

## PREFERRED INCOME FUND INCORPORATED

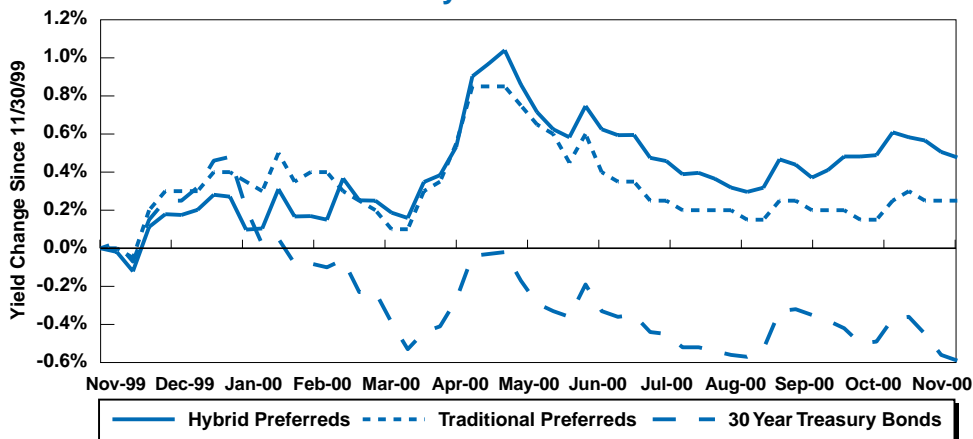
Dear Shareholder:

Fiscal 2000 was sort of a “betwixt and between” year for the Preferred Income Fund. The results were better than we would normally have expected given market conditions during the year, but they were not as good as we would like. The total returns earned on net asset value and market value were 4.5% and 6.9%, respectively.

The behavior of the domestic taxable fixed income markets in fiscal 2000 was, in a word, bizarre. Long term U.S. Treasury bonds far outdistanced the field with total percentage returns in the low to mid-teens. High yield bonds (junk bonds, if you prefer) brought up the rear with returns that frequently dipped into the negative teens. Most other categories of investment quality fixed income securities ended up in between with single digit positive returns.

At the risk of oversimplifying, these diverse market trends reflect the “push-pull” effect of two main forces. First, the likelihood that federal budget surpluses would shrink the supply of U.S. Treasury bonds caused bond investors to bid up their prices (and push down their yields), especially in the first half of the fiscal year. Second, signs of a slowdown in economic growth surfaced later in the year, suggesting an increase in credit risks. This caused investors to demand still larger margins of additional yield from fixed income securities other than Treasury bonds. The following graph illustrates the impact of these trends over the fiscal year on the yields of preferreds and Treasury bonds, the two market sectors that impact the Fund the most.

**Cumulative Changes In Yields of Preferreds  
and Treasury Bonds Since 11/30/99**



The Fund's portfolio of preferreds actually performed very well despite the rise in preferred yields to historically very wide levels over Treasuries. However, the superior performance of our holdings of preferreds was offset by the drag of losses on the Fund's hedges. Our hedges presume that preferreds and Treasuries will move more or less "in sync", but the foregoing chart clearly indicates that they did not. (See the Q&A Section for a further discussion of hedging.) When all was said and done, the returns on the Fund's portfolio including the hedges pretty much mirrored the generally uninspiring performance of the preferred market.

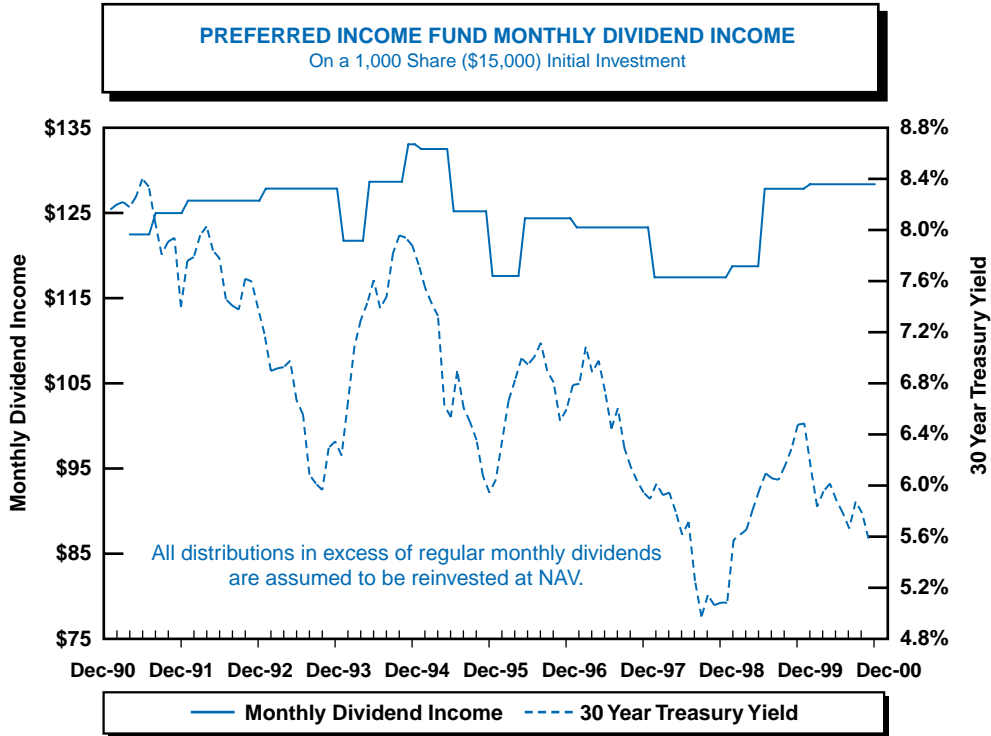
The table below shows the "bottom line" for the Fund in terms of its total return on net asset value for various time periods ending on November 30, 2000. As in past years, we have compared those results to the returns from a Lipper composite of investment grade closed-end bond funds. Although the investment strategies that we use in the Fund typically differ significantly from those of the bond funds, we believe that Preferred Income Fund provides a superior way of accomplishing a similar investment objective.

| <b>TOTAL RETURN PER YEAR ON NET ASSET VALUE<sup>(1)</sup><br/>FOR PERIODS ENDED 11/30/00</b> |                     |                       |                                       |
|--|---------------------|-----------------------|---------------------------------------|
|  | <u>One<br/>Year</u> | <u>Five<br/>Years</u> | <u>Life of<br/>Fund<sup>(2)</sup></u> |
| Preferred Income Fund . . . . .  | 3.7%                | 6.5%                  | 12.0%                                 |
| Lipper Composite of Investment Grade Bond Funds <sup>(3)</sup> . . . . .                     | 7.6%                | 6.2%                  | 7.9%                                  |

(1) Based on monthly data provided by Lipper Inc. Distributions are assumed to be reinvested at NAV in accordance with Lipper's practice, which differs from the procedures used elsewhere in this report.  
 (2) Since inception on January 31, 1991.  
 (3) Includes all U.S. Government bond, mortgage bond and term trust, and investment grade bond funds in Lipper's closed-end fund database at each point in time.

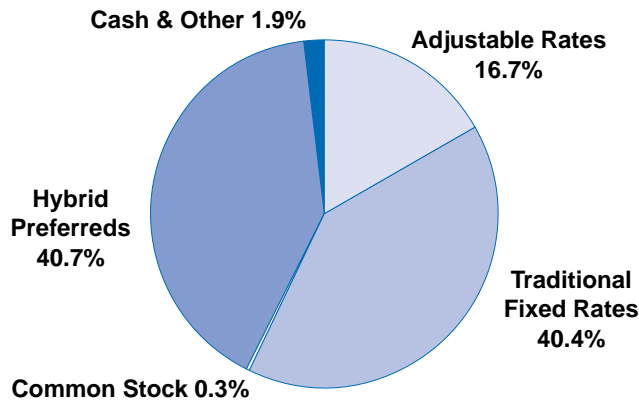
Over the long pull, the Fund has been a better alternative to higher quality closed-end bond funds. However, the bond funds have been tough competition more recently. To some extent, this reflects the strength of the government bond market since two-thirds of the bond funds are concentrated in securities issued or guaranteed by the U.S. Treasury or federal agencies.

