

NUVEEN MARYLAND DIVIDEND ADVANTAGE MUNICIPAL FUND 3
Form N-CSR
August 05, 2011

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 811-21153

Nuveen Maryland Dividend Advantage Municipal Fund 3
(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, 2011

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.

INVESTMENT ADVISER NAME CHANGE

Effective January 1, 2011, Nuveen Asset Management, the Funds' investment adviser, changed its name to Nuveen Fund Advisors, Inc. ("Nuveen Fund Advisors"). Concurrently, Nuveen Fund Advisors formed a wholly-owned subsidiary, Nuveen Asset Management, LLC, to house its portfolio management capabilities.

NUVEEN INVESTMENTS COMPLETES STRATEGIC COMBINATION WITH FAF ADVISORS

On December 31, 2010, Nuveen Investments completed the strategic combination between Nuveen Asset Management, the largest investment affiliate of Nuveen Investments, and FAF Advisors. As part of this transaction, U.S. Bancorp – the parent of FAF Advisors – received cash consideration and a 9.5% stake in Nuveen Investments in exchange for the long-term investment business of FAF Advisors, including investment management responsibilities for the non-money market mutual funds of the First American Funds family.

The approximately \$27 billion of mutual fund and institutional assets managed by FAF Advisors, along with the investment professionals managing these assets and other key personnel, have become part of Nuveen Asset Management, LLC. With these additions to Nuveen Asset Management, LLC, this affiliate now manages more than \$100 billion of assets across a broad range of strategies from municipal and taxable fixed income to traditional and specialized equity investments.

This combination does not affect the investment objectives or strategies of the Funds in this report. Over time, Nuveen Investments expects that the combination will provide even more ways to meet the needs of investors who work with financial advisors and consultants by enhancing the multi-boutique model of Nuveen Investments, which also includes highly respected investment teams at HydePark, NWQ Investment Management, Santa Barbara Asset Management, Symphony Asset Management, Tradewinds Global Investors and Winslow Capital. Nuveen Investments managed approximately \$206 billion of assets as of March 31, 2011.

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Chairman's
Letter to Shareholders

Dear Shareholders,

In 2010, the global economy recorded another year of recovery from the financial and economic crises of 2008, but many of the factors that caused the downturn still weigh on the prospects for continued improvement. In the U.S., ongoing weakness in housing values has put pressure on homeowners and mortgage lenders. Similarly, the strong earnings recovery for corporations and banks is only slowly being translated into increased hiring or more active lending. Globally, deleveraging by private and public borrowers has inhibited economic growth and that process is far from complete.

Encouragingly, constructive actions are being taken by governments around the world to deal with economic issues. In the U.S., the recent passage of a stimulatory tax bill relieved some of the pressure on the Federal Reserve to promote economic expansion through quantitative easing and offers the promise of sustained economic growth. A number of European governments are undertaking programs that could significantly reduce their budget deficits. Governments across the emerging markets are implementing various steps to deal with global capital flows without undermining international trade and investment.

The success of these government actions could determine whether 2011 brings further economic recovery and financial market progress. One risk associated with the extraordinary efforts to strengthen U.S. economic growth is that the debt of the U.S. government will continue to grow to unprecedented levels. Another risk is that over time there could be inflationary pressures on asset values in the U.S. and abroad, because what happens in the U.S. impacts the rest of the world economy. Also, these various actions are being taken in a setting of heightened global economic uncertainty, primarily about the supplies of energy and other critical commodities. In this challenging environment, your Nuveen investment team continues to seek sustainable investment opportunities and to remain alert to potential risks in a recovery still facing many headwinds. On your behalf, we monitor their activities to assure they maintain their investment disciplines.

As you will note elsewhere in this report, on December 31, 2010, Nuveen Investments completed a strategic combination with FAF Advisors, Inc., the manager of the First American Funds. The combination adds highly respected and distinct investment teams to meet the needs of investors and their advisors and is designed to benefit all fund shareholders by creating a fund organization with the potential for further economies of scale and the ability to draw from even greater talent and expertise to meet those investor needs.

