

NUVEEN GEORGIA DIVIDEND ADVANTAGE MUNICIPAL FUND 2
Form N-CSR
August 05, 2013

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 811-21152

Nuveen Georgia Dividend Advantage Municipal Fund 2
(Exact name of registrant as specified in charter)

Nuveen Investments
333 West Wacker Drive
Chicago, IL 60606
(Address of principal executive offices) (Zip code)

Kevin J. McCarthy
Nuveen Investments
333 West Wacker Drive
Chicago, IL 60606
(Name and address of agent for service)

Registrant's telephone number, including area code: (312) 917-7700

Date of fiscal year end: May 31

Date of reporting period: May 31, 2013

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget ("OMB") control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. ss. 3507.

ITEM 1. REPORTS TO STOCKHOLDERS.

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Chairman's
Letter to Shareholders

Dear Shareholders,

After nine years of serving as lead director and independent chairman of the Nuveen Fund Board, my term of office is coming to an end. It has been a privilege to use this space to communicate with you on some of the broad economic trends in the U.S. and abroad and how they are impacting the investment environment in which your funds operate. In addition, I have enjoyed offering some perspective on how your Board views the various Nuveen investment teams as they apply their investment disciplines in that investment environment.

My term has coincided with a particularly challenging period for both mutual fund sponsors and investors. Since 2000 there have been three periods of unusually strong stock market growth and two major market declines. Recent years have been characterized by a search for yield in fixed income securities to compensate for an extended period of very low interest rates. Funds are investing more in foreign and emerging markets that require extensive research capabilities to overcome the more limited transparency and higher volatility in those markets. New fund concepts often incorporate derivative financial instruments that offer efficient ways to hedge investment risk or gain exposure to selected markets. Fund trading teams operate in many new domestic and international venues with quite different characteristics. Electronic trading and global communication networks mean that fund managers must be able to thrive in financial markets that react instantaneously to newsworthy events and are more interconnected than ever.

Nuveen has committed additional resources to respond to these changes in the fund industry environment. It has added IT and research resources to assemble and evaluate the increased flow of detailed information on economies, markets and individual companies. Based on its experience during the financial crisis of 2008-09, Nuveen has expanded its resources dedicated to valuing and trading portfolio securities with a particular focus on stressed financial market conditions. It has added systems and experienced risk management professionals to work with investment teams to better help evaluate whether their funds' risk exposures are appropriate in view of the return targets. The investment teams have also reflected on recent experience to reaffirm or modify their investment disciplines. Finally, experienced professionals and IT resources have been added to address new regulatory requirements designed to better inform and protect investors. The Board has enthusiastically encouraged these initiatives.

The Nuveen Fund Board has always viewed itself as your representatives to assure that Nuveen brings together experienced people, proven technologies and effective processes designed to produce results that meet investor expectations. It is important to note that our activities are highlighted by the annual contract renewal process. Despite its somewhat formal language, I strongly encourage you to read the summary because it offers an insight into our oversight process. The report is included in the back of this or a subsequent shareholder report. The renewal process is very comprehensive and includes a number of evaluations and discussions between the Board and Nuveen during the year. The summary also describes what has been achieved across the Nuveen fund complex and at individual funds such as yours.

As I leave the chairmanship and resume my role as a member of the Board, please be assured that I and my fellow Board members will continue to hold your interests uppermost in our minds as we oversee the management of your funds and that we greatly appreciate your confidence in your Nuveen fund.

Very sincerely,

Robert P. Bremner

Chairman of the Board
July 23, 2013

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Portfolio Managers' Comments

Nuveen Georgia Dividend Advantage Municipal Fund 2 (NKG)
 Nuveen Maryland Premium Income Municipal Fund (NMY)
 Nuveen Missouri Premium Income Municipal Fund (NOM)
 Nuveen North Carolina Premium Income Municipal Fund (NNC)
 Nuveen Virginia Premium Income Municipal Fund (NPV)

Portfolio managers Daniel Close, Chris Drahn and Tom Spalding review economic and municipal market conditions at the national and state levels, key investment strategies and the twelve-month performance of these five Funds. Dan assumed portfolio management responsibility for the Nuveen Georgia and North Carolina Funds in 2007. Chris took on portfolio management responsibility for the Nuveen Missouri Fund in 2011 and Tom assumed portfolio management responsibility for the Nuveen Maryland and Virginia Funds in 2011.

