

NUVEEN DIVIDEND ADVANTAGE MUNICIPAL FUND 3

Form 497

December 16, 2010

**PROSPECTUS**

**\$65,000,000**

## *Nuveen Dividend Advantage Municipal Fund 3*

### *MUNIFUND TERM PREFERRED SHARES*

*6,500,000 Shares, 2.80% Series 2016*

*Liquidation Preference \$10 Per Share*

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**The Offering.** *Nuveen Dividend Advantage Municipal Fund 3 is offering 6,500,000 MuniFund Term Preferred Shares, 2.80% Series 2016 ( Series 2016 MTP Shares ), with a liquidation preference of \$10 per share ( MTP Shares ). The Fund intends to use the net proceeds from the sale of MTP Shares to refinance and redeem a portion of the Fund's outstanding Municipal Auction Rate Cumulative Preferred Shares ( MuniPreferred Shares ), and to maintain the Fund's leveraged capital structure. Certain of the underwriters and their affiliates or their customers own or are obligated to repurchase in the future MuniPreferred shares and, as a result, may benefit from any such redemption. See Prospectus Summary The Offering.*

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**The Fund.** *The Fund is a diversified, closed-end management investment company. The Fund's investment objectives are to provide current income exempt from regular federal income tax and to enhance portfolio value relative to the municipal bond market by investing in tax-exempt municipal bonds that the Fund's investment adviser believes are underrated or undervalued or that represent municipal market sectors that are undervalued.*

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**Listing.** *Application has been made to list the MTP Shares on the New York Stock Exchange so that trading on such exchange will begin within 30 days after the date of this prospectus, subject to notice of issuance. Prior to the expected commencement of trading on the New York Stock Exchange, the underwriters do not intend to make a market in the MTP Shares. Consequently, it is anticipated that, prior to the commencement of trading on the New York Stock Exchange, an investment in the MTP Shares will be illiquid and holders of MTP Shares may not be able to sell such shares as it is unlikely that a secondary market for the MTP Shares will develop. If a secondary market does develop prior to the commencement of trading on the New York Stock Exchange, holders of MTP Shares may be able to sell such shares only at substantial discounts from their liquidation preference. The trading or ticker symbol is NZF Pr C.*

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*Investing in MuniFund Term Preferred Shares involves risks. See Risks beginning on page 49.*

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PRICE \$10 A SHARE

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	<u>Price to Public</u>	<u>Underwriting Discounts and Commissions<sup>1</sup></u>	<u>Proceeds to the Fund<sup>2</sup></u>
<i>Per Share</i>	\$10.00	\$0.15	\$9.85
<i>Total</i>	\$65,000,000	\$975,000	\$64,025,000

<sup>1</sup> Total expenses of issuance and distribution, excluding underwriting discounts and commissions, are estimated to be \$385,000.

<sup>2</sup> The Fund has granted the underwriters the right to purchase up to 975,000 additional MTP Shares at the public offering price, less underwriting discounts and commissions, within 30 days of the date of this prospectus solely to cover over-allotments, if any. If such option is exercised in full, the Price to Public, Underwriting Discounts and Commissions and Proceeds to the Fund will be \$74,750,000, \$1,121,250 and \$73,628,750, respectively. See Underwriters on page 66 of this prospectus.

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

**Book-Entry Only.** It is expected that the MTP Shares will be delivered to the underwriters in book-entry form only, through the facilities of the Depository Trust Company, on or about December 20, 2010.

CUSIP No. 67070X 507

Sole Structuring Coordinator

Joint Book Runners

**MORGAN STANLEY BofA MERRILL LYNCH CITI UBS INVESTMENT BANK WELLS FARGO SECURITIES**

Co-Manager

**NUVEEN INVESTMENTS, LLC**

December 15, 2010

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**Investment Strategies.** Under normal circumstances, the Fund will invest at least 80% of its Managed Assets (as defined below) in municipal securities and other related investments the income from which is exempt from regular federal income tax. Under normal circumstances, the Fund will invest at least 80% of its Managed Assets in investment grade securities that, at the time of investment, are rated within the four highest grades (Baa or BBB or better) by at least one nationally recognized statistical rating organization ( NRSRO ) or are unrated but judged to be of comparable quality by Nuveen Asset Management. The Fund may invest up to 20% of its Managed Assets in municipal securities that at the time of investment are rated below investment grade or are unrated but judged to be of comparable quality by Nuveen Asset Management. No more than 10% of the Fund's Managed Assets may be invested in municipal securities rated below B3/B- or that are unrated but judged to be of comparable quality by Nuveen Asset Management. Securities of below investment grade quality are regarded as having predominately speculative characteristics with respect to the issuer's capacity to pay interest and repay principal, and are commonly referred to as junk bonds. Managed Assets are net assets, including assets attributable to any principal amount of any borrowings (including the issuance of commercial paper or notes) and any Preferred Stock (as defined herein) outstanding. There is no assurance that the Fund will achieve its investment objectives. See The Fund's Investments.

Fixed Dividend Rate:

Series 2016 MTP Shares

2.80% per annum

The Fixed Dividend Rate may be adjusted in the event of a change in the credit rating of the MTP Shares, as described herein. See Description of MTP Shares Dividends and Dividend Periods.

**Dividends.** Dividends on the MTP Shares will be payable monthly. The first dividend period for the MTP Shares will commence on the first date of original issuance of MTP Shares and end on January 31, 2011 and each subsequent dividend period will be a calendar month (or the portion thereof occurring prior to the redemption of such MTP Shares). Dividends will be paid on the first business day of the month next following a dividend period and upon redemption of the MTP Shares, except that dividends paid with respect to any dividend period consisting of the month of December in any year will be paid on the last business day of December. Except for the first dividend period, dividends with respect to any monthly dividend period will be declared and paid to holders of record of MTP Shares as their names shall appear on the registration books of the Fund at the close of business on the 15th day of such monthly dividend period (or if such day is not a business day, the next preceding business day). Dividends with respect to the first dividend period for the MTP Shares will be declared and paid to holders of record of such MTP Shares as their names appear on the registration books of the Fund at the close of business on January 28, 2011.

**Redemption.** The Fund is required to redeem the MTP Shares on January 1, 2016 unless earlier redeemed or repurchased by the Fund. In addition, MTP Shares are subject to optional and mandatory redemption in certain circumstances. As of January 1, 2012, the Series 2016 MTP Shares will be subject to redemption at the option of the Fund, subject to payment of a premium through December 31, 2012, and at par thereafter. The Series 2016 MTP Shares also will be subject to redemption, at the option of the Fund, at par in the event of certain changes in the credit rating of the MTP Shares, as described herein. See Description of MTP Shares Redemption.

**Tax Exemption.** The dividend rate for MTP Shares assumes that each month's distribution is comprised solely of dividends exempt from regular federal income tax, although a portion of those dividends may be subject to the federal alternative minimum tax. From time to time, the Fund may be required to allocate capital gains and/or ordinary income to a given month's distribution on MTP Shares. To the extent that it does so, the Fund will contemporaneously make a separate, supplemental distribution of an amount that, when combined with the total amount of regular tax-exempt income, capital gains and ordinary income in the monthly distribution, is intended to make the two distributions equal on an after-tax basis (determined based upon the maximum marginal federal income tax rates in effect at the time of such payment) to the amount of the monthly distribution if it had been entirely comprised of dividends exempt from regular federal income tax. Alternatively

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(particularly in cases where the amount of capital gains or ordinary income to be allocated to the MTP Shares is small), the Fund will satisfy the requirement to allocate capital gains or ordinary income to MTP Shares by making a supplemental distribution of such gains or income to holders of MTP Shares, over and above the monthly dividend that is fully exempt from regular federal income taxes. If, in connection with a redemption of MTP Shares, the Fund allocates capital gains or ordinary income to a distribution on MTP Shares without having made either a contemporaneous supplemental distribution of an additional amount or an alternative supplemental distribution of capital gains and/or ordinary income, it will cause an additional amount to be distributed to holders of MTP Shares whose interests are redeemed, which amount, when combined with the total amount of regular tax-exempt income, capital gains and ordinary income allocated in the distribution, is intended to make the distribution and the additional amount equal on an after-tax basis (determined based upon the maximum marginal federal income tax rates in effect at the time of such payment) to the amount of the distribution if it had been entirely comprised of dividends exempt from regular federal income tax. Investors should consult with their own tax advisors before making an investment in the MTP Shares. See *Tax Matters* and *Description of MTP Shares Dividends and Dividend Periods Distribution with respect to Taxable Allocations*.

