

PIMCO MUNICIPAL INCOME FUND III

Form N-CSRS

May 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: March 31, 2013

Table of Contents

Item 1. REPORT TO SHAREHOLDERS

Semi-Annual Report

March 31, 2013

PIMCO Municipal Income Fund III

PIMCO California Municipal Income Fund III

PIMCO New York Municipal Income Fund III

Table of Contents

Contents

<u>Letter to Shareholders</u>	2-3
<u>Fund Insights</u>	4
<u>Performance & Statistics</u>	5-6
<u>Schedules of Investments</u>	7-24
<u>Statements of Assets and Liabilities</u>	25
<u>Statements of Operations</u>	26
<u>Statements of Changes in Net Assets</u>	28-29
<u>Notes to Financial Statements</u>	30-37
<u>Financial Highlights</u>	38-40
<u>Annual Shareholder Meeting Results/Proxy Voting</u>	
<u>Policies & Procedures</u>	41

3.31.13 PIMCO Municipal Income Funds III Semi-Annual Report 1

Table of Contents

Hans W. Kertess

Chairman

Brian S. Shlissel

President & CEO

Dear Shareholder:

Municipal bonds performed well during the six-month reporting period ended March 31, 2013. Yields remained attractive relative to US Treasury bonds as US Treasuries lost some of their appeal as a safe haven investment amid signs of an improving economy. An increase in federal tax rates for top-earning US households also supported municipal securities during the period.

Six-Month Period in Review

For the fiscal six-month period ended March 31, 2013:

PIMCO Municipal Income Fund III returned 4.28% on net asset value (NAV) and -4.10% on market price.

PIMCO California Municipal Income Fund III returned 3.94% on NAV and -1.94% on market price.

PIMCO New York Municipal Income Fund III returned 1.80% on NAV and -1.87% on market price. The Barclays Municipal Bond Index returned a tax-advantaged 0.96% while the broad taxable bond market, as represented by the Barclays US Aggregate Bond Index, returned 0.09% during the reporting period.

As the fiscal reporting period began, 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, was growing at a 3.1% annual rate. GDP growth slowed to a 0.4% annual pace during the fourth quarter of 2012, which the government indicated was due to the drop in defense spending. Economic data released early in 2013 suggests economic growth will remain modest.

The Federal Reserve (the Fed) maintained an accommodative monetary policy, and indicated interest rates are expected to remain low until the US unemployment rate falls to 6.5%. At March 31, 2013, unemployment stood at 7.6%.

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

According to The Securities Industry and Financial Markets Association (SIMFA), municipal issuance volume trended lower during the six-month period ended March 31, 2013. In October 2012, issuance was \$34.6 billion, by February 2013, issuance had declined to \$23.7 billion. However, SIMFA reported that issuance during January and February 2013 reflected a strong year-on-year increase over the comparable months in 2012.

2 PIMCO Municipal Income Funds III Semi-Annual Report 3.31.13

Table of Contents

US Treasury bond interest rates edged higher during the six-month period, with the yield on the benchmark 10-year Treasury bond rising from 1.65% to 1.87%. Since municipal bonds tend to track comparable US Treasury bonds, their yields moved accordingly.

The Road Ahead

The Washington standoff regarding taxes and spending was partially resolved in the early hours of 2013, when Congress approved legislation which raised taxes on income, capital gains and dividends for households earning in excess of \$450,000. However there are still unresolved issues as well as

new areas of concern, such as the Obama administration's proposal to cap the amount of municipal bond interest deductible from taxes. According to the National League of Cities (NLC), if a cap is implemented it may force municipalities to pull back projects or pass certain costs onto residents in order to go forward with much needed infrastructure projects.

The fiscal situation at state and local levels remains challenging. The National Association of State Budget Officers reported that in aggregate, state tax collections are projected to pass pre-recession levels for the first time during 2013. However, revenues in 21 states will remain lower than in 2008. Meanwhile, the NLC indicated that general fund revenues for the 19,000 cities and towns it represents declined in 2012, the sixth consecutive year-over-year decline.

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

Receive this report electronically and eliminate paper mailings. To enroll, go to us.allianzgi.com/edelivery.

Table of Contents

PIMCO Municipal Income Funds III Fund Insights

March 31, 2013 (unaudited)

For the six-month period ended March 31, 2013, PIMCO Municipal Income III returned 4.28% on net asset value (NAV) and -4.10% on market price.