FUND REORGANIZATIONS

Effective before the opening of business on July 9, 2012, certain Georgia and North Carolina funds and on August 6, 2012, certain Maryland and Virginia funds were reorganized into four of the larger-state funds included in this report as follows:

Acquired Funds	Symbol	Acquiring Fund	Symbol
Georgia Funds			
Nuveen Georgia Premium Income Municipal Fund	NPG	Nuveen Georgia Dividend Advantage Municipal Fund 2	NKG
Nuveen Georgia Dividend Advantage Municipal Fund	NZX		
Maryland Funds			
Nuveen Maryland Dividend Advantage Municipal Fund	NFM	Nuveen Maryland Premium Income Municipal Fund	NMY
Nuveen Maryland Dividend Advantage Municipal Fund 2	NZR		
Nuveen Maryland Dividend Advantage Municipal Fund 3	NWI		
North Carolina Funds			
Nuveen North Carolina Dividend Advantage Municipal Fund	NRB	Nuveen North Carolina Premium Income Municipal Fund	NNC
Nuveen North Carolina Dividend Advantage Municipal Fund 2	NNO		
Nuveen North Carolina Dividend Advantage Municipal Fund 3	NII		
Virginia Funds			
Nuveen Virginia Dividend Advantage Municipal Fund	NGB	Nuveen Virginia Premium Income Municipal Fund	NPV
Nuveen Virginia Dividend Advantage Municipal Fund 2	NNB		

Upon the closing of the reorganizations, the Acquired Funds transferred their assets to the Acquiring Funds in exchange for common and preferred shares of the Acquiring Funds and the assumption by the Acquiring Funds of the liabilities of the Acquired Funds. The Acquired Funds were then liquidated, dissolved and terminated in accordance

with their Declaration of Trust. Shareholders of the Acquired Funds became shareholders of the Acquiring Funds. Holders of common shares of the Acquired Funds received newly issued common shares of the Acquiring Funds, the aggregate net asset value of which was equal to the aggregate net asset value of the common shares of the Acquired

Certain statements in this report are forward-looking statements. Discussions of specific investments are for illustration only and are not intended as recommendations of individual investments. The forward-looking statements and other views expressed herein are those of the portfolio managers as of the date of this report. Actual future results or occurrences may differ significantly from those anticipated in any forward-looking statements, and the views expressed herein are subject to change at any time, due to numerous market and other factors. The Funds disclaim any obligation to update publicly or revise any forward-looking statements or views expressed herein.

Ratings shown are the highest rating given by one of the following national rating agencies: Standard & Poor's, Moody's Investors Service, Inc., or Fitch, Inc. Credit ratings are subject to change. AAA, AA, A, and BBB are investment grade ratings; BB, B, CCC, CC, C and D are below investment grade ratings. Certain bonds backed by U.S. government or agency securities are regarded as having an implied rating equal to the rating of such securities. Holdings designated N/R are not rated by these national rating agencies.

Funds held immediately prior to the reorganizations (including for this purpose fractional Acquiring Funds shares to which shareholders would be entitled). Fractional shares were sold on the open market and shareholders received cash in lieu of such fractional shares. Holders of MuniFund Term Preferred (MTP) Shares of the Acquired Funds received on a one-for-one basis newly issued MTP Shares of the Acquiring Funds, in exchange for their MTP Shares of the Acquired Funds held immediately prior to the reorganizations.

What factors affected the U.S. economy and the national municipal bond market during the twelve-month period ended May 31, 2013?

During this reporting period, the U.S. economy's progress toward recovery from recession continued at a moderate pace. The Federal Reserve (Fed) maintained its efforts to improve the overall economic environment by holding the benchmark fed funds rate at the record low level of zero to 0.25% that it established in December 2008. The Fed also continued its monthly purchases of \$40 billion of mortgage-backed securities and \$45 billion of longer-term Treasury securities in an open-ended effort to bolster growth. However, at its June 2013 meeting (subsequent to the end of this reporting period), the Central Bank indicated that downside risks to the economy had diminished since the fall of 2012. Although the Fed made no changes to its highly accommodative monetary policies at the June meeting, Chairman Bernanke's remarks afterward indicated the Central Bank could slow the pace of its bond buying program later this year if the economy continues to improve.