**Priority of Payment.** MTP Shares will be senior securities that represent stock of the Fund and are senior, with priority in all respects, to the Fund's common shares as to payments of dividends and as to distribution of assets upon dissolution, liquidation or winding up of the affairs of the Fund. MTP Shares will have equal priority as to payments of dividends and as to distribution of assets upon dissolution, liquidation or winding up of the affairs of the Fund with other preferred shares currently outstanding. The Fund may issue additional preferred shares on parity with MTP Shares, subject to certain limitations. The Fund may not issue additional classes of shares that are senior to MTP Shares and other outstanding preferred shares of the Fund as to payments of dividends or as to distribution of assets upon dissolution, liquidation or winding up of the affairs of the Fund. See *Description of MTP Shares*. The Fund, as a fundamental policy, may not issue debt securities that rank senior to MTP Shares. In addition, as a fundamental policy, the Fund may not borrow money, except from banks for temporary or emergency purposes, or for repurchase of its shares, subject to certain restrictions. See *Investment Restrictions* in the *Statement of Additional Information*.

**Redemption and Paying Agent.** The redemption and paying agent for MTP Shares will be State Street Bank and Trust Company, Canton, Massachusetts.

**Adviser.** Nuveen Asset Management, the Fund's investment adviser, is responsible for determining the Fund's overall investment strategies and their implementation.

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You should read this prospectus, which contains important information about the Fund, before deciding whether to invest in MTP Shares and retain it for future reference. A *Statement of Additional Information*, dated December 15, 2010, and as it may be supplemented, containing additional information about the Fund has been filed with the Securities and Exchange Commission and is incorporated by reference in its entirety into this prospectus. You may request a free copy of the *Statement of Additional Information*, the table of contents of which is on page 70 of this prospectus, annual and semi-annual reports to shareholders, when available, and other information about the Fund, and make shareholder inquiries by calling (800) 257-8787 or by writing to the Fund, or from the Fund's website (<http://www.nuveen.com>). The information contained in, or that can be accessed through, the Fund's website is not part of this prospectus. You also may obtain a copy of the *Statement of Additional Information* (and other information regarding the Fund) from the Securities and Exchange Commission's website (<http://www.sec.gov>).

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

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You should rely only on the information contained in or incorporated by reference to this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. We are offering to sell MTP Shares and seeking offers to buy MTP Shares, only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or any sale of MTP Shares.

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**PROSPECTUS SUMMARY**

*This is only a summary. You should review the more detailed information contained elsewhere in this prospectus and in the Statement of Additional Information (the SAI), including the Fund's Statement Establishing and Fixing the Rights and Preferences of MuniFund Term Preferred Shares (the Statement), attached as Appendix A to the SAI, prior to making an investment in the Fund, especially the information set forth under the heading Risks. Capitalized terms used but not defined in this prospectus shall have the meanings given to such terms in the Statement.*

**The Fund**

Nuveen Dividend Advantage Municipal Fund 3 (the Fund) is a diversified, closed-end management investment company. The Fund's common shares, \$0.01 par value, are traded on the NYSE Amex under the symbol NZF. See Description of Outstanding Shares Common Shares. The Fund commenced investment operations on September 25, 2001. As of November 30, 2010, the Fund had 40,387,484 common shares outstanding and 9,478 preferred shares outstanding. Preferred shares previously offered by the Fund are referred to as MuniPreferred shares or auction rate preferred shares (ARPS). MTP Shares, as defined below, and any other preferred shares, including MuniPreferred shares, that may then be outstanding are collectively referred to as Preferred Stock.

**The Offering**

The Fund is offering 6,500,000 MuniFund Term Preferred Shares, 2.80% Series 2016 (Series 2016 MTP Shares or MTP Shares), at a purchase price of \$10 per share. MTP Shares are being offered by the underwriters listed under Underwriters. The Fund has granted the underwriters the right to purchase up to 975,000 additional MTP Shares to cover over-allotments. Unless otherwise specifically stated, the information throughout this prospectus does not take into account the possible issuance to the underwriters of additional MTP Shares pursuant to their right to purchase additional MTP Shares to cover over-allotments. The Fund intends to use the net proceeds from the sale of MTP Shares to refinance and redeem a portion of the outstanding MuniPreferred shares, and to maintain the Fund's leveraged capital structure. Certain underwriters and their affiliates, including Morgan Stanley & Co. Incorporated, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Citigroup Global Markets Inc., UBS Securities LLC and Wells Fargo Securities, LLC, currently own or are obligated to repurchase in the future outstanding MuniPreferred shares. In addition, customers of certain underwriters and their affiliates currently own outstanding MuniPreferred shares. Upon the successful completion of this offering, these outstanding MuniPreferred shares may be redeemed or purchased by the Fund with the net proceeds of the offering as set forth in Use of Proceeds. Although such a redemption or purchase would be done in accordance with the Investment Company Act of 1940, as amended (the 1940 Act) in a manner that did not favor these underwriters, affiliates or customers, the underwriters or their affiliates may nonetheless be deemed to obtain a material benefit from the offering of the MTP

Shares due to such redemption or purchase including, for certain of the underwriters and their affiliates, potentially substantial financial relief and/or relief related to legal and regulatory matters associated with currently illiquid MuniPreferred shares.

The first issuance date of the MTP Shares upon the closing of this offering is referred to herein as the Date of Original Issue. MTP Shares will be senior securities that constitute stock of the Fund and are senior, with priority in all respects, to the Fund's common shares as to payments of dividends and as to distribution of assets upon dissolution, liquidation or winding up of the affairs of the Fund. MTP Shares will have equal priority as to payments of dividends and as to distributions of assets upon dissolution, liquidation or winding up of the affairs of the Fund and will be in parity in all respects with MuniPreferred shares outstanding. The Fund may not issue additional classes of shares that are senior to Preferred Stock as to payments of dividends and as to distribution of assets upon dissolution, liquidation or winding up of the affairs of the Fund.

### **Who May Want to Invest**

You should consider your investment goals, time horizons and risk tolerance before investing in MTP Shares. An investment in MTP Shares is not appropriate for all investors and is not intended to be a complete investment program. MTP Shares are designed as an intermediate-term investment to help achieve the after-tax income and capital preservation goals of investors, and not as a trading vehicle. MTP Shares may be an appropriate investment for you if you are seeking:

- Current income exempt from regular federal income tax;
- Consistent monthly dividends;
- Return of your capital investment after a limited term of 5 years;
- A security that benefits from significant over-collateralization and related protective provisions;
- Municipal market exposure through the Fund (rather than a single municipal issuer) that diversifies credit risk by investing in many securities and various essential-service sectors;
- Potential for daily liquidity and transparency afforded by New York Stock Exchange listing, once the MTP Shares begin trading on such exchange as anticipated; and
- An intermediate-term fixed income investment with potentially less price volatility than longer-dated fixed income securities.

However, keep in mind that you will need to assume the risks associated with an investment in MTP Shares and the Fund. See Risks.

### **Fixed Dividend Rate**

MTP Shares pay a dividend at a fixed rate of 2.80% per annum of the \$10 liquidation preference per share (the Fixed Dividend Rate). The

Fixed Dividend Rate is subject to adjustment in certain circumstances (but will not in any event be lower than the 2.80% Fixed Dividend Rate). See Description of MTP Shares Dividends and Dividend Periods Fixed Dividend Rate, Adjustments to Fixed Dividend Rate Ratings and Default Period.

