

BLACKROCK MUNIYIELD MICHIGAN QUALITY FUND, INC.

Form 497

June 18, 2015

Table of Contents

**BLACKROCK MUNIYIELD MICHIGAN QUALITY FUND, INC.**

**BLACKROCK MUNIYIELD MICHIGAN QUALITY FUND II, INC.**

**100 Bellevue Parkway**

**Wilmington, Delaware 19809**

**(800) 882-0052**

June 16, 2015

Dear Common Shareholder:

You are cordially invited to attend a joint special shareholder meeting (the *Special Meeting*) of BlackRock MuniYield Michigan Quality Fund II, Inc. ( *MYM* or the *Target Fund* ) and BlackRock MuniYield Michigan Quality Fund, Inc. ( *MIY* or the *Acquiring Fund* and together with the *Target Fund*, the *Funds* ), to be held at the offices of BlackRock Advisors, LLC, 1 University Square Drive, Princeton, New Jersey 08540-6455, on August 6, 2015 at 4:00 p.m. (Eastern time). Before the *Special Meeting*, I would like to provide you with additional background information and ask for your vote on important proposals affecting the *Funds*.

*Common Shareholders of MYM:* You and the preferred shareholders of MYM are being asked to vote as a single class on a proposal to approve the reorganization of MYM into MIY (the *Reorganization* ). Preferred shareholders of MYM are also being asked to vote as a separate class on a proposal to approve the *Reorganization*. The *Funds* have substantially identical investment objectives, investment policies and investment restrictions.

*Common Shareholders of MIY:* You and the preferred shareholders of the MIY are being asked to vote as a single class on a proposal to approve the issuance of additional common shares of MIY in connection with the *Reorganization*. Preferred shareholders of MIY are also being asked to vote as a separate class on a proposal to approve the *Reorganization*.

The enclosed Joint Proxy Statement/Prospectus is only being delivered to the *Funds* common shareholders. The preferred shareholders of each Fund are also being asked to attend the *Special Meeting* and to vote as a separate class with respect to the proposals describe above. Each Fund is delivering to its preferred shareholders a separate Joint Proxy Statement with respect to the proposals described above.

The Board of Directors of each Fund believes the proposal that the common shareholders of its Fund are being asked to vote upon is in the best interests of its respective Fund and its shareholders and unanimously recommends that you vote **FOR** such proposal.

The enclosed materials explain these proposals in more detail, and I encourage you to review them carefully. As a shareholder, your vote is important, and we hope that you will respond today to ensure that your shares will be represented at the *Special Meeting*. You may vote using one of the methods below by following the instructions on your proxy card:

By touch-tone telephone;

By internet;

By returning the enclosed proxy card in the postage-paid envelope; or

## Edgar Filing: BLACKROCK MUNIYIELD MICHIGAN QUALITY FUND, INC. - Form 497

In person at the Special Meeting.

If you do not vote using one of these methods described above, you may be contacted by Georgeson Inc., our proxy solicitor, to vote your shares over the telephone.

As always, we appreciate your support.

Sincerely,

JOHN M. PERLOWSKI

President and Chief Executive Officer of the Funds

**Table of Contents**

**Please vote now. Your vote is important.**

To avoid the wasteful and unnecessary expense of further solicitation(s), we urge you to indicate your voting instructions on the enclosed proxy card, date and sign it and return it promptly in the postage-paid envelope provided, or record your voting instructions by telephone or via the internet, no matter how large or small your holdings may be. If you submit a properly executed proxy but do not indicate how you wish your common shares to be voted, your common shares will be voted **FOR** the proposal, as applicable. If your common shares are held through a broker, you must provide voting instructions to your broker about how to vote your common shares in order for your broker to vote your common shares as you instruct at the Special Meeting.

**Table of Contents**

June 16, 2015

**IMPORTANT NOTICE**  
**TO COMMON SHAREHOLDERS OF**  
**BLACKROCK MUNIYIELD MICHIGAN QUALITY FUND, INC.**  
**BLACKROCK MUNIYIELD MICHIGAN QUALITY FUND II, INC.**

**QUESTIONS & ANSWERS**

Although we urge you to read the entire Joint Proxy Statement/Prospectus, we have provided for your convenience a brief overview of some of the important questions concerning the meeting and the proposals to be voted on. The enclosed Joint Proxy Statement/Prospectus is being sent only to the holders of shares of common stock ( Common Shares ) of BlackRock MuniYield Michigan Quality Fund II, Inc. ( MYM or the Target Fund ) and BlackRock MuniYield Michigan Quality Fund, Inc. ( MIY or the Acquiring Fund, and together with the Target Fund, the Funds and each, a Fund ). Each Fund is separately soliciting the votes of its holders of Variable Rate Demand Preferred Shares ( VRDP Shares ) through a separate Joint Proxy Statement.

**Q: Why is a shareholder meeting being held?**

A: *Common Shareholders of BlackRock MuniYield Michigan Quality Fund II, Inc. (NYSE Ticker: MYM):* You and the holders of the VRDP Shares ( VRDP Holders ) of MYM are being asked to vote as a single class on a proposal to approve the Agreement and Plan of Reorganization (the Reorganization Agreement ) between MYM and MIY, pursuant to which (i) MIY will acquire substantially all of MYM's assets and assume substantially all of MYM's liabilities in exchange solely for newly issued Common Shares and VRDP Shares of the MIY, which will be distributed to the common shareholders (although cash may be distributed in lieu of fractional Common Shares) and VRDP Holders, respectively, of MYM, and (ii) MYM will terminate its registration under the Investment Company Act of 1940, as amended (the 1940 Act ), and liquidate, dissolve and terminate in accordance with its charter and Maryland law.

MYM VRDP Holders are also being asked to vote as a separate class on a proposal to approve the Reorganization Agreement and the transactions contemplated therein, including the termination of MYM's registration under the 1940 Act and the dissolution of MYM under Maryland law, through a separate Joint Proxy Statement.

*Common Shareholders of BlackRock MuniYield Michigan Quality Fund, Inc. (NYSE Ticker: MIY):* You and the MIY VRDP Holders are being asked to vote as a single class on a proposal to approve the issuance of additional Common Shares of the MIY in connection with the Reorganization Agreement (the Issuance ).

MIY VRDP Holders are also being asked to vote as a separate class on a proposal to approve the Reorganization Agreement and the transactions contemplated therein, including the issuance of additional MIY VRDP Shares, through a separate Joint Proxy Statement.

The transactions contemplated by the Reorganization Agreement, including the Issuance, are referred to herein as the Reorganization . The term Combined Fund refers to MIY as the surviving Fund after the consummation of the Reorganization.

**Q: Why has each Fund's Board recommended these proposals?**

A: The Board of Directors (each, a Board and each member thereof, a Board Member ) of each Fund has determined that the proposed Reorganization would be in the best interests of its Fund. The proposed Reorganization seeks to achieve certain economies of scale and other operational efficiencies by combining two Funds that have substantially identical investment objectives, investment policies, investment restrictions and portfolio compositions and are managed by the same investment advisor, BlackRock Advisors, LLC (the

Investment Advisor ), and portfolio management team.

## **Table of Contents**

In light of these similarities, the proposed Reorganization is intended to reduce fund redundancies and create a single, larger state fund that may benefit from anticipated operating efficiencies and economies of scale. The proposed Reorganization is intended to result in the following potential benefits to common shareholders:

- (i) lower total expenses per Common Share for common shareholders of each Fund (as common shareholders of the Combined Fund following the Reorganization) due to economies of scale resulting from the larger size of the Combined Fund;
- (ii) improved earnings yield on net asset value ( NAV ) for common shareholders of the Target Fund and a comparable (i.e., the same or slightly lower or higher) earnings yield on NAV for common shareholders of the Acquiring Fund;
- (iii) improved secondary market trading of the Common Shares of the Combined Fund; and
- (iv) operating and administrative efficiencies for the Combined Fund, including the potential for the following:
  - (a) greater investment flexibility and investment options;
  - (b) greater diversification of portfolio investments;
  - (c) the ability to trade in larger positions and more favorable transaction terms;
  - (d) benefits from having fewer closed-end funds offering similar products in the market, including an increased focus by investors on the remaining funds in the market (including the Combined Fund) and additional research coverage; and
  - (e) benefits from having fewer similar funds in the same fund complex, including a simplified operational model and a reduction in risk of operational, legal and financial errors.

The Board of each Fund, including Board Members thereof who are not interested persons (as defined in the 1940 Act), approved the Reorganization Agreement and the Issuance, as applicable, concluding that the Reorganization is in the best interests of its Fund and that the interests of existing common shareholders and preferred shareholders of its Fund will not be diluted with respect to NAV and liquidation preference, respectively, as a result of the Reorganization. As a result of the Reorganization, however, common and preferred shareholders of each Fund will hold a reduced percentage of ownership in the larger Combined Fund than they did in any of the individual Funds before the Reorganization. The Board's conclusion was based on each Board Member's business judgment after consideration of all relevant factors taken as a whole with respect to its Fund and the Fund's common and preferred shareholders, although individual Board Members may have placed different weight on various factors and assigned different degrees of materiality to various factors.

### **Q: How will the Reorganization affect the fees and expenses of the Funds?**

A: For the fiscal year ended July 31, 2014, the Total Expense Ratios of the Target Fund and the Acquiring Fund were 1.55% and 1.54%, respectively. For the 12-month period ended January 31, 2015, the Total Expense Ratios of the Target Fund and the Acquiring Fund were 1.48% and 1.48%, respectively. Total Expenses means a Fund's total annual operating expenses (including interest expenses and applicable fee waivers). Total Expense Ratio means a Fund's Total Expenses expressed as a percentage of its average net assets attributable to its

## Edgar Filing: BLACKROCK MUNIYIELD MICHIGAN QUALITY FUND, INC. - Form 497

Common Shares. The Funds estimate that the completion of the Reorganization would result in a Total Expense Ratio for the Combined Fund of 1.43% on a historical and pro forma basis for the 12-month period ended January 31, 2015, representing a reduction in the Total Expense Ratio for the common shareholders of the Target Fund and the Acquiring Fund of 0.05% and 0.05%, respectively. The Funds' VRDP Shares have the same mechanism for determining the applicable dividend rate and maximum rate, and the same liquidity provider, remarketing agent and tender and paying agent. Each Fund's VRDP Shares are currently in a three year special rate period that will end on June 24, 2015. The

## **Table of Contents**

special rate period is expected to be extended to June 22, 2016. During the special rate period, the Funds' VRDP Shares have the same mechanism for determining the applicable dividend rate and maximum rate, redemption premiums and transfer restrictions. For the fiscal year ended July 31, 2014, the annualized dividend rate for the VRDP Shares of the Target Fund and the Acquiring Fund were 1.01% and 1.01%, respectively. As of May 31, 2015, the dividend rate for the VRDP Shares of the Target Fund and the Acquiring Fund were 1.05% and 1.05%, respectively. Please see "Information about the VRDP Shares of the Funds" for additional information.

The Combined Fund will have a lower annual contractual investment management fee rate than each Fund. Each Fund currently pays the Investment Advisor a monthly fee at an annual contractual management fee rate of 0.50% of its average daily net assets (0.79% of the average daily net assets attributable to the Target Fund's Common Shares, and 0.80% of the average daily net assets attributable to the Acquiring Fund's Common Shares, each for the 12-month period ended January 31, 2015). Average daily net assets are the average daily value of a Fund's total assets minus its total accrued liabilities (which does not include liabilities represented by tender option bond (TOB) leverage and the liquidation preference of the VRDP shares).

If the Reorganization is consummated, the annual contractual investment management fee rate of the Combined Fund will be 0.49% of the average daily net assets of the Combined Fund (0.78% of the average daily net assets attributable to the Combined Fund's Common Shares on a historical and pro forma basis for the 12-month period ended January 31, 2015).

Based on a pro-forma Lipper peer expense group for the Combined Fund, the estimated total annual fund expense ratio (excluding investment-related expenses) and contractual management fee rate are each expected to be in the second and first quartile, respectively. There can be no assurance that future expenses will not increase or that any expense savings for any Fund will be realized as a result of the Reorganization.

### **Q: How will the Reorganization affect the earnings, distributions and undistributed net income of the Funds?**

A: The Combined Fund's earnings yield on NAV following the Reorganization is expected to be comparable (i.e., the same or slightly lower or higher) to the Acquiring Fund's current earnings yield on NAV and potentially higher than the Target Fund's current earnings yield on NAV; thus, assuming that the Reorganization is consummated and that the Acquiring Fund's distribution policy remains in place after the Reorganization, common shareholders of the Acquiring Fund may experience a distribution rate on NAV comparable (i.e., the same or slightly lower or higher) to their current distribution rate on NAV and common shareholders of the Target Fund may experience a distribution rate on NAV that is potentially higher than their current distribution rate on NAV. The Combined Fund's earnings and distribution rate on NAV will change over time, and depending on market conditions, may be higher or lower than each Fund's earnings and distribution rate on NAV prior to the Reorganization. A Fund's earnings and net investment income are variables which depend on many factors, including its asset mix, portfolio turnover level, the amount of leverage utilized by the Fund, the costs of such leverage, the performance of its investments, the movement of interest rates and general market conditions.

If the Reorganization is approved by shareholders, then substantially all of the undistributed net investment income, if any, of each Fund is expected to be declared to such Fund's common shareholders prior to the effective date of the Reorganization (the "Closing Date") (the "Pre-Reorganization Declared UNII Distributions"). The declaration date, ex-dividend date (the "Ex-Dividend Date") and record date of the Pre-Reorganization Declared UNII Distributions will occur prior to the Closing Date. However, all or a significant portion of the Pre-Reorganization Declared UNII Distributions may be paid in one or more distributions to common shareholders of the Funds entitled to such Pre-Reorganization Declared UNII Distributions after the Closing Date. Former Target Fund shareholders entitled to such Pre-Reorganization Declared UNII Distributions paid after the Closing Date will receive such distributions in cash.



**Table of Contents**

BlackRock MuniYield Michigan Quality Fund, Inc. (MIY), as the Combined Fund following the Reorganization, does not currently expect to declare any distributions during the first month following the Closing Date. Accordingly, persons who purchase Common Shares of any of the Funds on or after the Ex-Dividend Date for the Pre-Reorganization Declared UNII Distributions should not expect to receive any distributions from any Fund until distributions, if any, are declared by the Board of the Combined Fund and paid to shareholders entitled to any such distributions. No such distributions are expected to be paid by the Combined Fund until at least approximately two months following the Closing Date.

The Combined Fund's earnings and distribution rate on NAV will change over time, and depending on market conditions, may be higher or lower than each Fund's earnings and distribution rate on NAV prior to the Reorganization. The Combined Fund is anticipated to retain a lower UNII balance after the Reorganization than the Acquiring Fund prior to the Reorganization; however, the Combined Fund is anticipated to benefit from a lower expense ratio and other benefits of economies of scale as discussed herein. Each Fund reserves the right to change its distribution policy with respect to common share distributions and the basis for establishing the rate of its distributions for the Common Shares at any time and may do so without prior notice to common shareholders. The payment of any distributions by any Fund is subject to, and will only be made when, as and if, declared by the Board of such Fund. There is no assurance the Board of any Fund will declare any distributions for such Fund.

To the extent any Pre-Reorganization Declared UNII Distributions is not an exempt interest dividend (as defined in the Internal Revenue Code of 1986, as amended (the "Code")), the distribution may be taxable to shareholders for U.S. Federal income tax purposes.

**Q: Have Common Shares of each Fund historically traded at a premium or discount?**

A: The Common Shares of each Fund have historically traded at both a premium and a discount. The table below sets forth the market price, NAV, and the premium/discount to NAV of each Fund as of June 5, 2015.

Fund	Market Price	NAV	Premium/(Discount) to NAV
Target Fund (MYM)	\$12.50	\$14.34	(12.83)%
Acquiring Fund (MIY)	\$13.44	\$15.34	(12.39)%

To the extent the Target Fund Common Shares are trading at a wider discount (or a narrower premium) than the Acquiring Fund at the time of the Reorganization, the Target Fund's common shareholders would have the potential for an economic benefit by the narrowing of the discount or widening of the premium. To the extent the Target Fund Common Shares are trading at a narrower discount (or wider premium) than the Acquiring Fund at the time of the Reorganization, Target Fund common shareholders may be negatively impacted if the Reorganization is consummated. Acquiring Fund common shareholders would only benefit from a premium/discount perspective to the extent the Acquiring Fund's post-Reorganization discount (or premium) improves. There can be no assurance that, after the Reorganization, Common Shares of the Combined Fund will trade at a narrower discount to NAV or wider premium to NAV than the Common Shares of any individual Fund prior to the Reorganization.

In the Reorganization, common shareholders of the Target Fund will receive Acquiring Fund Common Shares based on the relative NAVs (not the market values) of the respective Fund's Common Shares. The market value of the Common Shares of the Combined Fund may be less than the market value of the Common Shares of each respective Fund prior to the Reorganization.

**Q: How will holders of VRDP Shares be affected by the Reorganization?**

A: As of the date of the enclosed Joint Proxy Statement/Prospectus, each Fund has VRDP Shares outstanding. As of May 31, 2015, the Target Fund has 873 Series W-7 VRDP Shares outstanding, and the Acquiring Fund has 1,446 Series W-7 VRDP Shares outstanding. In connection with the Reorganization, the Acquiring Fund expects to issue 873 additional VRDP Shares to Target Fund VRDP Holders. Following the completion of the Reorganization, the Combined Fund is expected to have 2,319 VRDP Shares outstanding.



## **Table of Contents**

Upon the Closing Date, Target Fund VRDP Holders will receive on a one-for-one basis one newly issued Acquiring Fund VRDP Share, par value \$0.10 per share and with a liquidation preference of \$100,000 per share (plus any accumulated and unpaid dividends that have accrued on such Target Fund VRDP Share up to and including the day immediately preceding the effective date of the Reorganization if such dividends have not been paid prior to such effective date), in exchange for each Target Fund VRDP Share held by such Target Fund VRDP Holder immediately prior to the Closing Date. The newly issued Acquiring Fund VRDP Share may be of the same series as the Acquiring Fund's Series W-7 VRDP Shares or a substantially identical series. No fractional Acquiring Fund VRDP Shares will be issued. Target Fund VRDP Holders will receive the same number of Acquiring Fund VRDP Shares, with terms substantially similar to the terms of the outstanding Target Fund VRDP Shares, held by such holders immediately prior to the Closing Date, with the only significant difference being that the Target Fund VRDP Shares have a mandatory redemption date of June 1, 2041 and the newly issued Acquiring Fund VRDP Shares are expected to have a mandatory redemption date of May 1, 2041.

The Acquiring Fund VRDP Shares to be issued in connection with the Reorganization will have terms that are substantially identical to the terms of the Acquiring Fund's outstanding VRDP Shares and will rank on a parity with the Acquiring Fund's existing VRDP Shares as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of the affairs of the Acquiring Fund. The Reorganization will not result in any changes to the terms of the Acquiring Fund's VRDP Shares currently outstanding.

The terms of the outstanding Target Fund VRDP Shares are substantially similar to the terms of the outstanding Acquiring Fund VRDP Shares. The only significant difference between the terms of the two Funds' VRDP Shares is that the Target Fund VRDP Shares have a mandatory redemption date of June 1, 2041 and the Acquiring Fund VRDP Shares have a mandatory redemption date of May 1, 2041. The Funds' VRDP Shares have the same \$100,000 liquidation preference per share, dividend period, dividend payment date, voting rights, redemption provisions, remarketing procedures, mandatory purchase events, mandatory tender events, transfer restrictions and covenants with respect to effective leverage, asset coverage and eligible investments. The Funds' VRDP Shares also have the same mechanism for determining the applicable dividend rate and maximum rate, and the same liquidity provider, remarketing agent and tender and paying agent. Each Fund's VRDP Shares are currently in a three year special rate period that will end on June 24, 2015. The special rate period is expected to be extended to June 22, 2016. The terms applicable to each Fund's VRDP Shares during the special rate period are substantially identical. During the special rate period, the Funds' VRDP Shares have the same mechanism for determining the applicable dividend rate and maximum rate, redemption premiums and transfer restrictions.

None of the expenses of the Reorganization are expected to be borne by the VRDP Holders of the Funds.

Following the Reorganization, the VRDP Holders of each Fund will be VRDP Holders of the larger Combined Fund that will have a larger asset base and more VRDP Shares outstanding than either Fund individually. With respect to matters requiring all preferred shareholders to vote separately or common and preferred shareholders to vote together as a single class, following the Reorganization, holders of VRDP Shares of the Combined Fund will hold a smaller percentage of the outstanding preferred shares of the Combined Fund as compared to their percentage holdings of outstanding preferred shares of their respective Fund prior to the Reorganization.

### **Q: How similar are the Funds?**

A: The Funds have the same investment advisor, portfolio managers, officers and directors. Each Fund is organized as a Maryland corporation with its Common Shares listed on the New York Stock Exchange and privately placed VRDP Shares outstanding. Each Fund is managed by a team of investment professionals comprised of Michael Kalinoski, Theodore R. Jaeckel, Jr. and Walter O. Connor.

The investment objective, significant investment strategies and operating policies, and investment restrictions of the Combined Fund will be those of the Acquiring Fund, which are substantially identical to those of the Target Fund.

## **Table of Contents**

### *Investment Objectives:*

Each Fund's investment objective is to provide shareholders with as high a level of current income exempt from federal and Michigan income taxes as is consistent with its investment policies and prudent investment management.

### *Michigan Municipal Bonds:*

Each Fund seeks to achieve its investment objective by investing at least 80% of an aggregate of its net assets (including proceeds from the issuance of any preferred shares) and the proceeds of any borrowings for investment purposes, in a portfolio of municipal obligations issued by or on behalf of the State of Michigan, its political subdivisions, agencies and instrumentalities and by other qualifying issuers, each of which pays interest that, in the opinion of bond counsel to the issuer, is excludable from gross income for U.S. federal income tax purposes (except that the interest may be includable in taxable income for purposes of the Federal alternative minimum tax) and exempt from Michigan income taxes.

### *Investment Grade Securities:*

Each Fund currently invests primarily in investment grade municipal bonds.

### *Leverage:*

Each Fund utilizes leverage in the form of VRDP Shares and tender option bonds.

Please see below a comparison of certain important ratios related to (i) each Fund's use of leverage as of May 31, 2015 and (ii) the Combined Fund's use of leverage, assuming the Reorganization had taken place as of May 31, 2015:

<b>Ratios</b>	<b>Target Fund (MYM)</b>	<b>Acquiring Fund (MIY)</b>	<b>Pro Forma Combined Fund (MIY)</b>
Asset Coverage Ratio	300%	295%	297%
Regulatory Leverage Ratio <sup>(1)</sup>	33%	34%	34%
Effective Leverage Ratio <sup>(2)</sup>	37%	37%	37%

(1) Regulatory leverage consists of VRDP Shares issued by the Fund, which is a part of a Fund's capital structure. Regulatory leverage is sometimes referred to as 1940 Act Leverage and is subject to asset coverage limits set forth in the 1940 Act.

(2) Effective leverage is a Fund's effective economic leverage, and includes both regulatory leverage and the leverage effects of certain derivative investments in the Fund's portfolio. Currently, the leverage effects of Tender Option Bond (TOB) inverse floater holdings, in addition to any regulatory leverage, are included in effective leverage ratios.

It is not anticipated that there will be any significant disposition of the holdings in any Fund as a result of the Reorganization because of the similarities among the portfolio guidelines of the Funds. The risk/return profile of the Combined Fund is expected to remain comparable to those of each Fund before the Reorganization because of the similarities in the investment policies of each Fund.

### **Q: How will the Reorganization be effected?**

## Edgar Filing: BLACKROCK MUNIYIELD MICHIGAN QUALITY FUND, INC. - Form 497

- A: Assuming the Reorganization receives the requisite shareholder approvals, as well as certain consents, confirmations and/or waivers from various third parties, including the liquidity provider with respect to the outstanding VRDP Shares, the Acquiring Fund will acquire substantially all of the Target Fund's assets and assume substantially all of the Target Fund's liabilities in exchange solely for newly issued Common Shares and VRDP Shares of the Acquiring Fund, which will be distributed to the shareholders of the Target Fund (although cash may be distributed in lieu of fractional Common Shares). The Target Fund will then terminate its registration under the 1940 Act and liquidate, dissolve and terminate in accordance with its charter and Maryland law.

## **Table of Contents**

Shareholders of the Target Fund will become shareholders of the Acquiring Fund. Common shareholders of the Target Fund will receive newly issued Common Shares of the Acquiring Fund, par value \$0.10 per share, the aggregate NAV (not the market value) of which will equal the aggregate NAV (not the market value) of the Common Shares of the Target Fund such shareholders held immediately prior to the Closing Date (although common shareholders may receive cash for fractional Common Shares). The NAV of the Target Fund and the Acquiring Fund immediately prior to the Closing Date will be reduced by the costs of the Reorganization borne by each Fund, if any. The NAV of Target Fund Common Shares will not be diluted as a result of the Reorganization. The common shareholders of each Fund have substantially similar voting rights and rights with respect to the payment of dividends and distribution of assets upon liquidation of their respective Fund and have no preemptive, conversion or exchange rights.

Target Fund VRDP Holders will receive on a one-for-one basis one newly issued Acquiring Fund VRDP Share, par value \$0.10 per share and with a liquidation preference of \$100,000 per share (plus any accumulated and unpaid dividends that have accrued on such Target Fund VRDP Share up to and including the day immediately preceding the effective date of the Reorganization if such dividends have not been paid prior to the Closing Date), in exchange for each Target Fund VRDP Share held by such Target Fund VRDP Holder immediately prior to the Closing Date. The newly issued Acquiring Fund VRDP Share may be of the same series as the Acquiring Fund's Series W-7 VRDP Shares or a substantially identical series. No fractional Acquiring Fund VRDP Shares will be issued. Target Fund VRDP Holders will receive the same number of Acquiring Fund VRDP Shares, with terms substantially similar to the terms of the outstanding Target Fund VRDP Shares, held by such holders immediately prior to the Closing Date, with the only significant difference being that the Target Fund VRDP Shares have a mandatory redemption date of June 1, 2041 and the newly issued Acquiring Fund VRDP Shares are expected to have a mandatory redemption date of May 1, 2041.

Shareholders of the Acquiring Fund will remain shareholders of the Acquiring Fund, which will have additional Common Shares and VRDP Shares outstanding after the Reorganization.

### **Q: Will I have to pay any U.S. federal income taxes as a result of the Reorganization?**

A: The Reorganization is intended to qualify as a reorganization within the meaning of Section 368(a) of the Code. If the Reorganization so qualifies, in general, shareholders of the Target Fund will recognize no gain or loss for U.S. federal income tax purposes upon the exchange of their Target Fund Shares for Acquiring Fund shares pursuant to the Reorganization (except with respect to cash received in lieu of fractional Common Shares). Additionally, the Target Fund will recognize no gain or loss for U.S. federal income tax purposes by reason of the Reorganization. Neither the Acquiring Fund nor its shareholders will recognize any gain or loss for U.S. federal income tax purposes pursuant to the Reorganization.

Shareholders of each Fund may receive distributions prior to, or after, the consummation of the Reorganization, including distributions attributable to their proportionate share of each Fund's undistributed net investment income declared prior to the consummation of the Reorganization or the Combined Fund built-in gains, if any, recognized after the Reorganization, when such income and gains are eventually distributed by the Combined Fund. To the extent that such a distribution is not an exempt interest dividend (as defined in the Code), the distribution may be taxable to shareholders for U.S. federal income tax purposes.

The Funds' shareholders should consult their own tax advisers regarding the U.S. federal income tax consequences of the Reorganization, as well as the effects of state, local and non-U.S. tax laws, including possible changes in tax laws.

### **Q: Will I have to pay any sales load, commission or other similar fees in connection with the Reorganization?**

A: You will pay no sales loads or commissions in connection with the Reorganization. Regardless of whether the Reorganization is completed, however, the costs associated with the proposed Reorganization, including

## **Table of Contents**

the costs associated with the shareholder meeting, will be borne directly by each of the respective Funds incurring the expense or will otherwise be allocated among the Funds proportionately or on another reasonable basis as discussed more fully in the Joint Proxy Statement/Prospectus.

Common shareholders of the Funds will indirectly bear the costs of the Reorganization. The expenses of the Reorganization are estimated to be \$331,000 for the Target Fund and \$351,000 for the Acquiring Fund. Because of the expected expense savings and other benefits for each Fund, the Investment Advisor recommended and the Board of each Fund has approved that its respective Fund be responsible for a portion of its own Reorganization expenses. The Investment Advisor will bear approximately \$115,000 of the Target Fund's Reorganization expenses and approximately \$120,000 of the Acquiring Fund's reorganization expenses. The actual costs associated with the proposed Reorganization may be more or less than the estimated costs discussed herein.

VRDP Holders are not expected to bear any costs of the Reorganization.

Neither the Funds nor the Investment Advisor will pay any expenses of shareholders arising out of or in connection with the Reorganization (e.g., expenses incurred by the shareholder as a result of attending the shareholder meeting, voting on the Reorganization or other action taken by the shareholder in connection with the Reorganization).

### **Q: What shareholder approvals are required to complete the Reorganization?**

A: The Reorganization is contingent upon the following approvals:

1. The approval of the Reorganization Agreement and the transactions contemplated therein, including the termination of the Target Fund's registration under the 1940 Act and the dissolution of the Target Fund under Maryland law, by the Target Fund's common shareholders and VRDP Holders voting as a single class;
2. The approval of the Reorganization Agreement and the transactions contemplated therein, including the termination of the Target Fund's registration under the 1940 Act and the dissolution of the Target Fund under Maryland law, by Target Fund VRDP Holders voting as a separate class;
3. The approval of the Reorganization Agreement and the transactions contemplated therein, including the issuance of additional Acquiring Fund VRDP Shares, by Acquiring Fund VRDP Holders voting as a separate class; and

4. The approval of the Issuance by the Acquiring Fund's common shareholders and VRDP Holders voting as a single class.

If the requisite shareholder approvals are not obtained, each Fund's Board may take such actions as it deems in the best interests of its Fund, including conducting additional solicitations with respect to the proposals or continuing to operate the Fund as a stand-alone Maryland corporation registered under the 1940 Act as a non-diversified closed-end investment management company advised by the Investment Advisor. The Investment Advisor may, in connection with the ongoing management of each Fund and its product line, recommend alternative proposals to the Board of each Fund.

