000 for the six month period ending June 30, 2011 to an average of \$226,073,000 for the same six month period in 2012. This increase was the direct result of increased loan originations throughout 2011 and the first six months of 2012.

Interest income increased by \$206,000 for the six months ended June 30, 2012 as compared to the same period in 2011. The first half of 2012 added \$528,000 of interest income as a result of the average outstanding performing portfolio of SBA loans held for investment increasing from \$25,112,000 to \$44,458,000 for the six months ended June 30, 2011 and 2012, respectively. Results for 2011 included \$326,000 in interest earned from SBA loans transferred, subject to recourse; all transferred loans achieved sales status at December 31, 2011.

Other income increased by \$26,000 primarily due to a \$92,000 increase in annual and upfront fees on financing clients earned by NBC, offset by a decrease in receivable and billing fee revenue of \$30,000. Additionally, NSBF incurred a \$35,000 reduction in other income period over period attributable to recognizing fewer prior period expense recoveries and packaging fees.

The increase in the net change in fair value associated with SBA loans transferred, subject to premium recourse is the direct result of all previously transferred loans having achieved sale status during 2011 as well as the SBA removing the warranty provision (as previously discussed above) allowing the Company to recognize premium income concurrent with the date of sale. During the six months ended, June 30, 2011, as a result of the elimination of the premium warranty, 23 previously transferred loans were recognized as sales, thereby reducing the corresponding fair value adjustment by \$3,216,000. The change in fair value associated with SBA loans held for sale is related to the total amount of loans converted from partially funded to fully funded status during a given period. During the six months ended June 30, 2011 and 2012, the Company converted \$59,000 in partially funded loans compared with \$335,000, respectively. The increase in the change in fair value on SBA loans held for investment is a result of reducing the upfront discount taken on unguaranteed loans, from 11% to 9.5% during the first quarter of 2012. This reduction was determined based on the investor price paid for the senior interest in our unguaranteed loans with respect to our two securitized transactions, adjusted for the estimated servicing and interest income retained by the trust over an estimated repayment term of three years and further adjusted to reflect the estimated default rate on the senior notes based on the default rate on our loan portfolio,

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assuming a worst case scenario of no recoveries. During the six months ended June 30, 2012, loans originated and held for investment aggregated \$10,824,000 resulting in a corresponding fair value loss of \$581,000, representing an improvement of \$357,000 over the first half of 2011. In connection with the Summit financing transaction which closed in April 2012, the Company recorded a fair value loss of \$111,000 for the six months ended June 30, 2012 to reflect the fair value of warrants issued as part of the transaction.

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Salaries and benefits increased by \$632,000 primarily due to the addition of staff in the originating, servicing and liquidation departments, as well as additional staff to service outside contracts. Combined headcount increased by 25.53% from an average of 47 for the six months ended June 30, 2011 to an average of 59 for the six months ended June 30, 2012.

Interest expense increased by \$464,000 for the six months ended June 30, 2012 compared with the same period in 2011, due primarily to \$379,000 of interest expense associated with the Summit financing transaction which closed in April 2012. The \$379,000 includes interest, payment-in-kind interest, discount on the valuation of the warrant and amortization of deferred financing costs. Additionally, NSBF experienced an increase in interest expense of \$330,000 in connection with the closing of the second securitization transaction in December 2011 and an additional \$86,000 increase related to the Capital One line of credit which increased from an average outstanding balance of \$5,614,000 for the six months ended June 30, 2011 to \$7,180,000 for the same period in 2012. These increases were offset by a reduction of \$326,000 attributable to the liability for SBA loans transferred, subject to premium recourse, which was reduced to zero in 2011 and a decrease of interest at NBC by \$24,000 due to the write off of the remaining deferred financing costs under the Wells line in 2011.

Professional fees for the six months ended June 30, 2012 increased by \$119,000 when compared with the six months ended June 30, 2011 primarily due to consulting and accounting expenses, as well as fees associated with the trustee for the loan portfolio securitization.

Loan Loss Reserves and Fair Value Discount

(In thousands):	Six months ended June 30:			
	2012	2011	\$ Change	% Change
Total reserves and discount, beginning of period	\$ 5,566	\$ 3,845	\$ 1,721	45%
Provision for loan loss	265	86	179	208%
Discount, loans held for investment at fair value (1)	581	938	(357)	(38)%
Charge offs (net of recoveries)	(785)	(367)	(418)	(114)%
Total reserves and discount, end of period	\$ 5,627	\$ 4,502	\$ 1,125	25%
Gross portfolio balance, end of period	\$ 55,024	\$ 37,728	\$ 17,296	46%
Total impaired nonaccrual loans, end of period	\$ 6,519	\$ 8,334	\$ (1,815)	(22)%

(1) Based on the investor price paid for the senior interest in our unguaranteed loans with respect to our two securitized transactions, adjusted for the estimated servicing and interest income retained by the trust over an estimated repayment term of three years and further adjusted to reflect the estimated default rate on the senior notes based on the default rate on our loan portfolio, assuming a worst case scenario of no recoveries, the upfront discount taken on unguaranteed loans was reduced from 11% to 9.5% during the first quarter of 2012.

The increase in loan loss provision of \$179,000 was offset by the \$378,000 net change in fair value of SBA loans held for investment for loans originated subsequent to September 30, 2010. The combined provision for loan loss and net change in fair value decreased from \$1,024,000 for the six months ended June 30, 2011 to \$846,000 for the six months ended June 30, 2012, a net decrease of \$178,000 period over period. The allowance for loan loss together with the cumulative adjustment related to SBA loans held for investment increased from \$4,502,000 or 12.0% of the gross portfolio balance of \$37,728,000 at June 30, 2011 to \$5,627,000 or 10.2% of the gross portfolio balance of \$55,024,000 at June 30, 2012. This decrease in reserve percentage also reflects the positive performance of the portfolio. Total impaired non-accrual loans decreased from \$8,334,000 or 22.1% of the total portfolio at June 30, 2011 to \$6,519,000 or 11.85% at June 30, 2012 with \$2,507,000 or 30.1% and \$1,943,000 or 29.8% of the allowance for loan losses being allocated against such impaired non-accrual loans, respectively. The year over year reduction in non-performing loans results from an improvement in the overall economic climate. The year over year reduction in the specific reserve reflects both the overall collateralization on the non-performing portfolio as well as the increase in the portion of that portfolio making periodic payments pending return to performing status reducing the need for a specific reserve at this time.

Other general and administrative costs increased by \$492,000 due primarily to the increase in loan originating, processing and servicing costs as a result of the increase in loans originated and serviced during the current quarter and an increase of \$242,000 in loan recovery costs associated with the sale of foreclosed properties during the first six months of 2012 and an increase in collateral preservation costs as compared with the same period in 2011.

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The increase of loan originations and the size of the portfolio, combined with improvements in servicing, and interest, generated by the addition to and enhanced performance of the portfolio, and an increase in third party servicing, were sufficient to offset additional salaries, servicing and origination expenses. The resulting pretax income of \$2,944,000 for the six months ended June 30, 2012 was a 28% improvement over pretax income of \$2,308,000 for the six months ended June 30, 2011.

Table of Contents**All Other**

(In thousands):	Three months ended June 30:		\$ Change	% Change
	2012	2011		
Revenue:				
Insurance commissions	\$ 319	\$ 269	\$ 50	19%
Other income	112	74	38	51%
Other income related party	19		19	100%
Interest income	1	4	(3)	(75)%
Total revenue	451	347	104	30%
Expenses:				
Salaries and benefits	491	499	(8)	(2)%
Professional fees	67	59	8	14%
Depreciation and amortization	2	20	(18)	(90)%
Other general and administrative costs	129	111	18	16%
Total expenses	689	689		%
Loss before income taxes	\$ (238)	\$ (342)	\$ 104	30%

Three months ended June 30, 2012 and 2011:

The All Other segment includes revenues and expenses primarily from Newtek Insurance Agency, LLC (NIA), Newtek Payroll Services and qualified businesses that received investments made through the Company's Capcos which cannot be aggregated with other operating segments.

Total revenue increased by \$104,000, or 30% for the three months ended June 30, 2012 as compared to the same period in 2011. Insurance commissions increased by \$50,000 which was due primarily to the expansion of NIA's force placed insurance portfolio. Other income increased by \$38,000 period over period, related in part to Newtek Payroll Services revenues which increased from \$17,000 for the three months ended June 30, 2011, to approximately \$41,000 for the three months ended June 30, 2012. The improvement was due to organic growth in the number of payroll clients which increased from 16 as of June 30, 2011, to 238 clients as of June 30, 2012. Other income related party represents fees charged by Newtek Payroll Services to Newtek and subsidiaries which are eliminated upon consolidation.

Total expenses remained unchanged period over period as reductions in salaries and benefits and depreciation and amortization were sufficient to offset slight increases in professional fees and other general and administrative expenses.

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(In thousands):	Six months ended June 30:		\$ Change	% Change
	2012	2011		
Revenue:				
Insurance commissions	\$ 630	\$ 525	\$ 105	20%
Other income	210	170	40	24%
Other income - related party	41		41	100%
Interest income	2	6	(4)	(67)%
Total revenue	883	701	182	26%
Expenses:				
Salaries and benefits	1,038	934	104	11%
Professional fees	142	123	19	15%
Depreciation and amortization	16	41	(25)	(61)%
Other general and administrative costs	245	241	4	2%
Total expenses	1,441	1,339	102	8%
Loss before income taxes	\$ (558)	\$ (638)	\$ 80	13%

Six months ended June 30, 2012 and 2011:

Total revenue increased by \$182,000 or 26% for the six months ended June 30, 2012 as compared to the same period in 2011. Insurance commissions increased by \$105,000 which was due primarily to the expansion of NIA's force placed insurance portfolio. Other income increased by \$40,000 period over period, due in part to Newtek Payroll Services revenues which increased from \$21,000 for the six months ended June 30, 2011, to approximately \$68,000 for the six months ended June 30, 2012. The improvement, which was due to organic growth, resulted from an increase in the number of payroll clients from 16 as of June 30, 2011 to 238 clients as of June 30, 2012. Other income - related party represents fees charged by Newtek Payroll Services to the Company and subsidiaries which are eliminated upon consolidation.

Total expenses increased by \$102,000 period over period primarily due to a \$104,000 increase in salaries and benefits. The majority of the increase, or \$65,000 was attributable to Newtek Payroll Services which had an increase in head count from three payroll services employees for the six months ended June 30, 2011, to six employees at June 30, 2012.

Table of Contents**Corporate activities**

(In thousands):	Three months ended June 30:		\$ Change	% Change
	2012	2011		
Revenue:				
Management fees related party	\$ 199	\$ 289	\$ (90)	(31)%
Interest and other income	6	15	(9)	(60)%
Total revenue	205	304	(99)	(33)%
Expenses:				
Salaries and benefits	1,221	1,708	(487)	(29)%
Professional fees	269	284	(15)	(5)%
Depreciation and amortization	29	47	(18)	(38)%
Other general and administrative costs	616	679	(63)	(9)%
Total expenses	2,135	2,718	(583)	(21)%
Loss before income taxes	\$ (1,930)	\$ (2,414)	\$ 484	20%

The Corporate activities segment implements business strategy, directs marketing, provides technology oversight and guidance, coordinates and integrates activities of the other segments, contracts with alliance partners, acquires customer opportunities, and owns our proprietary NewTracker® referral system and all other intellectual property rights. This segment includes revenue and expenses not allocated to other segments, including interest income, Capco related party management fee income, and corporate operating expenses. These operating expenses consist primarily of internal and external public accounting expenses, internal and external corporate legal expenses, corporate officer salaries, sales and marketing expense and rent for the principal executive offices.

Revenue is derived primarily from management fees earned from the Capcos. Management fee revenue declined 31%, or \$90,000, to \$199,000 for the three months ended June 30, 2012, from \$289,000 for the three months ended June 30, 2011. Related party management fees, which are eliminated upon consolidation, are expected to continue to decline in the future as the Capcos mature and utilize their cash. If a Capco does not have current or projected cash sufficient to pay management fees, then such fees are not accrued.

Total expenses decreased by \$583,000, or 21%, for the three months ended June 30, 2012 from the same period in 2011. The \$487,000 decrease in salaries and benefits was due to the departure of an executive officer resulting in a severance pay accrual of \$276,000 in the 2011 period, as well as other reductions in personnel period over period. Professional fees declined approximately \$15,000 period over period as a result of reduced annual audit fees and overall decreases in legal and other professional fees. Depreciation and amortization decreased \$18,000 period over period due to fixed assets becoming fully depreciated over the past twelve months. The decrease of \$63,000 in other general and administrative costs was primarily attributable to reduced rent and related occupancy costs of approximately \$109,000, resulting primarily from the Company's prior year corporate office relocation, offset in part by increases in marketing and related costs.

Loss before income taxes decreased \$484,000 for the three months ended June 30, 2012, as compared to the same period in 2011, primarily due to the decrease in overall expenses explained above, partially offset by a decrease in related party management fee revenue.

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(In thousands):	Six months ended June 30:		\$ Change	% Change
	2012	2011		
Revenue:				
Management fees related party	\$ 448	\$ 620	\$ (172)	(28)%
Interest and other income	7	19	(12)	(63)%
Total revenue	455	639	(184)	(29)%
Expenses:				
Salaries and benefits	2,583	3,105	(522)	(17)%
Professional fees	465	535	(70)	(13)%
Depreciation and amortization	55	105	(50)	(48)%
Other general and administrative costs	1,082	1,273	(191)	(15)%
Total expenses	4,185	5,018	(833)	(17)%
Loss before income taxes	\$ (3,730)	\$ (4,379)	\$ 649	(15)%

Six months ended June 30, 2012 and 2011:

Revenue is derived primarily from management fees earned from the Capcos. Related party management fee revenue declined 28%, or \$172,000, to \$448,000 for the six months ended June 30, 2012, from \$620,000 for the six months ended June 30, 2011. Related party management fees, which are eliminated upon consolidation, are expected to continue to decline in the future as the Capcos mature and utilize their cash. If a Capco does not have current or projected cash sufficient to pay management fees, then such fees are not accrued.

Total expenses decreased \$833,000, or 17%, for the six months ended June 30, 2012 from the same period in 2011. The decrease in total expenses was primarily due to a \$522,000 decrease in salaries and benefits resulting from a severance pay accrual of \$276,000 in 2011 for the departure of an executive officer, as well as other reductions in personnel in accounting and marketing, which reduced salaries and benefits period over period. Professional fees declined by \$70,000 for the six months ended June 30, 2012 primarily due to overall decreases in audit, legal and other professional services. In addition, depreciation and amortization decreased by \$50,000 period over period due to fixed assets becoming fully depreciated over the past twelve months. Other general and administrative costs declined by \$191,000 due mainly to a reduction in rent and related costs resulting from our corporate office relation which occurred in November 2011.

Loss before income taxes decreased \$649,000 for the six months ended June 30, 2012, as compared to the same period in 2011, primarily due to the overall decreases in expenses partially offset by a decrease in related party management fee revenue.

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As described in Note 3 to the condensed consolidated financial statements, effective January 1, 2008, the Company adopted fair value accounting for its financial assets and financial liabilities concurrent with its election of the fair value option for substantially all credits in lieu of cash, notes payable in credits in lieu of cash and prepaid insurance. These are the financial assets and liabilities associated with the Company's Capco notes that are reported within the Company's Capco segment. The tables below reflect the effects of the adoption of fair value measurement on the income and expense items (income from tax credits, interest expense and insurance expense) related to the revalued financial assets and liability for the three and six months ended June 30, 2012 and 2011. In addition, the net change to the revalued financial assets and liability for the three and six months ended June 30, 2012 and 2011 is reported in the line "Net change in fair market value of Credits in lieu of cash and Notes payable in credits in lieu of cash" on the condensed consolidated statement of operations.

The Company does not anticipate creating any new Capcos in the foreseeable future and the Capco segment will continue to incur losses going forward. The Capcos will continue to earn cash investment income on their cash balances and incur cash management fees and operating expenses. The amount of cash available for investment and to pay management fees will be primarily dependent upon future returns generated from investments in qualified businesses. Income from tax credits will consist solely of accretion of the discounted value of the declining dollar amount of tax credits the Capcos will receive in the future; the Capcos will continue to incur non-cash interest expense.

(In thousands):	Three months ended June 30:		\$ Change	% Change
	2012	2011		
Revenue:				
Income from tax credits	\$ 129	\$ 317	\$ (188)	(59)%
Interest income	6	6		%
Other income	6	1	5	500%
Total revenue	141	324	(183)	(56)%
Net change in fair value of:				
Credits in lieu of cash and Notes payable in credits in lieu of cash	5	1	4	400%
Expenses:				
Management fees - related party	345	435	(90)	(21)%
Interest	144	327	(183)	(56)%
Professional fees	43	51	(8)	(16)%
Other general and administrative costs	12	(3)	15	500%
Total expenses	544	810	(266)	(33)%
Loss before income taxes	\$ (398)	\$ (485)	\$ 87	18%

Three months ended June 30, 2012 and 2011:

Revenue is derived primarily from non-cash income from tax credits. The decrease in total revenues for the three months ended June 30, 2012 versus the three months ended June 30, 2011 reflects the effect of the declining dollar amount of tax credits remaining in 2012. The amount of future income from tax credits revenue will fluctuate with future interest rates. However, over future periods through 2016, the amount of tax credits, and the income the Company will recognize, will decrease to zero.

Expenses consist primarily of management fees and non-cash interest expense. Related party management fees decreased 21%, or \$90,000, to \$345,000 for the three months ended June 30, 2012 from \$435,000 for the same period ended 2011. Related party management fees, which are eliminated upon consolidation, are expected to decline in the future as the Capcos mature and utilize their cash. Interest expense decreased 56%, or \$183,000, to \$144,000 for the three months ended June 30, 2012 from \$327,000 as a result of the declining amount of tax credits payable in 2012. Professional fees decreased \$8,000 between periods as a result of reduced consulting and accounting fees. The increase in other general and administrative costs of \$15,000 was due primarily to a reversal of a previously written off guaranteed portion of an investment in 2011 of \$51,000. In addition, there was a reduction in bank charges, filing fees and general office expenses incurred for the three months ended June 30,

2012 versus the three months ended June 30, 2011.

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(In thousands):	Six months ended June 30:		\$ Change	% Change
	2012	2011		
Revenue:				
Income from tax credits	\$ 319	\$ 630	\$ (311)	(49)%
Interest income	15	31	(16)	(52)%
Other income	121	2	119	5,950%
Total revenue	455	663	(208)	(31)%
Net change in fair value of:				
Credits in lieu of cash and Notes payable in credits in lieu of cash	41	76	(35)	(46)%
Expenses:				
Management fees related party	740	912	(172)	(19)%
Interest	381	723	(342)	(47)%
Professional fees	138	135	3	2%
Other general and administrative costs	44	65	(21)	(32)%
Total expenses	1,303	1,835	(532)	(29)%
Loss before income taxes	\$ (807)	\$ (1,096)	\$ 289	26%

Six months ended June 30, 2012 and 2011:

Revenue is derived primarily from non-cash income from tax credits. The decrease in total revenue for the six months ended June 30, 2012 versus the same period in 2011 reflects the effect of the declining dollar amount of tax credits remaining in 2012 partially offset by a \$100,000 gain on the sale of an investment with a zero carrying basis. The amount of future income from tax credits revenue will fluctuate with future interest rates. However, over future periods through 2016, the amount of tax credits, and therefore the income the Company will recognize, will decrease to zero.

Expenses consist primarily of management fees and non-cash interest expense. Related party management fees decreased 19%, or \$172,000, to \$740,000 for the six months ended June 30, 2012 from \$912,000 for the same period ended 2011. Related party management fees, which are eliminated upon consolidation, are expected to decline in the future as the Capcos mature and utilize their cash. Interest expense decreased 47%, or \$342,000, to \$381,000 for the six months ended June 30, 2012 from \$723,000 as a result of the declining dollar amount of tax credits payable in 2012. Other general and administrative costs decreased by 32%, or \$21,000 for the six months ended June 30, 2012 over the prior period primarily due to a \$6,000 lease restructuring charge that occurred in the first quarter of 2011 as well as reduced bank charges, annual filing fees and general office expenses in the current period.

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Critical Accounting Policies and Estimates:

The Company's significant accounting policies are described in Note 2 of the Notes to Consolidated Financial Statements included in its Form 10-K for the fiscal year ended December 31, 2011. A discussion of the Company's critical accounting policies, and the related estimates, are included in Management's Discussion and Analysis of Results of Operations and Financial Position in its Form 10-K for the fiscal year ended December 31, 2011.

Liquidity and Capital Resources

Cash requirements and liquidity needs over the next twelve months are anticipated to be funded primarily through cash generated from operations, available cash and cash equivalents, the newly secured and existing lines of credit and term loan, and additional securitizations of the Company's SBA lender's unguaranteed loan portions. As more fully described below, the Company's SBA lender is dependent on funding sources to maintain SBA loan originations at anticipated levels; although failure to find and maintain these sources may require the reduction in the Company's SBA lending and related operations, it will not impair the Company's overall ability to operate.

In order to operate, the Company's SBA lender depends on the continuation of the SBA 7(a) guaranteed loan program of the United States Government. The Company's SBA lender depends on the availability of purchasers for SBA loans held for sale transferred to the secondary markets and the premium earned therein to support its lending operations. At this time, the Company's SBA lender depends on the availability of purchasers for SBA loans held for sale transferred to the secondary markets and the premium earned therein to support its lending operations. At this time, the secondary market for the SBA loans held for sale is robust.

The Company's SBA lender has historically financed the operations of its lending business through loans or credit facilities from various lenders and will need to continue to do so in the future. Such lenders invariably require a security interest in the SBA loans as collateral which, under the applicable law, requires the prior approval of the SBA. If the Company should ever be unable to obtain the approval for its financing arrangements from the SBA, it would likely be unable to continue to make loans.

As an alternative to holding indefinitely the portions of SBA loans remaining after sale of the guaranteed portions in the SBA supervised secondary market, the Company has undertaken to securitize these unguaranteed portions. In December 2010, the first such securitization trust established by the Company issued to one investor notes in the amount of \$16,000,000 which received an S&P rating of AA. A second securitization, an amendment to the original transaction, was completed in December 2011, and resulted in an additional \$14,900,000 of notes issued to the same investor. The SBA lender used the cash generated from the first transaction to retire its outstanding term loan from Capital One, N.A. and to fund a \$3,000,000 account which during the first quarter of 2011 purchased unguaranteed portions originated subsequent to the securitization transaction. Similarly, the proceeds from the second securitization in 2011 were used to pay down its outstanding term loan with Capital One, N.A., and to fund a \$5,000,000 account, which was used to purchase unguaranteed portions of loans in the first quarter of 2012. While this securitization process can provide a long-term funding source for the SBA lender, there is no certainty that it can be conducted on an economic basis. In addition, the securitization mechanism itself does not provide liquidity in the short term for funding SBA loans.

In December 2010, the SBA lender entered into a new revolving loan agreement with Capital One, N.A. for up to \$12,000,000 to be used to fund the guaranteed portions of SBA loans and to be repaid with the proceeds of the sale in the secondary market of those portions. Also, in June 2011, the SBA lender entered into a new revolving loan agreement with Capital One N.A., for up to \$15,000,000 to be used to fund the unguaranteed portions of SBA loans and to be repaid with the proceeds of loan repayments from the borrowers as well as excess cash flow of NSBF. As a result of these two facilities, the SBA lender was able to increase the amount of loans it can fund at any one time.

Through February 28, 2011, the receivables financing unit, NBC, utilized a \$10,000,000 line of credit provided by Wells Fargo Bank to purchase and warehouse receivables. On February 28, 2011, NBC entered into a three year line of credit of up to \$10,000,000 with Sterling National Bank which replaced the Wells Fargo line. There is no cross collateralization between the Sterling lending facility and the Capital One term loan and credit facility; however, a default under the Capital One term loan or line of credit will create a possibility of default under the Sterling line of credit. The availability of the Sterling line of credit and the performance of the Capital One term loans are subject to compliance with certain covenants and collateral requirements as set forth in their respective agreements, as well as limited restrictions on distributions or loans to the Company by the respective debtor, none of which are material to the liquidity of the Company. At June 30, 2012, the Company and its subsidiaries were in full compliance with applicable loan covenants. The Company guarantees these loans for the subsidiaries up to the amount borrowed; in addition, the Company deposited \$750,000 with Sterling to collateralize the guarantee.

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In April 2012, the Company closed a \$15,000,000 Second Lien Credit Facility (the Facility) issued by Summit Partners Credit Advisors, L.P. (Summit), comprised of a \$10,000,000 term loan, which was drawn at closing, and a \$5,000,000 delayed draw term loan to be made upon the satisfaction of certain conditions. The funds were used primarily for general corporate purposes including the origination of SBA 7(a) loans. The loan bears interest at 12.5% per annum on the amount outstanding plus payment-in-kind interest at 2.5%, which can either be paid quarterly in arrears or added to the outstanding loan amount. The Facility will mature in 5.5 years and can be prepaid without penalty at any time following the second anniversary date of the closing date.

As of June 30, 2012, the Company's unused sources of liquidity consisted of \$23,061,000 in unrestricted cash and cash equivalents and \$424,000 and \$584,000 available through the Capital One and Sterling National Bank lines of credit, respectively.

Restricted cash of \$8,938,000 as of June 30, 2012 is primarily held in NSBF, the Capcos and Corporate. For NSBF, approximately \$2,011,000 is held by the securitization trust as a reserve on future nonperforming loans and \$1,556,000 is due to participants. For the Capcos, restricted cash can be used in managing and operating the Capcos, making qualified investments and for the payment of taxes on Capco income. In addition, as discussed above, the Company deposited \$750,000 with Sterling to collateralize its guarantee. In summary, Newtek generated and used cash as follows:

(Dollars in thousands)

	Six months ended	
	June 30,	
	2012	2011
Net cash provided by operating activities	\$ 2,345	\$ 2,557
Net cash used in investing activities	(9,181)	(5,635)
Net cash provided by financing activities	18,534	4,397
Net increase in cash and cash equivalents	11,698	1,319
Cash and cash equivalents, beginning of period	11,363	10,382
Cash and cash equivalents, end of period	\$ 23,061	\$ 11,701

Net cash flows provided by operating activities decreased \$212,000 to net cash flow provided by operations of \$2,345,000 for the six months ended June 30, 2012 compared to net cash flows provided by operations of \$2,557,000 for the six months ended June 30, 2011. The change includes a \$34,686,000 use of funds to originate SBA loans held for sale, which was offset by \$35,019,000 in proceeds from loans sold during the period. Other changes in operating assets and liabilities were equally matched during the period, resulting in the overall minimal change between periods.

Net cash used in investing activities primarily includes activity for the unguaranteed portions of SBA loans, the purchase of fixed assets and customer merchant accounts, and changes in restricted cash. Net cash used in investing activities increased by \$(3,546,000) to cash used of \$(9,181,000) for the six months ended June 30, 2012 compared to cash used of \$(5,635,000) for the six months ended June 30, 2011. The increase in cash used in investing activities for the six months ended June 30, 2012 was primarily due to a greater amount of SBA loans originated for investment, \$(10,923,000) in 2012 versus \$(8,623,000) in 2011, as a result of an increase in total dollars funded and the return to the majority of our loans being funded with a 75% loan guarantee in the current year, offset by an increase in payments received on SBA loans from \$1,692,000 in 2011 to \$2,086,000 in 2012.

Net cash provided by financing activities primarily includes the net borrowings (repayments) on notes payable as well as securitization activities. Net cash provided by financing activities increased by \$14,137,000 to cash provided of \$18,534,000 for the six months ended June 30, 2012 from cash provided of \$4,397,000 for the six months ended June 30, 2011. The primary reason for the increase was the proceeds received from the Summit term loan which added \$10,000,000 in cash during the period. The current six month period also reflects an increase to cash of \$2,763,000 related to the consolidation of Expo (a VIE), as well as the release of approximately \$5,041,000 of restricted cash related to the second securitization that was designed as a pre-funding account in December 2011 and was used during the first quarter of 2012 to originate

unguaranteed portions of SBA 7(a) loans.

The \$11,698,000 increase in cash and cash equivalents in 2012 was essentially related to the proceeds received in connection with the Summit credit facility and the other financing activities noted above.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk.

We consider the principal types of risk in our business activities to be fluctuations in interest rates and loan portfolio valuations and the availability of the secondary market for our SBA loans held for sale. Risk management systems and procedures are designed to identify and analyze our risks, to set appropriate policies and limits and to continually monitor these risks and limits by means of reliable administrative and information systems and other policies and programs.

Our SBA lender primarily lends at an interest rate of prime, which resets on a quarterly basis, plus a fixed margin. Our receivable financing business purchases receivables priced to equate to a similar prime plus a fixed margin structure. The Capital One term loan and revolver loan, the securitization notes and the new Sterling line of credit are, and the former Wells Fargo line of credit was, on a prime plus a fixed factor basis (although the Company had elected under the Wells Fargo line to borrow under a lower cost LIBOR basis). As a result, the Company believes it has matched its cost of funds to its interest income in its financing activities. However, because of the differential between the amount lent and the smaller amount financed a significant change in market interest rates will have a material effect on our operating income. In periods of sharply rising interest rates, our cost of funds will increase at a slower rate than the interest income earned on the loans we have made; this should improve our net operating income, holding all other factors constant. However, a reduction in interest rates, as has occurred since 2008, has and will result in the Company experiencing a reduction in operating income; that is interest income will decline more quickly than interest expense resulting in a net reduction of benefit to operating income.

Our lender depends on the availability of secondary market purchasers for the guaranteed portions of SBA loans and the premium received on such sales to support its lending operations. At this time the secondary market for the guaranteed portions of SBA loans is robust but during the 2008 and 2009 financial crisis the Company had difficulty selling its loans for a premium; although not expected at this time, if such conditions did recur our SBA lender would most likely cease making new loans and could experience a substantial reduction in profitability.

We do not have significant exposure to changing interest rates on invested cash which was approximately \$31,999,000 at June 30, 2012. We do not purchase or hold derivative financial instruments for trading purposes. All of our transactions are conducted in U.S. dollars and we do not have any foreign currency or foreign exchange risk. We do not trade commodities or have any commodity price risk.

We believe that we have placed our demand deposits, cash investments and their equivalents with high credit-quality financial institutions. Invested cash is held almost exclusively at financial institutions with ratings from S&P of A- or better. The Company invests cash not held in interest free checking accounts or bank money market accounts mainly in U.S. Treasury-only money market instruments or funds and other investment-grade securities. As of June 30, 2012, cash deposits in excess of FDIC and SIPC insurance totaled approximately \$1,726,000 and funds held in U.S. Treasury-only money market funds or equivalents in excess of SIPC insurance totaled approximately \$3,430,000.

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Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures.

Our management, with the participation of our Chief Executive Officer and Chief Accounting Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Accounting Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report and provide reasonable assurance that the information required to be disclosed by us in reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. A controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls systems are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

(b) Change in Internal Control over Financial Reporting.

No change in our internal control over financial reporting occurred during the quarter ended June 30, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

(c) Limitations.

A controls system, no matter how well designed and operated, can provide only reasonable, not absolute, assurances that the controls system's objectives will be met. Furthermore, the design of a controls system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all controls systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with its policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. We periodically evaluate our internal controls and make changes to improve them.

Table of Contents**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

We are not involved in any material pending litigation. We and/or one or more of our investee companies are involved in lawsuits regarding wrongful termination claims by employees or consultants, none of which are individually or in the aggregate material to Newtek.

Item 5. Other Information.

The Company held its Annual Meeting of Shareholders on June 12, 2012 (the Annual Meeting). A total of 32,894,594 Common Shares were present or represented by proxy at the meeting, or 91.25% of the outstanding Common Shares. Proposals I and II were approved. The proposals are described in detail in the Company's definitive Proxy Statement, dated May 1, 2012. The Company's shareholders cast their votes for each of the two proposals as follows:

Proposal I: To elect all four directors of the Company to serve on the Board of Directors until the Company's Annual Meeting of Shareholders in 2013:

Director	Votes For	Votes Withheld	Broker Non-Votes
David C. Beck	18,359,216	84,557	14,450,821
Sam Kirschner	18,361,216	82,557	14,450,821
Salvatore F. Mulia	18,330,360	113,413	14,450,821
Barry Sloane	18,358,795	84,978	14,450,821

Proposal II: To ratify the appointment of J.H. Cohn LLP as the Company's independent registered accounting firm (independent auditors) for the year ended December 31, 2012:

Votes For	Votes Against	Abstentions	Broker Non-Votes
32,645,091	113,905	135,598	

Table of Contents**Item 6. Exhibits**

Exhibit No.	Description
10.10	Employment Agreement with Jennifer Eddelson, dated June 1, 2012, filed herewith.
31.1	Certification by Principal Executive Officer required by Rule 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as amended.
31.2	Certification by Principal Financial Officer required by Rule 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as amended.
32.1	Certification by Principal Executive and Principal Financial Officers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document
	XBRL Taxonomy

* XBRL (eXtensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NEWTEK BUSINESS SERVICES, INC.