**Dividend Payments**

The holders of MTP Shares will be entitled to receive cumulative cash dividends and distributions on each such share, when, as and if declared by, or under authority granted by, the Board of Trustees, out of funds legally available for payment. Dividends on the MTP Shares will be payable monthly. The first dividend period for the MTP Shares will commence on the Date of Original Issue of MTP Shares and end on January 31, 2011 and each subsequent dividend period will be a calendar month (or the portion thereof occurring prior to the redemption of such MTP Shares) (each dividend period a Dividend Period ). Dividends will be paid on the first Business Day of the month next following a Dividend Period and upon redemption of the MTP Shares, except that dividends paid with respect to any Dividend Period consisting of the month of December in any year will be paid on the last Business Day of December (each payment date a Dividend Payment Date ). Except for the first Dividend Period, dividends with respect to any monthly Dividend Period will be declared and paid to holders of record of MTP Shares as their names shall appear on the registration books of the Fund at the close of business on the 15th day of such monthly Dividend Period (or if such day is not a Business Day, the next preceding Business Day). Dividends with respect to the first Dividend Period of the Series 2016 MTP Shares will be declared and paid to holders of record of such MTP Shares as their names appear on the registration books of the Fund at the close of business on January 28, 2011. See Description of MTP Shares Dividends and Dividend Periods.

Business Day means any calendar day on which the New York Stock Exchange is open for trading.

On account of the foregoing provisions, only the holders of MTP Shares on the record date for a Dividend Period will be entitled to receive dividends and distributions payable with respect to such Dividend Period, and holders of MTP Shares who sell shares before such a record date and purchasers of MTP Shares who purchase shares after such a record date should take the effect of the foregoing provisions into account in evaluating the price to be received or paid for such MTP Shares.

**Term Redemption**

The Fund is required to provide for the mandatory redemption of all outstanding Series 2016 MTP Shares on January 1, 2016 at a redemption price equal to \$10 per share plus an amount equal to accumulated but unpaid dividends thereon (whether or not earned or declared but excluding interest thereon) to (but excluding) the redemption date (the Term Redemption Price ). No amendment, alteration or repeal of the obligations of the Fund to redeem all of the Series 2016 MTP Shares on January 1, 2016 can be effected without

the prior unanimous vote or consent of the holders of Series 2016 MTP Shares. See Description of MTP Shares Redemption.

**Mandatory Redemption for**

**Asset Coverage and Effective**

**Leverage Ratio**

*Asset Coverage.* If the Fund fails to have Asset Coverage (as defined below) of at least 225% as of the close of business on any Business Day on which such Asset Coverage is required to be calculated and such failure is not cured as of the close of business on the date that is 30 calendar days following such Business Day (the Asset Coverage Cure Date), the Fund will redeem within 30 calendar days of the Asset Coverage Cure Date shares of Preferred Stock equal to the lesser of (i) the minimum number of shares of Preferred Stock that will result in the Fund having Asset Coverage of at least 230% and (ii) the maximum number of shares of Preferred Stock that can be redeemed out of monies expected to be legally available; and, at the Fund's sole option, the Fund may redeem a number of shares of Preferred Stock (including shares of Preferred Stock required to be redeemed) that will result in the Fund having Asset Coverage of up to and including 285%. The Preferred Stock to be redeemed may include at the Fund's sole option any number or proportion of MTP Shares. If MTP Shares are to be redeemed in such an event, they will be redeemed at a redemption price equal to their \$10 liquidation preference per share plus accumulated but unpaid dividends thereon (whether or not declared, but excluding interest thereon) to (but excluding) the date fixed for such redemption (the Mandatory Redemption Price).

*Effective Leverage Ratio.* If the Effective Leverage Ratio (as defined below) of the Fund exceeds 50% as of the close of business on any Business Day on which such ratio is required to be calculated and such failure is not cured as of the close of business on the date that is 30 calendar days following such Business Day (the Effective Leverage Ratio Cure Date), the Fund will within 30 calendar days following the Effective Leverage Ratio Cure Date cause the Fund to have an Effective Leverage Ratio that does not exceed 50% by (A) engaging in transactions involving or relating to the floating rate securities not owned by the Fund and/or the inverse floating rate securities owned by the Fund, including the purchase, sale or retirement thereof, (B) redeeming a sufficient number of shares of Preferred Stock, which at the Fund's sole option may include any number or proportion of MTP Shares, in accordance with the terms of such Preferred Stock, or (C) engaging in any combination of the actions contemplated by (A) and (B) above. Any MTP Shares so redeemed will be redeemed at a price per share equal to the Mandatory Redemption Price. See Portfolio Composition Municipal Securities Inverse Floating Rate Securities and Floating Rate Securities.

**Optional Redemption**

As of January 1, 2012, Series 2016 MTP Shares will be subject to optional redemption (in whole or from time to time, in part) at the

sole option of the Fund out of monies legally available therefor, at the redemption price per share equal to the sum of the \$10 liquidation preference per share plus (i) an initial premium of 1.00% of the liquidation preference (with such premium declining by 0.5% every six months so that by January 1, 2013 there will cease to be a premium) and (ii) an amount equal to accumulated but unpaid dividends thereon (whether or not earned or declared but excluding interest thereon) to (but excluding) the date fixed for such redemption. See Description of MTP Shares Redemption Optional Redemption. The period from the Date of Original Issue to the date that the MTP Shares are subject to such optional redemption is referred to herein as the Non-Call Period. In addition to the optional redemption described above, the MTP Shares will also be subject to optional redemption on any Business Day during a Rating Downgrade Period with respect to such MTP Shares at the redemption price per share equal to the sum of the \$10 liquidation preference per share (without any additional premium) plus an amount equal to accumulated but unpaid dividends thereon (whether or not earned or declared, but excluding interest thereon) to (but excluding) the date fixed for redemption. A Rating Downgrade Period means any period during which the MTP Shares are rated A+ or lower by Standard & Poor's Financial Services, LLC, a subsidiary of The McGraw-Hill Companies, Inc. ( S&P ), A1 or lower by Moody's Investors Service, Inc. ( Moody's ) and A+ or lower by Fitch Ratings, Inc. ( Fitch ). See Description of MTP Shares Redemption.

#### **Federal Income Tax**

Because under normal circumstances the Fund will invest substantially all of its assets in municipal securities that pay interest exempt from regular federal income tax, the dividends designated by the Fund as exempt-interest dividends received by a holder of MTP Shares will be similarly exempt. The dividends received by a holder of MTP Shares may be subject to other state and local taxes. A portion of the income from the Fund's portfolio securities, and in turn the exempt-interest dividends paid to holders of MTP Shares, may be subject to the federal alternative minimum tax, so MTP Shares may not be a suitable investment if you are subject to this tax. Taxable income or gain earned by the Fund will be allocated proportionately to holders of Preferred Stock and common shares, based on the percentage of total Preferred Stock dividends relative to common share dividends.

The Fund has elected to be treated, and intends to continue to qualify each year, as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986, as amended (the Code ), and generally does not expect to be subject to federal income tax.

#### **Ratings**

It is a condition of the underwriters' obligation to purchase MTP Shares that MTP Shares will be rated, as of the Date of Original Issue, at certain minimum levels by Rating Agencies (as defined in this prospectus) designated by the Fund's Board of Trustees. There can be

no assurance that such ratings will be maintained at the level originally assigned through the term of the MTP Shares. The ratings may be changed, suspended or withdrawn in the Rating Agencies' discretion. The Fund, however, will use commercially reasonable efforts to cause at least one Rating Agency (as defined in this prospectus) to publish a credit rating with respect to MTP Shares for so long as MTP Shares are outstanding. The Fixed Dividend Rate will be subject to an increase in the event that the ratings of the MTP Shares by the Rating Agencies are each downgraded below such minimum levels or if no Rating Agency is then rating the shares. See Description of MTP Shares Dividends and Dividend Periods Adjustment to Fixed Dividend Rate Ratings. The Board of Trustees of the Fund has the right to terminate the designation of any of the Rating Agencies for purposes of the MTP Shares, provided that at least one Rating Agency continues to maintain a rating with respect to the MTP Shares. In such event, any rating of such terminated Rating Agency, to the extent it would have been taken into account in any of the provisions of the MTP Shares which are described in this prospectus or included in the Statement, will be disregarded, and only the ratings of the then-designated Rating Agencies will be taken into account.