As of the end of June 2011, Nuveen Investments had completed the refinancing of all of the Auction Rate Preferred Securities issued by its taxable closed-end funds and 93% of the MuniPreferred shares issued by its tax-exempt closed-end funds. Please consult the Nuveen Investments web site, www.Nuveen.com, for the current status of this important refinancing program.

As always, I encourage you to contact your financial consultant if you have any questions about your investment in a Nuveen Fund. On behalf of the other members of your Fund Board, we look forward to continuing to earn your trust in the months and years ahead.

Sincerely,

Robert P. Bremner

Chairman of the Board
July 21, 2011

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Portfolio Manager's Comments

Nuveen Maryland Premium Income Municipal Fund (NMY)
Nuveen Maryland Dividend Advantage Municipal Fund (NFM)
Nuveen Maryland Dividend Advantage Municipal Fund 2 (NZR)
Nuveen Maryland Dividend Advantage Municipal Fund 3 (NWI)
Nuveen Virginia Premium Income Municipal Fund (NPV)
Nuveen Virginia Dividend Advantage Municipal Fund (NGB)
Nuveen Virginia Dividend Advantage Municipal Fund 2 (NNB)

Portfolio manager Tom Spalding reviews economic and municipal market conditions at the national and state levels, key investment strategies, and the twelve-month performance of the Nuveen Maryland and Virginia Funds. With 34 years of investment experience at Nuveen, Tom assumed portfolio management responsibility for these seven Funds in January 2011 from Cathryn Steeves, who managed the Funds from 2006 until December 2010.

What factors affected the U.S. economic and municipal market environments during the twelve-month reporting period ended May 31, 2011?

During this period, the U.S. economy demonstrated some signs of modest improvement, supported by the efforts of both the Federal Reserve (Fed) and the federal government. For its part, the Fed continued to hold the benchmark fed funds rate in a target range of zero to 0.25% since cutting it to this record low level in December 2008. At its June 2011 meeting (following the end of this reporting period), the central bank stated that it anticipated keeping the fed funds rate at "exceptionally low levels" for an "extended period." The Fed also completed its second round of quantitative easing with the purchase of \$600 billion in longer-term U.S. Treasury bonds. The goal of this plan was to lower long-term interest rates and thereby stimulate economic activity and create jobs. The federal government continued to focus on implementing the economic stimulus package passed in early 2009 and aimed at providing job creation, tax relief, fiscal assistance to state and local governments, and expansion of unemployment benefits and other federal social welfare programs.

In the first quarter of 2011, the U.S. economy, as measured by the U.S. gross domestic product (GDP), grew at an annualized rate of 1.9%, marking the seventh consecutive quarter of positive growth. The employment situation slowly improved, with the national jobless rate registering 9.1% in May 2011, down from 9.6% a year earlier. While the Fed's longer-term inflation expectations remained stable, inflation over this period posted its largest twelve-month gain since October 2008, as the Consumer Price Index (CPI) rose 3.6% year-over-year as of May 2011. The core CPI (which excludes food and energy) increased 1.5%, staying within the Fed's unofficial objective of 2.0% or lower for

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 manager 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.

Any reference to credit ratings for portfolio holdings denotes the highest rating assigned by a Nationally Recognized Statistical Rating Organization (NRSRO) such as Standard & Poor's (S&P), Moody's or Fitch. AAA, AA, A and BBB ratings are investment grade; BB, B, CCC, CC C, and D ratings are below investment grade. Holdings and ratings may change over time.

this measure. The housing market remained a major weak spot in the economy. For the twelve months ended April 2011 (most recent data available at the time this report was prepared), the average home price in the Standard & Poor's (S&P)/Case-Shiller Index of 20 major metropolitan areas lost 4.0%, with six of the 20 metropolitan areas hitting their lowest levels since housing prices peaked in 2006.

The municipal bond market was affected by a significant decline in new tax exempt issuance during this period. One reason for the decrease in new tax-exempt supply was the heavy issuance of taxable municipal debt in 2010 under the Build America Bond (BAB) program, which was created as part of the American Recovery and Reinvestment Act of February 2009 and expired on December 31, 2010. Between the beginning of this reporting period on June 1, 2010, and the end of the BAB program, taxable Build America Bond issuance totaled \$74.5 billion, accounting for 28% of new bonds issued in the municipal market.