Income is what Preferred Income Fund is all about. The graph below shows that the Fund's income (represented by the solid line) has performed remarkably well over the years. Income has generally managed to hold up pretty well when the interest rate on long term Treasury bonds (the dotted line) has gone down. In contrast, when the Treasury interest rate has increased, the Fund has typically shared in the increase. The Fund's stated mission calls for us to seek this kind of result. We have succeeded!



The allocation of the Fund's portfolio among major market sectors, illustrated by the pie chart on the following page, did not change significantly over the year. Just below that radar screen, however, some meaningful moves between institutional and retail oriented hybrid preferreds took place within the hybrid preferreds sector. In addition, the Fund was able to take advantage of numerous mispricings and out-of-line values at the "nitty gritty" level, which were part of the fallout from the generally sloppy conditions in the preferred market. All of this contributed to the superior performance of our preferred portfolio (before hedging) mentioned previously.

### Portfolio Allocation as of 11/30/00



We will be spending some time in the next few months working with Moody's Investors Service on revising the Fund's corporate Articles regarding the shares of Money Market Cumulative Preferred™ stock ("MMP") that the Fund has issued for leverage. Moody's recently announced its intention to restructure the scale on which it rates preferred stocks in order to make those ratings more consistent with its ratings on bonds. Moody's has also stated that the planned changes are not meant to indicate any change in its view of the investment quality of preferreds. Nonetheless, the revisions of the rating scale could adversely affect the Fund and its MMP unless certain changes, which must be approved by Moody's, are made to the Fund's Articles. Moody's analysts have acknowledged that this potential impact on the Fund was not intended and have indicated a willingness to work with us to solve the problem.

Have you visited our web site at [www.preferredincome.com](http://www.preferredincome.com)? Our shareholders that have say the web site is a great source for up-to-date information on the Fund. We would really like to hear what you think.

We urge you to read the following Questions and Answers section, which contains additional important information on the Fund.

Sincerely,

Robert T. Flaherty  
*Chairman of the Board*

December 28, 2000

## QUESTIONS & ANSWERS

### HAS THE FUND'S HEDGING STRATEGY CHANGED?

If you will forgive us, the most accurate answer is "Yes and no!". Through the end of fiscal 2000, our hedges consisted exclusively of purchased put options on Treasury bond futures contracts, just as they always have. Last summer, the Fund's Board of Directors also approved the purchase of options on interest rate swaps (called "swaptions") as an additional hedging tool. So far, however, we have not bought any swaptions.

We should never expect a hedge to be any better than the price at which we enter into it. The disappointing performance of Treasury based hedges early in the year caused a mad scramble among hedgers to find alternative hedges, with interest rate swaps being a primary object of their attention. Naturally, the perception that "the grass was greener on the other side of the hill" was promptly reflected in market prices. As things turned out, one of our best decisions of the year was to avoid that bandwagon and to stick with our Treasury hedges, which functioned relatively efficiently in the second half of the year.

We expect to purchase swaptions at times in the future, but only when it appears that "the price is right".

### WHAT DO SWAPTIONS ADD TO THE FUND'S HEDGING STRATEGY?

Two alternatives are almost always better than one. Subject to numerous conditions, interest rate swaps (and, therefore, swaptions) should track reasonably closely the value of corporate bonds as interest rates change. Our traditional Treasury based hedges are naturally more likely to follow the path of Treasury bonds. Being able to choose between the two alternatives gives us another way to attempt to manage tracking discrepancies between our hedges and the preferred portfolio.

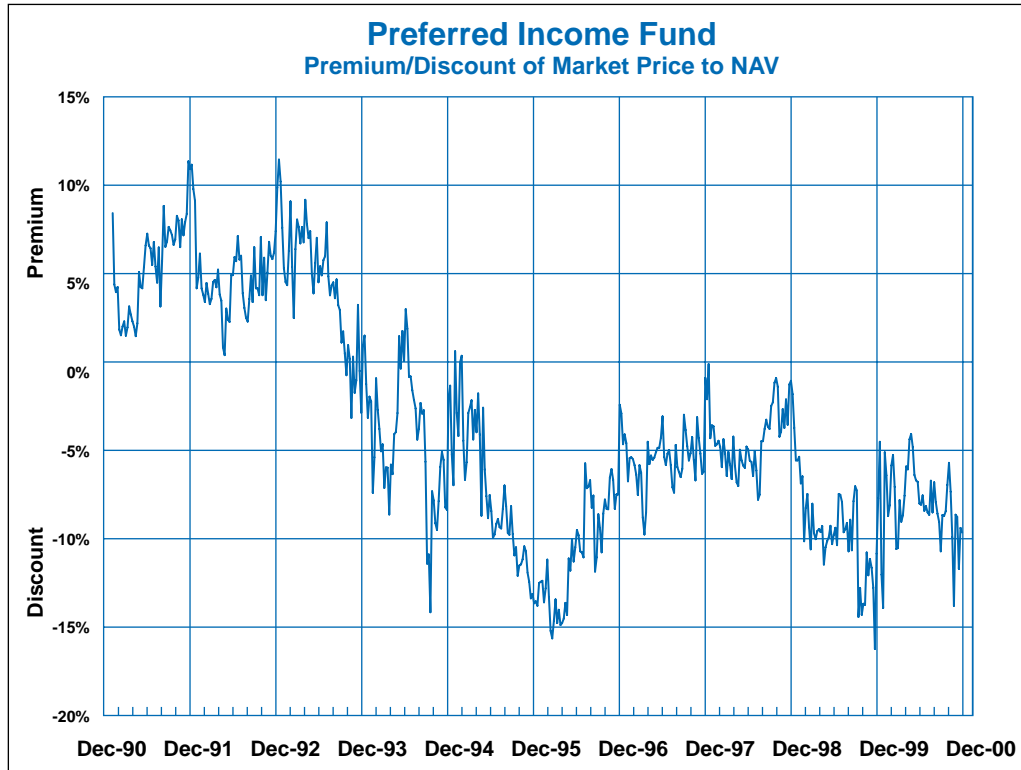
Further discussions of the valuation and risks of hedge instruments appear in Footnotes 1 and 7 to the financial statements on pages 18 and 22 of this report.

### WHY WAS THERE NO SPECIAL YEAR-END DISTRIBUTION THIS YEAR?

In fiscal 2000, the Fund did not realize net long-term capital gains, which are the primary source of special year-end distributions. Accordingly, the regular monthly dividend of 8.2 cents per share was paid in December and has been continued for January, 2001. As detailed more fully in the Tax Information section of this report, the Fund has a long-term capital loss carryforward, which may result in tax savings to the shareholders in future years.

**WHAT IS THE DISCOUNT FROM NET ASSET VALUE ON THE FUND'S SHARES?**

The graph below tells the story. The range for the discount has typically been in the upper single digits recently.



Our web site at [www.preferredincome.com](http://www.preferredincome.com) offers a wide selection of up-to-date data on the Fund including the market value and net asset value of the shares and the discount.