On August 31, 2010 S&P published a Request for Comment concerning its new proposal (the S&P Proposal) to change its methods and assumptions for rating certain market value securities, including those issued by registered closed-end funds such as the MTP Shares to be issued by the Fund. The S&P Proposal defined market value securities as those whose source of repayment is liquidation proceeds generated from open market sales of assets (in the Fund's case, portfolio securities), rather than cash flow generated by assets held to maturity. S&P has requested comments on the S&P Proposal and the comment period ended October 29, 2010. S&P stated that after the comment period expired, it would review the comments and publish updated criteria methodology and assumptions, which would be applicable to all outstanding S&P ratings of market value securities. S&P has not yet published updated criteria methodology and assumptions. The updated criteria, if adopted by S&P, may be the same as proposed or may differ based upon comments received by S&P. Under the current S&P Proposal, when rating market value securities (including MTP Shares) issued by the Fund, S&P would substantially increase the reductions in value, or haircuts, applied to the Fund's portfolio securities compared with its present methodology. Due to these increased haircuts, any market value securities issued by the Fund (including MTP Shares) in the future may be ineligible for a AAA rating from S&P. In addition, any market value securities (including the MTP Shares offered hereby) that had a rating of AAA from S&P prior to the adoption of the proposed criteria may be unable to maintain such rating after the adoption of such criteria, if adopted as proposed. In the event that S&P downgrades the MTP Shares, the Fixed Dividend Rate would not change. However, if each of the other Rating Agencies also

downgrades the MTP Shares, the Fixed Dividend Rate would increase. See Description of MTP Shares Dividends and Dividend Periods Adjustments to Fixed Dividend Rate Ratings. Nevertheless, a downgrade by S&P could adversely affect the market pricing and liquidity of the MTP Shares. There can be no assurance that S&P will or will not take any action with respect to the S&P Proposal or that any such action would not result in a downgrade of MTP Shares. Further, there can be no assurance that any other Rating Agency will not also alter its rating criteria resulting in downgrades of ratings, which could further adversely affect the market pricing and liquidity of MTP Shares.

**Asset Coverage**

If the Fund fails to maintain at least 225% asset coverage as of the close of business on each Business Day, the MTP Shares may become subject to mandatory redemption as provided above. Asset coverage for Preferred Stock is calculated pursuant to Section 18(h) of the 1940 Act, as in effect on the date of the Statement, and is determined on the basis of values calculated as of a time within 48 hours (only including Business Days) preceding each daily determination ( Asset Coverage ). See Description of MTP Shares Asset Coverage.

The Fund estimates that on the Date of Original Issue, the Asset Coverage, based on the composition of its portfolio as of July 31, 2010, and after giving effect to (i) the issuance of MTP Shares offered hereby (\$65,000,000), and (ii) \$1,360,000 of underwriting discounts and commissions and estimated offering costs for such MTP Shares, and assuming the redemption of \$63,625,000 in liquidation preference of MuniPreferred shares, will be 347%. The Fund's net investment income coverage calculated by dividing the Fund's per share net investment income by the per share distributions from net investment income to preferred shareholders has averaged approximately 1,353% from November 1, 2001 through July 31, 2010. Net investment income coverage has varied significantly year over year since the Fund's inception, and there is no assurance that historical coverage levels can be maintained.

**Effective Leverage Ratio**

If the Fund's Effective Leverage Ratio exceeds 50% as of the close of business on any Business Day, the MTP Shares may become subject to mandatory redemption as provided above.

The Effective Leverage Ratio on any date means the quotient of the sum of (A) the aggregate liquidation preference of the Fund's senior securities (as that term is defined in the 1940 Act) that are stock, excluding, without duplication, (1) any such senior securities for which the Fund has issued a notice of redemption and either has delivered Deposit Securities to the paying agent for such Preferred Stock or otherwise has adequate Deposit Securities on hand for the purpose of such redemption and (2) the Fund's outstanding Preferred

Stock that is to be redeemed with net proceeds from the sale of the MTP Shares, for which the Fund has delivered Deposit Securities to the paying agent for such Preferred Stock or otherwise has adequate Deposit Securities on hand for the purpose of such redemption; (B) the aggregate principal amount of the Fund's senior securities representing indebtedness (as that term is defined in the 1940 Act); and (C) the aggregate principal amount of floating rate securities not owned by the Fund that correspond to the associated inverse floating rate securities owned by the Fund; divided by the sum of (A) the market value (determined in accordance with the Fund's valuation procedures) of the Fund's total assets (including amounts attributable to senior securities), less the amount of the Fund's accrued liabilities (other than liabilities for the aggregate principal amount of senior securities representing indebtedness, including floating rate securities); and (B) the aggregate principal amount of floating rate securities not owned by the Fund that correspond to the associated inverse floating rate securities owned by the Fund.

**Voting Rights**

Except as otherwise provided in the Fund's Declaration of Trust or as otherwise required by law, (i) each holder of MTP Shares shall be entitled to one vote for each MTP Share held by such holder on each matter submitted to a vote of shareholders of the Fund and (ii) the holders of outstanding Preferred Stock and of common shares shall vote together as a single class; provided that holders of Preferred Stock, voting separately as a class, shall elect at least two of the Fund's trustees and will elect a majority of the Fund's trustees to the extent the Fund fails to pay dividends on any Preferred Stock in an amount equal to two full years of dividends on that stock. See Description of MTP Shares Voting Rights.

**Liquidation Preference**

The liquidation preference of MTP Shares will be \$10 per share (the Liquidation Preference). In the event of any liquidation, dissolution or winding up of the affairs of the Fund, whether voluntary or involuntary, the holders of MTP Shares will be entitled to receive a liquidation distribution per share equal to the Liquidation Preference plus an amount equal to all unpaid dividends and distributions accumulated to (but excluding) the date fixed for distribution or payment (whether or not earned or declared by the Fund, but excluding interest thereon). See Description of MTP Shares Liquidation Rights.

**Investment Objectives and Policies**

The Fund's investment objectives are to provide current income exempt from regular federal income tax and to enhance portfolio value relative to the municipal bond market by investing in tax-exempt municipal bonds that Nuveen Asset Management believes are underrated or undervalued or that represent municipal market sectors that are undervalued.

Under normal circumstances, the Fund will invest at least 80% of its Managed Assets in municipal securities and other related investments the income from which is exempt from regular federal income tax. Under normal circumstances, the Fund will invest at least 80% of its Managed Assets in investment grade securities that, at the time of investment, are rated within the four highest grades (Baa or BBB or better) by at least one NRSRO or are unrated but judged to be of comparable quality by Nuveen Asset Management. The Fund may invest up to 20% of its Managed Assets in municipal securities that at the time of investment are rated below investment grade or are unrated but judged to be of comparable quality by Nuveen Asset Management. No more than 10% of the Fund's Managed Assets may be invested in municipal securities rated below B3/B- or that are unrated but judged to be of comparable quality by Nuveen Asset Management. Municipal securities of below investment grade quality are regarded as having predominately speculative characteristics with respect to the issuer's capacity to pay interest and repay principal, and are commonly referred to as junk bonds. See Risks General Risks of Investing in the Fund - Credit and Below Investment Grade Risk. Managed Assets are net assets, including assets attributable to any principal amount of any borrowings (including the issuance of commercial paper or notes) and any Preferred Stock outstanding. During temporary defensive periods and in order to keep the Fund's cash fully invested, the Fund may invest up to 100% of its net assets in short-term investments including high quality, short-term securities that may be either tax-exempt or taxable. A portion of the dividends from MTP Shares may be subject to the federal alternative minimum tax. There is no assurance that the Fund will achieve its investment objectives. See The Fund's Investments.

**Investment Adviser**

Nuveen Asset Management is the Fund's investment adviser, responsible for determining the Fund's overall investment strategy and its implementation. See Management of the Fund - Investment Adviser and Portfolio Managers.

Nuveen Investments, LLC, a registered broker-dealer affiliate of Nuveen Asset Management that is involved in the offering of the Fund's MTP Shares, has received notice of certain charges that may be brought against it by the Financial Industry Regulatory Authority (FINRA) in connection with the marketing of MuniPreferred shares. See Underwriters.