After rallying strongly during the first part of the period, the municipal market suffered a reversal in mid-November 2010, due largely to investor concerns about inflation, the federal deficit, and the deficit's impact on demand for U.S. Treasury securities. Adding to this market pressure was media coverage of the strained finances of some state and local governments. As a result, money began to flow out of municipal mutual funds as yields rose and valuations declined. As we moved into the second quarter of 2011, we saw the environment in the municipal market improve.

Over the twelve months ended May 31, 2011, municipal bond issuance nationwide—both tax-exempt and taxable—totaled \$335.7 billion, a decrease of 15% compared with the issuance of the twelve-month period ended May 31, 2010. For the first five months of 2011, municipal issuance nationwide was down 50% from the first five months of 2010. This decline reflects the heavy issuance of BABs at the end of 2010, as borrowers took advantage of the program's favorable terms before its expiration at year end.

How were economic and market conditions in Maryland and Virginia during this period?

Overall, the recent recession in Maryland was less severe than in many other states, as the state's credit profile remained relatively strong due to historically sound fiscal management as well as a diverse economy. In 2010, Maryland's economy expanded at a rate of 2.9%, compared with the national growth rate of 2.6%, ranking Maryland 16th in the nation in terms of percentage GDP growth by state. As of May 2011, Maryland's unemployment rate stood at 6.8%, its lowest level since March 2009, down from 7.4% in May 2010. This was well below the national jobless rate of 9.1% for May 2011. Maryland has one of the nation's best educated workforces, which 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. In April 2011, Maryland adopted a \$14.7 billion general fund budget for fiscal 2012. The budget was balanced largely through cuts, including eliminating 450 state jobs and freezing state salaries, limiting increases in school aid to enrollment growth for both K-12 and higher education institutions, and reducing health care spending. As of May 2011, Moody's and

S&P rated Maryland general obligation debt at Aaa and AAA, respectively, with stable outlooks. During the twelve months ended May 31, 2011, municipal issuance in the state totaled \$4.9 billion, down 23% from the previous twelve-month period.

Like Maryland, Virginia's proximity to Washington D.C. and a large military presence added some stability to the commonwealth's economy during the recent recession and lessened its impact to some degree. For 2010, Virginia posted GDP growth of 2.6%, on par with the national growth rate, which ranked Virginia 20th in percentage GDP growth by state. Unemployment in the commonwealth fell from 7.0% in May 2010 to 6.0% in May 2011, its lowest point since January 2009. Virginia's economy is led by employment in the government, professional and business services, education and health services, and retail trade sectors. Virginia also continued to serve as a center for research and development facilities. Virginia was hard hit by the housing recession, especially in the Washington D.C. area, although the downturn was more muted in other areas. Recently, home prices have risen, helping to stabilize residential construction. According to the S&P/Case-Shiller home price Index, the Washington D.C. area was the only one of 20 major metropolitan areas to post a year-over-year gain for the twelve months ended April 2011 (most recent data available at the time this report was prepared), as the average home price there rose 4.0% during that time. This compared with a 4.0% decline in home prices nationally for the same period. In February 2011, Virginia approved a \$32 billion two-year general fund budget that included increased funding for higher education and a \$38 million economic development incentive package. As of May 2011, Moody's and S&P maintained their ratings on Virginia general obligation debt at Aaa and AAA, respectively, with stable outlooks. During the twelve months ended May 31, 2011, issuance in Virginia totaled \$6.2 billion, a decrease of 20% from the previous twelve months.

What key strategies were used to manage these Funds during this reporting period?

As previously mentioned, the new issue supply of tax-exempt bonds declined nationally during this period, due largely to the issuance of taxable bonds under the BAB program. The BAB program also significantly affected the availability of tax-exempt bonds in Maryland and Virginia. Between the beginning of this reporting period on June 1, 2010, and the end of the BAB program, BABs accounted for approximately 36% of municipal supply in Maryland and 33% in Virginia. Since interest payments from BABs represent taxable income, we did not view these bonds as appropriate investment opportunities for these Funds. Further compounding the supply situation was the drop-off in new municipal issuance during the first five months of 2011, when issuance in Maryland and Virginia declined 34% and 57%, respectively, from that of the same period in 2010.