Preferred Income Fund Incorporated

**FINANCIAL DATA**

**Per Share of Common Stock**

|                         | <u>Dividends<br/>Paid</u> | <u>Net Asset<br/>Value</u> | <u>NYSE<br/>Closing Price</u> | <u>Dividend<br/>Reinvestment<br/>Price (1)</u> |
|-------------------------|---------------------------|----------------------------|-------------------------------|--|
| December 31, 1999.....  | <b>\$0.5600</b>           | \$13.74                    | \$12.2500                     | \$12.64  |
| January 31, 2000.....   | 0.0820                    | 13.65                      | 12.0000                       | 12.62  |
| February 29, 2000.....  | 0.0820                    | 13.45                      | 12.5000                       | 12.49  |
| March 31, 2000.....     | 0.0820                    | 13.62                      | 12.1875                       | 12.28  |
| April 30, 2000.....     | 0.0820                    | 13.05                      | 12.0625                       | 12.08  |
| May 31, 2000.....       | 0.0820                    | 12.75                      | 12.0625                       | 12.22  |
| June 30, 2000.....      | 0.0820                    | 13.18                      | 12.1250                       | 12.24  |
| July 31, 2000.....      | 0.0820                    | 13.28                      | 12.3125                       | 12.29  |
| August 31, 2000.....    | 0.0820                    | 13.50                      | 12.3750                       | 12.47  |
| September 30, 2000..... | 0.0820                    | 13.51                      | 12.0625                       | 12.23  |
| October 31, 2000.....   | 0.0820                    | 13.27                      | 12.3750                       | 12.38  |
| November 30, 2000.....  | 0.0820                    | 13.41                      | 12.1250                       | 12.12  |
| December 31, 2000.....  | 0.0820                    | 13.42                      | 12.1250                       | 12.78  |

(1) Whenever the net asset value per share of the Fund's common stock is less than or equal to the market price per share on the payment date, new shares issued will be valued at the higher of net asset value or 95% of the then current market price. Otherwise, the reinvestment shares of common stock will be purchased in the open market.

See Notes to Financial Statements.

Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS**

**November 30, 2000**

| <u>Shares/\$ Par</u>                                      | <u>Value<br/>(Note 1)</u>   | <u>Shares/\$ Par</u> | <u>Value<br/>(Note 1)</u>   |
|---|---|----------------------|---|
| <b>PREFERRED STOCKS AND SECURITIES — 97.8%</b>            |   |                      |   |
| <b>ADJUSTABLE RATE PREFERRED STOCKS — 16.7%</b>           |   |                      |   |
| <b>BANKING — 11.5%</b>                                    |   |                      |   |
| Bank One Corporation:                                     |   |                      |   |
| 107,775   | Series B, Adj. Rate Pfd. . . . . \$ 9,268,650*  | 146,377              | 5.864% Pfd., Series M . . . . . 6,366,668*  |
| 3,200   | Series C, Adj. Rate Pfd. . . . . 292,800*   | 4,850                | 6.213% Pfd., Series G . . . . . 220,529*  |
| 26,000  | Chase Manhattan Corporation, Series L,<br>Adj. Rate Pfd. . . . . 2,249,000*               | 5,500                | 6.231% Pfd., Series H . . . . . 252,340*  |
|   | Citigroup Inc.:   |                      | Deutsche Bank AG:   |
| 75,000  | Series Q, Adj. Rate Pfd. . . . . 1,612,500*   | \$3,250,000          | BT Capital Trust B,<br>7.90% 1/15/27 Capital Security . . . . . 2,920,791   |
| 102,850   | Series R, Adj. Rate Pfd. . . . . 2,211,275*   | 2,800                | Firststar Realty LLC,<br>8.875% Pfd. REIT, 144A*** . . . . . 2,650,690  |
| 15,050  | J.P. Morgan & Company, Inc., Series A,<br>Adj. Rate Pfd. . . . . 1,143,800*               | \$1,500,000          | First Union Corporation:  |
| 114,400   | Wells Fargo & Company, Series B,<br>Adj. Rate Pfd. . . . . 4,976,400*                     | \$1,750,000          | First Union Capital II,<br>7.95% 11/15/29 Capital Security . . . . . 1,338,037  |
|   | <b>TOTAL BANKING ADJUSTABLE RATE<br/>PREFERRED STOCKS . . . . . 21,754,425</b>            | \$2,500,000          | First Union Institutional Capital II,<br>7.85% 1/1/27 Capital Security . . . . . 1,532,457                            |
|   | <b>UTILITIES — 5.2%</b>   | \$2,500,000          | First Union Institutional Capital I,<br>8.04% 12/1/26 Capital Security . . . . . 2,225,475                            |
| 37,000  | Delmarva Power & Light,<br>Adj. Rate Pfd. . . . . 3,256,000*                              | \$2,500,000          | GreenPoint Financial Corporation:<br>GreenPoint Capital Trust I,<br>9.10% 6/1/27 Capital Security . . . . . 2,178,150 |
|   | Niagara Mohawk Power Corporation:   |                      | HSBC USA, Inc.:   |
| 154,879   | Series A, Adj. Rate Pfd. . . . . 3,639,656*   | 60,600               | \$2.8575 Pfd. . . . . 2,620,344*  |
| 29,674  | Series B, Adj. Rate Pfd. . . . . 730,722*   | \$5,250,000          | Republic New York Capital II,<br>7.53% 12/4/26 STOPS . . . . . 4,547,576  |
| 88,745  | Series C, Adj. Rate Pfd. . . . . 2,185,346*   |                      | Keycorp:  |
|   | <b>TOTAL UTILITIES ADJUSTABLE RATE<br/>PREFERRED STOCKS . . . . . 9,811,724</b>           | \$1,000,000          | Keycorp Institutional Capital II,<br>6.875% 3/17/29 Capital Security . . . . . 787,140                                |
|   | <b>TOTAL ADJUSTABLE RATE<br/>PREFERRED STOCKS . . . . . 31,566,149</b>                    | \$1,870,000          | Keycorp Institutional Capital B,<br>8.25% 12/15/26 Capital Security . . . . . 1,711,817                               |
| <b>FIXED RATE PREFERRED STOCKS AND SECURITIES — 81.1%</b> |   |                      |   |
| <b>BANKING — 23.2%</b>                                    |   |                      |   |
|   | ABN AMRO North America:   | \$1,000,000          | Summit Bancorp:<br>Summit Capital Trust I,<br>8.40% 3/15/27 Capital Security, Series B . . . . . 958,680              |
| 1,480   | LaSalle National Corporation,<br>6.46% Pfd. 144A*** . . . . . 1,412,771*                  | \$2,750,000          | Washington Mutual, Inc.,<br>8.375% 6/1/27 Capital Security . . . . . 2,537,837  |
|   | BancWest Corporation:   | \$2,500,000          | Wells Fargo & Company, Capital I,<br>7.96% 12/15/26 Capital Security . . . . . 2,370,787                              |
| \$6,500,000   | First Hawaiian Capital I,<br>8.343% 7/1/27 Capital Security, Series B . . . . . 5,829,785 |                      | <b>TOTAL BANKING FIXED RATE<br/>PREFERRED STOCKS<br/>AND SECURITIES . . . . . 44,139,111</b>                          |

See Notes to Financial Statements.

Preferred Income Fund Incorporated  
**PORTFOLIO OF INVESTMENTS (Continued)**  
**November 30, 2000**

