

PIMCO MUNICIPAL INCOME FUND III

Form N-CSR

November 29, 2013

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED

MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-21187

PIMCO Municipal Income Fund III

(Exact name of registrant as specified in charter)

1633 Broadway, New York, New York 10019

(Address of principal executive offices) (Zip code)

Lawrence G. Altadonna 1633 Broadway, New York, New York 10019

(Name and address of agent for service)

Registrant's telephone number, including area code: 212-739-3371

Date of fiscal year end: September 30, 2013

Date of reporting period: September 30, 2013

Table of Contents

Item 1. REPORT TO SHAREHOLDERS

PIMCO Municipal Income Fund III

PIMCO California Municipal Income Fund III

PIMCO New York Municipal Income Fund III

Annual Report

September 30, 2013

Table of Contents

Table of Contents

2-3	<u>Letter from the Chairman of the Board & President</u>
4-5	<u>Fund Insights</u>
6-7	<u>Performance & Statistics</u>
8-24	<u>Schedules of Investments</u>
25	<u>Statements of Assets and Liabilities</u>
26	<u>Statements of Operations</u>
28-29	<u>Statements of Changes in Net Assets</u>
30-42	<u>Notes to Financial Statements</u>
43-45	<u>Financial Highlights</u>
46	<u>Report of Independent Registered Public Accounting Firm</u>
47	<u>Tax Information/Annual Shareholder Meeting Results</u>
48-52	<u>Matters Relating to the Trustees – Consideration of the Investment Management & Portfolio Management Agreements</u>
53-54	<u>Privacy Policy/Proxy Voting Policies & Procedures</u>
55-56	<u>Dividend Reinvestment Plan</u>
57-58	<u>Board of Trustees</u>
59	<u>Fund Officers</u>

Table of Contents

Letter from the Chairman of the Board &
President

Hans W. Kertess
Chairman

Brian S. Shlissel
President & CEO

Dear Shareholder:

Municipal bonds generated weak results during the fiscal twelve-month reporting period ended September 30, 2013. Yields moved higher as the US economy continued to expand and the Federal Reserve (the Fed) indicated that it may begin tapering its asset purchase program. Investor demand for municipal securities also weakened as the reporting period progressed given concerns regarding the fallout from Detroit's bankruptcy filing.

12-Month Period in Review

For the 12-month period ended September 30, 2013, PIMCO Municipal Income III returned -5.95% on net asset value (NAV) and -15.39% on market price.

For the 12-month period ended September 30, 2013, PIMCO California Municipal Income III returned -4.47% on NAV and -13.98% on market price.

For the 12-month period ended September 30, 2013, PIMCO New York Municipal Income III returned -5.63% on NAV and -6.83% on market price.

The Barclays Municipal Bond Index declined 2.21% while the broad taxable bond market, as represented by the Barclays US Aggregate Bond Index, returned -1.68% during the reporting period.

US gross domestic product (GDP), the value of goods and services produced in the country, the broadest measure of US economic activity and the principal indicator of economic performance, grew at a 2.8% annual rate

during the third quarter of 2012. GDP growth decelerated to a 0.1% annual pace during the fourth quarter, as private inventory investment and federal government spending moderated. However, annual GDP growth rose to 1.1% during the first quarter and 2.5% during the second quarter of 2013. While US economic data was mixed, there were signs of the long-awaited recovery in the housing market. In addition, while unemployment remained elevated, the

unemployment rate declined during the reporting period.

The Federal Reserve (the Fed) maintained an accommodative monetary policy throughout the reporting period. However, with unemployment falling and signs of improving economic activity, in June 2013 the Fed announced its intention to begin tapering its monthly \$85 billion asset purchase program. This triggered sharply rising yields and declining bond prices. However, the Fed surprised many investors by choosing not to begin tapering at its meeting in September 2013. This caused yields to decline somewhat from their reporting period peak that occurred in early September. All told, US Treasury bond interest rates moved sharply higher during the 12-month fiscal period, with the yield on the benchmark 10-year Treasury bond rising from 1.65% to 2.64%. Since municipal bonds tend to track comparable US Treasury bonds, municipal yields increased accordingly.

2 September 30, 2013 | Annual Report

Table of Contents

Outlook

Market volatility increased sharply during the second half of the reporting period. This was partially triggered by concerns regarding the Fed's plans to taper its asset purchase program, mixed global growth and mounting expectations for the partial US government shutdown on October 1, 2013.

We now expect the Fed's policy stance to remain accommodative until 2014. In addition, while Fed tapering is likely to create greater volatility, we believe

Receive this report electronically and eliminate paper mailings.

To enroll, visit:

us.allianzgi.com/edelivery.

the Fed will only raise short-term interest rates if it is confident the economic recovery is on solid footing. Concerns of higher mortgage rates impacting the housing market, geopolitical issues, and continued dysfunction in Washington DC may also contribute to market volatility.