In this environment of constrained tax-exempt municipal bond issuance, we continued to take a bottom-up approach to discovering undervalued sectors and individual credits with the potential to perform well over the long term. Because of the lack of supply in Maryland, we purchased some territorial bonds issued by Puerto Rico and Guam to help keep these Funds as fully invested as possible. These bonds also benefited the Funds through diversification and double exemption (i.e., exemption from both federal and state taxes). The Virginia Funds also added tobacco bonds from a recent issue backed

by the 1998 master tobacco settlement agreement, which helped to enhance the Funds' durations and yields.

During this period, the Funds generally focused on bonds with maturities of 25 years and longer in order to take advantage of attractive yields at the longer end of the municipal yield curve. The purchase of longer maturity bonds also provided some protection for the Funds' duration and yield curve positioning in the event that the BAB program was extended and continued to have an impact on tax-exempt issuance, especially at the long end of the curve.

Cash for new purchases during this period was generated primarily by the proceeds from bond calls and maturing bonds, which we worked to redeploy to keep the Funds fully invested. In general, selling was minimal because of the challenge of finding appropriate tax-exempt paper.

As of May 31, 2011, all of these Funds continued to use inverse floating rate securities. We employ inverse floaters as a form of leverage for a variety of reasons, including duration management, income enhancement and total return enhancement.

How did the Funds perform?

Individual results for the Nuveen Maryland and Virginia Funds, as well as relevant index and peer group information, are presented in the accompanying table.

Average Annual Total Returns on Common Share Net Asset Value
For periods ended 5/31/11

	1-Year	5-Year	10-Year
Maryland Funds			
NMY	2.53%	4.81%	5.95%
NFM	1.73%	4.37%	5.76%
NZR	1.59%	4.29%	N/A
NWI	1.96%	4.74%	N/A
Standard & Poor's (S&P) Maryland Municipal Bond Index¹			
	3.17%	4.62%	4.89%
Standard & Poor's (S&P) National Municipal Bond Index²			
	3.17%	4.46%	5.02%
Lipper Other States Municipal Debt Funds Average³			
	2.49%	4.18%	5.60%
Virginia Funds			
NPV	3.48%	4.71%	5.68%
NGB	2.86%	4.05%	5.87%
NNB	2.59%	4.28%	N/A
Standard & Poor's (S&P) Virginia Municipal Bond Index¹			
	3.21%	4.35%	4.90%
Standard & Poor's (S&P) National Municipal Bond Index²			
	3.17%	4.46%	5.02%
Lipper Other States Municipal Debt Funds Average³			
	2.49%	4.18%	5.60%

Past performance is not predictive of future results. Current performance may be higher or lower than the data shown. Returns do not reflect the deduction of taxes that shareholders may have to pay on Fund distributions or upon the sale of Fund shares.

For additional information, see the individual Performance Overview for your Fund in this report.

- 1 The Standard & Poor's (S&P) Municipal Bond Indexes for Maryland and Virginia are unleveraged, market value-weighted indexes designed to measure the performance of the tax-exempt, investment-grade Maryland and Virginia municipal bond markets, respectively. These indexes do not reflect any initial or ongoing expenses and are not available for direct investment.
 - 2 The Standard & Poor's (S&P) National Municipal Bond Index is an unleveraged, market value-weighted index designed to measure the performance of the tax- exempt, investment-grade U.S. municipal bond market. This index does not reflect any initial or ongoing expenses and is not available for direct investment.
 - 3 The Lipper Other States Municipal Debt Funds Average is calculated using the returns of all closed-end funds in this category for each period as follows: 1-year, 46 funds; 5- year, 46 funds; and 10-year, 27 funds. Lipper returns account for the effects of management fees and assume reinvestment of dividends, but do not reflect any applicable sales charges. The Lipper average is not available for direct investment. Shareholders should note that the performance of the Lipper Other States category represents the overall average of returns for funds from ten different states with a wide variety of municipal market conditions, which may make direct comparisons less meaningful.
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For the twelve months ended May 31, 2011, the total return on common share net asset value (NAV) for NPV exceeded the returns for the Standard & Poor's (S&P) Virginia Municipal Bond Index and the Standard & Poor's (S&P) National Municipal Bond Index, while the remaining Maryland and Virginia Funds underperformed the returns for their respective state's S&P Municipal Bond Index as well as the S&P National Municipal Bond Index. For the same period, NMY, NPV, NGB and NNB outperformed the average return for the Lipper Other States Municipal Debt Funds Average, while NFM, NZR and NWI lagged this benchmark.