| <u>Shares/\$ Par</u>  | <u>Value<br/>(Note 1)</u>                          | <u>Shares/\$ Par</u> | <u>Value<br/>(Note 1)</u>                                |
|---|--|----------------------|--|
| <b>PREFERRED STOCKS AND SECURITIES (Continued)</b>            |  |                      |  |
| <b>FIXED RATE PREFERRED STOCKS AND SECURITIES (Continued)</b> |  |                      |  |
| <b>FINANCIAL SERVICES — 14.8%</b>                             |  |                      |  |
|   |  |                      | SAFECO Corporation:                                      |
|   |  | \$2,480,000          | SAFECO Capital Trust I,                                  |
|   |  |                      | 8.072% 7/15/37 Capital Security . . . . \$ 2,014,120     |
|   |  |                      | The St. Paul Companies, Inc.:                            |
| 208,840   | 5.49% Pfd., Series G . . . . . \$ 8,227,252*       | \$4,700,000          | MMI Capital Trust I, 7.625%                              |
| 11,790  | 5.72% Pfd., Series F . . . . . 480,560*            |                      | 12/15/27 Capital Security, Series B . . . 4,253,993      |
| 9,790   | 6.15% Pfd., Series E . . . . . 429,047*            |                      | UnumProvident Corporation:                               |
| \$3,972,000   | Countrywide Credit Capital I,                      | \$4,000,000          | Provident Financing Trust I,                             |
|   | 8.00% 12/15/26 Capital Security . . . . 3,484,735  |                      | 7.405% 3/15/38 Capital Security . . . . <u>3,032,640</u> |
|   | Household International, Inc.:                     |                      |  |
| 10,000  | \$4.30 Pfd. . . . . 616,450*                       |                      | <b>TOTAL INSURANCE FIXED RATE</b>                        |
| 2,405   | 5.00% Pfd. . . . . 89,238*                         |                      | <b>PREFERRED STOCKS</b>                                  |
| 70,000  | Household Capital Trust IV, 7.25% . . . 1,531,950  |                      | <b>AND SECURITIES . . . . . <u>15,481,889</u></b>        |
|   | Lehman Brothers Holdings, Inc.:                    |                      | <b>OIL AND GAS — 5.9%</b>                                |
| 50,650  | 5.67%, Series D . . . . . 2,056,896*               | 8,800                | Anadarko Petroleum Corporation,                          |
| 116,050   | 5.94% Pfd., Series C . . . . . 4,937,347*          |                      | 5.46% Pfd. . . . . 746,240*                              |
| 127,450   | USA Education, Inc.,                               | 44,600               | Apache Corporation,                                      |
|   | 6.97% Pfd., Series A . . . . . <u>6,305,589*</u>   |                      | 5.68% Pfd., Series B . . . . . 3,914,542*                |
|   | <b>TOTAL FINANCIAL SERVICES FIXED</b>              | 42,800               | Coastal Corporation.:                                    |
|   | <b>RATE PREFERRED STOCKS</b>                       |                      | Coastal Finance I,                                       |
|   | <b>AND SECURITIES . . . . . <u>28,159,064</u></b>  | 1,860                | 8.375% TOPrS . . . . . 1,037,044                         |
|   | <b>INSURANCE — 8.2%</b>                            | 30,000               | EOG Resources, Inc.,                                     |
|   | Allstate Corporation:                              |                      | 7.195% Pfd., Series B, 144A*** . . . . 1,969,721*        |
| \$1,900,000   | Allstate Financing II,                             | 50,000               | LASMO America Ltd.,                                      |
|   | 7.83% 12/1/45 Capital Security . . . . . 1,742,927 |                      | 8.15% Pfd. 144A*** . . . . . 3,251,850*                  |
| \$ 520,000  | AON Corporation:                                   | 14,700               | Ultramar Diamond Shamrock Corporation:                   |
|   | AON Capital Trust A,                               |                      | UDS Capital I,   |
|   | 8.205% 1/1/27 Capital Security . . . . . 480,888   |                      | 8.32% TOPrS . . . . . <u>328,765</u>                     |
|   | Conseco, Inc.:                                     |                      | <b>TOTAL OIL AND GAS FIXED RATE</b>                      |
| 37,650  | Conseco Financing Trust I,                         |                      | <b>PREFERRED STOCKS</b>                                  |
|   | 9.16% 11/30/26 . . . . . 487,379                   |                      | <b>AND SECURITIES . . . . . <u>11,248,162</u></b>        |
| 75,000  | Conseco Financing Trust VI,                        |                      | <b>MISCELLANEOUS INDUSTRIES — 2.5%</b>                   |
|   | 9.00% 12/31/28 . . . . . 969,750                   | 26                   | BHP Operations,  |
| 29,350  | Conseco Financing Trust V,                         |                      | 6.76% Pfd. 144A*** . . . . . 2,614,909*                  |
|   | 8.70% 9/30/28 . . . . . 377,001                    | 57,600               | Farmland Industries, Inc.,                               |
| 21  | Prudential Human Resources                         |                      | 8.00% Pfd. 144A*** . . . . . 1,552,896*                  |
|   | Management Company, Inc.,                          |                      |  |
|   | 6.30% Private Placement, Sinking                   |                      |  |
|   | Fund Pfd., Series A . . . . . 2,123,191*           |                      |  |

See Notes to Financial Statements.

Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)**

**November 30, 2000**

| <u>Shares/\$ Par</u>   | <u>Value<br/>(Note 1)</u>  | <u>Shares/\$ Par</u>          | <u>Value<br/>(Note 1)</u>  |
|--|--|-------------------------------|--|
| <b>PREFERRED STOCKS AND SECURITIES (Continued)</b>   |  | 4,440                         | Entergy Gulf States Inc.,<br>7.56% Pfd. .... \$ 454,123*                               |
| <b>FIXED RATE PREFERRED STOCKS AND SECURITIES (Continued)</b>                                  |  |                               | Entergy Louisiana, Inc.:   |
| <b>MISCELLANEOUS INDUSTRIES (Continued)</b>  |  | 260                           | 7.84% Pfd. .... 27,080*  |
| 9,520  | Viad Corporation,<br>\$4.75 Sinking Fund Pfd. .... \$ 496,040*                   | 105,500                       | 8.00% Pfd., Series 92 .... 2,697,635*  |
| <b>TOTAL MISCELLANEOUS INDUSTRIES<br/>FIXED RATE PREFERRED STOCKS<br/>AND SECURITIES</b> ..... |  | 8,500                         | Entergy Mississippi, Inc.,<br>7.44% Pfd. .... 856,885*                                 |
|  | <u>4,663,845</u>   | 5,350                         | Florida Power & Light Company:<br>4.35% Pfd., Series E, Pvt. .... 359,199*             |
| <b>UTILITIES — 26.5%</b>   |  | 100                           | 6.75% Pfd., Series U .... 10,184*  |
| 72,700   | Alabama Power Company,<br>5.20% Pfd. .... 1,519,430*                             | Florida Progress Corporation: |  |
| 76,450   | Appalachian Power Company,<br>8.00% QUIDS, Series B .... 1,879,141               | 71,300                        | FPC Capital I,<br>7.10% QUIPS, Series A .... 1,540,080                                 |
| 10,000   | Boston Edison Company,<br>4.78% Pfd. .... 784,100*                               | 20,000                        | Hawaiian Electric Company, Inc.:<br>HECO Capital Trust I,<br>8.05% QUIPS .... 466,800  |
|  | Central Hudson Gas & Electric Corporation:                                       | Illinois Power Company:       |  |
| 5,000  | 4.35% Pfd., Series D, Pvt. .... 344,650*   | 4,530                         | 4.08% Pfd., Series A .... 140,339*   |
| 750  | 4.96% Pfd., Series E, Pvt. .... 58,057*  | 8,960                         | 4.42% Pfd., Series D .... 300,698*   |
|  | Central Power and Light Company:   | 29,370                        | 4.70% Pfd., Series E .... 1,047,922*   |
| 144,950  | CPL Capital I,<br>8.00% QUIPS, Series A .... 3,491,845                           | 785                           | 7.75% Pfd. .... 38,469*  |
| 12,450   | Columbus Southern Power Company,<br>7.92%, Jr. Sub. Debt., Series B .... 301,850 | 10,000                        | Indiana Michigan Power Company,<br>8.00% Pfd., Series A .... 247,300                   |
|  | Connecticut Light and Power Company:   | 12,000                        | Indianapolis Power & Light Company,<br>5.65% Pfd. .... 1,049,040*                      |
| 885  | \$2.06 Pfd. (\$50 Par) .... 24,258*  | 6,429                         | Jersey Central Power & Light Company,<br>7.52% Sinking Fund Pfd., Series K .. 671,445* |
| 459  | \$3.24 Pfd. (\$50 Par) .... 19,907*  | 1,810                         | Kansas City Power & Light Company,<br>4.50% Pfd. .... 127,714*                         |
| 2,000  | 4.50% Pfd. .... 59,870*  | 8,500                         | Monongahela Power Company,<br>\$7.73 Pfd., Series L .... 884,382*                      |
| 6,870  | Dayton Power and Light Company,<br>3.90% Pfd., Series C .... 433,016*            | Nevada Power Company:         |  |
|  | Duke Energy Corporation:   | 27,860                        | NVP Capital I,<br>8.20% QUIPS, Series A .... 640,919                                   |
| 5,550  | 4.50% Pfd., Series C .... 394,688*   | 30,000                        | NVP Capital III,<br>7.75% TIPS .... 678,000  |
| 3,412  | 7.85% Pfd., Series S .... 355,718*   | 3,500                         | Northern Indiana Public Service Company,<br>7.44% Pfd. .... 357,298*                   |
| 10,900   | El Paso Tennessee Pipeline Company,<br>8.25% Pfd., Series A .... 558,080*        |                               |  |
|  | Entergy Arkansas, Inc.:  |                               |  |
| 2,800  | 7.32% Pfd. .... 283,094*   |                               |  |
| 11,350   | 7.40% Pfd. .... 1,160,140*   |                               |  |
| 1,147  | 7.88% Pfd. .... 119,707*   |                               |  |

See Notes to Financial Statements.