For the six-month period ended March 31, 2013, PIMCO California Municipal Income III returned 3.94% on NAV and -1.94% on market price.

For the six-month period ended March 31, 2013, PIMCO New York Municipal Income III returned 1.80% on NAV and -1.87% on market price.

The municipal bond market generated mixed results during the fiscal six-month reporting period ended March 31, 2013. The overall municipal market, as measured by the Barclays Municipal Bond Index (the Index), advanced during the first two months of the period. During this time, many states continued to benefit from both positive year-over-year tax receipts and technical drivers as new supply was not sufficient to meet investor demand. The Index declined in December 2012, as investor sentiment weakened due to uncertainties surrounding the fiscal cliff and the future tax-exempt status of municipal bonds. In January and February 2013, the Index registered positive returns, as the uncertainty of the tax status of municipal bonds subsided and demand resumed, albeit at a slower pace than in 2012. The Index, a measure of the broad municipal market, observed negative returns in March, primarily driven by seasonal technical factors, as investors rotated out of the asset class during tax season during a period of higher new issue supply and rising Treasury rates. During the six-month reporting period, the Index returned 0.96%. In comparison, the overall taxable fixed income market, as measured by the Barclays US Aggregate Bond Index, gained 0.09%.

An underweight duration relative to the benchmark contributed to performance of all three Funds as municipal yields moved higher during the six-months ended March 31, 2013. The Funds' overweighting to the Industrial Revenue sector contributed to performance as this segment outperformed the Index. Municipal Income III's overweight to revenue-backed municipal bonds was additive given the outperformance of revenue bonds versus the broad market index. New York Municipal Income III's overweight to the Healthcare sector and California Municipal Income III's overweight to the Tobacco sector contributed to performance as these higher beta sectors generally outperformed the Index as credit spreads compressed during the six-month period.

Each Funds' underweighting to the Transportation sector detracted from performance as this sector outperformed in comparison to the Index. Municipal Income III's and California Municipal Income III's underweight to the Lease-Backed sector detracted from performance as this segment outperformed the Index. New York Municipal Income III's underweight to Education sector detracted from performance during the period.

Table of Contents

PIMCO Municipal Income Funds III Performance & Statistics

March 31, 2013 (unaudited)

Municipal III:

Total Return^{(1):}	Market Price	NAV
Six Month	4.10%	4.28%
1 Year	11.99%	15.12%
5 Year	5.28%	5.16%
10 Year	5.84%	5.00%
Commencement of Operations (10/31/02) to 3/31/13	5.33%	4.98%

Market Price/NAV Performance:

Commencement of Operations (10/31/02) to 3/31/13

Market Price/NAV:

Market Price	\$12.33
NAV	\$11.07
Premium to NAV	11.38%
Market Price Yield ⁽²⁾	6.81%
Leverage Ratio ⁽³⁾	37.97%

Moody's Ratings

(as a % of total investments)

California Municipal III:

Total Return^{(1):}	Market Price	NAV
------------------------------------	---------------------	------------

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

Six Month	1.94%	3.94%
1 Year	13.91%	12.58%
5 Year	3.21%	3.20%
10 Year	4.59%	4.03%
Commencement of Operations (10/31/02) to 3/31/13	4.05%	3.85%

Market Price/NAV Performance:

Commencement of Operations (10/31/02) to 3/31/13

Market Price/NAV:

Market Price	\$11.08
NAV	\$10.27
Premium to NAV	7.89%
Market Price Yield ⁽²⁾	6.50%
Leverage Ratio ⁽³⁾	41.26%

Moody's Ratings

(as a % of total investments)

Table of Contents**PIMCO Municipal Income Funds III Performance & Statistics**

March 31, 2013 (unaudited)

New York Municipal III:

Total Return⁽¹⁾:	Market Price	NAV
Six Month	1.87%	1.80%
1 Year	12.40%	10.43%
5 Year	2.18%	0.36%
10 Year	3.46%	2.48%
Commencement of Operations (10/31/02) to 3/31/13	2.65%	2.45%

Market Price/NAV Performance:

Commencement of Operations (10/31/02) to 3/31/13

Market Price/NAV:

Market Price	\$10.14
NAV	\$9.51
Premium to NAV	6.62%
Market Price Yield ⁽²⁾	6.21%
Leverage Ratio ⁽³⁾	42.08%

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 less than one year is not annualized. 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 the Funds 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 March 31, 2013.

