Important Information about Variable Rate Demand Notes (also known as Put Bonds or Seven-Day Floaters)

Baird underwrites and serves as remarketing agent on offerings of variable rate demand notes ("VRDNs"), otherwise known as "put bonds" or "seven-day floaters." VRDNs are complex securities. This document explains some of the risk considerations and the basic features of VRDNs. You should read the prospectus, official statement, or offering memorandum for any VRDN before making an investment decision. Your Baird Financial Advisor can assist you in understanding these securities.

VRDN STRUCTURE

VRDNs are issued in a public offering or private placement by a corporate borrower, a municipality or a conduit agency (the "issuer") that then lends the proceeds of the note offering to a borrower. A prospectus, official statement or offering memorandum is prepared and delivered to purchasers in the offering, and is available to subsequent investors upon request. The VRDNs are issued under an indenture of trust in which a trustee is appointed to serve as registrar, paying agent and transfer agent and to provide other administrative services. As underwriter of the bonds in the initial offering, Baird agrees to buy the VRDNs from the issuer and sells them to clients at par. After VRDNs have been issued, the interest rate on the VRDNs is reset on a weekly basis by Baird in its capacity as remarketing agent based on prevailing market conditions (taking into account applicable short-term interest rates).

Liquidity Provisions

Although they have longer-term maturities, VRDNs can be tendered at par by the investor to the trustee at any time generally on seven days' notice, giving them the characteristics of a short-term instrument. A liquidity facility, enabling investors to receive the tender price, is provided by a bank through a letter of credit, standby bond purchase agreement, line of credit, loan or similar instrument. In many cases, a letter of credit provided by a bank may also serve as a means of ensuring scheduled payments of principal and interest on VRDNs. Alternatively, some VRDNs may be insured as to the payment of principal and interest by an insurance company. Absent a letter of credit, bond insurance or other form of credit enhancement, VRDNs are generally unsecured obligations of the issuer or borrower. VRDNs also generally have mandatory and optional redemption features, allowing the borrower or issuer to repurchase at par.

It is important to understand the terms of the liquidity facility associated with a VRDN. See "Risk Considerations – Structure Risk" below.

RISK CONSIDERATIONS

Investors should carefully consider the risks associated with VRDNs, which generally relate to default risk (the borrower's ability to pay interest and principal at maturity on a timely basis), price risk (market price fluctuation if you sell prior to maturity) and liquidity risk (the lack of marketability of a particular VRDN which may present difficulties for the VRDN to be sold quickly enough to prevent or minimize a loss).

Default Risk

With respect to default risk, investors should review the credit rating of the particular VRDN. Investors should also review the financial condition and/or credit rating of the borrower through available documents prepared by the borrower. VRDNs may also have a letter of credit issued by a bank or an insurance policy to provide funding for the payment of interest and principal should the borrower be unable to pay. Letters of credit also offer liquidity when VRDNs are tendered. In instances where a letter of credit or insurance policy is provided, investors should look primarily to the financial strength of the bank issuing the letter of credit or the bond insurer issuing the policy backing the VRDN and other indications of the credit quality of the bank or bond insurer in considering whether to invest in a VRDN. In selected instances, VRDNs may have both a primary letter of credit issued by a bank and a standby or confirming letter of credit issued by a Federal Home Loan Bank or other financial institution that is triggered if the bank does not meet its obligations on the primary letter of credit. In these instances, investors should consider the creditworthiness of the bank issuing the primary letter of credit and the financial institution issuing the standby letter of credit. However, investors should bear in mind that VRDNs are not deposit accounts of a bank, are not secured by the assets of a bank and are not insured by the Federal Deposit Insurance Corporation or any other government agency. Certain VRDNs have liquidity facilities (such as standby bond purchase agreements) provided by a bank that only offer liquidity when VRDNs are tendered and do not provide protection for scheduled payments of interest and principal. In these events, investors should look to the financial strength of the borrower and any other available credit enhancements provided, such as bond insurance, regarding the ability to make regularly scheduled principal and interest payments.

