

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

MUNIENHANCED FUND INC  
Form N-CSR  
March 27, 2003

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 811-5739

Name of Fund: MuniEnhanced Fund, Inc.

Fund Address: P.O. Box 9011  
Princeton, NJ 08543-9011

Name and address of agent for service: Terry K. Glenn, President, MuniEnhanced  
Fund, Inc., 800 Scudders Mill Road, Plainsboro, NJ 08536. Mailing  
address: P.O. Box 9011, Princeton, NJ 08543-9011

Registrant's telephone number, including area code: (609) 282-2800

Date of fiscal year end: 01/31/03

Date of reporting period: 02/01/02 - 1/31/03

Item 1 - Attach shareholder report

[LOGO] Merrill Lynch Investment Managers

Annual Report  
January 31, 2003

MuniEnhanced  
Fund, Inc.

[www.mlim.ml.com](http://www.mlim.ml.com)

MuniEnhanced Fund, Inc.

The Benefits and  
Risks of Leveraging

MuniEnhanced Fund, Inc. utilizes leveraging to seek to enhance the yield and net asset value of its Common Stock. However, these objectives cannot be achieved in all interest rate environments. To leverage, the Fund issues Preferred Stock, which pays dividends at prevailing short-term interest rates, and invests the proceeds in long-term municipal bonds. The interest earned on these investments is paid to Common Stock shareholders in the form of dividends, and the value of these portfolio holdings is reflected in the per share net asset value of the Fund's Common Stock. However, in order to benefit Common Stock shareholders, the yield curve must be positively sloped; that is, short-term interest rates must be lower than long-term interest rates. At the same time, a period of generally declining interest rates will benefit Common Stock shareholders. If either of these conditions change, then the risks of leveraging will begin to outweigh the benefits.

## Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

To illustrate these concepts, assume a fund's Common Stock capitalization of \$100 million and the issuance of Preferred Stock for an additional \$50 million, creating a total value of \$150 million available for investment in long-term municipal bonds. If prevailing short-term interest rates are approximately 3% and long-term interest rates are approximately 6%, the yield curve has a strongly positive slope. The fund pays dividends on the \$50 million of Preferred Stock based on the lower short-term interest rates. At the same time, the fund's total portfolio of \$150 million earns the income based on long-term interest rates. Of course, increases in short-term interest rates would reduce (and even eliminate) the dividends on the Common Stock.

In this case, the dividends paid to Preferred Stock shareholders are significantly lower than the income earned on the fund's long-term investments, and therefore the Common Stock shareholders are the beneficiaries of the incremental yield. However, if short-term interest rates rise, narrowing the differential between short-term and long-term interest rates, the incremental yield pickup on the Common Stock will be reduced or eliminated completely. At the same time, the market value on the fund's Common Stock (that is, its price as listed on the New York Stock Exchange), may, as a result, decline. Furthermore, if long-term interest rates rise, the Common Stock's net asset value will reflect the full decline in the price of the portfolio's investments, since the value of the fund's Preferred Stock does not fluctuate. In addition to the decline in net asset value, the market value of the fund's Common Stock may also decline.

As a part of its investment strategy, the Fund may invest in certain securities whose potential income return is inversely related to changes in a floating interest rate ("inverse floaters"). In general, income on inverse floaters will decrease when short-term interest rates increase and increase when short-term interest rates decrease. Investments in inverse floaters may be characterized as derivative securities and may subject the Fund to the risks of reduced or eliminated interest payments and losses on invested principal. In addition, inverse floaters have the effect of providing investment leverage and, as a result, the market value of such securities will generally be more volatile than that of fixed rate, tax-exempt securities. To the extent the Fund invests in inverse floaters, the market value of the Fund's portfolio and the net asset value of the Fund's shares may also be more volatile than if the Fund did not invest in these securities.

### Swap Agreements

The Fund may also invest in swap agreements, which are over-the-counter contracts in which one party agrees to make periodic payments based on the change in market value of a specified bond, basket of bonds, or index in return for periodic payments based on a fixed or variable interest rate or the change in market value of a different bond, basket of bonds or index. Swap agreements may be used to obtain exposure to a bond or market without owning or taking physical custody of securities.

MuniEnhanced Fund, Inc., January 31, 2003

### TO OUR SHAREHOLDERS

For the year ended January 31, 2003, the Common Stock of MuniEnhanced Fund, Inc. had a net annualized yield of 5.99%, based on a year-end per share net asset value of \$11.65 and \$.698 per share income dividends. Over the same period, the total investment return on the Fund's Common Stock was +8.62%, based on a change in per share net asset value from \$11.43 to \$11.65, and assuming reinvestment of

## Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

\$.696 per share ordinary income dividends. For the six months ended January 31, 2003, the Fund's Common Stock had a total investment return of +3.61%, based on change in per share net asset value from \$11.61 to \$11.65, and assuming reinvestment of \$.348 per share income dividends.

For the six-month period ended January 31, 2003, the Fund's Preferred Stock had an average dividend yield as follows: Series A, 1.34%; Series B, 2.03%; and Series C, 1.26%.

### The Municipal Market Environment

During the six-month period ended January 31, 2003, long-term fixed income interest rates continued to move lower. As they had in 2002, declining U.S. equity markets and escalating worldwide political tensions easily overshadowed the incipient U.S. economic recovery, allowing bond yields to fall to recent historical lows. Economic releases, such as national employment and purchasing manager surveys, were generally weak early in the period. Additionally, at its August 2002 meeting, the Federal Reserve Board indicated that concerns about future economic weakness outweighed those of rising inflation. This signaled that the Federal Reserve Board was more likely to continue to lower short-term interest rates to boost economic activity rather than to raise them to reduce inflationary pressures. These factors combined to generate a very favorable fixed income environment during August and September 2002. The dramatic decline in equity values in late August and September triggered a significant fixed income rally as investors sought the safe-haven status of U.S. Treasury issues. By the end of September, U.S. Treasury bond yields had fallen to 4.65%.

Bolstered by an unexpected decline in the national unemployment rate to 5.6% in early October, U.S. equity markets staged a strong rally throughout much of the month. The Standard & Poor's 500 (S&P 500) Index rose over 8% for October, triggered by stronger-than-expected earnings reports from a large number of companies, such as General Electric Company, International Business Machines Corporation and Microsoft Corporation. As they have throughout most of the period, bond prices traded in an inverse relationship to equity prices. Consequently, as stocks rallied, bond yields rose in October, despite generally weak economic releases. During October, the U.S. housing sector remained quite robust, but retail sales and industrial production slowed. Fixed income bond yields remained under pressure in November as U.S. equity markets continued to strengthen. During November, the S&P 500 Index rose an additional 5.5%. Equity prices were supported by further signs of U.S. economic recovery, especially improving labor market activity. By the end of November, third quarter gross domestic product growth was 4%. Financial conditions were also strengthened by a larger-than-expected reduction in short-term interest rates by the Federal Reserve Board in early November. The Federal Funds target rate was lowered 50 basis points (.50%) to 1.25%, its lowest level since the 1960s. Recent action by the Federal Reserve Board was largely viewed as being taken to bolster the sputtering U.S. economic recovery. Rebounding U.S. equity markets and the prospects for a more substantial U.S. economic recovery pushed long-term U.S. Treasury yield levels to 5.10% by late November.

In December 2002 and January 2003, softer equity prices and renewed investor concerns about potential military action against Iraq and nuclear tensions in North Korea again pushed bond prices higher. The S&P 500 Index declined more than 5% in December on disappointing earnings reports and anticipated weak holiday retail sales. During January, the S&P 500 Index declined an additional 2.5% as businesses tried to scale back analysts' expectations of future earnings. In early 2003, investors again sought the safety of U.S. Treasury securities. U.S. Treasury bond yields declined more than 25 basis points in December and January to end the period at approximately 4.85%. Over the last six months, U.S. Treasury bond yields fell more than 45 basis points.