As measured by gross domestic product (GDP), the U.S. economy grew at an annualized rate of 1.8% in the first quarter of 2013, compared with 0.4% for the fourth quarter of 2012, continuing the pattern of positive economic growth for the 15th consecutive quarter. The Consumer Price Index (CPI) rose 1.4% year-over-year as of May 2013, while the core CPI (which excludes food and energy) increased 1.7% during the period, staying within the Fed's unofficial objective of 2.0% or lower for this inflation measure. Meanwhile, labor market conditions continued to slowly show signs of improvement, although unemployment remained above the Central Bank's 6.5% target. As of May 2013, the national unemployment rate was 7.6%, down from 8.2% a year ago. The housing market, long a major weak spot in the U.S. economic recovery, also delivered some good news as the average home price in the S&P/Case-Shiller Index of 20 major metropolitan areas rose 12.1% for the twelve months ended April 2013 (most recent data available at the time this report was prepared). This marked the largest twelve-month percentage gain for the index since 2006.

However, the outlook for the U.S. economy continued to be clouded by uncertainty about global financial markets and the outcome of the "fiscal cliff." The tax consequences of the fiscal cliff situation, which had been scheduled to become effective in January 2013, were averted through a last minute deal that raised payroll taxes, but left in place a number of tax breaks. However, lawmakers postponed and then failed to reach a resolution on \$1.2 trillion in spending cuts intended to address the federal budget deficit. As a result, automatic spending cuts (or sequestration) affecting both defense and non-defense programs (excluding Social Security and Medicaid) took effect March 1, 2013, with potential implications for U.S. economic growth over the next decade. In late March 2013, Congress passed legislation that established federal funding levels for the remainder of fiscal 2013, which ends on September 30, 2013, preventing a federal government shutdown. The proposed federal budget for fiscal 2014 remains under debate.

Municipal bond prices generally rallied nationally during this period, as strong demand and tight supply combined to create favorable market conditions for municipal bonds. However, the market also encountered some additional volatility generated by the political environment, particularly the fiscal cliff at the end of 2012 and the approach of federal tax season. Although the total volume of tax-exempt supply improved over that of the same period a year earlier, the issuance pattern remained light compared with long-term historical trends and new money issuance was relatively flat. This supply/demand dynamic served as a key driver of performance. At the state level, state governments in aggregate appeared to have made good progress in dealing with budget issues. On the revenue side, state tax

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collections have grown for 13 straight quarters, exceeding pre-recession levels beginning in September 2011, while on the expense side, the states made headway in cutting and controlling costs. The current low level of municipal issuance reflects the current political distaste for additional borrowing by state and local governments facing fiscal constraints and the prevalent atmosphere of municipal budget austerity. During this period, we continued to see municipal yields remain relatively low. Borrowers seeking to take advantage of the low rate environment sparked an increase in refunding activity, with approximately 50% of municipal paper issued by borrowers that were calling existing debt and refinancing at lower rates.

Over the twelve months ended May 31, 2013, municipal bond issuance nationwide totaled \$376 billion, an increase of 5.2% over the issuance for the twelve-month period ended May 31, 2012. As previously mentioned, the majority of this supply was attributable to refunding issues, rather than new money issuance. During this reporting period, demand for municipal bonds remained very strong, especially from individual investors, but also from mutual funds, banks and insurance companies.

How were the economic and market conditions in Georgia, Maryland, Missouri, North Carolina and Virginia during this reporting period?