**Legal Proceedings**

Certain Nuveen leveraged closed-end funds (including the Fund) were named as nominal defendants in putative shareholder derivative action complaints filed in the Circuit Court of Cook County, Illinois, Chancery Division (the Complaints). The Complaints, filed on behalf of purported holders of the funds' common shares, also name Nuveen Asset Management as a defendant, together with current and former officers and a trustee of each of the funds (together with the

nominal defendants, collectively, the Defendants ). The Complaints allege that the Defendants breached their fiduciary duties by favoring the interests of holders of each fund's ARPS over those of its common shareholders in connection with each fund's ARPS refinancing and/or redemption activities. See Legal Proceedings.

#### **Listing**

Application has been made to list the MTP Shares on the New York Stock Exchange so that trading on such exchange will begin within 30 days after the date of this prospectus, subject to notice of issuance. Prior to the expected commencement of trading on the New York Stock Exchange, the underwriters do not intend to make a market in the MTP Shares. Consequently, it is anticipated that, prior to the commencement of trading on the New York Stock Exchange, an investment in the MTP Shares will be illiquid and holders of MTP Shares may not be able to sell such shares as it is unlikely that a secondary market for the MTP Shares will develop. If a secondary market does develop prior to the commencement of trading on the New York Stock Exchange, holders of MTP Shares may be able to sell such shares only at substantial discounts from their liquidation preference. The trading or ticker symbol is NZF Pr C.

#### **Redemption and Paying Agent**

The Fund has entered into an amendment to its Transfer Agency and Service Agreement with State Street Bank and Trust Company, Canton, Massachusetts (the Redemption and Paying Agent ) for the purpose of causing the Fund's transfer agent and registrar to serve as transfer agent and registrar, dividend disbursing agent, and redemption and paying agent with respect to MTP Shares.

#### **Risks**

Risk is inherent in all investing. Therefore, before investing in MTP Shares you should consider certain risks carefully. The primary risks of investing in the Fund, and in MTP Shares in particular, are:

#### **Risks of Investing in MTP Shares**

- *Interest Rate Risk MTP Shares.* MTP Shares pay dividends at a fixed dividend rate. Prices of fixed income investments vary inversely with changes in market yields. The market yields on intermediate term securities comparable to MTP Shares may increase, which would likely result in a decline in the secondary market price of MTP Shares prior to the term redemption date. See also Secondary Market and Delayed Listing Risk.

- *Secondary Market and Delayed Listing Risk.* Because the Fund has no prior trading history for exchange-listed preferred shares, it is difficult to predict the trading patterns of MTP Shares, including the effective costs of trading MTP Shares. Moreover, MTP Shares will not be listed on a stock exchange until up to 30 days after the date of this prospectus and during this time period an investment in

MTP Shares will be illiquid. Even after the MTP Shares are listed on the New York Stock Exchange as anticipated, there is a risk that the market for MTP Shares may be thinly traded and relatively illiquid compared to the market for other types of securities, with the spread between the bid and asked prices considerably greater than the spreads of other securities with comparable terms, credit ratings and tax-advantaged income features.

- *Ratings Risk.* The Fund expects that, at issuance, the MTP Shares will be rated at certain minimum levels by Rating Agencies designated by the Fund's Board of Trustees and that such ratings will be a requirement of issuance of such shares by the underwriters pursuant to an underwriting agreement. There can be no assurance that the MTP Shares will receive any particular rating from any of Moody's, S&P or Fitch (each, a Rating Agency), or that any such ratings will be maintained at the level originally assigned through the term of the MTP Shares. In the event that one or more of the Rating Agencies do not issue a rating on the MTP Shares at all or at the minimum level required, the issuance and sale of MTP Shares in this offering may not be completed. Ratings do not eliminate or mitigate the risks of investing in MTP Shares. A rating issued by a Rating Agency is only the opinion of the entity issuing the rating at that time, and is not a guarantee as to quality, or an assurance of the future performance, of the rated security (in this case, MTP Shares). In addition, the manner in which the Rating Agency obtains and processes information about a particular security may affect the Rating Agency's ability to timely react to changes in an issuer's circumstances (in this case, the Fund) that could influence a particular rating. A Rating Agency could downgrade MTP Shares, which may make MTP Shares less liquid in the secondary market and reduce market prices. As described above under Ratings, S&P is currently considering adopting the S&P Proposal, which may result in S&P downgrading the MTP Shares after such proposal becomes effective. In the event that S&P downgrades the MTP Shares, the Fixed Dividend Rate would only increase if each of the other Rating Agencies also downgrades the MTP Shares. Nevertheless, a downgrade by S&P could adversely affect the market pricing and liquidity of the MTP Shares. There can be no assurance that S&P will or will not take any action with respect to the S&P Proposal or that any such action would not result in a downgrade of MTP Shares. Further, there can be no assurance that any other Rating Agency will not also alter its rating criteria resulting in downgrades of ratings, which could further adversely affect the market pricing and liquidity of MTP Shares.
- *Early Redemption Risk.* The Fund may voluntarily redeem MTP Shares or may be forced to redeem MTP Shares to meet regulatory requirements and the asset coverage requirements of the MTP Shares. Such redemptions may be at a time that is unfavorable to

holders of MTP Shares. The Fund expects to voluntarily redeem MTP Shares before the Term Redemption Date to the extent that market conditions allow the Fund to issue other preferred shares or debt securities at a rate that is lower than the Fixed Dividend Rate on MTP Shares. For further information, see Description of MTP Shares Redemption and Asset Coverage.

- *Tax Risk.* To qualify for the favorable U.S. federal income tax treatment generally accorded to regulated investment companies, among other things, the Fund must derive in each taxable year at least 90% of its gross income from certain prescribed sources. If for any taxable year the Fund does not qualify as a regulated investment company, all of its taxable income (including its net capital gain) would be subject to tax at regular corporate rates without any deduction for distributions to stockholders, and such distributions would be taxable as ordinary dividends to the extent of the Fund's current and accumulated earnings and profits. The value of MTP Shares may be adversely affected by changes in tax rates and policies. Because dividends from MTP Shares are generally not expected to be subject to regular federal income taxation, the attractiveness of such shares in relation to other investment alternatives is affected by changes in federal income tax rates or changes in the tax-exempt treatment of dividends on MTP Shares. A portion of the dividends from MTP Shares may be subject to the federal alternative minimum tax. See Tax Matters. See also the opinion of counsel included as Appendix C to the SAI.
  
- *Credit Crisis and Liquidity Risk.* General market uncertainty and extraordinary conditions in the credit markets, including the municipal market, may impact the liquidity of the Fund's investment portfolio, which in turn, during extraordinary circumstances, could impact the Fund's distributions and/or the liquidity of the Term Redemption Liquidity Account (as described under Description of MTP Shares). Further, there may be market imbalances of sellers and buyers of MTP Shares during periods of extreme illiquidity and volatility. Such market conditions may lead to periods of thin trading in any secondary market for MTP Shares and may make valuation of MTP Shares uncertain. As a result, the spread between bid and asked prices is likely to increase significantly such that an MTP Shares investor may have greater difficulty selling his or her MTP Shares. Less liquid and more volatile trading environments could result in sudden and significant valuation increases or declines in MTP Shares.
  
- *Inflation Risk.* Inflation is the reduction in the purchasing power of money resulting from the increase in the price of goods and services. Inflation risk is the risk that the inflation-adjusted (or real) value of an investment in MTP Shares or the income from that investment will be worth less in the future. As inflation occurs, the real value of MTP Shares and dividends on MTP Shares declines.

- *Reinvestment Risk MTP Shares.* Given the five-year term and potential for early redemption of MTP Shares, holders of MTP Shares may face an increased reinvestment risk, which is the risk that the return on an investment purchased with proceeds from the sale or redemption of MTP Shares may be lower than the return previously obtained from an investment in MTP Shares.