With respect to the US economy, in the wake of the Fed's decision in September not to taper its bond buying program, some investors may be concerned that the economy is deteriorating. However, recent data indicates continuing improvement in economic conditions, particularly in manufacturing and employment. It appears the Fed's decision was more preventative in nature, intended to avoid derailing the housing recovery and to offset a drag on the economy created by the possibility of a government shutdown and concerns related to the raising of the debt ceiling.

For specific information on the Funds and their performance, please review the following pages. If you have any questions regarding the information provided, we encourage you to contact your financial advisor or call the Funds shareholder servicing agent at (800) 254-5197. In addition, a wide range of information and resources is available on our website, us.allianzgi.com/closedendfunds.

Together with Allianz Global Investors Fund Management LLC, the Funds' investment manager, and Pacific Investment Management Company LLC (PIMCO), the Funds' sub-adviser, we thank you for investing with us.

We remain dedicated to serving your investment needs.

Sincerely,

Hans W. Kertess
Chairman of the Board of Trustees

Brian S. Shlissel
President & Chief Executive Officer

Annual Report | September 30, 2013 **3**

Table of Contents

Fund Insights

PIMCO Municipal Income Funds III

September 30, 2013 (unaudited)

For the 12-month fiscal year ended September 30, 2013, PIMCO Municipal Income III (Municipal III) returned -5.95% on net asset value (NAV) and -15.39% on market price.

For the 12-month fiscal year ended September 30, 2013, PIMCO California Municipal Income III (California Municipal III) returned -4.47% on NAV and -13.98% on market price.

For the 12-month fiscal year ended September 30, 2013, PIMCO New York Municipal Income III (New York Municipal III) returned -5.63% on NAV and -6.83% on market price.

The municipal bond market experienced periods of elevated volatility during the 12-month reporting period ended September 30, 2013. The overall municipal market, as measured by the Barclays Municipal Bond Index (the Index), returned 0.96% during the first half of the period. Supporting the municipal market were improving fundamentals, as many states benefited from positive year-over-year tax receipts. This offset a number of headwinds, including uncertainties surrounding the fiscal cliff and the future tax-exempt status of municipal bonds. The second half of the reporting period started off well, as the Index gained 1.10% in April. However, the Index moved sharply lower during the subsequent four months. This turnaround was triggered by sharply rising yields primarily resulting from the Federal Reserve's (the Fed) announcement of a possible shift in monetary policy. Investor demand for municipal bonds also weakened due to several high profile credit events, including Detroit's bankruptcy filing in July 2013. The Index

rallied sharply at the end of the reporting period after the Fed surprised the market and chose not to begin tapering its asset purchase program during its meeting on September 18, 2013. All told, the Index returned -2.21% during the 12-month reporting period. In comparison, the overall taxable fixed income market, as measured by the Barclays US Aggregate Bond Index, declined 1.68%.

Overweight duration relative to the Index detracted from the performance of all three Funds as municipal yields moved higher during the 12-months ended September 30, 2013. An underweight exposure to Puerto Rico securities contributed to the Funds' performance as these securities underperformed the general municipal market during the period. Municipal III's overweighting to the Industrial Revenue and Water and Sewer sectors detracted from performance as these sectors underperformed the Index. New York Municipal III's and California Municipal III's overweighting to Tobacco detracted from performance as this sector underperformed the Index. New York Municipal III's security selection in the Lease-Backed sector detracted from performance. California Municipal III's overweighting to the Revenue-Backed sector hindered results as this sector lagged the Index. California Municipal III's underweighting to the Lease-Backed sector detracted from results as this sector outperformed the Index.

Municipal III's security selection in the Electric Utility sector was beneficial for performance. Municipal III's and California Municipal III's underweighting to the Transportation sector

Table of Contents

contributed to performance as this sector underperformed the Index. Municipal III s underweighting to the Special Tax sector was beneficial given its underperformance versus the Index. New York Municipal III s overweighting to the Healthcare sector contributed to results due to its outperformance versus the Index. New York Municipal III s underweighting to the Water and Sewer sector was additive given its underperformance compared to the Index. New York Municipal III s security selection within the Pre-Refunded sector contributed to performance. California Municipal III s security selection within the Special Tax sector was positive for performance.