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

Table of Contents**PIMCO Municipal Income Fund III Schedule of Investments**

March 31, 2013 (unaudited)

Principal Amount (000s)		Value
MUNICIPAL BONDS & NOTES 96.9%		
Alabama 1.9%		
\$ 500	Birmingham Special Care Facs. Financing Auth. Rev., Childrens Hospital, 6.00%, 6/1/39 (AGC)	\$ 569,900
9,000	Birmingham-Baptist Medical Centers Special Care Facs. Financing Auth. Rev., Baptist Health Systems, Inc., 5.00%, 11/15/30, Ser. A	9,414,720
1,000	State Docks Department Rev., 6.00%, 10/1/40	1,190,480
		11,175,100
Arizona 6.6%		
	Health Facs. Auth. Rev.,	
1,250	Banner Health, 5.00%, 1/1/35, Ser. A	1,326,750
900	Banner Health, 5.50%, 1/1/38, Ser. D	1,000,449
2,250	Beatitudes Campus Project, 5.20%, 10/1/37	2,207,227
	Pima Cnty. Industrial Dev. Auth. Rev.,	
13,000	5.00%, 9/1/39 (i)	13,621,270
750	Tucson Electric Power Co., 5.25%, 10/1/40, Ser. A	818,813
	Salt River Project Agricultural Improvement & Power Dist. Rev., 5.00%, 1/1/39,	
5,000	Ser. A (i)	5,644,850
11,600	Salt Verde Financial Corp. Rev., 5.00%, 12/1/37	12,996,988
		37,616,347
California 14.0%		
	Bay Area Toll Auth. Rev., San Francisco Bay Area,	
1,500	5.00%, 10/1/29	1,710,810
500	5.00%, 4/1/34, Ser. F-1	558,350
3,260	5.00%, 10/1/42	3,600,246
	Golden State Tobacco Securitization Corp. Rev., Ser. A-1,	
3,000	4.50%, 6/1/27	2,893,170
3,600	5.125%, 6/1/47	3,182,148
7,120	5.75%, 6/1/47	6,842,106
	Health Facs. Financing Auth. Rev.,	
2,500	Catholic Healthcare West, 6.00%, 7/1/39, Ser. A	2,960,000
600	Sutter Health, 5.00%, 11/15/42, Ser. A (IBC-NPFGC)	636,378
1,500	Sutter Health, 6.00%, 8/15/42, Ser. B	1,806,375
3,350	Indian Wells Redev. Agcy., Tax Allocation, Whitewater Project, 4.75%, 9/1/34, Ser. A (AMBAC)	3,119,687

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

130	Los Angeles Unified School Dist., GO, 5.00%, 7/1/30, Ser. E (AMBAC)	139,942
2,000	M-S-R Energy Auth. Rev., 6.50%, 11/1/39, Ser. B	2,724,340
1,500	Municipal Finance Auth. Rev., Azusa Pacific Univ. Project, 7.75%, 4/1/31, Ser. B	1,769,100
1,250	Palomar Pomerado Health, CP, 6.75%, 11/1/39	1,405,513
1,600	San Marcos Unified School Dist., GO, 5.00%, 8/1/38, Ser. A	1,761,072
	State, GO,	
5,000	5.00%, 6/1/37	5,412,700
5,300	5.00%, 12/1/37	5,786,593

3.31.13 PIMCO Municipal Income Funds III Semi-Annual Report 7

Table of Contents**PIMCO Municipal Income Fund III Schedule of Investments**

March 31, 2013 (unaudited) (continued)

Principal Amount (000s)		Value
	California (continued)	
\$ 1,350	5.25%, 3/1/38	\$ 1,500,093
1,300	5.25%, 11/1/40	1,466,842
3,200	5.50%, 3/1/40	3,745,984
2,500	5.75%, 4/1/31	2,942,100
5,000	6.00%, 4/1/38	5,922,750
	Statewide Communities Dev. Auth. Rev.,	
1,000	American Baptist Homes West, 6.25%, 10/1/39	1,136,140
1,935	California Baptist Univ., 5.75%, 11/1/17, Ser. B (a)(d)	2,103,113
2,580	Methodist Hospital Project, 6.625%, 8/1/29 (FHA)	3,170,356
9,200	Methodist Hospital Project, 6.75%, 2/1/38 (FHA)	11,097,868
1,200	Tobacco Securitization Auth. of Southern California Rev., 5.00%, 6/1/37, Ser. A-1	1,088,988
		80,482,764
	Colorado 0.8%	
500	Confluence Metrop	