#### General Risks of Investing in the Fund

- *Credit and Below Investment Grade Risk.* Credit risk is the risk that one or more municipal securities in the Fund's portfolio will decline in price, or the issuer thereof will fail to pay interest or principal when due, because the issuer 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. The Fund may invest up to 20% (measured at the time of investment) of its Managed Assets in municipal securities that are rated below investment grade or that are unrated but judged to be of comparable quality by Nuveen Asset Management. If a municipal security satisfies the rating requirements described above at the time of investment and is subsequently downgraded below that rating, the Fund will not be required to dispose of the security. If a downgrade occurs, Nuveen Asset Management will consider what action, including the sale of the security, is in the best interests of the Fund and its shareholders. Municipal securities of below investment grade quality are regarded as having predominately speculative characteristics with respect to the issuer's capacity to pay interest and repay principal when due, and are more susceptible to default or decline in market value due to adverse economic and business developments than investment grade municipal securities. Also, to the extent that the rating assigned to a municipal security in the Fund's portfolio is downgraded by any NRSRO, the market price and liquidity of such security may be adversely affected. The market values for municipal securities of below investment grade quality tend to be volatile, and these securities are less liquid than investment grade municipal securities. For these reasons, an investment in the Fund, compared with a portfolio consisting solely of investment grade securities, may experience the following:

increased price sensitivity resulting from a deteriorating economic environment and changing interest rates;

greater risk of loss due to default or declining credit quality;

adverse issuer specific events that are more likely to render the issuer unable to make interest and/or principal payments; and

the possibility that a negative perception of the below investment grade market develops, resulting in the price and liquidity of below investment grade securities

becoming depressed, and this negative perception could last for a significant period of time.

- *Municipal Securities Market Risk.* Investing in the municipal securities market involves certain risks. The municipal securities 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 became severely constrained. As a result, some firms were unwilling to commit their capital to purchase and to serve as a dealer for municipal securities. The amount of public information available about the municipal securities in the Fund's portfolio is generally less than that for corporate equities or bonds, and the Fund's investment performance may therefore be more dependent on Nuveen Asset Management's analytical abilities than if the Fund were to invest in stocks or taxable bonds. As noted above, the secondary market for municipal securities also tends to be less well-developed or liquid than many other securities markets, which may adversely affect the Fund's ability to sell its municipal securities at attractive prices or at prices approximating those at which the Fund currently values them.
- *Interest Rate Risk The Fund.* Generally, when market interest rates rise, bond prices fall, and vice versa. Interest rate risk is the risk that the municipal securities in the Fund's portfolio will decline in value because of increases in market interest rates. In typical market interest rate environments, the prices of longer-term municipal securities generally fluctuate more than prices of shorter-term municipal securities as interest rates change.
- *Inverse Floating Rate Securities Risk.* The Fund may invest up to 15% of its net assets in inverse floating rate securities. Typically, inverse floating rate securities represent beneficial interests in a special purpose trust (sometimes called a tender option bond trust) formed by a third party sponsor for the purpose of holding municipal securities. See Portfolio Composition Municipal Securities Inverse Floating Rate Securities. In general, income on inverse floating rate securities will decrease when interest rates increase and increase when interest rates decrease. Investments in inverse floating rate securities may subject the Fund to the risks of reduced or eliminated interest payments and losses of principal. In addition, inverse floating rate securities may increase or decrease in value at a greater rate than the underlying interest rate, which effectively leverages the Fund's investment. As a result, the market value of such securities generally will be more volatile than that of fixed rate securities.

The Fund may invest in inverse floating rate securities issued by special purpose trusts that have recourse to the Fund. In Nuveen Asset Management's discretion, the Fund may enter into a

separate shortfall and forbearance agreement with the third party sponsor of a special purpose trust. The Fund may enter into such recourse agreements (i) when the liquidity provider to the special purpose trust requires such an agreement because the level of leverage in the special purpose trust exceeds the level that the liquidity provider is willing to support absent such an agreement; and/or (ii) to seek to prevent the liquidity provider from collapsing the special purpose trust in the event that the municipal obligation held in the trust has declined in value. Such an agreement would require the Fund to reimburse the third party sponsor of the trust, upon termination of the trust issuing the inverse floater, the difference between the liquidation value of the bonds held in the trust and the principal amount due to the holders of floating rate securities. In such instances, the Fund may be at risk of loss that exceeds its investment in the inverse floating rate securities.

The Fund's investments in inverse floating rate securities issued by special purpose trusts that have recourse to the Fund may be highly leveraged. The structure and degree to which the Fund's inverse floating rate securities are highly leveraged will vary based upon a number of factors, including the size of the trust itself and the terms of the underlying municipal security held in a special purpose trust. An inverse floating rate security generally is considered highly leveraged if the principal amount of the short-term floating rate interests issued by the related special purpose trust is in excess of three times the principal amount of the inverse floating rate securities owned by the trust (the ratio of the principal amount of such short-term floating rate interests to the principal amount of the inverse floating rate securities is referred to as the "gearing"). In the event of a significant decline in the value of an underlying security, the Fund may suffer losses in excess of the amount of its investment (up to an amount equal to the value of the municipal securities underlying the inverse floating rate securities) as a result of liquidating special purpose trusts or other collateral required to maintain the Fund's anticipated effective leverage ratio.

The economic effect of leverage through the Fund's purchase of inverse floating rate securities creates an opportunity for increased net income and returns, but also creates the possibility that the Fund's long-term returns will be diminished if the cost of leverage exceeds the return on the inverse floating rate securities purchased by the Fund.

Inverse floating rate securities have varying degrees of liquidity based upon the liquidity of the underlying securities deposited in a special purpose trust. The market price of inverse floating rate securities is more volatile than the underlying securities due to leverage. The leverage attributable to such inverse floating rate securities may be "called away" on relatively short notice and

therefore may be less permanent than more traditional forms of leverage. In certain circumstances, the likelihood of an increase in the volatility of net asset value and market price of the common shares may be greater for the Fund to the extent that it relies on inverse floating rate securities to achieve a significant portion of its desired effective leverage ratio. The Fund may be required to sell its inverse floating rate securities at less than favorable prices, or liquidate other Fund portfolio holdings in certain circumstances, including, but not limited to, the following:

If the Fund has a need for cash and the securities in a special purpose trust are not actively trading due to adverse market conditions;

If special purpose trust sponsors (as a collective group or individually) experience financial hardship and consequently seek to terminate their respective outstanding special purpose trusts; and

If the value of an underlying security declines significantly (to a level below the notional value of the floating rate securities issued by the trust) and if additional collateral has not been posted by the Fund.

- *Insurance Risk.* The Fund may purchase municipal securities that are additionally secured by insurance, bank credit agreements, or escrow accounts. The credit quality of the companies that provide such credit enhancements will affect the value of those securities. Many significant providers of insurance for municipal securities have recently incurred significant losses and 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 to do so in the future. Assuming that the insurer remains creditworthy, the insurance feature of a municipal security guarantees the full payment of principal and interest when due through the life of an insured obligation. Such insurance does not guarantee the market value of the insured obligation or the value of the Fund's common shares. See *Risks General Risks of Investing in the Fund Insurance Risk.*
- *Reinvestment Risk the Fund.* With respect to the Fund, reinvestment risk is the risk that income from the Fund's portfolio will decline if and when the Fund invests the proceeds from matured, traded or called bonds at market interest rates that are below the Fund's portfolio's current earnings rate.
- *Anti-Takeover Provisions.* The Fund's Declaration of Trust and By-Laws include provisions that could limit the ability of other entities or persons to acquire control of the Fund or convert the Fund to open-end status. See *Certain Provisions in the Declaration of Trust and By-Laws.*

For additional risks of investing in MTP Shares and general risks of the Fund, see Risks.

**Governing Law**

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

**FINANCIAL HIGHLIGHTS**

The following Financial Highlights table is intended to help a prospective investor understand the Fund's financial performance for the periods shown. Certain information reflects financial results for a single common share or MuniPreferred share of the Fund. The total returns in the table represent the rate an investor would have earned or lost on an investment in common shares of the Fund (assuming reinvestment of all dividends). The information with respect to the fiscal year ended October 31, 2009 has been audited by Ernst & Young LLP, whose report for the fiscal year ended October 31, 2009, along with the financial statements of the Fund including the Financial Highlights for each of the five years in the year then ended, are included in the Fund's 2009 Annual Report. The information with respect to the six months ended April 30, 2010 is unaudited and is included in the Fund's 2010 Semi-Annual Report. Results of the interim period are not necessarily indicative of results of the full year. Copies of the Annual Report and Semi-Annual Report may be obtained from [www.sec.gov](http://www.sec.gov) or by visiting [www.nuveen.com](http://www.nuveen.com). The information contained in, or that can be accessed through, the Fund's website is not part of this prospectus. Past results are not indicative of future performance.