Annual Report | September 30, 2013 **5**

Table of Contents**Performance & Statistics**

PIMCO Municipal Income Funds III

September 30, 2013 (unaudited)

Municipal III:

Total Return⁽¹⁾:	Market Price	NAV
1 Year	15.39%	5.95%
5 Year	7.01%	6.47%
10 Year	4.24%	3.74%
Commencement of Operations (10/31/02) to 9/30/13	3.88%	3.76%

Market Price/NAV Performance:

Commencement of Operations (10/31/02) to 9/30/13

Market Price/NAV:

Market Price	\$10.45
NAV	\$9.58
Premium to NAV	9.08%
Market Price Yield ⁽²⁾	8.04%
Leverage Ratio ⁽³⁾	41.13%

Moody's Ratings

(as a % of total investments)

California Municipal III:

Total Return⁽¹⁾:	Market Price	NAV
1 Year	13.98%	4.47%
5 Year	5.57%	3.99%
10 Year	3.30%	3.25%
Commencement of Operations (10/31/02) to 9/30/13	2.62%	2.88%

Market Price/NAV Performance:

Commencement of Operations (10/31/02) to 9/30/13

Market Price/NAV:

Market Price	\$9.36
NAV	\$9.09
Premium to NAV	2.97%
Market Price Yield ⁽²⁾	7.69%
Leverage Ratio ⁽³⁾	44.20%

Moody's Ratings

(as a % of total investments)

Table of Contents**Performance & Statistics**

PIMCO Municipal Income Funds III

September 30, 2013 (unaudited)

New York Municipal III:

Total Return⁽¹⁾:	Market Price	NAV
1 Year	6.83%	5.63%
5 Year	5.74%	1.19%
10 Year	2.62%	1.37%
Commencement of Operations (10/31/02) to 9/30/13	2.04%	1.63%

Market Price/NAV Performance:

Commencement of Operations (10/31/02) to 9/30/13

Market Price/NAV:

Market Price	\$9.30
NAV	\$8.51
Premium to NAV	9.28%
Market Price Yield ⁽²⁾	6.77%
Leverage Ratio ⁽³⁾	43.48%

Moody's Ratings

(as a % of total investments)

(1) **Past performance is no guarantee of future results.** Total return is calculated by determining the percentage change in NAV or market price (as applicable) in the specified period. The calculation assumes that all dividends and distributions, if any, have been reinvested. Total return does not reflect broker commissions or sales charges in connection with the purchase or sale of Fund shares. Total return for a period of more than one year represents the average annual total return.

Performance at market price will differ from results at NAV. Although market price returns typically reflect investment results over time, during shorter periods returns at market price can also be influenced by factors such as changing views about the Funds, market conditions, supply and demand for each Fund's shares, or changes in each Fund's dividends.

An investment in each Fund involves risk, including the loss of principal. Total return, market price, market price yield and NAV will fluctuate with changes in market conditions. This data is provided for information purposes only and is not intended for trading purposes. Closed-end funds, unlike open-end funds, are not continuously offered. There is a one time public offering and once issued, shares of closed-end funds are traded in the open market through a stock exchange. NAV is equal to total assets attributable to common shareholders less total liabilities divided by the number of common shares outstanding. Holdings are subject to change daily.

(2) Market Price Yield is determined by dividing the annualized current monthly dividend per common share (comprised of net investment income) by the market price per common share at September 30, 2013.

(3) Represents Floating Rate Notes issued in tender option bond transactions and Preferred Shares outstanding (collectively Leverage), as a percentage of total managed assets. Total managed assets refer to total assets (including assets attributable to Leverage) minus accrued liabilities (other than liabilities representing Leverage).

Table of Contents**Schedule of Investments**

PIMCO Municipal Income Fund III

September 30, 2013

Principal Amount (000s)		Value
Municipal Bonds & Notes 92.0%		
Alabama 1.9%		
\$ 500	Birmingham Special Care Facs. Financing Auth. Rev., Childrens Hospital, 6.00%, 6/1/39 (AGC)	\$ 551,780
9,000	Birmingham-Baptist Medical Centers Special Care Facs. Financing Auth. Rev., Baptist Health Systems, Inc., 5.00%, 11/15/30, Ser. A	8,552,340
1,000	State Docks Department Rev., 6.00%, 10/1/40	1,106,840
		10,210,960
Arizona 6.4%		
	Health Facs. Auth. Rev.,	
1,250	Banner Health, 5.00%, 1/1/35, Ser. A	1,263,712
900	Banner Health, 5.50%, 1/1/38, Ser. D	938,943
2,250	Beatitudes Campus Project, 5.20%, 10/1/37	1,795,635
	Pima Cnty. Industrial Dev. Auth. Rev.,	
13,000	5.00%, 9/1/39 (i)	13,045,370
750	Tucson Electric Power Co., 5.25%, 10/1/40, Ser. A	737,243
	Salt River Project Agricultural Improvement & Power Dist. Rev.,	
5,000	5.00%, 1/1/39, Ser. A (i)	5,207,700
11,600	Salt Verde Financial Corp. Rev., 5.00%, 12/1/37	11,486,784
		34,475,387
California 17.2%		
	Bay Area Toll Auth. Rev.,	
12,000	5.25%, 4/1/53, Ser. S-4	12,152,160
1,500	San Francisco Bay Area, 5.00%, 10/1/29	1,586,040
500	San Francisco Bay Area, 5.00%, 4/1/34, Ser. F-1	522,475
3,260	San Francisco Bay Area, 5.00%, 10/1/42	3,308,020
	Golden State Tobacco Securitization Corp. Rev., Ser. A-1,	
2,630	4.50%, 6/1/27	2,263,299
3,600	5.125%, 6/1/47	2,512,764
11,120	5.75%, 6/1/47	8,545,275
	Health Facs. Financing Auth. Rev.,	
2,500	Catholic Healthcare West, 6.00%, 7/1/39, Ser. A	2,708,800
600	Sutter Health, 5.00%, 11/15/42, Ser. A (IBC-NPFGC)	601,170
4,390	Sutter Health, 5.00%, 8/15/52, Ser. A	4,272,392
1,500	Sutter Health, 6.00%, 8/15/42, Ser. B	1,648,275
	Indian Wells Redev. Agcy., Tax Allocation, Whitewater Project,	
3,350	4.75%, 9/1/34, Ser. A (AMBAC)	2,868,873