In order for the Reorganization to occur, each Fund must obtain all requisite shareholder approvals with respect to the Reorganization, as well as certain consents, confirmations and/or waivers from various third parties, including the liquidity provider with respect to the outstanding VRDP Shares. Because the closing of the Reorganization is contingent upon the Target Fund and the Acquiring Fund obtaining the requisite shareholder approvals and third party consents and satisfying (or obtaining the waiver of) other closing conditions, it is possible that the Reorganization will not occur, even if shareholders of either Fund entitled to vote on the Reorganization approve the Reorganization and such Fund satisfies all of its closing conditions, if the other Fund does not obtain its requisite shareholder approvals or satisfy its closing conditions.

## **Table of Contents**

The VRDP Shares were issued on a private placement basis to one or a small number of institutional holders. Please see Shareholder Information for additional information. To the extent that one or more VRDP Holder of either the Target Fund or the Acquiring Fund owns, holds or controls, individually or in the aggregate, all or a significant portion of such Fund's outstanding VRDP Shares, the VRDP shareholder approval required for the Reorganization may turn on the exercise of voting rights by such particular VRDP Holder(s) and its (or their) determination as to the favorability of the proposal with respect to its (or their) interests. The Funds exercise no influence or control over the determinations of such VRDP Holder(s) with respect to the proposal; there is no guarantee that such VRDP Holder(s) will approve the proposal, over which it (or they) may exercise effective disposition power.

**Q: Why is the vote of shareholders of the Acquiring Fund being solicited in connection with the Reorganization?**

A: The rules of the New York Stock Exchange (on which the Acquiring Fund Common Shares are listed) require the Acquiring Fund's shareholders to approve the Issuance. If the Issuance is not approved, then the Reorganization will not occur.

We are also seeking the approval of the Reorganization Agreement and the transactions contemplated therein, including the issuance of additional Acquiring Fund VRDP Shares, by the Acquiring Fund VRDP Holders voting as a separate class pursuant to the governing document of the Acquiring Fund VRDP Shares. If Acquiring Fund VRDP Holders do not approve the Reorganization Agreement as a separate class, then the Reorganization will not occur.

**Q: How does the Board of my Fund suggest that I vote?**

A: After careful consideration, the Board of your Fund unanimously recommends that you vote **FOR** each of the items proposed for your Fund.

**Q: How do I vote my proxy?**

A: You may cast your vote by mail, phone, internet or in person at the Special Meeting. To vote by mail, please mark your vote on the enclosed proxy card and sign, date and return the card in the postage-paid envelope provided. If you choose to vote by phone or internet, please refer to the instructions found on the proxy card accompanying the Joint Proxy Statement/Prospectus. To vote by phone or internet, you will need the control number that appears on the proxy card.

**Q: Whom do I contact for further information?**

A: You may contact your financial advisor for further information. You may also call Georgeson Inc., the Funds' proxy solicitor, at 1-888-654-1722.



**Table of Contents**

**BLACKROCK MUNIYIELD MICHIGAN QUALITY FUND, INC.**

**BLACKROCK MUNIYIELD MICHIGAN QUALITY FUND II, INC.**

**100 Bellevue Parkway**

**Wilmington, Delaware 19809**

**(800) 882-0052**

**NOTICE OF JOINT SPECIAL MEETING OF SHAREHOLDERS**

**TO BE HELD ON AUGUST 6, 2015**

Notice is hereby given that a joint special meeting of shareholders (the *Special Meeting*) of BlackRock MuniYield Michigan Quality Fund II, Inc. (NYSE Ticker: MYM) ( *MYM* or the *Target Fund* ) and BlackRock MuniYield Michigan Quality Fund, Inc. (NYSE Ticker: MIY) ( *MIY* or the *Acquiring Fund*, and together with the Target Fund, each, a *Fund* ) will be held at the offices of BlackRock Advisors, LLC, 1 University Square Drive, Princeton, New Jersey 08540-6455, on August 6, 2015 at 4:00 p.m. (Eastern time) for the following purposes:

**Proposal 1: The Reorganization of the Funds**

*For Shareholders of the Target Fund:*

*Proposal 1(A):* The holders of shares of common stock ( *Common Shares* ) and holders of Variable Rate Demand Preferred Shares ( *VRDP Shares* ) of the Target Fund are being asked to vote as a single class on a proposal to approve an Agreement and Plan of Reorganization between the Target Fund and the Acquiring Fund (the *Reorganization Agreement* ), pursuant to which (i) the Acquiring Fund will acquire substantially all of the Target Fund's assets and assume substantially all of the Target Fund's liabilities in exchange solely for newly issued Common Shares and VRDP Shares of the Acquiring Fund, which will be distributed to the common shareholders and holders of VRDP Shares ( *VRDP Holders* ), respectively, of the Target Fund (although cash may be distributed in lieu of fractional Common Shares), and (ii) the Target Fund will terminate its registration under the Investment Company Act of 1940, as amended (the *1940 Act* ), as amended, and liquidate, dissolve and terminate in accordance with its charter and Maryland law.

*Proposal 1(B):* The VRDP Holders of the Target Fund are being asked to vote as a separate class on a proposal to approve the Reorganization Agreement and the transactions contemplated therein, including the termination of the Target Fund's registration under the 1940 Act and the dissolution of the Target Fund under Maryland law.

*For Shareholders of the Acquiring Fund:*

*Proposal 1(C):* The VRDP Holders of the Acquiring Fund are being asked to vote as a separate class on a proposal to approve the Reorganization Agreement and the transactions contemplated therein, including the issuance of additional Acquiring Fund VRDP Shares.

**Proposal 2: The Issuance of Additional Acquiring Fund Common Shares**

*Proposal 2:* The common shareholders and VRDP Holders of the Acquiring Fund are being asked to vote as a single class on a proposal to approve the issuance of additional Common Shares of the Acquiring Fund in connection with the Reorganization Agreement.

Shareholders of record of each Fund as of the close of business on June 8, 2015 are entitled to notice of and to vote at the Special Meeting or any adjournment or postponement thereof.

The Funds are soliciting the vote of their common shareholders on Proposal 1(A) and Proposal 2 through a Joint Proxy Statement/Prospectus.

Each Fund is separately soliciting the votes of its respective VRDP Holders on each of the foregoing proposals through a separate Joint Proxy Statement and not through the Joint Proxy Statement/Prospectus.

**Table of Contents**

The officers or directors of each Fund named as proxies by shareholders may participate in the Special Meeting by remote communications, including, without limitation, by means of a conference telephone or similar communications equipment by means of which all persons participating in the Special Meeting can hear and be heard by each other, and the participation of such officers and directors in the Special Meeting pursuant to any such communications system shall constitute presence in person at the Special Meeting.

**THE BOARD OF DIRECTORS (EACH, A BOARD ) OF EACH OF THE FUNDS RECOMMENDS THAT YOU VOTE YOUR SHARES BY INDICATING YOUR VOTING INSTRUCTIONS ON THE ENCLOSED PROXY CARD, DATING AND SIGNING SUCH PROXY CARD AND RETURNING IT IN THE ENVELOPE PROVIDED, WHICH IS ADDRESSED FOR YOUR CONVENIENCE AND NEEDS NO POSTAGE IF MAILED IN THE UNITED STATES, OR BY RECORDING YOUR VOTING INSTRUCTIONS BY TELEPHONE OR VIA THE INTERNET.**

**THE BOARD OF THE TARGET FUND UNANIMOUSLY RECOMMENDS THAT COMMON SHAREHOLDERS OF THE TARGET FUND CAST THEIR VOTE:**

**FOR THE REORGANIZATION AGREEMENT AS DESCRIBED IN THE JOINT PROXY STATEMENT/ PROSPECTUS.  
THE BOARD OF THE TARGET FUND UNANIMOUSLY RECOMMENDS THAT PREFERRED SHAREHOLDERS OF THE TARGET FUND CAST THEIR VOTE:**

**FOR THE REORGANIZATION AGREEMENT AS DESCRIBED IN THE JOINT PROXY STATEMENT.  
THE BOARD OF THE ACQUIRING FUND UNANIMOUSLY RECOMMENDS THAT COMMON SHAREHOLDERS OF THE ACQUIRING FUND CAST THEIR VOTE:**

**FOR THE ISSUANCE OF ADDITIONAL COMMON SHARES IN CONNECTION WITH THE REORGANIZATION AGREEMENT AS DESCRIBED IN THE JOINT PROXY STATEMENT/PROSPECTUS.  
THE BOARD OF THE ACQUIRING FUND UNANIMOUSLY RECOMMENDS THAT PREFERRED SHAREHOLDERS OF THE ACQUIRING FUND CAST THEIR VOTE:**

**FOR THE REORGANIZATION AGREEMENT AS DESCRIBED IN THE JOINT PROXY STATEMENT.**

**FOR THE ISSUANCE OF ADDITIONAL COMMON SHARES IN CONNECTION WITH THE REORGANIZATION AGREEMENT AS DESCRIBED IN THE JOINT PROXY STATEMENT.  
IN ORDER TO AVOID THE ADDITIONAL EXPENSE OF FURTHER SOLICITATION, WE ASK THAT YOU MAIL YOUR PROXY CARD OR RECORD YOUR VOTING INSTRUCTIONS BY TELEPHONE OR VIA THE INTERNET PROMPTLY.**

For the Board of Directors of the Funds

JOHN M. PERLOWSKI

*President and Chief Executive Officer of the Funds*

June 16, 2015

**Table of Contents**

**YOUR VOTE IS IMPORTANT.**

**PLEASE VOTE PROMPTLY BY SIGNING AND RETURNING THE  
ENCLOSED PROXY CARD OR BY RECORDING YOUR VOTING INSTRUCTIONS BY  
TELEPHONE OR VIA THE INTERNET, NO MATTER HOW MANY SHARES YOU OWN.  
IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR  
THE SPECIAL MEETING OF SHAREHOLDERS TO BE HELD ON AUGUST 6, 2015.**

**THE PROXY STATEMENT FOR THIS MEETING IS AVAILABLE AT:**

**[HTTPS://WWW.PROXY-DIRECT.COM/BLK-26676](https://www.proxy-direct.com/BLK-26676)**

**Table of Contents**

**Joint Proxy Statement/Prospectus**

**BLACKROCK MUNIYIELD MICHIGAN QUALITY FUND, INC.**

**BLACKROCK MUNIYIELD MICHIGAN QUALITY FUND II, INC.**

**100 Bellevue Parkway**

**Wilmington, Delaware 19809**

**(800) 882-0052**

This Joint Proxy Statement/Prospectus is furnished to you as a common shareholder of BlackRock MuniYield Michigan Quality Fund II, Inc. (NYSE Ticker: MYM) ( MYM or the Target Fund ) and/or BlackRock MuniYield Michigan Quality Fund, Inc. (NYSE Ticker: MIY) ( MIY or the Acquiring Fund and together with the Target Fund, each, a Fund ). A special meeting (the Special Meeting ) of shareholders of each Fund will be held at the offices of BlackRock Advisors, LLC (the Investment Advisor ), 1 University Square Drive, Princeton, New Jersey 08540-6455, on August 6, 2015 at 4:00 p.m. (Eastern time) to consider the items listed below and discussed in greater detail elsewhere in this Joint Proxy Statement/Prospectus. If you are unable to attend the Special Meeting or any adjournment or postponement thereof, the Board of Directors of your Fund (the Board ) recommends that you vote your shares of common stock ( Common Shares ) by completing and returning the enclosed proxy card or by recording your voting instructions by telephone or via the internet. The approximate mailing date of this Joint Proxy Statement/Prospectus and accompanying form of proxy is June 26, 2015.

The purposes of the Special Meeting are:

**Proposal 1: The Reorganization of the Funds**

*For Shareholders of the Target Fund:*

*Proposal 1(A):* The common shareholders and holders of Variable Rate Demand Preferred Shares ( VRDP Shares ) of the Target Fund are being asked to vote as a single class on a proposal to approve an Agreement and Plan of Reorganization between the Target Fund and the Acquiring Fund (the Reorganization Agreement ), pursuant to which (i) the Acquiring Fund will acquire substantially all of the Target Fund's assets and assume substantially all of the Target Fund's liabilities in exchange solely for newly issued Common Shares and VRDP Shares (collectively, the Shares ) of the Acquiring Fund, which will be distributed to the Target Fund's common shareholders (although cash may be distributed in lieu of fractional Common Shares) and holders of VRDP Shares ( VRDP Holders ), respectively, and (ii) the Target Fund will terminate its registration under the Investment Company Act of 1940, as amended (the 1940 Act ), and liquidate, dissolve and terminate in accordance with its charter and Maryland law.

*Proposal 1(B):* The VRDP Holders of the Target Fund are being asked to vote as a separate class on a proposal to approve the Reorganization Agreement and the transactions contemplated therein, including the termination of the Target Fund's registration under the 1940 Act and the dissolution of the Target Fund under Maryland law.

*For Shareholders of the Acquiring Fund:*

*Proposal 1(C):* The VRDP Holders of the Acquiring Fund are being asked to vote as a separate class on a proposal to approve the Reorganization Agreement and the transactions contemplated therein, including the issuance of additional Acquiring Fund VRDP Shares.

**Proposal 2: The Issuance of Additional Acquiring Fund Common Shares**

*Proposal 2:* The common shareholders and VRDP Holders of the Acquiring Fund are being asked to vote as a single class on a proposal to approve the issuance of additional Common Shares of Acquiring Fund in connection with the Reorganization Agreement (the Issuance ).

## **Table of Contents**

Shareholders of record of each Fund as of the close of business on June 8, 2015 (the Record Date ) are entitled to notice of and to vote at the Special Meeting or any adjournment or postponement thereof.

Shareholders of each Fund are entitled to one vote for each Share held, with no Shares having cumulative voting rights. VRDP Holders of each Fund will have equal voting rights with the common shareholders of such Fund with respect to the proposals that require the vote of the Fund's VRDP Shares and Common Shares as a single class. The quorum and voting requirements for each Fund are described in the section herein entitled Voting Information and Requirements.

This Joint Proxy Statement/Prospectus is only being delivered to the common shareholders of each Fund. Each Fund is separately soliciting the votes of its respective VRDP Holders on each of the foregoing proposals that require the vote of VRDP Holders through a separate joint proxy statement and not through this Joint Proxy Statement/Prospectus.

The Reorganization Agreement that Fund shareholders are being asked to consider involves transactions, including the Issuance, that will be referred to in this Joint Proxy Statement/Prospectus as the Reorganization. The Fund surviving the Reorganization is referred to herein as the Combined Fund.

Each Fund is organized as a Maryland corporation. Each Fund is a non-diversified closed-end investment company registered under the 1940 Act. The Reorganization seeks to achieve certain economies of scale and other operational efficiencies by combining two Funds that have substantially identical investment policies and investment restrictions.

In the Reorganization, the Acquiring Fund will acquire substantially all of the assets and assume substantially all of the liabilities of the Target Fund in exchange solely for newly issued Common Shares and VRDP Shares of the Acquiring Fund in the form of book entry interests. The Acquiring Fund will list the newly issued Common Shares on the New York Stock Exchange ( NYSE ). Such newly issued Acquiring Fund Shares will be distributed to the Target Fund shareholders (although cash may be distributed in lieu of fractional Common Shares) and the Target Fund will terminate its registration under the 1940 Act and liquidate, dissolve and terminate in accordance with its charter and Maryland law. The Acquiring Fund will continue to operate after the Reorganization as a registered, non-diversified, closed-end management investment company with the investment objective, investment policies and investment restrictions described in this Joint Proxy Statement/Prospectus.

As a result of the Reorganization, each common shareholder of the Target Fund will own Acquiring Fund Common Shares that (except for cash payments received in lieu of fractional Common Shares) will have an aggregate net asset value ( NAV ) (not the market value) immediately after the Closing Date equal to the aggregate NAV (not the market value) of that shareholder's Target Fund Common Shares immediately prior to the effective date of the Reorganization ( Closing Date ). The NAV of the Target Fund and the Acquiring Fund immediately prior to the Closing Date will be reduced by the costs of the Reorganization borne by each Fund, if any. The value of each Fund's net assets will be calculated net of the liquidation preference (including accumulated and unpaid dividends) of all outstanding VRDP Shares of such Fund.

Each outstanding VRDP Share of the Target Fund will, without any action on the part of the holder thereof, be exchanged for one newly issued VRDP Share of the Acquiring Fund, which will have terms that are substantially similar to the terms of such outstanding Target Fund VRDP Share, with the only significant difference being that such outstanding Target Fund VRDP Share has a mandatory redemption date of June 1, 2041 and the newly issued Acquiring Fund VRDP Share is expected to have a mandatory redemption date of May 1, 2041. The Acquiring Fund VRDP Shares to be issued in connection with the Reorganization will have terms that are substantially identical to the terms of the Acquiring Fund's outstanding VRDP Shares and will rank on a parity with the Acquiring Fund's existing VRDP Shares as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of the affairs of the Acquiring Fund. The Reorganization will not result in any changes to the terms of the Acquiring Fund's VRDP Shares currently outstanding.

## **Table of Contents**

If the requisite shareholder approvals are not obtained, each Fund's Board may take such actions as it deems in the best interests of its Fund, including conducting additional solicitations with respect to the proposals or continuing to operate the Fund as a stand-alone fund and the Investment Advisor may, in connection with the ongoing management of each Fund and its product line, recommend alternative proposals to the Board of each Fund.

The Board of each Fund has determined that including these proposals in one Joint Proxy Statement/Prospectus will reduce costs and is in the best interests of each Fund's shareholders.

The Fund(s) in which you owned shares on the Record Date is named on the proxy card or Notice of Internet Availability of Proxy Materials. If you owned shares in more than one Fund on the Record Date, you may receive more than one proxy card. Even if you plan to attend the Special Meeting, please sign, date and return EACH proxy card you receive or, if you provide voting instructions by telephone or via the Internet, please vote on each proposal affecting EACH Fund you own. If you vote by telephone or via the Internet, you will be asked to enter a unique code that has been assigned to you, which is printed on your proxy card(s) or Notice of Internet Availability of Proxy Materials, as applicable. This code is designed to confirm your identity, provide access into the voting website and confirm that your voting instructions are properly recorded.

All properly executed proxies received prior to the Special Meeting will be voted at the Special Meeting. On any matter coming before the Special Meeting as to which a shareholder has specified a choice on that shareholder's proxy, the Shares will be voted accordingly. If a proxy card is properly executed and returned and no choice is specified with respect to a proposal, the Shares will be voted FOR the proposal. Shareholders who execute proxies or provide voting instructions by telephone or via the Internet may revoke them with respect to a proposal at any time before a vote is taken on the proposal by filing with the applicable Fund a written notice of revocation (addressed to the Secretary of the Fund at the principal executive offices of the Fund at the New York address provided herein), by delivering a duly executed proxy bearing a later date or by attending the Special Meeting and voting in person by ballot, in all cases prior to the exercise of the authority granted in the proxy card. Merely attending the Special Meeting, however, will not revoke any previously executed proxy. If you hold Shares through a bank or other intermediary, please consult your bank or intermediary regarding your ability to revoke voting instructions after such instructions have been provided.

**If you are a record holder of a Fund's Shares and plan to attend the Special Meeting in person, in order to gain admission you must show valid photographic identification, such as your driver's license or passport. If you hold your Shares of a Fund through a bank, broker or other nominee, and plan to attend the Special Meeting in person, in order to gain admission you must show valid photographic identification, such as your driver's license or passport, and satisfactory proof of ownership of Shares in a Fund, such as your voting instruction form (or a copy thereof) or a letter from your bank, broker or other nominee or broker's statement indicating ownership as of the Record Date. If you hold your Shares of a Fund in a brokerage account or through a bank or other nominee, you will not be able to vote in person at the Special Meeting unless you have previously requested and obtained a legal proxy from your broker, bank or other nominee and present it at the Special Meeting. Even if you plan to attend the Special Meeting, please promptly follow the enclosed instructions to submit voting instructions by telephone or via the Internet. Alternatively, you may submit voting instructions by signing and dating each proxy card you receive, and if received by mail, returning it in the accompanying postage-paid return envelope.**

For directions to the Special Meeting, please contact Georgeson Inc., the firm assisting us in the solicitation of proxies, at 1-888-654-1722.

This Joint Proxy Statement/Prospectus sets forth concisely the information that common shareholders of each Fund should know before voting on the proposal and constitutes an offering of the Acquiring Fund Common Shares. Please read it carefully and retain it for future reference. A Statement of Additional Information, dated June 16, 2015, relating to this Joint Proxy Statement/Prospectus (the "Statement of Additional Information") has been filed with the United States Securities and Exchange Commission (the "SEC") and is incorporated herein by reference. Copies of each Fund's most recent annual report and semi-annual report can be

---

**Table of Contents**

obtained on a website maintained by BlackRock, Inc. ( "BlackRock" ) at [www.blackrock.com](http://www.blackrock.com). In addition, each Fund will furnish, without charge, a copy of the Statement of Additional Information, or its most recent annual report or semi-annual report to any shareholder upon request. Any such request should be directed to BlackRock by calling (800) 882-0052 or by writing to the respective Fund at 100 Bellevue Parkway, Wilmington, Delaware 19809. The Statement of Additional Information and the annual and semi-annual reports of each Fund are available on the EDGAR Database on the SEC's website at [www.sec.gov](http://www.sec.gov). The address of the principal executive offices of the Funds is 100 Bellevue Parkway, Wilmington, Delaware 19809, and the telephone number is (800) 882-0052.

Each Fund is subject to the informational requirements of the Securities Exchange Act of 1934 (the "Exchange Act") and the 1940 Act and, in accordance therewith, file reports, proxy statements, proxy materials and other information with the SEC. Materials filed with the SEC can be reviewed and copied at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549 or downloaded from the SEC's website at [www.sec.gov](http://www.sec.gov). Information on the operation of the SEC's Public Reference Room may be obtained by calling the SEC at (202) 551-8090. You may also request copies of these materials, upon payment at the prescribed rates of a duplicating fee, by electronic request to the SEC's e-mail address ([publicinfo@sec.gov](mailto:publicinfo@sec.gov)) or by writing the Public Reference Branch, Office of Consumer Affairs and Information Services, Securities and Exchange Commission, Washington, D.C. 20549-0102. Reports, proxy statements and other information concerning the Funds may also be inspected at the offices of the NYSE, 20 Broad Street, New York, New York 10005.

BlackRock updates performance information and certain other data for the Funds on a monthly basis on its website in the "Closed-End Funds" section of [www.blackrock.com](http://www.blackrock.com) as well as certain other material information as necessary from time to time. Investors and others are advised to check the website for updated performance information and the release of other material information about the Funds. References to BlackRock's website are intended to allow investors public access to information regarding the Funds and do not, and are not intended to, incorporate BlackRock's website in this Joint Proxy Statement/Prospectus.

Please note that only one copy of shareholder documents, including annual or semi-annual reports and proxy materials, may be delivered to two or more shareholders of the Funds who share an address, unless the Funds have received instructions to the contrary. This practice is commonly called "householding" and it is intended to reduce expenses and eliminate duplicate mailings of shareholder documents. Mailings of your shareholder documents may be househanded indefinitely unless you instruct us otherwise. To request a separate copy of any shareholder document or for instructions as to how to request a separate copy of these documents or as to how to request a single copy if multiple copies of these documents are received, shareholders should contact the Fund at the address and phone number set forth above.

Each Fund is a non-diversified closed-end investment company registered under the 1940 Act. The Common Shares of BlackRock MuniYield Michigan Quality Fund, Inc. are listed on the NYSE under the ticker symbol "MIY" and will continue to be so listed after the completion of the Reorganization. The Common Shares of BlackRock MuniYield Michigan Quality Fund II, Inc. are listed on the NYSE under the ticker symbol "MYM". Reports, proxy statements and other information concerning the Funds may be inspected at the offices of the NYSE, 20 Broad Street, New York, New York 10005.

This Joint Proxy Statement/Prospectus serves as a prospectus of the Acquiring Fund in connection with the Issuance. No person has been authorized to give any information or make any representation not contained in this Joint Proxy Statement/Prospectus and, if so given or made, such information or representation must not be relied upon as having been authorized. This Joint Proxy Statement/Prospectus does not constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction in which, or to any person to whom, it is unlawful to make such offer or solicitation.

**THE SEC HAS NOT APPROVED OR DISAPPROVED THESE SECURITIES OR PASSED UPON THE ADEQUACY OF THIS JOINT PROXY STATEMENT/PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.**

**The date of this Joint Proxy Statement/Prospectus is June 16, 2015.**

**Table of Contents**

**TABLE OF CONTENTS**

<u>SUMMARY</u>	1
<u>EXPENSE TABLE FOR COMMON SHAREHOLDERS</u>	12
<u>RISK FACTORS AND SPECIAL CONSIDERATIONS</u>	13
<u>INFORMATION ABOUT THE REORGANIZATION</u>	37
<u>THE FUNDS</u>	49
<u>THE ACQUIRING FUND'S INVESTMENTS</u>	50
<u>COMPARISON OF THE FUNDS' INVESTMENTS</u>	71
<u>MANAGEMENT OF THE FUNDS</u>	72
<u>INFORMATION ABOUT THE COMMON SHARES OF THE FUNDS</u>	75
<u>INFORMATION ABOUT THE VRDP SHARES OF THE FUNDS</u>	78
<u>FINANCIAL HIGHLIGHTS</u>	82
<u>DIVIDENDS AND DISTRIBUTIONS</u>	90
<u>AUTOMATIC DIVIDEND REINVESTMENT PLAN</u>	92
<u>CERTAIN PROVISIONS OF THE CHARTERS AND BYLAWS</u>	94
<u>GOVERNING LAW</u>	95
<u>CONVERSION TO OPEN-END FUND</u>	95
<u>CAPITALIZATION</u>	95
<u>VOTING RIGHTS</u>	96
<u>APPRAISAL RIGHTS</u>	96
<u>CERTAIN U.S. FEDERAL INCOME TAX CONSEQUENCES OF THE REORGANIZATION</u>	96
<u>VOTING INFORMATION AND REQUIREMENTS</u>	99
<u>SHAREHOLDER INFORMATION</u>	101
<u>SHAREHOLDER PROPOSALS</u>	102
<u>SOLICITATION OF PROXIES</u>	103
<u>LEGAL MATTERS</u>	103
<u>INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u>	103
<u>SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE</u>	103
<u>OTHER MATTERS WITH RESPECT TO THE MEETING</u>	103
<u>ADJOURNMENTS AND POSTPONEMENTS</u>	104
<u>PRIVACY PRINCIPLES OF THE FUNDS</u>	104
<u>OTHER INFORMATION</u>	105



**Table of Contents**

**SUMMARY**

*The following is a summary of certain information contained elsewhere in this Joint Proxy Statement/Prospectus and is qualified in its entirety by reference to the more complete information contained in this Joint Proxy Statement/Prospectus and in the Statement of Additional Information. Shareholders should read the entire Joint Proxy Statement/Prospectus carefully.*

**The Proposed Reorganization**

Assuming the Reorganization receives the requisite shareholder approvals, as well as certain consents, confirmations and/or waivers from various third parties, including the liquidity provider with respect to the outstanding VRDP Shares, the Acquiring Fund will acquire substantially all of the assets and assume substantially all of the liabilities of the Target Fund in exchange solely for newly issued Acquiring Fund Shares in the form of book entry interests. The Acquiring Fund will list the newly issued Common Shares on the NYSE. Such newly issued Acquiring Fund Shares will be distributed to the Target Fund shareholders (although cash may be distributed in lieu of fractional Common Shares) and the Target Fund will terminate its registration under the 1940 Act and liquidate, dissolve and terminate in accordance with its charter and Maryland law. The Acquiring Fund will continue to operate after the Reorganization as a registered, non-diversified, closed-end management investment company with the investment objective, investment policies and investment restrictions described in this Joint Proxy Statement/Prospectus.

As a result of the Reorganization, each common shareholder of the Target Fund will own Acquiring Fund Common Shares that (except for cash payments received in lieu of fractional Common Shares) will have an aggregate NAV (not the market value) immediately after the Closing Date equal to the aggregate NAV (not the market value) of that shareholder's Target Fund Common Shares immediately prior to the Closing Date. The NAV of the Target Fund and the Acquiring Fund immediately prior to the Closing Date will be reduced by the costs of the Reorganization borne by each Fund, if any. The value of each Fund's net assets will be calculated net of the liquidation preference (including accumulated and unpaid dividends) of all outstanding VRDP Shares of such Fund.

Each outstanding VRDP Share of the Target Fund will, without any action on the part of the holder thereof, be exchanged for one newly issued VRDP Share of the Acquiring Fund, which will have terms that are substantially similar to the terms of such outstanding Target Fund VRDP Share, with the only significant difference being that such Target Fund VRDP Share has a mandatory redemption date of June 1, 2041 and the newly issued Acquiring Fund VRDP Share is expected to have a mandatory redemption date of May 1, 2041. The Reorganization will not result in any changes to the terms of the Acquiring Fund's VRDP Shares currently outstanding.

## **Table of Contents**

Subject to the requisite approval of the shareholders of each Fund with respect to the Reorganization, as well as certain consents, confirmations and/or waivers from various third parties, including the liquidity provider with respect to the outstanding VRDP Shares, it is expected that the Closing Date of the Reorganization will be sometime during the third quarter of 2015, but it may be at a different time as described herein.

If the Reorganization is not consummated, then each Fund will continue to operate for the time being as a stand-alone Maryland corporation and will continue to be advised by the Investment Advisor. However, if the Reorganization is not consummated, the Investment Advisor may, in connection with ongoing management of each Fund and its product line, recommend alternative proposals to the Board of each Fund.

### **Background and Reasons for the Proposed Reorganization**

The proposed Reorganization seeks to achieve certain economies of scale and other operational efficiencies by combining two funds that have substantially identical investment objectives, investment policies, investment restrictions and portfolio compositions and are managed by the same investment advisor and portfolio management team.

The proposed Reorganization is intended to result in the following potential benefits to common shareholders: (i) lower total expenses per Common Share for common shareholders of each Fund (as common shareholders of the Combined Fund following the Reorganization) due to economies of scale resulting from the larger size of the Combined Fund; (ii) improved earnings yield on NAV for common shareholders of the Target Fund and a comparable (i.e., the same or slightly lower or higher) earnings yield on NAV for common shareholders of the Acquiring Fund; (iii) improved secondary market trading of the Common Shares; and (iv) operating and administrative efficiencies for the Combined Fund, including the potential for the following: (a) greater investment flexibility and investment options; (b) greater diversification of portfolio investments; (c) the ability to trade in larger positions and more favorable transaction terms; (d) benefits from having fewer closed-end funds offering similar products in the market, including an increased focus by investors on the remaining funds in the market (including the Combined Fund) and additional research coverage; and (e) benefits from having fewer similar funds in the same fund complex, including a simplified operational model and a reduction in risk of operational, legal and financial errors.