Date: August 6, 2012

By: /s/ Barry Sloane
Barry Sloane

Chairman of the Board, Chief Executive Officer

and Secretary

(Principal Executive Officer)

Date: August 6, 2012

By: /s/ Jennifer C. Eddelson
Jennifer C. Eddelson

Chief Accounting Officer

(Principal Financial Officer)

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(s), the dividend reset date(s), the dividend reset period(s), the minimum or maximum dividend rate, the day count convention, the dividend period(s) and other dividend-related terms;

optional tender provisions and/or mandatory tender provisions;

a liquidity facility or other credit enhancement, including provisions for mandatory purchase by the provider of the liquidity facility or credit enhancement; and

redemption provisions.

Notwithstanding the foregoing, the Fund may not use the Mode change provisions to modify the provisions of the Statement or the Statement Supplement governing ranking, preemptive rights, voting rights, restrictions on dividends and other distributions, the term redemption date, restrictions on redemptions if the Fund is not current on paying accumulated and unpaid dividends, compliance with applicable law in connection with redemptions, liquidation rights or restrictions on amendments or supplements to the Statement or the Statement Supplement, or to modify any terms affecting the parity ranking of the VRRM-MFP Shares relative to any other series of Preferred Shares of the Fund at any time outstanding with respect to dividends or distributions of assets upon dissolution, liquidation or winding up of the affairs of the Fund.

Following delivery of the Mode Change Notice, all outstanding VRRM-MFP Shares automatically will be subject to mandatory tender for remarketing and delivered to the Calculation and Paying Agent for delivery to the Remarketing Agent, or directly to the Remarketing Agent, for sale to, and purchase by, purchasers in the remarketing on the New Mode Commencement Date, in the event of a successful remarketing. All tendered VRRM-MFP Shares will be remarketed at the Purchase Price of such VRRM-MFP Shares. VRRM-MFP shareholders will not have the right or the obligation to retain their VRRM-MFP Shares in the event of a transition to a new Mode.

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In the event of a successful remarketing, the VRR Mode will terminate, and the new Mode will commence.

If the remarketing for transition to a new Mode is not successful, a Failed Remarketing Event shall have occurred.

In the event that a Failed Remarketing Event occurs, the new Mode designated by the relevant Mode Change Notice will not be established. In such event, the VRR Mode will continue in the form determined by the Fund's election made as described in the following paragraph, a Failed Remarketing Period will commence and the Dividend Rate will be the Step-Up Dividend Rate. All tendered VRRM-MFP Shares will be returned to the relevant tendering holders. Upon the occurrence of a Failed Remarketing Event, all outstanding VRRM-MFP Shares will become subject to mandatory redemption on the related Failed Remarketing Mandatory Redemption Date.

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By not later than the Business Day immediately following the occurrence of a Failed Remarketing Event, the Fund will make an election, and provide notice thereof in writing by electronic means to the holders, the Remarketing Agent and the Calculation and Paying Agent, to either (i) cancel the related attempted transition to a new Mode, in which case the provisions relating to a mandatory tender for remarketing due to a Failed Remarketing Event will apply to the Failed Remarketing Period, or (ii) continue to attempt to transition to a new Mode, in which case the Fund will continue to use its reasonable best efforts to successfully establish a new Mode for the VRRM-MFP Shares and, in connection with each such attempt, may designate by a Mode Change Notice a new Mode with new or different terms, until (x) a new Mode is established, (y) the Fund makes a new election to cancel the attempted Mode transition as provided in clause (i) above in connection with a subsequent failure to establish a new Mode, or (z) no VRRM-MFP Shares remain outstanding. If a subsequent Failed Remarketing Event occurs in connection with the remarketing relating to such continued attempt to establish a new Mode, any such Failed Remarketing Event will not alter the Failed Remarketing Period, the Failed Remarketing Mandatory Redemption Date or the Step-Up Dividend Rate.

In the event that, within the Failed Remarketing Period, (i) if the Fund shall have made the election set forth in clause (i) of the preceding paragraph, all (but not less than all) of the VRRM-MFP Shares are successfully remarketed pursuant to a mandatory tender for remarketing due to a Failed Remarketing Event, or (ii) if the Fund shall have made the election set forth in clause (ii) of the preceding paragraph, the Fund successfully establishes a new Mode, the Failed Remarketing Period will terminate, the VRRM-MFP Shares will not be subject to redemption on the related Failed Remarketing Mandatory Redemption Date and, as applicable, the VRR Mode will continue or the VRRM-MFP Shares will be subject to the terms established for the new Mode.

TAX MATTERS

Because the discussion below is general in nature and does not address all of the tax consequences of holding the VRRM-MFP Shares and because the tax laws governing the VRRM-MFP Shares are complex, you are encouraged to consult your tax advisor about the tax consequences of investing in the VRRM-MFP Shares under your particular circumstances before making an investment.

The discussion below is the opinion of Sidley Austin LLP (Tax Counsel) on the anticipated U.S. federal income tax consequences to United States persons (as defined by section 7701(a)(30) of the Code) of acquiring, holding and disposing of the VRRM-MFP Shares.

Tax Counsel's opinion is based on the current provisions and interpretations of the Code and the accompanying Treasury regulations and on current judicial and administrative rulings. All of these authorities are subject to change and any change can apply retroactively.

Upon issuance of the VRRM-MFP Shares, and subject to certain assumptions and conditions, and based upon certain representations made by the Fund, including representations regarding the nature of the Fund's assets and the conduct of the Fund's business, it is Tax Counsel's opinion that for U.S. federal income tax purposes (1) the Fund will qualify as a regulated investment company under the Code, (2) the VRRM-MFP Shares will qualify as stock in the Fund, and (3) distributions made with respect to the VRRM-MFP Shares will qualify as exempt-interest dividends to the extent properly reported by the Fund and not otherwise limited under Section 852(b)(5)(A) of the Code (under which the total amount of dividends that may be treated as exempt-interest dividends is limited, based on the total amount of tax-exempt income generated by the Fund).

Investors should be aware that Tax Counsel's opinion is not binding on the Internal Revenue Service or any court. See the discussions below under the caption "Treatment of VRRM-MFP Shares as Stock." In addition, the Fund's qualification and taxation as a regulated investment company depends upon the Fund's ability to meet on a continuing basis, through actual annual operating results, certain requirements in the federal tax laws. Tax Counsel will not review the Fund's compliance with those requirements. Accordingly, no assurance can be given that the actual results of the Fund's operations for any particular taxable year will satisfy such requirements.

Tax Act Changes. Numerous changes to the U.S. federal income tax laws have been made by the recent legislation commonly referred to as the Tax Cuts and Jobs Act (the Tax Act). Among other changes, the Tax Act temporarily replaces the individual tax rate structure, which includes a reduction in the highest marginal rate applicable to individuals, estates and trusts. The Tax Act eliminates the graduated corporate tax rate structure and instead taxes domestic corporate taxable income at 21%. It also modifies the individual alternative minimum tax and repeals the corporate alternative minimum tax. In general, these changes are effective for taxable years beginning after December 31, 2017.

The Fund cannot predict the long-term impact of the Tax Act on an investment in the VRRM-MFP Shares and the effect of any administrative and judicial interpretations of the Tax Act. Prospective investors in the VRRM-MFP Shares are urged to consult their tax advisors regarding the effect of the Tax Act and other potential changes to the U.S. federal tax laws on their investment.

Qualification and Taxation of the Fund. The Fund intends to continue to qualify as a regulated investment company under Subchapter M of the Code, and intends to distribute substantially all of its net income and gains to its shareholders. Therefore, it is not expected that the Fund will have to pay any U.S. federal income tax to the extent its earnings are so distributed. To qualify under Subchapter M for tax treatment as a regulated investment company, the Fund must, among other requirements: (a) distribute to its shareholders at least 90% of the sum of (i) its investment company taxable income (as that term is defined in the Code) determined without regard to the deduction for dividends paid and (ii) its net tax-exempt income (the excess of its gross tax-exempt interest income over certain disallowed deductions) and (b) diversify its holdings so that, at the end of each fiscal quarter of the Fund (i) at least 50% of the market value of the Fund's total assets is represented by cash, cash items, U.S. Government securities, securities of other regulated investment companies, and other securities, with these other securities limited, with respect to any one issuer, to an amount not greater in value than 5% of the Fund's total assets, and to not more than 10% of the outstanding voting securities of such issuer, and (ii) not more than 25% of the market value of the Fund's total assets is invested in the securities of any one issuer (other than U.S. Government securities or securities of other regulated investment companies), 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 one or more qualified publicly traded partnerships. In meeting these requirements of Subchapter M of the Code, the Fund may be restricted in the utilization of certain of the investment techniques described under "The Fund's Investments" in the prospectus. If in any year the Fund should fail to qualify under Subchapter M for tax treatment as a regulated investment company and not cure such failure, the Fund would incur a regular federal corporate income tax on its taxable income for that year, and distributions to its shareholders would be taxable to such holders as ordinary income to the extent of the earnings and profits of the Fund.

A regulated investment company that fails to distribute, by the close of each calendar year, an amount equal to the sum of 98% of its ordinary taxable income for such year and 98.2% of its capital

gain net income for the one year period ending October 31 in such year, *plus* any shortfalls from the prior year's required distribution, is liable for a 4% excise tax on the excess of the required distribution for such calendar year over the distributed amount for such calendar year. To avoid the imposition of this excise tax, the Fund generally intends to make the required distributions of its ordinary taxable income, if any, and its capital gain net income, to the extent possible, by the close of each calendar year.

Treatment of VRRM-MFP Shares as Stock. In order for any distributions to owners of the Fund's VRRM-MFP Shares to be eligible to be treated as exempt-interest dividends, the VRRM-MFP Shares must be classified as stock for U.S. federal income tax purposes. The Investment Adviser believes and, as discussed above, it is Tax Counsel's opinion that, the VRRM-MFP Shares will qualify as stock in the Fund for U.S. federal income tax purposes. By acquiring VRRM-MFP Shares, an investor agrees to treat the VRRM-MFP Shares as stock for U.S. federal income tax purposes.

Distributions on VRRM-MFP Shares. A VRRM-MFP shareholder will be required to report the dividends declared by the Fund for each day on which such VRRM-MFP shareholder is the shareholder of record. Distributions, if any, in excess of the Fund's earnings and profits will first reduce the adjusted tax basis of a shareholder's shares and, after that basis has been reduced to zero, will constitute capital gain to the shareholder (assuming the shares are held as a capital asset). As long as the Fund qualifies as a regulated investment company under the Code, no part of its distributions to shareholders will qualify for the dividends received deduction available to corporate shareholders.

Tax Character of Distributions

In General. The tax character of the Fund's distributions in the hands of the Fund's shareholders will be determined primarily by the tax character of the Fund's underlying income. Although the Fund expects that most of its income will be tax-exempt, some of the Fund's income may be taxable as capital gains or ordinary income. In addition, although the Fund expects that under normal circumstances it will not invest in municipal bonds the interest on which is subject to the federal alternative minimum tax, at times a portion of the Fund's tax-exempt income may be subject to the federal alternative minimum tax. The Internal Revenue Service requires a regulated investment company that has two or more classes of shares outstanding to designate to each such class proportionate amounts of each type of its income for each tax year based upon the percentage of total dividends distributed to each class for such year. The Fund intends each year to allocate, to the fullest extent practicable, net tax-exempt interest, net capital gain and ordinary income, if any, between its Common Shares and Preferred Shares, including the VRRM-MFP Shares, in proportion to the total dividends paid to each class with respect to such year. To the extent permitted under applicable law, the Fund reserves the right to make special allocations of income within a class, consistent with the objectives of the Fund.

Exempt-Interest Dividends. The Fund intends to qualify to pay exempt-interest dividends, as defined in the Code, on its Common Shares and Preferred Shares, including the VRRM-MFP Shares, by satisfying the requirement that at the close of each quarter of its taxable year, at least 50% of the value of its total assets consists of tax-exempt municipal bonds. Exempt-interest dividends are dividends paid by the Fund that are attributable to interest on municipal bonds and are so designated by the Fund. The Fund intends to invest primarily in municipal bonds the income of which is otherwise exempt from regular U.S. federal income tax, the federal alternative minimum tax. Thus, substantially all of the Fund's dividends to the common shareholders and VRRM-MFP shareholders will qualify as

exempt-interest dividends. Exempt-interest dividends will be exempt from U.S. federal income tax, subject to the possible application of the federal alternative minimum tax.

Exempt-Interest Dividends Subject to the Federal Alternative Minimum Tax. Federal tax law imposes a federal alternative minimum tax with respect to corporations, individuals, trusts and estates. Interest on certain municipal securities, such as bonds issued to make loans for housing purposes or to private entities (but not to certain tax-exempt organizations such as universities and non-profit hospitals) is included as an item of tax preference in determining the amount of a taxpayer's alternative minimum taxable income. To the extent that the Fund receives income from municipal securities subject to the federal alternative minimum tax, a portion of the dividends paid by it, although otherwise exempt from U.S. federal income tax, will be taxable to its shareholders to the extent that their tax liability is determined under the federal alternative minimum tax. The Fund will annually supply a report indicating the percentage of the Fund's income attributable to municipal securities subject to the federal alternative minimum tax.

Dividends Attributable to Ordinary Income and Capital Gains. Distributions to shareholders by the Fund of net income received, if any, from taxable temporary investments and net short-term capital gains, if any, realized by the Fund will be taxable to its shareholders as ordinary income. In addition, gains of the Fund that are attributable to market discount on municipal securities will be treated as ordinary income. Distributions by the Fund of net capital gain (that is, the excess of net long-term capital gain over net short-term capital loss), if any, are taxable as long-term capital gain regardless of the length of time the shareholder has owned Common Shares or VRRM-MFP Shares of the Fund. The amount of capital gains and ordinary income allocable to the Fund's VRRM-MFP Shares will depend upon the amount of such income realized by the Fund, but is not generally expected to be significant. Except for dividends paid on VRRM-MFP Shares that include an allocable portion of any net capital gain or ordinary income, the Fund anticipates that all other dividends paid on VRRM-MFP Shares will constitute exempt-interest dividends for U.S. federal income tax purposes.

If the Fund allocates any net capital gain or ordinary income for regular U.S. federal income tax purposes to a dividend on VRRM-MFP Shares, the Fund has agreed as set forth in the Statement Supplement to make certain payments to holders of VRRM-MFP Shares to offset the regular U.S. federal income tax effect thereof. In addition, the Fund has agreed as set forth in the Statement Supplement in certain circumstances to provide notice of the amount of any allocation prior to the date such dividend is declared. See Description of VRRM-MFP Shares Dividends Taxable Allocations.

Sales, Exchanges and Other Dispositions of VRRM-MFP Shares. On the sale or other disposition of VRRM-MFP Shares (other than redemptions, the rules for which are described below under the caption Redemptions of VRRM-MFP Shares), the amount paid for the seller's right to any dividends that are accumulated but unpaid at the time of such sale or other disposition will be treated as dividends and subject to the rules described above under the caption Tax Character of Distributions. The balance of the amount paid, will generally be treated as (1) capital gain to the extent it exceeds the seller's basis in the VRRM-MFP Shares, and (2) capital loss to the extent it is less than the seller's basis in the VRRM-MFP Shares. In the case of corporate taxpayers, both long-term and short-term capital gains are taxed at the same rate that applies to ordinary income. In the case of non-corporate taxpayers, short-term capital gains and ordinary income are taxed at a maximum rate of 37% and long-term capital gains at a maximum rate of 20%. In addition, because of certain limitations on itemized deductions and the deduction for personal exemptions, the effective rate of tax may be higher in certain circumstances.

In the case of a taxpayer that is an individual, estate or trust, and for taxable years starting after December 31, 2017 and before January 1, 2026, the Tax Act disallows miscellaneous itemized deductions within the meaning of Code Section 67, repeals the personal exemption and suspends the general limitation imposed on itemized deductions by Code Section 68.

Losses realized by a shareholder on the sale or exchange of VRRM-MFP Shares held for six months or less are disallowed to the extent of any distribution of exempt-interest dividends received (or deemed received on a sale) with respect to such shares, and, if not disallowed, such losses are treated as long-term capital losses to the extent of any distribution of long-term capital gain received with respect to such shares.

Any loss realized on a sale or exchange of VRRM-MFP Shares will be disallowed to the extent those shares are replaced by other shares within a period of 61 days beginning 30 days before and ending 30 days after the date of disposition of the original shares. In that event, the basis of the replacement shares of the Fund will be adjusted to reflect the disallowed loss.

Redemptions of VRRM-MFP Shares. The Fund may, at its option, redeem VRRM-MFP Shares in whole or in part, or be required to redeem all of the outstanding VRRM-MFP Shares on a Failed Remarketing Mandatory Redemption Date, and will be required to redeem Preferred Shares, which may include VRRM-MFP Shares, in which event the redemption will be made from all VRRM-MFP shareholders pro rata, or by lot or other fair method, to the extent required to maintain Asset Coverage or comply with the Effective Leverage Ratio. Gain or loss, if any, resulting from a redemption of the VRRM-MFP Shares will be taxed as gain or loss from the sale or exchange of the VRRM-MFP Shares under Section 302 of the Code rather than as a dividend, but only if the redemption distribution (a) is deemed not to be essentially equivalent to a dividend, (b) is in complete redemption of an owner's interest in the Fund, (c) is substantially disproportionate with respect to the owner, or (d) with respect to non-corporate owners, is in partial liquidation of the Fund. For purposes of (a), (b) and (c) above, a shareholder's ownership of the Common Shares will be taken into account.

Tax on Net Investment Income. A 3.8% tax is imposed on net investment income of individuals, estates and trusts with incomes above certain threshold amounts. The types of investment income used to calculate net investment income, include taxable distributions (if any) made by the Fund with respect to VRRM-MFP Shares and gains (if any) from the sale or other disposition of VRRM-MFP Shares.

Consequences of Insufficient Distributions. If at any time when the Fund's VRRM-MFP Shares are outstanding the Fund fails to meet 200% asset coverage (as determined pursuant to the 1940 Act), the Fund will be required to suspend distributions to holders of its Common Shares until such maintenance amount or asset coverage, as the case may be, is restored. This may prevent the Fund from distributing at least 90% of its investment company taxable income and net tax-exempt income (as that term is defined in the Code) determined without regard to the deduction for dividends paid, and may therefore jeopardize the Fund's qualification for taxation as a regulated investment company or cause the Fund to incur an income tax liability or the non-deductible 4% excise tax on the undistributed taxable income (including gain), or both. Upon failure to meet the 225% Asset Coverage required under the Statement Supplement, the Fund will be required to redeem Preferred Shares, which may include VRRM-MFP Shares, in order to maintain or restore such asset coverage and avoid the adverse consequences to the Fund and its shareholders of failing to qualify as a regulated investment company. There can be no assurance, however, that any such redemption would achieve such objectives.

The foregoing is a general summary of the provisions of the Code and regulations thereunder presently in effect as they directly govern the taxation of the Fund and its VRRM-MFP shareholders. These provisions are subject to change by legislative, judicial or administrative action, and any such change may be retroactive. Moreover, the foregoing does not address many of the factors that may be determinative of whether an investor will be liable for the federal alternative minimum tax. Shareholders are advised to consult their own tax advisors for more detailed information concerning the regular U.S. federal income tax and federal alternative minimum income tax consequences of purchasing, holding and disposing of VRRM-MFP Shares.

BOOK-ENTRY PROCEDURES AND SETTLEMENT

The information in this section concerning DTC and DTC's book-entry system has been obtained by the Fund from DTC.

The VRRM-MFP Shares will be book-entry (global) securities. Upon issuance, all book-entry securities will be represented by one or more fully-registered global securities. Each global security will be deposited with, or on behalf of, DTC, a securities depository, and will be registered in the name of DTC or a nominee of DTC. DTC will thus be the only registered holder of VRRM-MFP Shares.

Purchasers of VRRM-MFP Shares may only hold interests in the global securities directly through DTC if they are participants in the DTC system. Purchasers may also hold interests through a securities intermediary—banks, brokerage houses and other institutions that maintain securities accounts for customers—that has an account with DTC or its nominee. DTC will maintain accounts showing the security holdings of its Agent Members, and these Agent Members will in turn maintain accounts showing the security holdings of their customers. Some of these customers may themselves be securities intermediaries holding securities for their customers. Thus, each beneficial owner of a book-entry security will hold that security indirectly through various intermediaries.

The interest of each beneficial owner in a book-entry security will be evidenced solely by entries on the books of the beneficial owner's securities intermediary or Agent Member. The actual purchaser of the securities will generally not be entitled to have the securities represented by the global securities registered in its name and will not be considered the owner under the terms of the securities and their governing documents. That means that the Fund and the Calculation and Paying Agent or any other agent of the Fund will be entitled to treat the registered holder, DTC or its nominee, as the holder of the securities for all purposes. In most cases, the beneficial owner will also not be able to obtain a paper certificate evidencing its ownership of VRRM-MFP Shares. The laws of some jurisdictions require some purchasers of securities to take physical delivery of their securities in definitive form. These laws may impair the ability to own, transfer or pledge beneficial interests in book-entry securities.

A beneficial owner of book-entry securities represented by a global security may exchange the securities for definitive (paper) securities only if:

DTC is unwilling or unable to continue as depository for such global security and the Fund does not appoint a qualified replacement for DTC within 90 days; or

the Fund in its sole discretion decides to allow some or all book-entry securities to be exchangeable for definitive securities in registered form.

Unless indicated otherwise, any global security that is so exchangeable will be exchangeable in whole for definitive securities in registered form, with the same terms and of an equal aggregate amount. Definitive securities will be registered in the name or names of the person or persons specified by DTC in a written instruction to the registrar of the VRRM-MFP Shares. DTC may base its written instruction upon directions that it receives from Agent Members.

In this prospectus supplement, in the case of book-entry securities, references to actions taken by beneficial owners will mean actions taken by DTC upon instructions from its Agent Members, and references to payments and notices relating to redemptions or the tendering of VRRM-MFP Shares will mean payments and notices related to the redemption or tender of VRRM-MFP Shares to DTC as the registered holder of the securities for distribution to Agent Members in accordance with DTC's procedures. If fewer than all the VRRM-MFP Shares are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Agent Member in the VRRM-MFP Shares to be redeemed.

Each sale of a book-entry security will settle in immediately available funds through DTC unless otherwise stated. Neither the Fund nor the Calculation and Paying Agent, or any agent of either, will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in any book-entry securities or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Neither DTC nor DTC's nominee will consent or vote with respect to the VRRM-MFP Shares unless authorized by a participant in accordance with DTC's procedures. Under its usual procedures, DTC mails an omnibus proxy (the Omnibus Proxy) to the Fund as soon as possible after the record date. The Omnibus Proxy assigns DTC's nominee consenting or voting rights to the Agent Members to whose accounts the VRRM-MFP Shares are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Dividend payments on the VRRM-MFP Shares and payments upon redemption of VRRM-MFP Shares will be made to DTC's nominee or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit participants' accounts upon DTC's receipt of funds and corresponding detail information from the Fund or the Calculation and Paying Agent on the payment date in accordance with their respective holdings shown on DTC records. Payments by Agent Members to beneficial owners will be governed by standing instructions and customary practices. Payment of dividends or redemption proceeds to DTC's nominee is the responsibility of the Fund or the Calculation and Paying Agent, disbursement of such payments to participants will be the responsibility of DTC, and disbursement of such payments to the beneficial owners will be the responsibility of Agent Members or securities intermediaries who hold through an Agent Member.

IT IS THE DUTY OF EACH BENEFICIAL OWNER TO ARRANGE WITH THE DTC AGENT MEMBER OR SECURITIES INTERMEDIARIES TO RECEIVE FROM SUCH DTC AGENT MEMBER OR SECURITIES INTERMEDIARY DIVIDEND PAYMENTS AND ALL OTHER COMMUNICATIONS WHICH THE DTC AGENT MEMBER OR SECURITIES INTERMEDIARY RECEIVES FROM DTC. THE FUND WILL NOT HAVE ANY RESPONSIBILITY OR OBLIGATIONS TO ANY DTC AGENT MEMBER, SECURITIES INTERMEDIARIES, OR THE PERSONS FOR WHOM THEY ACT AS NOMINEES WITH RESPECT TO DIVIDEND PAYMENTS TO OR THE PROVIDING OF NOTICE FOR THE DTC AGENT MEMBERS, THE SECURITIES INTERMEDIARIES OR THE BENEFICIAL OWNERS.

UNDERWRITING

The Fund, the Investment Adviser, the Sub-Adviser, and [], located at [], have entered into an underwriting agreement with respect to the VRRM-MFP Shares. The underwriter has agreed, subject to the terms and conditions of the underwriting agreement, to purchase from the Fund [] VRRM-MFP Shares. The underwriter is committed to purchase and pay for all such VRRM-MFP Shares if any are purchased.

The following table shows the per VRRM-MFP Share and the total underwriting discounts and commissions that the Fund is to pay to the underwriter in connection with this offering.

Per VRRM-MFP Share	\$ []
Total	\$ []

The Fund estimates that the total expenses of this offering payable by the Fund, exclusive of the underwriting discount or commission, will be approximately \$[].

Shares sold by the underwriter to the public will initially be offered at the public offering price set forth on the cover of this prospectus supplement. **The minimum purchase amount in this offering is [] ([]) VRRM-MFP Shares. Purchases in excess of the minimum purchase amount may be made only in multiples of [] ([]) VRRM-MFP Shares.**

Each of the Fund, the Investment Adviser and the Sub-Adviser has agreed to indemnify the underwriter against certain liabilities, including liabilities under the 1933 Act.

The underwriter also will act as the Remarketing Agent in connection with the VRRM-MFP Shares and receive a fee from the Fund in such capacity. See Description of VRRM-MFP Shares Remarketing Remarketing Agent.

The underwriter and its affiliates are full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, investment research, principal investment, hedging, financing and brokerage activities. The underwriter and its affiliates have in the past and may in the future perform various financial advisory and investment banking services for the Fund, for which they received or will receive customary fees and expenses. The Fund anticipates that the underwriter may from time to time act as broker and dealer in connection with the execution of the Fund's portfolio transactions after it has ceased to be an underwriter and, subject to certain restrictions, may act as such broker while it is the underwriter.

In the ordinary course of their various business activities, the underwriter and its affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers and such investment and securities activities may involve securities and/or instruments of the issuer. The underwriter and its affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or instruments and may at any time hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

[], an affiliate of the underwriter, is one of a group of lenders under a committed unsecured credit facility pursuant to which the Fund and certain other funds managed by Nuveen Fund Advisors may borrow for temporary purposes only. See Prospectus Summary Use of Leverage in the prospectus. [] and its affiliates, may routinely hedge their credit exposure to the Fund consistent with their customary risk management policies. Typically, they would hedge such exposure by entering into transactions which consist of either the purchase of credit default swaps or the creation of short positions in the Fund's securities, including potentially the VRRM-MFP Shares offered hereby. Any such credit default swaps or short positions could adversely affect future trading prices of the VRRM-MFP Shares offered hereby.

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LEGAL MATTERS

Certain legal matters in connection with the VRRM-MFP Shares will be passed upon for the Fund by Sidley Austin LLP, New York, New York, and for the underwriter and the Remarketing Agent by [], New York, New York. Sidley Austin LLP may rely as to certain matters of Massachusetts law on the opinion of Morgan, Lewis & Bockius LLP, Boston, Massachusetts.

CUSTODIAN, TRANSFER AGENT, CALCULATION AND PAYING AGENT

State Street Bank and Trust Company (the Custodian) serves as custodian of the Fund's assets. Computershare Inc. and Computershare Trust Company, N.A. serve as transfer agent for the Common Shares. See Custodian, Transfer Agent, Dividend Disbursing Agent and Redemption and Paying Agent in the accompanying prospectus.

The Bank of New York Mellon will serve as calculation agent and as the transfer agent and registrar, dividend disbursing agent, and paying agent and redemption price disbursing agent for the VRRM-MFP Shares.

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The audited Financial Statements and Financial Highlights of the Fund appearing in the Fund's Annual Report for the fiscal year ended October 31, 2018 are incorporated by reference into the SAI. The audited financial statements and financial highlights have been audited by KPMG LLP, an independent registered public accounting firm, as set forth in their report thereon and incorporated herein by reference. Such audited financial statements and financial highlights are incorporated by reference in reliance upon such report given on the authority of such firm as experts in accounting and auditing. The information with respect to the fiscal years ended prior to October 31, 2014 has been audited by other auditors. The principal business address of KPMG LLP is 200 East Randolph Street, Chicago, Illinois 60601.

WHERE YOU CAN FIND MORE INFORMATION

The Fund is subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the 1934 Act), and the 1940 Act and is required to file reports, proxy statements and other information with the SEC. These documents can be inspected and copied for a fee at the SEC's public reference room, 100 F Street, NE, Washington, D.C. 20549. Reports, proxy statements, and other information about the Fund can be inspected at the offices of the SEC.

Additional information about the Fund and VRRM-MFP Shares can be found in the Fund's registration statement (including amendments, exhibits, and schedules) on Form N-2 filed with the SEC. The SEC maintains a web site (<http://www.sec.gov>) that contains the Fund's registration statement, other documents incorporated by reference, and other information the Fund has filed electronically with the SEC, including proxy statements and reports filed under the 1934 Act. Additional information may be found on the Internet at <http://www.nuveen.com>. The information contained in, or that can be accessed through, those websites is not part of this prospectus supplement or the accompanying prospectus.

\$

Nuveen AMT-Free Municipal Credit Income Fund

Series [] MuniFund Preferred Shares

Variable Rate Remarketed Mode

Liquidation Preference \$[] Per Share

PROSPECTUS SUPPLEMENT

[], 20[]

[Underwriter(s)]

The information in this preliminary prospectus supplement is not complete and may be changed. A registration statement relating to these securities was filed with the Securities and Exchange Commission and became effective. This preliminary prospectus supplement and the accompanying prospectus are not an offer to sell these securities and we are not soliciting offers to buy these securities in any jurisdiction where the offer or sale is not permitted.

Subject to Completion

Preliminary Prospectus Supplement dated [], 20[]

PROSPECTUS SUPPLEMENT

(To Prospectus dated [] 2019)

\$()

Nuveen AMT-Free Municipal Credit Income Fund

[] SERIES [] MUNIFUND PREFERRED SHARES

VARIABLE RATE MODE

LIQUIDATION PREFERENCE \$() PER SHARE

Nuveen AMT-Free Municipal Credit Income Fund (the Fund), a diversified, closed-end management investment company is offering [] Series [] MuniFund Preferred Shares (the MFP Shares), liquidation preference \$() per share (the Liquidation Preference), in the Variable Rate Mode (the MFP Shares, while in the Variable Rate Mode, the VRM-MFP Shares). The VRM-MFP Shares will be in the Variable Rate Mode until [], subject to [extension or]¹ earlier redemption, repurchase or transition to a new Mode (as defined herein) by the Fund.

During the Variable Rate Mode, the dividend rate for the VRM-MFP Shares [(unless adjusted as described in this prospectus supplement)]² will be equal to [the sum of (i) the SIFMA Municipal Swap Index (as defined herein) made available by approximately 4:00 p.m., New York City time, on the Rate Determination Date (as defined herein) or if such index is not made so available on such date, the SIFMA Municipal Swap Index as determined on the previous Rate Determination Date, as determined for each Dividend Reset Period (as defined herein), plus (ii) the Applicable Spread (as defined herein)]. The dividend rate for the initial Dividend Reset Period commencing on, and including, [], 20[], the first day of the Variable Rate Mode, and ending on, and including, [], 20[] will be equal to [the sum of (i) the SIFMA Municipal Swap Index, made available by approximately 4:00 p.m., New York City time, on Wednesday, [], plus (ii) the Applicable Spread, or []% per annum if the SIFMA Municipal Swap Index is not so published]³.

During the Variable Rate Mode, dividends on the VRM-MFP Shares generally will be paid monthly on the first Business Day (as defined herein) of each month, commencing on [], 20[], and are expected to be exempt from both regular U.S. federal income tax and the federal alternative minimum tax, with exceptions for certain portions that may represent the pass through of capital gains,

¹ Include references to Mode extension if the Mode Termination Date is prior to the Term Redemption Date

² Include for Adjustable Rate VRM

³ Replace references to SIFMA and related terms if a different Index Rate is used

if any, from portfolio transactions. In connection with any transfer of VRM-MFP Shares, the transferor as beneficial owner of VRM-MFP Shares shall be deemed to have agreed pursuant to the terms of the VRM-MFP Shares to transfer to the transferee the right to receive from the Fund any dividends declared and unpaid for each day prior to the transferee becoming the beneficial owner of the VRM-MFP Shares in exchange for payment of the purchase price for such VRM-MFP Shares by the transferee.

The VRM-MFP Shares will not be listed or traded on any securities exchange.

The VRM-MFP Shares will be subject to mandatory redemption by the Fund on [] (the Term Redemption Date), unless earlier redeemed or repurchased by the Fund.

Investing in VRM-MFP Shares involves risks. See Risk Factors beginning on page S-17 and on page 9 of the accompanying prospectus. You should consider carefully these risks together with all of the other information in this prospectus supplement and the accompanying prospectus before making a decision to invest in the VRM-MFP Shares.

Neither the Securities and Exchange Commission (the SEC) nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus supplement or the accompanying prospectus. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	\$ []	\$ []
Underwriting discounts and commissions	\$ []	\$ []
Proceeds, before expenses, to the Fund	\$ []	\$ []

It is expected that the VRM-MFP Shares will be delivered to investors in book-entry form only, through the facilities of The Depository Trust Company, on or about [], 20[].