Georgia continued to recover from the recent recession during this reporting period. In 2012, the state saw its economy expand at a rate of 2.1%, compared with the national average of 2.5%, ranking Georgia 24th in the nation in terms of GDP growth by state. Job growth has picked up pace in Georgia in recent months. As of May 2013, unemployment in Georgia was 8.3%, its lowest level since December 2008, but still higher than the national rate of 7.6%. Georgia's growth has been supported by a diverse economic base including service industries, transportation, tourism, agriculture and manufacturing. The state's transportation capabilities include one of the world's busiest airports (Hartsfield-Jackson Atlanta International Airport) and the Port of Savannah, a major east coast port facility. The deepening of the Port of Savannah in preparation for the Panama Canal's expansion is expected to lead to further growth in the state's economy by way of increasing its export business. In May 2013, Georgia adopted a \$19.9 billion state budget for fiscal 2014, increasing spending by 4.6% from fiscal 2013. As of May 2013, Georgia's general obligation debt continued to be rated Aaa and AAA with stable outlooks from both Moody's and S&P, respectively. For the twelve months ended May 31, 2013, municipal issuance in Georgia totaled \$5.2 billion, a decrease of 33% over the twelve months ended May 31, 2012.

In Maryland, the state's credit profile remains relatively strong due to sound fiscal management and a diverse economy. In 2012, Maryland's economy expanded at a rate of 2.4%, up significantly from the prior year. The national average was 2.5%, ranking Maryland 15th in the nation in terms of GDP growth by state. Job growth in health care and professional services has buoyed the market and has lowered the statewide unemployment as of May 30, 2013 to 6.7%. Employment in the manufacturing and financial services sectors continues to decline and Maryland's proximity to Washington D.C. results in a greater dependency on federal employment than most states, leaving it vulnerable to federal cost cutting and reductions in government employment. The state's largest employer is Fort George G. Meade, with more than 56,000 workers. Maryland has one of the nation's best educated workforces, which has facilitated the development of advanced technology and the growth of public and private research facilities. Combined with the influence of the government sector and the presence of 56 universities, this has made Maryland a center for national security and medical and biomedical research. Regarding the state's financial operations, Maryland passed its fiscal 2014 budget with a 3% increase in revenues and expenditures and an allocation to increase the state's rainy day fund \$921 million or 6% of budget. As of May 2013, Moody's and S&P rated Maryland general obligation debt at Aaa with a negative outlook and AAA with a stable outlook, respectively. During the twelve months ended May 31, 2013, municipal issuance in the state totaled \$7.3 billion, up 17% from the previous twelve-month period.

For 2012, the national recovery of 2.5% continued to outpace Missouri's state GDP growth of 2.0%, ranking Missouri's growth 26th among all states. Continued job losses in the government sector were offset by employment growth in the transportation, leisure and hospitality, education and health services sectors. As of May 2013, Missouri's seasonally adjusted unemployment rate was 6.8%. Missouri's overexposure to defense related manufacturing jobs continues to cause a drag on the state's recovery, but efforts to transition part of the state economy away from traditional defense related manufacturing jobs into the development of biotechnology and alternative energy industries should help diversify the economy. Governor Nixon's priority to expand exports experienced a slight step backwards with exports falling 1.4% in 2012 compared to 2011, but increases in exports to Mexico helped offset declines in exports to Canada and China. For fiscal 2014, the \$25 billion Missouri state budget, which was introduced in January 2013 and sent to the Governor for approval in May 2013, focused on Medicaid expansion, job creation, increased K-12 education funding and increased higher education funding. The Governor's budget, which contained no new taxes, also called for eliminating 190 additional state jobs, bringing total reductions to 4,500 since 2009 and resulting in the smallest state workforce since 1997. As of May 2013, Moody's and S&P rated Missouri general obligation debt at Aaa and AAA, respectively, with stable outlooks. During the twelve months ended May 31, 2013, municipal issuance in Missouri totaled \$6.2 billion, a 33.5% increase from the twelve months ended May 31, 2012.