The Board of each Fund, including the directors ( Board Members ) who are not interested persons of each Fund (as defined in the 1940 Act) ( Independent Board Members ), has unanimously approved the Reorganization, concluding that the Reorganization is in the best

## **Table of Contents**

interests of its Fund and that the interests of existing common shareholders and VRDP Holders of its Fund will not be diluted with respect to NAV and liquidation preference, respectively, as a result of the Reorganization. As a result of the Reorganization, however, common and preferred shareholders of each Fund will hold a reduced percentage of ownership in the larger Combined Fund than they did in any of the individual Funds before the Reorganization. The Board's conclusion was based on each Board Member's business judgment after consideration of all relevant factors taken as a whole with respect to its Fund and the Fund's common and preferred shareholders, although individual Board Members may have placed different weight on various factors and assigned different degrees of materiality to various factors. Please see "Information about the Reorganization" "Reasons for the Reorganization" for additional information about the factors considered by each Board.

### **Net and Managed Assets**

As of May 31, 2015, the Target Fund has \$175 million in net assets and \$276 million in managed assets, and the Acquiring Fund has \$282 million in net assets and \$451 million in managed assets.

### **Total Expenses and Management Fees**

For the fiscal year ended July 31, 2014, the Total Expense Ratios of the Target Fund and the Acquiring Fund were 1.55% and 1.54%, respectively. For the 12-month period ended January 31, 2015, the Total Expense Ratios of the Target Fund and the Acquiring Fund were 1.48% and 1.48%, respectively. Total Expenses means a Fund's total annual operating expenses (including interest expenses and applicable fee waivers). Total Expense Ratio means a Fund's Total Expenses expressed as a percentage of its average net assets attributable to its Common Shares. The Funds estimate that the completion of the Reorganization would result in a Total Expense Ratio for the Combined Fund of 1.43% on a historical and pro forma basis for the 12-month period ended January 31, 2015, representing a reduction in the Total Expense Ratio for the common shareholders of the Target Fund and the Acquiring Fund of 0.05% and 0.05%, respectively.

The Funds' VRDP Shares have the same mechanism for determining the applicable dividend rate and maximum rate, and the same liquidity provider, remarketing agent and tender and paying agent. Each Fund's VRDP Shares are currently in a three year special rate period that will end on June 24, 2015. The special rate period is expected to be extended to June 22, 2016. During the special rate period, the Funds' VRDP Shares have the same mechanism for determining the applicable dividend rate and maximum rate, redemption premiums and transfer restrictions. For the fiscal year ended July 31, 2014, the annualized dividend rate for the VRDP Shares of the Target Fund and the Acquiring Fund were 1.01% and 1.01%, respectively. As of May 31, 2015, the dividend rate for the VRDP Shares of the Target Fund and the Acquiring Fund were 1.05%

## **Table of Contents**

and 1.05%, respectively. Please see Information about the VRDP Shares of the Funds for additional information.

The Combined Fund will have a lower annual contractual investment management fee rate than each Fund. Each Fund currently pays the Investment Advisor a monthly fee at an annual contractual management fee rate of 0.50% of its average daily net assets (0.79% of the average daily net assets attributable to the Target Fund's Common Shares, and 0.80% of the average daily net assets attributable to the Acquiring Fund's Common Shares, each for the 12-month period ended January 31, 2015). Average daily net assets are the average daily value of a Fund's total assets minus its total accrued liabilities (which does not include liabilities represented by TOB leverage and the liquidation preference of the VRDP shares).

If the Reorganization is consummated, the annual contractual investment management fee rate of the Combined Fund will be 0.49% of the average daily net assets of the Combined Fund (0.78% of the average daily net assets attributable to the Combined Fund's Common Shares on a historical and pro forma basis for the 12-month period ended January 31, 2015).

Based on a pro-forma Lipper peer expense group for the Combined Fund, the estimated total annual fund expense ratio (excluding investment-related expenses) and contractual management fee rate are each expected to be in the second and first quartile, respectively.

There can be no assurance that future expenses will not increase or that any expense savings for any Fund will be realized as a result of the Reorganization.

## **Earnings, Distributions and Undistributed Net Investment Income**

*Earnings and Distribution Rate:* The Combined Fund's earnings yield on NAV following the Reorganization is expected to be comparable (i.e., the same or slightly lower or higher) to the Acquiring Fund's current earnings yield on NAV and potentially higher than the Target Fund's current earnings yield on NAV; thus, assuming that the Reorganization is consummated and that the Acquiring Fund's distribution policy remains in place after the Reorganization, common shareholders of the Acquiring Fund may experience a distribution rate on NAV comparable (i.e., the same or slightly lower or higher) to their current distribution rate on NAV and common shareholders of the Target Fund may experience a distribution rate on NAV that is potentially higher than their current distribution rate on NAV.

The Combined Fund's earnings and distribution rate on NAV will change over time, and depending on market conditions, may be higher or lower than each Fund's earnings and distribution rate on NAV prior to the Reorganization. A Fund's earnings and net

## Table of Contents

investment income are variables which depend on many factors, including its asset mix, portfolio turnover level, the amount of leverage utilized by the Fund, the costs of such leverage, the performance of its investments, the movement of interest rates and general market conditions. There can be no assurance that the future earnings of a Fund, including the Combined Fund after the Reorganization, will remain constant.

*Distribution Policy:* Each Fund intends to make regular monthly cash distributions of all or a portion of its net investment income to holders of such Fund's shares of common stock, except as described below under Undistributed Net Investment Income. Each Fund intends to pay any capital gains distributions at least annually. A return of capital distribution may involve a return of the common shareholder's original investment. Though not currently taxable, such a distribution may lower a common shareholder's basis in such Fund, thus potentially subjecting the common shareholder to future tax consequences in connection with the sale of Fund Common Shares, even if sold at a loss to the common shareholder's original investment. When total distributions exceed total return performance for the period, the difference will reduce a Fund's total assets and NAV and, therefore, could have the effect of increasing the Fund's expense ratio and reducing the amount of assets the Fund has available for long term investment.

*Automatic Dividend Reinvestment:* Common shareholders of each Fund will automatically have all dividends and distributions reinvested in Common Shares of such Fund in accordance with such Fund's dividend reinvestment plan, unless an election is made to receive cash by contacting the Reinvestment Plan Agent (as defined herein), at (800) 699-1236. See Automatic Dividend Reinvestment Plan.

*Undistributed Net Investment Income:* If the Reorganization is approved by shareholders, then substantially all of the undistributed net investment income, if any, of each Fund is expected to be declared to such Fund's common shareholders prior to the Closing Date (the Pre-Reorganization Declared UNII Distributions). The declaration date, ex-dividend date (the Ex-Dividend Date) and record date of the Pre-Reorganization Declared UNII Distributions will occur prior to the Closing Date. However, all or a significant portion of the Pre-Reorganization Declared UNII Distributions may be paid in one or more distributions to common shareholders of the Funds entitled to such Pre-Reorganization Declared UNII Distributions after the Closing Date. Former Target Fund shareholders entitled to such Pre-Reorganization Declared UNII Distributions paid after the Closing Date will receive such distributions in cash.

MuniYield Michigan Quality Fund, Inc. (MIY), as the Combined Fund following the Reorganization, does not currently expect to

**Table of Contents**

declare any distributions during the first month following the Closing Date. Accordingly, persons who purchase Common Shares of any of the Funds on or after the Ex-Dividend Date for the Pre-Reorganization Declared UNII Distributions should not expect to receive any distributions from any Fund until distributions, if any, are declared by the Board of the Combined Fund and paid to shareholders entitled to any such distributions. No such distributions are expected to be paid by the Combined Fund until at least approximately two months following the Closing Date.

The Combined Fund's earnings and distribution rate on NAV will change over time, and depending on market conditions, may be higher or lower than each Fund's earnings and distribution rate on NAV prior to the Reorganization. The Combined Fund is anticipated to retain a lower UNII balance after the Reorganization than the Acquiring Fund prior to the Reorganization; however, the Combined Fund is anticipated to benefit from a lower expense ratio and other benefits of economies of scale as discussed herein. Each Fund reserves the right to change its distribution policy with respect to common share distributions and the basis for establishing the rate of its distributions for the Common Shares at any time and may do so without prior notice to common shareholders. The payment of any distributions by any Fund is subject to, and will only be made when, as and if, declared by the Board of such Fund. There is no assurance the Board of any Fund will declare any distributions for such Fund.

To the extent any Pre-Reorganization Declared UNII Distributions is not an exempt interest dividend (as defined in the Code), the distribution may be taxable to shareholders for U.S. Federal income tax purposes.

**Premium/Discount to NAV of Common Shares**

The Common Shares of each Fund have historically traded at both a premium and a discount. The table below sets forth the market price, NAV, and the premium/discount to NAV of each Fund as of June 5, 2015.

<b>Fund</b>	<b>Market Price</b>	<b>NAV</b>	<b>Premium/(Discount) to NAV</b>
Target Fund (MYM)	\$12.50	\$14.34	(12.83)%
Acquiring Fund (MIY)	\$13.44	\$15.34	(12.39)%

To the extent the Target Fund Common Shares are trading at a wider discount (or a narrower premium) than the Acquiring Fund at the time of the Reorganization, the Target Fund's common shareholders would have the potential for an economic benefit by the narrowing of the discount or widening of the premium. To the extent the Target Fund Common Shares are trading at a narrower discount (or wider premium) than the Acquiring Fund at the time of the Reorganization,

## **Table of Contents**

Target Fund common shareholders may be negatively impacted if the Reorganization is consummated. Acquiring Fund common shareholders would only benefit from a premium/discount perspective to the extent the Acquiring Fund's post-Reorganization discount (or premium) improves. There can be no assurance that, after the Reorganization, Common Shares of the Combined Fund will trade at a narrower discount to NAV or wider premium to NAV than the Common Shares of any individual Fund prior to the Reorganization.

In the Reorganization, common shareholders of the Target Fund will receive Acquiring Fund Common Shares based on the relative NAVs (not the market values) of the respective Fund's Common Shares. The market value of the Common Shares of the Combined Fund may be less than the market value of the Common Shares of each respective Fund prior to the Reorganization.

### **VRDP Shares**

As of May 31, 2015, the Target Fund has 873 Series W-7 VRDP Shares outstanding, and the Acquiring Fund has 1,446 Series W-7 VRDP Shares outstanding. In connection with the Reorganization, the Acquiring Fund expects to issue 873 additional VRDP Shares to Target Fund VRDP Holders. Following the completion of the Reorganization, the Combined Fund is expected to have 2,319 VRDP Shares outstanding.

Upon the Closing Date, Target Fund VRDP Holders will receive on a one-for-one basis one newly issued Acquiring Fund VRDP Share, par value \$0.10 per share and with a liquidation preference of \$100,000 per share (plus any accumulated and unpaid dividends that have accrued on such Target Fund VRDP Share up to and including the day immediately preceding the Closing Date if such dividends have not been paid prior to the Closing Date), in exchange for each Target Fund VRDP Share held by such Target Fund VRDP Holder immediately prior to the Closing Date. The newly issued Acquiring Fund VRDP Share may be of the same series as the Acquiring Fund's Series W-7 VRDP Shares or a substantially identical series. No fractional Acquiring Fund VRDP Shares will be issued. Target Fund VRDP Holders will receive the same number of Acquiring Fund VRDP Shares, with terms substantially similar to the terms of the outstanding Target Fund VRDP Shares, held by such holders immediately prior to the Closing Date, with the only significant difference being that the Target Fund VRDP Shares have a mandatory redemption date of June 1, 2041 and the newly issued Acquiring Fund VRDP Shares are expected to have a mandatory redemption date of May 1, 2041.

The Acquiring Fund VRDP Shares to be issued in connection with the Reorganization will have terms that are substantially identical to the terms of the Acquiring Fund's outstanding VRDP Shares and will rank on a parity with the Acquiring Fund's existing VRDP Shares as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of the affairs of the Acquiring

## **Table of Contents**

Fund. The Reorganization will not result in any changes to the terms of the Acquiring Fund's VRDP Shares currently outstanding.

The terms of the outstanding Target Fund VRDP Shares are substantially similar to the terms of the outstanding Acquiring Fund VRDP Shares. The only significant difference between the terms of the two Funds' VRDP Shares is that the Target Fund VRDP Shares have a mandatory redemption date of June 1, 2041 and the Acquiring Fund VRDP Shares have a mandatory redemption date of May 1, 2041. The Funds' VRDP Shares have the same \$100,000 liquidation preference per share, dividend period, dividend payment date, voting rights, redemption provisions, remarketing procedures, mandatory purchase events, mandatory tender events, transfer restrictions and covenants with respect to effective leverage, asset coverage and eligible investments. The Funds' VRDP Shares also have the same mechanism for determining the applicable dividend rate and maximum rate, and the same liquidity provider, remarketing agent and tender and paying agent. Each Fund's VRDP Shares are currently in a three year special rate period that will end on June 24, 2015. The special rate period is expected to be extended to June 22, 2016. The terms applicable to each Fund's VRDP Shares during the special rate period are substantially identical. During the special rate period, the Funds' VRDP Shares have the same mechanism for determining the applicable dividend rate and maximum rate, redemption premiums and transfer restrictions.

None of the expenses of the Reorganization are expected to be borne by the VRDP Holders of the Funds.

Following the Reorganization, the VRDP Holders of each Fund will be VRDP Holders of the larger Combined Fund that will have a larger asset base and more VRDP Shares outstanding than either Fund individually. With respect to matters requiring all preferred shareholders to vote separately or common and preferred shareholders to vote together as a single class, following the Reorganization, holders of VRDP Shares of the Combined Fund will hold a smaller percentage of the outstanding preferred shares of the Combined Fund as compared to their percentage holdings of outstanding preferred shares of their respective Fund prior to the Reorganization.

## **Appraisal Rights**

Under Maryland law, stockholders of an investment company whose shares are traded publicly on a national securities exchange, such as Common Shares of the Target Fund, are not entitled to demand the fair value of their shares in connection with a reorganization. However, because the Target Fund's VRDP Shares are not traded publicly on a national securities exchange and the Target Fund will be selling substantially all of its assets to the Acquiring Fund in the Reorganization, the holders of Target Fund VRDP Shares will be entitled under Maryland law to demand and receive payment of the fair value of such Target Fund VRDP Shares upon the consummation of the Reorganization.



## **Table of Contents**

**Certain U.S. Federal Income Tax Consequences of the Reorganization** The Reorganization is intended to qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended (the Code). If the Reorganization so qualifies, in general, shareholders of the Target Fund will recognize no gain or loss for U.S. federal income tax purposes upon the exchange of their Target Fund Shares for Acquiring Fund Shares pursuant to the Reorganization (except with respect to cash received in lieu of fractional Common Shares). Additionally, the Target Fund will recognize no gain or loss for U.S. federal income tax purposes by reason of the Reorganization. Neither the Acquiring Fund nor its shareholders will recognize any gain or loss for U.S. federal income tax purposes pursuant to the Reorganization.

Shareholders of each Fund may receive distributions prior to, or after, the consummation of the Reorganization, including distributions attributable to their proportionate share of each Fund's undistributed net investment income declared prior to the consummation of the Reorganization or the Combined Fund built-in gains, if any, recognized after the Reorganization, when such income and gains are eventually distributed by the Combined Fund. To the extent that such a distribution is not an exempt interest dividend (as defined in the Code), the distribution may be taxable to shareholders for U.S. federal income tax purposes.

The Funds' shareholders should consult their own tax advisers regarding the U.S. federal income tax consequences of the Reorganization, as well as the effects of state, local and non-U.S. tax laws, including possible changes in tax laws.

## **General Information and History**

Each Fund is organized as a corporation under the laws of the State of Maryland as a non-diversified, closed-end management investment company registered under the 1940 Act.

Each Fund's principal office is located at 100 Bellevue Parkway, Wilmington, Delaware 19809, and its telephone number is (800) 882-0052.

Each Fund has a July 31 fiscal year end.

The Acquiring Fund Common Shares are listed on the NYSE as MIY.

The Target Fund Common Shares are listed on the NYSE as MYM.

Each Fund has VRDP Shares outstanding. Each Fund's VRDP Shares are not listed on a national stock exchange and have not been registered under the Securities Act, or any state securities laws, and unless so registered, may not be offered, sold, assigned, transferred, pledged, encumbered or otherwise disposed of except pursuant to an

**Table of Contents**

exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable state securities laws.

**Investment Objectives and Policies**

The Funds have substantially identical investment objectives, investment policies and investment restrictions. The investment objective, significant investment strategies and operating policies, and investment restrictions of the Combined Fund will be those of the Acquiring Fund, which are substantially identical to those of the Target Fund.

*Investment Objectives:*

Each Fund's investment objective is to provide shareholders with as high a level of current income exempt from federal and Michigan income taxes as is consistent with its investment policies and prudent investment management.

*Michigan Municipal Bonds:*

Each Fund seeks to achieve its investment objective by investing at least 80% of an aggregate of its net assets (including proceeds from the issuance of any preferred shares) and the proceeds of any borrowings for investment purposes, in a portfolio of municipal obligations issued by or on behalf of the State of Michigan, its political subdivisions, agencies and instrumentalities and by other qualifying issuers, each of which pays interest that, in the opinion of bond counsel to the issuer, is excludable from gross income for U.S. federal income tax purposes (except that the interest may be includable in taxable income for purposes of the Federal alternative minimum tax) and exempt from Michigan income taxes.

*Investment Grade Securities:*

Each Fund currently invests primarily in investment grade municipal bonds.

*Leverage:*

Each Fund utilizes leverage in the form of VRDP Shares and tender option bonds. Please see below a comparison of certain important ratios related to (i) each Fund's use of leverage as of May 31, 2015 and (ii) the Combined Fund's use of leverage, assuming the Reorganization had taken place as of May 31, 2015:

<b>Ratios</b>	<b>Target Fund (MYM)</b>	<b>Acquiring Fund (MIY)</b>	<b>Pro Forma Combined Fund (MIY)</b>
Asset Coverage Ratio	300%	295%	297%
Regulatory Leverage Ratio <sup>(1)</sup>	33%	34%	34%
Effective Leverage Ratio <sup>(2)</sup>	37%	37%	37%

- (1) Regulatory leverage consists of VRDP Shares issued by the Fund, which is a part of a Fund's capital structure. Regulatory leverage is sometimes referred to as 1940 Act Leverage and is subject to asset coverage limits set forth in the 1940 Act.
- (2) Effective leverage is a Fund's effective economic leverage, and includes both regulatory leverage and the leverage effects of certain derivative investments in the Fund's portfolio. Currently, the leverage effects of Tender Option Bond (TOB) inverse floater holdings, in addition to any regulatory leverage, are included in effective leverage ratios.

## **Table of Contents**

### **Fund Management**

The Board of each Fund is responsible for the overall supervision of the operations of its respective Fund and performs the various duties imposed on the directors of investment companies by the 1940 Act and under applicable state law. Each Fund has the same Board Members and officers.

### **Investment Advisor**

BlackRock Advisors, LLC serves as the investment advisor for each Fund and is expected to continue to serve as investment advisor for the Combined Fund.

### **Portfolio Management Team**

Each Fund is managed by a team of investment professionals comprised of Michael Kalinoski, CFA, Director at BlackRock, Theodore R. Jaeckel, Jr., CFA, Managing Director at BlackRock, and Walter O. Connor, CFA, Managing Director at BlackRock. After the Reorganization, it is expected that each Fund's current portfolio management team will continue to comprise the team of investment professionals for the Combined Fund.

### **Other Service Providers**

The other professional service providers for the Funds are as follows:

<b>Service</b>	<b>Service Providers to the Funds</b>
Custodian	State Street Bank and Trust Company
Transfer Agent, Dividend Disbursing Agent and Registrar	Computershare Trust Company, N.A.
Liquidity Provider to VRDP Shares	Citibank, N.A.
Remarketing Agent to VRDP Shares	Citigroup Global Markets Inc.
Tender and Paying Agent to VRDP Shares	The Bank of New York Mellon
Accounting Services Provider	State Street Bank and Trust Company
Independent Registered Public Accounting Firm	Deloitte & Touche LLP
Fund Counsel	Skadden, Arps, Slate, Meagher & Flom LLP
Counsel to the Independent Board Members	Debevoise & Plimpton LLP

**Table of Contents****EXPENSE TABLE FOR COMMON SHAREHOLDERS**

The following table illustrates the anticipated reduction or increases in the Total Expense Ratio for the common shareholders of each Fund expected as a result of the completion of the Reorganization. The table sets forth (i) the Total Expense Ratio for each Fund for the 12-month period ended January 31, 2015; and (ii) the *pro forma* Total Expense Ratio for the Combined Fund, assuming the Reorganization had taken place on January 31, 2015.

	Target Fund (MYM)	Acquiring Fund (MIY)	Pro Forma Combined Fund (MIY) <sup>(a)</sup>
<b>Shareholder Transaction Expenses</b>			
Maximum Sales Load (as a percentage of the offering price) imposed on purchases of Common Shares <sup>(b)</sup>	None	None	None
	\$0.02 per share for open-market purchases of Common Shares	Same as MYM	Same as MYM
Dividend Reinvestment Plan Fees <sup>(c)</sup>			
<b>Annual Total Expenses (as a percentage of average net assets attributable to Common Shares)</b>			
Investment Management Fees <sup>(d)</sup>	0.79%	0.80%	0.78%
Other Expenses	0.14%	0.11%	0.09%
Interest Expenses <sup>(e)</sup>	0.55%	0.57%	0.56%
Total Annual Fund Operating Expenses <sup>(d)(e)</sup>	1.48%	1.48%	1.43%

(a) Assumes the Reorganization had taken place on January 31, 2015.

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

(c) The Reinvestment Plan Agent's fees for the handling of the reinvestment of dividends will be paid by the Fund. However, you will pay a \$0.02 per share fee incurred in connection with open-market purchases of Common Shares pursuant to the Dividend Reinvestment Plan, which will be deducted from the value of the dividend. You will also be charged a \$0.02 per share fee if you direct the Reinvestment Plan Agent to sell your Common Shares held in a dividend reinvestment account. Per share fees include any applicable brokerage commissions the Reinvestment Plan Agent is required to pay. See Automatic Dividend Reinvestment Plan for additional information.

(d) Each Fund pays the Investment Advisor a monthly fee at an annual contractual management fee rate of 0.50% of the Fund's average daily net assets. Average daily net assets are the average daily value of a Fund's total assets minus its total accrued liabilities (which does not include liabilities represented by TOB leverage and the liquidation preference of the VRDP shares). If the Reorganization is consummated, the annual contractual management fee rate of the Combined Fund will be 0.49% of the average daily net assets of the Combined Fund.

(e) The total expense table includes interest expenses associated with the Funds' investments in tender option bonds (also known as inverse floaters). Although such interest expenses are actually paid by special purpose vehicles in which the Funds invest, they are recorded on the Funds' financial statements for accounting purposes. The total expense table also includes, in interest expenses, dividends associated with the VRDP Shares because the VRDP Shares are considered debt of the Funds for financial reporting purposes.

Each Fund uses leverage to seek to enhance its returns to common shareholders. This leverage generally takes two forms: the issuance of preferred shares and investment in tender option bonds. Both forms of leverage benefit common shareholders if the cost of the leverage is



## Table of Contents

lower than the returns earned by a Fund when it invests the proceeds from the leverage. In order to help you better understand the costs associated with the Funds leverage strategy, the Total Annual Fund Operating Expenses (excluding interest expense) for the Funds are presented below:

<i>Pro Forma</i>		
Target Fund (MYM)	Acquiring Fund (MIY)	Combined Fund (MIY)
0.93%	0.91%	0.87%
The following example is intended to help you compare the costs of investing in the Common Shares of the Combined Fund <i>pro forma</i> if the Reorganization is completed with the costs of investing in the Target Fund and the Acquiring Fund without the Reorganization. An investor in Common Shares would pay the following expenses on a \$1,000 investment, assuming (1) the Total Annual Fund Operating Expenses for each Fund set forth in the total expenses table above and (2) a 5% annual return throughout the period:		

	1 Year	3 Years	5 Years	10 Years
Target Fund (MYM)	\$ 15	\$ 47	\$ 81	\$ 177
Acquiring Fund (MIY)	\$ 15	\$ 47	\$ 81	\$ 177
Pro Forma Combined Fund (MIY)	\$ 15	\$ 45	\$ 78	\$ 171

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

The Investment Advisor will bear a portion of each Fund's costs with respect to the Reorganization. The expenses of the Reorganization are estimated to be \$331,000 for the Target Fund and \$351,000 for the Acquiring Fund, without consideration of any amount to be borne by the Investment Advisor. The Investment Advisor has agreed to pay approximately \$115,000 of the Target Fund's costs of the Reorganization and approximately \$120,000 of the Acquiring Fund's costs of the Reorganization. The actual costs associated with the proposed Reorganization may be more or less than the estimated costs discussed herein.

## RISK FACTORS AND SPECIAL CONSIDERATIONS

### Comparison of Risks

The Combined Fund will be managed in accordance with the same investment objective and investment policies, and subject to the same risks, as the Acquiring Fund. The Funds have substantially identical investment policies and investment restrictions and are subject to substantially identical investment risks. Each Fund invests at least 80% of its assets in municipal obligations exempt from federal income taxes (except that the interest may be subject to the federal alternative minimum tax) and Michigan income taxes. Each Fund also currently invests primarily in investment grade municipal bonds.

Risks that predominately affect the Common Shares of the Funds include risks associated with municipal obligations, including Michigan municipal obligations, interest rate risk, credit risk, non-diversification risk and leverage risk. In addition, as exchange-traded closed-end funds, the Funds are subject to the risk that the Funds' Common Shares may trade at a discount from the Funds' NAV. Accordingly, the Funds are primarily designed for long-term investors and should not be considered a vehicle for trading purposes. In the normal course of business, each Fund invests in securities and enters into transactions where risks exist due to fluctuations in the market (market risk) or failure of the issuer of a security to meet all its obligations (issuer credit risk). The value of securities held by the Funds may decline in response to certain events, including those directly involving the issuers whose securities are owned by the Funds; conditions affecting the general economy; overall market

**Table of Contents**

changes; local, regional or global political, social or economic instability; and currency and interest rate and price fluctuations. Similar to issuer credit risk, the Funds may be exposed to counterparty credit risk, or the risk that an entity with which the Funds have unsettled or open transactions may fail to or be unable to perform on its commitments.

The Combined Fund will be managed in accordance with the same investment objective and investment policies, and subject to the same risks, as the Acquiring Fund. Risk is inherent in all investing. An investment in the Common Shares of the Acquiring Fund should not be considered a complete investment program. Each shareholder should take into account the Acquiring Fund's investment objective as well as the shareholder's other investments when considering an investment in the Acquiring Fund. You may lose part or all of your investment in the Acquiring Fund or your investment may not perform as well as other similar investments.

**Risks Related to the Reorganization***Expenses.*

While the Funds currently estimate that the Reorganization will result in reduced aggregate expenses of the Combined Fund by approximately \$214,000 per year, the realization of these reduced expenses will not affect holders of the Funds proportionately, and may take longer than expected to be realized or may not be realized at all.

For the fiscal year ended July 31, 2014, the Total Expense Ratios of the Target Fund and the Acquiring Fund were 1.55% and 1.54%, respectively. For the 12-month period ended January 31, 2015, the Total Expense Ratios of the Target Fund and the Acquiring Fund were 1.48% and 1.48%, respectively. As of January 31, 2015, the historical and *pro forma* Total Expense Ratios applicable to the Reorganization are as follows:

Target Fund (MYM)	Acquiring Fund (MIY)	Pro Forma Combined Fund (MIY)
1.48%	1.48%	1.43%

The Funds estimate that the completion of the Reorganization would result in a Total Expense Ratio for the Combined Fund of 1.43% on a historical and pro forma basis for the 12-month period ended January 31, 2015, representing a reduction in the Total Expense Ratio for the common shareholders of the Target Fund and the Acquiring Fund of 0.05% and 0.05%, respectively.

The Funds' VRDP Shares have the same mechanism for determining the applicable dividend rate and maximum rate, and the same liquidity provider, remarketing agent and tender and paying agent. Each Fund's VRDP Shares are currently in a three year special rate period that will end on June 24, 2015. The special rate period is expected to be extended to June 22, 2016. During the special rate period, the Funds' VRDP Shares have the same mechanism for determining the applicable dividend rate and maximum rate, redemption premiums and transfer restrictions. For the fiscal year ended July 31, 2014, the annualized dividend rate for the VRDP Shares of the Target Fund and the Acquiring Fund were 1.01% and 1.01%, respectively. As of May 31, 2015, the dividend rate for the VRDP Shares of the Target Fund and the Acquiring Fund were 1.05% and 1.05%, respectively. Please see Information about the VRDP Shares of the Funds for additional information.

The Combined Fund will have a lower annual contractual investment management fee rate than each Fund. Each Fund currently pays the Investment Advisor a monthly fee at an annual contractual management fee rate of 0.50% of its average daily net assets (0.79% of the average daily net assets attributable to the Target Fund's Common Shares, and 0.80% of the average daily net assets attributable to the Acquiring Fund's Common Shares, each for the 12-month period ended January 31, 2015). Average daily net assets are the average daily value of a Fund's total assets minus its total accrued liabilities (which does not include liabilities represented by TOB leverage and the liquidation preference of the VRDP shares).



## **Table of Contents**

If the Reorganization is consummated, the annual contractual investment management fee rate of the Combined Fund will be reduced to 0.49% of the average daily net assets of the Combined Fund (0.78% of the average daily net assets attributable to the Combined Fund's Common Shares on a historical and pro forma basis for the 12-month period ended January 31, 2015).

Based on a pro-forma Lipper peer expense group for the Combined Fund, the estimated total annual fund expense ratio (excluding investment-related expenses) and contractual management fee rate are each expected to be in the second and first quartile, respectively.

There can be no assurance that future expenses will not increase or that any expense savings for any Fund will be realized as a result of the Reorganization. Please see the Expense Table For Common Shareholders for additional information about the Funds' expenses.