The following per share data and ratios have been derived from information provided in the financial statements.

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### FINANCIAL HIGHLIGHTS

Information contained in the table below under the headings **Per Share Operating Performance** and **Ratios/Supplemental Data** shows the operating performance of the Fund since the commencement of operations.

Selected data for a common share outstanding throughout each period:

	Year Ended October 31,			
	2010(c)	2009	2008	2007
<b>PER SHARE OPERATING PERFORMANCE</b>				
Beginning Common Share Net Asset Value	\$ 14.19	\$ 12.10	\$ 15.03	\$ 15.54
<b>Investment Operations:</b>				
Net Investment Income	0.54	1.08	1.06	1.07
Net Realized/Unrealized Gain (Loss)	0.28	1.91	(2.95)	(0.44)
Distributions from Net Investment Income to Preferred Shareholders	(0.01)	(0.05)	(0.27)	(0.27)
Distributions from Capital Gains to Preferred Shareholders	0.00****	0.00	0.00	(0.01)
<b>Total</b>	<b>0.81</b>	<b>2.94</b>	<b>(2.16)</b>	<b>0.35</b>
<b>Less Distributions:</b>				
Net Investment Income to Common Shareholders	(0.46)	(0.85)	(0.77)	(0.84)
Capital Gains to Common Shareholders	(0.06)	0.00	0.00	(0.02)
<b>Total</b>	<b>(0.52)</b>	<b>(0.85)</b>	<b>(0.77)</b>	<b>(0.86)</b>
Offering Costs and Preferred Share Underwriting Discounts	0.00	0.00	0.00	0.00
Ending Common Share Net Asset Value	\$ 14.48	\$ 14.19	\$ 12.10	\$ 15.03
Ending Market Value	\$ 14.10	\$ 13.38	\$ 10.72	\$ 13.85
<b>Total Returns:</b>				
Based on Market Value**	9.47%	33.89%	(17.85)%	(7.72)%
Based on Common Share Net Asset Value**	5.87%	25.08%	(14.99)%	2.31%
<b>Ratios/Supplemental Data</b>				
Ending Net Assets Applicable to Common Shares (000)	\$ 584,560	\$ 573,088	\$ 488,561	\$ 606,908
<b>Ratios to Average Net Assets Applicable to Common Shares Before Reimbursement :</b>				
Expenses Including Interest(b)	1.19%*	1.26%	1.34%	1.32%
Expenses Excluding Interest	1.10%*	1.15%	1.15%	1.13%
Net Investment Income	7.41%*	7.98%	7.08%	6.65%
<b>Ratios to Average Net Assets Applicable to Common Shares After Reimbursement ***:</b>				
Expenses Including Interest(b)	1.03%*	1.04%	1.04%	0.94%
Expenses Excluding Interest	0.94%*	0.92%	0.85%	0.76%
Net Investment Income	7.57%*	8.20%	7.37%	7.02%
Portfolio Turnover Rate	1%	2%	7%	14%

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Preferred Shares at End of Period:

Aggregate Amount Outstanding (000)	\$ 236,950	\$ 236,950	\$ 270,775	\$ 312,000
Liquidation and Market Value Per Share	\$ 25,000	\$ 25,000	\$ 25,000	\$ 25,000
Asset Coverage Per Share	\$ 86,675	\$ 85,465	\$ 70,108	\$ 73,630

\* Annualized.

\*\* Total Return Based on Market Value is the combination of changes in the market price per share and the effect of reinvested dividend income and reinvested capital gains distributions, if any, at the average price paid per share at the time of reinvestment. The last dividend declared in the period, which is typically paid on the first business day of the following month, is assumed to be reinvested at the ending market price. The actual reinvestment for the last dividend declared in the period may take place over several days, and in some instances may not be based on the market price, so the actual reinvestment price may be different from the price used in the calculation. Total returns are not annualized.

Total Return Based on Common Share Net Asset Value is the combination of changes in Common share net asset value, reinvested dividend income at net asset value and reinvested capital gains distributions at net asset value, if any. The last dividend declared in the period, which is typically paid on the first business day of the following month, is assumed to be reinvested at the ending net asset value. The actual reinvestment price for the last dividend declared in the period may often be based on the Fund's market price (and not its net asset value), and therefore may be different from the price used in the calculation. Total returns are not annualized.

Year Ended October 31,

2006	2005	2004	2003	2002	2001(a)
\$ 15.32	\$ 15.36	\$ 14.74	\$ 14.56	\$ 14.47	\$ 14.33
1.07	1.06	1.06	1.07	1.03	0.03
0.29	0.01	0.59	0.10	0.16	0.14
(0.24)	(0.15)	(0.07)	(0.07)	(0.10)	0.00
0.00	0.00	0.00	0.00	0.00	0.00
1.12	0.92	1.58	1.10	1.09	0.17
(0.90)	(0.96)	(0.96)	(0.93)	(0.91)	0.00
0.00	0.00	0.00	0.00	0.00	0.00
(0.90)	(0.96)	(0.96)	(0.93)	(0.91)	0.00
0.00	0.00	0.00	0.01	(0.09)	(0.03)
\$ 15.54	\$ 15.32	\$ 15.36	\$ 14.74	\$ 14.56	\$ 14.47
\$ 15.88	\$ 14.41	\$ 14.50	\$ 13.80	\$ 13.53	\$ 15.07
16.90%	6.11%	12.45%	9.04%	(4.26)%	0.47%
7.57%	6.09%	11.10%	7.82%	7.20%	0.98%
\$ 626,836	\$ 617,358	\$ 619,118	\$ 594,154	\$ 586,799	\$ 583,100
1.13%	1.13%	1.15%	1.17%	1.17%	0.72%*
1.13%	1.13%	1.15%	1.17%	1.17%	0.72%*
6.51%	6.39%	6.64%	6.80%	6.78%	2.05%*
0.68%	0.69%	0.69%	0.71%	0.70%	0.42%*
0.68%	0.69%	0.69%	0.71%	0.70%	0.42%*
6.96%	6.83%	7.10%	7.26%	7.25%	2.36%*
9%	3%	3%	3%	7%	1%
\$ 312,000	\$ 312,000	\$ 312,000	\$ 312,000	\$ 312,000	\$ 0
\$ 25,000	\$ 25,000	\$ 25,000	\$ 25,000	\$ 25,000	\$ 0
\$ 75,227	\$ 74,468	\$ 74,609	\$ 72,608	\$ 72,019	\$ 0

\*\*\* After expense reimbursement from the Adviser, where applicable. Expense ratios do not reflect the reduction of custodian fee credits earned on the Fund's net cash on deposit with the custodian bank, where applicable.

\*\*\*\* Rounds to less than \$.01 per share.

The amounts shown are based on Common share equivalents.

Ratios do not reflect the effect of dividend payments to Preferred shareholders; Net Investment Income ratios reflect income earned on assets and expenses incurred attributable to Preferred shares.

(a) For the period September 25, 2001 (commencement of operations) through October 31, 2001.

(b) The expense ratios in the above table reflect, among other things, the interest expense deemed to have been paid by the Fund on the floating rate certificates issued by the special purpose trusts for the self-deposited inverse floaters held by the Fund, as described in Footnote 1 Inverse Floating Rate Securities, in the most recent shareholder report.

(c) For the six months ended April 30, 2010. (Unaudited.)



### THE FUND

The Fund is a diversified, closed-end management investment company registered under the 1940 Act. The Fund was organized as a Massachusetts business trust on March 21, 2001 pursuant to a Declaration of Trust governed by the laws of the Commonwealth of Massachusetts (the Declaration of Trust). The Fund's common shares are listed on the NYSE Amex under the symbol NZF. The Fund's principal office is located at 333 West Wacker Drive, Chicago, Illinois 60606, and its telephone number is (800) 257-8787.

The table below provides information on MuniPreferred shares since 2002.