For the six-month period ended January 31, 2003, tax-exempt bond prices also

## Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

generally rose. In recent months, municipal bond yields have declined in response to the positive fixed income environment engendered by falling equity valuations. Price advances in tax-exempt issues have not been able to keep pace with U.S. Treasury bond price improvement as municipal bonds cannot offer foreign investors the safe-haven status U.S. Treasury obligations enjoy in periods of economic and political instability. Additionally, tax-exempt bond issuance increased dramatically in the last half of 2002, removing some of the positive technical support the municipal bond market enjoyed earlier in 2002. At the end of January 2003, long-term municipal bond yields, as measured by the Bond Buyer Revenue Bond Index, stood at 5.34%, a decline of approximately 15 basis points during the last six months.

Investor demand for tax-exempt products remained positive throughout the period. In addition to the approximately \$75 billion investors received from June to August 2002 from bond maturities, coupon income and proceeds from early redemptions, investors also received approximately \$30 billion from these sources in January 2003. The Investment Company Institute reported that in 2002 municipal bond funds net cash flows were very positive at more than \$16 billion, an increase of over 40% compared to 2001. However, these positive demand factors have not been able to offset the increase in tax-exempt new-issue supply that has resulted in the underperformance seen in recent months. This price underperformance served to make municipal bonds a particularly attractive purchase relative to their taxable counterparts. Throughout most of the yield curve, municipal bonds have been available for purchase at yields near or exceeding those of comparable U.S. Treasury issues. Compared to their recent historical averages of 82% - 88% of U.S. Treasury yields, municipal bond yield ratios in their current 95% - 105% range are likely to prove attractive to long-term investors.

Continued uncertainty regarding the pace of the current U.S. economic recovery as well as the resolution of the U.N./Iraq confrontation are likely to keep interest rates near their present levels for the immediate future. Equity market declines over the past three years have helped push interest rates lower than economic fundamentals alone would support. When U.S. business conditions improve and equity markets stabilize, any associated interest rate increases should not be extreme. Inflationary pressures are negligible and any move by the Federal Reserve Board to raise short-term interest rates is unlikely before late 2003. As equity valuations are likely to only gradually improve, the U.S. economic recovery is also likely to be a moderate process. This suggests that the pace of any interest rate increases will also be gradual. As the municipal bond market's strong technical position can be expected to remain supportive in the coming months, future tax-exempt interest rate increases should be more restrained than their taxable counterparts.

### Portfolio Strategy

For the six-month period ended January 31, 2003, we maintained the Fund's fully invested position and strong credit profile in an effort to seek to enhance shareholder income. Our strategy focused on remaining in a modestly defensive structure by investing primarily in premium coupon issues and intermediate maturities. We concentrated new purchases on premium coupon bonds in the 20-year - 25-year maturity range. These maturities offered approximately 95% of maximum yield available in the entire municipal yield curve with less interest rate volatility than that associated with longer maturity bonds. Because of the steepness of the municipal bond yield curve, purchases of shorter maturity bonds would result in a significant yield sacrifice. We adopted this strategy in recognition of relatively low nominal municipal yields against a backdrop of a cautious economic environment. At the end of the six-month period, 98.4% of the Fund's assets were invested in securities rated A or better and more than 85% of the Fund's assets were invested in securities insured by AAA-rated municipal bond insurers.

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

2 & 3

MuniEnhanced Fund, Inc., January 31, 2003

During the period, the Fund's borrowing costs were very low, at approximately 1.5%. These levels, in combination with a steep tax-exempt yield curve, provided a generous income benefit to the Common Stock shareholders from the leveraging of the Preferred Stock. Further material declines in short-term interest rates would require significant easing of monetary policy by the Federal Reserve Board. While such action is not expected, neither is a material increase in short-term interest rates. We believe that the Fund's short-term borrowing costs should remain at current levels for the foreseeable future. However, should the spread between short-term and long-term interest rates narrow, the benefits of leveraging will decline and, as a result, reduce the yield on the Fund's Common Stock. (For a more complete explanation of the benefits and risks of leveraging, see page 1 of this report to shareholders.)

Despite significant monetary and fiscal stimuli, the U.S. economy is facing considerable uncertainty. International economic weakness has also contributed, with the potential conflict in Iraq weighing on the domestic economy and future fiscal considerations. Consequently, we expect to retain the Fund's current stance for the immediate future. Looking ahead, we intend to remain essentially fully invested and maintain the Fund's current high credit quality profile. We will continue to seek opportunities in the new-issue market to purchase premium coupon issues. However, should the economic outlook brighten, we will adjust the portfolio to become more defensive.

In Conclusion

We appreciate your ongoing interest in MuniEnhanced Fund, Inc., and we look forward to assisting you with your financial needs in the months and years ahead.

Sincerely,

/s/ Terry K. Glenn

Terry K. Glenn  
President and Director

/s/ Kenneth A. Jacob

Kenneth A. Jacob  
Senior Vice President

/s/ John M. Loffredo

John M. Loffredo  
Senior Vice President

/s/ Michael Kalinoski

Michael Kalinoski  
Vice President and Portfolio Manager

March 5, 2003

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

SCHEDULE OF INVESTMENTS

(in Thousands)

STATE	S&P Ratings+	Moody's Ratings+	Face Amount	Issue
Alabama--1.7%	AAA	NR*	\$ 3,000	Birmingham, Alabama, Capital Improvement GO, Series A, 5.55% due 8/01/2021 (f)
	AAA	Aaa	2,500	Huntsville, Alabama, Health Care Authority Care Facilities Revenue Bonds, Series B due 6/01/2004 (f) (g)
Alaska--2.6%	AAA	Aaa	3,285	Alaska Energy Authority, Power Revenue Bonds (Bradley Lake), Fourth Series, 6%
	AA+	NR*	5,000	Valdez, Alaska, Marine Terminal Revenue Bonds (Sohio Pipeline--British Petroleum) due 12/01/2025
California--6.1%	AAA	Aaa	5,000	Anaheim, California, Public Financing Authority Revenue Bonds (Public Improvements Project Senior-Series A, 6% due 9/01/2024 (d)
	AAA	NR*	3,755	California Rural Home Mortgage Finance S/F Mortgage Revenue Bonds, AMT, Series due 6/01/2031 (c)
	BBB+	A3	1,800	California State, Department of Water Resources Power Supply Revenue Bonds, Series A, 5% due 5/01/2022
	A	A1	3,000	Golden State Tobacco Securitization Corporation California, Tobacco Settlement Revenue Series 2003-A-1, 6.75% due 6/01/2039
	AAA	Aaa	1,595	San Diego, California, Unified School District Election 1998, GO, Series D, 5.25% due
	AAA	Aaa	4,210	San Francisco, California, City and County Commission, International Airport Revenue AMT, Second Series, Issue 6, 6.60% due
Colorado--18.0%	AAA	Aaa	400	Adams County, Colorado, School District 501 GO (Adams 12 Five Star Schools), Series due 12/15/2022 (d)
	AA	NR*	2,705	Boulder County, Colorado, Hospital Development Revenue Bonds (Longmont United Hospital) 5.60% due 12/01/2015
	AA	NR*	2,135	5.75% due 12/01/2020

Portfolio Abbreviations

To simplify the listings of MuniEnhanced Fund, Inc.'s portfolio holdings in the Schedule of Investments, we have abbreviated the names of many of the securities according to the list below and at right.