### *Earnings and Distribution Rate.*

The Combined Fund's earnings yield on NAV following the Reorganization is expected to be comparable (i.e., the same or slightly lower or higher) to the Acquiring Fund's current earnings yield on NAV and potentially higher than the Target Fund's current earnings yield on NAV; thus, assuming that the Reorganization is consummated and that the Acquiring Fund's distribution policy remains in place after the Reorganization, common shareholders of the Acquiring Fund may experience a distribution rate on NAV comparable (i.e., the same or slightly lower or higher) to their current distribution rate on NAV and common shareholders of the Target Fund may experience a distribution rate on NAV that is potentially higher than their current distribution rate on NAV.

The Combined Fund's earnings and distribution rate on NAV may change over time, and depending on market conditions, may be higher or lower than each Fund's earnings and distribution rate on NAV prior to the Reorganization. It is also anticipated that shareholders of the Target Fund may benefit from other potential benefits associated with the Reorganization (including as a result of the Combined Fund's larger size) as more fully discussed herein. See Information About the Reorganization Reasons for the Reorganization. A Fund's earnings and net investment income are variables which depend on many factors, including its asset mix, portfolio turnover level, the amount of leverage utilized by the Fund, the costs of such leverage, the performance of its investments, the movement of interest rates and general market conditions. There can be no assurance that the future earnings of a Fund, including the Combined Fund after the Reorganization, will remain constant.

### *Undistributed Net Investment Income.*

If the Reorganization is approved by shareholders, then substantially all of the undistributed net investment income, if any, of each Fund is expected to be declared to such Fund's common shareholders prior to the Closing Date (the Pre-Reorganization Declared UNII Distributions). The declaration date, ex-dividend date (the Ex-Dividend Date) and record date of the Pre-Reorganization Declared UNII Distributions will occur prior to the Closing Date. However, all or a significant portion of the Pre-Reorganization Declared UNII Distributions may be paid in one or more distributions to common shareholders of the Funds entitled to such Pre-Reorganization Declared UNII Distributions after the Closing Date. Former Target Fund shareholders entitled to such Pre-Reorganization Declared UNII Distributions paid after the Closing Date will receive such distributions in cash.

BlackRock MuniYield Michigan Quality Fund, Inc. (MIY), as the Combined Fund following the Reorganization, does not currently expect to declare any distributions during the first month following the Closing Date. Accordingly, persons who purchase Common Shares of any of the Funds on or after the Ex-Dividend Date for the Pre-Reorganization Declared UNII Distributions should not expect to receive any distributions from any Fund until distributions, if any, are declared by the Board of the Combined Fund and paid to shareholders entitled to any such distributions. No such distributions are expected to be paid by the Combined Fund until at least approximately two months following the Closing Date.

**Table of Contents**

The Combined Fund's earnings and distribution rate on NAV will change over time, and depending on market conditions, may be higher or lower than each Fund's earnings and distribution rate on NAV prior to the Reorganization. The Combined Fund is anticipated to retain a lower UNII balance after the Reorganization than the Acquiring Fund prior to the Reorganization; however, the Combined Fund is anticipated to benefit from a lower expense ratio and other benefits of economies of scale as discussed herein. Each Fund reserves the right to change its distribution policy with respect to common share distributions and the basis for establishing the rate of its distributions for the Common Shares at any time and may do so without prior notice to common shareholders. The payment of any distributions by any Fund is subject to, and will only be made when, as and if, declared by the Board of such Fund. There is no assurance the Board of any Fund will declare any distributions for such Fund.

To the extent any Pre-Reorganization Declared UNII Distributions is not an exempt interest dividend (as defined in the Code), the distribution may be taxable to shareholders for U.S. Federal income tax purposes.

*Premium/Discount to NAV.*

As with any capital stock, the price of each Fund's Common Shares will fluctuate based on market conditions and other factors. If Common Shares are sold, the price received may be more or less than the original investment. Each Fund's Common Shares are designed for long-term investors and should not be treated as trading vehicles. Shares of closed-end management investment companies frequently trade at a discount from their NAV. This risk may be greater for investors who sell their Common Shares in a relatively short period of time after the completion of the Reorganization.

The Common Shares of each Fund have historically traded at both a premium and a discount. The table below sets forth the market price, NAV, and the premium/discount to NAV of each Fund as of June 5, 2015.

<b>Fund</b>	<b>Market Price</b>	<b>NAV</b>	<b>Premium/(Discount) to NAV</b>
Target Fund (MYM)	\$12.50	\$14.34	(12.83)%
Acquiring Fund (MIY)	\$13.44	\$15.34	(12.39)%

To the extent the Target Fund Common Shares are trading at a wider discount (or a narrower premium) than the Acquiring Fund at the time of the Reorganization, the Target Fund's common shareholders would have the potential for an economic benefit by the narrowing of the discount or widening of the premium. To the extent the Target Fund Common Shares are trading at a narrower discount (or wider premium) than the Acquiring Fund at the time of the Reorganization, Target Fund common shareholders may be negatively impacted if the Reorganization is consummated. Acquiring Fund common shareholders would only benefit from a premium/discount perspective to the extent the Acquiring Fund's post-Reorganization discount (or premium) improves.

There can be no assurance that, after the Reorganization, Common Shares of the Combined Fund will trade at a narrower discount to NAV or wider premium to NAV than the Common Shares of any individual Fund prior to the Reorganization. Upon consummation of the Reorganization, the Acquiring Fund Common Shares may trade at a price that is less than the Acquiring Fund's current trading market price. In the Reorganization, common shareholders of the Target Fund will receive Common Shares of the Acquiring Fund based on the relative NAVs (not the market values) of each respective Fund's Common Shares. The market value of the Common Shares of the Combined Fund may be less than the market value of the Common Shares of each respective Fund prior to the Reorganization.

*Tax Considerations.*

The Reorganization is intended to qualify as a reorganization within the meaning of Section 368(a) of the Code. If the Reorganization so qualifies, in general, shareholders of the Target Fund will recognize no gain or loss for U.S. federal income tax purposes upon the exchange of their Target Fund Shares for Acquiring Fund

## **Table of Contents**

Shares pursuant to the Reorganization (except with respect to cash received in lieu of fractional Common Shares). Additionally, the Target Fund will recognize no gain or loss for U.S. federal income tax purposes by reason of the Reorganization. Neither the Acquiring Fund nor its shareholders will recognize any gain or loss for U.S. federal income tax purposes pursuant to the Reorganization.

Shareholders of each Fund may receive distributions prior to, or after, the consummation of the Reorganization, including distributions attributable to their proportionate share of each Fund's undistributed net investment income declared prior to the consummation of the Reorganization or the Combined Fund built-in gains, if any, recognized after the Reorganization, when such income and gains are eventually distributed by the Combined Fund. To the extent that such a distribution is not an exempt interest dividend (as defined in the Code), the distribution may be taxable to shareholders for U.S. federal income tax purposes.

The Funds' shareholders should consult their own tax advisers regarding the U.S. federal income tax consequences of the Reorganization, as well as the effects of state, local and non-U.S. tax laws, including possible changes in tax laws.

See Certain U.S. Federal Income Tax Consequences of the Reorganization for a summary of certain U.S. federal income tax consequences of the Reorganization.

### **General Risks of Investing in the Acquiring Fund**

The Combined Fund will be managed in accordance with the same investment objective and investment policies, and subject to the same risks, as the Acquiring Fund. Risk is inherent in all investing. The value of your investment in the Acquiring Fund, as well as the amount of return you receive on your investment, may fluctuate significantly from day to day and over time. The Acquiring Fund is not meant to provide a vehicle for those who wish to exploit short-term swings in the stock market and is intended for long-term investors. An investment in Common Shares of the Acquiring Fund should not be considered a complete investment program. Each shareholder should take into account the Acquiring Fund's investment objective as well as the shareholder's other investments when considering an investment in the Acquiring Fund. You may lose part or all of your investment in the Acquiring Fund or your investment may not perform as well as other similar investments. The risks that predominately affect Common Shares of the Acquiring Fund include the following:

**Non-Diversified Status.** The Acquiring Fund is a non-diversified fund. As defined in the 1940 Act, a non-diversified fund may have a significant part of its investments in a smaller number of issuers than can a diversified fund. Having a larger percentage of assets in a smaller number of issuers makes a non-diversified fund, like the Acquiring Fund, more susceptible to the risk that one single event or occurrence can have a significant adverse impact upon the Acquiring Fund.

**Investment and Market Discount Risk.** An investment in the Acquiring Fund's Common Shares is subject to investment risk, including the possible loss of the entire amount that you invest. As with any stock, the price of the Acquiring Fund's Common Shares will fluctuate with market conditions and other factors. Common Shares are designed for long-term investors and the Acquiring Fund should not be treated as a trading vehicle. Shares of closed-end management investment companies frequently trade at a discount from their NAV. This risk is separate and distinct from the risk that the Acquiring Fund's NAV could decrease as a result of its investment activities. At any point in time an investment in the Acquiring Fund's Common Shares may be worth less than the original amount invested, even after taking into account distributions paid by the Acquiring Fund. This risk may be greater for investors who sell their Common Shares in a relatively short period of time after completion of the Reorganization.

**Municipal Bond Market Risk.** Economic exposure to the municipal bond market involves certain risks. The Acquiring Fund's economic exposure to municipal bonds includes municipal bonds in the Acquiring Fund's portfolio and municipal bonds to which the Acquiring Fund is exposed through the ownership of residual interest

## **Table of Contents**

municipal tender option bonds ( TOBs Residuals ). The municipal market is one in which dealer firms make markets in bonds on a principal basis using their proprietary capital, and during the recent market turmoil these firms' capital was severely constrained. As a result, some firms were unwilling to commit their capital to purchase and to serve as a dealer for municipal bonds. Certain municipal bonds may not be registered with the SEC or any state securities commission and will not be listed on any national securities exchange. The amount of public information available about the municipal bonds to which the Acquiring Fund is economically exposed is generally less than that for corporate equities or bonds, and the investment performance of the Acquiring Fund may therefore be more dependent on the analytical abilities of the Investment Advisor than would be a stock fund or taxable bond fund. The secondary market for municipal bonds, particularly the below investment grade bonds to which the Acquiring Fund may be economically exposed, also tends to be less well-developed or liquid than many other securities markets, which may adversely affect the ability to sell such bonds at attractive prices or at prices approximating those at which the Acquiring Fund currently values them.

In addition, many state and municipal governments that issue securities are under significant economic and financial stress and may not be able to satisfy their obligations. The ability of municipal issuers to make timely payments of interest and principal may be diminished during general economic downturns and as governmental cost burdens are reallocated among federal, state and local governments. The taxing power of any governmental entity may be limited by provisions of state constitutions or laws and an entity's credit will depend on many factors, including the entity's tax base, the extent to which the entity relies on federal or state aid, and other factors which are beyond the entity's control. In addition, laws enacted in the future by Congress or state legislatures or referenda could extend the time for payment of principal and/or interest, or impose other constraints on enforcement of such obligations or on the ability of municipalities to levy taxes. Issuers of municipal bonds might seek protection under the bankruptcy laws. In the event of bankruptcy of such an issuer, holders of municipal bonds could experience delays in collecting principal and interest and such holders may not, in all circumstances, be able to collect all principal and interest to which they are entitled. To enforce its rights in the event of a default in the payment of interest or repayment of principal, or both, the Acquiring Fund may take possession of and manage the assets securing the issuer's obligations on such securities, which may increase the Acquiring Fund's operating expenses. Any income derived from the Acquiring Fund's ownership or operation of such assets may not be tax-exempt.

**Risk Factors and Special Considerations Relating to Michigan Municipal Bonds.** The Fund ordinarily will invest at least 80% of its total assets in Michigan Municipal Bonds; therefore, it is more susceptible to factors adversely affecting issuers of Michigan Municipal Bonds than is a municipal bond fund that is not concentrated in issuers of Michigan Municipal Bonds to this degree. The information set forth below and the related information in Appendix B of this prospectus are derived from sources that are generally available to investors. This information is intended to give a recent historical description and is not intended to indicate future or continuing trends in the financial or other positions of the State of Michigan ( State ) or its local units of government. It should be noted that the information set forth below and the related information in Appendix B of this prospectus is based on the economic and budget forecasts found in certain recent publications issued by the State. The accuracy and completeness of those publications have not been independently verified.

Following the 2000 recession, the State's economy experienced a faster decline than the U.S. economy, hampered by continued job losses, mostly in the manufacturing sector. Michigan's economy relies heavily on the performance of the manufacturing sector in general, and the auto industry specifically. Employment in Michigan peaked in June 2000 and dropped steadily until 2003. Throughout most of the 2000s, employment in Michigan fluctuated with monthly job gains offset by monthly job losses. However, in 2009, Michigan's unemployment rate rose to 13.5 percent- the State's highest rate since 1983. In each year between 2010 and 2014, inclusive, the State's unemployment rate decreased. Over the past four years, Michigan's unemployment rate dropped a combined 4.7 percentage points with the largest share of decline occurring in 2011 (-2.3 points). Michigan's 2013 unemployment rate was 8.8%, the State's lowest annual unemployment rate since 2008. Although unemployment in Michigan continues to fall, it still remains above the national rate.

## **Table of Contents**

The unemployment rate has had a significant adverse impact on the revenue of the State and its local governments, and has had the effect of requiring the State and local units of government to make significant adjustments in expenditures, and to seek additional revenue sources. The City of Detroit was hit hardest by the broad decline in economic activity and rise in unemployment. On July 18, 2013, the City of Detroit filed for bankruptcy protection under Chapter 9 of Title 11 of the United States Code. On December 10, 2014, less than seventeen months later, the City of Detroit emerged from the nation's largest municipal bankruptcy. The bankruptcy process included a Grand Bargain whereby philanthropic and business communities joined with the State to contribute funds to the City of Detroit to reduce the impact on pensions and extend vital services. \$194.8 million was withdrawn to fund the State's contribution to the Detroit bankruptcy Grand Bargain. The impact of the bankruptcy filing on the State and other local units of government in Michigan cannot be predicted at this time.

The State's outstanding debt totaled \$7.02 billion as of September 30, 2014. This was comprised of \$1.942 billion in general obligation bonds, \$5.075 billion in revenue dedicated bonds, and \$99 million in commercial paper.

As of June 1, 2015 Moody's and S&P have assigned Michigan's long term general obligation bonds ratings of Aa2 and AA- respectively. These ratings reflect the State's credit quality only, and do not indicate the creditworthiness of other tax-exempt securities in which the Fund may invest. Additionally, it should be noted that the creditworthiness of obligations issued by local Michigan issuers may be unrelated to the creditworthiness of obligations issued by the State, and that there is no obligation on the part of the State to make payment on such local obligations in the event of default.

Michigan's economic problems heighten the risk of investing in bonds issued by the State and its political subdivisions, agencies, instrumentalities and authorities, including the risk of potential issuer default. There is a heightened risk that there could be an interruption in payments to bondholders in some cases. This possibility, along with the risk of a further downgrade in the credit rating of the State's general obligation debt, could result in a reduction in the market value of the bonds held by the Fund, which could adversely affect the Fund's net asset values or the distributions paid by the Fund. No assurance can be given that such rating will not be lowered in the future.

**Fixed Income Securities Risks.** Fixed income securities in which the Acquiring Fund may invest are generally subject to the following risks:

*Interest Rate Risk.* The market value of bonds and other fixed-income securities changes in response to interest rate changes and other factors. Interest rate risk is the risk that prices of bonds and other fixed-income securities will increase as interest rates fall and decrease as interest rates rise. The Acquiring Fund may be subject to a greater risk of rising interest rates due to the current period of historically low interest rates. The magnitude of these fluctuations in the market price of bonds and other fixed-income securities is generally greater for those securities with longer maturities. Fluctuations in the market price of the Acquiring Fund's investments will not affect interest income derived from instruments already owned by the Acquiring Fund, but will be reflected in the Acquiring Fund's NAV. The Acquiring Fund may lose money if short-term or long-term interest rates rise sharply in a manner not anticipated by the Acquiring Fund's management. To the extent the Acquiring Fund invests in debt securities that may be prepaid at the option of the obligor (such as mortgage-related securities), the sensitivity of such securities to changes in interest rates may increase (to the detriment of the Acquiring Fund) when interest rates rise. Moreover, because rates on certain floating rate debt securities typically reset only periodically, changes in prevailing interest rates (and particularly sudden and significant changes) can be expected to cause some fluctuations in the NAV of the Acquiring Fund to the extent that it invests in floating rate debt securities. These basic principles of bond prices also apply to U.S. government securities. A security backed by the full faith and credit of the U.S. government is guaranteed only as to its stated interest rate and face value at maturity, not its current market price. Just like other fixed-income securities, government-guaranteed securities will fluctuate in value when interest rates change.

## **Table of Contents**

The Acquiring Fund's use of leverage, as described below, will tend to increase the Acquiring Fund's interest rate risk. The Acquiring Fund may utilize certain strategies, including taking positions in futures or interest rate swaps, for the purpose of reducing the interest rate sensitivity of fixed income securities held by the Acquiring Fund and decreasing the Acquiring Fund's exposure to interest rate risk. The Acquiring Fund is not required to hedge its exposure to interest rate risk and may choose not to do so. In addition, there is no assurance that any attempts by the Acquiring Fund to reduce interest rate risk will be successful or that any hedges that the Acquiring Fund may establish will perfectly correlate with movements in interest rates.

*Issuer Risk.* The value of fixed income securities may decline for a number of reasons which directly relate to the issuer, such as management performance, financial leverage, reduced demand for the issuer's goods and services, historical and prospective earnings of the issuer and the value of the assets of the issuer.

*Credit Risk.* Credit risk is the risk that one or more fixed income securities in the Acquiring Fund's portfolio will decline in price or fail to pay interest or principal when due because the issuer of the security experiences a decline in its financial status. Credit risk is increased when a portfolio security is downgraded or the perceived creditworthiness of the issuer deteriorates. In addition, to the extent the Acquiring Fund uses credit derivatives, such use will expose it to additional risk in the event that the bonds underlying the derivatives default. The degree of credit risk depends on the issuer's financial condition and on the terms of the securities.

*Prepayment Risk.* During periods of declining interest rates, borrowers may exercise their option to prepay principal earlier than scheduled. For fixed rate securities, such payments often occur during periods of declining interest rates, forcing the Acquiring Fund to reinvest in lower yielding securities, resulting in a possible decline in the Acquiring Fund's income and distributions to shareholders. This is known as prepayment or call risk. For premium bonds (bonds acquired at prices that exceed their par or principal value) purchased by the Acquiring Fund, prepayment risk may be enhanced.

*Reinvestment Risk.* Reinvestment risk is the risk that income from the Acquiring Fund's portfolio will decline if the Acquiring Fund invests the proceeds from matured, traded or called fixed income securities at market interest rates that are below the Acquiring Fund portfolio's current earnings rate.

*Duration and Maturity Risk.* The Investment Advisor may seek to adjust the portfolio's duration or maturity based on their assessment of current and projected market conditions and all factors that the Investment Advisor deems relevant. Any decisions as to the targeted duration or maturity of any particular category of investments or of the Acquiring Fund's portfolio generally will be made based on all pertinent market factors at any given time. The Acquiring Fund may incur costs in seeking to adjust the portfolio average duration or maturity. There can be no assurance that the Investment Advisor's assessment of current and projected market conditions will be correct or that any strategy to adjust the portfolio's duration or maturity will be successful at any given time. Generally speaking, the longer the duration of the Acquiring Fund's portfolio, the more exposure the Acquiring Fund will have to the interest rate risks described above.

**Municipal Securities Risks.** Municipal securities risks include the ability of the issuer to repay the obligation, the relative lack of information about certain issuers of municipal securities, and the possibility of future legislative changes which could affect the market for and value of municipal securities. These risks include:

*General Obligation Bonds Risks.* The full faith, credit and taxing power of the municipality that issues a general obligation bond secures payment of interest and repayment of principal. Timely payments depend on the issuer's credit quality, ability to raise tax revenues and ability to maintain an adequate tax base.

*Revenue Bonds Risks.* Revenue bonds issued by state or local agencies to finance the development of low-income, multi-family housing involve special risks in addition to those associated with municipal bonds generally, including that the underlying properties may not generate sufficient income to pay expenses and

## **Table of Contents**

interest costs. Payments of interest and principal on revenue bonds are made only from the revenues generated by a particular facility, class of facilities or the proceeds of a special tax or other revenue source. These payments depend on the money earned by the particular facility or class of facilities, or the amount of revenues derived from another source. Such bonds are generally nonrecourse against the property owner, may be junior to the rights of others with an interest in the properties, may pay interest that changes based in part on the financial performance of the property, may be prepayable without penalty and may be used to finance the construction of housing developments which, until completed and rented, do not generate income to pay interest. Increases in interest rates payable on senior obligations may make it more difficult for issuers to meet payment obligations on subordinated bonds.

*Private Activity Bonds Risks.* Municipalities and other public authorities issue private activity bonds to finance development of industrial facilities for use by a private enterprise. The private enterprise pays the principal and interest on the bond, and the issuer does not pledge its full faith, credit and taxing power for repayment. If the private enterprise defaults on its payments, the Acquiring Fund may not receive any income or get its money back from the investment. These bonds may subject certain investors in the Acquiring Fund to the federal alternative minimum tax.

*Moral Obligation Bonds Risks.* Moral obligation bonds are generally issued by special purpose public authorities of a state or municipality. If the issuer is unable to meet its obligations, repayment of these bonds becomes a moral commitment, but not a legal obligation, of the state or municipality.

*Municipal Notes Risks.* Municipal notes are shorter term municipal debt obligations. They may provide interim financing in anticipation of, and are secured by, tax collection, bond sales or revenue receipts. If there is a shortfall in the anticipated proceeds, the notes may not be fully repaid and the Acquiring Fund may lose money.

*Municipal Lease Obligations Risks.* In a municipal lease obligation, the issuer agrees to make payments when due on the lease obligation. The issuer will generally appropriate municipal funds for that purpose, but is not obligated to do so. Although the issuer does not pledge its unlimited taxing power for payment of the lease obligation, the lease obligation is secured by the leased property. However, if the issuer does not fulfill its payment obligation it may be difficult to sell the property and the proceeds of a sale may not cover the Acquiring Fund's loss.

Municipal leases and certificates of participation involve special risks not normally associated with general obligations or revenue bonds. 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 nonappropriation 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 that the governmental issuer is prevented from maintaining occupancy of the lease premises or utilizing the leased equipment. Although the obligations may be secured by the leased equipment or facilities, the disposition of the property in the event of nonappropriation or foreclosure might prove difficult, time consuming and costly, and may result in a delay in recovering or the failure to fully recover ownership of the assets.

Certificates of participation, which represent interests in unmanaged pools of municipal leases or installment contracts, involve the same risks as the underlying municipal leases. In addition, the Acquiring Fund may be dependent upon the municipal authority issuing the certificate of participation to exercise remedies with respect to the underlying securities.

## **Table of Contents**

Certificates of participation also entail a risk of default or bankruptcy, both of the issuer of the municipal lease and also the municipal agency issuing the certificate of participation.

**Tax-Exempt Status Risk.** In making investments, the Acquiring Fund and the Investment Advisor will rely on the opinion of issuers' bond counsel and, in the case of derivative securities, sponsors' counsel, on the tax-exempt status of interest on municipal obligations and payments under tax-exempt derivative securities. Neither the Acquiring Fund nor the Investment Advisor will independently review the bases for those tax opinions. If any of those tax opinions are ultimately determined to be incorrect or if events occur after the security is acquired that impact the security's tax-exempt status, the Acquiring Fund and its shareholders could be subject to substantial tax liabilities. An assertion by the Internal Revenue Service (IRS) that a portfolio security is not exempt from U.S. federal income tax (contrary to indications from the issuer) could affect the Acquiring Fund's and shareholder's income tax liability for the current or past years and could create liability for information reporting penalties. In addition, an IRS assertion of taxability may impair the liquidity and the fair market value of the securities.

**Taxability Risk.** The Acquiring Fund intends to minimize the payment of taxable income to shareholders by investing in tax-exempt or municipal securities in reliance at the time of purchase on an opinion of bond counsel to the issuer that the interest paid on those securities will be excludable from gross income for U.S. federal income tax purposes. Such securities, however, may be determined to pay, or have paid, taxable income subsequent to the Acquiring Fund's acquisition of the securities. In that event, the IRS may demand that the Acquiring Fund pay U.S. federal income taxes on the affected interest income, and, if the Acquiring Fund agrees to do so, the Acquiring Fund's yield could be adversely affected. In addition, the treatment of dividends previously paid or to be paid by the Acquiring Fund as exempt interest dividends could be adversely affected, subjecting the Acquiring Fund's shareholders to increased U.S. federal income tax liabilities. In addition, future laws, regulations, rulings or court decisions may cause interest on municipal securities to be subject, directly or indirectly, to U.S. federal income taxation or interest on state municipal securities to be subject to state or local income taxation, or the value of state municipal securities to be subject to state or local intangible personal property tax, or may otherwise prevent the Acquiring Fund from realizing the full current benefit of the tax-exempt status of such securities. Any such change could also affect the market price of such securities, and thus the value of an investment in the Acquiring Fund.

**Leverage Risk.** The use of leverage creates an opportunity for increased net investment income dividends to Common Shares, but also creates risks for the holders of Common Shares. There is no assurance that the Acquiring Fund's intended leveraging strategy will be successful. Leverage involves risks and special considerations for common shareholders, including:

the likelihood of greater volatility of net asset value, market price and dividend rate of the Common Shares than a comparable portfolio without leverage;

the risk that fluctuations in interest rates on borrowings and short-term debt or in the interest or dividend rates on any leverage that the Acquiring Fund must pay will reduce the return to the common shareholders;

the effect of leverage in a declining market, which is likely to cause a greater decline in the net asset value of the Common Shares than if the Acquiring Fund were not leveraged, which may result in a greater decline in the market price of the Common Shares;

when the Acquiring Fund uses financial leverage, the investment advisory fees payable to the Investment Advisor will be higher than if the Acquiring Fund did not use leverage; and

leverage may increase operating costs, which may reduce total return.

Any decline in the net asset value of the Acquiring Fund's investments will be borne entirely by the holders of Common Shares. Therefore, if the market value of the Acquiring Fund's portfolio declines, leverage will



## **Table of Contents**

result in a greater decrease in net asset value to the holders of Common Shares than if the Acquiring Fund were not leveraged. This greater net asset value decrease will also tend to cause a greater decline in the market price for the Common Shares. There can be no assurance that the Acquiring Fund will reduce leverage in the future or that any reduction, if undertaken, will benefit the holders of Common Shares. Changes in the future direction of interest rates are very difficult to predict accurately. If the Acquiring Fund were to reduce leverage based on a prediction about future changes to interest rates, and that prediction turned out to be incorrect, the reduction in leverage would likely operate to reduce the income and/or total returns to holders of Common Shares relative to the circumstance where the Acquiring Fund had not reduced leverage. The Acquiring Fund may decide that this risk outweighs the likelihood of achieving the desired reduction to volatility in income and share price if the prediction were to turn out to be correct, and determine not to reduce leverage.

The Acquiring Fund currently utilizes leverage through the issuance of VRDP Shares (see Information about the VRDP Shares of the Funds ) and investments in TOBs Residuals (see Tender Option Bond Risk ). The use of TOBs Residuals may require the Acquiring Fund to segregate or designate on its books and records assets to cover its obligations. While the segregated or earmarked assets may be invested in liquid securities, they may not be used for other operational purposes. Consequently, the use of leverage may limit the Acquiring Fund's flexibility and may require that the Acquiring Fund sell other portfolio investments to pay Fund expenses, to maintain assets in an amount sufficient to cover the Acquiring Fund's leveraged exposure or to meet other obligations at a time when it may be disadvantageous to sell such assets.

Certain types of leverage used by the Acquiring Fund may result in the Acquiring Fund being subject to covenants relating to asset coverage and portfolio composition requirements. The Acquiring Fund may be subject to certain restrictions on investments imposed by guidelines of one or more rating agencies that issue ratings for the Acquiring Fund VRDP Shares, an agreement with the liquidity provider for the Acquiring Fund VRDP Shares or the governing instrument for the Acquiring Fund VRDP Shares. These guidelines may impose asset coverage or portfolio composition requirements that are more stringent than those imposed by the 1940 Act. The Investment Advisor does not believe that these covenants or guidelines will impede it from managing the Acquiring Fund's portfolio in accordance with the Acquiring Fund's investment objective and policies.

While there are any preferred shares of the Acquiring Fund outstanding, the Acquiring Fund may not declare any cash dividend or other distribution on its Common Shares, unless at the time of such declaration, (i) all accrued preferred shares dividends have been paid and (ii) the value of the Acquiring Fund's total assets (determined after deducting the amount of such dividend or other distribution), less all liabilities and indebtedness of the Acquiring Fund, is at least 200% (as required by the 1940 Act) of the liquidation preference of the outstanding preferred shares (expected to equal the aggregate original purchase price of the outstanding preferred shares plus any accrued and unpaid dividends thereon, whether or not earned or declared on a cumulative basis). In addition to the requirements of the 1940 Act, the Acquiring Fund may be required to comply with other asset coverage requirements as a condition of the Acquiring Fund obtaining a rating of its preferred shares from a nationally recognized rating service or other asset coverage requirements under an agreement with the liquidity provider of the Acquiring Fund VRDP Shares. These requirements may include an asset coverage test more stringent than that under the 1940 Act. This limitation on the Acquiring Fund's ability to make distributions on its Common Shares could in certain circumstances impair the ability of the Acquiring Fund to maintain its qualification for taxation as a regulated investment company under the Code. The Acquiring Fund may, however, to the extent possible, purchase or redeem preferred shares from time to time to maintain compliance with such asset coverage requirements and may pay special dividends to the holders of the preferred shares in certain circumstances in connection with any such impairment of the Acquiring Fund's status as a regulated investment company under the Code.

The Acquiring Fund may invest in the securities of other investment companies. Such securities may also be leveraged, and will therefore be subject to the leverage risks described above. This additional leverage may in certain market conditions reduce the net asset value of the Acquiring Fund's Common Shares and the returns to the holders of Common Shares.

## **Table of Contents**

**Tender Option Bond Risk.** The Acquiring Fund currently leverages its assets through the use of TOB Residuals, which are derivative interests in municipal bonds. The TOB Residuals in which the Acquiring Fund will invest pay interest or income that, in the opinion of counsel to the issuer, is exempt from regular Federal income tax. BlackRock will not conduct its own analysis of the tax status of the interest or income paid by TOB Residuals held by the Acquiring Fund, but will rely on the opinion of counsel to the issuer. There is no assurance that the Acquiring Fund's strategy of using TOB Residuals to leverage its assets will be successful.