<u>Period Ended</u>	<u>Amount Outstanding Exclusive of Treasury Securities</u>	<u>Asset Coverage Per Share*</u>	<u>Involuntary Liquidation Preference Per Share</u>	<u>Asset Coverage Ratio**</u>
October 31, 2002	12,480	\$ 72,019	\$ 25,000	288%
October 31, 2003	12,480	\$ 72,608	\$ 25,000	290%
October 31, 2004	12,480	\$ 74,609	\$ 25,000	298%
October 31, 2005	12,480	\$ 74,468	\$ 25,000	298%
October 31, 2006	12,480	\$ 75,227	\$ 25,000	301%
October 31, 2007	12,480	\$ 73,630	\$ 25,000	295%
October 31, 2008	10,831	\$ 70,108	\$ 25,000	280%
October 31, 2009	9,478	\$ 85,465	\$ 25,000	342%
July 31, 2010	9,478	\$ 87,210	\$ 25,000	349%

\* Calculated by dividing net assets (including net assets attributable to preferred shares) at period end by the number of MuniPreferred shares outstanding at period end.

\*\* Calculated by dividing Asset Coverage Per Share by Involuntary Liquidation Preference Per Share.

The following provides information about the Fund's outstanding shares as of November 30, 2010.

<u>Title of Class</u>	<u>Amount Authorized</u>	<u>Amount Held by the Fund or for its Account</u>	<u>Amount Outstanding</u>
Common	unlimited		40,387,484
MuniPreferred	unlimited		
Series W	10,000		3,159
Series TH	10,000		3,159
Series F	10,000		3,160
MTP	unlimited		
Series 2016			

### USE OF PROCEEDS

The net proceeds of the offering will be approximately \$63,640,000 or \$73,243,750 if the underwriters exercise the overallotment option in full, after payment of the underwriting discounts and commissions and estimated offering costs. The Fund intends to use the net proceeds from the

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sale of MTP Shares to refinance and redeem a portion of the Fund's outstanding MuniPreferred shares, and to maintain the Fund's leveraged capital structure. To the extent the underwriters purchase additional shares to cover over-allotments, the proceeds to the Fund from such additional purchase will be invested in accordance with the Fund's investment policies. Such redemption of the MuniPreferred shares is expected to occur within four weeks of the closing of the offering.

### CAPITALIZATION

The following table sets forth the capitalization of the Fund as of July 31, 2010, and as adjusted to give effect to (i) the issuance of all MTP Shares offered hereby (assuming that the underwriters' overallotment option is not exercised) and (ii) the redemption of 2,545 outstanding MuniPreferred shares with the proceeds of the issuance of MTP Shares. Fewer than 2,545 of the Fund's outstanding MuniPreferred shares may be redeemed. The as adjusted information is illustrative only.

	Actual July 31, 2010	As Adjusted July 31, 2010
	(Unaudited)	(Unaudited)
MuniPreferred shares, \$25,000 stated value per share, at liquidation value; unlimited shares authorized (9,478 shares outstanding and 6,933 shares outstanding as adjusted, respectively)*	\$ 236,950,000	\$ 173,325,000
MTP Shares, \$10 stated value per share, at liquidation value; unlimited shares authorized; (no shares outstanding and 6,500,000 shares outstanding as adjusted, respectively)*	\$	\$ 65,000,000
<b>COMMON SHAREHOLDERS' EQUITY:</b>		
Common shares, \$.01 par value per share; unlimited shares authorized, 40,378,174 shares outstanding*	\$ 403,782	\$ 403,782
Paid-in surplus	573,909,890	573,909,890**
Undistributed net investment income	9,603,911	9,603,911
Accumulated net realized gain (loss) from investments and derivative transactions	(2,593,182)	(2,593,182)
Net unrealized appreciation (depreciation) of investments and derivative transactions	8,304,686	8,304,686
Net assets applicable to common shares	\$ 589,629,087	\$ 589,629,087

\* None of these outstanding shares are held by or for the account of the Fund.

\*\* Assumes a total of \$1,360,000 of underwriting discounts and commissions and other estimated offering costs of the MTP Shares issuance will be capitalized and amortized over the life of the MTP Shares.

### SUPPLEMENTAL PORTFOLIO INFORMATION

*Set forth below are selected historical data (unaudited) relating to the Fund and its portfolio holdings at each period noted.*

	July 31, 2010	October 31,		
		2009	2008	2007
<b>OPERATING PERFORMANCE RATIOS</b>				
Asset Coverage(a)	349%	342%	280%	295%
Net Investment Income Coverage(b)	4,000%	2,160%	393%	396%
Structural Leverage(c)	29%	29%	36%	34%
Effective Leverage(d)	38%	38%	42%	38%

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- (a) Based on 1940 Act requirements that are described in this prospectus under the heading Description of MTP Shares Restrictions on Dividend, Redemption and Other Payments.
- (b) Calculated by dividing Net Investment Income by Distributions from Net Investment Income to Preferred Shareholders.
- (c) Based on the inverse of the Asset Coverage Ratio (meaning the ratio of the Fund's total debt, if any, and the involuntary liquidation preference of Preferred Stock to the Fund's total assets less liabilities and indebtedness not represented by senior securities).
- (d) Effective Leverage Ratio is previously defined in the prospectus summary under the heading Effective Leverage Ratio.

	July 31, 2010	October 31,		
		2009	2008	2007
<b>PORTFOLIO DATA</b>				
Total Managed Assets (000s)(a)	\$ 826,579	\$ 810,038	\$ 759,336	\$ 918,908
Number of Issuers(b)	164	164	162	157
Number of Issuers in Default	1			
Average Issuer Holding (000s)(c)	\$ 5,436	\$ 5,302	\$ 4,844	\$ 5,933
Top 10 Issuers (as % of Total Investments)	26.61%	27.68%	30.58%	32.88%
Average Effective Maturity on Securities (years)	14.69	14.56	15.06	16.72
Average Duration (years)	4.95	6.60	9.12	6.26
AMT Bonds (as % of Total Investments)	22.95%	24.20%	28.01%	27.35%
Inverse Floaters (as % of Total Investments)(d)	6.68%	6.37%	3.80%	3.25%

(a) Net assets applicable to common shares plus Preferred Stock at liquidation value.

(b) Issuer is defined as the legal entity or obligor that develops, registers and sells municipal securities for the purpose of financing its operations.

(c) Calculated by dividing the market value of the municipal securities in the Fund's portfolio by the number of issuers.

(d) Inverse floating rate securities (sometimes referred to as inverse floaters) are securities whose interest rates bear an inverse relationship to the interest rate on another security or the value of an index. See Portfolio Composition Municipal Securities Inverse Floating Rate Securities.

	July 31, 2010	October 31,		
		2009	2008	2007
<b>CREDIT QUALITY (AS % OF TOTAL MUNICIPAL BONDS)(a),(b)</b>				
AAA/U.S. Guaranteed	38%	41%	46%	75%
AA	22%	19%	34%	7%
A	20%	21%	6%	2%
BBB	7%	7%	6%	7%
BB or lower	3%	3%	2%	2%
N/R	10%	9%	6%	7%
	100%	100%	100%	100%

(a) The percentages shown in the table above may reflect the ratings on certain bonds whose insurer has experienced downgrades.

(b) Under normal market conditions, the Fund will invest its net assets in a portfolio of municipal securities that are exempt from regular federal income taxes.

	July 31, 2010	October 31,		
		2009	2008	2007
<b>STATES OF ISSUANCE (AS % OF TOTAL MUNICIPAL BONDS)</b>				
California	9.0%	8.9%	8.1%	9.1%
Colorado	4.0%	4.4%	3.2%	3.8%
Illinois	10.8%	10.0%	10.6%	12.7%
Indiana	3.9%	3.9%	4.1%	3.8%
Iowa	3.6%	4.1%	4.5%	3.9%
Kentucky	2.3%	2.3%	2.4%	2.1%
Louisiana	3.0%	2.8%	2.5%	2.5%
Michigan	6.3%	6.4%	6.8%	6.3%
Missouri	2.0%	2.0%	2.1%	1.9%
New Jersey	3.1%	2.6%	2.5%	2.6%
New York	3.0%	2.7%	2.4%	2.6%
Texas	14.1%	13.3%	12.8%	11.8%
Washington	10.5%	10.9%	11.1%	