Although Baird seeks to remarket the value of VRDNs at par, it is possible to lose money by investing in VRDNs. VRDNs are not secured by the assets of the issuer or borrower. As a result, VRDNs are subject to the risk of default by the borrower. VRDNs backed by a letter of credit or insurance policy are subject to the risk of default by the bank providing the letter of credit or the bond insurer issuing the policy. Investors do not have any remedies against the issuer and may only have limited remedies against the borrower should the bank or bond insurer fail to meet its obligations under the letter of credit or insurance policy.

The payment of interest and repayment of principal on a VRDN ultimately depends upon the ability of the borrower to honor its debt obligations or, as the case may be, the bank or bond insurer to honor its obligations under the letter of credit, liquidity facility or insurance policy supporting the VRDN, and no assurance can be given in this regard. Although Baird initially and thereafter periodically reviews the creditworthiness of the borrowers or the banks or bond insurers that provide the letter of credit, liquidity facility or insurance policy underlying the VRDNs for which Baird serves as underwriter or remarketing agent, Baird cannot promise or guarantee that borrowers, banks or bond insurers will meet their obligations or that the VRDNs will remain liquid or otherwise marketable. In addition, when a VRDN is backed by both a primary letter of credit and a standby or confirming letter of credit issued by a Federal Home Loan Bank, Baird will not review the creditworthiness of the bank issuing the primary letter of credit. Baird will also not review the creditworthiness of the Federal Home Loan Bank issuing the standby or confirming letter of credit, but if the standby or confirming letter of credit is issued by another financial institution Baird will initially and periodically review the creditworthiness of the financial institution providing the standby or confirming letter of credit. Potential purchasers and owners of VRDNs are advised to consider the financial strength of the borrower, bank, other liquidity facility provider and, if applicable, bond insurer in determining whether to invest in VRDNs. In some instances, such as when Baird has concerns about the financial condition or continued strength of the bank or other liquidity facility provider or bond insurer, Baird may request that borrowers obtain enhancements or take other actions (such as replacing the bank, liquidity facility provider or bond insurer or converting a standby bond purchase agreement to an irrevocable letter of credit) to provide adequate support so that the VRDNs remain marketable, but ultimately the borrowers are responsible for taking the necessary action. If a borrower determines not to take appropriate action, Baird may advise its clients to tender their VRDNs (or sell them back to Baird who will then tender them) and may then resign as remarketing agent.

Liquidity Risk

As remarketing agent, Baird engages in best efforts to solicit investors to purchase VRDNs that holders want to sell or redeem, but provides no assurance that it will be successful in finding such investors. Baird may also act as principal in purchasing VRDNs from holders but is under no obligation to do so. Baird is also able to terminate its services as remarketing agent at any time. If Baird elects not to purchase VRDNs from holders who want to sell them or cannot find persons willing to buy them, of if Baird resigns as remarketing agent, the holders may be required to exercise their right and option to tender their VRDNs at par at any time with seven days' notice. As previously mentioned, VRDNs have a liquidity facility under which a bank provides the funding necessary to purchase the VRDNs that are tendered. However, liquidity facilities (such as standby bond purchase agreements), other than irrevocable letters of credit, may terminate immediately or following notice upon various events of default, such as a default in a scheduled interest and/or principal payment, the bankruptcy of the borrower or issuer or a significant decline in the credit rating of the borrower or issuer or, if applicable, bond insurer. As a result, should either new investors or Baird be unwilling or unable to purchase all the VRDNs then currently being offered for resale, existing investors may be unable to sell all or some portion of their holdings if letter of credit or other liquidity facility providers are unwilling or unable to honor their commitments or their commitments terminate. In that event, the VRDNs would lose their short-term characteristics and may become long-term, illiquid investments. In many instances, when the liquidity facility terminates, the borrower or issuer then seeks an alternative liquidity facility provider. If an alternative liquidity facility provider cannot be obtained, the VRDNs may convert to fixed-rate notes or be accelerated.