- AMT Alternative Minimum Tax (subject to)
- COP Certificates of Participation
- DRIVERS Derivative Inverse Tax-Exempt Receipts
- EDA Economic Development Authority
- GO General Obligation Bonds
- HDA Housing Development Authority
- HFA Housing Finance Agency

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

IDA Industrial Development Authority  
 PCR Pollution Control Revenue Bonds  
 RIB Residual Interest Bonds  
 RITR Residual Interest Trust Receipts  
 S/F Single-Family

4 & 5

MuniEnhanced Fund, Inc., January 31, 2003

SCHEDULE OF INVESTMENTS (continued)

(in Thousands)

STATE	S&P Ratings+	Moody's Ratings+	Face Amount	Issue
Colorado (concluded)	AAA	NR*	\$ 2,130	Boulder County, Colorado, Sales and Use Space Revenue Bonds, Series A, 6% due 1
	AAA	Aaa	500	Broomfield, Colorado, COP, Refunding, 5 due 12/01/2024 (a)
	NR*	Aa2	865	Colorado HFA, Revenue Bonds (S/F Progra AMT, Senior Series A-1, 7.40% due 11/01
	NR*	Aa2	3,665	Colorado HFA, Revenue Refunding Bonds (
	AA	Aa2	3,155	AMT, Senior Series A-2, 7.50% due
	NR*	Aa2	3,300	AMT, Series D-2, 6.90% due 4/01/20 Senior Series A-3, 6.05% due 10/01
	AA	Aa2	1,800	Colorado Health Facilities Authority Re Series A: (Catholic Health Initiatives), 5.5
	AA	NR*	1,200	(Covenant Retirement Communities), due 12/01/2027
	AA	NR*	675	(Covenant Retirement Communities), 12/01/2033 (1)
	NR*	Aa2	7,025	Colorado Housing and Finance Authority DRIVERS, AMT, Series 251, 12.10% due 4/
	AAA	Aaa	4,280	Colorado Water Resource Power Developme Clean Water Revenue Bonds, Series A, 6.
	AAA	Aaa	11,000	Denver, Colorado, City and County Airpo AMT, Series D, 7.75% due 11/15/2013 (f)
	AAA	Aaa	2,000	Denver, Colorado, City and County Airpo Refunding Bonds, AMT, Series A, 6% due
	AAA	Aaa	5,450	El Paso County, Colorado, School Distri Falcon, GO, Series A, 6% due 12/01/2018
	AAA	Aaa	1,900	Northwest Parkway, Colorado, Public Hig Revenue Bonds, Series A, 5.50% due 6/15
Connecticut--1.1%	AAA	Aaa	3,500	Connecticut State Special Tax Obligatio 6.25% due 10/01/2004 (b) (g)
Delaware--0.7%	AAA	Aaa	2,000	Delaware Transportation Authority, Tran Revenue Bonds, 7% due 7/01/2004 (b) (g)
District of Columbia--1.8%	AAA	Aaa	5,150	District of Columbia, GO, Refunding, DR 9.527% due 6/01/2013 (d) (h)
Georgia--5.2%	AAA	Aaa	1,500	Atlanta, Georgia, Airport Revenue Refun Series A, 5.60% due 1/01/2030 (b) Georgia Municipal Electric Authority, P

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

				Refunding Bonds:
	AAA	Aaa	7,725	Series EE, 7% due 1/01/2025 (a)
	AAA	Aaa	340	Series V, 6.60% due 1/01/2018 (f)
	AAA	Aaa	940	Series W, 6.60% due 1/01/2018 (f)
	AAA	Aaa	60	Series W, 6.60% due 1/01/2018 (f)
	AAA	NR*	700	Series Z, 5.50% due 1/01/2020 (f)
	AAA	Aaa	3,500	Metropolitan Atlanta, Georgia, Rapid Tr Sales Tax Revenue Bonds, Second Indenture 6.90% due 7/01/2004 (f) (g)
=====				
Hawaii--0.3%	AAA	Aaa	1,105	Hawaii State Department of Budget and F Purpose Mortgage Revenue Bonds (Hawaii Company, Inc. Project), AMT, Series C, due 12/01/2020 (f)
=====				
Illinois--14.2%	NR*	Aaa	5,125	Chicago, Illinois, Board of Education, 10.06% due 12/01/2027 (a) (h)
	AAA	Aaa	3,750	Chicago, Illinois, Gas Supply Revenue R (People's Gas, Light & Coke), Series A, due 6/01/2025 (a)
	AAA	NR*	4,550	Chicago, Illinois, O'Hare International Refunding Bonds, DRIVERS, AMT, Series 2 due 1/01/2021 (f) (h)
	AAA	Aaa	3,000	Cook County, Illinois, Capital Improvem 5.50% due 11/15/2026 (a)
	AAA	Aaa	2,240	Cook County, Illinois, Community Colleg Chicago, COP, Refunding, 8.75% due 1/01
	AAA	Aaa	3,000	Illinois Health Facilities Authority, R Bonds (Servantcor Project), Series A, 6 due 8/15/2006 (d) (g)
	NR*	Aaa	4,505	McHenry County, Illinois, Community Con District Number 047, Crystal Lake, GO, due 2/01/2019 (d)
	AAA	Aaa	3,000	Metropolitan Pier and Exposition Author Dedicated State Tax Revenue Refunding B Place Expansion), Series B, 5.75% due 6
	NR*	Aaa	1,000	Ogle Lee and De Kalb Counties, Illinois School District Number 212, GO (f): 6% due 12/01/2016
	NR*	Aaa	1,340	6% due 12/01/2019
	AAA	Aaa	10,115	Regional Transportation Authority, Illi Series A, 7.20% due 11/01/2020 (a)
=====				
Indiana--2.5%	AAA	Aaa	2,500	Brownsburg, Indiana, School Building Co Mortgage Revenue Bonds (Brownsburg Comm 5.55% due 2/01/2024 (f)
	AAA	Aaa	4,080	Hammond, Indiana, Multi-School Building First Mortgage Revenue Refunding Bonds, due 7/15/2019 (f)
	AAA	Aaa	1,000	New Albany, Floyd County, Indiana, Firs Revenue Bonds (School Building Corporat due 7/15/2020 (b)
=====				
Kansas--9.3%	NR*	Aaa	14,740	Kansas City, Kansas, Utility System, Re Bonds, RITR, Series 1, 11.12% due 9/01/
	NR*	Aaa	1,715	Kansas State Development Finance Author Bonds (Public Water Supply Revolving Lo 2, 5.75% due 4/01/2015 (a)
	NR*	Aaa	1,985	Sedgwick and Shawnee Counties, Kansas, Bonds, AMT (e): (Mortgage-Backed Securities Progra 7.60% due 12/01/2031 (f)

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

	NR*	Aaa	2,480	Series A-1, 6.875% due 12/01/2026
	AAA	Aaa	4,125	Series A-1, 6.875% due 12/01/2026
	AAA	Aaa	2,500	Wamego, Kansas, PCR, Refunding (Kansas Electric Company Project), 7% due 6/01/2026
Louisiana--2.1%	AAA	Aaa	6,000	Louisiana Local Government, Environment Community Development Authority Revenue (Capital Projects and Equipment Acquisition), 6.30% due 7/01/2030 (a)
Massachusetts--0.9%	AAA	Aaa	850	Massachusetts State, GO, Refunding, Common Series D, 5.375% due 8/01/2022 (f)
	AAA	Aaa	1,970	Massachusetts State Port Authority, Special Revenue Bonds (Delta Air Lines Inc. Project), Series A, 5.50% due 1/01/2019 (a)

6 & 7

MuniEnhanced Fund, Inc., January 31, 2003

SCHEDULE OF INVESTMENTS (continued)

(in Thousands)

STATE	S&P Ratings+	Moody's Ratings+	Face Amount	Issue
Michigan--3.1%	AAA	NR*	\$ 2,200	Michigan Higher Education Student Loan Student Loan Revenue Refunding Bonds, Series XVII-G, 5.20% due 9/01/2020 (a)
	AAA	Aaa	1,500	Michigan State Strategic Fund, Limited Revenue Refunding Bonds (Detroit Edison Project) (m): 5.45% due 9/01/2029
	AAA	Aaa	2,500	AMT, Series C, 5.65% due 9/01/2029
	AAA	Aaa	4,300	AMT, Series C, 5.45% due 12/15/2030
Minnesota--2.7%	AAA	NR*	5,840	Minneapolis and St. Paul, Minnesota, Metropolitan Airports Commission, Airport Revenue Bonds, Series AMT, Series 203, 10.01% due 1/01/2012 (a)
	AAA	Aaa	1,100	Minnesota State Retirement System, Building Bonds: 5.80% due 6/01/2020
	AAA	Aaa	1,000	5.875% due 6/01/2022
Mississippi--0.8%	AAA	Aaa	2,400	Walnut Grove, Mississippi, Correctional Institute, Series 6% due 11/01/2019 (a)
Missouri--1.5%	AAA	Aaa	3,000	Kansas City, Missouri, Airport Revenue Bonds, Series B, 6.875% due 9/01/2026
	AAA	NR*	1,560	Missouri State Housing Development Commission, Mortgage Revenue Bonds (Homeowner Loan Program), Series C-1, 7.15% due 3/01/2032 (c)
Montana--0.7%	AAA	Aaa	2,185	Forsyth, Montana, PCR, Refunding (Puget Sound and Light Company), AMT, 7.25% due 8/01/2026