[UNDERWRITER(S)]

[], 20[]

(continued from previous page)

The Fund's investment objectives are to provide current income exempt from regular federal income tax and federal alternative minimum tax applicable to individuals, and to enhance portfolio value relative to the municipal bond market by investing in tax-exempt municipal bonds that the Fund's investment adviser, Nuveen Fund Advisors, LLC, believes are underrated or undervalued or that represent municipal market sectors that are undervalued. As a fundamental investment policy, under normal circumstances, the Fund will invest at least 80% of its Assets (as defined herein) in municipal securities and other related investments, the income from which is exempt from regular federal income taxes. As a non-fundamental investment policy, under normal circumstances, the Fund will invest 100% of its Managed Assets (as defined herein) and at least 80% of its Assets in municipal securities and other related investments, the income from which is exempt from the federal alternative minimum tax applicable to individuals at the time of purchase. As a non-fundamental investment policy, under normal circumstances, the Fund may invest up to 55% of its Managed Assets in securities rated, at the time of investment, below the three highest grades (Baa or BBB or lower) by at least one nationally recognized statistical rating organization, which includes below-investment-grade or unrated securities judged to be of comparable quality by the Fund's sub-adviser, Nuveen Asset Management, LLC. There can be no assurance that the Fund will achieve its investment objectives.

You should read this prospectus supplement, together with the accompanying prospectus, which contains important information about the Fund, before deciding whether to invest in VRM-MFP Shares and retain it for future reference. A statement of additional information, dated [], 2019, and as it may be supplemented (the SAI), containing additional information about the Fund, has been filed with the SEC and is incorporated by reference in its entirety into this prospectus supplement and the accompanying prospectus. You may request a free copy of the SAI, the table of contents of which is on page 69 of the accompanying prospectus, annual and semi-annual reports to shareholders, when available, and other information about the Fund, and make shareholder inquiries by calling (800) 257-8787 or by writing to the Fund, or from the Fund's website (www.nuveen.com). The information contained in, or that can be accessed through, the Fund's website is not part of this prospectus supplement, the accompanying prospectus or the SAI. You also may obtain a copy of the SAI (and other information regarding the Fund) from the SEC's website (www.sec.gov).

VRM-MFP Shares do not represent a deposit or obligation of, and are not guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency.

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You should rely only on the information contained or incorporated by reference into this prospectus supplement and the accompanying prospectus. The Fund has not authorized anyone to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. The Fund is not making an offer of VRM-MFP Shares in any state where the offer is not permitted. You should not assume that the information contained in this prospectus supplement and the accompanying prospectus is accurate as of any date other than the respective dates on the front covers. The Fund's business, financial condition and prospects may have changed since such dates.

FORWARD-LOOKING STATEMENTS

Any projections, forecasts and estimates contained or incorporated by reference herein are forward looking statements and are based upon certain assumptions. Projections, forecasts and estimates are necessarily speculative in nature, and it can be expected that some or all of the assumptions underlying any projections, forecasts or estimates will not materialize or will vary significantly from actual results. Actual results may vary from any projections, forecasts and estimates and the variations may be material. Some important factors that could cause actual results to differ materially from those in any forward looking statements include changes in interest rates, market, financial or legal uncertainties, including changes in tax law, and the timing and frequency of defaults on underlying investments. Consequently, the inclusion of any projections, forecasts and estimates herein should not be regarded as a representation by the Fund or any of its affiliates or any other person or entity of the results that will actually be achieved by the Fund. Neither the Fund nor its affiliates has any obligation to update or otherwise revise any projections, forecasts and estimates including any revisions to reflect changes in economic conditions or other circumstances arising after the date hereof or to reflect the occurrence of unanticipated events, even if the underlying assumptions do not come to fruition. The Fund acknowledges that, notwithstanding the foregoing, the safe harbor for forward-looking statements under the Private Securities Litigation Reform Act of 1995 does not apply to investment companies such as the Fund.

PROSPECTUS SUPPLEMENT SUMMARY

This is only a summary. You should review the more detailed information contained elsewhere in this prospectus supplement, in the accompanying prospectus and in the statement of additional information, dated [], 2019, and as it may be supplemented (the SAI), including the documents incorporated by reference, prior to making an investment in the Fund, especially the information set forth under the heading Risk Factors beginning on page S-17 of this prospectus supplement and beginning on page 9 in the accompanying prospectus.

The Fund

Nuveen AMT-Free Municipal Credit Income Fund (the Fund) is a diversified, closed-end management investment company. The Fund's common shares, \$.01 par value per share (the Common Shares), are traded on the New York Stock Exchange under the symbol NVG. See Description of Securities Common Shares in the prospectus. As of [], 20[], the Fund had [] Common Shares outstanding, and net assets applicable to Common Shares of \$[]. The Fund commenced investment operations on November 21, 2002.

As of the date of this prospectus supplement, the Fund has outstanding [one series of MuniFund Preferred Shares (MFP Shares), consisting of 4,054 Series A MFP Shares, and five series of Variable Rate Demand Preferred Shares (VRDP Shares), consisting of 1,790 Series 1 VRDP Shares, 3,854 Series 2 VRDP Shares, 1,800 Series 4 VRDP Shares, 3,405 Series 5 VRDP Shares and 3,267 Series 6 VRDP Shares]. See Description of Securities Preferred Shares in the prospectus. MFP Shares, VRDP Shares and any other preferred shares of the Fund as may be outstanding from time to time are collectively referred to as Preferred Shares.

Investment Objectives and Policies

The Fund's investment objectives are to provide current income exempt from regular federal income tax and federal alternative minimum tax applicable to individuals, and to enhance portfolio value relative to the municipal bond market by investing in tax-exempt municipal bonds that the Fund's investment adviser, Nuveen Fund Advisors, LLC (Nuveen Fund Advisors or the Investment Adviser), believes are underrated or undervalued or that represent municipal market sectors that are undervalued.

As a fundamental investment policy, under normal circumstances, the Fund will invest at least 80% of its Assets (as defined below) in municipal securities and other related investments, the income from which is exempt from regular federal income taxes.

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As a non-fundamental investment policy that may be changed by the Fund's trustees without prior shareholder notice, under normal circumstances, the Fund will invest 100% of its Managed Assets (as defined below) in municipal securities and other related investments, the income from which is exempt from the federal alternative minimum tax applicable to individuals at the time of purchase. As a non-fundamental investment policy subject to change by the Fund's trustees upon 60 days' notice to shareholders, under normal circumstances, the Fund will invest at least 80% of its Assets in municipal securities and other related investments, the income from which is exempt from the federal alternative minimum tax applicable to individuals at the time of purchase.

Assets means net assets of the Fund plus the amount of any borrowings for investment purposes. Managed Assets means the total assets of the Fund, minus the sum of its accrued liabilities (other than Fund liabilities incurred for the express purpose of creating leverage). Total assets for this purpose shall include assets attributable to the Fund's use of leverage (whether or not those assets are reflected in the Fund's financial statements for purposes of generally accepted accounting principles), and derivatives will be valued at their market value.

As a non-fundamental investment policy that may be changed by the Fund's trustees without prior shareholder notice, under normal circumstances, the Fund may invest up to 55% of its Managed Assets in securities rated, at the time of investment, below the three highest grades (Baa or BBB or lower) by at least one nationally recognized statistical rating organization (NRSRO), which includes below-investment-grade securities or unrated securities judged to be of comparable quality by the Fund's sub-adviser, Nuveen Asset Management, LLC (NAM or the Sub-Adviser).

There can be no assurance that the Fund will achieve its investment objectives. See Risk Factors and The Fund's Investments Investment Objectives and Policies in the prospectus.

Investment Adviser

Nuveen Fund Advisors is the Fund's investment adviser, responsible for overseeing the Fund's overall investment strategy and its implementation.

Sub-Adviser

NAM serves as the Fund's investment sub-adviser and is an affiliate of Nuveen Fund Advisors. NAM is a registered investment adviser. NAM oversees the day-to-day investment operations of the Fund.

The Offering

The Fund is offering [] Series [] MuniFund Preferred Shares (the MFP Shares), liquidation preference of \$[] per share (the Liquidation Preference), in the Variable Rate Mode (the MFP Shares, while in the Variable Rate Mode, the VRM-MFP Shares). [See Underwriting.] The first issuance date of the VRM-MFP Shares upon the closing of this offering is referred to herein as the Date of Original Issue.

VRM-MFP Shares

The VRM-MFP Shares are Preferred Shares of the Fund, ranking on parity with each other and other Preferred Shares with respect to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of the affairs of the Fund. Each Preferred Share, including each VRM-MFP Share, ranks and will rank senior in priority to the Common Shares as to the payment of dividends and as to the distribution of assets upon dissolution, liquidation or winding up of the affairs of the Fund.

The VRM-MFP Shares are being issued in the Variable Rate Mode designated pursuant to the Statement and the Statement Supplement (each as defined below). So long as the VRM-MFP Shares are outstanding, they will remain in the Variable Rate Mode until [], subject to the right of the Fund, at its option, to terminate the Variable Rate Mode and change the VRM-MFP Shares to a new Mode (as defined below) with different terms. See Description of VRM-MFP Shares Mode Change in this prospectus supplement and Description of Securities Preferred Shares MuniFund Preferred Shares Designation of Modes in the prospectus.

Variable Rate Mode[-Adjustable Rate]¹

The terms and conditions of the VRM-MFP Shares described in this prospectus supplement apply to the VRM-MFP Shares during the Variable Rate Mode ([] to [], inclusive, subject to [extension or] early transition). During the Variable Rate Mode, the dividend rate for the VRM-MFP Shares [(unless adjusted as described in this prospectus supplement)]² generally will be a variable rate equal to [the SIFMA Municipal Swap Index (as defined below) plus the Applicable Spread (as defined below)]. A complete description of the preferences, voting powers, restrictions, limitations as to dividends, qualification, and terms and conditions of redemption of the VRM-MFP Shares during the Variable Rate Mode, can be found in the Fund's Declaration of Trust (the Declaration of Trust), the Statement Establishing and Fixing the Rights and Preferences of Series [] MuniFund Preferred Shares (the Statement) and the

¹ Include for Adjustable Rate VRM

² Include for Adjustable Rate VRM

Supplement to the Statement Establishing and Fixing the Rights and Preferences of Series [] MuniFund Preferred Shares (the Statement Supplement). These documents are filed with the Securities and Exchange Commission as exhibits to the Fund's registration statement of which the prospectus is a part. Copies may be obtained as described under Where You Can Find More Information.

[The dividend rate is subject to adjustment from time to time. Commencing on any day after [], either the Fund or the beneficial owner of more than 50% of the outstanding VRM-MFP Shares (the Majority Beneficial Owner) may propose Adjusted Rate Terms (as defined herein), but any Adjusted Rate Terms must be agreed to by the Fund and the beneficial owners of 100% of the outstanding VRM-MFP Shares (the Required Beneficial Owners) prior to going into effect.]

[Adjusted Rate Terms may include, but are not limited to, the dividend rate (which may be fixed or floating), as well as, as applicable, the index rate, the index maturity, the index multiplier, the spread, the spread multiplier, the rate determination date(s), the dividend reset date(s), the dividend reset period(s), the minimum dividend rate, the day count convention, the dividend period(s) and other terms as set forth in a rate adjustment notice; provided, that no Adjusted Rate Terms may modify the terms or applicability of the provisions of the Statement or the Statement Supplement governing ranking, preemptive rights, voting rights, restrictions on dividends and other distributions, the term redemption date, restrictions on redemptions if the Fund is not current on paying accumulated and unpaid dividends, compliance with applicable law in connection with redemptions, liquidation rights or restrictions on amendments or supplements to the Statement or the Statement Supplement; and provided further, that no Adjusted Rate Terms shall modify any terms affecting the parity ranking of the VRM-MFP Shares relative to any other series of Preferred Shares of the Fund at any time outstanding with respect to dividends or distributions of assets upon dissolution, liquidation or winding up of the affairs of the Fund.]³

Mode means the Variable Rate Mode, or any subsequent Mode, including any extension thereof, for which terms and conditions of the VRM-MFP Shares are designated pursuant to the Statement and the Statement Supplement. See Description of VRM-MFP Shares Mode Change.

³ Include for Adjustable Rate VRM

Dividend Rate

During the Variable Rate Mode, [subject to change in the event of agreement to Adjusted Rate Terms as described under Adjusted Rate Terms below] the dividend rate for the VRM-MFP Shares is determined with respect to Dividend Reset Periods that will generally commence on a Thursday and end on the following Wednesday when a new Index Rate (as defined below) is made available. The Index Rate for any such Dividend Reset Period will be [(i) the SIFMA Municipal Swap Index (as defined below) made available by approximately 4:00 p.m., New York City time, on the Rate Determination Date for such Dividend Reset Period or if such index is not made so available on such date, the SIFMA Municipal Swap Index as determined on the previous Rate Determination Date.] If the day immediately preceding a Dividend Reset Period is not a Business Day, that Dividend Reset Period will begin on the first day following the date on which such index is next made available but the end date of such Dividend Reset Period will not be adjusted. [Except [during a Failed Transition Period (as defined below), if any, or]⁵ as may be provided for in the Adjusted Rate Terms as described below,]⁶ the Dividend Rate for any Dividend Reset Period will be equal to the Index Rate plus the Applicable Spread. The Applicable Spread will initially be []% per annum and is subject to adjustment in certain circumstances, including a change in the credit rating assigned to the VRM-MFP Shares by a rating agency providing a credit rating for the VRM-MFP Shares at the request of the Fund, as described below, provided that the Dividend Rate will in no event exceed 15% per annum.

Failed Transition Period means, upon the occurrence of [a Failed Adjustment Event (as defined below) or] a Failed Transition Event (as defined below), the period commencing on the date of such [Failed Adjustment Event or] Failed Transition Event and ending on the earliest to occur of (i) the redemption by the Fund on the Failed Transition Redemption Date or, if earlier, another Redemption Date, if any, of 100% of the outstanding MFP Shares, or (ii) the repurchase by the Fund of 100% of the outstanding MFP Shares, or (iii) the successful transition remarketing of 100% of the outstanding MFP Shares, or (iv) mutual agreement by the Fund and the Required Beneficial Owners to terminate the Failed Transition Period and revert to the Variable Rate Mode on the terms mutually agreed by the Fund and the Required Beneficial Owners.

⁴ Include for Adjustable Rate VRM

⁵ Include references to Failed Transition Period and related terms if the terms of the VRM offered provide for such a period following a failed attempt to transition to a new Mode

⁶ Include for Adjustable Rate VRM

[Failed Adjustment Event means that, in the case of Adjusted Rate Terms proposed by the Majority Beneficial Owner, the Fund and the Required Beneficial Owners shall have failed to agree in writing to Adjusted Rate Terms by the [] calendar day, or such other date as the Fund and the Required Beneficial Owners shall agree, following the date of delivery of a rate adjustment notice, unless the rate adjustment notice shall have been withdrawn prior to such [] calendar day or other agreed day⁷]

Failed Transition Event means that either (i) the transition notice states that the transition remarketing agent was unable to successfully remarket all of the VRM-MFP Shares to be purchased on the date a new Mode commences or (ii) the remarketing proceeds for any tendered VRM-MFP Shares are not received for any reason (x) by the Calculation and Paying Agent (as defined herein) by 4:30 p.m., New York City time or (y) if payment is made directly to the beneficial owners, by the beneficial owners by 3:00 p.m., New York City time, subject to the Statement Supplement, in each case, on the date a new Mode commences, or (iii) the Fund has otherwise been unsuccessful in extending the Variable Rate Mode or establishing a new Mode to succeed the Variable Rate Mode on the date a new Mode commences (in each of which cases the related VRM-MFP Shares will be treated as not having been successfully remarketed).

The dividend rate for the initial Dividend Reset Period commencing on, and including, [] and ending on, and including, [], will be equal to [the sum of (i) the SIFMA Municipal Swap Index, made available by approximately 4:00 p.m., New York City time, on Wednesday, [], plus (ii) the Applicable Spread or []% per annum if the SIFMA Municipal Swap Index is not so published].

[SIFMA Municipal Swap Index means the Securities Industry and Financial Markets Association Municipal Swap Index, or such other weekly, high-grade index comprised of seven-day, tax-exempt variable rate demand notes produced by Bloomberg or its successor, or as otherwise designated by the Securities Industry and Financial Markets Association; provided, however, that if such index is no longer produced by Bloomberg or its successor, then SIFMA Municipal Swap Index shall mean (i) the S&P Municipal Bond 7 Day High Grade Rate Index produced by Standard & Poor's Financial Services LLC or its successors or (ii) if the S&P Municipal Bond 7 Day High Grade Rate Index is no longer produced,

⁷ Include for Adjustable Rate VRM

such other reasonably comparable index selected in good faith by the Board of Trustees of the Fund (the Board).]

Business Day means a day (a) other than a day on which commercial banks in The City of New York, New York are required or authorized by law or executive order to close and (b) on which the New York Stock Exchange is not closed.

Rate Determination Date means with respect to the initial Dividend Reset Period, [], and, with respect to any subsequent Dividend Reset Period, [(i)] the last day of the immediately preceding Dividend Reset Period or, if such day is not a Business Day, the next succeeding Business Day; provided however that the next succeeding Rate Determination Date will be determined without regard to any prior extension of a Rate Determination Date to a Business Day [or (ii) as may be otherwise provided for in the Adjusted Rate Terms]⁸].

The applicable dividend rate for the VRM-MFP Shares is referred to herein as the Dividend Rate.

[Adjusted Rate Terms

The Dividend Rate is subject to adjustment from time to time. Commencing on any day after [], either the Fund or the Majority Beneficial Owner may propose Adjusted Rate Terms, but any Adjusted Rate Terms must be agreed to by the Fund and the Required Beneficial Owners prior to going into effect.

If the Fund proposes Adjusted Rate Terms, and the Required Beneficial Owners do not agree to Adjusted Rate Terms, then the Dividend Rate and other terms already in effect will continue. If the Majority Beneficial Owner proposes Adjusted Rate Terms, and the Fund and the Required Beneficial Owners do not agree to Adjusted Rate Terms, then the proposed Adjusted Rate Terms will not take effect, constituting a Failed Adjustment Event (as defined herein), and a Failed Transition Period will commence. In such case, the Fund will use its reasonable best efforts, to the extent it can do so on a commercially reasonable basis, to establish a new Mode for the VRM-MFP Shares, the Dividend Rate will be the Failed Transition Period Dividend Rate and the VRM-MFP Shares will be subject to mandatory redemption on the Failed Transition Redemption Date (as defined below), if the Fund has not successfully established a new Mode or redeemed or repurchased all of the VRM-MFP Shares or agreed to termination of the Failed Transition Period with the Required Beneficial Owners prior to the end of the Failed Transition Period. See Transition to a New Mode, Failed Transition

⁸ Include for Adjustable Rate VRM

Period Dividend Rate and Redemption Provisions Failed Transition Mandatory Redemption below.

Adjusted Rate Terms, once established, may be further adjusted or replaced with new Adjusted Rate Terms.⁹

Applicable Spread Adjustments

The Applicable Spread will initially be []% per annum but [(i)] will adjust based on the highest applicable credit rating most recently assigned to the VRM-MFP Shares by [] or any additional or different Rating Agency (as defined below) providing a long-term credit rating on the VRM-MFP Shares and which is designated a Rating Agency by the Fund to the per annum percentage set forth opposite such assigned rating in the table below[, or (ii) such spread or spreads as may be provided for in Adjusted Rate Terms]¹⁰ [(provided, however, the Applicable Spread shall not apply for any Dividend Reset Period or portion thereof occurring during the Failed Transition Period, if any, except as provided in the definition of Failed Transition Period Applicable Spread or in the case of an Increased Rate Period occurring during the Failed Transition Period)]:

Long Term Ratings* []	Applicable Percentage**
AAA to AA	[]%
AA-	[]%
A+	[]%
A	[]%
A-	[]%
BBB+	[]%
BBB	[]%
BBB-	[]%

*And/or the equivalent ratings of another Rating Agency then rating the VRM-MFP Shares utilizing the highest of the ratings of the Rating Agencies then rating the VRM-MFP Shares.

**Unless an Increased Rate Period is in effect, in which case the Applicable Spread will be []% for such Increased Rate Period.

Each NRSRO rating the VRM-MFP Shares at the request of the Fund is referred to in this prospectus supplement as a Rating Agency.

⁹ Include for Adjustable Rate VRM

¹⁰ Include for Adjustable Rate VRM

The Applicable Spread will increase to []% per annum for each Increased Rate Period. An Increased Rate Period will commence (A) on a Dividend Payment Date if the Fund has failed to deposit with [] and its successors or any other calculation and paying agent appointed by the Fund with respect to the VRM-MFP Shares (the Calculation and Paying Agent) by 12:00 noon, New York City time, on such Dividend Payment Date, deposit securities that will provide funds available to the Calculation and Paying Agent on such Dividend Payment Date sufficient to pay the full amount of any dividend on the VRM-MFP Shares payable on such Dividend Payment Date (a Dividend Default) and continue to, but excluding, the Business Day on which the Dividend Default is cured; (B) on an applicable redemption date if the Fund has failed to deposit with the Calculation and Paying Agent for the VRM-MFP Shares by 12:00 noon, New York City time, on such redemption date for the VRM-MFP Shares, deposit securities that will provide funds available to the Tender and Paying Agent on such redemption date sufficient to pay the full amount of the Redemption Price payable in respect of such shares on such redemption date (a Redemption Default) and continue to, but excluding, the Business Day on which such Redemption Default is cured; (C) on the Business Day on which any Rating Agency has withdrawn the credit rating required to be maintained with respect to the VRM-MFP Shares pursuant to the Statement Supplement, other than due to the Rating Agency ceasing to rate tax-exempt closed-end management investment companies generally and such withdrawal is continuing, or the Fund has terminated the designation of a Rating Agency without complying with the requirements of the Statement Supplement and continue to, but excluding, the Business Day on which the Fund restores compliance with its Rating Agency obligations under the Statement Supplement; (D) on the Business Day on which a Ratings Event (as defined below) has occurred with respect to the VRM-MFP Shares and continue to, but excluding, the Business Day on which such Ratings Event has ended; or (E) on the Business Day on which (i) a court or other applicable governmental authority has made a final determination that for U.S. federal income tax purposes the VRM-MFP Shares do not qualify as equity in the Fund and (ii) such determination results from an act or failure to act on the part of the Fund and continue so long as any VRM-MFP Shares are outstanding in the Variable Rate Mode. A Ratings Event will be deemed to exist with respect to the VRM-MFP Shares at any time such VRM-MFP Shares have a long-term credit rating from at least one-half of the Rating Agencies designated at such time (or

from the Rating Agency designated at such time if only one Rating Agency is then designated) that is below investment grade.

[For each Dividend Reset Period or portion thereof during the Failed Transition Period, if any, the Dividend Rate will be the Failed Transition Period Dividend Rate (as defined below).]

Dividend Payments

The holders of VRM-MFP Shares will be entitled to receive, when, as and if declared by, or under authority granted by, the Board out of funds legally available for payment, cumulative cash dividends and distributions on each such VRM-MFP Share at the Dividend Rate. Dividends and other distributions on each VRM-MFP Share accumulate from the Date of Original Issue with respect to such share. During the Variable Rate Mode, the Dividend Period will generally be a calendar month, and the Dividend Payment Date in respect of each Dividend Period will be the first Business Day following the end of such Dividend Period, except that the first Dividend Period will begin on (and include) [] and end on (and include) [], and the first Dividend Payment Date will be [], and the final Dividend Period in the Variable Rate Mode will end on and include the last calendar day of the Variable Rate Mode. Notwithstanding the foregoing, [(i)] the Fund in its discretion may establish Dividend Payment Dates (each, a Special Dividend Payment Date) more frequent than monthly Dividend Payment Dates in respect of the Variable Rate Mode; provided, that any such Special Dividend Payment Date shall be a Business Day[, or (ii) the Fund and the Required Beneficial Owners may establish the date or dates as may be provided for in the Adjusted Rate Terms.]¹¹

The amount of dividends per share payable on the VRM-MFP Shares on any Dividend Payment Date will equal the sum of the dividends accumulated but not yet paid for each Dividend Reset Period (or portion thereof) in the related Dividend Period. The amount of dividends per share accumulated for each such Dividend Reset Period (or portion thereof) will be computed by (i) multiplying the Dividend Rate in effect for the VRM-MFP Shares for such Dividend Reset Period (or portion thereof) by a fraction, the numerator of which will be [the actual number of days in such Dividend Reset Period (or portion thereof) and the denominator of which will be the actual number of days in the year in which such Dividend Reset Period (or portion thereof) occurs (365 or 366)] and (ii) multiplying the product determined pursuant to clause (i) by the Liquidation Preference for a VRM-MFP Share (\$[]). [The Dividend Rate may be

¹¹ Include for Adjustable Rate VRM

adjusted to a new Dividend Rate as provided in the Adjusted Rate Terms.]¹² The Dividend Rate for the VRM-MFP Shares will be adjusted to the Increased Rate for each Increased Rate Period. Dividends on VRM-MFP Shares with respect to any Dividend Period will be declared to the holders of record of such shares as their names shall appear on the registration books of the Fund at the close of business on each day in such Dividend Period. In connection with any transfer of VRM-MFP Shares, the transferor will, subject to any agreement between the transferor and transferee, transfer to the transferee the transferor's right to receive from the Fund any unpaid dividends so declared for each day prior to the transferee becoming the holder or beneficial owner, as applicable, of the VRM-MFP Shares in consideration of a portion of the purchase price for such VRM-MFP Shares paid by the transferee.

Dividends on VRM-MFP Shares will be paid on each Dividend Payment Date to the holders of VRM-MFP Shares as their names appear on the registration books of the Fund at the close of business on the day immediately preceding such Dividend Payment Date (or if such day is not a Business Day, the next preceding Business Day).

See Description of VRM-MFP Shares Dividends and Distributions.

Transition to New Mode

On any day after [], the Fund may at its option elect to transition to a new Mode. [In addition, (i) during a Rate Adjustment Notice Period (as defined herein), if the Majority Beneficial Owner is the proposing party, the Fund will use its reasonable best efforts, to the extent it can do so on a commercially reasonable basis, to either agree with the Required Beneficial Owners on the Adjusted Rate Terms or transition to a new Mode and (ii) during a Failed Transition Period following the occurrence of a Failed Adjustment Event or a Failed Transition Event (as defined herein), the Fund will use its reasonable best efforts, to the extent that it can do so on a commercially reasonable basis, to transition to a new Mode by establishing a new Mode to succeed the Variable Rate Mode that will result in a transition to such new Mode on a Thursday that is a Business Day (such Business Day, the New Mode Commencement Date), with terms as set forth in a new Statement supplement designating the terms of such Mode.]¹³ See Description of VRM-MFP Shares Mode [Extension or] Change.

¹² Include for Adjustable Rate VRM

¹³ Include for Adjustable Rate VRM

In the case of a transition to a new Mode, all outstanding VRM-MFP Shares automatically will be subject to mandatory tender for transition remarketing and delivered to the Calculation and Paying Agent for purchase by purchasers in the transition remarketing on the New Mode Commencement Date, in the event of a successful transition remarketing; provided, that the Required Beneficial Owners, by agreement with the Fund, may (1) waive their right to the mandatory tender and (2) retain their VRM-MFP Shares. Such waiver and retention of 100% of the outstanding VRM-MFP Shares shall be deemed to constitute a successful transition remarketing. Otherwise, a transition remarketing shall be deemed successful only if a Failed Transition Event shall not have occurred. Upon the occurrence of a Failed Transition Event, all tendered VRM-MFP Shares will be returned to the relevant tendering holders by the Calculation and Paying Agent.

[During a Failed Transition Period, if any, dividends on the VRM-MFP Shares will accumulate at the Failed Transition Period Dividend Rate (as defined below), and the VRM-MFP Shares will be subject to mandatory redemption by the Fund, if the Fund has not successfully established a new Mode or redeemed or repurchased all of the VRM-MFP Shares or agreed to termination of the Failed Transition Period with the Required Beneficial Owners prior to the end of the Failed Transition Period. See Failed Transition Period Dividend Rate and Failed Transition Mandatory Redemption below.]

Upon the occurrence of a successful transition remarketing, the Fund will be deemed to have successfully established a new Mode, and the VRM-MFP Shares will be subject to the terms established for the new Mode.

[Failed Transition Period Dividend Rate

For each Dividend Reset Period (or portion thereof) occurring during the Failed Transition Period, if any, the Dividend Rate shall be the Failed Transition Period Dividend Rate, which will equal the Index Rate for such Dividend Reset Period (or portion thereof) plus the Failed Transition Period Applicable Spread for such Dividend Reset Period (or portion thereof); provided, however, that, with respect to any Increased Rate Period, the Failed Transition Period Dividend Rate shall mean the Increased Rate for such Increased Rate Period; and provided further, that the Failed Transition Period Dividend Rate for any Dividend Reset Period (or portion thereof) shall in no event exceed the Maximum Rate.

Failed Transition Period Applicable Spread means, for each Dividend Reset Period or portion thereof occurring while the Failed Transition Period, if any, has occurred and is continuing: the higher of (i) the Applicable Spread that would otherwise be in effect absent a Failed Transition Event; and (ii) [] basis points ([]%) (up to 59 days of the continued Failed Transition Period), 225 basis points ([]%) (60 days but fewer than 90 days of the continued Failed Transition Period), [] basis points ([]%) (90 days but fewer than 120 days of the continued Failed Transition Period), [] basis points ([]%) (120 days but fewer than 150 days of the continued Failed Transition Period), [] basis points ([]%) (150 days but fewer than 180 days of the Failed Transition Period), and [] basis points ([]%) (180 days or more of the continued Failed Transition Period).]

Coverage and Leverage Tests

The Fund will agree in the Statement Supplement to comply on an ongoing basis with asset coverage and effective leverage requirements. A failure to comply may result in the mandatory redemption of Preferred Shares, which may include some number of VRM-MFP Shares. See Redemption Provisions Asset Coverage Mandatory Redemption and Effective Leverage Ratio Mandatory Redemption below and Description of VRM-MFP Shares Coverage and Leverage Tests and Redemptions Asset Coverage Mandatory Redemption and Effective Leverage Ratio Mandatory Redemption.

Redemption Provisions

Optional Redemption. Subject to certain conditions, VRM-MFP Shares may be redeemed on any Business Day, at the option of the Fund (in whole or from time to time, in part), out of funds legally available therefor, at the Redemption Price per share. The

Redemption Price per share is equal to the Liquidation Preference per VRM-MFP Share plus an amount equal to all unpaid dividends and other distributions on such VRM-MFP Share accumulated from and including the Date of Original Issue to (but excluding) the redemption date (whether or not earned or declared by the Fund, but without interest thereon).

See Description of VRM-MFP Shares Redemption Optional Redemption.

Term Mandatory Redemption. The Fund will redeem all outstanding VRM-MFP Shares on [], 20[] (the Term Redemption Date) at the aggregate Redemption Price.

Failed Transition Mandatory Redemption. The Fund will redeem all outstanding VRM-MFP Shares at the aggregate Redemption Price on the Failed Transition Redemption Date

(as defined herein), if a Failed Transition Event shall have occurred and be continuing as of such date, or, if earlier, on the Term Redemption Date.

Asset Coverage Mandatory Redemption. If the Fund fails to have Asset Coverage of at least 225% and such failure is not timely cured, the Fund will proceed to redeem Preferred Shares (which may include at the sole option of the Fund any number or proportion of VRM-MFP Shares) to restore compliance with the Asset Coverage requirement. In the event that any VRM-MFP Shares then outstanding are to be redeemed, the Fund will redeem such VRM-MFP Shares at a price per VRM-MFP Share equal to the Redemption Price on the redemption date therefor.

See Description of VRM-MFP Shares Redemption Asset Coverage Mandatory Redemption.

Effective Leverage Ratio Mandatory Redemption. If the Effective Leverage Ratio of the Fund exceeds 45% (or 46% solely by reason of fluctuations in the market value of the Fund's portfolio securities) as of the close of business on any Business Day on which such ratio is required to be calculated and such failure is not cured as of the close of business on the date that is seven Business Days following the Business Day on which such non-compliance is first determined, the Fund will cause the Effective Leverage Ratio to not exceed 45% by (x)engaging in transactions involving or relating to the floating rate securities not owned by the Fund and/or the inverse floating rate securities owned by the Fund, including the purchase, sale or retirement thereof, (y)proceeding with redeeming a sufficient number of Preferred Shares, which at the Fund's sole option may include any number or proportion of VRM-MFP Shares, in accordance with the terms of such series, or (z)engaging in any combination of the actions contemplated by (x)and (y)above. In the event that any VRM-MFP Shares then outstanding are to be redeemed, the Fund will redeem such VRM-MFP Shares at a price per VRM-MFP Share equal to the Redemption Price on the redemption date thereof.

See Description of VRM-MFP Shares Redemption Effective Leverage Ratio Mandatory Redemption.

Any optional or mandatory redemption of VRM-MFP Shares by the Fund shall be done in accordance with the requirements of the Statement and Statement Supplement and the provisions of the 1940 Act and rules thereunder, including Rule 23c-2.