Preferred Income Fund Incorporated  
**PORTFOLIO OF INVESTMENTS (Continued)**  
**November 30, 2000**

| <u>Shares/\$ Par</u>  | <u>Value<br/>(Note 1)</u>   | <u>Shares/\$ Par</u> | <u>Value<br/>(Note 1)</u>   |
|---|---|----------------------|---|
| <b>PREFERRED STOCKS AND SECURITIES (Continued)</b>            |   |                      |   |
| <b>FIXED RATE PREFERRED STOCKS AND SECURITIES (Continued)</b> |   |                      |   |
| <b>UTILITIES (Continued)</b>                                  |   |                      |   |
| 6,170   | Ohio Edison Company,<br>4.44% Pfd. . . . . \$ 366,159*  | 26,311               | South Carolina Electric & Gas Company:<br>5.125% Purchase Fund Pfd. . . . . \$ 1,109,930*         |
|   | Ohio Power Company:   | 8,000                | 6.00% Purchase Fund Pfd. . . . . 391,760*   |
| 36,300  | 7.375% Sr. Notes . . . . . 847,968  | 65,000               | Southern Union Company:<br>Southern Union Financing I,<br>9.48% TOPrS . . . . . 1,617,850         |
| 15,500  | 7.92% QUIIDS, Series B . . . . . 377,193  | 6,050                | TransCanada PipeLines Ltd.,<br>8.25% . . . . . 145,714  |
| 33,600  | 8.16% Pfd., Series A . . . . . 827,736  | 10                   | TXU Corporation,<br>7.24% Pfd., Series B . . . . . 1,051,294*                                     |
|   | PacifiCorp:   | \$3,800,000          | Union Electric Power Company,<br>7.69% 12/15/36 Capital Security,<br>Series A . . . . . 3,473,922 |
| 125   | \$4.56 Pfd. . . . . 8,968*  |                      | XCEL Energy, Inc.:<br>\$4.10 Pfd., Series C . . . . . 919,308*                                    |
| 5,410   | \$4.72 Pfd. . . . . 401,720*  |                      | PSCO Capital Trust I,<br>7.60% TOPrS . . . . . 1,134,480  |
| 5,000   | PECO Energy Company:<br>\$4.40 Pfd., Series C . . . . . 313,550*  | 14,200               | Southwestern Public Service Capital I,<br>7.85%, Series A . . . . . 119,375                       |
| \$1,050,000   | Capital Trust III,<br>\$7.38 4/6/28 Capital Security, Series D . . . . . 905,678                                  | 48,000               |   |
| 5,000   | PPL Electric Utilities Corporation,<br>6.75% Pfd. . . . . 496,750*  | 5,000                |   |
| 9,410   | PSI Energy, Inc.,<br>4.32% Pfd. . . . . 156,865*  |                      | <b>TOTAL UTILITIES FIXED RATE<br/>PREFERRED STOCKS<br/>AND SECURITIES . . . . . 50,429,438</b>    |
| 10,000  | Public Service Company of New Mexico,<br>4.58% Private Pfd. . . . . 630,850*                                      |                      | <b>TOTAL FIXED RATE<br/>PREFERRED STOCKS<br/>AND SECURITIES . . . . . 154,121,509</b>             |
| 53,500  | Public Service Enterprise Group Inc.:<br>Enterprise Capital Trust I,<br>7.44% TOPrS, Series A . . . . . 1,153,995 |                      | <b>TOTAL PREFERRED STOCKS<br/>AND SECURITIES<br/>(Cost \$188,953,961) . . . . . 185,687,658</b>   |
| 92,200  | Puget Sound Energy, Inc.:<br>7.45% Pfd., Series II . . . . . 2,411,952*   |                      | <b>COMMON STOCKS — 0.3% (Cost \$561,856)</b>  |
| 11,758  | 7.75% Sinking Fund Pfd. . . . . 1,229,946*  |                      | <b>UTILITIES — 0.3%</b>   |
| 45,000  | Reliant Energy, Inc.:<br>HL&P Capital Trust I,<br>8.125% QUIPS . . . . . 1,090,800                                | 27,500               | Wisconsin Energy Corporation . . . . . 587,813*   |
| 57,750  | REI Trust I,<br>7.20% TOPrS, Series C . . . . . 1,255,196   | \$ 968,000           | <b>COMMERCIAL PAPER — 0.5% (Cost \$968,000)</b>   |
| \$3,500,000   | Houston Light & Power, Capital Trust II,<br>8.257%, 2/1/37 Capital Security,<br>Series B . . . . . 3,291,505      |                      | General Electric Capital Corporation,<br>6.54%, due 12/01/00 . . . . . 968,000                    |
| 4,984   | Rochester Gas & Electric Corporation,<br>4.10% Pfd., Series H . . . . . 315,911*                                  |                      |   |

See Notes to Financial Statements.

Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)**

**November 30, 2000**

| <u>Shares/\$ Par</u>   | <u>Value<br/>(Note 1)</u> |
|--|---------------------------|
| <b>OPTIONS CONTRACTS — 0.3%</b> (Cost \$1,873,275)                             |                           |
| 1,220 Put Options on U.S. Treasury<br>Bond March Futures,<br>expiring 2/17/01† | \$ 633,829                |
| <b>TOTAL INVESTMENTS</b> (Cost \$192,357,092**) 98.9%                          | 187,877,300               |
| <b>OTHER ASSETS AND LIABILITIES</b> (Net) . . . . . 1.1                        | 2,105,233                 |
| <b>NET ASSETS</b> . . . . . 100.0%   | <u>\$189,982,533</u>      |

- \* Securities eligible for the Dividends Received Deduction.
- \*\* Aggregate cost for federal tax purposes is \$191,536,851.
- \*\*\* Securities exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registration to qualified institutional buyers.
- † Non-income producing.

ABBREVIATIONS (Note 6):

- QUIDS — Quarterly Income Debt Securities
- QUIPS — Quarterly Income Preferred Securities
- REIT — Real Estate Investment Trust
- STOPS — Semi-Annual Trust Originated Pass Through Securities
- TIPS — Trust Issued Preferred Securities
- TOPrS — Trust Originated Preferred Securities

Capital Securities are considered debt instruments for financial statement purposes and the amounts shown in the Shares/\$ Par column are dollar amounts of par value.

See Notes to Financial Statements.