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

Nebraska--0.5%	A+	A1	1,700	Washington County, Nebraska, Wastewater Revenue Bonds (Cargill Inc. Project), A due 11/01/2027
Nevada--4.3%	AAA	Aaa	750	Director of State, Nevada, Department of Industry Revenue Bonds (Las Vegas Monorail Project), First Tier, 5.625% due 1/01/2027
	AAA	Aaa	10,450	Washoe County, Nevada, Gas and Water Facilities Revenue Refunding Bonds (Sierra Pacific Power Company), 6.30% due 12/01/2014 (a)
	AAA	Aaa	3,000	Washoe County, Nevada, Water Facility Revenue Bonds (Sierra Pacific Power Company), A due 6/01/2017 (f)
New Hampshire--3.1%	AAA	Aaa	7,390	New Hampshire Health and Education Facilities Revenue Bonds (Dartmouth-Hitchcock Obligation), 5.50% due 8/01/2027 (d)
	AAA	Aaa	2,650	New Hampshire State Business Finance Authority Refunding (Public Service Company of New Hampshire Project), Series C, 5.45% due 5/01/2021
New Jersey--1.8%	AAA	Aaa	2,590	New Jersey State Housing and Mortgage Finance Home Buyer Revenue Bonds, AMT, Series K due 10/01/2026 (f)
	AAA	Aaa	1,440	New Jersey State Transportation Trust Refunding Series B, 6% due 12/15/2011 (g)
	A	A1	2,000	Tobacco Settlement Financing Corporation Asset-Backed Revenue Refunding Bonds, 6% due 6/01/2042
New Mexico--0.7%	AAA	Aaa	2,300	Santa Fe, New Mexico, Revenue Bonds, 6.6% due 6/01/2004 (a) (g)
New York--8.7%	AAA	A2	1,500	New York City, New York, GO: DRIVERS, Series 194, 10.06% due 2/15/2027 (m)
	AAA	Aaa	1,000	Series E, 5.875% due 8/01/2013 (m)
	AAA	Aaa	3,290	Series E, 5.75% due 5/15/2018 (m)
	AAA	Aaa	1,000	Series G, 6% due 10/15/2016 (m)
	AAA	Aaa	4,000	Series I, 6.25% due 4/15/2027 (m)
	AAA	Aaa	4,000	New York City, New York, GO, Refunding: Series A, 6.375% due 5/15/2013 (b)
	AAA	Aaa	3,995	Series A, 6.375% due 5/15/2014 (b)
	AAA	Aaa	5,000	Series A, 6.375% due 5/15/2015 (b)
	AAA	Aaa	2,000	Series L, 5.75% due 8/01/2013 (m)
North Carolina--2.4%	AAA	Aaa	7,000	North Carolina, Eastern Municipal Power Generation System Revenue Refunding Bonds, Series S, 6.125% due 1/01/2009 (f)
Ohio--0.8%	AAA	Aaa	2,500	North Canton, Ohio, City School District Revenue Bonds due 12/01/2004 (a) (g)
Pennsylvania--4.4%	AAA	Aaa	600	Allegheny County, Pennsylvania, Sanitation Sewer Revenue Bonds, 5.50% due 12/01/2020
	AAA	Aaa	6,500	Philadelphia, Pennsylvania, Authority for Economic Development, Lease Revenue Bonds, Series A due 10/01/2020 (d)
	AAA	Aaa	4,500	Philadelphia, Pennsylvania, School District Refunding, 5.625% due 8/01/2020 (b) (k)
	AAA	Aaa	2,250	Washington County, Pennsylvania, Capital Projects Authority Revenue Bonds (Capital Project)

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

Equipment Program), 6.15% due 12/01/202				
=====				
Rhode Island--2.7%	AAA	Aaa	4,345	Providence, Rhode Island, Public Building
	AAA	Aaa	3,355	General Revenue Bonds, Series A, 6.25% Rhode Island State Economic Development Airport Revenue Bonds, Series B, 6.50%
=====				
South Carolina--2.4%	A	A2	3,000	Lexington County, South Carolina, Health
	AA	NR*	3,440	District Inc., Hospital Revenue Refunding Bonds, 5.75% due 11/01/2028
	NR*	Aaa	1,265	South Carolina Educational Facilities A Nonprofit Institutions Revenue Bonds (T College), 5.625% due 7/01/2031 (1) South Carolina Housing Finance and Deve Authority, Mortgage Revenue Refunding B Series A-2, 5.875% due 7/01/2009 (d)
=====				
South Dakota--2.5%	AAA	NR*	7,000	South Dakota State Health and Education Authority, Revenue Refunding Bonds, Ser due 7/01/2014 (f)
=====				
Tennessee--5.7%	AAA	Aaa	8,500	Metropolitan Government of Nashville an County, Tennessee, Water and Sewer Reve Bonds (Cab Converter), 7.70% due 1/01/2
	AAA	Aaa	5,450	Mount Juliet, Tennessee, Public Building Revenue Bonds (Madison Suburban Utility Series B, 7.80% due 2/01/2004 (f)(g)
	AAA	Aaa	2,280	Tennessee HDA, Revenue Refunding Bonds (Homeownership Program), AMT, Series 1, due 7/01/2012 (f)
=====				
Texas--6.8%				Bell County, Texas, Health Facilities D Corporation, Revenue Refunding Bonds (S Memorial Hospital), Series A (f):
	AAA	Aaa	1,555	6.25% due 8/15/2011
	AAA	Aaa	1,650	6.25% due 8/15/2012
	AAA	Aaa	1,615	Bexar, Texas, Metropolitan Water Distri System Revenue Refunding Bonds, 6.35% d

8 & 9

MuniEnhanced Fund, Inc., January 31, 2003

SCHEDULE OF INVESTMENTS (concluded)

(in Thousands)

STATE	S&P Ratings+	Moody's Ratings+	Face Amount	Issue
=====				
Texas (concluded)	AAA	Aaa	\$ 1,000	Gregory Portland, Texas, Independent So GO, 5.75% due 8/15/2015 (f) Houston, Texas, Airport System Revenue Bonds, Sub-Lien (d):
	AAA	Aaa	1,000	AMT, Series A, 5.50% due 7/01/2023
	AAA	Aaa	900	Series B, 5.50% due 7/01/2030
	AA	NR*	3,200	Sam Rayburn, Texas, Municipal Power Age Refunding Bonds, 5.75% due 10/01/2021 (

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

				San Antonio, Texas, Airport System, Imp
				Revenue Bonds (Passenger Facility), AMT
	AAA	Aaa	1,465	5.75% due 7/01/2016
	AAA	Aaa	1,550	5.75% due 7/01/2017
	AA+	Aa2	1,000	San Antonio, Texas, General Improvement
				due 2/01/2020
	AAA	Aaa	5,200	Travis County, Texas, Health Facilities
				Corporation Revenue Refunding Bonds, RI
				10.218% due 11/15/2024 (a) (h)
	AAA	Aaa	1,000	University of Houston, Texas, Universit
				5.50% due 2/15/2030 (f)
Utah--1.7%	AAA	NR*	5,000	Salt Lake County, Utah, Hospital Revenue
				DRIVERS, Series 186, 9.54% due 5/15/201
Virginia--5.9%	AAA	Aaa	10,000	Fairfax County, Virginia, EDA, Resource
				Revenue Refunding Bonds, AMT, Series A,
				6.10% due 2/01/2010 (a)
	AAA	Aaa	2,300	Halifax County, Virginia, IDA, Exempt F
				Refunding Bonds (Old Dominion Electric
				Project), AMT, 5.625% due 6/01/2028 (a)
	AAA	Aaa	6,000	Loudoun County, Virginia, COP, 6.80% du
Washington--10.2%	AAA	NR*	5,000	Energy Northwest, Washington, Electric
				DRIVERS, Series 242, 10.04% due 7/01/20
				Franklin County, Washington, Public Ut
				Number 001, Electric Revenue Refunding
	AAA	Aaa	1,505	5.625% due 9/01/2019
	AAA	Aaa	1,585	5.625% due 9/01/2020
	AAA	Aaa	1,375	5.625% due 9/01/2021
	AAA	Aaa	2,150	King County, Washington, Sewer Revenue
				Bonds, Series B, 5.50% due 1/01/2027 (d)
	AAA	Aaa	1,500	Port Seattle, Washington, Revenue Bonds
				5.625% due 4/01/2016 (b)
	NR*	Aaa	5,000	Snohomish County, Washington, Arlington
				Number 016, GO, 6.50% due 12/01/2015 (b)
	AAA	Aaa	450	Snohomish County, Washington, Public Ut
				Number 001, Electric Revenue Bonds, 5.5
				due 12/01/2023 (d)
	AAA	Aaa	2,000	Snohomish County, Washington, Public Ut
				Number 001, Electric Revenue Refunding
				5.375% due 12/01/2024 (d)
				Washington State, GO:
	AAA	Aaa	3,000	Series 2000 A, 5.625% due 7/01/202
	AAA	Aaa	7,000	Series A and AT-6, 6.25% due 2/01/
Wisconsin--0.5%	NR*	Aaa	1,650	Osceola, Wisconsin, School District, GO
				Series A, 5.50% due 5/01/2019 (b)
				Total Municipal Bonds (Cost--\$446,941)-
				Shares
				Held
				Common Stock
				7,901
				Merrill Lynch Institutional Tax-Exempt
				Total Common Stock (Cost--\$7,901)--2.3%
				Total Investments (Cost--\$454,842)--142.7%