Tax Exemption

The dividend rate for VRM-MFP Shares assumes that each month's distribution is comprised solely of dividends exempt from regular U.S. federal income tax and the federal alternative minimum tax. From time to time, the Fund may be required to allocate capital gains and/or ordinary income to a given month's distribution on VRM-MFP Shares. To the extent that it does so, the Fund will provide notice thereof and make Additional Amount Payments at the times and in accordance with, and to the extent required in, the provisions relating thereto as described under Description of VRM-MFP Shares Dividends Taxable Allocations. Investors should consult with their own tax advisors before making an investment in the VRM-MFP Shares. See Tax Matters.

Ratings

The Fund expects that at the Date of Original Issue, the VRM-MFP Shares will have a long-term rating from [] and a long-term credit rating from [].

There can be no assurance that the Fund will maintain any ratings of the VRM-MFP Shares or, if at any time the VRM-MFP Shares have one or more ratings, that any particular ratings will be maintained. See Risk Factors Ratings and Asset Coverage Risk.

Voting Rights

Except as otherwise provided in the Declaration of Trust or as otherwise required by law, (i) each holder of VRM-MFP Shares will be entitled to one vote for each VRM-MFP Share held by such holder on each matter submitted to a vote of shareholders of the Fund, and (ii) the holders of outstanding Preferred Shares, including each VRM-MFP Share, and of Common Shares will vote together as a single class; provided, however, that the holders of outstanding Preferred Shares, including VRM-MFP Shares, voting as a class, to the exclusion of the holders of all other securities and classes of shares of beneficial interest of the Fund, will be entitled to elect two trustees of the Fund at all times, each Preferred Share, including each VRM-MFP Share, entitling the holder thereof to one vote. The holders of outstanding Common Shares and Preferred Shares, including VRM-MFP Shares, voting together as a single class, will elect the balance of the trustees.

Liquidation Preference

The Liquidation Preference of VRM-MFP Shares will be [] per share. In the event of any liquidation, dissolution or winding up of the affairs of the Fund, whether voluntary or involuntary, the holders of VRM-MFP Shares will be entitled to receive a liquidation distribution per share equal to the Liquidation Preference plus an amount equal to all unpaid dividends and other distributions accumulated to (but excluding) the date fixed for distribution or payment (whether

or not earned or declared by the Fund, but without interest thereon). See Description of VRM-MFP Shares Priority of Payment and Liquidation Preference.

Trading Market

The VRM-MFP Shares are a new issue of securities and there is currently no established trading market for such shares. The Fund does not intend to apply for a listing of the VRM-MFP Shares on a securities exchange or an automated dealer quotation system. Accordingly, there can be no assurance as to the development or liquidity of any market for the VRM-MFP Shares.

Further Issuance

The Fund may issue additional Preferred Shares on parity with VRM-MFP Shares. The Fund may not issue additional classes of shares that are senior to VRM-MFP Shares or that are senior to other outstanding Preferred Shares of the Fund as to payments of dividends or as to distribution of assets upon dissolution, liquidation or winding up of the affairs of the Fund.

Calculation and Paying Agent

The Fund will enter into a Tender and Paying Agent Agreement with the Calculation and Paying Agent, effective as of the Date of Original Issue in connection with the initial issuance of VRM-MFP Shares. In connection with the Variable Rate Mode, the Calculation and Paying Agent will serve as the Fund's calculation agent, transfer agent and registrar, dividend disbursing agent, and paying agent and redemption price disbursing agent with respect to the VRM-MFP Shares. See Custodian, Transfer Agent, Calculation and Paying Agent.

Use of Proceeds

The Fund estimates that the total net proceeds from this offering after deducting the underwriting discounts and commissions and estimated offering expenses payable by the Fund will be approximately \$[]. The Fund intends to use the net proceeds from the sale of VRM-MFP Shares to []. See Use of Proceeds.

Book-Entry

It is expected that the VRM-MFP Shares will be delivered to investors in book-entry form only, through the facilities of The Depository Trust Company (DTC).

Governing Law

The Declaration of Trust, the Statement and the Statement Supplement are governed by the laws of the Commonwealth of Massachusetts.

Risk Factors

See Risk Factors in this prospectus supplement, as well as Risks Factors and other information included in the accompanying prospectus, for a discussion of the principal risks you should carefully consider before deciding to invest in VRM-MFP Shares.

RISK FACTORS

Investing in the VRM-MFP Shares involves risk, including the risk that you may receive little or no return on your investment or that you may lose part or all of your investment. Therefore, before investing in the VRM-MFP Shares you should consider carefully the following risks, as well as the risk factors set forth under Risk Factors beginning on page 9 of the accompanying prospectus.

Dividend Rate Risk VRM-MFP Shares

VRM-MFP Shares are variable dividend rate securities. Such securities generally are less sensitive to interest and dividend rate changes but may decline in value if their dividend rate does not rise as much, or as quickly, as interest and dividend rates in general. Conversely, variable dividend rate securities will not generally increase in value if interest and dividend rates decline.

[Risks Related to SIFMA Municipal Swap Index

The Dividend Rate on the VRM-MFP Shares is based on the weekly SIFMA Municipal Swap Index plus an applicable spread that is determined based on the long-term credit rating of the VRM-MFP Shares. The SIFMA Municipal Swap Index is affected by factors that may affect other interest or dividend rates and rate indexes differently, including the following:

Marginal Tax Rates. As the SIFMA Municipal Swap Index represents the rate payable on tax-exempt variable rate demand obligations, decreases in the marginal tax rate may increase the SIFMA Municipal Swap Index, including in relation to other interest and dividend rates and rate indexes, as a result of the reduced after-tax benefits of the tax-exempt variable rate demand obligations included in the SIFMA Municipal Swap Index. Conversely, increases in the marginal tax rate may decrease the SIFMA Municipal Swap Index, including in relation to other interest and dividend rates and rate indexes, as a result of the greater after-tax benefits of the tax-exempt variable rate demand obligations included in the SIFMA Municipal Swap Index.

Tax-Exempt Status of Municipal Securities. Changes in the tax-exempt status of municipal securities may also affect the SIFMA Municipal Swap Index in relation to other interest and dividend rates and rate indexes. If the tax-exempt status of municipal securities were to be removed, reduced or otherwise adversely affected, the SIFMA Municipal Swap Index would likely increase, converging toward non-tax-exempt interest and dividend rates.

Tax Treatment of Comparable Securities. Changes in tax laws that grant non-municipal securities more favorable tax treatment to investors may adversely impact market demand for, and the pricing of, municipal securities generally and the tax-exempt variable rate demand obligations included in the SIFMA Municipal Swap Index specifically.

Creditworthiness of Municipal Securities. Any actual or anticipated decline in the actual or perceived creditworthiness of issuers of municipal securities could significantly increase the level of the SIFMA Municipal Swap Index. Issues of creditworthiness that disproportionately affect issuers of municipal securities in relation to issuers of other variable interest and dividend rate securities would increase the level of the SIFMA Municipal Swap Index in relation to other interest and dividend rates and rate indexes.

Supply and Demand for Municipal Securities; Remarketing Practices. In addition to the creditworthiness of municipal securities, other factors can affect the level of the SIFMA Municipal Swap Index, including in relation to other interest and dividend rates and rate indexes, such as supply and demand imbalances, any changes in the remarketing practices for tax-exempt variable rate demand obligations, and other technical trading factors. Aside from changes in the tax law, such supply and demand movements could derive from fragmentation in the market for municipal securities, uncertainty with respect to the rights of the holders of municipal securities, and illiquidity generally in the market.

Yield Compression. As market interest and dividend rates in general decrease, municipal securities may become subject to decreasing demand (as the positive tax effects of holding tax-exempt municipal securities decline on a relative basis) and increasing supply (as municipal issuers seek to exploit low interest rates by issuing more securities). This demand and supply imbalance could increase the SIFMA Municipal Swap Index, including in relation to other interest and dividend rates and rate indexes.]

[Discontinuation or Modification of the SIFMA Municipal Swap Index

The SIFMA Municipal Swap Index was created by the Securities Industry and Financial Markets Association (SIFMA) and is produced by Bloomberg. SIFMA and/or Bloomberg may make methodological or other changes that could change the index level of the SIFMA Municipal Swap Index, including changes related to the method by which the index level is calculated, the criteria for eligibility for inclusion in the SIFMA Municipal Swap Index, and/or the timing on which the SIFMA Municipal Swap Index is published. In addition, SIFMA and/or Bloomberg may alter, discontinue or suspend calculation or dissemination of the SIFMA Municipal Swap Index. SIFMA and Bloomberg have no obligation to consider the interests of the holders of the VRM-MFP Shares in calculating, revising or discontinuing the SIFMA Municipal Swap Index. In the event that the SIFMA Municipal Swap Index is no longer published, the Dividend Rate will be based on the S&P Municipal Bond 7 Day High Grade Rate Index. If the S&P Municipal Bond 7 Day High Grade Rate Index is no longer published, the Fund may in good faith select another reasonably comparable index as a replacement subject to approval of a majority of holders of the VRM-MFP Shares. No assurance can be given that the S&P Municipal Bond 7 Day High Grade Rate Index or such other comparable index selected by the Board will be an accurate assessment of average tax-exempt variable rate demand obligation interest and dividend rates that the SIFMA Municipal Swap Index is currently proposed to measure.]

No Public Trading Market

The VRM-MFP Shares will be a new issue of securities and there is currently no established trading market for the VRM-MFP Shares. The Fund does not intend to apply for a listing of the VRM-MFP Shares on a securities exchange or an automated dealer quotation system. Thus, an investment in VRM-MFP Shares may be illiquid and there may be no active trading market.

Risk of Mandatory and Optional Redemptions or Mode Change

The Fund may be forced to redeem VRM-MFP Shares to meet requirements in the Statement Supplement or regulatory or Rating Agency requirements, or may voluntarily redeem VRM-MFP Shares at any time, or may elect to make a Mode Change, including in circumstances that are unfavorable to VRM-MFP shareholders, at times when attractive alternative investment opportunities

for reinvestment of the redemption proceeds are not available. See Description of VRM-MFP Shares Redemption and Mode [Extension or] Change.

Dividend Rate Risk

The VRM-MFP Shares are variable dividend rate securities. Such securities generally are less sensitive to interest and dividend rate changes but may decline in value if their dividend rate does not rise as much, or as quickly, as interest and dividend rates in general. Conversely, variable dividend rate securities will not generally increase in value if interest and dividend rates decline.

Interest Rate and Income Shortfall Risk

VRM-MFP Shares generally pay dividends based on short-term interest rates, and the proceeds from the issuance of the Fund's Preferred Shares are used to buy municipal bonds, which pay interest based on long-term yields. Long-term municipal bond yields are typically, although not always, higher than short-term interest rates. Long-term, intermediate-term and short-term interest rates may fluctuate. If short-term interest rates rise, VRM-MFP Share rates may rise so that the amount of dividends paid to the VRM-MFP Shareholders exceeds the income from the portfolio securities purchased with the proceeds from the sale of VRM-MFP Shares. Because income from the Fund's entire investment portfolio (not just the portion of the portfolio attributable to the proceeds from the issuance of Preferred Shares) is available to pay dividends on the Fund's outstanding Preferred Shares, however, dividend rates on the Preferred Shares would need to greatly exceed the Fund's net portfolio income before the Fund's ability to pay dividends on the Preferred Shares, including the VRM-MFP Shares, would be jeopardized. If long-term rates rise, the value of the Fund's investment portfolio will decline, reducing the amount of assets serving as the Asset Coverage for the VRM-MFP Shares.

Additionally, in certain market environments, short-term market interest rates may be higher than the Maximum Rate allowable for the dividend reset for VRM-MFP Shares. In such extreme circumstances, this scenario may adversely affect the valuation of VRM-MFP Shares and the liquidity of VRM-MFP Shares.

Subordination Risk

While VRM-MFP shareholders will have equal liquidation and distribution rights to any other Preferred Shares issued or that might be issued by the Fund, they will be subordinated to the rights of holders of indebtedness and the claims of other creditors of the Fund. Therefore, dividends, distributions and other payments to VRM-MFP Shareholders in liquidation or otherwise will be subject to prior payments due, if any, to the holders of indebtedness or other creditors of the Fund. Creditors of the Fund may include lenders and counterparties in connection with any borrowings, delayed delivery purchases and/or forward delivery contracts or derivatives, including interest rate swaps or caps, entered into by the Fund.

Ratings and Asset Coverage Risk

It is a condition of the issuance of the VRM-MFP Shares offered hereby that, at the Date of Original Issuance, the VRM-MFP Shares will have a long-term credit rating of from [] and a long-term credit rating from [].

There can be no assurance that any particular rating will be maintained at the level currently assigned to the VRM-MFP Shares. Ratings do not eliminate or mitigate the risks of investing in VRM-MFP Shares. A rating issued by a Rating Agency (including [] and []) is only the opinion of the entity issuing the rating at that time, and is not a guarantee as to quality, or an assurance of the future performance, of the rated security (in this case, VRM-MFP Shares). In addition, the manner in which the Rating Agency obtains and processes information about a particular security may affect the Rating Agency's ability to react in a timely manner to changes in an issuer's circumstances (in this case, the Fund) that could influence a particular rating. A Rating Agency downgrade of the VRM-MFP Shares that results in an increase in the Dividend Rate may make VRM-MFP Shares less liquid in the secondary market.

Additionally, so long as the VRM-MFP Shares or other Preferred Shares of the Fund have long-term ratings, the Fund will be required to meet certain asset coverage or other criteria in order to maintain such rating. The Fund's failure to meet such criteria may cause the Fund to sell portfolio positions or to redeem VRM-MFP Shares at inopportune times in an amount necessary to restore compliance with such criteria, or may result in a downgrade of ratings. The ratings do not eliminate or necessarily mitigate the risks of investing in VRM-MFP Shares. A rating issued by a Rating Agency is only the opinion of the entity issuing the rating at that time and is not a guarantee as to quality, or an assurance of the future performance, of the rated security. In addition, the manner in which the Rating Agency obtains and processes information about a particular security may affect the Rating Agency's ability to timely react to changes in an issuer's (in this case, the Fund's) circumstances that could influence a particular rating. A Rating Agency could downgrade VRM-MFP Shares, which may make VRM-MFP Shares less liquid in the secondary market, although the downgrade would probably result in higher dividend rates.

A rating on the VRM-MFP Shares is not a recommendation to purchase, hold, or sell those shares, inasmuch as the rating does not comment as to market price or suitability for a particular investor. A Rating Agency could downgrade VRM-MFP Shares.

Tax Risks

The Fund is relying on an opinion of counsel that the VRM-MFP Shares will qualify as stock in the Fund for U.S. federal income tax purposes. Because there is no direct legal authority on the classification of instruments similar to the VRM-MFP Shares, investors should be aware that the Internal Revenue Service and other governmental taxing authorities could assert a contrary position. See Tax Matters.

Multiple Series Risk

Following the issuance of the VRM-MFP Shares, the Fund will have [] series of MFP Shares and [] series of VRDP Shares outstanding. All Preferred Shares of the Fund have equal priority as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of the affairs of the Fund, but, to the extent that the terms of the various series or types of Preferred Shares differ, there is a risk that market or other events may impact one series of Preferred Shares differently from other series. If market or other events cause the Fund to breach covenants applicable to one series or type of Preferred Shares but not others, the Fund may nevertheless be granted discretion to redeem shares of any series of Preferred Shares, including the affected series, in order to restore compliance, subject to the redemption terms of each series. In addition, the voting power of

certain series of Preferred Shares may be more concentrated than others. The Fund, without the consent of VRM-MFP shareholders, may from time to time issue additional Preferred Shares of a new or existing series in connection with new financings, refinancing or reorganizations. The issuance by the Fund of additional Preferred Shares may require the consent of liquidity providers or other Fund counterparties.

Dividend Risk

The Fund may be unable to pay dividends on VRM-MFP Shares in extraordinary circumstances.

CAPITALIZATION

[TO BE FURNISHED AT THE TIME OF THE OFFERING]

ASSET COVERAGE RATIO

As provided in the 1940 Act and subject to certain exceptions, the Fund may issue Preferred Shares with the condition that immediately after the issuance the value of its assets, less certain ordinary course liabilities, exceeds 200% of the amount of Preferred Shares outstanding. The Statement Supplement and other instruments and agreements to which the Fund is subject place additional restrictions on the ability of the Fund to issue Preferred Shares. The Fund estimates that based on its capitalization as of [], 20[], the Fund's asset coverage, after giving effect to this offering will be []%.

USE OF PROCEEDS

The Fund estimates that the net proceeds of the offering will be approximately \$[], after payment of the underwriting discounts and commissions and estimated offering expenses payable by the Fund. The Fund intends to use the net proceeds from the sale of VRM-MFP Shares to [].

DESCRIPTION OF VRM-MFP SHARES

The following is a brief description of the material terms of the VRM-MFP Shares.

General

The Fund’s Declaration of Trust authorizes the issuance of an unlimited number of preferred shares, including the VRM-MFP Shares. As of [], 20[], the Fund had outstanding [1,790 Series 1 VRDP Shares, 3,854 Series 2 VRDP Shares, 1,800 Series 4 VRDP Shares, 3,405 Series 5 VRDP Shares, 3,267 Series 6 VRDP Shares, and 4,054 Series A MFP Shares.]. The VRM-MFP Shares and any other preferred shares, including the previously authorized MFP Shares and VRDP Shares, of the Fund that may then be outstanding are collectively referred to as Preferred Shares. See Description of Securities in the prospectus. Copies of the Declaration of Trust and the Statement and the Statement Supplement for the VRM-MFP Shares are filed with the Securities and Exchange Commission as exhibits to the Fund’s registration statement of which this prospectus supplement is a part. Copies may be obtained as described under Where You Can Find More Information.

Priority of Payment and Liquidation Preference

VRM-MFP Shares will be senior securities that constitute shares of beneficial interest of the Fund and are senior, with priority in all respects, to the Fund’s Common Shares as to payments of dividends and as to distribution of assets upon dissolution, liquidation or winding up of the affairs of the Fund. VRM-MFP Shares will have equal priority as to payments of dividends and as to distribution of assets upon dissolution, liquidation or winding up of the affairs of the Funds with each other and with other Preferred Shares. The Fund may issue additional Preferred Shares on parity with the VRM-MFP Shares. The Fund may not issue additional classes of shares that are senior to VRM-MFP Shares or that are senior to other outstanding Preferred Shares of the Fund as to payments of dividends or as to distribution of assets upon dissolution, liquidation or winding up of the affairs of the Fund. As a fundamental policy, the Fund may not borrow money, except from banks for temporary or emergency purposes, or for repurchase of its shares, subject to certain restrictions.

In the event of any liquidation, dissolution or winding up of the affairs of the Fund, whether voluntary or involuntary, the holders of VRM-MFP Shares will be entitled to receive a liquidation distribution per share equal to the Liquidation Preference plus an amount equal to all unpaid dividends and other distributions accumulated to (but excluding) the date fixed for distribution or payment (whether or not earned or declared by the Fund, but without interest thereon).

Dividends

Dividend Rate

[Subject to change in the event of agreement to Adjusted Rate Terms as described under Adjusted Rate Terms below¹⁴, the dividend rate for the VRM-MFP Shares is determined with respect to Dividend Reset Periods that will generally commence [on a Thursday and end on the following Wednesday] when a new Index Rate (as defined below) is made available. The Index Rate for any such Dividend Reset Period will be [(i) the SIFMA Municipal Swap Index (as defined below) made available by approximately 4:00 p.m., New York City time, on the Rate Determination Date for

¹⁴ Include for Adjustable Rate VRM

such Dividend Reset Period or if such index is not made so available on such date, the SIFMA Municipal Swap Index as determined on the previous Rate Determination Date.] If the day immediately preceding a Dividend Reset Period is not a Business Day, that Dividend Reset Period will begin on the first day following the date on which such index is next made available but the end date of such Dividend Reset Period will not be adjusted. [Except [during a Failed Transition Period, if any, or] as may be provided for in the Adjusted Rate Terms as described below,]¹⁵ the Dividend Rate for any Dividend Reset Period will be equal to the Index Rate plus the Applicable Spread. The Applicable Spread will initially be []% per annum and is subject to adjustment in certain circumstances, including a change in the credit rating assigned to the VRM-MFP Shares by a rating agency providing a credit rating for the VRM-MFP Shares at the request of the Fund, as described below, provided that the Dividend Rate will in no event exceed 15% per annum.

The dividend rate for the initial Dividend Reset Period commencing on, and including, [] and ending on, and including, Wednesday, [], will be equal to [(i) the sum of the SIFMA Municipal Swap Index, made available by approximately 4:00 p.m., New York City time, on Wednesday, [], plus the Applicable Spread or (ii) []% per annum if the SIFMA Municipal Swap Index is not so published].

[SIFMA Municipal Swap Index means the Securities Industry and Financial Markets Association Municipal Swap Index, or such other weekly, high-grade index comprised of seven-day, tax-exempt variable rate demand notes produced by Bloomberg or its successor, or as otherwise designated by the Securities Industry and Financial Markets Association; provided, however, that if such index is no longer produced by Bloomberg or its successor, then SIFMA Municipal Swap Index shall mean (i) the S&P Municipal Bond 7 Day High Grade Rate Index produced by Standard & Poor's Financial Services LLC or its successors or (ii) if the S&P Municipal Bond 7 Day High Grade Rate Index is no longer produced, such other reasonably comparable index selected in good faith by the Board.]

Business Day means a day (a) other than a day on which commercial banks in The City of New York, New York are required or authorized by law or executive order to close and (b) on which the New York Stock Exchange is not closed.

Rate Determination Date means with respect to the initial Dividend Reset Period, [], and, with respect to any subsequent Dividend Reset Period, [(i) the last day of the immediately preceding Dividend Reset Period or, if such day is not a Business Day, the next succeeding Business Day; provided however that the next succeeding Rate Determination Date will be determined without regard to any prior extension of a Rate Determination Date to a Business Day or (ii) as may be otherwise provided for an Adjusted Dividend Rate.]¹⁶

Dollar amounts resulting from the calculation of dividends will be rounded to the nearest cent, with one-half cent being rounded upward.

The applicable dividend rate for the VRM-MFP Shares is referred to herein as the Dividend Rate.

¹⁵ Include for Adjustable Rate VRM

¹⁶ Include for Adjustable Rate VRM

[Adjusted Rate Terms

The Dividend Rate is subject to adjustment from time to time as follows:

On any day after [], the Fund, at its option, may seek to establish Adjusted Rate Terms (i) by email transmission, confirmed promptly by telephone, to the holders of the VRM-MFP Shares, or (ii) by requesting the Calculation and Paying Agent, on behalf of the Fund, to promptly do so; provided, that, if the VRM-MFP Shares are in certificated form, the rate adjustment notice may be delivered to the holders at their addresses as shown on the records of the Calculation and Paying Agent by overnight delivery or by first class mail, postage prepaid. The date of delivery of a rate adjustment notice shall be deemed to be the day on which it is sent by email transmission or, if applicable, overnight delivery or by first class mail, postage prepaid.

On any day after [], the beneficial owner of more than 50% of the outstanding VRM-MFP Shares (the Majority Beneficial Owner), at such beneficial owner's option, may seek to have the Fund establish Adjusted Rate Terms by delivering a rate adjustment notice by email transmission, confirmed promptly by telephone, to the Fund. Promptly after receiving such notice from such Majority Beneficial Owner, if such Majority Beneficial Owner then owns less than 100% of the outstanding VRM-MFP Shares, the Fund shall deliver, or request the Calculation and Paying Agent, on behalf of the Fund, to deliver, notice thereof by overnight delivery, by first class mail, postage prepaid or by electronic means to the holders of the VRM-MFP Shares. The date of delivery of a rate adjustment notice shall be deemed to be the day on which it is sent by email transmission or, if applicable, overnight delivery or by first class mail, postage prepaid.

A rate adjustment notice may be withdrawn at any time by the proposing party prior to agreement in writing to proposed Adjusted Rate Terms with the other party pursuant to such rate adjustment notice, in which case the Rate Adjustment Notice Period shall terminate. Notice of withdrawal of a rate adjustment notice shall be made by email transmission, confirmed promptly by telephone; provided, that if the VRM-MFP Shares are in certificated form, notice of withdrawal may be made by overnight delivery, by first class mail, postage prepaid to the holders at their addresses as shown on the records of the Calculation and Paying Agent. If at any time after the Majority Beneficial Owner delivers a rate adjustment notice and while the related Rate Adjustment Notice Period is continuing, the Majority Beneficial Owner decreases its ownership level of VRM-MFP Shares to 50% or less of the outstanding VRM-MFP Shares, such beneficial owner's rate adjustment notice shall be deemed withdrawn and the Rate Adjustment Notice Period shall terminate.

The Fund and the beneficial owners of 100% of the outstanding VRM-MFP Shares (the Required Beneficial Owners) shall have until the [] calendar day following the date of delivery of a rate adjustment notice, or such other date as the Fund and the Required Beneficial Owners shall agree, to agree in writing to proposed Adjusted Rate Terms pursuant to the rate adjustment notice (the date of such written agreement, the Rate Adjustment Agreement Date). The agreed Adjusted Rate Terms, if any, may be the Adjusted Rate Terms proposed in the rate adjustment notice or such other Adjusted Rate Terms as the Fund and the Required Beneficial Owners may agree. If the Fund and the

Required Beneficial Owners agree to Adjusted Rate Terms during the Rate Adjustment Notice Period, then the Adjusted Rate Terms shall become effective from and including the Dividend Reset Period immediately succeeding the Rate Adjustment Agreement Date.

During a Rate Adjustment Notice Period, if the Majority Beneficial Owner is the proposing party, the Fund shall use its reasonable best efforts, to the extent it can do so on a commercially reasonable basis, to either agree with the Required Beneficial Owners on the Adjusted Rate Terms or establish a new Mode for the VRM-MFP Shares. If the Majority Beneficial Owner is the proposing party, and the Fund and the Required Beneficial Owners fail to agree in writing to Adjusted Rate Terms during the Rate Adjustment Notice Period, then the proposed Adjusted Rate Terms shall not take effect, such failure shall constitute a Failed Adjustment Event [and a Failed Transition Period shall commence]. In such case, the Fund shall use its reasonable best efforts, to the extent that it can do so on a commercially reasonable basis, to establish a new Mode for the VRM-MFP Shares prior to the Failed Transition Redemption Date resulting from such Failed Adjustment Event.

During a Rate Adjustment Notice Period, if the Fund is the proposing party, the Fund shall use its reasonable best efforts, to the extent it can do so on a commercially reasonable basis, to agree with the Required Beneficial Owners on the Adjusted Rate Terms. If the Fund and the Required Beneficial Owners fail to reach such agreement during the Rate Adjustment Notice Period, then the rate adjustment notice shall be deemed withdrawn and the Rate Adjustment Notice Period shall terminate.

Adjusted Rate Terms, once established, may be further adjusted or replaced with new Adjusted Rate Terms.

Adjusted Rate Terms may include, but are not limited to, the dividend rate (which may be fixed or floating), as well as, as applicable, the index rate, the index maturity, the index multiplier, the spread, the spread multiplier, the rate determination date(s), the dividend reset date(s), the dividend reset period(s), the minimum dividend rate, the day count convention, the dividend period(s) and other terms as set forth in a rate adjustment notice; provided, that no Adjusted Rate Terms may modify the terms or applicability of the provisions of the Statement or the Statement Supplement governing ranking, preemptive rights, voting rights, restrictions on dividends and other distributions, the term redemption date, restrictions on redemptions if the Fund is not current on paying accumulated and unpaid dividends, compliance with applicable law in connection with redemptions, liquidation rights or restrictions on amendments or supplements to the Statement or the Statement Supplement; and provided further, that no Adjusted Rate Terms shall modify any terms affecting the parity ranking of the VRM-MFP Shares relative to any other series of Preferred Shares of the Fund at any time outstanding with respect to dividends or distributions of assets upon dissolution, liquidation or winding up of the affairs of the Fund.

Rate Adjustment Notice Period means, with respect to any rate adjustment notice, the period commencing on the date of delivery of the rate adjustment notice and ending on the earliest to occur of (i) withdrawal or deemed withdrawal of the rate adjustment notice, (ii) the related Rate Adjustment

Agreement Date, (iii) the redemption, repurchase or successful transition remarketing of 100% of the outstanding VRM-MFP Shares to a new Mode or (iv) the date of a Failed Adjustment Event, as applicable.]¹⁷

Applicable Spread Adjustments

The Applicable Spread will initially be []% per annum but [(i)] will adjust based on the highest applicable credit rating most recently assigned to the VRM-MFP Shares by [], [] or any additional or different rating agency providing a long-term credit rating on the VRM-MFP Shares and which is designated a Rating Agency, to the per annum percentage set forth opposite such assigned rating in the table below[, or (ii) such spread or spreads as may be provided for in Adjusted Rate Terms]¹⁸ [(provided, however, the Applicable Spread shall not apply for any Dividend Reset Period or portion thereof occurring during the Failed Transition Period, if any, except in the case of an Increased Rate Period occurring during the Failed Transition Period)]:

<u>Long Term Ratings*</u>	<u>Applicable Percentage**</u>
[]	
AAA to AA	[]%
AA-	[]%
A+	[]%
A	[]%
A-	[]%
BBB+	[]%
BBB	[]%
BBB-	[]%

*And/or the equivalent ratings of another Rating Agency then rating the VRM-MFP Shares utilizing the highest of the ratings of the Rating Agencies then rating the VRM-MFP Shares.

**Unless an Increased Rate Period is in effect, in which case the Applicable Spread will be []% for such Increased Rate Period.

The Applicable Spread will increase to []% per annum for each Increased Rate Period. An Increased Rate Period will commence (A) on a Dividend Payment Date if the Fund has failed to deposit with the Calculation and Paying Agent by 12:00 noon, New York City time, on such Dividend Payment Date, deposit securities that will provide funds available to the Calculation and Paying Agent on such Dividend Payment Date sufficient to pay the full amount of any dividend on the VRM-MFP Shares payable on such Dividend Payment Date (a Dividend Default) and continue to, but excluding, the Business Day on which the Dividend Default is cured; (B) on an applicable Redemption Date if the Fund has failed to deposit with the Calculation and Paying Agent for the VRM-MFP Shares by 12:00 noon, New York City time, on such Redemption Date for the VRM-MFP Shares, deposit securities that will provide funds available to the Tender and Paying Agent on such redemption date sufficient to pay the full amount of the Redemption Price payable in respect of such shares on such redemption date (a Redemption Default) and continue to, but excluding, the Business Day on which such Redemption

¹⁷ Include for Adjustable Rate VRM

¹⁸ Include for Adjustable Rate VRM

Default is cured; (C) on the Business Day on which any Rating Agency has withdrawn the credit rating required to be maintained with respect to the VRM-MFP Shares pursuant to the Statement Supplement, other than due to the Rating Agency ceasing to rate tax-exempt closed-end management investment companies generally and such withdrawal is continuing, or the Fund has terminated the designation of a Rating Agency without complying with the requirements of the Statement Supplement and continue to, but excluding, the Business Day on which the Fund restores compliance with its Rating Agency obligations under the Statement Supplement; (D) on the Business Day on which a Ratings Event (as defined below) has occurred with respect to the VRM-MFP Shares and continue to, but excluding, the Business Day on which such Ratings Event has ended; or (E) on the Business Day on which (i) a court or other applicable governmental authority has made a final determination that for U.S. federal income tax purposes the VRM-MFP Shares do not qualify as equity in the Fund and (ii) such determination results from an act or failure to act on the part of the Fund and continue so long as any VRM-MFP Shares are outstanding in the Variable Rate Mode.

A Ratings Event will be deemed to exist with respect to the VRM-MFP Shares at any time such VRM-MFP Shares have a long-term credit rating from at least one-half of the Rating Agencies designated at such time (or from the Rating Agency designated at such time if only one Rating Agency is then designated) that is below investment grade. For the avoidance of doubt, no determination by any court or other applicable governmental authority that requires the Fund to make an Additional Amount Payment in respect of a Taxable Allocation shall be deemed to be a Tax Event hereunder. In no event shall an Increased Rate be cumulative, notwithstanding the existence of and continuation of multiple conditions giving rise to an Increased Rate Period.

[For each Dividend Reset Period or portion thereof during the Failed Transition Period, if any, the Dividend Rate will be the Failed Transition Period Dividend Rate (as defined below).]