TOB Residuals represent beneficial interests in a special purpose trust formed for the purpose of holding municipal bonds contributed by one or more funds (a TOB Trust). A TOB Trust typically issues two classes of beneficial interests: short-term floating rate interests (TOB Floaters), which are sold to third party investors, and TOB Residuals, which are generally issued to the fund(s) that transferred municipal bonds to the TOB Trust. TOB Floaters may have first priority on the cash flow from the municipal bonds held by the TOB Trust and are enhanced with a liquidity support arrangement provided by a third-party bank or other financial institution (the TOBs Liquidity Provider) which allows holders to tender their position at par (plus accrued interest). The Acquiring Fund, as a holder of TOB Residuals, is paid the residual cash flow from the TOB Trust. As result, distributions on TOB Residuals will bear an inverse relationship to short-term municipal bond interest rates. Distributions on the TOB Residuals paid to the Acquiring Fund will be reduced or, in the extreme, eliminated as short-term municipal interest rates rise and will increase when short-term municipal interest rates fall. The amount of such reduction or increase is a function, in part, of the amount of TOB Floaters sold by the TOB Trust relative to the amount of the TOB Residuals that it sells. The greater the amount of TOB Floaters sold relative to the TOB Residuals, the more volatile the distributions on the TOB Residuals will be. Short-term interest rates are at historic lows and may be more likely to rise in the current market environment.

Any economic leverage achieved through the Acquiring Fund's investment in TOB Residuals will increase the possibility that Common Share long-term returns will be diminished if the cost of the TOB Floaters issued by a TOB Trust exceeds the return on the securities in the TOB Trust. If the income and gains earned on municipal securities owned by a TOB Trust that issues TOB Residuals to the Acquiring Fund are greater than the payments due on the TOB Floaters issued by the TOB Trust, the Acquiring Fund's returns will be greater than if it had not invested in the TOB Residuals.

Although the Acquiring Fund generally would unwind a TOB transaction rather than try to sell a TOB Residual, if it did try to sell a TOB Residual, its ability to do so would depend on the liquidity of the TOB Residual. TOB Residuals have varying degrees of liquidity based, among other things, upon the liquidity of the underlying securities deposited in the TOB Trust. The market price of TOB Residuals is more volatile than the underlying municipal bonds due to leverage.

The leverage attributable to the Acquiring Fund's use of TOB Residuals may be called away on relatively short notice and therefore may be less permanent than more traditional forms of leverage. The TOB Trust may be collapsed without the consent of the Acquiring Fund upon the occurrence of tender option termination events (TOTES) and mandatory termination events (MTEs), as defined in the TOB Trust agreements. In the case of an MTE, after the payment of fees, the holders of the TOB Floaters would be paid senior to the TOB Residual holders (i.e., the Acquiring Fund). In contrast, in the case of a TOTE, after payment of fees, the holders of TOB Floaters and the TOB Residual holders would be paid pro rata in proportion to the respective face values of their certificates.

The Acquiring Fund may invest in a TOB Trust on either a non-recourse or recourse basis. If the Acquiring Fund invests in a TOB Trust on a recourse basis, it will typically enter into a reimbursement agreement with the TOBs Liquidity Provider pursuant to which the Acquiring Fund is required to reimburse the TOBs Liquidity Provider the balance, if any, of the amount owed under the liquidity facility over the liquidation proceeds (the Liquidation Shortfall). As a result, if the Acquiring Fund invests in a recourse TOB Trust, the Acquiring Fund will bear the risk of loss with respect to any Liquidation Shortfall.

## **Table of Contents**

The use of TOB Residuals will require the Acquiring Fund to earmark or segregate liquid assets in an amount equal to any TOB Floaters, plus any accrued but unpaid interest due on the TOB Floaters, issued by TOB Trusts sponsored by, or on behalf of, the Acquiring Fund that are not owned by the Acquiring Fund. The use of TOB Residuals may also require the Acquiring Fund to earmark or segregate liquid assets in an amount equal to loans provided by the TOBs Liquidity Provider to the TOB Trust to purchase tendered TOB Floaters. While the segregated assets may be invested in liquid securities, they may not be used for other operational purposes. Consequently, the use of leverage through TOB Residuals may limit the Acquiring Fund's flexibility and may require that the Acquiring Fund sell other portfolio investments to pay Fund expenses, to maintain assets in an amount sufficient to cover the Acquiring Fund's leveraged exposure or to meet other obligations at a time when it may be disadvantageous to sell such assets. Future regulatory requirements or SEC guidance may necessitate more onerous contractual or regulatory requirements, which may increase the costs or reduce the degree of potential economic benefits of TOB Trust transactions or limit the Acquiring Fund's ability to enter into or manage TOB Trust transactions.

On December 10, 2013, regulators published final rules implementing section 619 of the Dodd-Frank Act (the Volcker Rule), which prohibit banking entities from engaging in proprietary trading of certain instruments and limit such entities' investments in, and relationships with, covered funds, as defined in the Volcker Rule. Banking entities subject to the Volcker Rule are required to fully comply by July 21, 2015, with respect to investments in and relationships with TOB Trusts that were not in place prior to December 31, 2013, and by July 21, 2016, with respect to investments in and relationships with TOB Trusts that were in place prior to December 31, 2013. As a result, TOB Trusts may need to be restructured or unwound.

In response to the restrictions imposed by the Volcker Rule, market participants have developed a new structure for TOB Trusts designed to ensure that no banking entity is sponsoring the TOB Trust for purposes of the Volcker Rule. This structure remains untested. It is possible that regulators could take positions that could limit the market for such newly structured TOB Trust transactions or the Acquiring Fund's ability to hold TOB Residuals. Under the new TOB Trust structure, the Acquiring Fund will have certain additional duties and responsibilities, which may give rise to certain additional risks including, but not limited to, compliance, securities law and operational risks.

The SEC and various federal banking and housing agencies recently adopted credit risk retention rules for securitizations (the Risk Retention Rules), which take effect in December 2016. The Risk Retention Rules would require the sponsor of a TOB Trust to retain at least 5% of the credit risk of the underlying assets supporting the TOB Trust's Municipal Bonds. The Risk Retention Rules may adversely affect the Acquiring Fund's ability to engage in TOB Trust transactions or increase the costs of such transactions in certain circumstances.

There can be no assurance that the Acquiring Fund can successfully enter into restructured TOB Trust transactions in order to refinance its existing TOB Residual holdings prior to the compliance date for the Volcker Rule, which may require that the Acquiring Fund unwinds existing TOB Trusts.

TOB Trust transactions constitute an important component of the municipal bond market. Accordingly, implementation of the Volcker Rule and the Risk Retention Rules may adversely impact the municipal market, including through reduced demand for and liquidity of municipal bonds and increased financing costs for municipal issuers. Any such developments could adversely affect the Acquiring Fund. The ultimate impact of these rules on the TOB market and the overall municipal market is not yet certain.

Please see The Acquiring Fund's Investments Leverage TOB Residuals for additional information.

**Insurance Risk.** Insurance guarantees that interest payments on a municipal security will be made on time and that the principal will be repaid when the security matures. Insurance is expected to protect the Acquiring Fund against losses caused by a municipal security issuer's failure to make interest and principal payments.

## **Table of Contents**

However, insurance does not protect the Acquiring Fund or its shareholders against losses caused by declines in a municipal security's value. Also, the Acquiring Fund cannot be certain that any insurance company will make the payments it guarantees. Certain significant providers of insurance for municipal securities have recently incurred significant losses as a result of exposure to sub-prime mortgages and other lower credit quality investments that have experienced recent defaults or otherwise suffered extreme credit deterioration. As a result, such losses have reduced the insurers' capital and called into question their continued ability to perform their obligations under such insurance if they are called upon to do so in the future. While an insured municipal security will typically be deemed to have the rating of its insurer, if the insurer of a municipal security suffers a downgrade in its credit rating or the market discounts the value of the insurance provided by the insurer, the rating of the underlying municipal security will be more relevant and the value of the municipal security would more closely, if not entirely, reflect such rating. The Acquiring Fund may lose money on its investment if the insurance company does not make payments it guarantees. If a municipal security's insurer fails to fulfill its obligations or loses its credit rating, the value of the security could drop.

**Yield and Ratings Risk.** The yields on certain obligations are dependent on a variety of factors, including general market conditions, conditions in the particular market for the obligation, the financial condition of the issuer, the size of the offering, the maturity of the obligation and the ratings of the issue. The ratings of Moody's, S&P and Fitch, which are described in Appendix C to the Statement of Additional Information, represent their respective opinions as to the quality of the obligations which they undertake to rate. Ratings are relative and subjective and, although ratings may be useful in evaluating the safety of interest and principal payments, they do not evaluate the market value risk of such obligations. Although these ratings may be an initial criterion for selection of portfolio investments, the Investment Advisor also will independently evaluate these securities and the ability of the issuers of such securities to pay interest and principal. To the extent that the Acquiring Fund invests in securities that have not been rated by a rating agency, the Acquiring Fund's ability to achieve its investment objective will be more dependent on the Investment Advisor's credit analysis than would be the case when the Acquiring Fund invests in rated securities.

**Unrated Securities Risk.** Because the Acquiring Fund may purchase securities that are not rated by any rating organization, the Investment Advisor may, after assessing their credit quality, internally assign ratings to certain of those securities in categories similar to those of rating organizations. Some unrated securities may not have an active trading market or may be difficult to value, which means the Acquiring Fund might have difficulty selling them promptly at an acceptable price. To the extent that the Acquiring Fund invests in unrated securities, the Acquiring Fund's ability to achieve its investment objective will be more dependent on the Investment Advisor's credit analysis than would be the case when the Acquiring Fund invests in rated securities.

**Zero Coupon Securities Risk.** Zero coupon securities are securities that are sold at a discount to par value and do not pay interest during the life of the security. The discount approximates the total amount of interest the security will accrue and compound over the period until maturity at a rate of interest reflecting the market rate of the security at the time of issuance. Upon maturity, the holder of a zero coupon security is entitled to receive the par value of the security.

While interest payments are not made on zero coupon securities, holders of such securities are deemed to have received income (phantom income) annually, notwithstanding that cash may not be received currently. The effect of owning instruments that do not make current interest payments is that a fixed yield is earned not only on the original investment but also, in effect, on all discount accretion during the life of the obligations. This implicit reinvestment of earnings at a fixed rate eliminates the risk of being unable to invest distributions at a rate as high as the implicit yield on the zero coupon bond, but at the same time eliminates the holder's ability to reinvest at higher rates in the future. For this reason, some of these securities may be subject to substantially greater price fluctuations during periods of changing market interest rates than are comparable securities that pay interest currently. Longer term zero coupon bonds are more exposed to interest rate risk than shorter term zero coupon bonds. These investments benefit the issuer by mitigating its need for cash to meet debt service, but also require a higher rate of return to attract investors who are willing to defer receipt of cash.

## **Table of Contents**

The Acquiring Fund accrues income with respect to these securities for U.S. federal income tax and accounting purposes prior to the receipt of cash payments. Zero coupon securities may be subject to greater fluctuation in value and less liquidity in the event of adverse market conditions than comparably rated securities that pay cash interest at regular intervals.

Further, to maintain its qualification for pass-through treatment under the Federal tax laws, the Acquiring Fund is required to distribute income to its shareholders and, consequently, may have to dispose of other, more liquid portfolio securities under disadvantageous circumstances or may have to leverage itself by borrowing in order to generate the cash to satisfy these distributions. The required distributions may result in an increase in the Acquiring Fund's exposure to zero coupon securities.

In addition to the above-described risks, there are certain other risks related to investing in zero coupon securities. During a period of severe market conditions, the market for such securities may become even less liquid. In addition, as these securities do not pay cash interest, a Fund's investment exposure to these securities and their risks, including credit risk, will increase during the time these securities are held in the Acquiring Fund's portfolio.

**Variable Rate Demand Obligations Risk.** Variable rate demand obligations are floating rate securities that combine an interest in a long-term municipal bond with a right to demand payment before maturity from a bank or other financial institution. If the bank or financial institution is unable to pay, the Acquiring Fund may lose money.

**Indexed and Inverse Securities Risk.** Investments in inverse floaters, residual interest tender option bonds and similar instruments expose the Acquiring Fund to the same risks as investments in fixed income securities and derivatives, as well as other risks, including those associated with leverage and increased volatility. An investment in these securities typically will involve greater risk than an investment in a fixed rate security. Distributions on inverse floaters, residual interest tender option bonds and similar instruments will typically bear an inverse relationship to short term interest rates and typically will be reduced or, potentially, eliminated as interest rates rise. Inverse floaters, residual interest tender option bonds and similar instruments will underperform the market for fixed rate securities in a rising interest rate environment. Inverse floaters may be considered to be leveraged to the extent that their interest rates vary by a magnitude that exceeds the magnitude of the change in a reference rate of interest (typically a short term interest rate). The leverage inherent in inverse floaters is associated with greater volatility in their market values. Investments in inverse floaters, residual interest tender option bonds and similar instruments that have fixed income securities underlying them will expose the Acquiring Fund to the risks associated with those fixed income securities and the values of those investments may be especially sensitive to changes in prepayment rates on the underlying fixed income securities.

**When-Issued and Delayed Delivery Transactions Risk.** When-issued and delayed delivery transactions occur when securities are purchased or sold by the Acquiring Fund with payment and delivery taking place in the future to secure an advantageous yield or price. Securities purchased on a when-issued or delayed delivery basis may expose the Acquiring Fund to counterparty risk of default as well as the risk that securities may experience fluctuations in value prior to their actual delivery. The Acquiring Fund will not accrue income with respect to a when-issued or delayed delivery security prior to its stated delivery date. Purchasing securities on a when-issued or delayed delivery basis can involve the additional risk that the price or yield available in the market when the delivery takes place may not be as favorable as that obtained in the transaction itself.

**Swaps.** Swap agreements are types of derivatives. In order to seek to hedge the value of the Acquiring Fund's portfolio, to hedge against increases in the Acquiring Fund's cost associated with the interest payments on its outstanding borrowings or to seek to increase the Acquiring Fund's return, the Acquiring Fund may enter into interest rate or credit default swap transactions. In interest rate swap transactions, there is a risk that yields will move in the direction opposite of the direction anticipated by the Acquiring Fund, which would cause the

## **Table of Contents**

Acquiring Fund to make payments to its counterparty in the transaction that could adversely affect Fund performance. In addition to the risks applicable to swaps generally, credit default swap transactions involve special risks because they are difficult to value, are highly susceptible to liquidity and credit risk, and generally pay a return to the party that has paid the premium only in the event of an actual default by the issuer of the underlying obligation (as opposed to a credit downgrade or other indication of financial difficulty). The Acquiring Fund is not required to enter into interest rate or credit default swap transactions for hedging purposes or to enhance its return and may choose not to do so.

**Repurchase Agreements Risk.** Repurchase agreements typically involve the acquisition by the Acquiring Fund of fixed income securities from a selling financial institution such as a bank, savings and loan association or broker-dealer. The agreement provides that the Acquiring Fund will sell the securities back to the institution at a fixed time in the future. The Acquiring Fund does not bear the risk of a decline in the value of the underlying security unless the seller defaults under its repurchase obligation. In the event of the bankruptcy or other default of a seller of a repurchase agreement, the Acquiring Fund could experience both delays in liquidating the underlying securities and losses, including possible decline in the value of the underlying security during the period in which the Acquiring Fund seeks to enforce its rights thereto; possible lack of access to income on the underlying security during this period; and expenses of enforcing its rights. The value of the collateral underlying the repurchase agreement will be at least equal to the repurchase price, including any accrued interest earned on the repurchase agreement. In the event of a default or bankruptcy by a selling financial institution, the Acquiring Fund generally will seek to liquidate such collateral. However, the exercise of the Acquiring Fund's right to liquidate such collateral could involve certain costs or delays and, to the extent that proceeds from any sale upon a default of the obligation to repurchase were less than the repurchase price, the Acquiring Fund could suffer a loss.

**Investment in Other Investment Companies Risk.** As with other investments, investments in other investment companies are subject to market and selection risk. In addition, if the Acquiring Fund acquires shares of investment companies, including ones affiliated with the Acquiring Fund, the Acquiring Fund's common shareholders will bear both their proportionate share of expenses in the Acquiring Fund (including management and advisory fees) and, indirectly, the expenses of the investment companies. To the extent the Acquiring Fund is held by an affiliated fund, the ability of the Acquiring Fund itself to hold other investment companies may be limited.

**Restricted and Illiquid Securities Risk.** The Acquiring Fund may invest in illiquid or less liquid securities or securities in which no secondary market is readily available or which are otherwise illiquid, including private placement securities. The Acquiring Fund may not be able to readily dispose of such securities at prices that approximate those at which the Acquiring Fund could sell such securities if they were more widely-traded and, as a result of such illiquidity, the Acquiring Fund may have to sell other investments or engage in borrowing transactions if necessary to raise cash to meet its obligations. Limited liquidity can also affect the market price of securities, thereby adversely affecting the Acquiring Fund's NAV and ability to make dividend distributions. The financial markets in general have in recent years experienced periods of extreme secondary market supply and demand imbalance, resulting in a loss of liquidity during which market prices were suddenly and substantially below traditional measures of intrinsic value. During such periods, some securities could be sold only at arbitrary prices and with substantial losses. Periods of such market dislocation may occur again at any time.

Restricted securities are securities that may not be sold to the public without an effective registration statement under the Securities Act, or that may be sold only in a privately negotiated transaction or pursuant to an exemption from registration. When registration is required to sell a security, the Acquiring Fund may be obligated to pay all or part of the registration expenses and considerable time may pass before the Acquiring Fund is permitted to sell a security under an effective registration statement. If adverse market conditions develop during this period, the Acquiring Fund might obtain a less favorable price than the price that prevailed when the Acquiring Fund decided to sell. The Acquiring Fund may be unable to sell restricted and other illiquid securities at opportune times or prices.

## **Table of Contents**

**Strategic Transactions Risk.** The Acquiring Fund may engage in various derivative transactions or portfolio strategies both to increase the return of the Acquiring Fund and for duration and risk management purposes ( Strategic Transactions ). These Strategic Transactions include the use of derivatives, such as indexed securities, inverse floating rate securities, options, futures, options on futures, interest rate swap transactions and credit default swaps. The risks associated with Strategic Transactions include (i) the imperfect correlation between the value of such instruments and the underlying assets, (ii) the possible default of the counterparty to the transaction, (iii) illiquidity of the derivative instruments, and (iv) high volatility losses caused by unanticipated market movements, which are potentially unlimited. Although both over-the-counter and exchange-traded derivatives markets may experience the lack of liquidity, over-the-counter non-standardized derivative transactions are generally less liquid than exchange-traded instruments. The Acquiring Fund's ability to successfully use Strategic Transactions depends on the Investment Advisor's ability to predict pertinent securities prices, interest rates, currency exchange rates and other economic factors, which cannot be assured. Strategic Transactions subject the Acquiring Fund to the risk that, if the Investment Advisor incorrectly forecasts market values, interest rates or other applicable factors, the Acquiring Fund's performance could suffer. Certain of these Strategic Transactions, such as investments in inverse floating rate securities and credit default swaps, may provide investment leverage to the Acquiring Fund's portfolio. The Acquiring Fund is not required to use derivatives or other portfolio strategies to seek to increase return or to seek to hedge its portfolio and may choose not to do so. There can be no assurance that the Acquiring Fund's Strategic Transactions will be effective. The use of Strategic Transactions may result in losses greater than if they had not been used, may require the Acquiring Fund to sell or purchase portfolio securities at inopportune times or for prices other than current market values, may limit the amount of appreciation the Acquiring Fund can realize on an investment or may cause the Acquiring Fund to hold a security that it might otherwise sell. Additionally, segregated liquid assets, amounts paid by a Fund as premiums and cash or other assets held in margin accounts with respect to Strategic Transactions are not otherwise available to the Acquiring Fund for investment purposes. Some of the derivative strategies that the Acquiring Fund may use to seek to increase its return are riskier than its hedging transactions and have speculative characteristics. Such strategies do not attempt to limit the Acquiring Fund's risk of loss.

**Derivatives Risk.** Derivatives are financial contracts or instruments whose value depends on, or is derived from, the value of an underlying asset, reference rate or index (or relationship between two indices). The Acquiring Fund's use of derivative instruments involves risks different from, or possibly greater than, the risks associated with investing directly in securities and other traditional investments. Derivatives are subject to a number of risks described elsewhere in this section, such as liquidity risk, interest rate risk, market risk, credit risk and management risk. They also involve the risk of mispricing or improper valuation. Derivatives also involve the risk that changes in the value of a derivative may not correlate perfectly with the underlying asset, rate or index. In this regard, the Acquiring Fund seeks to achieve its investment objective, in part, by investing in derivatives positions that are designed to closely track the performance (or inverse performance) of an index on a daily basis. However, the overall investment strategies of the Acquiring Fund are not designed or expected to produce returns which replicate the performance (or inverse performance) of the particular index, and the degree of variation could be substantial, particularly over longer periods. There are a number of factors which may prevent the Acquiring Fund, or the derivatives or other strategies used by the Acquiring Fund, from achieving desired correlation (or inverse correlation) with an index, such as the impact of fees, expenses and transaction costs, the timing of pricing, and disruptions or illiquidity in the markets for derivative instruments or securities in which the Acquiring Fund invests.

The Acquiring Fund's investments in a derivative instrument could lose more than the principal amount invested. Also, suitable derivative transactions may not be available in all circumstances and there can be no assurance that the Acquiring Fund will engage in these transactions to reduce exposure to other risks when that would be beneficial. Although the Investment Advisor seeks to use derivatives to further the Acquiring Fund's investment objective, there is no assurance that the use of derivatives will achieve this result.

Certain derivative transactions may give rise to a form of leverage. Leverage associated with derivative transactions may cause the Acquiring Fund to liquidate portfolio positions when it may not be advantageous to

## **Table of Contents**

do so to satisfy its obligations or to meet earmarking or segregation requirements, pursuant to applicable SEC rules and regulations, or may cause the Acquiring Fund to be more volatile than if the Acquiring Fund had not been leveraged.

**Counterparty Risk.** The Acquiring Fund will be subject to credit risk with respect to the counterparties to the derivative contracts purchased by the Acquiring Fund. Because derivative transactions in which the Acquiring Fund may engage may involve instruments that are not traded on an exchange but are instead traded between counterparties based on contractual relationships, the Acquiring Fund is subject to the risk that a counterparty will not perform its obligations under the related contracts. If a counterparty becomes bankrupt or otherwise fails to perform its obligations due to financial difficulties, the Acquiring Fund may experience significant delays in obtaining any recovery in bankruptcy or other reorganization proceedings. The Acquiring Fund may obtain only a limited recovery, or may obtain no recovery, in such circumstances. Although the Acquiring Fund intends to enter into transactions only with counterparties that the Investment Advisor believes to be creditworthy, there can be no assurance that, as a result, a counterparty will not default and that the Acquiring Fund will not sustain a loss on a transaction. In the event of the counterparty's bankruptcy or insolvency, the Acquiring Fund's collateral may be subject to the conflicting claims of the counterparty's creditors, and the Acquiring Fund may be exposed to the risk of a court treating the Acquiring Fund as a general unsecured creditor of the counterparty, rather than as the owner of the collateral. There can be no assurance that a clearing organization, or its members, will satisfy its obligations to the Acquiring Fund.

In addition, the Acquiring Fund is subject to the risk that issuers of the instruments in which it invests and trades may default on their obligations under those instruments, and that certain events may occur that have an immediate and significant adverse effect on the value of those instruments. There can be no assurance that an issuer of an instrument in which the Acquiring Fund invests will not default, or that an event that has an immediate and significant adverse effect on the value of an instrument will not occur, and that the Acquiring Fund will not sustain a loss on a transaction as a result.

**Legal, Tax and Regulatory Risks.** Legal, tax and regulatory changes could occur that may materially adversely affect the Acquiring Fund. For example, the regulatory and tax environment for derivative instruments in which the Acquiring Fund may participate is evolving, and changes in the regulation or taxation of derivative instruments may materially adversely affect the value of derivative instruments held by the Acquiring Fund and the ability of the Acquiring Fund to pursue its investment strategies. To qualify for the favorable U.S. federal income tax treatment generally accorded to regulated investment companies ( "RICs" ), the Acquiring Fund must, among other things, derive in each taxable year at least 90% of its gross income from certain prescribed sources and distribute for each taxable year at least 90% of its investment company taxable income (generally, ordinary income plus the excess, if any, of net short-term capital gain over net long-term capital loss) and its net tax-exempt interest income. If for any taxable year the Acquiring Fund does not qualify as a RIC, all of its taxable income for that year (including its net capital gain) would be subject to tax at regular corporate rates without any deduction for distributions to shareholders, and such distributions would be taxable as ordinary dividends to the extent of the Acquiring Fund's current and accumulated earnings and profits.

**1940 Act Regulation.** The Acquiring Fund is a registered closed-end investment company and as such is subject to regulations under the 1940 Act. Generally speaking, any contract or provision thereof that is made, or where performance involves a violation of the 1940 Act or any rule or regulation thereunder is unenforceable by either party unless a court finds otherwise.

**Legislation Risk.** At any time after the date of this Joint Proxy Statement/Prospectus, legislation may be enacted that could negatively affect the assets of the Acquiring Fund. Legislation or regulation may change the way in which the Acquiring Fund itself is regulated. The Investment Advisor cannot predict the effects of any new governmental regulation that may be implemented and there can be no assurance that any new governmental regulation will not adversely affect the Acquiring Fund's ability to achieve its investment objective.



## **Table of Contents**

**LIBOR Risk.** According to various reports, certain financial institutions, commencing as early as 2005 and throughout the global financial crisis, routinely made artificially low submissions in the London Interbank Offered Rate ( LIBOR ) setting process. Since the LIBOR scandal came to light, several financial institutions have been fined significant amounts by various financial regulators in connection with allegations of manipulation of LIBOR. Other financial institutions in various countries are being investigated for similar actions. These developments may have adversely affected the interest rates on securities whose interest payments were determined by reference to LIBOR. Any future similar developments could, in turn, reduce the value of such securities owned by the Acquiring Fund.

**Risks Associated with Recent Market Events.** In the recent past, the debt and equity capital markets in the United States were negatively impacted by significant write-offs in the financial services sector relating to sub-prime mortgages and the repricing of credit risk in the broadly syndicated market, among other things. These events, along with the downgrade to the United States credit rating, deterioration of the housing market, the failure of major financial institutions and the resulting United States federal government actions led in the recent past, and may lead in the future, to worsening general economic conditions, which did, and could, materially and adversely impact the broader financial and credit markets and reduce the availability of debt and equity capital for the market as a whole and financial firms in particular. These events may increase the volatility of the value of securities owned by the Acquiring Fund and/or result in sudden and significant valuation increases or decreases in its portfolio. These events also may make it more difficult for the Acquiring Fund to accurately value its securities or to sell its securities on a timely basis.

While the extreme volatility and disruption that U.S. and global markets experienced for an extended period of time beginning in 2007 and 2008 has generally subsided, uncertainty and periods of volatility remain, and risks to a robust resumption of growth persist. In 2010, several EU countries, including Greece, Ireland, Italy, Spain and Portugal, began to face budget issues, some of which may have negative long-term effects for the economies of those countries and other EU countries. There is continued concern about national-level support for the Euro and the accompanying coordination of fiscal and wage policy among European Monetary Union ( EMU ) member countries. Recent downgrades to the credit ratings of major banks could result in increased borrowing costs for such banks and negatively affect the broader economy. Moreover, the policy of the Board of Governors of the Federal Reserve System ( Federal Reserve ), including with respect to certain interest rates and the decision to end its quantitative easing policy, may adversely affect the value, volatility and liquidity of dividend and interest paying securities. Market volatility, rising interest rates and/or a return to unfavorable economic conditions could impair the Acquiring Fund's ability to achieve its investment objective.

General market uncertainty and consequent repricing of risk have led to market imbalances of sellers and buyers, which in turn have resulted in significant valuation uncertainties in a variety of securities and significant and rapid value decline in certain instances. Additionally, periods of market volatility remain, and may continue to occur in the future, in response to various political, social and economic events both within and outside of the United States. These conditions resulted in, and in many cases continue to result in, greater price volatility, less liquidity, widening credit spreads and a lack of price transparency, with many securities remaining illiquid and of uncertain value. Such market conditions may make valuation of some of the Acquiring Fund's securities uncertain and/or result in sudden and significant valuation increases or declines in its holdings.

**EMU and Redenomination Risk.** As the European debt crisis progressed, the possibility of one or more Eurozone countries exiting the EMU, or even the collapse of the Euro as a common currency, arose, creating significant volatility at times in currency and financial markets generally. The effects of the collapse of the Euro, or of the exit of one or more countries from the EMU, on the U.S. and global economy and securities markets are impossible to predict and any such events could have a significant adverse impact on the value and risk profile of the Acquiring Fund's portfolio. Any partial or complete dissolution of the EMU could have significant adverse effects on currency and financial markets, and on the values of the Acquiring Fund's portfolio investments.

## **Table of Contents**

**Market Disruption and Geopolitical Risk.** The aftermath of the war in Iraq, instability in Afghanistan, Pakistan, Egypt, Libya, Syria and the Middle East, the ongoing epidemic of the Ebola virus disease in West Africa, possible terrorist attacks in the United States and around the world, growing social and political discord in the United States, the European debt crisis, further downgrades of U.S. Government securities and other similar events may result in market volatility, may have long-term effects on the U.S. and worldwide financial markets and may cause further economic uncertainties in the United States and worldwide. The effects of these events or similar events in the future on the U.S. economy and securities markets cannot be predicted. Non-investment grade and equity securities tend to be more volatile than investment grade fixed income securities; therefore these events and other market disruptions may have a greater impact on the prices and volatility of non-investment grade and equity securities than on investment grade fixed income securities. There can be no assurance that these events and other market disruptions will not have other material and adverse implications.