Preferred Income Fund Incorporated

**STATEMENT OF ASSETS AND LIABILITIES**

**November 30, 2000**

**ASSETS:**

|  |  |                    |
|--|--|--------------------|
| Investments, at value (Cost \$192,357,092) (Note 1)<br>See accompanying schedule . . . . . |  | \$187,877,300      |
| Receivable for securities purchased . . . . .  |  | 425,449            |
| Dividends and interest receivable . . . . .  |  | 2,143,158          |
| Prepaid expenses . . . . .   |  | 30,098             |
| Total Assets . . . . .   |  | <u>190,476,005</u> |

**LIABILITIES:**

|  |            |                |
|--|------------|----------------|
| Payable for securities purchased . . . . .         | \$ 119,580 |                |
| Dividends payable to Common Shareholders . . . . . | 175,943    |                |
| Investment advisory fee payable (Note 2) . . . . . | 87,814     |                |
| Professional fees payable . . . . .                | 45,074     |                |
| Accrued expenses and other payables . . . . .      | 65,061     |                |
| Total Liabilities . . . . .                        |            | <u>493,472</u> |

**NET ASSETS**

\$189,982,533

**NET ASSETS** consist of:

|  |             |                      |
|--|-------------|----------------------|
| Undistributed net investment income (Note 1) . . . . .               | \$ 670,224  |                      |
| Accumulated net realized loss on investments sold (Note 1) . . . . . | (5,540,082) |                      |
| Unrealized depreciation of investments (Note 3) . . . . .            | (4,479,792) |                      |
| Par value of Common Stock . . . . .                                  | 98,386      |                      |
| Paid-in capital in excess of par value of Common Stock . . . . .     | 141,733,797 |                      |
| Money Market Cumulative Preferred™ Stock (Note 5) . . . . .          | 57,500,000  |                      |
| Total Net Assets . . . . .   |             | <u>\$189,982,533</u> |

Per Share

**NET ASSETS AVAILABLE TO:**

|  |                     |                    |
|--|---------------------|--------------------|
| Money Market Cumulative Preferred™ Stock (575 shares<br>outstanding) redemption value . . . . .    | \$100,000.00        | \$57,500,000       |
| Accumulated undeclared dividends on Money Market<br>Cumulative Preferred™ Stock (Note 9) . . . . . | 1,027.83            | 591,000            |
|  | <u>\$101,027.83</u> | <u>58,091,000</u>  |
| Common Stock (9,838,571 shares outstanding) . . . . .  | <u>\$13.41</u>      | <u>131,891,533</u> |

**TOTAL NET ASSETS**

\$189,982,533

Preferred Income Fund Incorporated

**STATEMENT OF OPERATIONS**

**For the Year Ended November 30, 2000**

**INVESTMENT INCOME:**

|                               |  |                  |
|-------------------------------|--|------------------|
| Dividends .....               |  | \$10,266,796     |
| Interest .....                |  | <u>4,573,119</u> |
| Total Investment Income ..... |  | 14,839,915       |

**EXPENSES:**

|   |               |                  |
|---|---------------|------------------|
| Investment advisory fee (Note 2) .....  | \$1,072,550   |                  |
| Administration fee (Note 2) .....   | 227,405       |                  |
| Money Market Cumulative Preferred™ broker commissions and<br>Auction Agent fees ..... | 146,146       |                  |
| Insurance expense .....   | 99,322        |                  |
| Legal and audit fees .....  | 76,500        |                  |
| Shareholder servicing agent fees and expenses (Note 2) .....                          | 68,207        |                  |
| Directors' fees and expenses (Note 2) .....   | 57,777        |                  |
| Custodian fees and expenses (Note 2) .....  | 29,023        |                  |
| Other .....   | <u>76,768</u> |                  |
| Total Expenses .....  |               | <u>1,853,698</u> |

**NET INVESTMENT INCOME** ..... 12,986,217

**REALIZED AND UNREALIZED LOSS ON INVESTMENTS**

(Notes 1 and 3):

|   |                    |
|---|--------------------|
| Net realized loss on investments sold during the year .....                   | (4,274,778)        |
| Change in net unrealized depreciation of investments<br>during the year ..... | <u>(1,234,988)</u> |

**NET REALIZED AND UNREALIZED LOSS ON INVESTMENTS** ..... (5,509,766)

**NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS** ... \$ 7,476,451

See Notes to Financial Statements.

Preferred Income Fund Incorporated

**STATEMENT OF CHANGES IN NET ASSETS**

|   | <u>Year Ended<br/>November 30, 2000</u> | <u>Year Ended<br/>November 30, 1999</u> |
|---|---|---|
| <b>INCREASE / (DECREASE) IN NET ASSETS</b>  |   |   |
| <b>OPERATIONS:</b>  |   |   |
| Net investment income . . . . .   | \$ 12,986,217                           | \$ 12,684,165                           |
| Net realized gain (loss) on investments sold during the year . . . . .  | (4,274,778)                             | 2,426,942                               |
| Change in net unrealized appreciation (depreciation)<br>of investments during the year . . . . .                                  | <u>(1,234,988)</u>                      | <u>(15,491,387)</u>                     |
| Net increase (decrease) in net assets resulting from operations . . . .   | 7,476,451                               | (380,280)                               |
| <b>DISTRIBUTIONS:</b>   |   |   |
| Dividends paid from net investment income to Money Market<br>Cumulative Preferred™ Stock Shareholders (Note 5) . . . . .          | (2,821,469)                             | (2,011,963)                             |
| Distributions paid from net realized capital gains to Money<br>Market Cumulative Preferred™ Stock Shareholders (Note 5) . . . . . | (151,753)                               | (815,122)                               |
| Dividends paid from net investment income to Common Stock<br>Shareholders . . . . .   | (10,268,842)                            | (11,066,234)                            |
| Distributions paid from net realized capital gains to Common Stock<br>Shareholders . . . . .                                      | <u>(4,115,149)</u>                      | <u>(5,261,030)</u>                      |
| Total Distributions . . . . .   | <u>(17,357,213)</u>                     | <u>(19,154,349)</u>                     |
| <b>NET DECREASE IN NET ASSETS FOR THE YEAR . . . . .</b>  | <b>(9,880,762)</b>                      | <b>(19,534,629)</b>                     |
| <b>NET ASSETS:</b>  |   |   |
| Beginning of year . . . . .   | <u>199,863,295</u>                      | <u>219,397,924</u>                      |
| End of year (including undistributed net investment income of<br>\$670,224 and \$804,614, respectively) . . . . .                 | <u><u>\$189,982,533</u></u>             | <u><u>\$199,863,295</u></u>             |

See Notes to Financial Statements.

Preferred Income Fund Incorporated

## FINANCIAL HIGHLIGHTS

For a Common share outstanding throughout each period.

Contained below is per share operating performance data, total investment returns, ratios to average net assets and other supplemental data. This information has been derived from information provided in the financial statements and market price data for the Fund's shares.

|   | Year Ended November 30, |            |           |           |           |
|---|-------------------------|------------|-----------|-----------|-----------|
|   | 2000                    | 1999       | 1998      | 1997      | 1996      |
| <b>PER SHARE OPERATING PERFORMANCE:</b>   |                         |            |           |           |           |
| Net asset value, beginning of year  | \$ 14.41                | \$ 16.43   | \$ 16.71  | \$ 16.50  | \$ 15.80  |
| <b>INVESTMENT OPERATIONS:</b>   |                         |            |           |           |           |
| Net investment income   | 1.32                    | 1.29       | 1.28      | 1.27      | 1.37      |
| Net realized and unrealized gain/(loss) on investments                          | (0.56)                  | (1.35)     | 0.05      | 1.00      | 0.65      |
| Total from investment operations  | 0.76                    | (0.06)     | 1.33      | 2.27      | 2.02      |
| <b>DISTRIBUTIONS:</b>   |                         |            |           |           |           |
| Dividends paid from net investment income to MMP* Shareholders                  | (0.29)                  | (0.20)     | (0.17)    | (0.22)    | (0.15)    |
| Distributions paid from net realized capital gains to MMP* Shareholders         | (0.01)                  | (0.08)     | (0.07)    | (0.06)    | (0.08)    |
| Dividends paid from net investment income to Common Stock Shareholders          | (1.04)                  | (1.12)     | (1.05)    | (1.15)    | (1.08)    |
| Distributions paid from net realized capital gains to Common Stock Shareholders | (0.42)                  | (0.53)     | (0.30)    | (0.65)    | —         |
| Change in accumulated undeclared dividends on MMP*                              | (0.00)†                 | (0.03)†    | (0.02)    | 0.02      | (0.01)    |
| Total distributions   | (1.76)                  | (1.96)     | (1.61)    | (2.06)    | (1.32)    |
| Net asset value, end of year  | \$ 13.41 †              | \$ 14.41 † | \$ 16.43  | \$ 16.71  | \$ 16.50  |
| Market value, end of year   | \$ 12.125               | \$ 12.750  | \$ 15.938 | \$ 16.188 | \$ 15.500 |
| Total investment return based on net asset value**                              | 4.55%                   | (1.81)%    | 6.91%     | 13.65%    | 12.78%    |
| Total investment return based on market value**                                 | 6.88%                   | (10.43)%   | 7.05%     | 17.20%    | 18.50%    |
| <b>RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:</b>     |                         |            |           |           |           |
| Operating expenses  | 1.41%                   | 1.37%      | 1.32%     | 1.34%     | 1.51%     |
| Net investment income***  | 7.58%                   | 6.66%      | 6.13%     | 6.22%     | 7.22%     |
| <b>SUPPLEMENTAL DATA:††</b>   |                         |            |           |           |           |
| Portfolio turnover rate   | 66%                     | 65%        | 87%       | 74%       | 98%       |
| Net assets, end of period (in 000's)  | \$189,983               | \$199,863  | \$219,398 | \$221,990 | \$220,088 |
| Ratio of operating expenses to total average net assets                         | 0.98%                   | 0.99%      | 0.97%     | 0.99%     | 1.10%     |

\* Money Market Cumulative Preferred™ Stock.