Dividend Payments

The holders of VRM-MFP Shares will be entitled to receive, when, as and if declared by, or under authority granted by, the Board out of funds legally available for payment, cumulative cash dividends and distributions on each such VRM-MFP Share at the Dividend Rate. Dividends and other distributions on each VRM-MFP Share accumulate from the Date of Original Issue with respect to such share. During the Variable Rate Mode, the Dividend Period will generally be a calendar month, and the Dividend Payment Date in respect of each Dividend Period will be the first Business Day following the end of such Dividend Period, except that the first Dividend Period will begin on (and include) [] and end on (and include) [], and the first Dividend Payment Date will be [], and the final Dividend Period in the Variable Rate Mode will end on and include the last calendar day of the Variable Rate Mode. Notwithstanding the foregoing, [(i)] the Fund in its discretion may establish Special Dividend Payment Dates more frequent than monthly Dividend Payment Dates in respect of the Variable Rate Mode; provided, that any such Special Dividend Payment Date shall be a Business Day[, or (ii) the Fund and the Required Beneficial Owners may establish the date or dates as may be provided for in the Adjusted Rate Terms.]¹⁹

The amount of dividends per share payable on the VRM-MFP Shares on any Dividend Payment Date will equal the sum of the dividends accumulated but not yet paid for each Dividend Reset Period (or portion thereof) in the related Dividend Period. The amount of dividends per share accumulated for

¹⁹ Include for Adjustable Rate VRM

each such Dividend Reset Period (or portion thereof) will be computed by (i) multiplying the Dividend Rate in effect for the VRM-MFP Shares for such Dividend Reset Period (or portion thereof) by a fraction, the numerator of which will be [the actual number of days in such Dividend Reset Period (or portion thereof) and the denominator of which will be the actual number of days in the year in which such Dividend Reset Period (or portion thereof) occurs (365 or 366)] and (ii) multiplying the product determined pursuant to clause (i) by the Liquidation Preference for a VRM-MFP Share (\$[]).

[The Dividend Rate may be adjusted to a new Dividend Rate as provided in the Adjusted Rate Terms.]²⁰ The Dividend Rate for the VRM-MFP Shares will be adjusted to the Increased Rate for each Increased Rate Period. Dividends on VRM-MFP Shares with respect to any Dividend Period will be declared to the holders of record of such shares as their names shall appear on the registration books of the Fund at the close of business on each day in such Dividend Period. In connection with any transfer of VRM-MFP Shares, the transferor will, subject to any agreement between the transferor and transferee, transfer to the transferee the transferor's right to receive from the Fund any unpaid dividends so declared for each day prior to the transferee becoming the holder or beneficial owner, as applicable, of the VRM-MFP Shares in consideration of a portion of the purchase price for such VRM-MFP Shares paid by the transferee.

Dividends on VRM-MFP Shares will be paid on each Dividend Payment Date to the holders of VRM-MFP Shares as their names appear on the registration books of the Fund at the close of business on the day immediately preceding such Dividend Payment Date (or if such day is not a Business Day, the next preceding Business Day).

[Failed Transition Period

For each Dividend Reset Period (or portion thereof) occurring during the Failed Transition Period, if any, the Dividend Rate shall be the Failed Transition Period Dividend Rate, which will equal the Index Rate for such Dividend Reset Period (or portion thereof) plus the Failed Transition Period Applicable Spread for such Dividend Reset Period (or portion thereof); provided, however, that, with respect to any Increased Rate Period (or any portion of a Dividend Reset Period to which the Increased Rate otherwise applies), the Failed Transition Period Dividend Rate shall mean the Increased Rate for such Increased Rate Period (or such portion of a Dividend Reset Period); and provided further, that the Failed Transition Period Dividend Rate for any Dividend Reset Period (or portion thereof) shall in no event exceed the Maximum Rate (exclusive of any Additional Amount Payments).

Failed Transition Period Applicable Spread means, for each Dividend Reset Period or portion thereof occurring while the Failed Transition Period, if any, has occurred and is continuing, [] basis points ([]%) (up to 59 days of the continued Failed Transition Period), [] basis points ([]%) (60 days but fewer than 90 days of the continued Failed Transition Period), [] basis points ([]%) (90 days but fewer than 120 days of the continued Failed Transition Period), [] basis points ([]%) (120 days but fewer than 150 days of the continued Failed Transition Period), [] basis points ([]%) (150 days but fewer than 180 days of the Failed Transition Period), and [] basis points ([]%) (180 days or more of the continued Failed Transition Period).]

²⁰ Include for Adjustable Rate VRM

Maximum Rate

The Maximum Rate for the VRM-MFP Shares will be 15% per annum. Neither the Regular Dividend Rate, the Increased Rate nor the Step-Up Dividend Rate determined as set forth above may exceed the Maximum Rate.

Taxable Allocations

Whenever a Taxable Allocation is to be paid by the Fund with respect to the VRM-MFP Shares with respect to any Dividend Period and either the Increased Rate or the Maximum Rate is not in effect during such Dividend Period, the Fund shall comply with one of clause (a), clause (b) or clause (c) below:

- (a) The Fund may provide notice to the Tender and Paying Agent prior to the commencement of any Dividend Period for the VRM-MFP Shares of the amount of the Taxable Allocation that will be made in respect of the VRM-MFP Shares for such Dividend Period (a Notice of Taxable Allocation). Such Notice of the Taxable Allocation will state the amount of the dividends payable in respect of each VRM-MFP Share for such Dividend Period that will be treated as a Taxable Allocation and the adjustment to the Dividend Rate for each Dividend Reset Period (or portion thereof) included in such Dividend Period that will be required to pay the Additional Amount Payment in respect of the Taxable Allocation paid on such VRM-MFP Share for such Dividend Period. In lieu of adjusting the Dividend Rate, the Fund may make, in addition to and in conjunction with the payment of regular dividends for such Dividend Period, a supplemental distribution in respect of each VRM-MFP Share for such Dividend Period equal to the Additional Amount Payment payable in respect of the Taxable Allocation paid on such share for such Dividend Period. The Fund will use commercially reasonable efforts to effect the distribution of Taxable Allocations in respect of the VRM-MFP Shares as described in this clause (a), and shall only effect the adjustment or distribution in respect of Taxable Allocations as described in clause (b) and/or clause (c) if such commercially reasonable efforts do not reasonably permit the Fund to effect the adjustment or distribution in respect of a Taxable Allocation as contemplated by this clause (a).
- (b) If the Fund does not provide a Notice of Taxable Allocation as provided in clause (a) with respect to a Taxable Allocation that is made in respect of the VRM-MFP Shares, the Fund may make one or more supplemental distributions on the VRM-MFP Shares equal to the Additional Amount Payment due in respect of such Taxable Allocation. Any such supplemental distribution in respect of the MFP Shares shall be made reasonably promptly following any such Taxable Allocation and may be declared and paid on any date, without reference to any regular Dividend Payment Date, to the holders of the VRM-MFP Shares as their names appear on the registration books of the Fund on such date, not exceeding fifteen (15) calendar days preceding the payment date of such supplemental distribution, as may be fixed by the Board.
- (c) If, in connection with a redemption of VRM-MFP Shares, the Fund makes a Taxable Allocation without having either given advance notice thereof pursuant to clause (a) or

made one or more supplemental distributions pursuant to clause (b), the Fund shall direct the Tender and Paying Agent to send an Additional Amount Payment in respect of such Taxable Allocation to the holders of the VRM-MFP Shares being redeemed.

- (d) [Except as required by the Purchase Agreement, so long as the applicable provision of the Purchase Agreement shall be in effect,] [Notwithstanding anything to the contrary in the Statement Supplement,] the Fund shall not be required to make Additional Amount Payments with respect to any net capital gains or ordinary income determined by the Internal Revenue Service to be allocable in a manner different from the manner used by the Fund.

Additional Amount Payment means a payment to a beneficial owner of VRM-MFP Shares of an amount which, when taken together with the aggregate amount of Taxable Allocations made to such beneficial owner to which such Additional Amount Payment relates, would cause such beneficial owner's dividends in dollars (after regular U.S. federal income tax consequences in respect of both the Taxable Allocations and Additional Amount Payment) from the aggregate of such Taxable Allocations and the related Additional Amount Payment to be equal to the dollar amount of the dividends that would have been received by such beneficial owner if the amount of such aggregate Taxable Allocations would have been excludable (for regular U.S. federal income tax purposes) from the gross income of such beneficial owner. Such Additional Amount Payment shall be calculated (i) without consideration being given to the time value of money; (ii) only taking into account the regular U.S. federal income tax with respect to dividends received from the Fund (that is, without giving effect to any other federal tax based on income, such as (A) the alternative minimum tax or (B) the Medicare tax, which at the date hereof is imposed at the rate of 3.8% on the net investment income (which includes taxable dividends and net capital gains) of certain individuals, trusts and estates); and (iii) assuming that each Taxable Allocation and each Additional Amount Payment (except to the extent such Additional Amount Payment is reported as an exempt-interest dividend for purposes of Section 852(b)(5) of the Code or successor provisions) would be taxable in the hands of each beneficial owner of VRM-MFP Shares at the maximum marginal regular U.S. federal income tax rate (taking account of the U.S. federal income tax deductibility of state and local taxes paid or incurred) applicable to ordinary income or net capital gains, as applicable, or the maximum marginal regular federal corporate income tax rate applicable to ordinary income or net capital gains, as applicable, whichever is greater, in effect at the time such Additional Amount Payment is paid.

Taxable Allocation means the allocation of any net capital gains or ordinary income taxable for regular U.S. federal income tax purposes to a dividend paid in respect of the VRM-MFP Shares.

Restrictions on Dividends and Other Distributions

Dividends on Preferred Shares. Except as set forth in the next sentence, no dividends and other distributions shall be declared or paid or set apart for payment on the shares of any class or series of shares of beneficial interest of the Fund ranking, as to the payment of dividends, on a parity with the VRM-MFP Shares for any period unless full cumulative dividends and other distributions have been or contemporaneously are declared and paid on the shares of all series of Preferred Shares through their most recent dividend payment date. When dividends and other distributions due are not paid in full upon the shares of all series of Preferred Shares through their most recent dividend payment date or upon the shares of any other class or series of shares of beneficial interest of the Fund ranking on a parity as to the payment of dividends with the VRM-MFP Shares through their most recent respective

dividend payment dates, all dividends declared and paid upon the VRM-MFP Shares and any other such class or series of shares of beneficial interest ranking on a parity as to the payment of dividends with the VRM-MFP Shares shall be declared and paid pro rata so that the amount of dividends declared and paid per share on the Preferred Shares of such series and such other class or series of shares of beneficial interest shall in all cases bear to each other the same ratio that accumulated dividends per share on the VRM-MFP Shares and such other class or series of shares of beneficial interest bear to each other (for purposes of this sentence, the amount of dividends declared and paid per VRM-MFP Share shall be based on the dividend rate for such share for the dividend periods during which dividends were not paid in full).

Dividends and Other Distributions With Respect to Common Shares Under the 1940 Act. The Board shall not declare or pay any dividend or distribution (except a dividend payable in Common Shares) upon the Common Shares, or purchase or redeem or otherwise acquire for consideration any Common Shares or pay any proceeds of the liquidation of the Fund in respect of any Common Shares, unless in every such case the Preferred Shares have, at the time of any such declaration or purchase, an asset coverage (as defined in and determined pursuant to the 1940 Act) of at least 200% (or such other asset coverage as may in the future be specified in or under the 1940 Act as the minimum asset coverage for senior securities which are shares of beneficial interest or stock of a closed-end investment company as a condition of declaring dividends on its common shares or common stock) after deducting the amount of such dividend, distribution or purchase price, as the case may be. See *Coverage and Leverage Tests* below.

Other Restrictions on Dividends and Other Distributions. For so long as any VRM-MFP Shares are outstanding, and except as described above under *Dividends on Preferred Shares* and *Priority of Payment and Liquidation Preference*, the Fund shall not declare, pay or set apart for payment any dividend or other distribution (other than a dividend or distribution paid in shares of, or in options, warrants or rights to subscribe for or purchase, Common Shares or other shares, if any, ranking junior to the VRM-MFP Shares as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up) in respect of the Common Shares or any other shares of the Fund ranking junior to or on a parity with the VRM-MFP Shares as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up, or call for redemption, redeem, purchase or otherwise acquire for consideration any Common Shares or any other such junior shares (except by conversion into or exchange for shares of the Fund ranking junior to the VRM-MFP Shares as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up), or any such parity shares (except by conversion into or exchange for shares of the Fund ranking junior to or on a parity with the Preferred Shares as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up), unless (i) full cumulative dividends on the VRM-MFP Shares through the most recently ended dividend period therefor shall have been paid or shall have been declared and sufficient funds for the payment thereof deposited with the Calculation and Paying Agent and (ii) the Fund has redeemed the full number of VRM-MFP Shares required to be redeemed by any provision for mandatory redemption pertaining thereto.

Coverage and Leverage Tests

Asset Coverage Requirements

Under the 1940 Act, the Fund could issue Preferred Shares, including VRM-MFP Shares, with an aggregate liquidation value of up to one-half (50%) of the value of the Fund's total net assets,

including any liabilities associated with borrowings, measured immediately after issuance of the Preferred Shares. Liquidation value means the original purchase price of the shares being liquidated plus any accrued and unpaid dividends. In addition, the Fund is not permitted to declare any cash dividend or other distribution on its Common Shares unless the liquidation value of the Preferred Shares is less than one-half (50%) of the value of the Fund's total net assets (determined after deducting the amount of such dividend or distribution) immediately after the distribution. The Fund intends to purchase or redeem Preferred Shares, if necessary, to keep that percentage below 50%.

In addition, the Fund is agreeing in the Statement Supplement to have Asset Coverage of at least 225% as of the close of business on each Business Day. If the Fund shall fail to maintain such Asset Coverage as of the close of business on any Business Day, the provisions described below under Redemption Asset Coverage Mandatory Redemption shall be applicable, which provisions to the extent complied with shall constitute the sole remedy for the Fund's failure to comply with the Asset Coverage requirement.

Asset Coverage means asset coverage, as defined in Section 18(h) of the 1940 Act as of the Date of Original Issuance, of at least 225%, with respect to all outstanding senior securities of the Fund which are stock, including all outstanding VRM-MFP Shares (or, in each case, if higher, such other asset coverage as may in the future be specified in or under the 1940 Act as the minimum asset coverage for senior securities which are stock of a closed-end investment company as a condition of declaring dividends on its common shares or stock).

Calculation of Asset Coverage. For purposes of determining whether the Asset Coverage requirement is satisfied, (i) no VRM-MFP Shares or other Preferred Shares shall be deemed to be outstanding for purposes of any required computation of Asset Coverage if, prior to or concurrently with such determination, sufficient deposit securities or other sufficient funds (in accordance with the terms of the VRM-MFP Shares or other Preferred Shares) to pay the full redemption price for the VRM-MFP Shares or other Preferred Shares (or the portion thereof to be redeemed) shall have been deposited in trust with the paying agent for the VRM-MFP Shares or other Preferred Shares and the requisite notice of redemption for the VRM-MFP Shares or other Preferred Shares (or the portion thereof to be redeemed) shall have been given, and (ii) the deposit securities or other funds that shall have been so deposited with the applicable paying agent shall not be included as assets of the Fund for purposes of such computation.

Effective Leverage Ratio Requirement

The Fund is agreeing in the Statement Supplement that the Effective Leverage Ratio will not exceed 45% (or 46% solely by reason of fluctuations in the market value of the Fund's portfolio securities) as of the close of business on any Business Day. If the Effective Leverage Ratio shall exceed the applicable percentage provided in the preceding sentence as of any time as of which such compliance is required to be determined as aforesaid, the provisions described below under Redemption Effective Leverage Ratio Mandatory Redemption shall be applicable, which provisions to the extent complied with shall constitute the sole remedy for the Fund's failure to comply with the Effective Leverage Ratio requirement.

Calculation of Effective Leverage Ratio. For purposes of determining whether the effective leverage requirement is satisfied, the Effective Leverage Ratio on any date shall mean the quotient of:

- (i) The sum of (A) the aggregate liquidation preference of the Fund's senior securities (as that term is defined in the 1940 Act) that are stock for purposes of the 1940 Act, excluding, without duplication, (1) any such senior securities for which the Fund has issued a notice of redemption and either has delivered deposit securities or sufficient funds (in accordance with the terms of such senior securities) to the paying agent for such senior securities or otherwise has adequate deposit securities or sufficient funds on hand for the purpose of such redemption and (2) any such senior securities that are to be redeemed with net proceeds from the sale of the VRM-MFP Shares, for which the Fund has delivered deposit securities or sufficient funds (in accordance with the terms of such senior securities) to the paying agent for such senior securities or otherwise has adequate deposit securities or sufficient funds on hand for the purpose of such redemption; (B) the aggregate principal amount of the Fund's senior securities representing indebtedness (as that term is defined in the 1940 Act); and (C) the aggregate principal amount of floating rate securities not owned by the Fund that correspond to the associated inverse floating rate securities owned by the Fund; divided by
- (ii) The sum of (A) the market value of the Fund's total assets (including amounts attributable to senior securities, but excluding any assets consisting of deposit securities or funds referred to in clauses (A)(1) and (A)(2) of paragraph (i) above), less the amount of the Fund's accrued liabilities (other than liabilities for the aggregate principal amount of senior securities representing indebtedness), and (B) the aggregate principal amount of floating rate securities not owned by the Fund that correspond to the associated inverse floating rate securities owned by the Fund.

Redemption

Optional Redemption

Subject to certain conditions, VRM-MFP Shares may be redeemed on any Business Day, at the option of the Fund (in whole or from time to time, in part), out of funds legally available therefor, at the Redemption Price per share. The Redemption Price per share is equal to the Liquidation Preference per VRM-MFP Share plus an amount equal to all unpaid dividends and other distributions on such VRM-MFP Share accumulated from and including the Date of Original Issue to (but excluding) the redemption date (whether or not earned or declared by the Fund, but without interest thereon).

Term Mandatory Redemption

The Fund will redeem all outstanding VRM-MFP Shares on the Term Redemption Date at the aggregate Redemption Price.

[Failed Transition Mandatory Redemption]

The Fund will be required to redeem all outstanding VRM-MFP Shares on the Failed Transition Redemption Date (as defined below) if any, if the Failed Transition Event, if any, is then continuing, at

a price per VRM-MFP Share equal to the Redemption Price. Failed Transition Redemption Date means [(i) in the case of a Failed Adjustment Event, the first Business Day falling on or after the [] calendar day following the Failed Adjustment Event or (ii) in the case of a Failed Transition Event, the first Business Day falling on or after the [] calendar day following the Failed Transition Event; in each case if the Failed Transition Period is then continuing].

[At least six months prior to the Failed Transition Redemption Date, if any, the Fund will earmark assets rated at least A- or the equivalent (and including deposit securities in an amount equal to []% of the Liquidation Preference of all outstanding VRM-MFP Shares, with [] days remaining to the redemption date, increasing to []% with [] days remaining) with a market value equal to at least []% of the Liquidation Preference of all outstanding VRM-MFP Shares until the redemption of all such outstanding VRM-MFP Shares.]

Asset Coverage Mandatory Redemption

If the Fund fails to have Asset Coverage of at least 225% as of the close of business on any Business Day (meaning a day (a) other than a day on which commercial banks in The City of New York, New York are required or authorized by law or executive order to close and (b) on which the New York Stock Exchange is not closed) on which such Asset Coverage is required to be calculated of each month and such failure is not cured as of thirty (30) calendar days following such Business Day (the Asset Coverage Cure Date), the Fund will proceed to redeem such number of Preferred Shares as determined by the Fund (which may include at the sole option of the Fund any number or proportion of VRM-MFP Shares) as shall be no fewer than (x) the minimum number of Preferred Shares, the redemption of which, if deemed to have occurred immediately prior to the opening of business on the Asset Coverage Cure Date, would result in the Fund having Asset Coverage on such Asset Coverage Cure Date of at least 225% (provided, however, that if there is no such minimum number of VRM-MFP Shares and other Preferred Shares the redemption or retirement of which would have such result, all VRM-MFP Shares and other Preferred Shares then outstanding shall be redeemed), or more than (y) the maximum number of Preferred Shares that can be redeemed out of funds expected to be legally available therefor in accordance with the Declaration of Trust and applicable law. In the event that any VRM-MFP Shares then outstanding are to be redeemed, the Fund will redeem such VRM-MFP Shares at a price per VRM-MFP Share equal to the Redemption Price on the redemption date therefor.

Effective Leverage Ratio Mandatory Redemption

If the Effective Leverage Ratio of the Fund exceeds 45% (or 46% solely by reason of fluctuations in the market value of the Fund's portfolio securities) as of the close of business on any Business Day on which such ratio is required to be calculated and such failure is not cured as of the close of business on the date that is seven Business Days following the Business Day on which such non-compliance is first determined, the Fund will cause the Effective Leverage Ratio to not exceed 45% by (x) engaging in transactions involving or relating to the floating rate securities not owned by the Fund and/or the inverse floating rate securities owned by the Fund, including the purchase, sale or retirement thereof, (y) proceeding with redeeming a sufficient number of Preferred Shares, which at the Fund's sole option may include any number or proportion of VRM-MFP Shares, in accordance with the terms of such series, or (z) engaging in any combination of the actions contemplated by (x) and (y) above. In the event that any VRM-MFP Shares then outstanding are to be redeemed, the Fund will redeem such VRM-MFP Shares at a price per VRM-MFP Share equal to the Redemption Price on the redemption date thereof.

Any optional or mandatory redemption of VRM-MFP Shares by the Fund shall be done in accordance with the requirements of the Statement and Statement Supplement and the provisions of the 1940 Act and rules thereunder, including Rule 23c-2.

Ratings

The Fund expects that at the Date of Original Issue, the VRM-MFP Shares will have a long-term rating from [] and a long-term credit rating from [].

There can be no assurance that the Fund will maintain any ratings of the VRM-MFP Shares or, if at any time the VRM-MFP Shares have one or more ratings, that any particular ratings will be maintained. The Fund may, at any time, replace a Rating Agency or terminate the services of any Rating Agencies then providing a rating for the VRM-MFP Shares without replacement, in either case, without the vote, approval or consent of holders of VRM-MFP Shares or other shareholders of the Fund.

In addition, the Rating Agency guidelines adopted by the Fund in connection with a Rating Agency's rating the VRM-MFP Shares may be changed or eliminated at any time without the approval of the VRM-MFP shareholders or other shareholders of the Fund, including in connection with the change or elimination of any or all long-term ratings of the VRM-MFP Shares.

An explanation of the significance of ratings may be obtained from the Rating Agencies. Generally, Rating Agencies base their ratings on such material and information, and such of their own investigations, studies and assumptions, as they deem appropriate. The ratings of the VRM-MFP Shares should be evaluated independently from similar ratings of other securities. A rating of a security is not a recommendation to buy, sell or hold securities and may be subject to review, revision, suspension, reduction or withdrawal at any time by the assigning Rating Agency.

See Risk Factors Ratings and Asset Coverage Risk.

Voting Rights

Except as otherwise provided in the Declaration of Trust or as otherwise required by law, (i) each holder of VRM-MFP Shares will be entitled to one vote for each VRM-MFP Share held by such holder on each matter submitted to a vote of shareholders of the Fund, and (ii) the holders of outstanding Preferred Shares, including each VRM-MFP Share, and of Common Shares will vote together as a single class; provided, however, that the holders of outstanding Preferred Shares, including VRM-MFP Shares, voting as a class, to the exclusion of the holders of all other securities and classes of shares of beneficial interest of the Fund, will be entitled to elect two trustees of the Fund at all times, each Preferred Share, including each VRM-MFP Share, entitling the holder thereof to one vote. The holders of outstanding Common Shares and Preferred Shares, including VRM-MFP Shares, voting together as a single class, will elect the balance of the trustees.

If at any time dividends (whether or not earned or declared) on any outstanding Preferred Shares, including the VRM-MFP Shares, will be due and unpaid in an amount equal to at least two full years' dividends thereon, and sufficient cash or specified securities have not been deposited with the Calculation and Paying Agent for the payment of such dividends, then, as the sole remedy of holders of outstanding Preferred Shares, including VRM-MFP Shares, the number of trustees constituting the

Board will be automatically increased by the smallest number that, when added to the two trustees elected exclusively by the holders of Preferred Shares, including VRM-MFP Shares, as described above, would constitute a majority of the Board of Trustees as so increased by such smallest number, and at a special meeting of shareholders which will be called and held as soon as practicable, and at all subsequent meetings at which trustees are to be elected, the holders of Preferred Shares, including VRM-MFP Shares, voting as a separate class, will be entitled to elect the smallest number of additional trustees that, together with the two trustees which such holders will be in any event entitled to elect, constitutes a majority of the total number of trustees of the Fund as so increased. The terms of office of the persons who are trustees at the time of that election will continue. If the Fund thereafter pays, or declares and sets apart for payment, in full, all dividends payable on all outstanding Preferred Shares, including VRM-MFP Shares, the voting rights stated in the second preceding sentence will cease, and the terms of office of all of the additional trustees elected by the holders of Preferred Shares, including VRM-MFP Shares (but not of the trustees with respect to whose election the holders of Common Shares were entitled to vote or the two trustees the holders of Preferred Shares have the right to elect in any event), will terminate automatically.

Except as otherwise permitted by the terms of the Statement, so long as any VRM-MFP Shares are outstanding, the Fund shall not, without the affirmative vote or consent of the holders of at least a majority of the VRM-MFP Shares outstanding at the time, voting together as a separate class, amend, alter or repeal the provisions of the Declaration of Trust or the Statement, whether by merger, consolidation or otherwise, (x) to modify certain terms of the Statement relating to ranking, limitations on Mode changes, restrictions on dividends and other distributions, the Fund's obligation to redeem all outstanding VRM-MFP Shares on the Term Redemption Date, liquidation rights or limitations on amendments to the Statement or (y) so as to materially and adversely affect any preference, right or power of such VRM-MFP Shares or the holders thereof; provided, however, that (i) a change in the capitalization of the Fund through the permitted issuance of additional Preferred Shares hereof shall not be considered to materially and adversely affect the rights and preferences of the VRM-MFP Shares, (ii) a division of a VRM-MFP Share shall be deemed to materially and adversely affect such preferences, rights or powers only if the terms of such division materially and adversely affect the holders of the VRM-MFP Shares and (iii) a Statement supplement establishing terms and conditions for a new Mode in accordance with the Statement or a modification of a Statement supplement then in effect in accordance with the Statement shall not be considered to materially and adversely affect the rights and preferences of the VRM-MFP Shares. For purposes of the foregoing, no other matter shall be deemed to materially and adversely affect any preference, right or power of a VRM-MFP Share or the holder thereof unless such matter (i) reduces or abolishes any preferential right of such VRM-MFP Share or (ii) reduces or abolishes any applicable right in respect of redemption of such VRM-MFP Share (other than solely as a result of a division of a VRM-MFP Share or as provided in the Statement supplement designating such Mode in accordance with the Statement).

So long as any VRM-MFP Shares are outstanding, the Fund shall not, without the affirmative vote or consent of at least $66\frac{2}{3}\%$ of the holders of the VRM-MFP Shares outstanding at the time, voting as a separate class, file a voluntary application for relief under federal bankruptcy law or any similar application under state law for so long as the Fund is solvent and does not foresee becoming insolvent.

Additionally, notwithstanding the foregoing, (1) (x) no extension of the Term Redemption Date or (y) reduction or repeal of the Liquidation Preference of the VRM-MFP Shares that adversely affects the rights of the holders of the VRM-MFP Shares relative to each other or any other shares of the Fund

shall be effected without, in each case, the prior unanimous vote or consent of the holders of the VRM-MFP Shares, and (2) no change reducing the amount or extending the timing of any payment due on the VRM-MFP Shares or adversely affecting the taxability of any payments due on the VRM-MFP Shares under the Statement Supplement in effect, in each case, other than in accordance with the terms of such Statement supplement, or to the obligation of the Fund to (x) pay the Redemption Price on any redemption date or (y) accumulate dividends at the Dividend Rate for, or other required distributions on, the VRM-MFP Shares, shall be effected without, in each case, the prior unanimous vote or consent of the holders of the VRM-MFP Shares. No vote of the holders of Common Shares shall be required to amend, alter or repeal the provisions of the Statement, including any Statement supplement.

Unless a higher percentage is provided for in the Declaration of Trust, the affirmative vote of the holders of at least a majority of the Outstanding Preferred Shares, including VRM-MFP Shares, outstanding at the time, voting as a separate class, shall be required to approve (A) any conversion of the Fund from a closed-end to an open-end investment company, (B) any plan of reorganization (as such term is used in the 1940 Act) adversely affecting such shares and (C) any other action requiring a vote of security holders of the Fund under Section 13(a) of the 1940 Act. For purposes of the foregoing, majority of the Outstanding Preferred Shares means (i) 67% or more of such shares present at a meeting, if the holders of more than 50% of such shares are present or represented by proxy, or (ii) more than 50% of such shares, whichever is less.

Except as otherwise required by the 1940 Act, other applicable law or the Declaration of Trust, (i) whenever a vote of holders of VRM-MFP Shares is otherwise required by the Statement, holders of outstanding VRM-MFP Shares will be entitled as a series, to the exclusion of the holders of all other shares, including other Preferred Shares, Common Shares and other classes of shares of beneficial interest of the Fund, to vote on matters affecting VRM-MFP Shares only and (ii) holders of outstanding VRM-MFP Shares will not be entitled to vote on matters affecting any other Preferred Shares that do not adversely affect any of the rights of holders of VRM-MFP Shares, as expressly set forth in the Declaration of Trust and the Statement.

Notwithstanding the foregoing, nothing in the Statement is intended in any way to limit the ability of the Board of Trustees to amend or alter other provisions of the Statement or any Statement supplement, without the vote, approval or consent of any holder of VRM-MFP Shares, or any other shareholder of the Fund, as otherwise provided in the Statement or any such Statement supplement; provided, that nothing in the Statement or any Statement supplement shall be deemed to preclude or limit the right of the Fund (to the extent permitted by applicable law) to contractually agree with any holder or beneficial owner of VRM-MFP Shares with regard to any special rights of such holder or beneficial owner with respect to its investment in the Fund.

In the event that the Fund fails to pay any dividends on the VRM-MFP Shares, the sole remedy of the holders under the Statement, without limitation of any rights to payment of such dividends or other rights under the Declaration of Trust, the Statement (including the Statement Supplement) and applicable law, shall be the right to vote for trustees pursuant to the provisions of the Statement.

[Additional Rights Under Purchase Agreement

The Fund may enter into an agreement (the Purchase Agreement) with the initial purchaser of the VRM-MFP Shares granting certain additional rights to the Purchaser [and, as to certain matters,

subsequent beneficial owners of VRM-MFP Shares]. The Purchase Agreement will be filed as an exhibit to the Fund's registration statement.

[The Purchaser will be entitled to receive various information concerning the Fund as provided in the Purchase Agreement. In particular, the Purchaser will be entitled to receive, [on the fifteenth and last days of each month (i) reports of portfolio holdings of the Fund and (ii) a report on the Fund's Asset Coverage ratio and Effective Leverage Ratio]. [A subsequent beneficial owner of VRM-MFP Shares will have the right to receive such information upon satisfying certain conditions.] [A fee is payable to the Purchaser if these reports have not been timely delivered and such failure is not cured within three (3) Business Days after notification of such failure is provided by the Purchaser. Also, in the event of such a failure, the Purchaser has the right to calculate the Effective Leverage Ratio for the VRM-MFP Shares based on the securities holdings contained in the most recent reports provided and current market prices at the time of calculation.]

[The consent of the holders of at least a majority of the outstanding VRM-MFP Shares will be required under the Purchase Agreement for certain actions affecting their investment in the Fund, including, but not limited to, (i) any amendment, alteration or repeal of any provision of the Declaration of Trust or the Statement applicable to the Variable Rate Mode or the Statement Supplement, that would affect any preference, right or power of the VRM-MFP Shares differently from, and adversely relative to, the rights of the holders of the Fund's Common Shares, (ii) any termination of any Rating Agency for the VRM-MFP Shares or any selection of a replacement or additional Rating Agency for the VRM-MFP Shares, (iii) the issuance of any indebtedness or additional Preferred Shares of the Fund (subject to certain exceptions including, but not limited to, certain permitted refinancing of Preferred Shares), and (iv) the creation or incurrence of certain liens on the Fund's assets. The Purchaser also has certain consent rights under the Purchase Agreement that are applicable only to it. [Certain (but not all) of these consent rights are assignable by the Purchaser to subsequent beneficial owners of VRM-MFP Shares that are permitted transferees of such VRM-MFP Shares as set forth in the Statement Supplement and the Purchase Agreement.] [In the event that the Purchaser transfers, in accordance with the Purchase Agreement, VRM-MFP Shares to a tender option bond trust in which the Purchaser retains a residual interest, for so long as no event has occurred that results in the termination of such tender option bond trust, for purposes of each of the applicable sections of the Purchase Agreement that requires, permits or provides for (i) notice to or the delivery of information to the Purchaser, (ii) voting of the VRM-MFP Shares by or the giving of any consent by the Purchaser or the holders of more than 50% of the outstanding VRM-MFP Shares, or (iii) payment of fees, expenses or other amounts to the Purchaser, the Purchaser, and not such tender option bond trust, shall be deemed to be the actual holder and beneficial owner of such VRM-MFP Shares.] See the Purchase Agreement for a complete description of all terms applicable to these rights and the limitations thereof. Anything in the Purchase Agreement to the contrary notwithstanding, except with respect to the applicable sections referred to above, each of the beneficial owners of a tender option bond trust will retain all of its other rights in respect of the Fund and the VRM-MFP Shares pursuant to the Purchase Agreement, the Statement and the Statement Supplement or under law.]