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

Variation Margin on Financial Futures Contracts\*\*--0.0%

Other Assets Less Liabilities--1.2%

Preferred Stock, at Redemption Value--(43.9%)

Net Assets Applicable to Common Stock--100.0%

- (a) AMBAC Insured.
- (b) FGIC Insured.
- (c) FNMA/GNMA Collateralized.
- (d) FSA Insured.
- (e) GNMA Collateralized.
- (f) MBIA Insured.
- (g) Prerefunded.
- (h) The interest rate is subject to change periodically and inversely based upon prevailing market rates. The interest rate shown is the rate in effect at January 31, 2003.
- (i) Escrowed to maturity.
- (j) Investments in companies considered to be an affiliate of the Fund (such companies are defined as "Affiliated Companies" in Section 2(a)(3) of the Investment Company Act of 1940) are as follows:

(in Thousands)

Affiliate	Net Share Activity	Net Cost	Dividend Income
Merrill Lynch Institutional Tax-Exempt Fund	7,901	\$7,901	\$31

- (k) All or a portion of security held as collateral in connection with open financial futures contracts.
- (l) Radian Insured.
- (m) XL Capital Insured.
- + Ratings of issues shown are unaudited.
- \* Not Rated.
- \*\* Financial futures contracts sold as of January 31, 2003 were as follows:

(in Thousands)

Number of Contracts	Issue	Expiration Date	Value
295	U.S. Treasury Bonds	March 2003	\$33,672
Total Financial Futures Contracts Sold (Total Contract Price--\$33,303)			\$33,672

See Notes to Financial Statements.

Quality Profile  
(unaudited)

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

The quality ratings of securities in the Fund as of January 31, 2003 were as follows:

S&P Rating/Moody's Rating	Percent of Total Investments
AAA/Aaa	87.5%
AA/Aa	8.6
A/A	2.3
Other*	1.6

\* Temporary investments in short-term securities.

10 & 11

MuniEnhanced Fund, Inc., January 31, 2003

STATEMENT OF NET ASSETS

As of January 31, 2003

=====	
Assets:	Investments, at value (identified cost--\$454,842,143) .....
	Receivables:
	Interest .....
	Securities sold .....
	Dividends .....
	Prepaid expenses .....
	Total assets .....
=====	
Liabilities:	Payables:
	Securities purchased .....
	Investment adviser .....
	Dividends to Common Stock shareholders .....
	Variation margin .....
	Accrued expenses and other liabilities .....
	Total liabilities .....
=====	
Preferred Stock:	Preferred Stock, at redemption value, par value \$.025 per share (2,000 Series A shares, 2,000 Series B shares and 2,000 Series C shares of AMPS* issued and outstanding at \$25,000 per share liquidation preference
=====	
Net Assets	Net assets applicable to Common Stock .....
Applicable to	
Common Stock:	
=====	
Analysis of Net	Common Stock, par value \$.10 per share (29,369,874 shares issued and
Assets Applicable to	outstanding) .....
Common Stock:	Paid-in capital in excess of par .....

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

Undistributed investment income--net .....  
 Accumulated realized capital losses on investments--net .....  
 Unrealized appreciation on investments--net .....  
  
 Total accumulated earnings--net .....  
  
 Total--Equivalent to \$11.65 net asset value per share of Common Stock  
 (market price--\$10.62) .....

=====

\* Auction Market Preferred Stock.  
  
 See Notes to Financial Statements.

STATEMENT OF OPERATIONS

For the Year Ended January 31, 2003

=====

Investment Income:           Interest .....  
                                   Dividends .....  
  
                                   Total income .....

=====

Expenses:                    Investment advisory fees .....  
                                   Commission fees .....  
                                   Accounting services .....  
                                   Transfer agent fees .....  
                                   Professional fees .....  
                                   Printing and shareholder reports .....  
                                   Directors' fees and expenses .....  
                                   Custodian fees .....  
                                   Listing fees .....  
                                   Pricing fees .....  
                                   Other .....

                                  Total expenses before reimbursement .....  
                                   Reimbursement of expenses .....

                                  Total expenses after reimbursement .....

                                  Investment income--net .....

=====

Realized &                    Realized loss on investments--net .....  
 Unrealized Gain (Loss)    Change in unrealized appreciation on investments--net .....  
 On Investments--Net:        Total realized and unrealized gain on investments--net .....

=====

Dividends to                 Investment income--net .....  
 Preferred Stock  
 Shareholders:                Net Increase in Net Assets Resulting from Operations .....

=====

See Notes to Financial Statements.

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

12 & 13

MuniEnhanced Fund, Inc., January 31, 2003

STATEMENTS OF CHANGES IN NET ASSETS

Increase (Decrease) in Net Assets:	
=====	
Operations:	Investment income--net .....
	Realized gain (loss) on investments--net .....
	Change in unrealized appreciation on investments--net .....
	Dividends to Preferred Stock shareholders .....
	Net increase in net assets resulting from operations .....
=====	
Dividends to Common Stock Shareholders:	Investment income--net .....
	Net decrease in net assets resulting from dividends to Common Stock shareholder .....
=====	
Net Assets Applicable to Common Stock:	Total increase in net assets applicable to Common Stock .....
	Beginning of year .....
	End of year* .....
=====	
	* Undistributed investment income--net .....
=====	

+ Certain prior year amounts have been reclassified to conform to current year presentation.

See Notes to Financial Statements.

FINANCIAL HIGHLIGHTS

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

Increase (Decrease) in Net Asset Value:		2003	2002
		-----	-----
Per Share Operating Performance:++	Net asset value, beginning of year .....	\$ 11.43	\$ 11.3
	Investment income--net+ .....	.83	.8
	Realized and unrealized gain (loss) on investments--net .....	.17	.0
	Dividends to Preferred Stock shareholders from investment income--net .....	(.08)	(.1

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

	Total from investment operations .....	.92	.6
	Less dividends and distributions to Common Stock shareholders:		
	Investment income--net .....	(.70)	(.6
	Realized gain on investments--net .....	--	--
	In excess of realized gain on investments--net .....	--	--
	Total dividends and distributions to Common Stock shareholders .....	(.70)	(.6
	Net asset value, end of year .....	\$ 11.65	\$ 11.4
	Market price per share, end of year .....	\$ 10.62	\$ 11.0
=====			
Total Investment	Based on market price per share .....	2.43%	8.61
Return:*	Based on net asset value per share .....	8.62%	6.52
=====			
Ratios Based on	Total expenses, net of reimbursement** .....	1.00%	1.00
Average Net Assets			
Of Common Stock:	Total expenses** .....	1.00%	1.00
	Total investment income--net** .....	7.17%	7.00
	Amount of dividends to Preferred Stock shareholders ...	.70%	1.18
	Investment income--net, to Common Stock shareholders ..	6.47%	5.82
=====			
Ratios Based on	Total expenses, net of reimbursement** .....	.70%	.69
Average Net Assets			
Of Common &	Total expenses .....	.70%	.69
Preferred Stock:**	Total investment income--net .....	4.97%	4.84
=====			
Ratios Based on	Dividends to Preferred Stock shareholders .....	1.57%	2.64
Average Net Assets			
Of Preferred Stock:			
=====			
Supplemental	Net assets applicable to Common Stock, end of year		
Data:	(in thousands) .....	\$342,014	\$335,61
	Preferred Stock outstanding, end of year (in thousands)	\$150,000	\$150,00
	Portfolio turnover .....	31.35%	43.12
=====			
Leverage:	Asset coverage per \$1,000 .....	\$ 3,280	\$ 3,23
=====			
Dividends Per Share	Series A--Investment income--net .....	\$ 350	\$ 67
On Preferred Stock			
Outstanding:	Series B--Investment income--net .....	\$ 510	\$ 68
	Series C--Investment income--net .....	\$ 327	\$ 62
=====			

## Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

- \* Total investment returns based on market value, which can be significantly greater or lesser than the net asset value, may result in substantially different returns. Total investment returns exclude the effects of sales charges.
- \*\* Do not reflect the effect of dividends to Preferred Stock shareholders.
- + Based on average shares outstanding.
- ++ Certain prior year amounts have been reclassified to conform to current year presentation.