Price Risk

As is the case with other debt securities, the value of VRDNs may fluctuate relative to changes in prevailing market interest rates. The interest rate on the VRDNs is re-set on a weekly basis by Baird in its capacity as remarketing agent based on prevailing market conditions (taking into account applicable short-term interest rates given the ability of investors to tender them at any time on seven days' notice). The intent is to set the interest rate so that the notes trade at par; however, Baird cannot assure that rates will reset in such a way that VRDNs trade at par. For example, some VRDNs are subject to rate caps which may limit Baird's ability to re-set a VRDN's interest rate to then current market levels. However, as mentioned above, VRDNs may be tendered for redemption at any time upon seven days notice by the holder to the trustee if the holder is not satisfied with the interest rate reset.

Structure Risk

There are important differences in the types of liquidity facilities that are associated with VRDNs. VRDNs are backed by a letter of credit or a standby bond purchase agreement. Letters of credit are typically irrevocable and draws on them are made to cover regularly scheduled principal and interest payments on the VRDNs. Draws on letters of credit are also made to redeem at par VRDNs that are properly tendered on seven days' notice. On the other hand, standby bond purchase agreements generally do not cover regularly scheduled principal and interest payments but only the obligation to redeem VRDNs that are tendered. Moreover, unlike an irrevocable letter of credit, under a standby bond purchase agreement, the bank may terminate or suspend its obligation to redeem tendered bonds at par upon certain events of default, such as the borrower's bankruptcy or insolvency, a significant downgrade of the borrower's credit rating, the failure of the borrower to pay interest or principal as scheduled or a significant monetary judgment or order against the borrower. The termination or suspension of the liquidity facility on a VRDN may cause the VRDN to convert to a fixed-rate, long-term and illiquid debt instrument. VRDNs backed by standby bond purchase agreements rather than a letter of credit may thus involve the additional risks that the borrower may not be able to pay principal and interest as scheduled and that certain events of default may trigger termination of suspension of the bank's obligations to redeem VRDNs that are tendered.

VRDN Tax Implications

The tax implications of VRDNs should also be considered. Interest paid on tax-exempt VRDNs is exempt from federal tax and, in certain cases, state tax as well. However, interest on some tax-exempt VRDNs may be a tax preference item for purposes of the federal alternative minimum tax (AMT). Taxable VRDNs are subject to federal tax (including AMT) and are usually subject to state tax. Investors should consult their tax adviser for further information on tax implications.

Payment of Principal and Interest

In the absence of a letter of credit provided by a bank, regularly scheduled payments of principal and interest on VRDNs are obligations of the borrower or issuer, and paid by the trustee. However, those payments are often accomplished via a draw upon the bank's letter of credit (referred to as a "direct pay" letter of credit). With this "direct pay" structure, holders do not receive payments from the borrower or issuer, but, as noted above, all payments come to holders from a draw upon the letter of credit. Through a reimbursement agreement with the borrower, the bank is reimbursed for amounts drawn on the letter of credit. By this process, the borrower "reimburses" the bank for any interest and principal payments that the bank makes on the borrower's behalf and holders are insulated from having to collect interest and principal payments from borrowers or issuers. The failure or inability of the borrower to repay the bank does not affect the bank's obligation to honor the terms of the letter of credit. As noted above, however, a bank may be unable to meet its obligations under the terms of a letter of credit. Payment of principal and interest on certain VRDNs may be made from an insurance policy issued by a bond insurer if the borrower or issuer fails to make those payments. Unlike letters of credit, standby bond purchase agreements on VRDNs do not cover the borrower's obligation to make regularly scheduled principal and interest payments.

Replacement of Letters of Credit or Liquidity Facilities

Borrowers normally have the right to replace the bank issuing the letter of credit or other liquidity facility with another bank. This action generally triggers a mandatory tender or redemption of the VRDNs. Once the tender occurs, the VRDNs will be remarketed to new investors with backing from the new letter of credit or liquidity facility provider. Letters of credit and other liquidity facilities remain in effect for a period of time determined by the borrower/issuer and the bank. If the issuing bank does not renew or extend the letter of credit or other liquidity facility, the borrower must obtain a letter of credit or other liquidity facility from another bank. If the borrower cannot find another bank to provide a new letter of credit or other liquidity facility, the VRDNs will be subject to a mandatory tender, with a draw upon the existing letter of credit or liquidity facility to pay off the holders.

For more information about VRDNs, please contact your Baird Financial Advisor.

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