\*\* Assumes reinvestment of distributions at the price obtained by the Fund's Dividend Reinvestment Plan.

\*\*\* The net investment income ratios reflect income net of operating expenses and payments to MMP\* Shareholders.

† Includes effect of additional distribution available to MMP\* Shareholders (\$0.03 per Common Share in 2000 and \$0.05 per Common Share in 1999). (See Note 5 to the Financial Statements.)

†† Information presented under heading Supplemental Data includes MMP\*.

See Notes to Financial Statements.

Preferred Income Fund Incorporated

**FINANCIAL HIGHLIGHTS (Continued)**

The table below sets out information with respect to Money Market Cumulative Preferred™ Stock currently outstanding.

|          | <u>Total Shares Outstanding</u> | <u>Asset Coverage Per Share</u> | <u>Involuntary Liquidating Preference Per Share (1)</u> | <u>Average Market Value Per Share (1) &amp; (2)</u> |
|----------|---------------------------------|---------------------------------|---|---|
| 11/30/00 | 575                             | \$330,404                       | \$100,000   | \$100,000   |
| 11/30/99 | 575                             | 347,588                         | 100,000   | 100,000   |
| 11/30/98 | 575                             | 381,562                         | 100,000   | 100,000   |
| 11/30/97 | 575                             | 386,070                         | 100,000   | 100,000   |
| 11/30/96 | 575                             | 382,762                         | 100,000   | 100,000   |

(1) Excludes accumulated undeclared dividends.

(2) See Note 5.

See Notes to Financial Statements.

Preferred Income Fund Incorporated

## NOTES TO FINANCIAL STATEMENTS

### 1. Significant Accounting Policies

Preferred Income Fund Incorporated (the "Fund") is a diversified, closed-end management investment company organized as a Maryland corporation and is registered with the Securities and Exchange Commission ("SEC") under the Investment Company Act of 1940, as amended. The policies described below are followed consistently by the Fund in the preparation of its financial statements in conformity with generally accepted accounting principles.

*Portfolio valuation:* The net asset value of the Fund's Common Stock is determined by the Fund's administrator no less frequently than on the last business day of each week and month. It is determined by dividing the value of the Fund's net assets attributable to common shares by the number of shares of Common Stock outstanding. The value of the Fund's net assets attributable to common shares is deemed to equal the value of the Fund's total assets less (i) the Fund's liabilities, (ii) the aggregate liquidation value of the outstanding Money Market Cumulative Preferred™ Stock and (iii) accumulated and unpaid dividends on the outstanding Money Market Cumulative Preferred™ Stock. Securities listed on a national securities exchange are valued on the basis of the last sale on such exchange on the day of valuation. In the absence of sales of listed securities and with respect to securities for which the most recent sale prices are not deemed to represent fair market value and unlisted securities (other than money market instruments), securities are valued at the mean between the closing bid and asked prices when quoted prices for investments are readily available. Investments in over-the-counter derivative instruments, such as interest rate swaps and options thereon (i.e., "swaptions") are valued at the prices obtained from the broker/dealer or bank that is the counterparty to such instrument, subject to comparison of such valuation with a valuation obtained from a broker/dealer or bank that is not a counterparty to the particular derivative instrument. Investments for which market quotations are not readily available or for which management determines that the prices are not reflective of current market conditions are valued at fair value as determined in good faith by or under the direction of the Board of Directors of the Fund, including reference to valuations of other securities which are comparable in quality, maturity and type. Investments in money market instruments, which mature in 60 days or less, are valued at amortized cost.

*Securities transactions and investment income:* Securities transactions are recorded as of the trade date. Realized gains and losses from securities sold are recorded on the identified cost basis. Dividend income is recorded on ex-dividend dates. Interest income is recorded on the accrual basis.

In November 2000, a revised AICPA Audit and Accounting Guide, *Audits of Investment Companies*, was issued, and is effective for fiscal years beginning after December 15, 2000. The revised Guide will require the Fund to amortize premium and discount on bonds and notes. Upon initial adoption, the Fund will be required to adjust the cost of its bonds and notes by the cumulative amount of amortization that would have been recognized had amortization been in effect from the purchase date of each holding. Adopting this accounting principle will not affect the Fund's net asset value, but will change the classification of certain amounts between interest income and realized and unrealized gain/loss in the

**NOTES TO FINANCIAL STATEMENTS (Continued)**

Statement of Operations. The Fund has not at this time undertaken to quantify the impact, if any, resulting from the adoption of this principle on the financial statements.

*Option accounting principles:* Upon the purchase of an option by the Fund, the total purchase price paid is recorded as an investment. The market valuation is determined as set forth in the preceding portfolio valuation paragraph. When the Fund enters into a closing sale transaction, the Fund will record a gain or loss depending on the difference between the purchase and sale price. The risks associated with purchasing options and the maximum loss the Fund would incur are limited to the purchase price originally paid.

*Repurchase Agreements:* The Fund may engage in repurchase agreement transactions. The Fund's Investment Adviser reviews and approves the eligibility of the banks and dealers with which the Fund may enter into repurchase agreement transactions. The value of the collateral underlying such transactions is at least equal at all times to the total amount of the repurchase obligations, including interest. The Fund maintains possession of the collateral through its custodian and, in the event of counterparty default, the Fund has the right to use the collateral to offset losses incurred. There is the possibility of loss to the Fund in the event the Fund is delayed or prevented from exercising its rights to dispose of the collateral securities.

*Dividends and distributions to shareholders:* The Fund expects to declare dividends on a monthly basis to shareholders of Common Stock. The shareholders of Money Market Cumulative Preferred™ Stock are entitled to receive cumulative cash dividends as declared by the Fund's Board of Directors. Distributions to shareholders are recorded on the ex-dividend date. Any net realized short-term capital gains will be distributed to shareholders at least annually. Any net realized long-term capital gains may be distributed to shareholders at least annually or may be retained by the Fund as determined by the Fund's Board of Directors. Capital gains retained by the Fund are subject to tax at the corporate tax rate. Subject to the Fund qualifying as a regulated investment company, any taxes paid by the Fund on such net realized long-term gains may be used by the Fund's Shareholders as a credit against their own tax liabilities.

*Federal income taxes:* The Fund intends to continue to qualify as a regulated investment company by complying with the requirements under subchapter M of the Internal Revenue Code of 1986, as amended, applicable to regulated investment companies and intends to distribute substantially all of its taxable net investment income to its shareholders. Therefore, no Federal income tax provision is required.

Income and capital gain distributions are determined and characterized in accordance with income tax regulations which may differ from generally accepted accounting principles. These differences are primarily due to (1) differing treatments of income and gains on various investment securities held by the Fund, including timing differences, (2) the attribution of expenses against certain components of taxable investment income, and (3) federal regulations requiring proportional allocation of income and gains to all classes of Shareholders.