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

Congress has enacted sweeping financial legislation, the Dodd-Frank Act, signed into law by President Obama on July 21, 2010, regarding the operation of banks, private fund managers and other financial institutions, which includes provisions regarding the regulation of derivatives. Many provisions of the Dodd-Frank Act have been or will be implemented through regulatory rulemakings and similar processes over a period of time. The impact of the Dodd-Frank Act, and of follow-on regulation, on trading strategies and operations is impossible to predict, and may be adverse. Practices and areas of operation subject to significant change based on the impact, direct or indirect, of the Dodd-Frank Act and follow-on regulation, may change in manners that are unforeseeable, with uncertain effects. By way of example and not limitation, direct and indirect changes from the Dodd-Frank Act and follow-on regulation may occur to a significant degree with regard to, among other areas, financial consumer protection, bank ownership of and involvement with private funds, proprietary trading, registration of investment advisers, and the trading and use of many derivative instruments, including swaps. There can be no assurance that such legislation or regulation will not have a material adverse effect on the Acquiring Fund. In addition, Congress may address tax policy, which also could have uncertain direct and indirect impacts on trading and operations, as well as, potentially, the operations and structure of the Acquiring Fund.

Furthermore, the Dodd-Frank Act created the Financial Stability Oversight Council (FSOC), an interagency body charged with identifying and monitoring systemic risks to financial markets. The FSOC has the authority to require that non-bank financial companies that are predominantly engaged in financial activities, such as the Acquiring Fund, the Advisor and BlackRock, whose failure it determines would pose systemic risk, be placed under the supervision of the Federal Reserve. The FSOC has the authority to recommend that the Federal Reserve adopt more stringent prudential standards and reporting and disclosure requirements for non-bank financial companies supervised by the Federal Reserve. The FSOC also has the authority to make recommendations to the Federal Reserve on various other matters that may affect the Acquiring Fund, including requiring financial firms to submit resolution plans, mandating credit exposure reports, establishing concentration limits and limiting short-term debt. The FSOC may also recommend that other federal financial regulators impose more stringent regulation upon, or ban altogether, financial activities of any financial firm that poses what it determines are significant risks to the financial system. In the event that the FSOC designates the Acquiring Fund, the Advisor or BlackRock as a systemic risk to be placed under the Federal Reserve's supervision, the Acquiring Fund, the Advisor or BlackRock could face stricter prudential standards, including risk-based capital requirements, leverage limits, liquidity requirements, concentration requirements and overall

## **Table of Contents**

risk management requirements, among other restrictions. Such requirements could hinder the Acquiring Fund's ability to meet its investment objectives and may place the Acquiring Fund at a disadvantage with respect to its competitors.

Moreover, the SEC is reportedly developing rules designed to address perceived systemic risks posed by the asset management industry. These rules reportedly may require asset managers, such as the Advisor, to give the SEC additional data about funds' portfolio holdings, to conduct stress tests on their funds to determine how they would weather economic shocks such as a sudden change in interest rates and to develop "living wills" for their funds describing how their businesses can be sold in an orderly manner should they become insolvent or otherwise go out of business. Any such new rules could increase the Acquiring Fund's expenses and impact its returns to shareholders.

The Volcker Rule contained in Section 619 of the Dodd-Frank Act will limit the ability of banking entities to sponsor, invest in or serve as investment manager of certain private investment funds. Because the Federal Reserve currently treats BlackRock as a nonbank subsidiary of The PNC Financial Services Group, Inc. ("PNC"), BlackRock may be required to conform its activities to the requirements of the Volcker Rule. On December 10, 2013, U.S. financial regulators adopted final regulations (the "Final Regulations") to implement the statutory mandate of the Volcker Rule. Pursuant to the Dodd-Frank Act, the Volcker Rule's effective date was July 21, 2012 and the Final Regulations become effective on April 14, 2014; however, concurrent with the adoption of the Final Regulations the Federal Reserve granted a statutorily permitted conformance period, essentially making the effective date of the Volcker Rule and the Final Regulations July 21, 2015. On December 18, 2014, the Federal Reserve granted an additional extension to the conformance period, giving banking entities until July 21, 2016 to comply with the Volcker Rule, in respect of investments in and relationships with certain funds that were in place prior to December 31, 2013 ("legacy covered funds and relationships"). The Federal Reserve also announced that, with respect to legacy covered funds and relationships, the Federal Reserve intends to grant a final one-year extension to the conformance period in 2015, which would give banking entities until July 21, 2017 to comply with the Volcker Rule. However, all investments in and relationships with funds covered by the Volcker Rule made after December 31, 2013 must be divested or restructured by July 21, 2015. The Volcker Rule and the Final Regulations could have a significant negative impact on BlackRock and the Investment Advisor. BlackRock may attempt to take certain actions to lessen the impact of the Volcker Rule, although no assurance can be given that such actions would be successful and no assurance can be given that such actions would not have a significant negative impact on the Acquiring Fund. Upon the end of the applicable conformance period, BlackRock's relationship with PNC may require BlackRock to curtail some or all of the Acquiring Fund's activities with respect to PNC (if any).

The continuing implementation of the Dodd-Frank Act could also adversely affect the Investment Advisor and the Acquiring Fund by increasing transaction and/or regulatory compliance costs. In addition, greater regulatory scrutiny and the implementation of enhanced and new regulatory requirements may increase the Investment Advisor's and the Acquiring Fund's exposure to potential liabilities, and in particular liabilities arising from violating any such enhanced and/or new regulatory requirements. Increased regulatory oversight could also impose administrative burdens on the Investment Advisor and the Acquiring Fund, including, without limitation, responding to investigations and implementing new policies and procedures. The ultimate impact of the Dodd-Frank Act, and any resulting regulation, is not yet certain and the Investment Advisor and the Acquiring Fund may be affected by the new legislation and regulation in ways that are currently unforeseeable.

In connection with an ongoing review by the SEC and its staff of the regulation of investment companies' use of derivatives, on August 31, 2011 the SEC issued a concept release to seek public comment on a wide range of issues raised by the use of derivatives by investment companies. The SEC noted that it intends to consider the comments to help determine whether regulatory initiatives or guidance are needed to improve the current regulatory regime for investment companies and, if so, the nature of any such initiatives or guidance. While the nature of any such regulations is uncertain at this time, it is possible that such regulations could limit the implementation of the Acquiring Fund's use of derivatives, which could have an adverse impact on the Acquiring

## **Table of Contents**

Fund. The Investment Advisor cannot predict the effects of these regulations on the Acquiring Fund's portfolio. The Investment Advisor intends to monitor developments and seek to manage the Acquiring Fund's portfolio in a manner consistent with achieving the Acquiring Fund's investment objective, but there can be no assurance that it will be successful in doing so.

Certain lawmakers support an increase in federal revenue as a component of a plan to address the growing federal budget deficit. Also, comprehensive federal tax reform is the subject of political attention.

In the aftermath of the recent financial crisis, there appears to be a renewed popular, political and judicial focus on finance related consumer protection. Financial institution practices are also subject to greater scrutiny and criticism generally. In the case of transactions between financial institutions and the general public, there may be a greater tendency toward strict interpretation of terms and legal rights in favor of the consuming public, particularly where there is a real or perceived disparity in risk allocation and/or where consumers are perceived as not having had an opportunity to exercise informed consent to the transaction. In the event of conflicting interests between retail investors holding common shares of a closed-end investment company such as the Acquiring Fund and a large financial institution, a court may similarly seek to strictly interpret terms and legal rights in favor of retail investors.

**Potential Conflicts of Interest of the Investment Advisor and Others.** BlackRock, the ultimate parent company of the Investment Advisor, and its affiliates, which include the Investment Advisor and PNC ( Affiliates ), are involved worldwide with a broad spectrum of financial services and asset management activities and may engage in the ordinary course of business in activities in which their interests or the interests of their clients may conflict with those of the Acquiring Fund. BlackRock and its Affiliates may provide investment management services to other funds and discretionary managed accounts that follow an investment program similar to that of the Acquiring Fund. Subject to the requirements of the 1940 Act, BlackRock and its Affiliates intend to engage in such activities and may receive compensation from third parties for their services. Neither BlackRock nor its Affiliates are under any obligation to share any investment opportunity, idea or strategy with the Acquiring Fund. As a result, BlackRock and its Affiliates may compete with the Acquiring Fund for appropriate investment opportunities. The results of the Acquiring Fund's investment activities, therefore, may differ from those of an Affiliate or another account managed by an Affiliate and it is possible that the Acquiring Fund could sustain losses during periods in which one or more Affiliates and other accounts achieve profits on their trading for proprietary or other accounts. The 1940 Act imposes limitations on certain transactions between a registered investment company and affiliated persons of the investment company, as well as affiliated persons of such affiliated persons. Among others, affiliated persons of an investment company include its investment adviser; officers; directors/trustees; any person who directly or indirectly controls, is controlled by or is under common control with such investment company; any person directly or indirectly owning, controlling or holding with power to vote, five percent or more of the outstanding voting securities of such investment company; and any person five percent or more of whose outstanding voting securities are directly or indirectly owned, controlled or held with power to vote by such investment company. BlackRock has adopted policies and procedures designed to address potential conflicts of interests. For additional information about potential conflicts of interest and the way in which BlackRock addresses such conflicts, please see Conflicts of Interest in the Statement of Additional Information.

**Market and Selection Risk.** Market risk is the possibility that the market values of securities owned by the Acquiring Fund will decline. There is a risk that equity and/or bond markets will go down in value, including the possibility that such markets will go down sharply and unpredictably. Stock markets are volatile, and the price of equity securities fluctuates based on changes in a company's financial condition and overall market and economic conditions. An adverse event, such as an unfavorable earnings report, may depress the value of a particular common stock held by the Acquiring Fund. Also, the price of common stocks is sensitive to general movements in the stock market and a drop in the stock market may depress the price of common stocks to which the Acquiring Fund has exposure. Common stock prices fluctuate for several reasons, including changes in investors' perceptions of the financial condition of an issuer or the general condition of the relevant stock market, or when political or economic events affecting the issuers occur.

## **Table of Contents**

Selection risk is the risk that the securities that the Investment Advisor selects for the Acquiring Fund will underperform the equity and/or bond market, the market relevant indices or other funds with a similar investment objective and investment strategies.

**Defensive Investing Risk.** For defensive purposes, the Acquiring Fund may allocate a substantial portion of its assets into cash or short-term tax-exempt or taxable fixed income securities. In doing so, the Acquiring Fund may succeed in avoiding losses but may otherwise fail to achieve its investment objective. Further, the value of short-term fixed income securities may be affected by changing interest rates and by changes in credit ratings of the investments. If the Acquiring Fund holds cash uninvested it will be subject to the credit risk of the depository institution holding the cash.

**Decision-Making Authority Risk.** Investors have no authority to make decisions or to exercise business discretion on behalf of the Acquiring Fund, except as set forth in the Acquiring Fund's governing documents. The authority for all such decisions is generally delegated to the Board, who in turn, has delegated the day-to-day management of its Fund's investment activities to the Investment Advisor, subject to oversight by the Board.

**Management Risk.** The Acquiring Fund is subject to management risk because it is an actively managed investment portfolio. The Investment Advisor and the individual portfolio managers will apply investment techniques and risk analyses in making investment decisions for the Acquiring Fund, but there can be no guarantee that these will produce the desired results. The Acquiring Fund may be subject to a relatively high level of management risk because the Acquiring Fund may invest in derivative instruments, which may be highly specialized instruments that require investment techniques and risk analyses different from those associated with equities and bonds.

**Reliance on the Investment Advisor.** The Acquiring Fund is dependent upon services and resources provided by the Investment Advisor, and therefore the Investment Advisor's parent, BlackRock. The Investment Advisor is not required to devote its full time to the business of the Acquiring Fund and there is no guarantee or requirement that any investment professional or other employee of the Investment Advisor will allocate a substantial portion of his or her time to the Acquiring Fund. The loss of one or more individuals involved with the Investment Advisor could have a material adverse effect on the performance or the continued operation of the Acquiring Fund.

**Reliance on Service Providers.** The Acquiring Fund must rely upon the performance of service providers to perform certain functions, which may include functions that are integral to the Acquiring Fund's operations and financial performance. Failure by any service provider to carry out its obligations to the Acquiring Fund in accordance with the terms of its appointment, to exercise due care and skill or to perform its obligations to the Acquiring Fund at all as a result of insolvency, bankruptcy or other causes could have a material adverse effect on the Acquiring Fund's performance and returns to common shareholders. The termination of the Acquiring Fund's relationship with any service provider, or any delay in appointing a replacement for such service provider, could materially disrupt the business of the Acquiring Fund and could have a material adverse effect on the Acquiring Fund's performance and returns to common shareholders.

**Information Technology Systems.** The Acquiring Fund is dependent on the Investment Advisor for certain management services as well as back-office functions. The Investment Advisor depends on information technology systems in order to assess investment opportunities, strategies and markets and to monitor and control risks for the Acquiring Fund. It is possible that a failure which causes disruptions to these information technology systems could materially limit the Investment Advisor's ability to adequately assess and adjust investments, formulate strategies and provide adequate risk control. Any such information technology-related difficulty could harm the performance of the Acquiring Fund. Further, failure of the back-office functions of the Investment Advisor to process trades in a timely fashion could prejudice the investment performance of the Acquiring Fund.

## **Table of Contents**

**Cyber Security Risk.** With the increased use of technologies such as the Internet to conduct business, the Acquiring Fund is susceptible to operational, information security and related risks. In general, cyber incidents can result from deliberate attacks or unintentional events. Cyber attacks include, but are not limited to, gaining unauthorized access to digital systems (e.g., through hacking or malicious software coding) for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption. Cyber attacks may also be carried out in a manner that does not require gaining unauthorized access, such as causing denial-of-service attacks on websites (i.e., efforts to make network services unavailable to intended users). Cyber security failures or breaches by the Acquiring Fund's investment adviser and other service providers (including, but not limited to, fund accountants, custodians, transfer agents and administrators), and the issuers of securities in which the Acquiring Fund invests, have the ability to cause disruptions and impact business operations, potentially resulting in financial losses, interference with the Acquiring Fund's ability to calculate its net asset value, impediments to trading, the inability of Acquiring Fund shareholders to transact business, violations of applicable privacy and other laws, regulatory fines, penalties, reputational damage, reimbursement or other compensation costs, or additional compliance costs. In addition, substantial costs may be incurred in order to prevent any cyber incidents in the future. While the Acquiring Fund has established business continuity plans in the event of, and risk management systems to prevent, such cyber attacks, there are inherent limitations in such plans and systems including the possibility that certain risks have not been identified. Furthermore, the Acquiring Fund cannot control the cyber security plans and systems put in place by service providers to the Acquiring Fund and issuers in which the Acquiring Fund invests. The Acquiring Fund and its shareholders could be negatively impacted as a result.

**Misconduct of Employees and of Service Providers.** Misconduct or misrepresentations by employees of the Investment Advisor or the Acquiring Fund's service providers could cause significant losses to the Acquiring Fund. Employee misconduct may include binding the Acquiring Fund to transactions that exceed authorized limits or present unacceptable risks and unauthorized trading activities, concealing unsuccessful trading activities (which, in any case, may result in unknown and unmanaged risks or losses) or making misrepresentations regarding any of the foregoing. Losses could also result from actions by the Acquiring Fund's service providers, including, without limitation, failing to recognize trades and misappropriating assets. In addition, employees and service providers may improperly use or disclose confidential information, which could result in litigation or serious financial harm, including limiting the Acquiring Fund's business prospects or future marketing activities. Despite the Investment Advisor's due diligence efforts, misconduct and intentional misrepresentations may be undetected or not fully comprehended, thereby potentially undermining the Investment Advisor's due diligence efforts. As a result, no assurances can be given that the due diligence performed by the Investment Advisor will identify or prevent any such misconduct.

**Inflation Risk.** Inflation risk is the risk that the value of assets or income from investment will be worth less in the future, as inflation decreases the value of money. As inflation increases, the real value of the Common Shares and distributions on those shares can decline. In addition, during any periods of rising inflation, interest rates on any borrowings by the Acquiring Fund would likely increase, which would tend to further reduce returns to the holders of Common Shares.

**Deflation Risk.** Deflation risk is the risk that prices throughout the economy decline over time, which may have an adverse effect on the market valuation of companies, their assets and their revenues. In addition, deflation may have an adverse effect on the creditworthiness of issuers and may make issuer default more likely, which may result in a decline in the value of the Acquiring Fund's portfolio.

**Portfolio Turnover Risk.** The Acquiring Fund's annual portfolio turnover rate may vary greatly from year to year, as well as within a given year. Portfolio turnover rate is not considered a limiting factor in the execution of investment decisions for the Acquiring Fund. A higher portfolio turnover rate results in correspondingly greater brokerage commissions and other transactional expenses that are borne by the Acquiring Fund. High portfolio turnover may result in an increased realization of net short-term capital gains by the Acquiring Fund which, when distributed to common and preferred shareholders, will be taxable as ordinary income. Additionally, in a declining market, portfolio turnover may create realized capital losses.

## **Table of Contents**

**Anti-Takeover Provisions Risk.** The Acquiring Fund's charter, bylaws and the Maryland General Corporation Law include provisions that could limit the ability of other entities or persons to acquire control of the Acquiring Fund or convert the Acquiring Fund to open-end status. These provisions could deprive the holders of Common Shares of opportunities to sell their Common Shares at a premium over the then current market price of the Common Shares or at net asset value. See Certain Provisions of the Charter and Bylaws.

## **INFORMATION ABOUT THE REORGANIZATION**

The Reorganization seeks to combine two funds that have the same investment advisor, the same portfolio managers, the same board members, and substantially identical investment objective, investment policies and investment restrictions.

### **Description of the Reorganization**

The Reorganization Agreement (a form of which is attached as Appendix A to the Statement of Additional Information) provides for the Acquiring Fund's acquisition of substantially all of the assets of the Target Fund and assumption of substantially all of the liabilities of the Target Fund in exchange for newly issued Acquiring Fund Common Shares, with a par value \$0.10 per share, and newly issued Acquiring Fund VRDP Shares, with a par value of \$0.10 per share and liquidation preference of \$100,000 per share (plus any accumulated and unpaid dividends that have accrued on such Target Fund VRDP Share up to and including the day immediately preceding the Closing Date if such dividends have not been paid prior to the Closing Date). The Acquiring Fund will list the newly issued Common Shares on the NYSE. The Target Fund will distribute Acquiring Fund Shares received by it pro rata to Target Fund shareholders (although cash may be paid in lieu of any fractional Common Shares). The newly-issued Acquiring Fund Shares will be issued in the form of book entry interests. Such distribution of Acquiring Fund Shares to Target Fund shareholders will be accomplished by opening new accounts on the books of the Acquiring Fund in the names of the shareholders of the Target Fund and transferring to those shareholder accounts Acquiring Fund Shares.

Each newly-opened account on the books of Acquiring Fund for the former common shareholders of the Target Fund will represent the respective pro rata number of Acquiring Fund Common Shares (rounded down, in the case of fractional Common Shares held other than in an automatic dividend reinvestment plan account ( " Plan Account " ), to the next largest number of whole Common Shares) due such common shareholder. No fractional Acquiring Fund Common Shares will be issued (except for Common Shares held in a Plan Account). In the event there are fractional Common Shares in an account other than a Plan Account, the Acquiring Fund's transfer agent will aggregate all such fractional Target Fund Common Shares and sell the resulting whole Common Shares on the NYSE, for the account of all holders of such fractional interests, and each such holder will be entitled to the pro rata share of the proceeds from such sale upon surrender of the Target Fund Common Share certificates. See Terms of the Reorganization Agreement Surrender and Exchange of Share Certificates for a description of the procedures to be followed by the Target Fund's common shareholders to obtain their Acquiring Fund Common Shares (and cash in lieu of fractional Common Shares, if any). Similarly, each newly-opened account on the books of the Acquiring Fund for the Target Fund VRDP Holders would represent the respective pro rata number of Acquiring Fund VRDP Shares due such VRDP Holder.

As a result of the Reorganization, each common shareholder of the Target Fund will own Acquiring Fund Common Shares that (except for cash payments received in lieu of fractional Common Shares) will have an aggregate NAV (not the market value) immediately after the Closing Date equal to the aggregate NAV (not the market value) of that shareholder's Target Fund Common Shares immediately prior to the Closing Date. The NAV of the Target Fund and the Acquiring Fund immediately prior to the Closing Date will be reduced by the costs of the Reorganization borne by each Fund, if any. The value of each Fund's net assets will be calculated net of the liquidation preference (including accumulated and unpaid dividends) of all outstanding VRDP Shares of such Fund. The market value of the Common Shares of the Combined Fund may be less than the market value of

## **Table of Contents**

the Common Shares of each respective Fund prior to the Reorganization. Since Acquiring Fund Common Shares will be issued at NAV in exchange for the Common Shares of the Target Fund having a value equal to the aggregate NAV (not the market value) of those Acquiring Fund Common Shares, the NAV per share of Acquiring Fund Common Shares should remain virtually unchanged by the Reorganization except for the Acquiring Fund's proportion of the applicable costs of the Reorganization. Thus, the Reorganization will result in no dilution of the NAV of Acquiring Fund Common Shares, other than to reflect the applicable costs of the Reorganization.

Upon the Closing Date, Target Fund VRDP Holders will receive on a one-for-one basis one newly issued Acquiring Fund VRDP Share, par value \$0.10 per share and with a liquidation preference of \$100,000 per share (plus any accumulated and unpaid dividends that have accrued on such Target Fund VRDP Share up to and including the day immediately preceding the Closing Date if such dividends have not been paid prior to the Closing Date), in exchange for each Target Fund VRDP Share held by such Target Fund VRDP Holder immediately prior to the Closing Date. The newly issued Acquiring Fund VRDP Share may be of the same series as the Acquiring Fund's Series W-7 VRDP Shares or a substantially identical series. No fractional Acquiring Fund VRDP Shares will be issued. Target Fund VRDP Holders will receive the same number of Acquiring Fund VRDP Shares, with terms substantially similar to the outstanding Target Fund VRDP Shares, held by such holders immediately prior to the Closing Date, with the only significant difference being that the Target Fund VRDP Shares have a mandatory redemption date of June 1, 2041 and the newly issued Acquiring Fund VRDP Shares are expected to have a mandatory redemption date of May 1, 2041.

The Acquiring Fund VRDP Shares to be issued in connection with the Reorganization will have terms that are substantially identical to the terms of the Acquiring Fund's outstanding VRDP Shares and will rank on a parity with the Acquiring Fund's existing VRDP Shares as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of the affairs of the Acquiring Fund. The Reorganization will not result in any changes to the terms of the Acquiring Fund's VRDP Shares currently outstanding.

The terms of the outstanding Target Fund VRDP Shares are substantially similar to the terms of the outstanding Acquiring Fund VRDP Shares. The only significant difference between the terms of the two Funds' VRDP Shares is that the Target Fund VRDP Shares have a mandatory redemption date of June 1, 2041 and the Acquiring Fund VRDP Shares have a mandatory redemption date of May 1, 2041. The Funds' VRDP Shares have the same \$100,000 liquidation preference per share, dividend period, dividend payment date, voting rights, redemption provisions, remarketing procedures, mandatory purchase events, mandatory tender events, transfer restrictions and covenants with respect to effective leverage, asset coverage and eligible investments. The Funds' VRDP Shares also have the same mechanism for determining the applicable dividend rate and maximum rate, and the same liquidity provider, remarketing agent and tender and paying agent. Each Fund's VRDP Shares are currently in a three year special rate period that will end on June 24, 2015. The special rate period is expected to be extended to June 22, 2016. The terms applicable to each Fund's VRDP Shares during the special rate period are substantially identical. During the special rate period, the Funds' VRDP Shares have the same mechanism for determining the applicable dividend rate and maximum rate, redemption premiums and transfer restrictions. Since the Acquiring Fund VRDP Shares would be issued at a liquidation preference and value per share equal to the liquidation preference and value per share of the VRDP Shares of the Target Fund, the interests of the Target Fund's VRDP Holders will not be diluted as a result of the Reorganization.

As a result of the Reorganization, a shareholder of any of the Funds will hold a reduced percentage of ownership in the Combined Fund than he or she did in the Target Fund. No sales charge or fee of any kind will be charged to shareholders of the Target Fund in connection with their receipt of Acquiring Fund Shares in the Reorganization.

As soon as practicable after the Closing Date for the Reorganization, the Target Fund will deregister as an investment company under the 1940 Act and liquidate, dissolve and terminate in accordance with its charter and



## **Table of Contents**

Maryland law. The Acquiring Fund will continue to operate after the Reorganization as a registered, non-diversified, closed-end management investment company with the investment objective, investment policies and investment restrictions described in this Joint Proxy Statement/Prospectus.

If the Reorganization is not consummated, each Fund will continue to operate, for the time being, as a stand-alone Maryland corporation and will continue to be advised by the Investment Advisor. If, however, the Reorganization is not consummated, the Investment Advisor may, in connection with ongoing management of each Fund and its product line, recommend alternative proposals to the Board of each Fund.

### **The Board's Recommendation**

The Board of the Target Fund recommends that the common shareholders of the Target Fund vote **FOR** the proposed Reorganization Agreement at the Special Meeting to be held on August 6, 2015 at 4:00 p.m. (Eastern time).

The Board of the Acquiring Fund recommends that common shareholders of the Acquiring Fund vote **FOR** the proposed Issuance at the Special Meeting to be held on August 6, 2015 at 4:00 p.m. (Eastern time).

Shareholder approval of the Reorganization Agreement requires (i) the affirmative vote of the holders of a majority of the outstanding Target Fund Common Shares and Target Fund VRDP Shares voting as a single class, (ii) the affirmative vote of a 1940 Act Majority (as defined below) of Target Fund VRDP Holders voting as a separate class and (iii) the affirmative vote of a majority of the outstanding Acquiring Fund VRDP Holders voting as a separate class. The Issuance requires the affirmative vote of a majority of the votes cast by the Acquiring Fund Common Shares and Acquiring Fund VRDP Shares voting as a single class. A 1940 Act Majority means the affirmative vote of either (i) 67% or more of the voting securities present at the Special Meeting, if the holders of more than 50% of the outstanding voting securities of the Fund are present or represented by proxy or (ii) more than 50% of the outstanding voting securities of the Fund, whichever is less.

In order for the Reorganization to occur, each Fund must obtain all requisite shareholder approvals with respect to the Reorganization, as well as certain consents, confirmations and/or waivers from various third parties, including the liquidity provider with respect to the outstanding VRDP Shares. Because the closing of the Reorganization is contingent upon the Target Fund and the Acquiring Fund obtaining the requisite shareholder approvals and third party consents and satisfying (or obtaining the waiver of) other closing conditions, it is possible that the Reorganization will not occur, even if shareholders of either Fund entitled to vote on the Reorganization approve the Reorganization and such Fund satisfies all of its closing conditions, if the other Fund does not obtain its requisite shareholder approvals or satisfy its closing conditions.

The VRDP Shares were issued on a private placement basis to one or a small number of institutional holders. Please see **Shareholder Information** for additional information. To the extent that one or more VRDP Holder of either the Target Fund or the Acquiring Fund owns, holds or controls, individually or in the aggregate, all or a significant portion of such Fund's outstanding VRDP Shares, the VRDP shareholder approval required for the Reorganization may turn on the exercise of voting rights by such particular VRDP Holder(s) and its (or their) determination as to the favorability of the proposal with respect to its (or their) interests. The Funds exercise no influence or control over the determinations of such VRDP Holder(s) with respect to the proposal; there is no guarantee that such VRDP Holder(s) will approve the proposal, over which it (or they) may exercise effective disposition power.

Subject to the requisite approval of the shareholders of each Fund with respect to the Reorganization, as well as certain consents, confirmations and/or waivers from various third parties, including the liquidity provider with respect to the outstanding VRDP Shares, it is expected that the Closing Date will be sometime during the third quarter of 2015, but it may be at a different time as described herein.

## **Table of Contents**

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

### **Reasons for the Reorganization**

The Board of each Fund, including the Independent Board Members, has unanimously approved the Reorganization at meetings held on April 30, 2015 (the Meeting). Based on the considerations below, the Board of each Fund, including the Independent Board Members, has determined that the Reorganization would be in the best interests of such Fund and that the interests of its existing common shareholders and VRDP Holders would not be diluted with respect to NAV and the liquidation preference, respectively, as a result of the Reorganization. As a result of the Reorganization, however, common and preferred shareholders of each Fund will hold a reduced percentage of ownership in the larger Combined Fund than they did in any of the individual Funds before the Reorganization.

Each Board's determination to approve the Reorganization was made on the basis of each Board Member's business judgment after consideration of all of the factors taken as a whole with respect to each Fund and its shareholders, although individual Board Members may have placed different weight and assigned different degrees of materiality to various factors. Before reaching these conclusions, the Board of each Fund, including the Independent Board Members, engaged in a thorough review process relating to the proposed Reorganization. The Board of each Fund also received a memorandum outlining, among other things, the legal standards and certain other considerations relevant to the Board's deliberations.

The Board of each Fund considered the Reorganization over a series of meetings. In preparation for the Meeting, the Investment Advisor provided each Board with information regarding the proposed Reorganization, including the rationale therefor and alternatives considered to the Reorganization.

Each Board considered a number of factors presented at the time of the Meeting or prior meetings in reaching their determinations, including, but not limited to, the following, which are discussed in further detail below:

potential for improved economies of scale and a lower Total Expense Ratio with respect to each Fund;

the potential effects of the Reorganization on the earnings and distributions of each Fund;

the potential effects of the Reorganization on each Fund's premium/discount to NAV of Common Shares;

the potential effects of the Reorganization on each Fund's VRDP Shares;

the compatibility of the Funds' investment objectives, investment policies and related risks and risk profiles;

consistency of portfolio management and portfolio composition;

the potential for improved secondary market trading, including the potential for greater secondary market liquidity for the Combined Fund's Common Shares, which may result in tighter bid-ask spreads and better trade execution for the Combined Fund's common shareholders when purchasing or selling the Combined Fund's Common Shares;

the potential for operating and administrative efficiencies for the Combined Fund, including the potential for the following benefits:

greater investment flexibility and investment options, greater diversification of portfolio investments, the ability to trade in larger positions, additional sources of leverage or more competitive leverage terms and more favorable transaction terms;

benefits from having fewer closed-end funds offering similar products in the market, including an increased focus by investors on the remaining funds in the market (including the Combined Fund) and additional research coverage; and

## **Table of Contents**

benefits from having fewer similar funds in the same fund complex, including a simplified operational model and a reduction in risk of operational, legal and financial errors;

the anticipated tax-free nature of the Reorganization (except with respect to taxable distributions, if any, from any Fund prior to, or after, the consummation of the Reorganization);

the potential effects on the Funds' capital loss carryforwards;

the potential effects on each Fund's undistributed net investment income;

the expected costs of the Reorganization;

the terms of the Reorganization and whether the Reorganization would dilute the interests of shareholders of the Funds;

the effect of the Reorganization on shareholder rights;

alternatives to the Reorganization for each Fund; and

any potential benefits of the Reorganization to the Investment Advisor and its affiliates.