See Notes to Financial Statements.

14 & 15

MuniEnhanced Fund, Inc., January 31, 2003

### NOTES TO FINANCIAL STATEMENTS

#### 1. Significant Accounting Policies:

MuniEnhanced Fund, Inc. (the "Fund") is registered under the Investment Company Act of 1940 as a non-diversified, closed-end management investment company. The Fund's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America, which may require the use of management accruals and estimates. The Fund determines and makes available for publication the net asset value of its Common Stock on a weekly basis. The Fund's Common Stock is listed on the New York Stock Exchange under the symbol MEN. The following is a summary of significant accounting policies followed by the Fund.

(a) Valuation of investments -- Municipal bonds are traded primarily in the over-the-counter markets and are valued at the last available bid price in the over-the-counter market or on the basis of yield equivalents as obtained by the Fund's pricing service from one or more dealers that make markets in the securities. Financial futures contracts and options thereon, which are traded on exchanges, are valued at their closing prices as of the close of such exchanges. Options written or purchased are valued at the last sale price in the case of exchange-traded options. In the case of options traded in the over-the-counter market, valuation is the last asked price (options written) or the last bid price (options purchased). Short-term investments with a remaining maturity of sixty days or less are valued at amortized cost, which approximates market value. Securities and assets for which market quotations are not readily available are valued at fair value as determined in good faith by or under the direction of the Board of Directors of the Fund, including valuations furnished by a pricing service retained by the Fund, which may utilize a matrix system for valuations. The procedures of the pricing service and its valuations are reviewed by the officers of the Fund under the general supervision of the Board of Directors.

(b) Derivative financial instruments -- The Fund may engage in various portfolio investment strategies to increase or decrease the level of risk to which the Fund is exposed more quickly and efficiently than transactions in other types of instruments. Losses may arise due to changes in the value of the contract or if the counterparty does not perform under the contract.

o Financial futures contracts -- The Fund may purchase or sell financial futures contracts and options on such futures contracts for the purpose of hedging the market risk on existing securities or the intended purchase of securities. Futures contracts are contracts for delayed delivery of securities at a specific

## Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

future date and at a specific price or yield. Upon entering into a contract, the Fund deposits and maintains as collateral such initial margin as required by the exchange on which the transaction is effected. Pursuant to the contract, the Fund agrees to receive from or pay to the broker an amount of cash equal to the daily fluctuation in value of the contract. Such receipts or payments are known as variation margin and are recorded by the Fund as unrealized gains or losses. When the contract is closed, the Fund records a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed.

o Options -- The Fund is authorized to write covered call options and purchase put options. When the Fund writes an option, an amount equal to the premium received by the Fund is reflected as an asset and an equivalent liability. The amount of the liability is subsequently marked to market reflecting the current market value of the option written.

When a security is purchased or sold through an exercise of an option, the related premium paid (or received) is added to (or deducted from) the basis of the security acquired or deducted from (or added to) the proceeds of the security sold. When an option expires (or the Fund enters into a closing transaction), the Fund realizes a gain or loss on the option to the extent of the premiums received or paid (or gain or loss to the extent the cost of the closing transaction exceeds the premium paid or received).

Written and purchased options are non-income producing investments.

o Forward interest rate swaps -- The Fund is allowed to enter into forward interest rate swaps for the purpose of hedging the interest rate risk on portfolio securities. In a forward interest rate swap, the Fund and the counterparty agree to pay or receive interest on a specified notional contract amount, commencing on a specified future effective date, unless terminated earlier. The value of the agreement is determined by quoted fair values received daily by the Fund from the counterparty. When the agreement is closed, the Fund records a realized gain or loss in an amount equal to the value of the agreement.

(c) Income taxes -- It is the Fund's policy to comply with the requirements of the Internal Revenue Code applicable to regulated investment companies and to distribute substantially all of its taxable income to its shareholders. Therefore, no Federal income tax provision is required.

(d) Security transactions and investment income -- Security transactions are recorded on the dates the transactions are entered into (the trade dates). Realized gains and losses on security transactions are determined on the identified cost basis. Dividend income is recorded on the ex-dividend dates. Interest income is recognized on the accrual basis. The Fund amortizes all premiums and discounts on debt securities.

(e) Dividends and distributions -- Dividends from net investment income are declared daily and paid monthly. Distributions of capital gains are recorded on the ex-dividend dates.

(f) Change in financial statement classification for Auction Market Preferred Stock ("AMPS") -- In accordance with the provisions of the Financial Accounting Standards Board's Emerging Issues Task Force D-98 ("EITF D-98"), "Classification and Measurement of Redeemable Securities," effective for the current period, the Fund has reclassified its AMPS outside of permanent equity in the Net Assets section of the Statement of Net Assets. In addition, dividends to Preferred Stock shareholders are now classified as a component of the "Net Increase in Net Assets Resulting from Operations" on the Statements of Operations and Changes in Net Assets and as a component of the "Total from investment operations" in the Financial Highlights. Prior year amounts presented have been reclassified to

## Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

conform to this period's presentation. The application of EITF D-98 related entirely to presentation and had no impact on net asset value or the allocation of net investment income or net realized capital gains or losses to Common Stock shareholders.

(g) Reclassification -- Accounting principles generally accepted in the United States of America require that certain components of net assets be adjusted to reflect permanent differences between financial and tax reporting. Accordingly, the current year's permanent book/tax difference of \$281,533 has been reclassified between paid-in capital in excess of par and undistributed net investment income. This reclassification has no effect on net assets or net asset value per share.

### 2. Investment Advisory Agreement and Transactions with Affiliates:

The Fund has entered into an Investment Advisory Agreement with Fund Asset Management, L.P. ("FAM"). The general partner of FAM is Princeton Services, Inc. ("PSI"), an indirect, wholly-owned subsidiary of Merrill Lynch & Co., Inc. ("ML & Co."), which is the limited partner.

FAM is responsible for the management of the Fund's portfolio and provides the necessary personnel, facilities, equipment and certain other services necessary to the operations of the Fund. For such services, the Fund pays a monthly fee at an annual rate of .50% of the Fund's average weekly net assets, including assets acquired from the issuance of Preferred Stock. For the year ended January 31, 2003, FAM reimbursed the Fund in the amount of \$5,085.

For the year ended January 31, 2003, the Fund reimbursed FAM \$12,324 for certain accounting services.

Certain officers and/or directors of the Fund are officers and/or directors of FAM, PSI, and/or ML & Co.

### 3. Investments:

Purchases and sales of investments, excluding short-term securities, for the year ended January 31, 2003 were \$155,747,671 and \$149,711,302, respectively.

Net realized gains (losses) for the year ended January 31, 2003 and net unrealized gains (losses) as of January 31, 2003 were as follows:

	Realized Gains (Losses)	Unrealized Gains (Losses)
Long-term investments .....	\$ 3,680,390	\$ 33,187,359
Financial futures contracts .....	(5,988,130)	(368,750)
Total .....	\$ (2,307,740)	\$ 32,818,609

As of January 31, 2003, net unrealized appreciation for Federal income tax purposes aggregated \$33,196,801, of which \$34,200,039 related to appreciated securities and \$1,003,238 related to depreciated securities. The aggregate cost of investments at January 31, 2003 for Federal income tax purposes was

## Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

\$454,832,701.