Mode [Extension or] Change

General

[The Fund agrees to use its reasonable best efforts, to the extent that it can do so on a commercially reasonable basis, to [extend the Variable Rate Mode or] transition to a new Mode by:

[extending the Variable Rate Mode through an extension of the Mode Termination Date then in effect, the terms of which extension are agreed to in writing by the Required Beneficial Owners; or]

establishing a new Mode to succeed the Variable Rate Mode that will result in a transition to such new Mode on the first Business Day immediately following the last day of the Variable Rate Mode, as such day may be accelerated (such first Business Day, whether or not a new Mode commences on such day, as so accelerated, if applicable, the New Mode Commencement Date), the terms of which are agreed to in writing by the Required Beneficial Owners; or

establishing any other Mode to succeed the Variable Rate Mode that will result in a transition to such new Mode on the New Mode Commencement Date.

[To the extent provided as described under Adjusted Rate Terms above, or upon the occurrence of a Failed Adjustment Event or a Failed Transition Event, or upon the Fund electing to effect an optional early transition as described below, the Fund agrees to use its reasonable best efforts, to the extent that it can do so on a commercially reasonable basis, to transition to a new Mode by establishing a new Mode to succeed the Variable Rate Mode that will result in a transition to such new Mode on a Thursday that is a Business Day (such Business Day, the New Mode Commencement Date); provided that, in the case of a Failed Adjustment Event or a Failed Transition Event, such Mode shall begin prior to the related scheduled redemption date.]²¹

In the event that the Fund successfully establishes a new Mode succeeding the Variable Rate Mode, and no Failed Transition Event otherwise shall have occurred and be continuing as of the New Mode Commencement Date, then on and as of the New Mode Commencement Date, the VRM-MFP Shares shall be subject to the terms established for such new Mode. If a Failed Transition Event shall have occurred and be continuing, (i) the new Mode designated by the Fund shall not be established, (ii) all tendered VRM-MFP Shares, if any, shall be returned to the relevant tendering holders by the Calculation and Paying Agent, and (iii) all of the then outstanding VRM-MFP Shares shall be redeemed by the Fund on the applicable Failed Transition Redemption Date.

The Fund shall use its best efforts to cause [the extension of the Variable Rate Mode or] the transition to a new Mode succeeding the Variable Rate Mode and the terms and conditions of such new Mode to be consistent with the continuing qualification of the VRM-MFP Shares as equity in the Fund for U.S. federal income tax purposes, and it shall be a condition precedent to a transition to a new Mode that the Fund shall have received an opinion of counsel to the effect that the VRM-MFP Shares will continue to qualify as equity in the Fund for U.S. federal income tax purposes.

²¹ Include for Adjustable Rate VRM

Election and Notice of Mode [Extension or] Change

The Fund shall provide notice of the termination or expiration of the Variable Rate Mode and proposed extension of the Variable Rate Mode or transition to a new Mode succeeding the Variable Rate Mode by delivering a notice of Mode [extension or] change (a Mode Change Notice) by overnight delivery, by first class mail, postage prepaid or by electronic means to the holders of the VRM-MFP Shares, or by requesting the Calculation and Paying Agent, on behalf of the Fund, to promptly do so. The Mode Change Notice shall be provided not more than forty-five (45) calendar days and not less than [] ([]) Business Days (or such shorter or longer notice period as may be consented to by the Required Beneficial Owners (which consent shall not be deemed to be a vote required by the Statement)) prior to the Mode Termination Date; provided that, no minimum notice period shall be required in connection with delivery of a Mode Change Notice following a Failed Adjustment Event or a Failed Transition Event]. Any Mode must end not later than the Term Redemption Date. The terms of [the extension of the Variable Rate Mode or] the new Mode may not, in any event, affect the parity ranking of VRM-MFP Shares relative to each other or to any other series of Preferred Shares of the Fund then outstanding with respect to dividends or distribution of assets upon dissolution, liquidation or winding up of the affairs of the Fund.

The Fund may provide in the Mode Change Notice that the Mode [extension or] change (but not the termination or expiration of the Variable Rate Mode) is subject to one or more additional conditions precedent and that the Fund shall not be required to effect such extension or change unless each such condition has been satisfied at the time or times and in the manner specified in such Mode Change Notice.

In connection with a Mode change, the Fund, subject to compliance with the terms and conditions of the Statement and Statement Supplement then in effect, without the vote or consent of any holder of VRM-MFP Shares, may establish terms for the new Mode that differ from those of the Variable Rate Mode, including, but not limited to, with respect to:

the dividend rate (which may be fixed or floating);

if the dividend may be determined by reference to an index, formula or other method, the manner in which it will be determined, the index rate or formula, the index maturity, the index multiplier, if any, the spread, if any, the spread multiplier, if any, the rate determination date(s), the dividend reset date(s), the dividend reset period(s), the minimum or maximum dividend rate, the day count convention, the dividend period(s) and other dividend-related terms;

optional tender provisions and/or mandatory tender provisions;

a liquidity facility or other credit enhancement, including provisions for mandatory purchase by the provider of the liquidity facility or credit enhancement; and

redemption provisions.

Notwithstanding the foregoing, the Fund may not use the Mode change provisions to modify the provisions of the Statement or the Statement Supplement governing ranking, preemptive rights, voting rights, restrictions on dividends and other distributions, the term redemption date, restrictions on

redemptions if the Fund is not current on paying accumulated and unpaid dividends, compliance with applicable law in connection with redemptions, liquidation rights or restrictions on amendments or supplements to the Statement or the Statement Supplement, or to modify any terms affecting the parity ranking of the VRM-MFP Shares relative to any other series of Preferred Shares of the Fund at any time outstanding with respect to dividends or distributions of assets upon dissolution, liquidation or winding up of the affairs of the Fund.

[Extension of the Variable Rate Mode or] Transition to a New Mode

Except as described in the next paragraph, in the case of a transition to a new Mode succeeding the Variable Rate Mode, all outstanding VRM-MFP Shares automatically shall be subject to mandatory tender for transition remarketing and delivered to the Calculation and Paying Agent for purchase by purchasers in the transition remarketing on the New Mode Commencement Date, in the event of a successful transition remarketing. All tendered VRM-MFP Shares shall be remarketed at the purchase price of such VRM-MFP Shares.

In the case of [an extension of the Variable Rate Mode or] a transition to a new Mode succeeding the Variable Rate Mode by agreement with the Required Beneficial Owners, the Required Beneficial Owners by agreement with the Fund as to such [extension or] new Mode shall be deemed to have irrevocably waived their right to the mandatory tender of their VRM-MFP Shares and shall retain their VRM-MFP Shares upon [the extension of the Variable Rate Mode or] as of the New Mode Commencement Date[, as applicable]. Such agreement and waiver shall be binding upon the then-current holders and beneficial owners and each subsequent holder and beneficial owner of the VRM-MFP Shares.

The retention of VRM-MFP Shares by the beneficial owners thereof by agreement of the Required Beneficial Owners shall be deemed to constitute a successful transition remarketing. Otherwise, a transition remarketing shall be deemed successful only if a Failed Transition Event shall not have occurred. Upon the occurrence of a Failed Transition Event, all tendered VRM-MFP Shares shall be returned to the relevant tendering holders by the Calculation and Paying Agent.

Upon the occurrence of a successful transition remarketing, the Fund will be deemed to have successfully established a new Mode, and the VRM-MFP Shares will be subject to the terms established for the new Mode.

[Failed Transition Period

If a Failed Adjustment Event occurs or a Failed Transition Event occurs where the Fund has initiated a proposed optional early transition, the Failed Transition Period shall commence and continue in as described in the next paragraph below, and shall be deemed a continuation of the Variable Rate Mode. For each Dividend Reset Period or portion thereof during the Failed Transition Period, the Dividend Rate shall be the Failed Transition Period Dividend Rate. If a Failed Transition Event occurs, the new Mode designated by the relevant Mode Change Notice shall not be established. In such event, all tendered VRM-MFP Shares shall be returned to the relevant tendering holders by the Calculation and Paying Agent.

During the Failed Transition Period, the Fund shall continue to use its reasonable best efforts to successfully establish a new Mode for the VRM-MFP Shares, and, in connection with each such

attempt, may designate by a Mode Change Notice a new Mode with new or different terms until a Mode to succeed the Variable Rate Mode is established, or no VRM-MFP Shares remain outstanding, or the Fund and the Required Beneficial Owners mutually agree to terminate the Failed Transition Period and revert to the Variable Rate Mode on the terms mutually agreed by the Fund and the Required Beneficial Owners. If a Failed Transition Event occurs in connection with the transition remarketing relating to such continued attempt to establish a new Mode to succeed the Variable Rate Mode, any such Failed Transition Event shall not alter the Failed Transition Period, the Failed Transition Redemption Date or the Failed Transition Period Dividend Rate applicable thereto. In the event that the Fund successfully establishes a new Mode to succeed the Variable Rate Mode, the Failed Transition Period shall terminate, and the VRM-MFP Shares shall be subject to the terms established for such new Mode.]

Optional Early Transition to New Mode at the Option of the Fund

For the purpose of effecting an early transition to a new Mode with respect to all of the outstanding VRM-MFP Shares, the Fund may at its option accelerate the expiration date of the Variable Rate Mode to any Wednesday that is a Business Day occurring on or after [] (the Optional Early Transition Date) by delivering a Mode Change Notice as described above.

TAX MATTERS

Because the discussion below is general in nature and does not address all of the tax consequences of holding the VRM-MFP Shares and because the tax laws governing the VRM-MFP Shares are complex, you are encouraged to consult your tax advisor about the tax consequences of investing in the VRM-MFP Shares under your particular circumstances before making an investment.

The discussion below is the opinion of Sidley Austin LLP (Tax Counsel) on the anticipated U.S. federal income tax consequences to United States persons (as defined by section 7701(a)(30) of the Code) of acquiring, holding and disposing of the VRM-MFP Shares.

Tax Counsel s opinion is based on the current provisions and interpretations of the Code and the accompanying Treasury regulations and on current judicial and administrative rulings. All of these authorities are subject to change and any change can apply retroactively.

Upon issuance of the VRM-MFP Shares, and subject to certain assumptions and conditions, and based upon certain representations made by the Fund, including representations regarding the nature of the Fund s assets and the conduct of the Fund s business, it is Tax Counsel s opinion that for U.S. federal income tax purposes (1) the Fund will qualify as a regulated investment company under the Code, (2) the VRM-MFP Shares will qualify as stock in the Fund, and (3) distributions made with respect to the VRM-MFP Shares will qualify as exempt-interest dividends to the extent properly reported by the Fund and not otherwise limited under Section 852(b)(5)(A) of the Code (under which the total amount of dividends that may be treated as exempt-interest dividends is limited, based on the total amount of tax-exempt income generated by the Fund).

Investors should be aware that Tax Counsel s opinion is not binding on the Internal Revenue Service or any court. See the discussions below under the caption Treatment of VRM-MFP Shares as Stock. In addition, the Fund s qualification and taxation as a regulated investment company depends upon the Fund s ability to meet on a continuing basis, through actual annual operating results,

certain requirements in the federal tax laws. Tax Counsel will not review the Fund's compliance with those requirements. Accordingly, no assurance can be given that the actual results of the Fund's operations for any particular taxable year will satisfy such requirements.

Tax Act Changes. Numerous changes to the U.S. federal income tax laws have been made by the recent legislation commonly referred to as the Tax Cuts and Jobs Act (the Tax Act). Among other changes, the Tax Act temporarily replaces the individual tax rate structure, which includes a reduction in the highest marginal rate applicable to individuals, estates and trusts. The Tax Act eliminates the graduated corporate tax rate structure and instead taxes domestic corporate taxable income at 21%. It also modifies the individual alternative minimum tax and repeals the corporate alternative minimum tax. In general, these changes are effective for taxable years beginning after December 31, 2017.

The Fund cannot predict the long-term impact of the Tax Act on an investment in the VRM-MFP Shares and the effect of any administrative and judicial interpretations of the Tax Act. Prospective investors in the VRM-MFP Shares are urged to consult their tax advisors regarding the effect of the Tax Act and other potential changes to the U.S. federal tax laws on their investment.

Qualification and Taxation of the Fund. The Fund intends to continue to qualify as a regulated investment company under Subchapter M of the Code, and intends to distribute substantially all of its net income and gains to its shareholders. Therefore, it is not expected that the Fund will have to pay any U.S. federal income tax to the extent its earnings are so distributed. To qualify under Subchapter M for tax treatment as a regulated investment company, the Fund must, among other requirements: (a) distribute to its shareholders at least 90% of the sum of (i) its investment company taxable income (as that term is defined in the Code) determined without regard to the deduction for dividends paid and (ii) its net tax-exempt income (the excess of its gross tax-exempt interest income over certain disallowed deductions) and (b) diversify its holdings so that, at the end of each fiscal quarter of the Fund (i) at least 50% of the market value of the Fund's total assets is represented by cash, cash items, U.S. Government securities, securities of other regulated investment companies, and other securities, with these other securities limited, with respect to any one issuer, to an amount not greater in value than 5% of the Fund's total assets, and to not more than 10% of the outstanding voting securities of such issuer, and (ii) not more than 25% of the market value of the Fund's total assets is invested in the securities of any one issuer (other than U.S. Government securities or securities of other regulated investment companies), 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 one or more qualified publicly traded partnerships. In meeting these requirements of Subchapter M of the Code, the Fund may be restricted in the utilization of certain of the investment techniques described under "The Fund's Investments" in the prospectus. If in any year the Fund should fail to qualify under Subchapter M for tax treatment as a regulated investment company and not cure such failure, the Fund would incur a regular federal corporate income tax on its taxable income for that year, and distributions to its shareholders would be taxable to such holders as ordinary income to the extent of the earnings and profits of the Fund.

A regulated investment company that fails to distribute, by the close of each calendar year, an amount equal to the sum of 98% of its ordinary taxable income for such year and 98.2% of its capital gain net income for the one year period ending October 31 in such year, plus any shortfalls from the prior year's required distribution, is liable for a 4% excise tax on the excess of the required distribution for such calendar year over the distributed amount for such calendar year. To avoid the imposition of

this excise tax, the Fund generally intends to make the required distributions of its ordinary taxable income, if any, and its capital gain net income, to the extent possible, by the close of each calendar year.

Treatment of VRM-MFP Shares as Stock. In order for any distributions to owners of the Fund's VRM-MFP Shares to be eligible to be treated as exempt-interest dividends, the VRM-MFP Shares must be classified as stock for U.S. federal income tax purposes. The Investment Adviser believes and, as discussed above, it is Tax Counsel's opinion that, the VRM-MFP Shares will qualify as stock in the Fund for U.S. federal income tax purposes. By acquiring VRM-MFP Shares, an investor agrees to treat the VRM-MFP Shares as stock for U.S. federal income tax purposes.

Distributions on VRM-MFP Shares. A VRM-MFP shareholder will be required to report the dividends declared by the Fund for each day on which such VRM-MFP shareholder is the shareholder of record. Distributions, if any, in excess of the Fund's earnings and profits will first reduce the adjusted tax basis of a shareholder's shares and, after that basis has been reduced to zero, will constitute capital gain to the shareholder (assuming the shares are held as a capital asset). As long as the Fund qualifies as a regulated investment company under the Code, no part of its distributions to shareholders will qualify for the dividends received deduction available to corporate shareholders.

Tax Character of Distributions

In General. The tax character of the Fund's distributions in the hands of the Fund's shareholders will be determined primarily by the tax character of the Fund's underlying income. Although the Fund expects that most of its income will be tax-exempt, some of the Fund's income may be taxable as capital gains or ordinary income. In addition, although the Fund expects that under normal circumstances it will not invest in municipal bonds the interest on which is subject to the federal alternative minimum tax, at times a portion of the Fund's tax-exempt income may be subject to the federal alternative minimum tax. The Internal Revenue Service requires a regulated investment company that has two or more classes of shares outstanding to designate to each such class proportionate amounts of each type of its income for each tax year based upon the percentage of total dividends distributed to each class for such year. The Fund intends each year to allocate, to the fullest extent practicable, net tax-exempt interest, net capital gain and ordinary income, if any, between its Common Shares and Preferred Shares, including the VRM-MFP Shares, in proportion to the total dividends paid to each class with respect to such year. To the extent permitted under applicable law, the Fund reserves the right to make special allocations of income within a class, consistent with the objectives of the Fund.

Exempt-Interest Dividends. The Fund intends to qualify to pay exempt-interest dividends, as defined in the Code, on its Common Shares and Preferred Shares, including the VRM-MFP Shares, by satisfying the requirement that at the close of each quarter of its taxable year, at least 50% of the value of its total assets consists of tax-exempt municipal bonds. Exempt-interest dividends are dividends paid by the Fund that are attributable to interest on municipal bonds and are so designated by the Fund. The Fund intends to invest primarily in municipal bonds the income of which is otherwise exempt from regular U.S. federal income tax, the federal alternative minimum tax. Thus, substantially all of the Fund's dividends to the common shareholders and VRM-MFP Shareholders will qualify as exempt-interest dividends. Exempt-interest dividends will be exempt from U.S. federal income tax, subject to the possible application of the federal alternative minimum tax.

Exempt-Interest Dividends Subject to the Federal Alternative Minimum Tax. Federal tax law imposes a federal alternative minimum tax with respect to individuals, trusts and estates. Interest on certain municipal securities, such as bonds issued to make loans for housing purposes or to private entities (but not to certain tax-exempt organizations such as universities and non-profit hospitals) is included as an item of tax preference in determining the amount of a taxpayer's alternative minimum taxable income. To the extent that the Fund receives income from municipal securities subject to the federal alternative minimum tax, a portion of the dividends paid by it, although otherwise exempt from U.S. federal income tax, will be taxable to its shareholders to the extent that their tax liability is determined under the federal alternative minimum tax. The Fund will annually supply a report indicating the percentage of the Fund's income attributable to municipal securities subject to the federal alternative minimum tax.

Dividends Attributable to Ordinary Income and Capital Gains. Distributions to shareholders by the Fund of net income received, if any, from taxable temporary investments and net short-term capital gains, if any, realized by the Fund will be taxable to its shareholders as ordinary income. In addition, gains of the Fund that are attributable to market discount on municipal securities will be treated as ordinary income. Distributions by the Fund of net capital gain (that is, the excess of net long-term capital gain over net short-term capital loss), if any, are taxable as long-term capital gain regardless of the length of time the shareholder has owned Common Shares or VRM-MFP Shares of the Fund. The amount of capital gains and ordinary income allocable to the Fund's VRM-MFP Shares will depend upon the amount of such income realized by the Fund, but is not generally expected to be significant. Except for dividends paid on VRM-MFP Shares that include an allocable portion of any net capital gain or ordinary income, the Fund anticipates that all other dividends paid on VRM-MFP Shares will constitute exempt-interest dividends for U.S. federal income tax purposes.

If the Fund allocates any net capital gain or ordinary income for regular U.S. federal income tax purposes to a dividend on VRM-MFP Shares, the Fund has agreed as set forth in the Supplement to make certain payments to holders of VRM-MFP Shares to offset the regular U.S. federal income tax effect thereof. In addition, the Fund has agreed as set forth in the Supplement in certain circumstances to provide notice of the amount of any allocation prior to the date such dividend is declared.

Sales, Exchanges and Other Dispositions of VRM-MFP Shares. On the sale or other disposition of VRM-MFP Shares (other than redemptions, the rules for which are described below under the caption "Redemptions of VRM-MFP Shares"), the amount paid for the seller's right to any dividends that are accumulated but unpaid at the time of such sale or other disposition will be treated as dividends and subject to the rules described above under the caption "Tax Character of Distributions." The balance of the amount paid, will generally be treated as (1) capital gain to the extent it exceeds the seller's basis in the VRM-MFP Shares, and (2) capital loss to the extent it is less than the seller's basis in the VRM-MFP Shares. In the case of corporate taxpayers, both long-term and short-term capital gains are taxed at the same rate that applies to ordinary income. In the case of non-corporate taxpayers, short-term capital gains and ordinary income are taxed at a maximum rate of 37% and long-term capital gains at a maximum rate of 20%. In addition, because of certain limitations on itemized deductions and the deduction for personal exemptions, the effective rate of tax may be higher in certain circumstances.

In the case of a taxpayer that is an individual, estate or trust, and for taxable years starting after December 31, 2017 and before January 1, 2026, the Tax Act disallows miscellaneous itemized deductions within the meaning of Code Section 67, repeals the personal exemption and suspends the general limitation imposed on itemized deductions by Code Section 68.

Losses realized by a shareholder on the sale or exchange of VRM-MFP Shares held for six months or less are disallowed to the extent of any distribution of exempt-interest dividends received (or deemed received on a sale) with respect to such shares, and, if not disallowed, such losses are treated as long-term capital losses to the extent of any distribution of long-term capital gain received with respect to such shares.

Any loss realized on a sale or exchange of VRM-MFP Shares will be disallowed to the extent those shares are replaced by other shares within a period of 61 days beginning 30 days before and ending 30 days after the date of disposition of the original shares. In that event, the basis of the replacement shares of the Fund will be adjusted to reflect the disallowed loss.

Redemptions of VRM-MFP Shares. The Fund may, at its option, redeem VRM-MFP Shares in whole or in part, or be required to redeem all of the outstanding VRM-MFP Shares on a Failed Transition Redemption Date, and will be required to redeem Preferred Shares, which may include VRM-MFP Shares, in which event the redemption will be made from all VRM-MFP Shareholders pro rata, or by lot or other fair method, to the extent required to maintain Asset Coverage or comply with the Effective Leverage Ratio. Gain or loss, if any, resulting from a redemption of the VRM-MFP Shares will be taxed as gain or loss from the sale or exchange of the VRM-MFP Shares under Section 302 of the Code rather than as a dividend, but only if the redemption distribution (a) is deemed not to be essentially equivalent to a dividend, (b) is in complete redemption of an owner's interest in the Fund, (c) is substantially disproportionate with respect to the owner, or (d) with respect to non-corporate owners, is in partial liquidation of the Fund. For purposes of (a), (b) and (c) above, a shareholder's ownership of the Common Shares will be taken into account.

Tax on Net Investment Income. A 3.8% tax is imposed on net investment income of individuals, estates and trusts with incomes above certain threshold amounts. The types of investment income used to calculate net investment income, include taxable distributions (if any) made by the Fund with respect to VRM-MFP Shares and gains (if any) from the sale or other disposition of VRM-MFP Shares.

Consequences of Insufficient Distributions. If at any time when the Fund's VRM-MFP Shares are outstanding the Fund fails to meet 200% asset coverage (as determined pursuant to the 1940 Act), the Fund will be required to suspend distributions to holders of its Common Shares until such maintenance amount or asset coverage, as the case may be, is restored. This may prevent the Fund from distributing at least 90% of its investment company taxable income and net tax-exempt income (as that term is defined in the Code) determined without regard to the deduction for dividends paid, and may therefore jeopardize the Fund's qualification for taxation as a regulated investment company or cause the Fund to incur an income tax liability or the non-deductible 4% excise tax on the undistributed taxable income (including gain), or both. Upon failure to meet the 225% Asset Coverage required under the Supplement, the Fund will be required to redeem Preferred Shares, which may include VRM-MFP Shares, in order to maintain or restore such asset coverage and avoid the adverse consequences to the Fund and its shareholders of failing to qualify as a regulated investment company. There can be no assurance, however, that any such redemption would achieve such objectives.

The foregoing is a general summary of the provisions of the Code and regulations thereunder presently in effect as they directly govern the taxation of the Fund and its VRM-MFP Shareholders. These provisions are subject to change by legislative, judicial or administrative action, and any such change may be retroactive. Moreover, the foregoing does not address many

of the factors that may be determinative of whether an investor will be liable for the federal alternative minimum tax. Shareholders are advised to consult their own tax advisors for more detailed information concerning the regular U.S. federal income tax and federal alternative minimum income tax consequences of purchasing, holding and disposing of VRM-MFP Shares.

BOOK-ENTRY PROCEDURES AND SETTLEMENT

The information in this section concerning DTC and DTC's book-entry system has been obtained by the Fund from DTC.

The VRM-MFP Shares will be book-entry (global) securities. Upon issuance, all book-entry securities will be represented by one or more fully-registered global securities. Each global security will be deposited with, or on behalf of, DTC, a securities depository, and will be registered in the name of DTC or a nominee of DTC. DTC will thus be the only registered holder of VRM-MFP Shares.

Purchasers of VRM-MFP Shares may only hold interests in the global securities directly through DTC if they are participants in the DTC system. Purchasers may also hold interests through a securities intermediary—banks, brokerage houses and other institutions that maintain securities accounts for customers—that has an account with DTC or its nominee. DTC will maintain accounts showing the security holdings of its Agent Members, and these Agent Members will in turn maintain accounts showing the security holdings of their customers. Some of these customers may themselves be securities intermediaries holding securities for their customers. Thus, each beneficial owner of a book-entry security will hold that security indirectly through various intermediaries.

The interest of each beneficial owner in a book-entry security will be evidenced solely by entries on the books of the beneficial owner's securities intermediary or Agent Member. The actual purchaser of the securities will generally not be entitled to have the securities represented by the global securities registered in its name and will not be considered the owner under the terms of the securities and their governing documents. That means that the Fund and the Calculation and Paying Agent or any other agent of the Fund will be entitled to treat the registered holder, DTC or its nominee, as the holder of the securities for all purposes. In most cases, the beneficial owner will also not be able to obtain a paper certificate evidencing its ownership of VRM-MFP Shares. The laws of some jurisdictions require some purchasers of securities to take physical delivery of their securities in definitive form. These laws may impair the ability to own, transfer or pledge beneficial interests in book-entry securities.

A beneficial owner of book-entry securities represented by a global security may exchange the securities for definitive (paper) securities only if:

DTC is unwilling or unable to continue as depository for such global security and the Fund does not appoint a qualified replacement for DTC within 90 days; or

the Fund in its sole discretion decides to allow some or all book-entry securities to be exchangeable for definitive securities in registered form.

Unless indicated otherwise, any global security that is so exchangeable will be exchangeable in whole for definitive securities in registered form, with the same terms and of an equal aggregate amount. Definitive securities will be registered in the name or names of the person or persons specified by DTC in a written instruction to the registrar of the VRM-MFP Shares. DTC may base its written instruction upon directions that it receives from Agent Members.

In this prospectus supplement, in the case of book-entry securities, references to actions taken by beneficial owners will mean actions taken by DTC upon instructions from its Agent Members, and references to payments and notices relating to redemptions or the tendering of VRM-MFP Shares will mean payments and notices related to the redemption or tender of VRM-MFP Shares to DTC as the registered holder of the securities for distribution to Agent Members in accordance with DTC's procedures. If fewer than all the VRM-MFP Shares are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Agent Member in the VRM-MFP Shares to be redeemed.

Each sale of a book-entry security will settle in immediately available funds through DTC unless otherwise stated. Neither the Fund nor the Calculation and Paying Agent, or any agent of either, will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in any book-entry securities or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Neither DTC nor DTC's nominee will consent or vote with respect to the VRM-MFP Shares unless authorized by a participant in accordance with DTC's procedures. Under its usual procedures, DTC mails an omnibus proxy (the Omnibus Proxy) to the Fund as soon as possible after the record date. The Omnibus Proxy assigns DTC's nominee consenting or voting rights to the Agent Members to whose accounts the VRM-MFP Shares are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Dividend payments on the VRM-MFP Shares and payments upon redemption of VRM-MFP Shares will be made to DTC's nominee or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit participants' accounts upon DTC's receipt of funds and corresponding detail information from the Fund or the Calculation and Paying Agent on the payment date in accordance with their respective holdings shown on DTC records. Payments by Agent Members to beneficial owners will be governed by standing instructions and customary practices. Payment of dividends or redemption proceeds to DTC's nominee is the responsibility of the Fund or the Calculation and Paying Agent, disbursement of such payments to participants will be the responsibility of DTC, and disbursement of such payments to the beneficial owners will be the responsibility of Agent Members or securities intermediaries who hold through an Agent Member.

Agent Member means a person with an account at DTC that holds one or more VRM-MFP Shares through DTC, directly or indirectly, for a beneficial owner and that will be authorized and instructed, directly or indirectly, by a beneficial owner to disclose information to the Calculation and Paying Agent with respect to such beneficial owner.

IT IS THE DUTY OF EACH BENEFICIAL OWNER TO ARRANGE WITH THE DTC AGENT MEMBER OR SECURITIES INTERMEDIARIES TO RECEIVE FROM SUCH DTC AGENT MEMBER OR SECURITIES INTERMEDIARY DIVIDEND PAYMENTS AND ALL OTHER COMMUNICATIONS WHICH THE DTC AGENT MEMBER OR SECURITIES INTERMEDIARY RECEIVES FROM DTC. THE FUND WILL NOT HAVE ANY RESPONSIBILITY OR OBLIGATIONS TO ANY DTC AGENT MEMBER, SECURITIES INTERMEDIARIES, OR THE PERSONS FOR WHOM THEY ACT AS NOMINEES WITH RESPECT TO DIVIDEND PAYMENTS TO OR THE PROVIDING OF NOTICE FOR THE DTC AGENT MEMBERS, THE SECURITIES INTERMEDIARIES OR THE BENEFICIAL OWNERS.

UNDERWRITING

[TO BE FURNISHED AT THE TIME OF THE OFFERING]

LEGAL MATTERS

Certain legal matters in connection with the VRM-MFP Shares will be passed upon for the Fund by Sidley Austin LLP, New York, New York, and for the underwriter by [], New York, New York. Sidley Austin LLP may rely as to certain matters of Massachusetts law on the opinion of Morgan, Lewis & Bockius LLP, Boston, Massachusetts.

CUSTODIAN, TRANSFER AGENT, CALCULATION AND PAYING AGENT

State Street Bank and Trust Company (the Custodian) serves as custodian of the Fund s assets. Computershare Inc. and Computershare Trust Company, N.A. serve as transfer agent for the Common Shares. See Custodian, Transfer Agent, Dividend Disbursing Agent and Redemption and Paying Agent in the accompanying prospectus.

[] will serve as calculation agent and as the transfer agent and registrar, dividend disbursing agent, and paying agent and redemption price disbursing agent for the VRM-MFP Shares.

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The audited Financial Statements and Financial Highlights of the Fund appearing in the Fund s Annual Report for the fiscal year ended October 31, 2018 are incorporated by reference into the SAI. The audited financial statements and financial highlights have been audited by KPMG LLP, an independent registered public accounting firm, as set forth in their report thereon and incorporated herein by reference. Such audited financial statements and financial highlights are incorporated by reference in reliance upon such report given on the authority of such firm as experts in accounting and auditing. The information with respect to the fiscal years ended prior to October 31, 2014 has been audited by other auditors. The principal business address of KPMG LLP is 200 East Randolph Street, Chicago, Illinois 60601.

WHERE YOU CAN FIND MORE INFORMATION

The Fund is subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the 1934 Act), and the 1940 Act and is required to file reports, proxy statements and other information with the SEC. These documents can be inspected and copied for a fee at the SEC s public reference room, 100 F Street, NE, Washington, D.C. 20549. Reports, proxy statements, and other information about the Fund can be inspected at the offices of the SEC.

Additional information about the Fund and VRM-MRP Shares can be found in the Fund s registration statement (including amendments, exhibits, and schedules) on Form N-2 filed with the SEC. The SEC maintains a web site (<http://www.sec.gov>) that contains the Fund s registration statement, other documents incorporated by reference, and other information the Fund has filed electronically with the SEC, including proxy statements and reports filed under the 1934 Act. Additional information may be found on the Internet at <http://www.nuveen.com>. The information contained in, or that can be accessed through, those websites is not part of this prospectus supplement or the accompanying prospectus.

[\$]

Nuveen AMT-Free Municipal Credit Income Fund

[] Series [] MuniFund Preferred Shares

Variable Rate Mode

Liquidation Preference \$[] Per Share

PROSPECTUS SUPPLEMENT

[], 20[]

[Underwriter(s)]

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 offers to buy these securities in any jurisdiction where the offer or sale is not permitted.

Subject to Completion

Dated January 11, 2019

NUVEEN AMT-FREE MUNICIPAL CREDIT INCOME FUND

333 West Wacker Drive

Chicago, Illinois 60606

STATEMENT OF ADDITIONAL INFORMATION

[], 2019

Nuveen AMT-Free Municipal Credit Income Fund (the Fund) is a diversified, closed-end management investment company registered under the Investment Company Act of 1940, as amended. The Fund was organized on July 12, 1999. This statement of additional information (the SAI) relating to the common shares (Common Shares) and MuniFund Preferred Shares (MFP Shares, and the Common Shares and the MFP Shares, collectively, the Securities) of the Fund does not constitute a prospectus, but should be read in conjunction with the prospectus relating thereto dated [], 2019 and any related prospectus supplement. This SAI relates to the offering, on an immediate, continuous or delayed basis, in one or more offerings, of up to \$550,000,000 in aggregate initial offering price of Securities. This SAI does not include all information that a prospective investor should consider before purchasing Securities. Investors should obtain and read the prospectus and any related prospectus supplement prior to purchasing such shares. In addition, the Fund's audited financial statements and the independent registered public accounting firm's report thereon included in the Fund's annual report for the fiscal year ended October 31, 2018 are incorporated into this SAI by reference. A copy of the prospectus and any related prospectus supplement may be obtained without charge by calling (800) 257-8787. You may also obtain a copy of the prospectus and any related prospectus supplement on the U.S. Securities and Exchange Commission's (the SEC) web site (<http://www.sec.gov>). Capitalized terms used but not defined in this SAI have the meanings ascribed to them in the prospectus.