*Potential for Improved Economies of Scale and Potential for a Lower Expense Ratio.* Each Board considered the fees and Total Expense Ratio of its Fund (including estimated expenses of the Combined Fund after the Reorganization). For the fiscal year ended July 31, 2014, the Total Expense Ratios of the Target Fund and the Acquiring Fund were 1.55% and 1.54%, respectively. For the 12-month period ended January 31, 2015, the Total Expense Ratios of the Target Fund and the Acquiring Fund were 1.48% and 1.48%, respectively. The Funds estimate that the completion of the Reorganization would result in a Total Expense Ratio for the Combined Fund of 1.43% on a historical and pro forma basis for the 12-month period ended January 31, 2015, representing a reduction in the Total Expense Ratio for the common shareholders of the Target Fund and the Acquiring Fund of 0.05% and 0.05%, respectively.

The Funds' VRDP Shares have the same mechanism for determining the applicable dividend rate and maximum rate, and the same liquidity provider, remarketing agent and tender and paying agent. Each Fund's VRDP Shares are currently in a three year special rate period that will end on June 24, 2015. The special rate period is expected to be extended to June 22, 2016. During the special rate period, the Funds' VRDP Shares have the same mechanism for determining the applicable dividend rate and maximum rate, redemption premiums and transfer restrictions. For the fiscal year ended July 31, 2014, the annualized dividend rate for the VRDP Shares of the Target Fund and the Acquiring Fund were 1.01% and 1.01%, respectively. As of May 31, 2015, the dividend rate for the VRDP Shares of the Target Fund and the Acquiring Fund were 1.05% and 1.05%, respectively. Please see "Information about the VRDP Shares of the Funds" for additional information.

The Combined Fund will have a lower annual contractual investment management fee rate than each Fund. Each Fund currently pays the Investment Advisor a monthly fee at an annual contractual management fee rate of 0.50% of its average daily net assets (0.79% of the average daily net assets attributable to the Target Fund's Common Shares, and 0.80% of the average daily net assets attributable to the Acquiring Fund's Common Shares, each for the 12-month period ended January 31, 2015). Average daily net assets are the average daily value of a Fund's total assets minus its total accrued liabilities (which does not include liabilities represented by TOB leverage and the liquidation preference of the VRDP shares).

If the Reorganization is consummated, the annual contractual investment management fee rate of the Combined Fund will be 0.49% of the average daily net assets of the Combined Fund (0.78% of the average daily net assets attributable to the Combined Fund's Common Shares on a historical and pro forma basis for the 12-month period ended January 31, 2015).

## Edgar Filing: BLACKROCK MUNIYIELD MICHIGAN QUALITY FUND, INC. - Form 497

Based on a pro-forma Lipper peer expense group for the Combined Fund, the estimated total annual fund expense ratio (excluding investment-related expenses) and contractual management fee rate are each expected to

## **Table of Contents**

be in the second and first quartile, respectively. There can be no assurance that future expenses will not increase or that any expense savings for any Fund will be realized as a result of the Reorganization.

*Potential Effects of the Reorganization on Earnings and Distributions.* The Boards noted that the Combined Fund's earnings yield on NAV following the Reorganization is expected to be comparable (i.e., the same or slightly lower or higher) to the Acquiring Fund's current earnings yield on NAV and potentially higher than the Target Fund's current earnings yield on NAV; thus, assuming that the Reorganization is consummated and that the Acquiring Fund's distribution policy remains in place after the Reorganization, common shareholders of the Acquiring Fund may experience a distribution rate on NAV comparable (i.e., the same or slightly lower or higher) to their current distribution rate on NAV and common shareholders of the Target Fund may experience a distribution rate on NAV that is potentially higher than their current distribution rate on NAV.

The Combined Fund's earnings and distribution rate on NAV will change over time, and depending on market conditions, may be higher or lower than each Fund's earnings and distribution rate on NAV prior to the Reorganization. A Fund's earnings and net investment income are variables which depend on many factors, including its asset mix, portfolio turnover level, the amount of leverage utilized by the Fund, the costs of such leverage, the performance of its investments, the movement of interest rates and general market conditions.

*Potential Effects of the Reorganization on Premium/Discount to NAV of Common Shares.* Each Board noted that the Common Shares of its Fund have historically traded at both a premium and a discount. As of June 5, 2015, the NAV per Common Share of the Target Fund was \$14.34 and the market price per Common Share of the Target Fund was \$12.50, representing a discount to NAV of (12.83)%, and the NAV per Common Share of the Acquiring Fund was \$15.34 and the market price per Common Share of the Acquiring Fund was \$13.44, representing a discount to NAV of (12.39)%. The Board of the Target Fund noted that to the extent the Target Fund Common Shares are trading at a wider discount (or a narrower premium) than the Acquiring Fund at the time of the Reorganization, the Target Fund's common shareholders would have the potential for an economic benefit by the narrowing of the discount or widening of the premium. The Board of the Target Fund also noted that to the extent the Target Fund Common Shares are trading at a narrower discount (or wider premium) than the Acquiring Fund at the time of the Reorganization, Target Fund common shareholders may be negatively impacted if the Reorganization is consummated. The Board of the Acquiring Fund noted that Acquiring Fund common shareholders would only benefit from a premium/discount perspective to the extent the Acquiring Fund's post-Reorganization discount (or premium) improves. There can be no assurance that, after the Reorganization, Common Shares of the Combined Fund will trade at a narrower discount to NAV or wider premium to NAV than the Common Shares of any individual Fund prior to the Reorganization.

*Potential Effects of the Reorganization on VRDP Shares.* The Board noted that each Fund has one series of VRDP Shares outstanding. As of May 31, 2015, the Target Fund has 873 Series W-7 VRDP Shares outstanding, and the Acquiring Fund has 1,446 Series W-7 VRDP Shares outstanding. In connection with the Reorganization, the Acquiring Fund expects to issue 873 additional VRDP Shares to Target Fund VRDP Holders. Following the completion of the Reorganization, the Combined Fund is expected to have 2,319 VRDP Shares outstanding.

The Board noted that upon the Closing Date, Target Fund VRDP Holders will receive on a one-for-one basis one newly issued Acquiring Fund VRDP Share, par value \$0.10 per share and with a liquidation preference of \$100,000 per share (plus any accumulated and unpaid dividends that have accrued on such Target Fund VRDP Share up to and including the day immediately preceding the Closing Date if such dividends have not been paid prior to the Closing Date), in exchange for each Target Fund VRDP Share held by such Target Fund VRDP Holder immediately prior to the Closing Date. The newly issued Acquiring Fund VRDP Share may be of the same series as the Acquiring Fund's Series W-7 VRDP Shares or a substantially identical series. No fractional Acquiring Fund VRDP Shares will be issued. Target Fund VRDP Holders will receive the same number of Acquiring Fund VRDP Shares, with terms substantially similar to the terms of the outstanding Target Fund VRDP Shares, held by such holders immediately prior to the Closing Date, with the only significant difference being that the Target Fund VRDP Shares have a mandatory redemption date of June 1, 2041 and the newly issued Acquiring Fund VRDP Shares are expected to have a mandatory redemption date of May 1, 2041.

## **Table of Contents**

The Acquiring Fund VRDP Shares to be issued in connection with the Reorganization will have terms that are substantially identical to the terms of the Acquiring Fund's outstanding VRDP Shares and will rank on a parity with the Acquiring Fund's existing VRDP Shares as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of the affairs of the Acquiring Fund. The Reorganization will not result in any changes to the terms of the Acquiring Fund's VRDP Shares currently outstanding.

The terms of the outstanding Target Fund VRDP Shares are substantially similar to the terms of the outstanding Acquiring Fund VRDP Shares. The only significant difference between the terms of the two Funds' VRDP Shares is that the Target Fund VRDP Shares have a mandatory redemption date of June 1, 2041 and the Acquiring Fund VRDP Shares have a mandatory redemption date of May 1, 2041. The Funds' VRDP Shares have the same \$100,000 liquidation preference per share, dividend period, dividend payment date, voting rights, redemption provisions, remarketing procedures, mandatory purchase events, mandatory tender events, transfer restrictions and covenants with respect to effective leverage, asset coverage and eligible investments. The Funds' VRDP Shares also have the same mechanism for determining the applicable dividend rate and maximum rate, and the same liquidity provider, remarketing agent and tender and paying agent. Each Fund's VRDP Shares are currently in a three year special rate period that will end on June 24, 2015. The special rate period is expected to be extended to June 22, 2016. The terms applicable to each Fund's VRDP Shares during the special rate period are substantially identical. During the special rate period, the Funds' VRDP Shares have the same mechanism for determining the applicable dividend rate and maximum rate, redemption premiums and transfer restrictions.

The Board noted that none of the expenses of the Reorganization are expected to be borne by the VRDP Holders of the Funds.

Following the Reorganization, the VRDP Holders of each Fund will be VRDP Holders of the larger Combined Fund that will have a larger asset base and more VRDP Shares outstanding than either Fund individually. With respect to matters requiring all preferred shareholders to vote separately or common and preferred shareholders to vote together as a single class, following the Reorganization, holders of VRDP Shares of the Combined Fund will hold a smaller percentage of the outstanding preferred shares of the Combined Fund as compared to their percentage holdings of outstanding preferred shares of their respective Fund prior to the Reorganization.

*Compatibility of Investment Objectives, Investment Policies and Related Risks and Risk Profiles.* Each Board noted that its Fund's shareholders will remain invested in an exchange-listed, non-diversified closed-end management investment company registered under the 1940 Act that will have substantially greater net assets and substantially identical investment objective, investment policies and investment restrictions. Each Fund invests at least 80% of its assets in municipal obligations exempt from federal income taxes (except that the interest may be subject to the federal alternative minimum tax) and Michigan income taxes. Each Fund also currently invests primarily in investment grade municipal bonds and utilize leverage in the form of VRDP Shares and tender option bonds. The risk/return profile of the Combined Fund is expected to remain comparable to those of each Fund before the Reorganization because of the similarities in the investment policies of each Fund.

*Consistency of Portfolio Management and Portfolio Composition.* Each Board noted that each Fund has the same investment adviser and portfolio managers and that each Fund's shareholders will benefit from the continuing experience and expertise of its current portfolio management team. Each Fund is managed by a team of investment professionals comprised of Michael Kalinoski, Theodore R. Jaeckel, Jr. and Walter O. Connor. Each Board also considered the portfolio composition of its Fund and the impact of the Reorganization on the Fund's portfolio. Each Board noted that it is not anticipated that there will be any significant disposition of the holdings in its Fund as a result of the Reorganization because of the similarities among the portfolio guidelines of the Funds. For additional information, please see *Comparison of the Funds' Investments and Risk Factors and Special Considerations*.

## **Table of Contents**

*Potential for Improved Secondary Market Trading for Common Shares.* While it is not possible to predict trading levels at the time the Reorganization closes, each Board considered that the Combined Fund may provide greater secondary market liquidity for its Common Shares as it would be larger than any of the Funds, which may result in tighter bid-ask spreads, better trade execution for the Combined Fund's common shareholders when purchasing or selling Combined Fund Common Shares and potential for improved premium/discount levels for the Combined Fund's Common Shares. However, there can be no assurance that, after the Reorganization, Common Shares of the Combined Fund will trade at a narrower discount to NAV or wider premium to NAV than Common Shares of any individual Fund prior to the Reorganization.

*Potential for Operating and Administrative Efficiencies.* Each Board noted that the Combined Fund may achieve certain operating and administrative efficiencies from its larger net asset size, including greater investment flexibility and investment options, greater diversification of portfolio investments, the ability to trade in larger positions, additional sources of leverage or more competitive leverage terms and more favorable transaction terms. Each Board also noted that the Combined Fund may experience potential benefits from having fewer closed-end funds offering similar products in the market, including an increased focus by investors on the remaining funds in the market (including the Combined Fund) and additional research coverage.

Each Board also noted that the Combined Fund may experience potential benefits from having fewer similar funds in the same fund complex, including a simplified operational model, the elimination of complexities involved with having duplicative funds, easier product differentiation for shareholders (including shareholders of the Combined Fund) and reduced risk of operational, legal and financial errors.

*Anticipated Tax-Free Reorganization.* Each Board noted that it is anticipated that shareholders of its Fund will recognize no gain or loss for U.S. federal income tax purposes as a result of the Reorganization (except with respect to cash received in lieu of fractional Common Shares), as the Reorganization is intended to qualify as a reorganization within the meaning of Section 368(a) of the Code.

Shareholders of each Fund may receive distributions prior to, or after, the consummation of the Reorganization, including distributions attributable to their proportionate share of each Fund's undistributed net investment income declared prior to the consummation of the Reorganization or the Combined Fund built-in gains, if any, recognized after the Reorganization, when such income and gains are eventually distributed by the Combined Fund. To the extent that such a distribution is not an exempt interest dividend (as defined in the Code), the distribution may be taxable to shareholders for U.S. federal income tax purposes.

*Capital Loss Carryforward Considerations.* Each Board considered that capital loss carryforwards of the Combined Fund attributable to the Target Fund will be subject to tax loss limitation rules by reason of the Target Fund undergoing an ownership change in the Reorganization. Each Board also noted that the Combined Fund's capital loss carryforward loss on a per share basis is expected to be lower than the Acquiring Fund's capital loss carryforward loss per share, but higher than the Target Fund's capital loss carryforward loss per share. Each Board considered that the ability of its Fund to fully utilize its existing capital loss carryforwards depends on many variables and assumptions, including projected performance, and is, therefore, highly uncertain.

The portion of distributions that exceeds the Fund's current and accumulated earnings and profits, which are calculated under tax principles, will constitute a non-taxable return of capital. Although capital loss carryforwards from prior years can offset realized net capital gains, capital loss carryforwards will offset current earnings and profits only if they were generated in the Fund's 2012 taxable year or thereafter. If distributions in any tax year are less than the Fund's current earnings and profits but are in excess of net investment income and net realized capital gains (which would occur, for example, if the Fund utilizes pre-2012 capital loss carryforwards to offset capital gains in that tax year), such excess is not treated as a non-taxable return of capital but rather may be taxable to shareholders at ordinary income rates even though it may economically represent a return of capital. Under certain circumstances, such taxable excess distributions could be significant. Please see Certain U.S. Federal Income Tax Consequences of the Reorganization for additional information.



## **Table of Contents**

*Potential Effects of the Reorganization on Undistributed Net Investment Income.* If the Reorganization is approved by shareholders, then substantially all of the undistributed net investment income, if any, of each Fund is expected to be declared to such Fund's common shareholders prior to the Closing Date (the "Pre-Reorganization Declared UNII Distributions"). The declaration date, ex-dividend date (the "Ex-Dividend Date") and record date of the Pre-Reorganization Declared UNII Distributions will occur prior to the Closing Date. However, all or a significant portion of the Pre-Reorganization Declared UNII Distributions may be paid in one or more distributions to common shareholders of the Funds entitled to such Pre-Reorganization Declared UNII Distributions after the Closing Date. Former Target Fund shareholders entitled to such Pre-Reorganization Declared UNII Distributions paid after the Closing Date will receive such distributions in cash.

BlackRock MuniYield Michigan Quality Fund, Inc. (MIY), as the Combined Fund following the Reorganization, does not currently expect to declare any distributions during the first month following the Closing Date. Accordingly, persons who purchase Common Shares of any of the Funds on or after the Ex-Dividend Date for the Pre-Reorganization Declared UNII Distributions should not expect to receive any distributions from any Fund until distributions, if any, are declared by the Board of the Combined Fund and paid to shareholders entitled to any such distributions. No such distributions are expected to be paid by the Combined Fund until at least approximately two months following the Closing Date.

The Combined Fund's earnings and distribution rate on NAV will change over time, and depending on market conditions, may be higher or lower than each Fund's earnings and distribution rate on NAV prior to the Reorganization. The Combined Fund is anticipated to retain a lower UNII balance after the Reorganization than the Acquiring Fund prior to the Reorganization; however, the Combined Fund is anticipated to benefit from a lower expense ratio and other benefits of economies of scale as discussed herein. Each Fund reserves the right to change its distribution policy with respect to common share distributions and the basis for establishing the rate of its distributions for the Common Shares at any time and may do so without prior notice to common shareholders. The payment of any distributions by any Fund is subject to, and will only be made when, as and if, declared by the Board of such Fund. There is no assurance the Board of any Fund will declare any distributions for such Fund.

To the extent any Pre-Reorganization Declared UNII Distributions is not an exempt interest dividend (as defined in the Code), the distribution may be taxable to shareholders for U.S. Federal income tax purposes.

*Expected Costs of the Reorganization.* Each Board considered the terms and conditions of the Reorganization Agreement, including the estimated costs associated with the Reorganization, and the allocation of such costs among the Funds. Each Board noted, however, that the Investment Advisor anticipated that the projected costs of the Reorganization may be recovered over time. The expenses of the Reorganization are estimated to be \$331,000 for the Target Fund and \$351,000 for the Acquiring Fund. Because of the expected expense savings and other benefits for each Fund, the Investment Advisor recommended and the Board of each Fund has approved that its respective Fund be responsible for a portion of its own Reorganization expenses. The Board of each Fund noted that the Investment Advisor will bear approximately \$115,000 of the Target Fund's Reorganization expenses and approximately \$120,000 of the Acquiring Fund's Reorganization expenses. Each Board also noted that the VRDP Holders of the Funds are not expected to bear any of the costs of the Reorganization, while the common shareholders of the Funds will indirectly bear the costs of the Reorganization.

*Terms of the Reorganization and Impact on Shareholders.* Each Board noted that the aggregate NAV (not the market value) of the Acquiring Fund Common Shares that Target Fund common shareholders will receive in the Reorganization is expected to equal the aggregate NAV (not the market value) of the Target Fund Common Shares that Target Fund common shareholders owned immediately prior to the Closing Date. The NAV of the Target Fund and the Acquiring Fund immediately prior to the Closing Date will be reduced by the costs of the Reorganization borne by each Fund, if any. The NAV of Target Fund Common Shares will not be diluted as a result of the Reorganization. Fractional Acquiring Fund Common Shares will generally not be issued to Target Fund common shareholders in connection with the Reorganization, and Target Fund common shareholders should expect to receive cash in lieu of such fractional Common Shares.

## **Table of Contents**

Each Board further noted that holders of Target Fund VRDP Shares will receive the same number of Acquiring Fund VRDP Shares with terms substantially similar to the terms of the outstanding VRDP Shares of the Target Fund held by such holders immediately prior to the Closing Date, with the only significant difference being that the Target Fund VRDP Shares have a mandatory redemption date of June 1, 2041 and the newly issued Acquiring Fund VRDP Shares are expected to have a mandatory redemption date of May 1, 2041.

*Effect on Shareholder Rights.* Each Board noted that each Fund is organized as a Maryland corporation. Each Board also noted that the common shareholders of each Fund have substantially similar voting rights and rights with respect to the payment of dividends and distribution of assets upon liquidation of their respective Fund and have no preemptive, conversion or exchange rights.

Each Board also noted that the terms of the Acquiring Fund VRDP Shares to be issued in connection with the Reorganization will have terms that are substantially identical to the terms of the Acquiring Fund's outstanding VRDP Shares and will rank on a parity with the Acquiring Fund's existing VRDP Shares as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of the affairs of the Acquiring Fund. The Reorganization will not result in any changes to the terms of the Acquiring Fund's VRDP Shares currently outstanding.

*Alternatives to the Reorganization.* In reaching its decision to approve the Reorganization, the Board considered the alternative of continuing to operate each Fund as a separate Fund.

*Potential Benefits to the Investment Advisor and its Affiliates.* Each Board recognized that the Reorganization may result in some benefits and economies of scale for the Investment Advisor and its affiliates. These may include, for example, administrative and operational efficiencies or a reduction in certain operational expenses as a result of the elimination of the Target Fund as a separate fund in the BlackRock closed-end fund complex.

Each Board noted that, if the Reorganization is consummated, the annual contractual investment management fee rate of the Combined Fund will be 0.49% of the average daily net assets of the Combined Fund.

Each Board also noted that the Investment Advisor will bear approximately \$115,000 of the Target Fund's Reorganization expenses and approximately \$120,000 of the Acquiring Fund's Reorganization expenses.

*Conclusion.* Each Board, including the Independent Board Members, approved the Reorganization Agreement and the Issuance, as applicable, concluding that the Reorganization is in the best interests of its Fund and that the interests of existing common shareholders and VRDP Holders of its Fund will not be diluted with respect to NAV and liquidation preference, respectively, as a result of the Reorganization. This determination was made on the basis of each Board Member's business judgment after consideration of all of the factors taken as a whole with respect to its Fund and the Fund's common and preferred shareholders, although individual Board Members may have placed different weight on various factors and assigned different degrees of materiality to various factors.

### **Terms of the Reorganization Agreement**

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

#### *Valuation of Assets and Liabilities*

The respective assets of each of the Funds will be valued on the business day prior to the Closing Date of the Reorganization (the Valuation Time). The valuation procedures are the same for each Fund: the NAV per

## **Table of Contents**

Common Share of each Fund will be determined after the close of business on the NYSE (generally, 4:00 p.m., Eastern time) at the Valuation Time. For the purpose of determining the NAV of a Common Share of each Fund, the value of the securities held by such Fund plus any cash or other assets (including interest accrued but not yet received) minus all liabilities (including accrued expenses) of such Fund is divided by the total number of Common Shares of such Fund outstanding at such time. Daily expenses, including the fees payable to the Investment Advisor, will accrue at the Valuation Time.

Dividends will accumulate on the Target Fund VRDP Shares up to and including the day immediately preceding the Closing Date. Target Fund VRDP Holders will receive on a one-for-one basis one newly issued VRDP Share of the Acquiring Fund, par value \$0.10 per share and with a liquidation preference of \$100,000 per share (plus any accumulated and unpaid dividends that have accrued on such Target Fund VRDP Share up to and including the day immediately preceding the Closing Date if such dividends have not been paid prior to Closing Date), in exchange for each Target Fund VRDP Share held by such Target Fund VRDP Holder immediately prior to the Closing Date. The newly issued Acquiring Fund VRDP Share may be of the same series as the Acquiring Fund's Series W-7 VRDP Shares or a substantially identical series. No fractional Acquiring Fund VRDP Shares will be issued.

The first dividend period for the Acquiring Fund VRDP Shares to be issued in the Reorganization will commence on the Closing Date and end on the day immediately preceding the first dividend payment date for such VRDP Shares, which will be the first business day of the month following the month in which the Closing Date occurs.

### *Amendments and Conditions*

The Reorganization Agreement may be amended at any time prior to the Closing Date with respect to any of the terms therein upon mutual agreement. However, after adoption of the Reorganization Agreement and approval of the Reorganization, no amendment or modification may be made which by law requires further approval by shareholders without such further approval. The obligations of each Fund pursuant to the Reorganization Agreement are subject to various conditions, including a registration statement on Form N-14 being declared effective by the SEC, approval of the Reorganization Agreement by the shareholders of the Target Fund and the VRDP Holders of the Acquiring Fund, certain third-party consents, the approval of the Issuance by the shareholders of the Acquiring Fund, receipt of an opinion of counsel as to tax matters, receipt of an opinion of counsel as to corporate and securities matters and the continuing accuracy of various representations and warranties of the Funds being confirmed by the respective parties.

### *Postponement; Termination*

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

### *Surrender and Exchange of Share Certificates*

The Acquiring Fund will issue to Target Fund VRDP Holders book entry interests for the Acquiring Fund VRDP Shares registered in the name of such holders on a one for one basis for each holder's holdings of Target Fund VRDP Shares. The Funds' VRDP Shares were issued in book-entry form as global securities, and such global securities were deposited with, or on behalf of, The Depository Trust Company (DTC) and registered in the name of Cede & Co., the nominee of DTC. Beneficial interests in the global securities are held only through DTC and any of its participants.

## **Table of Contents**

The Acquiring Fund will issue to Target Fund common shareholders book entry interests for the Acquiring Fund Common Shares registered in the name of such shareholders on the basis of each holder's proportionate interest in the aggregate net asset value of the Target Fund Common Shares. With respect to any Target Fund common shareholder holding certificates evidencing ownership of Target Fund Common Shares as of the Closing Date, and subject to the Acquiring Fund being informed thereof in writing by the Target Fund, the Acquiring Fund will not permit such shareholder to receive new book entry interests of Acquiring Fund Common Shares, until notified by the Target Fund or its agent that such shareholder has surrendered his or her outstanding certificates evidencing ownership of Target Fund Common Shares or, in the event of lost certificates, posted adequate bond. The Target Fund, at its own expense, will request its common shareholders to surrender their outstanding certificates evidencing ownership of Target Fund Common Shares or post adequate bond. From and after the Closing Date, there will be no transfers on the stock transfer books of the Target Fund. If, after the Closing Date, certificates representing Common Shares of the Target Fund are presented to the Acquiring Fund, they will be cancelled and exchanged for book entry interests representing Acquiring Fund Common Shares and cash in lieu of fractional Common Shares, if applicable, distributable with respect to the Target Fund Common Shares in the Reorganization.

### *Expenses of the Reorganization*

Each Fund will bear expenses incurred in connection with the Reorganization. The expenses incurred in connection with the Reorganization include but are not limited to, costs related to the preparation and distribution of materials distributed to each Fund's Board, expenses incurred in connection with the preparation of the Reorganization Agreement, the registration statement on Form N-14 and the separate Proxy Statement to VRDP Holders, the printing and distribution of this Joint Proxy Statement/Prospectus delivered to common shareholders, the separate Joint Proxy Statement delivered to VRDP Holders and any other materials required to be distributed to shareholders, SEC and state securities commission filing fees, and legal and audit fees in connection with the Reorganization, including fees incurred in obtaining the requisite consents of rating agencies, counterparties or service providers to the VRDP Shares, legal fees incurred in connection with amending the transaction documents for the VRDP Shares, which may include the legal fees of counterparties and service providers to the extent applicable, legal fees incurred preparing each Fund's Board materials, attending each Fund's Board meetings and preparing the minutes, auditing fees associated with each Fund's financial statements, stock exchange fees, transfer agency fees, rating agency fees, portfolio transfer taxes (if any) and any similar expenses incurred in connection with the Reorganization, which will be borne directly by the respective Fund incurring the expense or allocated among the Funds proportionately or on another reasonable basis, as appropriate.

The expenses of the Reorganization are estimated to be \$331,000 for the Target Fund and \$351,000 for the Acquiring Fund. Because of the expected expense savings and other benefits for each Fund, the Investment Advisor recommended and the Board of each Fund has approved that its respective Fund be responsible for a portion of its own Reorganization expenses. The Board of each Fund noted that the Investment Advisor will bear approximately \$115,000 of the Target Fund's reorganization expenses and approximately \$120,000 of the Acquiring Fund's Reorganization expenses. Each Board also noted that the VRDP Holders of the Funds are not expected to bear any of the costs of the Reorganization, while the common shareholders of the Funds will indirectly bear the costs of the Reorganization.

Neither the Funds nor the Investment Advisor will pay any expenses of shareholders arising out of or in connection with the Reorganization (e.g., expenses incurred by the shareholder as a result of attending the shareholder meeting, voting on the Reorganization or other action taken by the shareholder in connection with the Reorganization). The actual costs associated with the proposed Reorganization may be more or less than the estimated costs discussed herein.

## **Table of Contents**

### **Appraisal Rights**

Under Maryland law, stockholders of an investment company whose shares are traded publicly on a national securities exchange, such as Common Shares of the Target Fund, are not entitled to demand the fair value of their shares in connection with a reorganization. However, because the Target Fund's VRDP Shares are not traded publicly on a national securities exchange and the Target Fund will be selling substantially all of its assets to the Acquiring Fund in the Reorganization, the holders of Target Fund VRDP Shares will be entitled under Maryland law to demand and receive payment of the fair value of such Target Fund VRDP Shares upon the consummation of the Reorganization.

### **Description of Common Shares to Be Issued by the Acquiring Fund**

The terms of the Acquiring Fund Common Shares to be issued pursuant to the Reorganization will be identical to the terms of the Acquiring Fund Common Shares that are currently outstanding. The Acquiring Fund Common Shares, when issued, will be fully paid and non-assessable and have no preemptive, conversion or exchange rights or rights to cumulative voting.

Please see [Information about the Common Shares of the Funds](#) for additional information about the Funds' Common Shares.

### **Description of VRDP Shares to Be Issued by the Acquiring Fund**

Upon the Closing Date, Target Fund VRDP Holders will receive on a one-for-one basis one newly issued Acquiring Fund VRDP Share, par value \$0.10 per share and with a liquidation preference of \$100,000 per share (plus any accumulated and unpaid dividends that have accrued on such Target Fund VRDP Share up to and including the day immediately preceding the Closing Date if such dividends have not been paid prior to the Closing Date), in exchange for each Target Fund VRDP Share held by such Target Fund VRDP Holder immediately prior to the Closing Date. Target Fund VRDP Holders will receive the same number of Acquiring Fund VRDP Shares, with terms substantially similar to the terms of the outstanding Target Fund VRDP Shares held by such holders immediately prior to the Closing Date, with the only significant difference being that the Target Fund VRDP Shares have a mandatory redemption date of June 1, 2041 and the newly issued Acquiring Fund VRDP Shares are expected to have a mandatory redemption date of May 1, 2041. The Acquiring Fund VRDP Shares to be issued in connection with the Reorganization will have terms that are substantially identical to the terms of the outstanding Acquiring Fund VRDP Shares and will rank on a parity with the Acquiring Fund's existing VRDP Shares as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of the affairs of the Acquiring Fund. The Reorganization will not result in any changes to the terms of the Acquiring Fund's VRDP Shares currently outstanding.

Please see [Information about the VRDP Shares of the Funds](#) for additional information about the Funds' VRDP Shares.

## **THE FUNDS**

Each Fund is organized as a corporation under the laws of the State of Maryland and is a non-diversified, closed-end management investment company registered under the 1940 Act. Each Fund's principal office is located at 100 Bellevue Parkway, Wilmington, Delaware 19809, and its telephone number is (800) 882-0052. The Acquiring Fund was incorporated under the laws of the State of Maryland on July 1, 1992 and commenced operations on October 30, 1992. The Acquiring Fund was known as MuniYield Michigan Insured Fund Inc. prior to September 29, 2006 and BlackRock MuniYield Michigan Insured Fund, Inc. prior to November 9, 2010.