Key management factors that influenced the Funds' returns during this period included duration and yield curve positioning, credit exposure and sector allocation. The use of leverage also had an impact on the Funds' performance. Leverage is discussed in more detail on page 10.

During this period, municipal bonds with intermediate maturities generally outperformed other maturity categories, with credits at both the shorter and longer ends of the yield curve posting weaker returns. Overall, duration and yield curve positioning was a positive contributor to the performance of these Funds. All of the Funds had good exposure to the intermediate parts of the yield curve that performed best, with NPV being the most advantageously positioned for the market environment of the past twelve months.

Credit exposure also played a role in performance. During the market reversal of late 2010, as redemption activity in high-yield funds increased and risk aversion mounted, lower-rated credits were negatively impacted. For the period as a whole, bonds rated BBB typically underperformed those rated AAA. In this environment, the Funds' performance generally benefited from their allocations to higher quality credits. As of May 31, 2011, NMY had the heaviest exposure to AAA rated bonds and a correspondingly lower weighting in bonds rated BBB, while NFM had the largest allocation to bonds rated BBB among all of these Funds, which restrained its performance during this period.

Holdings that generally made positive contributions to the Funds' returns during this period included general obligation (GO) and other tax-supported bonds, housing credits and resource recovery bonds. The electric utilities, water and sewer, and leasing sectors also outperformed the municipal market as a whole. All of these Funds were underweighted in the tax-supported sector, specifically in state GOs, which restricted their ability to participate in the rally of this sector.

In contrast, the industrial development revenue, health care and transportation sectors turned in relatively weaker performance. NFM, NZR, NWI and NNB had the heaviest weightings in the health care sector (20% or higher), which hurt their performance. The Maryland Funds tended to be underweighted in transportation, which lessened the

negative impact of these holdings, while transportation was neutral for the Virginia Funds, which had heavier concentrations in bonds issued for Washington Dulles International Airport, the Dulles tollroad, and the airport's new AeroTrain people mover system.

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. This is what happened in these Funds during the period, as the use of leverage hurt their overall performance.

RECENT DEVELOPMENTS REGARDING THE FUNDS' REDEMPTION OF AUCTION RATE PREFERRED SHARES

Shortly after their respective inceptions, each of the Funds issued auction rate preferred shares (ARPS) to create structural leverage. As noted in past shareholder reports, the ARPS issued by many closed-end funds, including these Funds, have been hampered by a lack of liquidity since February 2008. Since that time, more ARPS have been submitted for sale in each of their regularly scheduled auctions than there have been offers to buy. In fact, offers to buy have been almost completely nonexistent since late February 2008. This means that these auctions have "failed to clear," and that many, or all, of the ARPS shareholders who wanted to sell their shares in these auctions were unable to do so. This lack of liquidity in ARPS did not lower the credit quality of these shares, and ARPS shareholders unable to sell their shares continued to receive distributions at the "maximum rate" applicable to failed auctions, as calculated in accordance with the pre-established terms of the ARPS. In the recent market, with short term rates at multi-generational lows, those maximum rates also have been low. One continuing implication for common shareholders from the auction failures is that each Fund's cost of leverage likely has been incrementally higher at times than it otherwise might have been had the auctions continued to be successful. As a result, each Fund's common share earnings likely have been incrementally lower at times than they otherwise might have been.

As noted in past shareholder reports, the Nuveen funds' Board of Directors/Trustees authorized several methods that can be used separately or in combination to refinance a portion