### 4. Stock Transactions:

The Fund is authorized to issue 200,000,000 shares of stock, par value \$.10 per share, all of which were initially classified as Common Stock. The Board of Directors is authorized, however, to reclassify any unissued shares of stock without the approval of the holders of Common Stock.

#### Common Stock

Shares issued and outstanding during the years ended January 31, 2003 and January 31, 2002 remained constant.

#### Preferred Stock

AMPS are shares of Preferred Stock of the Fund, with a par value of \$.025 per share and a liquidation preference of \$25,000 per share, plus accrued and unpaid dividends, that entitle their holders to receive cash dividends at an annual rate that may vary for the successive dividend period for each series. The yields in effect at January 31, 2003 were as follows: Series A, 1.05%; Series B, 2.00%; and Series C, 1.04%.

Shares issued and outstanding during the years ended January 31, 2003 and January 31, 2002 remained constant.

The Fund pays commissions to certain broker-dealers at the end of each auction at an annual rate ranging from .25% to .50%, calculated on the proceeds of each auction. For the year ended January 31, 2003, Merrill Lynch, Pierce, Fenner & Smith Incorporated, an affiliate of FAM, received \$123,140 as commissions.

### 5. Distributions to Shareholders:

On February 6, 2003, a tax-exempt income dividend of \$.060000 was declared. The dividend was paid on February 27, 2003 to shareholders of record on February 14, 2003.

The tax character of distributions paid during the fiscal years ended January 31, 2003 and January 31, 2002 was as follows:

	1/31/2003	1/31/2002
Distributions paid from:		
Tax-exempt income .....	\$22,815,272	\$22,673,404
Total distributions .....	\$22,815,272	\$22,673,404
	=====	=====

As of January 31, 2003, the components of accumulated earnings on a tax basis were as follows:

Undistributed tax-exempt income--net .....	\$ 4,572,399
Undistributed long-term capital gains--net .....	--
Total undistributed earnings--net .....	4,572,399
Capital loss carryforward .....	(17,065,033) *
Unrealized gains--net .....	28,464,737**
Total accumulated earnings--net .....	\$ 15,972,103

=====

- 
- \* On January 31, 2003, the Fund had a net capital loss carryforward of \$17,065,033, of which \$6,604,230 expires in 2008, \$8,505,599 expires in 2009 and \$1,955,204 expires in 2011. This amount will be available to offset like amounts of any future taxable gains.
  - \*\* The difference between book-basis and tax-basis net unrealized gains is attributable primarily to the tax deferral of losses on straddles, the realization for tax purposes of unrealized gains (losses) on certain futures contracts, the difference between book and tax amortization methods for premiums and discounts on fixed income securities and the deferral of post-October capital losses for tax purposes.

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders,  
MuniEnhanced Fund, Inc.:

We have audited the accompanying statement of net assets, including the schedule of investments, of MuniEnhanced Fund, Inc., as of January 31, 2003, the related statements of operations for the year then ended and changes in net assets for each of the years in the two-year period then ended, and the financial highlights for each of the years presented. These financial statements and the financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements and the financial highlights based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and the financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned at January 31, 2003 by correspondence with the custodian and broker; where a reply was not received from the broker, we performed other auditing procedures. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements and financial highlights present fairly, in all material respects, the financial position of MuniEnhanced Fund, Inc. as of January 31, 2003, the results of its operations, the changes in its net assets, and the financial highlights for the respective stated periods in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP  
Princeton, New Jersey  
March 12, 2003

18 & 19

MuniEnhanced Fund, Inc., January 31, 2003

IMPORTANT TAX INFORMATION (unaudited)

All of the net investment income distributions paid by MuniEnhanced Fund, Inc.

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

during its taxable year ended January 31, 2003 qualify as tax-exempt interest dividends for Federal income tax purposes.

Please retain this information for your records.

MANAGED DIVIDEND POLICY

The Fund's dividend policy is to distribute all or a portion of its net investment income to its shareholders on a monthly basis. In order to provide shareholders with a more consistent yield to the current trading price of shares of Common Stock of the Fund, the Fund may at times pay out less than the entire amount of net investment income earned in any particular month and may at times in any particular month pay out such accumulated but undistributed income in addition to net investment income earned in that month. As a result, the dividends paid by the Fund for any particular month may be more or less than the amount of net investment income earned by the Fund during such month. The Fund's current accumulated but undistributed net investment income, if any, is disclosed in the Statement of Net Assets, which comprises part of the financial information included in this report.

OFFICERS AND DIRECTORS

Name	Address & Age	Position(s) Held with Fund	Length of Time Served	Principal Occupation During Past 5 Years
Interested Director				
Terry K. Glenn*	P.O. Box 9011 Princeton, NJ 08543-9011 Age: 62	President and Director	1999 to present and 1989 to present	Chairman, Americas since 2001 and Executive Vice President since 2001 of Fund Asset Management ("FAM") and Merrill Lynch Investment Managers ("MLIM"); President Merrill Lynch Mutual since 1999; Executive President and Director Princeton Services, ("Princeton Services" since 1993; President Princeton Administrators L.P. since 1988; Director of Financial Data Services Inc. since 1985.

\* Mr. Glenn is a director, trustee or member of an advisory board of certain other investment funds. MLIM acts as investment adviser. Mr. Glenn is an "interested person," as described in the Fund based on his positions as Chairman (Americas Region) and Executive Vice President of Princeton Services; and President of Princeton Administrators, L.P. The Directors serve until their resignation, removal or death, or until December 31, of the Fund President, Mr. Glenn serves at the pleasure of the Board of Directors.

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

Name	Address & Age	Position(s) Held with Fund	Length of Time Served*	Principal Occupation During Past 5 Years
=====				
Independent Directors				
=====				
James H. Bodurtha	P.O. Box 9095 Princeton, NJ 08543-9095 Age: 58	Director	1995 to present	Director and Executive President of The Ch Business Group, Inc 1996; Chairman, Ber Holding Corporation 1980.
=====				

20 & 21

MuniEnhanced Fund, Inc., January 31, 2003

OFFICERS AND DIRECTORS (concluded)

Name	Address & Age	Position(s) Held with Fund	Length of Time Served*	Principal Occupation During Past 5 Years
=====				
Independent Directors (concluded)				
=====				
Joe Grills	P.O. Box 9095 Princeton, NJ 08543-9095 Age: 67	Director	2002 to present	Member of the Commi Investment of Emplo Benefit Assets of t Association of Fina Professionals ("CIE since 1986; Member CIEBA's Executive C since 1988; Member Investment Advisory Committees of the S New York Common Ret Fund since 1989; Me the Investment Advi Committee of the Ho Hughes Medical Inst from 1997 to 2000; of Duke Management since 1992 and Vice Chairman thereof si 1998; Director, LaS Street Fund from 19 2001; Member of the Investment Advisory Committee of the Vi Retirement System s

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

1998; Director, Mon  
Foundation since 20  
Member of the Inves  
Committee of the Wo  
Forest School since  
Member of the Inves  
Committee of the Na  
Trust for Historic  
Preservation since

=====  
Herbert I.                    P.O. Box 9095                    Director                    1989 to                    John M. Olin  
London                    Princeton, NJ 08543-9095                    present                    Professor of  
Age: 63                                                                                                Humanities, New York  
University since 19  
and Professor there  
since 1980; Preside  
of Hudson Institute  
since 1997 and  
Trustee thereof sin  
1980.

=====  
Andre F. Perold                    P.O. Box 9095                    Director                    1989 to                    George Gund Profess  
of Finance and  
Banking, Harvard  
Business School sin  
2000 and a member o  
the faculty since  
1979; Director of  
Stockback.com since  
2002.

=====  
Roberta Cooper                    P.O. Box 9095                    Director                    1999 to                    Shareholder, Modral  
Sperling, Roehl,  
Harris & Sisk, P.A.  
since 1993; Directo  
Cooper's Inc. since  
1999; Director, ECM  
Inc. since 2001.