In North Carolina, the uptick in economic growth that started at the end of 2011 has continued into 2013. In 2012, the state's economy expanded 2.7%, compared with the national average of 2.5%, ranking North Carolina 11th in the nation in terms of GDP growth by state. The state's manufacturing sector, once a leader in textiles, furniture and tobacco, is not expected to resume its role as a major driver in the North Carolina economy, as overseas competitors take the lead in those industries. However, the sector posted steady employment gains in 2012 by adding jobs in computer and electronic parts manufacturing. While North Carolina has worked to transition its economy away from old-line manufacturing into sectors oriented toward research, technology and services, manufacturing continues to represent 11% of the state's jobs. At the same time, job losses in the public sector resulting from tight state budgets finally appear to be curtailed. Two of North Carolina's top three employers include U.S. military bases (Fort Bragg and Camp Lejeune), supporting more than 110,000 workers. As of May 2013, the unemployment rate remains high at 8.8%. In the state's housing market, single-family housing permits and starts have continued to increase each quarter since mid-2011. This is driven by population growth that is outpacing the national average and healthy demographics. According to the S&P/Case-Schiller Index of 20 major metropolitan areas, housing prices in Charlotte rose 7.3% during the twelve months ended April 2013 (most recent data available at the time this report was prepared), compared with a 12.1% price increase nationally. In June 2011, North Carolina enacted a two-year budget for fiscal 2012 and 2013. The state's key revenue sources are personal income tax and sales tax collections. In fiscal 2012, personal income tax collections exceeded budget though sales tax collections lagged just slightly. As of May 2013, North Carolina is one of only eight states to carry a AAA rating by all three major rating agencies. During the twelve months ended May 31, 2013, municipal issuance in North Carolina totaled \$8.7 billion, an increase of 55% from that issued during the twelve months ended May 31, 2012.

The economic recovery in Virginia continues at a relatively slow pace. In 2012, Virginia posted growth of 1.1%, compared with the national GDP of 2.5% for 2012, which ranked Virginia 42nd in economic growth by state. However, economic indicators pointed to an economy that's still relatively healthy. As of May 2013, unemployment in the commonwealth fell to 5.3%, just above its lowest point since January 2009. Job growth in Virginia was led by the education and health services as well as transportation and utilities sectors but the looming effects of sequestration could hit this job market hard as federal employment and federal spending are well above average. Virginia continues to be a center for research and development facilities, with Richmond, Charlottesville and Northern Virginia forming a research triangle. In recent months, home prices in the Virginia area have risen. According to the S&P/Case-Shiller Index of 20 major metropolitan areas, the Washington D.C. area posted a 7.2% gain for the twelve months ended April 2013 (most

recent data available at the time this report was prepared), compared with a 12.1% rise in home prices nationally. Virginia's \$85 billion biennium budget for fiscal 2013 and 2014 was signed into law in May 2012. It included \$34.5 billion in general fund spending and several fee increases and cuts to various state services and programs. In March 2012, Virginia passed a wide ranging pension reform measure that required full funding of the Virginia retirement system within eight years, altered benefits and contribution rates and established a hybrid defined benefit/defined contribution plan for new employees. As of May 2013, Moody's and S&P rated Virginia general obligation debt at Aaa with a negative outlook and AAA with a stable outlook, respectively. During the twelve months ended May 31, 2013, issuance in Virginia totaled \$9.6 billion, an increase of 10.6% from the previous twelve months.

What key strategies were used to manage these Funds during the twelve-month reporting period ended May 31, 2013?

During this reporting period, municipal bond prices generally rallied, as strong demand and tight supply combined to create favorable market conditions for municipal bonds. However, the municipal market also encountered some additional volatility generated by the political environment, particularly the "fiscal cliff" at the end of 2012 and the approach of federal tax season. Although the total volume of tax-exempt supply improved, the issuance pattern remained light compared with long-term historical trends. This supply/demand dynamic served as a key driver of performance. Concurrent with rising prices, yields continued to decline across most maturities, especially at the longer end of the municipal yield curve. During this period, we saw an increased number of borrowers come to market seeking to take advantage of the low rate environment through refunding activity, with approximately 50% of new municipal paper issued by borrowers that were calling existing debt and refinancing at lower rates.

In this environment, we continued to take a bottom-up approach to discovering sectors that appeared undervalued as well as individual credits that had the potential to perform well over the long term. During this reporting period, NKG and NNC found value to varying degrees in several areas of the market, including health care, water and sewer bonds, as well as multi-family and airport bonds in NKG and higher education and utility bonds in NNC. NOM and NMY added local general obligations (GO) credits. NMY also added transportation and dedicated tax bonds. In NPV, we continued to add to our positions in the transportation sector, including bonds issued by the Virginia Small Business Financing Authority for the Elizabeth River Crossing. In North Carolina, the health care sector was the predominant issuer during this time, offering attractive opportunities from a number of hospitals across the state, with credit quality of A and BBB and intermediate and longer maturities.