## **Table of Contents**

The Target Fund was incorporated under the laws of the State of Maryland on December 17, 1991 and commenced operations on February 28, 1992. The Target Fund was known as Michigan MuniYield Fund, Inc. prior to January 7, 1992; MuniYield Michigan Fund, Inc. prior to May 28, 2002; MuniYield Michigan Insured Fund II Inc. prior to September 29, 2006 and BlackRock MuniYield Michigan Insured Fund II, Inc. prior to November 9, 2010.

The Acquiring Fund Common Shares are listed on the NYSE as MIY.

The Target Fund Common Shares are listed on the NYSE as MYM.

Each Fund has a July 31 fiscal year end.

Each Fund has VRDP Shares outstanding. Each Fund's VRDP Shares are not listed on a national stock exchange and have not been registered under the Securities Act, or any state securities laws, and unless so registered, may not be offered, sold, assigned, transferred, pledged, encumbered or otherwise disposed of except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable state securities laws. Please see Information about the VRDP Shares of the Funds for additional information.

## **THE ACQUIRING FUND'S INVESTMENTS**

### **Investment Objective and Policies**

The Acquiring Fund's investment objective is to provide shareholders with as high a level of current income exempt from federal and Michigan income taxes as is consistent with its investment policies and prudent investment management. The Acquiring Fund seeks to achieve its investment objective by investing at least 80% of an aggregate of the Acquiring Fund's net assets (including proceeds from the issuance of any preferred shares) and the proceeds of any borrowings for investment purposes, in a portfolio of municipal obligations issued by or on behalf of the State of Michigan, its political subdivisions, agencies and instrumentalities and by other qualifying issuers, each of which pays interest that, in the opinion of bond counsel to the issuer, is excludable from gross income for U.S. federal income tax purposes (except that the interest may be includable in taxable income for purposes of the Federal alternative minimum tax) and exempt from Michigan income taxes (Michigan Municipal Bonds). The Acquiring Fund may invest directly in such securities or synthetically through the use of derivatives. The Acquiring Fund also may invest in municipal obligations issued by or on behalf of states, territories and possessions of the United States and their political subdivisions, agencies or instrumentalities, each of which pays interest that is excludable from gross income for U.S. federal income tax purposes, in the opinion of bond counsel to the issuer, but is not excludable from gross income for Michigan income tax purposes (Municipal Bonds). In general, the Acquiring Fund does not intend for its investments to earn a large amount of interest income that is (i) includable in gross income for U.S. federal income tax purposes or (ii) not exempt from Michigan income taxes. There can be no assurance that the Acquiring Fund's investment objective will be realized. Unless otherwise noted, the term Municipal Bonds also includes Michigan Municipal Bonds.

The Acquiring Fund's investment objective and its policy of investing at least 80% of an aggregate of the Acquiring Fund's net assets (including proceeds from the issuance of any preferred shares) and the proceeds of any borrowings for investment purposes, in Michigan Municipal Bonds are fundamental policies that may not be changed without the approval of a majority of the outstanding voting securities of the Acquiring Fund (as defined in the 1940 Act).

The Acquiring Fund may invest in certain tax exempt securities classified as private activity bonds (or industrial development bonds, under pre-1986 law) (PABs) (in general, bonds that benefit non-governmental entities) that may subject certain investors in the Acquiring Fund to an alternative minimum tax. The percentage of the Acquiring Fund's total assets invested in PABs will vary from time to time.

## **Table of Contents**

Under normal market conditions, the Acquiring Fund expects to invest primarily in a portfolio of long term Municipal Bonds that are commonly referred to as investment grade securities, which are obligations rated at the time of purchase within the four highest quality ratings as determined by either Moody's (currently Aaa, Aa, A and Baa), S&P (currently AAA, AA, A and BBB) or Fitch (currently AAA, AA, A and BBB). In the case of short term notes, the investment grade rating categories are SP-1+ through SP-2 for S&P, MIG-1 through MIG-3 for Moody's and F-1+ through F-3 for Fitch. In the case of tax exempt commercial paper, the investment grade rating categories are A-1+ through A-3 for S&P, Prime-1 through Prime-3 for Moody's and F-1+ through F-3 for Fitch. Obligations ranked in the lowest investment grade rating category (BBB, SP-2 and A-3 for S&P; Baa, MIG-3 and Prime-3 for Moody's and BBB and F-3 for Fitch), while considered investment grade, may have certain speculative characteristics. There may be sub-categories or gradations indicating relative standing within the rating categories set forth above. In assessing the quality of Municipal Bonds with respect to the foregoing requirements, the Investment Advisor takes into account the Municipal Bond insurance as well as the nature of any letters of credit or similar credit enhancement to which particular Municipal Bonds are entitled and the creditworthiness of the financial institution that provided such Municipal Bond insurance or credit enhancement. Insurance is expected to protect the Acquiring Fund against losses caused by a bond issuer's failure to make interest or principal payments. However, insurance does not protect the Acquiring Fund or its shareholders against losses caused by declines in a bond's market value. Also, the Acquiring Fund cannot be certain that any insurance company does not make these payments. If a bond's insurer fails to fulfill its obligations or loses its credit rating, the value of the bond could drop. See Appendix C Ratings of Investments to the Statement of Additional Information. If unrated, such securities will possess creditworthiness comparable, in the opinion of the Investment Advisor, to other obligations in which the Acquiring Fund may invest.

All percentage and ratings limitations on securities in which the Acquiring Fund may invest apply at the time of making an investment and shall not be considered violated if an investment rating is subsequently downgraded to a rating that would have precluded the Acquiring Fund's initial investment in such security. In the event that the Acquiring Fund disposes of a portfolio security subsequent to its being downgraded, the Acquiring Fund may experience a greater risk of loss than if such security had been sold prior to such downgrade.

The net asset value of the common shares of a closed-end investment company, such as the Acquiring Fund, which invests primarily in fixed income securities, changes as the general levels of interest rates fluctuate. When interest rates decline, the value of a fixed income portfolio can be expected to rise. Conversely, when interest rates rise, the value of a fixed income portfolio can be expected to decline. Prices of longer term securities generally fluctuate more in response to interest rate changes than do shorter term securities. These changes in net asset value are likely to be greater in the case of a fund having a leveraged capital structure, such as the Acquiring Fund.

The Acquiring Fund invests primarily in long term Municipal Bonds with maturities of more than ten years. However, the Acquiring Fund also may invest in intermediate term Municipal Bonds with maturities of between three years and ten years. The Acquiring Fund also may invest from time to time in short term Municipal Bonds with maturities of less than three years. The average maturity of the Acquiring Fund's portfolio securities will vary based upon the Investment Advisor's assessment of economic and market conditions.

For temporary periods or to provide liquidity, the Acquiring Fund has the authority to invest as much as 20% of its total assets in tax exempt and taxable money market obligations with a maturity of one year or less (such short term obligations being referred to herein as Temporary Investments). In addition, the Acquiring Fund reserves the right as a defensive measure to invest temporarily a greater portion of its assets in Temporary Investments, when, in the opinion of the Investment Advisor, prevailing market or financial conditions warrant. Taxable money market obligations will yield taxable income. The Acquiring Fund also may invest in variable rate demand obligations (VRDOs) and VRDOs in the form of participation interests (Participating VRDOs) in variable rate tax exempt obligations held by a financial institution. See Other Investment Policies Temporary Investments. The Acquiring Fund's hedging strategies, which are described in more detail under Hedging Transactions Financial Futures Transactions and Options, are not fundamental policies and may

## **Table of Contents**

be modified by the Board of Directors of the Acquiring Fund without the approval of the Acquiring Fund's shareholders. The Acquiring Fund is also authorized to invest in indexed and inverse floating rate obligations for hedging purposes and to seek to enhance return.

The Acquiring Fund may invest in securities not issued by or on behalf of a state or territory or by an agency or instrumentality thereof, if the Acquiring Fund receives an opinion of counsel to the issuer that such securities pay interest that is excludable from gross income for U.S. federal income tax purposes and, if applicable, exempt from Michigan income taxes ( "Non-Municipal Tax Exempt Securities" ). Non-Municipal Tax Exempt Securities could include trust certificates, partnership interests or other instruments evidencing interest in one or more long term municipal securities. Non-Municipal Tax Exempt Securities also may include securities issued by other investment companies that invest in Municipal Bonds, to the extent such investments are permitted by the Acquiring Fund's investment restrictions and applicable law. Non-Municipal Tax Exempt Securities are subject to the same risks associated with an investment in Municipal Bonds as well as many of the risks associated with investments in derivatives. If the Internal Revenue Service were to issue any adverse ruling or take an adverse position with respect to the taxation of Non-Municipal Tax Exempt Securities, there is a risk that the interest paid on such securities would be deemed taxable at the Federal level.

The Acquiring Fund ordinarily does not realize significant investment income not exempt from federal and Michigan income taxes. From time to time, the Acquiring Fund may realize taxable capital gains.

Federal tax legislation may limit the types and volume of bonds the interest on which qualifies for a U.S. federal income tax exemption. As a result, current legislation and legislation that may be enacted in the future may affect the availability of Municipal Bonds for investment by the Acquiring Fund.

## **Description of Municipal Bonds**

Set forth below is a detailed description of the Municipal Bonds and Temporary Investments in which the Acquiring Fund may invest. Information with respect to ratings assigned to tax exempt obligations that the Acquiring Fund may purchase is set forth in Appendix C to the Statement of Additional Information. Obligations are included within the term Municipal Bonds if the interest paid thereon is excluded from gross income for U.S. federal income tax purposes in the opinion of bond counsel to the issuer.

Municipal Bonds include debt obligations issued to obtain funds for various public purposes, including the construction of a wide range of public facilities, refunding of outstanding obligations and obtaining funds for general operating expenses and loans to other public institutions and facilities. In addition, certain types of private activity bonds ( "PABs" ) are issued by or on behalf of public authorities to finance various privately owned or operated facilities, including among other things, airports, public ports, mass commuting facilities, multi-family housing projects, as well as facilities for water supply, gas, electricity, sewage or solid waste disposal and other specialized facilities. Other types of PABs, the proceeds of which are used for the construction, equipment or improvement of privately operated industrial or commercial facilities, may constitute Municipal Bonds. The interest on Municipal Bonds may bear a fixed rate or be payable at a variable or floating rate. The two principal classifications of Municipal Bonds are general obligation bonds and revenue bonds, which latter category includes PABs and, for bonds issued on or before August 15, 1986, industrial development bonds or IDBs. Municipal Bonds typically are issued to finance public projects, such as roads or public buildings, to pay general operating expenses or to refinance outstanding debt. Municipal Bonds may also be issued for private activities, such as housing, medical and educational facility construction, or for privately owned industrial development and pollution control projects. General obligation bonds are backed by the full faith and credit, or taxing authority, of the issuer and may be repaid from any revenue source. Revenue bonds may be repaid only from the revenues of a specific facility or source. Municipal Bonds 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



## **Table of Contents**

project revenues, which may include tolls, fees and other user charges, lease payments and mortgage payments. Municipal Bonds may also be issued to finance projects on a short-term interim basis, anticipating repayment with the proceeds of the later issuance of long-term debt.

The Acquiring Fund has not established any limit on the percentage of its portfolio that may be invested in PABs. The Acquiring Fund may not be a suitable investment for investors who are already subject to the Federal alternative minimum tax or who would become subject to the Federal alternative minimum tax as a result of an investment in the Acquiring Fund's Common Shares.

*General Obligation Bonds.* General obligation bonds are typically secured by the issuer's pledge of faith, credit and taxing power for the repayment of principal and the payment of interest. The taxing power of any governmental entity may be limited, however, by provisions of its state constitution or laws, and an entity's creditworthiness will depend on many factors, including potential erosion of its tax base due to population declines, natural disasters, declines in the state's industrial base or inability to attract new industries, economic limits on the ability to tax without eroding the tax base, state legislative proposals or voter initiatives to limit ad valorem real property taxes and the extent to which the entity relies on Federal or state aid, access to capital markets or other factors beyond the state's or entity's control. Accordingly, the capacity of the issuer of a general obligation bond as to the timely payment of interest and the repayment of principal when due is affected by the issuer's maintenance of its tax base.

*Revenue Bonds.* Revenue or special obligation bonds are typically payable only from the revenues derived from a particular facility or class of facilities or, in some cases, from the proceeds of a special excise tax or other specific revenue source such as from the user of the facility being financed. Accordingly, the timely payment of interest and the repayment of principal in accordance with the terms of the revenue or special obligation bond is a function of the economic viability of such facility or such revenue source. Revenue bonds issued by state or local agencies to finance the development of low-income, multi-family housing involve special risks in addition to those associated with municipal securities generally, including that the underlying properties may not generate sufficient income to pay expenses and interest costs. Such bonds are generally non-recourse against the property owner, may be junior to the rights of others with an interest in the properties, may pay interest that changes based in part on the financial performance of the property, may be prepayable without penalty and may be used to finance the construction of housing developments which, until completed and rented, do not generate income to pay interest. Increases in interest rates payable on senior obligations may make it more difficult for issuers to meet payment obligations on subordinated bonds.

*Municipal Notes.* Municipal notes are shorter term municipal debt obligations. They may provide interim financing in anticipation of tax collection, bond sales or revenue receipts. If there is a shortfall in the anticipated proceeds, repayment on the note may be delayed or the note may not be fully repaid, and the Acquiring Fund may lose money.

*Municipal Commercial Paper.* Municipal commercial paper is generally unsecured and issued to meet short-term financing needs. The lack of security presents some risk of loss to the Acquiring Fund since, in the event of an issuer's bankruptcy, unsecured creditors are repaid only after the secured creditors out of the assets, if any, that remain.

*PABs.* The Acquiring Fund may purchase Municipal Bonds classified as PABs. Interest received on certain PABs is treated as an item of tax preference for purposes of the federal alternative minimum tax and may impact the overall tax liability of certain investors in the Acquiring Fund. PABs, formerly referred to as industrial development bonds, are issued by, or on behalf of, states, municipalities or 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 PABs, the proceeds of which are used for the construction, equipment, repair or improvement of privately operated industrial or commercial facilities, may constitute municipal securities,

## **Table of Contents**

although the federal tax laws may place substantial limitations on the size of such issues. Such bonds are secured primarily by revenues derived from loan repayments or lease payments due from the entity which may or may not be guaranteed by a parent company or otherwise secured. PABs generally are not secured by a pledge of the taxing power of the issuer of such bonds. Therefore, an investor should be aware that repayment of such bonds generally depends on the revenues of a private entity and be aware of the risks that such an investment may entail. Continued ability of an entity to generate sufficient revenues for the payment of principal and interest on such bonds will be affected by many factors including the size of the entity, capital structure, demand for its products or services, competition, general economic conditions, government regulation and the entity's dependence on revenues for the operation of the particular facility being financed.

*Moral Obligation Bonds.* Municipal Bonds may also include moral obligation bonds, which are normally issued by special purpose public authorities. If an issuer of moral obligation bonds is unable to meet its obligations, the repayment of such bonds becomes a moral commitment but not a legal obligation of the state or municipality in question.

*Municipal Lease Obligations.* Also included within the general category of Municipal Bonds are certificates of participation (COPs) issued by government authorities or entities to finance the acquisition or construction of equipment, land and/or facilities. The COPs represent participations in a lease, an installment purchase contract or a conditional sales contract (hereinafter collectively called lease obligations) relating to such equipment, land or facilities. Municipal leases, like other municipal debt obligations, are subject to the risk of non-payment. Although lease obligations do not constitute general obligations of the issuer for which the issuer's unlimited taxing power is pledged, a lease obligation is frequently backed by the issuer's covenant to budget for, appropriate and make the payments due under the lease obligation. However, certain lease obligations contain non-appropriation clauses which provide that the issuer has no obligation to make lease or installment purchase payments in future years unless money is appropriated for such purpose on a yearly basis. Although non-appropriation lease obligations are secured by the leased property, disposition of the property in the event of foreclosure might prove difficult and the value of the property may be insufficient to issue lease obligations. Certain investments in lease obligations may be illiquid.

The ability of issuers of municipal leases to make timely lease payments may be adversely impacted in general economic downturns and as relative governmental cost burdens are allocated and reallocated among federal, state and local governmental units. Such non-payment would result in a reduction of income to the Acquiring Fund, and could result in a reduction in the value of the municipal lease experiencing non-payment and a potential decrease in the net asset value of the Acquiring Fund. Issuers of municipal securities might seek protection under the bankruptcy laws. In the event of bankruptcy of such an issuer, the Acquiring Fund could experience delays and limitations with respect to the collection of principal and interest on such municipal leases and the Acquiring Fund may not, in all circumstances, be able to collect all principal and interest to which it is entitled. To enforce its rights in the event of a default in lease payments, the Acquiring Fund might take possession of and manage the assets securing the issuer's obligations on such securities, which may increase the Acquiring Fund's operating expenses and adversely affect the net asset value of the Acquiring Fund. When the lease contains a non-appropriation clause, however, the failure to pay would not be a default and the Acquiring Fund would not have the right to take possession of the assets. Any income derived from the Acquiring Fund's ownership or operation of such assets may not be tax-exempt. In addition, the Acquiring Fund's intention to qualify as a regulated investment company under the Internal Revenue Code of 1986, may limit the extent to which the Acquiring Fund may exercise its rights by taking possession of such assets, because as a regulated investment company the Acquiring Fund is subject to certain limitations on its investments and on the nature of its income.

*Zero Coupon Bonds.* Municipal Bonds may include zero-coupon bonds. Zero coupon bonds are securities that are sold at a discount to par value and do not pay interest during the life of the security. The discount approximates the total amount of interest the security will accrue and compound over the period until maturity at a rate of interest reflecting the market rate of the security at the time of issuance. Upon maturity, the holder of a zero coupon bond is entitled to receive the par value of the security.

## **Table of Contents**

While interest payments are not made on such securities, holders of such securities are deemed to have received income ( phantom income ) annually, notwithstanding that cash may not be received currently. The effect of owning instruments that do not make current interest payments is that a fixed yield is earned not only on the original investment but also, in effect, on all discount accretion during the life of the obligations. This implicit reinvestment of earnings at a fixed rate eliminates the risk of being unable to invest distributions at a rate as high as the implicit yield on the zero coupon bond, but at the same time eliminates the holder's ability to reinvest at higher rates in the future. For this reason, some of these securities may be subject to substantially greater price fluctuations during periods of changing market interest rates than are comparable securities that pay interest currently. Longer term zero coupon bonds are more exposed to interest rate risk than shorter term zero coupon bonds. These investments benefit the issuer by mitigating its need for cash to meet debt service, but also require a higher rate of return to attract investors who are willing to defer receipt of cash.

The Acquiring Fund accrues income with respect to these securities for U.S. federal income tax and accounting purposes prior to the receipt of cash payments. Zero coupon bonds may be subject to greater fluctuation in value and less liquidity in the event of adverse market conditions than comparably rated securities that pay cash interest at regular intervals.

Further, to maintain its qualification for pass-through treatment under the Federal tax laws, the Acquiring Fund is required to distribute income to its shareholders and, consequently, may have to dispose of other, more liquid portfolio securities under disadvantageous circumstances or may have to leverage itself by borrowing in order to generate the cash to satisfy these distributions. The required distributions may result in an increase in the Acquiring Fund's exposure to zero coupon bonds.

In addition to the above-described risks, there are certain other risks related to investing in zero coupon bonds. During a period of severe market conditions, the market for such securities may become even less liquid. In addition, as these securities do not pay cash interest, the Acquiring Fund's investment exposure to these securities and their risks, including credit risk, will increase during the time these securities are held in the Acquiring Fund's portfolio.

*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.

*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 (a type of municipal security established by the Mello-Roos Community Facilities District Act of 1982), are generally 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 are generally 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.

## **Table of Contents**

*Indexed and Inverse Floating Rate Securities.* The Acquiring Fund may invest in Municipal Bonds (and Non-Municipal Tax-Exempt Securities) that yield a return based on a particular index of value or interest rates. For example, the Acquiring Fund may invest in Municipal Bonds that pay interest based on an index of Municipal Bond interest rates. The principal amount payable upon maturity of certain Municipal Bonds also may be based on the value of the index. To the extent the Acquiring Fund invests in these types of Municipal Bonds, the Acquiring Fund's return on such Municipal Bonds will be subject to risk with respect to the value of the particular index. Interest and principal payable on the Municipal Bonds may also be based on relative changes among particular indices. Also, the Acquiring Fund may invest in so-called "inverse floating rate bonds" or residual interest bonds on which the interest rates typically vary inversely with a short-term floating rate (which may be reset periodically by a dutch auction, a remarketing agent, or by reference to a short-term tax-exempt interest rate index). The Acquiring Fund may purchase synthetically-created inverse floating rate bonds evidenced by custodial or trust receipts. Generally, income on inverse floating obligations will decrease when short-term interest rates increase, and will increase when short-term interest rates decrease. Such securities have the effect of providing a degree of investment leverage, since they may increase or decrease in value in response to changes, as an illustration, in market interest rates at a rate that is a multiple (typically two) of the rate at which fixed-rate, long-term, tax-exempt securities increase or decrease in response to such changes. As a result, the market values of such securities generally will be more volatile than the market values of fixed-rate tax-exempt securities. To seek to limit the volatility of these securities, the Acquiring Fund may purchase inverse floating rate bonds with shorter-term maturities or limitations on the extent to which the interest rate may vary. Certain investments in such obligations may be illiquid.

*When Issued Securities, Delayed Delivery Securities and Forward Commitments.* The Acquiring Fund may purchase or sell securities that it is entitled to receive on a when issued basis. The Acquiring Fund may also purchase or sell securities on a delayed delivery basis. The Acquiring Fund may also purchase or sell securities through a forward commitment. These transactions involve the purchase or sale of securities by the Acquiring Fund at an established price with payment and delivery taking place in the future. The purchase will be recorded on the date the Acquiring Fund enters into the commitment and the value of the securities will thereafter be reflected in the Acquiring Fund's net asset value. The Acquiring Fund has not established any limit on the percentage of its assets that may be committed in connection with these transactions. At the time the Acquiring Fund enters into a transaction on a when-issued basis, it will segregate or designate on its books and records cash or liquid assets with a value not less than the value of the when-issued securities.

There can be no assurance that a security purchased on a when issued basis will be issued or that a security purchased or sold through a forward commitment will be delivered. A default by a counterparty may result in the Acquiring Fund missing the opportunity of obtaining a price considered to be advantageous. The value of securities in these transactions on the delivery date may be more or less than the Acquiring Fund's purchase price. The Acquiring Fund may bear the risk of a decline in the value of the security in these transactions and may not benefit from an appreciation in the value of the security during the commitment period.

If deemed advisable as a matter of investment strategy, the Acquiring Fund may dispose of or renegotiate a commitment after it has been entered into, and may sell securities it has committed to purchase before those securities are delivered to the Acquiring Fund on the settlement date. In these cases the Acquiring Fund may realize a taxable capital gain or loss.

When the Acquiring Fund engages in when-issued, delayed delivery or forward commitment transactions, it relies on the other party to consummate the trade. Failure of such party to do so may result in the Acquiring Fund's incurring a loss or missing an opportunity to obtain a price considered to be advantageous.

The market value of the securities underlying a commitment to purchase securities, and any subsequent fluctuations in their market value, is taken into account when determining the market value of the Acquiring Fund starting on the day the Acquiring Fund agrees to purchase the securities. The Acquiring Fund does not earn interest on the securities it has committed to purchase until they are paid for and delivered on the settlement date.

## **Table of Contents**

*Call Rights.* The Acquiring Fund may purchase a Municipal Bond issuer's right to call all or a portion of such Municipal Bond for mandatory tender for purchase (a "Call Right"). A holder of a Call Right may exercise such right to require a mandatory tender for the purchase of related Municipal Bonds, subject to certain conditions. A Call Right that is not exercised prior to the maturity of the related Municipal Bond will expire without value. The economic effect of holding both the Call Right and the related Municipal Bond is identical to holding a Municipal Bond as a non-callable security. Certain investments in such obligations may be illiquid.

*Yields.* Yields on Municipal Bonds are dependent on a variety of factors, including the general condition of the money market and of the municipal bond market, the size of a particular offering, the financial condition of the issuer, the maturity of the obligation and the rating of the issue. The ability of the Acquiring Fund to achieve its investment objective is also dependent on the continuing ability of the issuers of the securities in which the Acquiring Fund invests to meet their obligations for the payment of interest and principal when due. There are variations in the risks involved in holding Municipal Bonds, both within a particular classification and between classifications, depending on numerous factors. Furthermore, the rights of owners of Municipal Bonds and the obligations of the issuer of such Municipal Bonds may be subject to applicable bankruptcy, insolvency and similar laws and court decisions affecting the rights of creditors generally and to general equitable principles, which may limit the enforcement of certain remedies.

## **Leverage**

The Acquiring Fund may utilize leverage to seek to enhance the yield and NAV of its Common Shares. However, this objective cannot be achieved in all interest rate environments. The Acquiring Fund currently leverages its assets through the use of VRDP Shares and tender option bonds. The Combined Fund would also utilize such forms of leverage. Each Fund's total economic leverage through the use of VRDP Shares and tender option bonds does not exceed 45% of its respective total assets.

Under the 1940 Act, the Acquiring Fund is permitted to issue debt up to 33 $\frac{1}{3}$ % of its total assets or equity securities (e.g., preferred shares) up to 50% of its total assets. The Acquiring Fund may voluntarily elect to limit its leverage to less than the maximum amount permitted under the 1940 Act. In addition, the Acquiring Fund may also be subject to certain asset coverage, leverage or portfolio composition requirements imposed by the VRDP Shares' governing instruments, counterparties or by agencies rating the VRDP Shares, which may be more stringent than those imposed by the 1940 Act.

The Acquiring Fund is authorized to borrow money in amounts of up to 5% of the value of its total assets at the time of such borrowings; provided, however, that the Acquiring Fund is authorized to borrow moneys in amounts of up to 33 $\frac{1}{3}$ % of the value of its total assets at the time of such borrowings to finance the repurchase of its own common stock pursuant to tender offers or otherwise to redeem or repurchase shares of preferred stock. Borrowings by the Acquiring Fund (commonly known, as with the issuance of preferred stock, as "leveraging") create an opportunity for greater total return since, for example, the Acquiring Fund will not be required to sell portfolio securities to repurchase or redeem shares but, at the same time, increase exposure to capital risk. In addition, borrowed funds are subject to interest costs that may offset or exceed the return earned on the borrowed funds.

In general, the concept of leveraging is based on the premise that the financing cost of leverage, which will be based on short-term interest rates, will normally be lower than the income earned by the Acquiring Fund on its longer-term portfolio investments purchased with the proceeds from leverage. To the extent that the total assets of the Acquiring Fund (including the assets obtained from leverage) are invested in higher-yielding portfolio investments, the Acquiring Fund's common shareholders can benefit from incremental net income. The interest earned on securities purchased with the proceeds from leverage is paid to common shareholders in the form of dividends, and the value of these portfolio holdings is reflected in the per share NAV.

## **Table of Contents**

To illustrate these concepts, assume the Acquiring Fund's Common Shares capitalization is \$100 million and it utilizes leverage for an additional \$30 million, creating a total value of \$130 million available for investment in longer-term income securities. If prevailing short-term interest rates are 3% and longer-term interest rates are 6%, the yield curve has a strongly positive slope. In this case, the Acquiring Fund's financing costs on the \$30 million of proceeds obtained from leverage are based on the lower short-term interest rates. At the same time, the securities purchased by the Acquiring Fund with the proceeds from leverage earn income based on longer-term interest rates. In this case, the Acquiring Fund's financing cost of leverage is significantly lower than the income earned on the Acquiring Fund's longer-term investments acquired from leverage proceeds, and therefore the holders of Common Shares are the beneficiaries of the incremental net income.

However, in order to benefit common shareholders, the return on assets purchased with leverage proceeds must exceed the ongoing costs associated with the leverage. If interest and other costs of leverage exceed the Acquiring Fund's return on assets purchased with leverage proceeds, income to common shareholders will be lower than if the Acquiring Fund had not used leverage. Furthermore, the value of the Acquiring Fund's portfolio investments generally varies inversely with the direction of long-term interest rates, although other factors can influence the value of portfolio investments. In contrast, the value of the Acquiring Fund's obligations under its leverage arrangement generally does not fluctuate in relation to interest rates. As a result, changes in interest rates can influence the Acquiring Fund's NAVs positively or negatively.

Changes in the future direction of interest rates are very difficult to predict accurately, and there is no assurance that the Acquiring Fund's intended leveraging strategy will be successful.

Leverage also will generally cause greater changes in the Acquiring Funds' NAVs, market prices and dividend rates than comparable portfolios without leverage. In a declining market, leverage is likely to cause a greater decline in the net asset value and market price of the Acquiring Fund's Common Shares than if the Acquiring Fund were not leveraged. In addition, the Acquiring Fund may be required to sell portfolio securities at inopportune times or at distressed values in order to comply with regulatory requirements applicable to the use of leverage or as required by the terms of leverage instruments, which may cause the Acquiring Fund to incur losses. The use of leverage may limit the Acquiring Fund's ability to invest in certain types of securities or use certain types of hedging strategies. The Acquiring Fund will incur expenses in connection with the use of leverage, all of which are borne by common shareholders and may reduce income to the Common Shares. During periods in which the Acquiring Fund is using leverage, the fees paid to the Investment Advisor for advisory services will be higher than if the Acquiring Fund did not use leverage, because the fees paid will be calculated on the basis of the Acquiring Fund's total managed assets, which includes the proceeds from leverage. The Acquiring Fund's leveraging strategy may not be successful.

There can be no assurance the Combined Fund will be able to continue to use leverage through the use of preferred shares, tender option bonds or otherwise during periods of instability or illiquidity in the debt markets, during periods of high short-term interest rates or due to other adverse market conditions, because the Combined Fund may not be able to enter into tender option bond transactions or use other forms of leverage during such periods. There can be no assurance that the Combined Fund's leverage strategy will be successful. The use of leverage can create risks. See Risk Factors and Special Considerations General Risks of Investing in the Acquiring Fund Leverage Risk.

### *Effects of Leverage*

Assuming that leverage will represent approximately 37.5% of the Acquiring Fund's total managed assets and that the Acquiring Fund will bear expenses relating to that leverage at an average annual rate of 0.94%, the income generated by the Acquiring Fund's portfolio (net of estimated expenses) must exceed 0.35% in order to cover the expenses specifically related to the Acquiring Fund's use of leverage. Of course, these numbers are merely estimates used for illustration. Actual leverage expenses will vary frequently and may be significantly higher or lower than the rate estimated above.