Edgar Filing: PIMCO MUNICIPAL INCOME FUND III - Form N-CSR

130	Los Angeles Unified School Dist., GO, 5.00%, 7/1/30, Ser. E (AMBAC)	135,464
2,000	M-S-R Energy Auth. Rev., 6.50%, 11/1/39, Ser. B	2,318,180
1,500	Municipal Finance Auth. Rev., Azusa Pacific Univ. Project, 7.75%, 4/1/31, Ser. B	1,644,270
1,250	Palomar Pomerado Health, CP, 6.75%, 11/1/39	1,288,750
1,600	San Marcos Unified School Dist., GO, 5.00%, 8/1/38, Ser. A	1,635,232
5,000	State, GO, 5.00%, 6/1/37	5,074,800
5,300	5.00%, 12/1/37	5,389,146
1,350	5.25%, 3/1/38	1,403,730

8 September 30, 2013 | Annual Report

Table of Contents**Schedule of Investments**

PIMCO Municipal Income Fund III

September 30, 2013 (continued)

Principal Amount (000s)		Value
	California (continued)	
\$ 1,300	5.25%, 11/1/40	\$ 1,356,095
3,200	5.50%, 3/1/40	3,411,200
2,500	5.75%, 4/1/31	2,778,950
5,000	6.00%, 4/1/38	5,694,850
	Statewide Communities Dev. Auth. Rev.,	
1,000	American Baptist Homes West, 6.25%, 10/1/39	1,024,540
1,935	California Baptist Univ., 5.75%, 11/1/17, Ser. B (a)(d)	2,015,341
2,580	Methodist Hospital Project, 6.625%, 8/1/29 (FHA)	2,995,664
9,200	Methodist Hospital Project, 6.75%, 2/1/38 (FHA)	10,411,088
	Tobacco Securitization Auth. of Southern California Rev., 5.00%, 6/1/37, Ser.	
1,200	A-1	904,188
		92,471,031
	Colorado 0.7%	
	Health Facs. Auth. Rev., Ser. A,	
500	Evangelical Lutheran, 6.125%, 6/1/38 (Pre-refunded @ \$100, 6/1/14) (c)	519,495
2,000	Sisters of Charity of Leavenworth Health System, 5.00%, 1/1/40	2,025,520
500	Public Auth. for Colorado Energy Rev., 6.50%, 11/15/38	574,340
	Regional Transportation Dist. Rev., Denver Transportation Partners, 6.00%,	
500	1/15/34	507,170
		3,626,525
	Connecticut 0.2%	
	Harbor Point Infrastructure Improvement Dist., Tax Allocation,	
1,250	7.875%, 4/1/39, Ser. A	1,357,075
	District of Columbia 2.0%	
10,000	Water & Sewer Auth. Rev., 5.50%, 10/1/39, Ser. A (i)	10,621,800
	Florida 3.6%	
3,480	Brevard Cnty. Health Facs. Auth. Rev., Health First, Inc. Project, 5.00%, 4/1/34	3,490,510
500	Broward Cnty. Airport System Rev., 5.375%, 10/1/29, Ser. O	541,585
4,500	Broward Cnty. Water & Sewer Utility Rev., 5.25%, 10/1/34, Ser. A (i)	4,847,310
3,000	Cape Coral Water & Sewer Rev., 5.00%, 10/1/41 (AGM)	3,049,410
350	Dev. Finance Corp. Rev., Renaissance Charter School, 6.50%, 6/15/21, Ser. A	363,685
	Hillsborough Cnty. Industrial Dev. Auth. Rev., Tampa General Hospital Project,	
2,500	5.25%, 10/1/34, Ser. B (Pre-refunded @ \$100, 10/1/13) (c)	