=====  
Robert S.                    P.O. Box 9095                    Director                    2002 to                    Principal of STI  
Management since  
1994; Trustee of  
Commonfund from 198  
to 2002; Trustee an  
Chairman of the  
Investment Manage-  
ment Workshop from  
1978 to 2000;  
Director of Rye  
Country Day School  
since 2001.

=====  
Stephen B.                    P.O. Box 9095                    Director                    2002 to                    Chairman of Fernwoo  
Advisors since 1996  
Principal of Fernwo  
Associates since  
1975; Chairman of R  
Corporation since  
1978; Director,  
International Mobil  
Communications, Inc  
since 1998.

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

\* The Director's term is unlimited. Directors serve until their resignation, removal or year in which they turn 72.

Name	Address & Age	Position(s) Held with Fund	Length of Time Served*	Principal Occupation
<b>Fund Officers</b>				
Donald C. Burke	P.O. Box 9011 Princeton, NJ 08543-9011 Age: 42	Vice President and Treasurer	1993 to present and 1999 to present	First Vice President 1997 and the Treasurer Senior Vice President Princeton Services of FAMD since 1999; since 1990.
Kenneth A. Jacob	P.O. Box 9011 Princeton, NJ 08543-9011 Age: 51	Senior Vice President	2002 to present	Managing Director of Vice President from
John M. Loffredo	P.O. Box 9011 Princeton, NJ 08543-9011 Age: 39	Senior Vice President	2002 to present	Managing Director of Vice President from
Michael Kalinoski	P.O. Box 9011 Princeton, NJ 08543-9011 Age: 32	Vice President	2000 to present	Vice President of M Bond Trader with St from 1993 to 1999.
Alice A. Pellegrino	P.O. Box 9011 Princeton, NJ 08543-9011 Age: 42	Secretary	1999 to present	Director (Legal Adv Vice President of M Attorney associated 1999.

\* Officers of the Fund serve at the pleasure of the Board of Directors.

Transfer Agents

Common Stock:

EquiServe Trust Company, I.A.  
P.O. Box 43011  
Providence, RI 02940-3011

Preferred Stock:

The Bank of New York  
100 Church Street  
New York, NY 10286

Custodian

State Street Bank and Trust Company  
P.O. Box 351  
Boston, MA 02101

NYSE Symbol

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

MEN

-----  
Melvin R. Seiden, Director of MuniEnhanced Fund, Inc., has recently retired. The Fund's Board of Directors wishes Mr. Seiden well in his retirement.  
-----

22 & 23

[LOGO] Merrill Lynch Investment Managers

[GRAPHICS OMITTED]

MuniEnhanced Fund, Inc. seeks to provide shareholders with as high a level of current income exempt from Federal income taxes as is consistent with its investment policies by investing primarily in a portfolio of long-term, investment-grade municipal obligations, the interest on which is exempt from Federal income taxes in the opinion of the bond counsel to the issuer.

This report, including the financial information herein, is transmitted to shareholders of MuniEnhanced Fund, Inc. for their information. It is not a prospectus. Past performance results shown in this report should not be considered a representation of future performance. The Fund has leveraged its Common Stock and intends to remain leveraged by issuing Preferred Stock to provide the Common Stock shareholders with a potentially higher rate of return. Leverage creates risks for Common Stock shareholders, including the likelihood of greater volatility of net asset value and market price of shares of the Common Stock, and the risk that fluctuations in the short-term dividend rates of the Preferred Stock may affect the yield to Common Stock shareholders. Statements and other information herein are as dated and are subject to change.

MuniEnhanced Fund, Inc.  
Box 9011  
Princeton, NJ  
08543-9011

[RECYCLED LOGO] Printed on post-consumer recycled paper

#10874--1/03

Item 2 - Did registrant adopt a code of ethics, as of the end of the period covered by this report, that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the registrant or a third party? If not, why not? Briefly describe any amendments or waivers that occurred during the period. State here if code of ethics/amendments/waivers are on website and give website address-. State here if fund will send code of ethics to shareholders without charge upon request-- N/A (not answered until July 15, 2003 and only annually for funds)

Item 3 - Did the registrant's board of directors determine that the registrant either: (i) has at least one audit committee financial expert serving on its audit committee; or (ii) does not have an audit committee financial expert serving on its audit committee? If yes, disclose name of financial expert and whether he/she is "independent," (fund may, but is not required, to disclose name/independence of more than one financial expert) If no, explain why not. -N/A (not answered until July 15, 2003 and only annually for funds)

## Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

Item 4 - Disclose annually only (not answered until December 15, 2003)

- (a) Audit Fees - Disclose aggregate fees billed for each of the last two fiscal years for professional services rendered by the principal accountant for the audit of the registrant's annual financial statements or services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years. N/A.
- (b) Audit-Related Fees - Disclose aggregate fees billed in each of the last two fiscal years for assurance and related services by the principal accountant that are reasonably related to the performance of the audit of the registrant's financial statements and are not reported under paragraph (a) of this Item. Registrants shall describe the nature of the services comprising the fees disclosed under this category. N/A.
- (c) Tax Fees - Disclose aggregate fees billed in each of the last two fiscal years for professional services rendered by the principal accountant for tax compliance, tax advice, and tax planning. Registrants shall describe the nature of the services comprising the fees disclosed under this category. N/A.
- (d) All Other Fees - Disclose aggregate fees billed in each of the last two fiscal years for products and services provided by the principal accountant, other than the services reported in paragraphs (a) through (c) of this Item. Registrants shall describe the nature of the services comprising the fees disclosed under this category. N/A.
- (e) (1) Disclose the audit committee's pre-approval policies and procedures described in paragraph (c) (7) of Rule 2-01 of Regulation S-X. N/A.
- (e) (2) Disclose the percentage of services described in each of paragraphs (b) through (d) of this Item that were approved by the audit committee pursuant to paragraph (c) (7) (i) (C) of Rule 2-01 of Regulation S-X. N/A.
- (f) If greater than 50%, disclose the percentage of hours expended on the principal accountant's engagement to audit the registrant's financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant's full-time, permanent employees. N/A.
- (g) Disclose the aggregate non-audit fees billed by the registrant's accountant for services rendered to the registrant, and rendered to the registrant's investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser), and any entity controlling, controlled by, or under common control with the adviser that provides ongoing services to the registrant for each of the last two fiscal years of the registrant. N/A.
- (h) Disclose whether the registrant's audit committee has considered whether the provision of non-audit services that were rendered to the registrant's investment adviser (not including any subadviser

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser), and any entity controlling, controlled by, or under common control with the investment adviser that provides ongoing services to the registrant that were not pre-approved pursuant to paragraph (c)(7)(ii) of Rule 2-01 of Regulation S-X is compatible with maintaining the principal accountant's independence. N/A.

Items 5-6 - Reserved

Item 7 - For closed-end funds that contain voting securities in their portfolio, describe the policies and procedures that it uses to determine how to vote proxies relating to those portfolio securities. N/A.

Item 8 -- Reserved

Item 9(a) - Disclose the conclusions of the registrant's principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, about the effectiveness of the registrant's disclosure controls and procedures (as defined in Rule 30a-2(c) under the Act (17 CFR 270.30a-2(c))) based on their evaluation of these controls and procedures as of a date within 90 days of the filing date of the report that includes the disclosure required by this paragraph. N/A.

Item 9(b) -- There were no significant changes in the registrant's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Item 10 - Exhibits

10(a) - Attach code of ethics or amendments/waivers, unless code of ethics or amendments/waivers is on website or offered to shareholders upon request without charge. N/A.

10(b) - Attach certifications (4 in total pursuant to Sections 302 and 906 for CEO/CFO). Attached hereto.

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MuniEnhanced Fund, Inc.

By: /s/ Terry K. Glenn

-----  
Terry K. Glenn,  
President of  
MuniEnhanced Fund, Inc.

Date: March 17, 2003

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ Terry K. Glenn

-----

Edgar Filing: MUNIENHANCED FUND INC - Form N-CSR

Terry K. Glenn,  
President of  
MuniEnhanced Fund, Inc.

Date: March 17, 2003

By: /s/ Donald C. Burke

-----  
Donald C. Burke,  
Chief Financial Officer of  
MuniEnhanced Fund, Inc.

Date: March 17, 2003