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THE FUND

Nuveen AMT-Free Municipal Credit Income Fund (the Fund) is a diversified, closed-end management investment company, organized as a Massachusetts business trust, registered under the Investment Company Act of 1940, as amended (the 1940 Act).

INVESTMENT OBJECTIVES AND POLICIES

The Fund's investment objectives are:

to provide current income exempt from regular federal income tax and federal alternative minimum tax applicable to individuals; and

to enhance portfolio value relative to the municipal bond market by investing in tax-exempt municipal bonds that the Investment Adviser believes are underrated or undervalued or that represent municipal market sectors that are undervalued.

Underrated municipal securities are those whose ratings do not, in the Investment Adviser's opinion, reflect their true value. Municipal securities may be underrated because of the time that has elapsed since their rating was assigned or reviewed, or because of positive factors that may not have been fully taken into account by NRSROs, or for other similar reasons. Municipal securities that are undervalued or that represent undervalued municipal market sectors are municipal securities that, in the Investment Adviser's opinion, are worth more than the value assigned to them in the marketplace. Municipal securities of particular types or purposes (*e.g.*, hospital bonds, industrial revenue bonds or bonds issued by a particular municipal issuer) may be undervalued because there is a temporary excess of supply in that market sector, or because of a general decline in the market price of municipal securities of the market sector for reasons that do not apply to the particular municipal securities that are considered undervalued. The Fund's investment in underrated or undervalued municipal securities will be based on the Investment Adviser's belief that the prices of such municipal securities should ultimately reflect their true value. Accordingly, enhancement of portfolio value relative to the municipal bond market refers to the Fund's objective of attempting to realize above-average capital appreciation in a rising market, and to experience less than average capital losses in a declining market. Thus, the Fund's second investment objective is not intended to suggest that capital appreciation is itself an objective of the Fund. Instead, the Fund seeks enhancement of portfolio value relative to the municipal bond market by prudent selection of municipal securities, regardless of which direction the market may move. Any capital appreciation realized by the Fund will generally result in the distribution of taxable capital gains to holders of Common Shares and holders of preferred shares of the Fund (Preferred Shares). The Fund is currently required to allocate net capital gains and ordinary income taxable for U.S. federal income tax purposes, if any, proportionately between Common Shares and Preferred Shares. See Tax Matters in the prospectus.

It is a fundamental policy that, under normal circumstances, the Fund will invest at least 80% of its Assets (as defined below) in municipal securities and other related investments, the income from which is exempt from regular federal income taxes.

As a non-fundamental investment policy that may be changed by the Fund's trustees without prior shareholder notice, under normal circumstances, the Fund will invest 100% of its Managed Assets (as defined below) in municipal securities and other related investments, the income from which is exempt

from the federal alternative minimum tax applicable to individuals at the time of purchase. As a non-fundamental policy subject to change by the Fund's trustees upon 60 days' notice to shareholders, under normal circumstances, the Fund will invest at least 80% of its Assets in municipal securities and other related investments, the income from which is exempt from the federal alternative minimum tax applicable to individuals at the time of purchase.

Assets means net assets of the Fund plus the amount of any borrowings for investment purposes. Managed Assets means the total assets of the Fund, minus the sum of its accrued liabilities (other than Fund liabilities incurred for the express purpose of creating leverage). Total assets for this purpose shall include assets attributable to the Fund's use of leverage (whether or not those assets are reflected in the Fund's financial statements for purposes of generally accepted accounting principles), and derivatives will be valued at their market value.

As a non-fundamental policy that may be changed by the Fund's trustees without prior shareholder notice, under normal circumstances, the Fund may invest up to 55% of its Managed Assets in securities rated, at the time of investment, below the three highest grades (Baa or BBB or lower) by at least one NRSRO, which includes below-investment-grade securities or unrated securities judged to be of comparable quality by NAM. The Fund may invest in distressed securities. The Fund may not invest in the securities of an issuer which, at the time of investment, is in default on its obligations to pay principal or interest thereon when due or that is involved in a bankruptcy proceeding (i.e. rated below C-, at the time of investment), provided, however, that NAM may determine that it is in the best interest of shareholders in pursuing a workout arrangement with issuers of defaulted securities to make loans to the defaulted issuer or another party, or purchase a debt, equity or other interest from the defaulted issuer or another party, or take other related or similar steps involving the investment of additional monies, but only if that issuer's securities are already held by the Fund.

The Fund's greater allocation to lower rated municipal securities is expected to result in meaningfully higher net earnings. However, investments in lower rated securities are subject to higher risks than investments in higher rated securities, including a higher risk that the issuer will be unable to pay interest or principal when due. In addition, the Fund's greater allocation to lower rated municipal securities may have a negative effect on one or more long-term ratings of the Fund's Preferred Shares. See Risk Factors in the prospectus for a discussion of the risks associated with an increased exposure to lower rated municipal securities and for a discussion of ratings risks.

Securities of below investment grade quality (Ba/BB or below) are commonly referred to as junk bonds. Issuers of securities rated Ba/BB or B are regarded as having current capacity to make principal and interest payments but are subject to business, financial or economic conditions which could adversely affect such payment capacity. Municipal securities rated Baa or BBB are considered investment grade securities; municipal securities rated Baa are considered medium grade obligations which lack outstanding investment characteristics and have speculative characteristics, while municipal securities rated BBB are regarded as having adequate capacity to pay principal and interest. Municipal securities rated AAA in which the Fund may invest may have been so rated on the basis of the existence of insurance guaranteeing the timely payment, when due, of all principal and interest. Municipal securities rated below investment grade quality are obligations of issuers that are considered predominately speculative with respect to the issuer's capacity to pay interest and repay principal according to the terms of the obligation and, therefore, carry greater investment risk, including the possibility of issuer default and bankruptcy and increased market price volatility. Municipal securities rated below investment grade tend to be less marketable than higher quality securities because the

market for them is less broad. The market for unrated municipal securities is even narrower. During periods of thin trading in these markets, the spread between bid and asked prices is likely to increase significantly and the Fund may have greater difficulty selling its portfolio securities. The Fund will be more dependent on the Investment Adviser and/or the Sub-Adviser's research and analysis when investing in these securities.

The foregoing credit quality policy targets apply only at the time a security is purchased, and the Fund is not required to dispose of a security in the event that a NRSRO upgrades or downgrades its assessment of the credit characteristics of a particular issuer or that valuation changes of various municipal securities cause the Fund's portfolio to fail to satisfy those targets. In determining whether to retain or sell such a security, the Investment Adviser and/or the Sub-Adviser may consider such factors as the Investment Adviser's and/or the Sub-Adviser's assessment of the credit quality of the issuer of such security, the price at which such security could be sold and the rating, if any, assigned to such security by other NRSROs. The ratings of S&P Global Ratings, Moody's Investor Service, Inc. and Fitch Ratings, Inc. represent their opinions as to the quality of the municipal securities they rate. It should be emphasized, however, that ratings are general and are not absolute standards of quality. Consequently, municipal securities with the same maturity, coupon and rating may have different yields while obligations of the same maturity and coupon with different ratings may have the same yield. See Appendix A Ratings of Investments for additional information about NRSRO ratings.

The Fund will invest primarily in municipal securities with long-term maturities in order to maintain an average effective maturity of 15 to 30 years, including the effects of leverage, but the average effective maturity of obligations held by the Fund may be lengthened or shortened as a result of portfolio transactions effected by the Investment Adviser and/or the Sub-Adviser, depending on market conditions and on an assessment by the portfolio manager of which segments of the municipal securities markets offer the most favorable relative investment values and opportunities for tax-exempt income and total return. As a result, the Fund's portfolio at any given time may include both long-term and intermediate-term municipal securities. Moreover, during temporary defensive periods (*e.g.*, times when, in the Investment Adviser's and/or the Sub-Adviser's opinion, temporary imbalances of supply and demand or other temporary dislocations in the tax-exempt bond market adversely affect the price at which long-term or intermediate-term municipal securities are available), and in order to keep the Fund's cash fully invested, the Fund may invest any percentage of its total assets in short-term investments including high quality, short-term debt securities that may be either tax-exempt or taxable. The Fund may not achieve its investment objectives during such periods.

The Fund may invest up to 15% of its Managed Assets in inverse floating rate securities. The economic effect of leverage through the Fund's purchase of inverse floating rate securities creates an opportunity for increased net income and returns for common shareholders but also creates the possibility that the Fund's long-term returns will be diminished if the cost of leverage exceeds the return of the inverse floating rate securities purchased by the Fund.

The Fund may invest in tobacco settlement bonds. Tobacco settlement bonds are bonds that are secured or payable solely from the collateralization of the proceeds from class action or other litigation against the tobacco industry.

The Fund may invest in securities of other open- or closed-end investment companies (including exchange-traded funds) that invest primarily in municipal securities of the types in which the Fund may invest directly, to the extent permitted by the 1940 Act, the rules and regulations issued

thereunder and applicable exemptive orders issued by the SEC. See "The Fund's Investments - Other Investment Companies" below.

The Fund may enter into certain derivative instruments in pursuit of its investment objectives, including to seek to enhance return, to hedge certain risks of its investments in fixed-income securities or as a substitute for a position in the underlying asset. Such instruments include financial futures contracts, swap contracts (including interest rate and credit default swaps), options on financial futures, options on swap contracts or other derivative instruments.

The Fund may purchase municipal securities that are additionally secured by insurance, bank credit agreements or escrow accounts. The credit quality of companies which provide such credit enhancements may affect the value of those securities. Although the insurance feature may reduce certain financial risks, the premiums for insurance and the higher market price paid for insured obligations may reduce the Fund's income. The insurance feature guarantees only the payment of principal and interest on the obligation when due and does not guarantee the market value of the insured obligations, which will fluctuate with the bond market and the financial success of the issuer and the insurer, and the effectiveness and value of the insurance itself is dependent on the continued creditworthiness of the insurer. No representation is made as to the insurers' ability to meet their commitments.

Obligations of issuers of municipal securities are subject to the provisions of bankruptcy, insolvency and other laws affecting the rights and remedies of creditors, such as the Bankruptcy Reform Act of 1978. In addition, the obligations of such issuers may become subject to the laws enacted in the future by Congress, state legislatures or referenda extending the time for payment of principal or interest, or both, or imposing other constraints upon enforcement of such obligations or upon municipalities to levy taxes. There is also the possibility that, as a result of legislation or other conditions, the power or ability of any issuer to pay, when due, the principal of and interest on its municipal securities may be materially affected.

The Fund is diversified for purposes of the 1940 Act. Consequently, as to 75% of its assets, the Fund may not invest more than 5% of its total assets in the securities of any single issuer (and in not more than 10% of the outstanding voting securities of an issuer), except that this limitation does not apply to cash, securities of the U.S. government, its agencies and instrumentalities, and securities of other investment companies.

The Fund cannot change its investment objectives without the approval of the holders of a majority of the outstanding Common and Preferred Shares, voting together as a single class, and of the holders of a majority of the outstanding Preferred Shares voting as a separate class, and with the prior written consent of the liquidity providers for Variable Rate Demand Preferred Shares ("VRDP Shares"), such consent to be determined in each liquidity provider's good faith discretion, and certain other Fund counterparties. A majority of the outstanding, under the 1940 Act, means (i) 67% or more of the shares present at a meeting, if the holders of more than 50% of the shares are present or represented by proxy, or (ii) more than 50% of the shares, whichever is less. See "Description of Securities" in the prospectus for additional information with respect to the voting rights of holders of Common Shares and Preferred Shares.

INVESTMENT RESTRICTIONS

Except as described below, the Fund as a fundamental policy may not without the approval of the holders of a majority of the outstanding Common Shares and Preferred Shares, including MFP Shares, voting together as a single class, and of the holders of a majority of the outstanding Preferred Shares, including MFP Shares, voting as a separate class, and the prior written consent of liquidity providers for VRDP Shares or other Fund counterparties:

- (1) Invest more than 5% of its total assets in securities of any one issuer, except that this limitation shall not apply to bonds issued by the United States Government, its agencies and instrumentalities or to the investment of 25% of its total assets.¹
- (2) Borrow money, except from banks for temporary or emergency purposes or for repurchase of its shares, and then only in an amount not exceeding one-third of the value of the Fund's total assets (including the amount borrowed) less the Fund's liabilities (other than borrowings).²
- (3) Issue senior securities, as defined in the 1940 Act, other than Preferred Shares, except to the extent permitted under the 1940 Act and except as otherwise described in the prospectus and this SAI.
- (4) Act as underwriter of another issuer's securities, except to the extent that the Fund may be deemed to be an underwriter within the meaning of the Securities Act of 1933, as amended (the "1933 Act"), in connection with the purchase and sale of portfolio securities.
- (5) Invest more than 25% of its total assets in securities of issuers in any one industry; provided, however, that such limitation shall not apply to municipal bonds other than those municipal bonds backed only by the assets and revenues of nongovernmental users.³
- (6) Purchase or sell real estate, but this shall not prevent the Fund from investing in municipal bonds secured by real estate or interests therein or foreclosing upon and selling such security.
- (7) Purchase or sell physical commodities unless acquired as a result of ownership of securities or other instruments (but this shall not prevent the Fund from purchasing or selling options, futures contracts or derivative instruments or from investing in securities or other instruments backed by physical commodities).
- (8) Make loans, except as permitted by the 1940 Act and exemptive orders granted under the 1940 Act.⁴

¹ Section 18(c) of the 1940 Act generally limits a registered closed-end investment company to issuing one class of senior securities representing indebtedness and one class of senior securities representing stock, except that the class of indebtedness or stock may be issued in one or more series, and promissory notes or other evidences of indebtedness issued in consideration of any loan, extension, or renewal thereof, made by a bank or other person and privately arranged, and not intended to be publicly distributed, are not deemed a separate class of senior securities.

² Section 18(a) of the 1940 Act generally prohibits a registered closed-end fund from incurring borrowings if, immediately thereafter, the aggregate amount of its borrowings exceeds 33 1/3% of its total assets.

³ For purposes of this restriction, governments and their political subdivisions are not members of any industry.

⁴ Section 21 of the 1940 Act makes it unlawful for a registered investment company, like the Fund, to lend money or other property if (i) the investment company's policies set forth in its registration statement do not permit such loan or (ii) the borrower controls or is under common control with the investment company. The Fund has not applied for, and currently does not intend to apply for, any exemptive relief that would allow it to make loans outside the limits of the 1940 Act.

(9) Issue debt securities that rank senior to Preferred Shares other than for temporary or emergency purposes.

For purposes of the foregoing, majority of the outstanding, when used with respect to particular shares of the Fund, means (i) 67% or more of the shares present at a meeting, if the holders of more than 50% of the shares are present or represented by proxy, or (ii) more than 50% of the shares, whichever is less.

For the purpose of applying the 25% industry limitation set forth in subparagraph (5) above, such limitation will apply to tax-exempt municipal securities if the payment of principal and interest for such securities is derived principally from a specific project associated with an issuer that is not a governmental entity or a political subdivision of a government, and in that situation the Fund will consider such municipal securities to be an industry associated with the project.

For the purpose of applying the 25% industry limitation set forth in subparagraph (5) above, the Fund will consider the investments of underlying investment companies when determining compliance with its own concentration policy, to the extent the Fund has sufficient information about such investments after making a reasonable effort to obtain current information about the investments in underlying companies.

For the purpose of applying the limitation set forth in subparagraph 1 above, an issuer shall be deemed the sole issuer of a security when its assets and revenues are separate from other governmental entities and its securities are backed only by its assets and revenues. Similarly, in the case of a non-governmental issuer, such as an industrial corporation or a privately owned or operated hospital, if the security is backed only by the assets and revenues of the non-governmental issuer, then such non-governmental issuer would be deemed to be the sole issuer. Where a security is also backed by the enforceable obligation of a superior or unrelated governmental or other entity (other than a bond insurer), it shall also be included in the computation of securities owned that are issued by such governmental or other entity. Where a security is guaranteed by a governmental entity or some other facility, such as a bank guarantee or letter of credit, such a guarantee or letter of credit would be considered a separate security and would be treated as an issue of such government, other entity or bank. When a municipal security is insured by bond insurance, it shall not be considered a security that is issued or guaranteed by the insurer; instead, the issuer of such municipal security will be determined in accordance with the principles set forth above. The foregoing restrictions do not limit the percentage of the Fund's assets that may be invested in municipal securities insured by any given insurer.

The Fund is diversified for purposes of the 1940 Act. Consequently, as to 75% of the Fund's total assets, the Fund may not (1) purchase the securities of any one issuer (other than cash, securities of other investment companies and securities issued by the U.S. Government or its agencies or instrumentalities) if immediately after such purchase, more than 5% of the value of the Fund's total assets would be invested in securities of such issuer or (2) purchase more than 10% of the outstanding voting securities of such issuer.

Subject to certain exemptions under the 1940 Act, the Fund may invest up to 10% of its total assets in the aggregate in shares of other investment companies and up to 5% of its total assets in any one investment company, provided the investment does not represent more than 3% of the voting shares of beneficial interest of the acquired investment company at the time such shares are purchased.

As a shareholder in any investment company, the Fund will bear its ratable share of that investment company's expenses and will remain subject to payment of the Fund's management, advisory and administrative fees with respect to assets so invested. Holders of Common Shares of the Fund would therefore be subject to duplicative expenses to the extent the Fund invests in other investment companies. In addition, the securities of other investment companies may be leveraged and therefore will be subject to leverage risk.

In addition to the foregoing fundamental investment policies, the Fund is also subject to the following non-fundamental restrictions and policies that may be changed by the Board of Trustees of the Fund (the Board) without prior shareholder notice. The Fund may not:

- (1) Sell securities short, unless the Fund owns or has the right to obtain securities equivalent in kind and amount to the securities sold at no added cost, and provided that transactions in options, futures contracts, options on futures contracts, or other derivative instruments are not deemed to constitute selling securities short.
- (2) Invest in securities of other open- or closed-end investment companies (including exchange-traded funds (ETFs)) except in compliance with the 1940 Act or any exemptive relief obtained thereunder.
- (3) Enter into futures contracts or related options or forward contracts, if more than 30% of the Fund's net assets would be represented by futures contracts or more than 5% of the Fund's net assets would be committed to initial margin deposits and premiums on futures contracts and related options.
- (4) Purchase securities when borrowings exceed 5% of its total assets if and so long as Preferred Shares are outstanding.
- (5) Purchase securities of companies for the purpose of exercising control, except that the Fund may invest up to 5% of its net assets in tax-exempt or taxable fixed-income securities or equity securities for the purpose of acquiring control of an issuer whose municipal bonds (a) the Fund already owns and (b) have deteriorated or are expected shortly to deteriorate significantly in credit quality, provided that the Fund's investment adviser, Nuveen Fund Advisors, LLC (Nuveen Fund Advisors or the Investment Adviser) determines that such investment should enable the Fund to better maximize the value of its existing investment in such issuer.

The restrictions and other limitations set forth above will apply only at the time of purchase of securities and will not be considered violated unless an excess or deficiency occurs or exists immediately after and as a result of an acquisition of securities.

The Fund may be subject to certain restrictions imposed by either guidelines of one or more nationally recognized statistical rating organizations (NRSROs) that may issue ratings for Preferred Shares, or, if issued, commercial paper or notes, or, if the Fund borrows from a lender, by the lender. These guidelines may impose asset coverage or portfolio composition requirements that are more stringent than those imposed on the Fund by the 1940 Act. If these restrictions were to apply, it is not anticipated that these covenants or guidelines would impede the Investment Adviser and the Fund's investment sub-adviser, Nuveen Asset Management LLC (the Sub-Adviser or NAM), from managing the Fund's portfolio in accordance with the Fund's investment objectives and policies.

At least six months prior to the final mandatory redemption date or term redemption date for all outstanding Preferred Shares of each series, the Fund will earmark assets rated at least A- or the equivalent (and including deposit securities including, but not limited to, cash or cash equivalents, U.S. government securities, highly rated municipal obligations or money market funds, in an amount equal to 20% of the liquidation preference of all outstanding Preferred Shares of the applicable series, with 135 days remaining to the redemption date, increasing to 100% with 15 days remaining) with a market value equal to at least 110% of the liquidation preference of all outstanding Preferred Shares of the applicable series until the redemption of all outstanding Preferred Shares of such series. As may be specified for a series of Preferred Shares, including MFP Shares, the Fund also may be required to earmark assets in connection with certain mandatory redemption events if they occur prior to the final mandatory redemption date or term redemption date.

THE FUND'S INVESTMENTS

Municipal Securities

General. The Fund may invest in various municipal securities, including municipal bonds and notes, other securities issued to finance and refinance public projects, and other related securities and derivative instruments creating exposure to municipal bonds, notes and securities that provide for the payment of interest income that is exempt from regular federal income taxes and the federal alternative minimum tax applicable to individuals. Municipal securities are generally debt obligations issued by state and local governmental entities and may be issued by U.S. territories to finance or refinance public projects such as roads, schools, and water supply systems. Municipal securities may also be issued for private activities, such as housing, medical and educational facility construction, or for privately owned transportation, electric utility and pollution control projects. Municipal securities may be issued on a long-term basis to provide permanent financing. The repayment of such debt may be secured generally by a pledge of the full faith and credit taxing power of the issuer, a limited or special tax, or any other revenue source including project revenues, which may include tolls, fees and other user charges, lease payments, and mortgage payments. Municipal securities may also be issued to finance projects on a short-term interim basis, anticipating repayment with the proceeds on long term debt. Municipal securities may be issued and purchased in the form of bonds, notes, leases or certificates of participation; structured as callable or non-callable; with payment forms including fixed coupon, variable rate, zero coupon, capital appreciation bonds, tender option bonds, and residual interest bonds or inverse floating rate securities; or acquired through investments in pooled vehicles, partnerships or other investment companies. Inverse floating rate securities are securities that pay interest at rates that vary inversely with changes in prevailing short-term tax-exempt interest rates and represent a leveraged investment in an underlying municipal security, which may increase the leverage of the Fund.

The Fund may invest in municipal bonds issued by U.S. territories and possessions (such as Puerto Rico or Guam) that are exempt from regular federal income taxes.

The yields on municipal securities depend on a variety of factors, including prevailing interest rates and the condition of the general money market and the municipal bond market, the size of a particular offering, the maturity of the obligation and the rating of the issue. The market value of municipal bonds will vary with changes in interest rate levels and as a result of changing evaluations of the ability of their issuers to meet interest and principal payments.

Tobacco Settlement Bonds. Included in the general category of municipal securities described in the Prospectus are tobacco settlement bonds. The Fund may invest in tobacco settlement bonds, which are municipal securities that are backed solely by expected revenues to be derived from lawsuits involving tobacco related deaths and illnesses which were settled between certain states and American tobacco companies. Tobacco settlement bonds are secured by an issuing state's proportionate share in the Master Settlement Agreement (MSA). The MSA is an agreement, reached out of court in November 1998 between 46 states and nearly all of the U.S. tobacco manufacturers. The MSA provides for annual payments in perpetuity by the manufacturers to the states in exchange for releasing all claims against the manufacturers and a pledge of no further litigation. Tobacco manufacturers pay into a master escrow trust based on their market share, and each state receives a fixed percentage of the payment as set forth in the MSA. A number of states have securitized the future flow of those payments by selling bonds pursuant to indentures or through distinct governmental entities created for such purpose. The principal and interest payments on the bonds are backed by the future revenue flow related to the MSA. Annual payments on the bonds, and thus risk to the Fund, are highly dependent on the receipt of future settlement payments to the state or its governmental entity.

The actual amount of future settlement payments is further dependent on many factors, including, but not limited to, annual domestic cigarette shipments, reduced cigarette consumption, increased taxes on cigarettes, inflation, financial capability of tobacco companies, continuing litigation and the possibility of tobacco manufacturer bankruptcy. The initial and annual payments made by the tobacco companies will be adjusted based on a number of factors, the most important of which is domestic cigarette consumption. If the volume of cigarettes shipped in the U.S. by manufacturers participating in the settlement decreases significantly, payments due from them will also decrease. Demand for cigarettes in the U.S. could continue to decline due to price increases needed to recoup the cost of payments by tobacco companies. Demand could also be affected by: anti-smoking campaigns, tax increases, reduced advertising, enforcement of laws prohibiting sales to minors; elimination of certain sales venues such as vending machines; and the spread of local ordinances restricting smoking in public places. As a result, payments made by tobacco manufacturers could be negatively impacted if the decrease in tobacco consumption is significantly greater than the forecasted decline. A market share loss by the MSA companies to non-MSA participating tobacco manufacturers would cause a downward adjustment in the payment amounts. A participating manufacturer filing for bankruptcy also could cause delays or reductions in bond payments. The MSA itself has been subject to legal challenges and has, to date, withstood those challenges.

Municipal Leases and Certificates of Participation. The Fund also may purchase municipal securities that represent lease obligations and certificates of participation in such leases. These carry special risks because the issuer of the securities may not be obligated to appropriate money annually to make payments under the lease. A municipal lease is an obligation in the form of a lease or installment purchase that is issued by a state or local government to acquire equipment and facilities. Income from such obligations generally is exempt from state and local taxes in the state of issuance. Leases and installment purchase or conditional sale contracts (which normally provide for title to the leased asset to pass eventually to the governmental issuer) have evolved as a means for governmental issuers to acquire property and equipment without meeting the constitutional and statutory requirements for the issuance of debt. The debt issuance limitations are deemed to be inapplicable because of the inclusion in many leases or contracts of non-appropriation clauses that relieve the governmental issuer of any obligation to make future payments under the lease or contract unless money is appropriated for such purpose by the appropriate legislative body on a yearly or other periodic basis. In addition, such leases or contracts may be subject to the temporary abatement of payments in the event the issuer is prevented

from maintaining occupancy of the leased premises or utilizing the leased equipment or facilities. Although the obligations may be secured by the leased equipment or facilities, the disposition of the property in the event of non-appropriation or foreclosure might prove difficult, time consuming and costly, and result in a delay in recovering, or the failure to recover fully, the Fund's original investment. To the extent that the Fund invests in unrated municipal leases or participates in such leases, the credit quality rating and risk of cancellation of such unrated leases will be monitored on an ongoing basis. In order to reduce this risk, the Fund will only purchase municipal securities representing lease obligations where the Investment Adviser and/or Sub-Adviser believes the issuer has a strong incentive to continue making appropriations until maturity.

A certificate of participation represents an undivided interest in an unmanaged pool of municipal leases, an installment purchase agreement or other instruments. The certificates typically are issued by a municipal agency, a trust or other entity that has received an assignment of the payments to be made by the state or political subdivision under such leases or installment purchase agreements. Such certificates provide the Fund with the right to a pro rata undivided interest in the underlying municipal securities. In addition, such participations generally provide the Fund with the right to demand payment, on not more than seven days' notice, of all or any part of the Fund's participation interest in the underlying municipal securities, plus accrued interest.

Municipal Notes. Municipal securities in the form of notes generally are used to provide for short-term capital needs, in anticipation of an issuer's receipt of other revenues or financing, and typically have maturities of up to three years. Such instruments may include tax anticipation notes, revenue anticipation notes, bond anticipation notes, tax and revenue anticipation notes and construction loan notes. Tax anticipation notes are issued to finance the working capital needs of governments. Generally, they are issued in anticipation of various tax revenues, such as income, sales, property, use and business taxes, and are payable from these specific future taxes. Revenue anticipation notes are issued in expectation of receipt of other kinds of revenue, such as federal revenues available under federal revenue sharing programs. Bond anticipation notes are issued to provide interim financing until long-term bond financing can be arranged. In most cases, the long-term bonds then provide the funds needed for repayment of the bond anticipation notes. Tax and revenue anticipation notes combine the funding sources of both tax anticipation notes and revenue anticipation notes. Construction loan notes are sold to provide construction financing. Mortgage notes insured by the Federal Housing Authority secure these notes; however, the proceeds from the insurance may be less than the economic equivalent of the payment of principal and interest on the mortgage note if there has been a default. The anticipated revenues from taxes, grants or bond financing generally secure the obligations of an issuer of municipal notes. An investment in such instruments, however, presents a risk that the anticipated revenues will not be received or that such revenues will be insufficient to satisfy the issuer's payment obligations under the notes or that refinancing will be otherwise unavailable.

Pre-Refunded Municipal Securities. The principal of, and interest on, pre-refunded municipal securities are no longer paid from the original revenue source for the securities. Instead, the source of such payments is typically an escrow fund consisting of U.S. government securities. The assets in the escrow fund are derived from the proceeds of refunding bonds issued by the same issuer as the pre-refunded municipal securities. Issuers of municipal securities use this advance refunding technique to obtain more favorable terms with respect to securities that are not yet subject to call or redemption by the issuer. For example, advance refunding enables an issuer to refinance debt at lower market interest rates, restructure debt to improve cash flow or eliminate restrictive covenants in the indenture or other governing instrument for the pre-refunded municipal securities. However, except for a change in the

revenue source from which principal and interest payments are made, the pre-refunded municipal securities remain outstanding on their original terms until they mature or are redeemed by the issuer.

Private Activity Bonds. Private activity bonds are issued by or on behalf of public authorities to obtain funds to provide privately operated housing facilities, airport, mass transit or port facilities, sewage disposal, solid waste disposal or hazardous waste treatment or disposal facilities and certain local facilities for water supply, gas or electricity. Other types of private activity bonds, the proceeds of which are used for the construction, equipment, repair or improvement of privately operated industrial or commercial facilities, may constitute municipal securities, although the current federal tax laws place substantial limitations on the size of such issues. The Fund's distributions of its interest income from private activity bonds may subject certain investors to the federal alternative minimum tax.

Inverse Floating Rate Securities. The Fund may invest in inverse floating rate securities. Inverse floating rate securities are securities whose interest rates bear an inverse relationship to the interest rate on another security or the value of an index. Generally, inverse floating rate securities represent beneficial interests in a special purpose trust, commonly referred to as a tender option bond trust (TOB trust), that holds municipal bonds. The TOB trust typically sells two classes of beneficial interests or securities: floating rate securities (sometimes referred to as short-term floaters or tender option bonds (TOBs)), and inverse floating rate securities (sometimes referred to as inverse floaters). Both classes of beneficial interests are represented by certificates or receipts. The floating rate securities have first priority on the cash flow from the municipal bonds held by the TOB trust. In this structure, the floating rate security holders have the option, at periodic short-term intervals, to tender their securities to the trust for purchase and to receive the face value thereof plus accrued interest. The obligation of the trust to repurchase tendered securities is supported by a remarketing agent and by a liquidity provider. As consideration for providing this support, the remarketing agent and the liquidity provider receive periodic fees. The holder of the short-term floater effectively holds a demand obligation that bears interest at the prevailing short-term, tax-exempt rate. However, the trust is not obligated to purchase tendered short-term floaters in the event of certain defaults with respect to the underlying municipal bonds or a significant downgrade in the credit rating assigned to the bond issuer.

As the holder of an inverse floating rate investment, the Fund receives the residual cash flow from the TOB trust. Because the holder of the short-term floater is generally assured liquidity at the face value of the security plus accrued interest, the holder of the inverse floater assumes the interest rate cash flow risk and the market value risk associated with the municipal bond deposited into the TOB trust. The volatility of the interest cash flow and the residual market value will vary with the degree to which the trust is leveraged. This is expressed in the ratio of the total face value of the short-term floaters to the value of the inverse floaters that are issued by the TOB trust, and can exceed three times for more highly leveraged trusts. All voting rights and decisions to be made with respect to any other rights relating to the municipal bonds held in the TOB trust are passed through, pro rata, to the holders of the short-term floaters and to the Fund as the holder of the associated inverse floaters.

Because any increases in the interest rate on the short-term floaters issued by a TOB trust would reduce the residual interest paid on the associated inverse floaters, and because fluctuations in the value of the municipal bond deposited in the TOB trust would affect only the value of the inverse floater and not the value of the short-term floater issued by the trust so long as the value of the municipal bond held by the trust exceeded the face amount of short-term floaters outstanding, the value of inverse floaters is generally more volatile than that of an otherwise comparable municipal bond held

on an unleveraged basis outside a TOB trust. Inverse floaters generally will underperform the market of fixed-rate bonds in a rising interest rate environment (*i.e.*, when bond values are falling), but will tend to outperform the market of fixed-rate bonds when interest rates decline or remain relatively stable. Although volatile in value and return, inverse floaters typically offer the potential for yields higher than those available on fixed-rate bonds with comparable credit quality, coupon, call provisions and maturity. Inverse floaters have varying degrees of liquidity or illiquidity based primarily upon the inverse floater holder's ability to sell the underlying bonds deposited in the TOB trust at an attractive price.

The Fund may invest in inverse floating rate securities issued by TOB trusts in which the liquidity providers have recourse to the Fund pursuant to a separate shortfall and forbearance agreement. Such an agreement would require the Fund to reimburse the liquidity provider, among other circumstances, upon termination of the TOB trust for the difference between the liquidation value of the bonds held in the trust and the principal amount and accrued interest due to the holders of floating rate securities issued by the trust. The Fund will enter into such a recourse agreement (1) when the liquidity provider requires such a recourse agreement because the level of leverage in the TOB trust exceeds the level that the liquidity provider is willing to support absent such an agreement; and/or (2) to seek to prevent the liquidity provider from collapsing the trust in the event the municipal bond held in the trust has declined in value to the point where it may cease to exceed the face amount of outstanding short-term floaters. In an instance where the Fund has entered such a recourse agreement, the Fund may suffer a loss that exceeds the amount of its original investment in the inverse floating rate securities; such loss could be as great as that original investment amount plus the face amount of the floating rate securities issued by the trust plus accrued interest thereon.