During this period, we emphasized bonds with longer maturities. The purchase of longer maturity bonds helped to extend the Funds' durations, and enabled us to take advantage of more attractive yields at the longer end of the municipal yield curve. We also purchased lower rated bonds when we found attractive opportunities, as we believed these bonds continued to offer relative value. Our opportunities were somewhat constrained by the structure of bonds typically issued as part of refinancing deals, which tended to be characterized by shorter maturities and higher quality. During the second half of the reporting period, NMY and NPV generally focused on the shorter and intermediate end of the yield curve with the goal of positioning these two Funds slightly more conservatively.

Because the issuance of new municipal supply in the primary market continued to be sporadic, especially in Georgia and North Carolina, we looked to the secondary market as an additional source of attractive opportunities. When in-state paper was scarce, NMY also purchased territorial bonds to keep the Fund as fully invested as possible, including dedicated sales tax bonds issued by the Puerto Rico Sales Tax Financing Corporation (COFINA). These territorial bonds offered higher yields, added diversification and triple exemption (i.e., exemption from federal, state and local taxes).

Cash for new purchases during this period was generated primarily by the proceeds from an increased number of bond calls resulting from the growth in refinancings. The elevated number of bond calls provided a meaningful source of liquidity, which drove much of our activity during this period as we worked to redeploy these proceeds, as well as those from maturing bonds, to keep the Funds fully invested and support their income streams. Overall, selling was minimal.

As of May 31, 2013, all of these Funds continued to use inverse floating rate securities. We employ inverse floaters for a variety of reasons, including duration management, income enhancement and total return enhancement.

How did the Funds perform during the twelve-month reporting period ended May 31, 2013?

The tables in each Fund's Performance Overview and Holding Summaries section of this report provide total returns for the Funds for the one-year, five-year and ten-year periods ended May 31, 2013. Each Fund's total returns are compared with performance of a corresponding market index and Lipper classification average.

For the twelve-months ended May 31, 2013, the cumulative returns on common share net asset value (NAV) for NKG, NMY and NOM exceeded the returns for their respective state's S&P Municipal Bond Index as well as the national S&P Municipal Bond Index. For the same period NNC underperformed both the state and national S&P Municipal Bond Index, while NPV outperformed the state S&P Municipal Bond Index and performed in line with the national S&P Municipal Bond Index. For the same period, NOM outperformed the average return for the Lipper Other States Municipal Debt Funds Classification Average. NMY performed in line with the average return for the national S&P Municipal Bond Index and the Lipper Other States Municipal Debt Funds Classification Average, while the rest of the Funds underperformed. Shareholders should note that the performance of the Lipper Other States classification represents the overall average of returns for funds from ten states with a wide variety of municipal market conditions, making direct comparisons less meaningful.

Key management factors that influenced the Funds' returns during this period included duration and yield curve positioning, credit exposure and sector allocation.

Generally speaking, credits at the longest end of the municipal yield curve posted the strongest returns, while bonds at the shortest end produced the weakest results. Duration and yield curve positioning was a net positive contributor to the performance of these Funds. These Funds benefited from being overweight in the longer part of the yield curve that performed well. However, their performance was somewhat restrained by overweightings at the underperforming shortest end of the curve, especially in NKG.

Credit exposure was another factor in the Funds' performance during this reporting period, as lower quality bonds generally outperformed higher quality bonds. This outperformance was due in part to the greater demand for lower rated bonds as investors looked for investment vehicles offering higher yields. As investors became more comfortable taking on additional investment risk, credit spreads, or the difference in yield spreads between U.S. Treasury securities and comparable investments such as municipal bonds, narrowed through a variety of rating categories. As a result of this spread compression, the Funds generally benefited from their holdings of lower rated credits, with NKG, NMY, NOM and NPV having an overweight in bonds rated BBB. NKG and NOM were also helped by being underweighted in the underperforming AAA quality sector. NNC and NPV had a higher allocation to AAA/AA quality sectors, while NNC also had a lower allocation to the better performing BBB quality sector, which slightly detracted from performance.