The Fund will segregate or earmark liquid assets with its custodian in accordance with the 1940 Act to cover its obligations with respect to its investments in TOB trusts.

The Fund may invest in both inverse floating rate securities and floating rate securities (as discussed below) issued by the same TOB trust.

Floating Rate Securities. The Fund may also invest in floating rate securities, as described above, issued by special purpose trusts. Floating rate securities may take the form of short-term floating rate securities or the option period may be substantially longer. Generally, the interest rate earned will be based upon the market rates for municipal securities with maturities or remarketing provisions that are comparable in duration to the periodic interval of the tender option, which may vary from weekly, to monthly, to extended periods of one year or multiple years. Since the option feature has a shorter term than the final maturity or first call date of the underlying bond deposited in the trust, the Fund, as the holder of the floating rate securities, relies upon the terms of the agreement with the financial institution furnishing the option as well as the credit strength of that institution. As further assurance of liquidity, the terms of the trust provide for a liquidation of the municipal bond deposited in the trust and the application of the proceeds to pay off the floating rate securities. The trusts that are organized to issue both short-term floating rate securities and inverse floaters generally include liquidation triggers to protect the investor in the floating rate securities.

Special Taxing Districts. Special taxing districts are organized to plan and finance infrastructure developments to induce residential, commercial and industrial growth and redevelopment. The bond financing methods such as tax increment finance, tax assessment, special services district and Mello-Roos bonds, generally are payable solely from taxes or other revenues

attributable to the specific projects financed by the bonds without recourse to the credit or taxing power of related or overlapping municipalities. They often are exposed to real estate development-related risks and can have more taxpayer concentration risk than general tax-supported bonds, such as general obligation bonds. Further, the fees, special taxes, or tax allocations and other revenues that are established to secure such financings generally are limited as to the rate or amount that may be levied or assessed and are not subject to increase pursuant to rate covenants or municipal or corporate guarantees. The bonds could default if development failed to progress as anticipated or if larger taxpayers failed to pay the assessments, fees and taxes as provided in the financing plans of the districts.

Short-Term Investments

Short-Term Taxable Fixed Income Securities. For temporary defensive purposes or to keep cash on hand fully invested, the Fund may invest up to 100% of its total assets in cash equivalents and short-term taxable fixed-income securities, although the Fund intends to invest in taxable short-term investments only in the event that suitable tax-exempt short-term investments are not available at reasonable prices and yields. Investment in taxable short-term investments would result in a portion of the dividends paid being subject to regular U.S. federal income tax and the federal alternative minimum tax applicable to individuals. Short-term taxable fixed income investments are defined to include, without limitation, the following:

- (1) U.S. government securities, including bills, notes and bonds differing as to maturity and rates of interest that are either issued or guaranteed by the U.S. Treasury or by U.S. government agencies or instrumentalities. U.S. government agency securities include securities issued by (a) the Federal Housing Administration, Farmers Home Administration, Export-Import Bank of the United States, Small Business Administration, and the Government National Mortgage Association, whose securities are supported by the full faith and credit of the United States; (b) the Federal Home Loan Banks, Federal Intermediate Credit Banks, and the Tennessee Valley Authority, whose securities are supported by the right of the agency to borrow from the U.S. Treasury; (c) the Federal National Mortgage Association, whose securities are supported by the discretionary authority of the U.S. government to purchase certain obligations of the agency or instrumentality; and (d) the Student Loan Marketing Association, whose securities are supported only by its credit. While the U.S. government provides financial support to such U.S. government-sponsored agencies or instrumentalities, no assurance can be given that it always will do so since it is not so obligated by law. The U.S. government, its agencies, and instrumentalities do not guarantee the market value of their securities. Consequently, the value of such securities may fluctuate.
- (2) Certificates of deposit issued against funds deposited in a bank or a savings and loan association. Such certificates are for a definite period of time, earn a specified rate of return, and are normally negotiable. The issuer of a certificate of deposit agrees to pay the amount deposited plus interest to the bearer of the certificate on the date specified thereon. Under current Federal Deposit Insurance Corporation regulations, the maximum insurance payable as to any one certificate of deposit is \$250,000; therefore, certificates of deposit purchased by the Fund may not be fully insured.
- (3) Repurchase agreements, which involve purchases of debt securities. At the time the Fund purchases securities pursuant to a repurchase agreement, it simultaneously agrees to resell and redeliver such securities to the seller, who also simultaneously agrees to buy back the securities at a fixed price and time. This assures a predetermined yield for the Fund during its holding period, since

the resale price is always greater than the purchase price and reflects an agreed-upon market rate. Such actions afford an opportunity for the Fund to invest temporarily available cash. The Fund may enter into repurchase agreements only with respect to obligations of the U.S. government, its agencies or instrumentalities; certificates of deposit; or bankers' acceptances in which the Fund may invest. Repurchase agreements may be considered loans to the seller, collateralized by the underlying securities. The risk to the Fund is limited to the ability of the seller to pay the agreed-upon sum on the repurchase date; in the event of default, the repurchase agreement provides that the Fund is entitled to sell the underlying collateral. If the value of the collateral declines after the agreement is entered into, and if the seller defaults under a repurchase agreement when the value of the underlying collateral is less than the repurchase price, the Fund could incur a loss of both principal and interest. The Investment Adviser monitors the value of the collateral at the time the action is entered into and at all times during the term of the repurchase agreement. The Investment Adviser does so in an effort to determine that the value of the collateral always equals or exceeds the agreed-upon repurchase price to be paid to the Fund. If the seller were to be subject to a federal bankruptcy proceeding, the ability of the Fund to liquidate the collateral could be delayed or impaired because of certain provisions of the bankruptcy laws.

(4) Commercial paper, which consists of short-term unsecured promissory notes, including variable rate master demand notes issued by corporations to finance their current operations. Master demand notes are direct lending arrangements between the Fund and a corporation. There is no secondary market for such notes. However, they are redeemable by the Fund at any time. The Investment Adviser will consider the financial condition of the corporation (*e.g.*, earning power, cash flow, and other liquidity ratios) and will continuously monitor the corporation's ability to meet all of its financial obligations, because the Fund's liquidity might be impaired if the corporation were unable to pay principal and interest on demand. Investments in commercial paper will be limited to commercial paper rated in the highest categories by a major NRSRO and which mature within one year of the date of purchase or carry a variable or floating rate of interest.

Short-Term Tax-Exempt Fixed Income Securities. Short-term tax-exempt fixed income securities are securities that are exempt from regular U.S. federal income tax and mature within three years or less from the date of issuance. Short-term tax-exempt fixed income securities are defined to include, without limitation, the following:

(1) Bond Anticipation Notes (BANs) are usually general obligations of state and local governmental issuers which are sold to obtain interim financing for projects that will eventually be funded through the sale of long-term debt obligations or bonds. The ability of an issuer to meet its obligations on its BANs is primarily dependent on the issuer's access to the long-term municipal bond market and the likelihood that the proceeds of such bond sales will be used to pay the principal and interest on the BANs.

(2) Tax Anticipation Notes (TANs) are issued by state and local governments to finance the current operations of such governments. Repayment is generally to be derived from specific future tax revenues. TANs are usually general obligations of the issuer. A weakness in an issuer's capacity to raise taxes due to, among other things, a decline in its tax base or a rise in delinquencies, could adversely affect the issuer's ability to meet its obligations on outstanding TANs.

(3) Revenue Anticipation Notes (RANs) are issued by governments or governmental bodies with the expectation that future revenues from a designated source will be used to repay the notes. In

general, they also constitute general obligations of the issuer. A decline in the receipt of projected revenues, such as anticipated revenues from another level of government, could adversely affect an issuer's ability to meet its obligations on outstanding RANs. In addition, the possibility that the revenues would, when received, be used to meet other obligations could affect the ability of the issuer to pay the principal and interest on RANs.

(4) Construction loan notes are issued to provide construction financing for specific projects. Frequently, these notes are redeemed with funds obtained from the Federal Housing Administration.

(5) Bank notes are notes issued by local government bodies and agencies, such as those described above, to commercial banks as evidence of borrowings. The purposes for which the notes are issued are varied but they are frequently issued to meet short-term working capital or capital project needs. These notes may have risks similar to the risks associated with TANs and RANs.

(6) Tax-exempt commercial paper (Municipal Paper) represents very short-term unsecured, negotiable promissory notes issued by states, municipalities and their agencies. Payment of principal and interest on issues of municipal paper may be made from various sources to the extent the funds are available therefrom. Maturities of municipal paper generally will be shorter than the maturities of TANs, BANs or RANs. There is a limited secondary market for issues of Municipal Paper.

(7) Certain municipal securities may carry variable or floating rates of interest whereby the rate of interest is not fixed but varies with changes in specified market rates or indices, such as a bank prime rate or a tax-exempt money market index.

While the various types of notes described above as a group represent the major portion of the short-term tax-exempt note market, other types of notes are available in the marketplace, and the Fund may invest in such other types of notes to the extent permitted under its investment objectives, policies and limitations. Such notes may be issued for different purposes and may be secured differently from those mentioned above.

When-Issued and Delayed Delivery Transactions

The Fund may buy and sell municipal securities on a when-issued or delayed delivery basis, making payment or taking delivery at a later date, normally within 15-45 days of the trade date. On such transactions the payment obligation and the interest rate are fixed at the time the buyer enters into the commitment. Beginning on the date the Fund enters into a commitment to purchase securities on a when-issued or delayed delivery basis, the Fund is required under interpretations of the SEC to maintain in a separate account liquid assets, consisting of cash, cash equivalents or liquid securities having a market value, at all times, at least equal to the amount of the commitment. Income generated by any such assets which provide taxable income for U.S. federal income tax purposes is includable in the taxable income of the Fund and, to the extent distributed, will be taxable to shareholders. The Fund may enter into contracts to purchase municipal securities on a forward basis (*i.e.*, where settlement will occur more than 60 days from the date of the transaction) only to the extent that the Fund specifically collateralizes such obligations with a security that is expected to be called or mature within sixty days before or after the settlement date of the forward transaction. The commitment to purchase securities on a when-issued, delayed delivery or forward basis may involve an element of risk because no interest accrues on the bonds prior to settlement and at the time of delivery the market value may be less than cost.

Derivatives and Hedging Strategies

The Fund may periodically engage in hedging transactions, and otherwise use various types of derivative instruments, described below, to reduce risk, to effectively gain particular market exposures, to seek to enhance returns, and to reduce transaction costs, among other reasons. In addition to inverse floating rate securities and structured notes, the Fund may invest in certain other derivative instruments in pursuit of its investment objectives. Such instruments include financial futures contracts, swap contracts (including interest rate and credit default swaps), options on financial futures, options on swap contracts or other derivative instruments whose prices, in the Investment Adviser's and/or the Sub-Adviser's opinion, correlate with the prices of the Fund's investments. The Investment Adviser and/or the Sub-Adviser uses derivatives to shorten or lengthen the effective duration of the Fund's portfolio securities, and therefore the interest rate risk, and to adjust other aspects of the portfolio's risk/return profile. The Fund may use these instruments if the Fund deems it more efficient from a transaction cost, total return or income standpoint than investing in cash securities. See Appendix B Derivative Strategies and Risks for additional information regarding the various techniques involving the use of derivatives.

Hedging is a term used for various methods of seeking to preserve portfolio capital value by offsetting price changes in one investment through making another investment whose price should tend to move in the opposite direction.

A derivative is a financial contract whose value is based on (or derived from) a traditional security (such as a stock or a bond), an asset (such as a commodity like gold), or a market index (such as the Barclays Capital Municipal Bond Index). Some forms of derivatives may trade on exchanges, while non-standardized derivatives, which tend to be more specialized and complex, trade in over-the-counter (OTC) or a one-on-one basis. It may be desirable and possible in various market environments to partially hedge the portfolio against fluctuations in market value due to market interest rate or credit quality fluctuations, or instead to gain a desired investment exposure, by entering into various types of derivative transactions, including financial futures and index futures as well as related put and call options on such instruments, structured notes, or interest rate swaps on taxable or tax-exempt securities or indexes (which may be forward-starting), credit default swaps, and options on interest rate swaps, among others.

These transactions present certain risks. In particular, the imperfect correlation between price movements in the futures contract and price movements in the securities being hedged creates the possibility that losses on the hedge by the Fund may be greater than gains in the value of the securities in the Fund's portfolio. In addition, futures and options markets may not be liquid in all circumstances. As a result, in volatile markets, the Fund may not be able to close out the transaction without incurring losses substantially greater than the initial deposit. Finally, the potential deposit requirements in futures contracts create an ongoing greater potential financial risk than do options transactions, where the exposure is limited to the cost of the initial premium. Losses due to hedging transactions will reduce yield. The Fund will invest in these instruments only in markets believed by the Investment Adviser and/or the Sub-Adviser to be active and sufficiently liquid. Net gains, if any, from hedging and other portfolio transactions will be distributed as taxable distributions to shareholders. These hedging strategies may generate taxable income.

The Investment Adviser and/or the Sub-Adviser may use derivative instruments to seek to enhance return, to hedge some of the risk of the Fund's investments in municipal securities or as a substitute for a position in the underlying asset. These types of strategies may generate taxable income.

There is no assurance that these derivative strategies will be available at any time or that the Investment Adviser and/or the Sub-Adviser will determine to use them for the Fund or, if used, that the strategies will be successful.

Swap Transactions. The Fund may enter into total return, interest rate and credit default swap agreements and interest rate caps, floors and collars. The Fund may also enter into options on the foregoing types of swap agreements (swap options).

Swap agreements typically are two-party contracts entered into primarily by institutional investors for periods ranging from a few weeks to several years. In a standard swap transaction, two parties agree to exchange the returns (or differentials in rates of return) earned or realized on particular predetermined investments or instruments. The gross returns to be exchanged or swapped between the parties are calculated with respect to a notional amount (e.g., the change in the value of a particular dollar amount invested at a particular interest rate or in a basket of securities representing a particular index).

The notional amount of a swap agreement is the agreed upon basis for calculating the obligations that the parties to a swap agreement have agreed to exchange. Under most swap agreements entered into by the Fund, the obligations of the parties would be exchanged on a net basis. Consequently, the Fund's obligation (or rights) under a net swap agreement will generally be equal only to the net amount to be paid or received under the agreement based on the relative values of the positions held by each party to the agreement. See Segregation of Assets below.

The swap market has grown substantially in recent years with a large number of banking firms acting as both principals and agents using standardized swap documentation. As a result, the swap market has become relatively liquid. However, swap agreements may still be subject to liquidity risk, which exists when a particular swap is difficult to purchase or sell. If a swap transaction is particularly large or if the relevant market is illiquid, it may not be possible to initiate a transaction or liquidate a position at an advantageous time or price, which may result in significant losses. Caps, floors and collars are more recent innovations for which standardized documentation has not been fully developed and, accordingly, swaps with these features are less liquid.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) sets forth a regulatory framework for certain derivatives, such as swaps, in which the Fund may be authorized to invest. The Dodd-Frank Act requires many swap transactions to be executed on registered exchanges or through swap execution facilities, cleared through a regulated clearinghouse and publicly reported. In addition, many market participants are now regulated as swap dealers or major swap participants and are subject to required business conduct standards and other regulatory burdens, and will be subject to minimum capital requirements upon the adoption of final capital rules. The statutory requirements of the Dodd-Frank Act have been implemented primarily through rules and regulations adopted by the SEC and the Commodity Futures Trading Commission (the CFTC). The CFTC is responsible for the regulation of most swaps, and has completed most of its rules implementing the Dodd-Frank Act swap regulations. The SEC has jurisdiction over a small segment of the market referred to as security-based swaps, which includes swaps on single securities or credits, or narrow-based indices of securities or credits, but has not yet completed its rulemaking.

Cleared swaps are transacted through CFTC-registered futures commission merchants that are members of central clearinghouses with the clearinghouse serving as a central counterparty similar to

transactions in futures contracts. Currently, central clearing is required only for certain categories of swaps, although central clearing for additional categories of swaps is expected to be implemented by the CFTC. The Fund may face the indirect risk of the failure of another clearing member customer to meet its obligations to its clearing member. Such scenario could arise due to a default by the clearing member on its obligations to the clearinghouse, triggered by a customer's failure to meet its obligations to the clearing member. In addition, the CFTC and bank regulators have imposed new margin requirements on uncleared OTC swaps that could adversely affect the Fund's ability to enter into swaps in the OTC market. The SEC is expected to adopt similar margin requirements for uncleared security-based swaps. These requirements may increase the amount of collateral the Fund is required to provide and the costs associated with providing it. These developments could cause the Fund to terminate new or existing swap agreements or to realize amounts to be received under such instruments at an inopportune time. Until the mandated rulemaking and regulations are implemented completely, it will not be possible to determine the complete impact of the Dodd-Frank Act and related regulations on the Fund, and the establishment of centralized clearinghouses and trading facilities for swap transactions may not result in swaps being easier to value or trade. However, it is expected that swap dealers, major market participants and swap counterparties will experience other new and/or additional regulations, requirements, compliance burdens and associated costs, and that such costs will be passed on to customers such as the Fund. The rules that have been and will be promulgated may exert a negative effect on the Fund's ability to meet its investment objectives, either through limits or requirements imposed on the Fund or its counterparties. The swap market could be disrupted or limited as a result of the new requirements, which may increase the cost of the Fund's investments and of doing business, which could adversely affect the Fund's ability to buy or sell derivatives. The overall impact of the Dodd-Frank Act on the Fund remains highly uncertain and it is unclear how the swap markets will adapt to this new regulatory regime, along with additional, sometimes overlapping, regulatory requirements imposed by non-U.S. regulators.

Interest Rate Swaps, Caps, Collars and Floors. Interest rate swaps are bilateral contracts in which each party agrees to make periodic payments to the other party based on different referenced interest rates (e.g., a fixed rate and a floating rate) applied to a specified notional amount. 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 on a notional principal amount from the party selling such interest rate floor. The purchase of an interest rate cap entitles the purchaser, to the extent that a specified index rises above a predetermined interest rate, to receive payments of interest on a notional principal amount from the party selling such interest rate cap. Interest rate collars involve selling a cap and purchasing a floor or vice versa to protect the Fund against interest rate movements exceeding given minimum or maximum levels.

The use of interest rate transactions, such as interest rate swaps and caps, is a highly specialized activity that involves investment techniques and risks different from those associated with ordinary portfolio security transactions. Depending on the state of interest rates in general, the Fund's use of interest rate swaps or caps could enhance or harm the overall performance of the Common Shares. To the extent there is a decline in interest rates, the value of the interest rate swap or cap could decline, and could result in a decline in the net asset value of the Common Shares. In addition, if short-term interest rates are lower than the Fund's fixed rate of payment on the interest rate swap, the swap will reduce Common Share net earnings. If, on the other hand, short-term interest rates are higher than the fixed rate of payment on the interest rate swap, the swap will enhance Common Share net earnings. Buying interest rate caps could enhance the performance of the Common Shares by providing a maximum leverage expense. Buying interest rate caps could also decrease the net earnings of the

Common Shares in the event that the premium paid by the Fund to the counterparty exceeds the additional amount the Fund would have been required to pay had it not entered into the cap agreement.

Total Return Swaps. In a total return swap, one party agrees to pay the other the total return of a defined underlying asset during a specified period, in return for periodic payments based on a fixed or variable interest rate or the total return from other underlying assets. A total return swap may be applied to any underlying asset but is most commonly used with equity indices, single stocks, bonds and defined baskets of loans and mortgages. The Fund might enter into a total return swap involving an underlying index or basket of securities to create exposure to a potentially widely-diversified range of securities in a single trade. An index total return swap can be used by the Investment Adviser and/or the Sub-Adviser to assume risk, without the complications of buying the component securities from what may not always be the most liquid of markets.

In connection with the Fund's position in a swap contract, the Fund will segregate liquid assets or will otherwise cover its position in accordance with applicable SEC requirements. See *Segregation of Assets* below.

Credit Default Swaps. A credit default swap is a bilateral contract that enables an investor to buy or sell protection against a defined-issuer credit event. The Fund may enter into credit default swap agreements either as a buyer or a seller. The Fund may buy protection to attempt to mitigate the risk of default or credit quality deterioration in an individual security or a segment of the fixed income securities market to which it has exposure, or to take a short position in individual bonds or market segments which it does not own. The Fund may sell protection in an attempt to gain exposure to the credit quality characteristics of particular bonds or market segments without investing directly in those bonds or market segments.

As the buyer of protection in a credit default swap, the Fund would pay a premium (by means of an upfront payment or a periodic stream of payments over the term of the agreement) in return for the right to deliver a referenced bond or group of bonds to the protection seller and receive the full notional or par value (or other agreed upon value) upon a default (or similar event) by the issuer(s) of the underlying referenced obligation(s). If no default occurs, the protection seller would keep the stream of payments and would have no further obligation to the Fund. Thus, the cost to the Fund would be the premium paid with respect to the agreement. If a credit event occurs, however, the Fund 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. The Fund bears the risk that the protection seller may fail to satisfy its payment obligations.

If the Fund is a seller of protection in a credit default swap and no credit event occurs, the Fund would generally receive an up-front payment or a periodic stream of payments over the term of the swap. If a credit event occurs, however, generally the Fund would have to 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 protection seller, the Fund effectively adds economic leverage to its portfolio because, in addition to being subject to investment exposure on its total net assets, the Fund is subject to investment exposure on the notional amount of the swap. See *Segregation of Assets* below. Thus, the Fund bears the same risk as it would by buying the reference obligations directly, plus the additional risks related to obtaining investment exposure through a derivative instrument discussed below under *Risks Associated with Swap Transactions*.

Swap Options. A swap option is a contract that gives a counterparty the right (but not the obligation), in return for payment of a premium, to enter into a new swap agreement or to shorten, extend, cancel, or otherwise modify an existing swap agreement at some designated future time on specified terms. A cash-settled option on a swap gives the purchaser the right, in return for the premium paid, to receive an amount of cash equal to the value of the underlying swap as of the exercise date. The Fund may write (sell) and purchase put and call swap options. Depending on the terms of the particular option agreement, the Fund generally would incur a greater degree of risk when it writes a swap option than when it purchases a swap option. When the Fund purchases a swap option, it risks losing only the amount of the premium it has paid should it decide to let the option expire unexercised. However, when the Fund writes a swap option, upon exercise of the option the Fund would become obligated according to the terms of the underlying agreement.

Risks Associated with Swap Transactions. The use of swap transactions is a highly specialized activity which involves strategies and risks different from those associated with ordinary portfolio security transactions. If the Investment Adviser and/or the Sub-Adviser is incorrect in its forecasts of default risks, market spreads or other applicable factors or events, the investment performance of the Fund would diminish compared with what it would have been if these techniques were not used. As the protection seller in a credit default swap, the Fund effectively adds economic leverage to its portfolio because, in addition to being subject to investment exposure on its total net assets, the Fund is subject to investment exposure on the notional amount of the swap. The Fund generally may only close out a swap, cap, floor, collar or other two-party contract with its particular counterparty, and generally may only transfer a position with the consent of that counterparty. In addition, the price at which the Fund may close out such a two-party contract may not correlate with the price change in the underlying reference asset. If the counterparty defaults, the Fund will have contractual remedies, but there can be no assurance that the counterparty will be able to meet its contractual obligations or that the Fund will succeed in enforcing its rights. It also is possible that developments in the derivatives market, including changes in government regulation, could adversely affect the Fund's ability to terminate existing swap or other agreements or to realize amounts to be received under such agreements.

Futures and Options on Futures Generally. A futures contract is an agreement between two parties to buy and sell a security, index or interest rate (each a financial instrument) for a set price on a future date. Certain futures contracts, such as futures contracts relating to individual securities, call for making or taking delivery of the underlying financial instrument. However, these contracts generally are closed out before delivery by entering into an offsetting purchase or sale of a matching futures contract (same exchange, underlying financial instrument, and delivery month). Other futures contracts, such as futures contracts on interest rates and indices, do not call for making or taking delivery of the underlying financial instrument, but rather are agreements pursuant to which two parties agree to take or make delivery of an amount of cash equal to the difference between the value of the financial instrument at the close of the last trading day of the contract and the price at which the contract was originally written. These contracts also may be settled by entering into an offsetting futures contract.

Unlike when the Fund purchases or sells a security, no price is paid or received by the Fund upon the purchase or sale of a futures contract. Initially, the Fund will be required to deposit with the futures broker, known as a futures commission merchant (FCM), an amount of cash or securities equal to a varying specified percentage of the contract amount. This amount is known as initial margin. The margin deposit is intended to ensure completion of the contract. Minimum initial margin

requirements are established by the futures exchanges and may be revised. In addition, FCMs may establish margin deposit requirements that are higher than the exchange minimums. Cash held in the margin account generally is not income producing. However, coupon-bearing securities, such as Treasury securities, held in margin accounts generally will earn income. Subsequent payments to and from the FCM, called variation margin, will be made on a daily basis as the price of the underlying financial instrument fluctuates, making the futures contract more or less valuable, a process known as marking the contract to market. Changes in variation margin are recorded by the Fund as unrealized gains or losses. At any time prior to expiration of the futures contract, the Fund may elect to close the position by taking an opposite position that will operate to terminate its position in the futures contract. A final determination of variation margin is then made, additional cash is required to be paid by or released to the Fund, and the Fund realizes a gain or loss. In the event of the bankruptcy or insolvency of an FCM that holds margin on behalf of the Fund, the Fund may be entitled to the return of margin owed to it only in proportion to the amount received by the FCM's other customers, potentially resulting in losses to the Fund. Futures transactions also involve brokerage costs and the Fund may have to segregate additional liquid assets in accordance with applicable SEC requirements. See Segregation of Assets below.

A futures option gives the purchaser of such option the right, in return for the premium paid, to assume a long position (call) or short position (put) in a futures contract at a specified exercise price at any time during the period of the option. Upon exercise of a call option, the purchaser acquires a long position in the futures contract and the writer is assigned the opposite short position. Upon the exercise of a put option, the opposite is true.

Bond Futures and Forward Contracts. Bond futures contracts are agreements in which one party agrees to deliver to the other an amount of cash equal to a specific dollar amount times the difference between the value of a specific bond at the close of the last trading day of the contract and the price at which the agreement is made. No physical delivery of securities is made. Forward contracts are agreements to purchase or sell a specified security or currency at a specified future date (or within a specified time period) and price set at the time of the contract. Forward contracts are usually entered into with banks, foreign exchange dealers or broker-dealers and are usually for less than one year, but may be renewed. Forward contracts are generally purchased or sold in OTC transactions.

Under regulations of the CFTC currently in effect, which may change from time to time with respect to futures contracts purchased by the Fund, the Fund will set aside in a segregated account liquid securities with a value at least equal to the value of instruments underlying such futures contracts less the amount of initial margin on deposit for such contracts. The current view of the staff of the SEC is that the Fund's long and short positions in futures contracts must be collateralized with cash or certain liquid assets held in a segregated account or covered in order to counter the impact of any potential leveraging.

Parties to a futures contract must make initial margin deposits to secure performance of the contract. There are also requirements to make variation margin deposits from time to time as the value of the futures contract fluctuates.

Index Futures. A tax-exempt bond index which assigns relative values to the tax-exempt bonds included in the index is traded on the Chicago Board of Trade. The index fluctuates with changes in the market values of all tax-exempt bonds included rather than a single bond. An index future is a bilateral agreement pursuant to which two parties agree to take or make delivery of an

amount of cash rather than any security equal to a specified dollar amount times the difference between the index value at the close of the last trading day of the contract and the price at which the index future was originally written. Thus, an index future is similar to traditional financial futures except that settlement is made in cash.

Index Options. The Fund may also purchase put or call options on U.S. government or tax-exempt bond index futures and enter into closing transactions with respect to such options to terminate an existing position. Options on index futures are similar to options on debt instruments except that an option on an index future gives the purchaser the right, in return for the premium paid, to assume a position in an index contract rather than an underlying security at a specified exercise price at any time during the period of the option. Upon exercise of the option, the delivery of the futures position by the writer of the option to the holder of the option will be accompanied by delivery of the accumulated balance of the writer's futures margin account which represents the amount by which the market price of the index futures contract, at exercise, is less than the exercise price of the option on the index future.

Bond index futures and options transactions would be subject to risks similar to transactions in financial futures and options thereon as described above.

Limitations on the Use of Futures, Options on Futures and Swaps. The Investment Adviser has claimed, with respect to the Fund, the exclusion from the definition of "commodity pool operator" under the Commodity Exchange Act of 1936, as amended (CEA), provided by CFTC Regulation 4.5 and is therefore not currently subject to registration or regulation as such under the CEA with respect to the Fund. In addition, the Sub-Adviser has claimed the exemption from registration as a commodity trading advisor provided by CFTC Regulation 4.14(a)(8) and is therefore not currently subject to registration or regulation as such under the CEA with respect to the Fund. In February 2012, the CFTC announced substantial amendments to certain exemptions, and to the conditions for reliance on those exemptions, from registration as a commodity pool operator. Under amendments to the exemption provided under CFTC Regulation 4.5, if the Fund uses futures, options on futures, or swaps other than for bona fide hedging purposes (as defined by the CFTC), the aggregate initial margin and premiums on these positions (after taking into account unrealized profits and unrealized losses on any such positions and excluding the amount by which options that are in-the-money at the time of purchase are in-the-money) may not exceed 5% of the Fund's net asset value, or alternatively, the aggregate net notional value of those positions may not exceed 100% of the Fund's net asset value (after taking into account unrealized profits and unrealized losses on any such positions). The CFTC amendments to Regulation 4.5 took effect on December 31, 2012, and the Fund intends to comply with amended Regulation 4.5's requirements such that the Investment Adviser will not be required to register as a commodity pool operator with the CFTC with respect to the Fund. The Fund reserves the right to employ futures, options on futures and swaps to the extent allowed by CFTC regulations in effect from time to time and in accordance with the Fund's policies. However, the requirements for qualification as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986, as amended (the Code), may limit the extent to which the Fund may employ futures, options on futures or swaps.

Structured Notes

The Fund may utilize structured notes and similar instruments for investment purposes and also for hedging purposes. Structured notes are privately negotiated debt obligations where the principal and/or interest is determined by reference to the performance of a benchmark asset, market or interest

rate (an embedded index), such as selected securities, an index of securities or specified interest rates, or the differential performance of two assets or markets. The terms of such structured instruments normally provide that their principal and/or interest payments are to be adjusted upwards or downwards (but not ordinarily below zero) to reflect changes in the embedded index while the structured instruments are outstanding. As a result, the interest and/or principal payments that may be made on a structured product may vary widely, depending upon a variety of factors, including the volatility of the embedded index and the effect of changes in the embedded index on principal and/or interest payments. The rate of return on structured notes may be determined by applying a multiplier to the performance or differential performance of the referenced index or indices or other assets. Application of a multiplier involves leverage that will serve to magnify the potential for gain and the risk of loss.

Inter-Fund Borrowing and Lending

The SEC has granted an exemptive order permitting the Nuveen registered open-end and closed-end funds, including the Fund, to participate in an inter-fund lending facility whereby those funds may directly lend to and borrow money from each other for temporary purposes (*e.g.*, to satisfy redemption requests or when a sale of securities fails, resulting in an unanticipated cash shortfall) (the Inter-Fund Program). The closed-end Nuveen funds will participate only as lenders, and not as borrowers, in the Inter-Fund Program because such closed-end funds rarely, if ever, need to borrow cash to meet redemptions. The Inter-Fund Program is subject to a number of conditions, including, among other things, the requirements that (1) no fund may borrow or lend money through the Inter-Fund Program unless it receives a more favorable interest rate than is typically available from a bank or other financial institution for a comparable transaction; (2) no fund may borrow on an unsecured basis through the Inter-Fund Program unless the fund's outstanding borrowings from all sources immediately after the inter-fund borrowing total 10% or less of its total assets; provided that if the borrowing fund has a secured borrowing outstanding from any other lender, including but not limited to another fund, the inter-fund loan must be secured on at least an equal priority basis with at least an equivalent percentage of collateral to loan value; (3) if a fund's total outstanding borrowings immediately after an inter-fund borrowing would be greater than 10% of its total assets, the fund may borrow through the inter-fund loan on a secured basis only; (4) no fund may lend money if the loan would cause its aggregate outstanding loans through the Inter-Fund Program to exceed 15% of its net assets at the time of the loan; (5) a fund's inter-fund loans to any one fund shall not exceed 5% of the lending fund's net assets; (6) the duration of inter-fund loans will be limited to the time required to receive payment for securities sold, but in no event more than seven days; and (7) each inter-fund loan may be called on one business days' notice by a lending fund and may be repaid on any day by a borrowing fund. In addition, a Nuveen fund may participate in the Inter-Fund Program only if and to the extent that such participation is consistent with the fund's investment objective and investment policies. The Board of Trustees of the Nuveen Funds is responsible for overseeing the Inter-Fund Program. The limitations detailed above and the other conditions of the SEC exemptive order permitting the Inter-Fund Program