During this period, revenue bonds as a whole outperformed the general municipal market. Holdings that generally made positive contributions to the Funds' returns included health care (together with hospitals), education and certain transportation bonds. In particular, NNC's overweight in toll roads was positive for performance, while NKG benefited

from its pre-paid gas credits. NOM was positively impacted by its holdings in the health care sector. During this period,

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tobacco credits backed by the 1998 master tobacco settlement agreement, as well as Puerto Rico backed tobacco credits, also performed well. NMY and NPV benefited from their holdings of tobacco credits as these bonds continued to perform well. NPV's Virginia Small Business Financing Authority for the Elizabeth River Crossing positively contributed to performance as well.

In contrast, pre-refunded bonds, which are often backed by U.S. Treasury securities, were among the poorest performing market segments during this period. The under-performance of these bonds can be attributed primarily to their shorter effective maturities and higher credit quality. NNC, NKG and NOM had a heavier weighting in pre-refunded bonds, which detracted from their performance for the period. We continued to hold these pre-refunded bonds in our portfolios due to the higher yields they provided. In addition, GO bonds lagged the performance of the general municipal market for this period. NKG benefited from being underweight GO bonds.

Shareholders also should be aware of issues impacting some of the Funds' non-state holdings. In December 2012, Moody's downgraded Puerto Rico GO bonds to Baa3 from Baa1 based on Puerto Rico's ongoing economic problems, unfunded pension liabilities, elevated debt levels and structural budget gaps. In addition, during July 2012, bonds issued by the Puerto Rico Sales Tax Financing Corporation (COFINA) also were downgraded by Moody's to Aa3 from Aa2. The downgrade of the COFINA bonds was due mainly to the performance of Puerto Rico's economy and its impact on the projected growth of sales tax revenues. In addition, the COFINA bonds were able to maintain a higher rating than the GOs because, unlike the revenue streams supporting some Puerto Rican issues, the sales taxes supporting the COFINA bonds cannot be diverted and used to support the commonwealth's GO bonds. NMY, NPV and NOM have exposure to Puerto Rico bonds, the majority of which had lower duration risk than their respective index. The Funds were also underweight their allocation to Puerto Rico bonds versus their index. As a result, the Funds' Puerto Rico holdings positively contributed to performance.

Fund Leverage

IMPACT OF THE FUNDS' LEVERAGE STRATEGIES ON PERFORMANCE

One important factor impacting the returns of all these Funds relative to the comparative indexes was the Funds' use of leverage. The Funds use leverage because their managers believe that, over time, leveraging provides opportunities for additional income and total return for common shareholders. However, use of leverage also can expose common shareholders to additional volatility. For example, as the prices of securities held by a Fund decline, the negative impact of these valuation changes on common share net asset value and common shareholder total return is magnified by the use of leverage. Conversely, leverage may enhance common share returns during periods when the prices of securities held by a Fund generally are arising. Leverage made a positive contribution to the performance of NKG, NMY, NOM and NPV, but detracted modestly from the performance of NNC over this reporting period.

As of May 31, 2013, the Funds' percentages of effective and regulatory leverage are shown in the accompanying table.

	Effective Leverage*	Regulatory Leverage*
NKG	35.27%	32.76%
NMY	34.18%	30.69%
NOM	37.15%	34.46%
NNC	37.42%	33.43%
NPV	36.23%	31.59%

* Effective Leverage is a Fund's effective economic leverage, and includes both regulatory leverage and the leverage effects of certain derivative and other investments in a Fund's portfolio that increase the Fund's investment exposure. Currently, the leverage effects of Tender Option Bond (TOB) inverse floater holdings are included in effective leverage values, in addition to any regulatory leverage. Regulatory leverage consists of preferred shares issued or borrowings of a Fund. Both of these are part of a Fund's capital structure. Regulatory leverage is sometimes referred to as "40 Act Leverage" and is subject to asset coverage limits set forth in the Investment Company Act of 1940.