Preferred Income Fund Incorporated

## NOTES TO FINANCIAL STATEMENTS (Continued)

The Internal Revenue Code of 1986, as amended, imposes a 4% nondeductible excise tax on the Fund to the extent the Fund does not distribute by the end of any calendar year at least (1) 98% of the sum of its net investment income for that year and its capital gains (both long term and short term) for its fiscal year and (2) certain undistributed amounts from previous years.

*Other:* The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates.

### 2. Investment Advisory Fee, Directors' Fees, Administration Fee and Transfer Agent Fee

Flaherty & Crumrine Incorporated (the "Adviser") serves as the Fund's Investment Adviser. The Fund pays the Adviser a monthly fee at an annual rate of 0.625% of the value of the Fund's average monthly net assets up to \$100 million and 0.50% of the value of the Fund's average monthly net assets in excess of \$100 million.

The Fund currently pays each Director who is not a director, officer or employee of the Adviser a fee of \$9,000 per annum, plus \$500 for each in-person meeting of the Board of Directors or any committee and \$100 for each telephone meeting. In addition, the Fund will reimburse all Directors for travel and out-of-pocket expenses incurred in connection with such meetings.

PFPC Inc. (formerly known as First Data Investor Services Group, Inc.), a member of the PNC Financial Services Group (formerly known as PNC Bank Corp.), serves as the Fund's Administrator and Transfer Agent. As Administrator, PFPC Inc. calculates the net asset value of the Fund's shares and generally assists in all aspects of the Fund's administration and operation. As compensation for PFPC Inc.'s services as Administrator, the Fund pays PFPC Inc. a monthly fee at an annual rate of 0.12% of the Fund's average monthly net assets. Boston Safe Deposit and Trust Company ("Boston Safe"), a wholly-owned subsidiary of Mellon Bank Corporation, serves as the Fund's Custodian. As compensation for Boston Safe's services as Custodian, the Fund pays Boston Safe a monthly fee at an annual rate of 0.01% of the Fund's average monthly net assets. PFPC Inc. also serves as the Fund's Common Stock servicing agent (transfer agent), dividend-paying agent and registrar, and as compensation for PFPC Inc.'s services as such, the Fund pays PFPC Inc. a fee at an annual rate of 0.02% of the Fund's average monthly net assets plus certain out-of-pocket expenses.

Bankers Trust Corporate & Agency Services, a wholly-owned subsidiary of Deutsche Bank, AG ("Auction Agent"), serves as the Fund's Money Market Cumulative Preferred™ Stock transfer agent, registrar, dividend disbursing agent and redemption agent.

### 3. Purchase and Sales of Securities

Cost of purchases and proceeds from sales of securities for the year ended November 30, 2000, excluding short-term investments, aggregated \$120,658,791 and \$122,446,234, respectively.

Preferred Income Fund Incorporated

**NOTES TO FINANCIAL STATEMENTS (Continued)**

At November 30, 2000, aggregate gross unrealized appreciation for all securities in which there is an excess of value over cost was \$6,462,766 and aggregate gross unrealized depreciation for all securities in which there is an excess of cost over value was \$10,942,558.

**4. Common Stock**

At November 30, 2000, 240,000,000 shares of \$0.01 par value Common Stock were authorized. There were no Common Stock transactions for the years ended November 30, 2000 and 1999.

**5. Money Market Cumulative Preferred™ Stock**

The Fund's Articles of Incorporation authorize the issuance of up to 10,000,000 shares of \$0.01 par value preferred stock. The Money Market Cumulative Preferred™ Stock is senior to the Common Stock and results in the financial leveraging of the Common Stock. Such leveraging tends to magnify both the risks and opportunities to Common Stock Shareholders. Dividends on shares of Money Market Cumulative Preferred™ Stock are cumulative.

The Fund is required to meet certain asset coverage tests with respect to the Money Market Cumulative Preferred™ Stock. If the Fund fails to meet these requirements and does not correct such failure, the Fund may be required to redeem, in part or in full, Money Market Cumulative Preferred™ Stock at a redemption price of \$100,000 per share plus an amount equal to the accumulated and unpaid dividends on such shares in order to meet these requirements. Additionally, failure to meet the foregoing asset requirements could restrict the Fund's ability to pay dividends to Common Stock Shareholders and could lead to sales of portfolio securities at inopportune times.

If the Fund allocates any net gains or income ineligible for the Dividends Received Deduction to shares of the Money Market Cumulative Preferred™ Stock, the Fund is required to make additional distributions to Money Market Cumulative Preferred™ Stock Shareholders or to pay a higher dividend rate in amounts needed to provide a return, net of tax, equal to the return had such originally paid distributions been eligible for the Dividends Received Deduction. Net assets available to Money Market Cumulative Preferred™ Stock at November 30, 2000 include an accrued additional distribution of \$315,000. The amount subsequently declared and paid to the Money Market Cumulative Preferred™ Shareholders for Fiscal 2000 was \$320,729. (See Note 9 – "Subsequent Events".)

Prior to November 30, 1999, additional distributions were not reported as available to Money Market Cumulative Preferred™ Stock until declared by the Board of Directors. The amount of additional distributions payable for any year may be highly uncertain and will not be known until after a fiscal year has been completed.

An auction of the Money Market Cumulative Preferred™ Stock is generally held every 49 days. Existing shareholders may submit an order to hold, bid or sell such shares at par value on each auction date. Money Market Cumulative Preferred™ Stock Shareholders may also trade shares in the secondary market between auction dates.

Preferred Income Fund Incorporated

## **NOTES TO FINANCIAL STATEMENTS (Continued)**

At November 30, 2000, 575 shares of Money Market Cumulative Preferred™ Stock were outstanding at the annual rate of 5.00%. The dividend rate, as set by the auction process, is generally expected to vary with short-term interest rates. These rates may vary in a manner unrelated to the income received on the Fund's assets, which could have either a beneficial or detrimental impact on net investment income and gains available to Common Stock Shareholders. While the Fund expects to structure its portfolio holdings and hedging transactions to lessen such risks to Common Stock Shareholders, there can be no assurance that such results will be attained.

### **6. Portfolio Investments, Concentration and Investment Quality**

The Fund invests primarily in adjustable and fixed rate preferred stocks and similar hybrid, i.e., fully taxable, preferred securities. Under normal market conditions, the Fund invests at least 25% of its assets in securities issued by utilities and at least 25% of its assets in securities issued by companies in the banking industry. The Fund's portfolio may therefore be subject to greater risk and market fluctuation than a portfolio of securities representing a broader range of investment alternatives. The risks could adversely affect the ability and inclination of companies in these industries to declare and pay dividends or interest and the ability of holders of securities of such companies to realize any value from the assets of the issuer upon liquidation or bankruptcy. The Fund may invest up to 15% of its assets at the time of purchase in securities rated below investment grade, provided that no such investment may be rated below both "Ba" by Moody's Investors Service, Inc. and "BB" by Standard & Poor's or judged to be comparable in quality at the time of purchase; however, any such securities must be issued by an issuer having an outstanding class of senior debt rated investment grade. The Fund may invest up to 15% of its assets in common stock. Under normal conditions, the Fund may invest up to 35% of its assets in debt securities. Certain of its investments in hybrid, i.e., fully taxable, preferred securities, such as TOPrS, TIPS, QUIPS, MIPS, QUIDS, QUICS, QIB's, STOPS, Capital Securities, and other similar or related investments, will be subject to the foregoing 35% limitation to the extent that, in the opinion of the Fund's Adviser, such investments are deemed to be debt-like in key characteristics.

### **7. Special Investment Techniques**

The Fund may employ certain investment techniques in accordance with its fundamental investment policies. These may include the use of when-issued and delayed delivery transactions. Securities purchased or sold on a when-issued or delayed delivery basis may be settled within 45 days after the date of the transaction. Such transactions may expose the Fund to credit and market valuation risk greater than that associated with regular trade settlement procedures. The Fund may also enter into transactions, in accordance with its fundamental investment policies, involving any or all of the following: lending of portfolio securities, short sales of securities, futures contracts, interest rate swaps, options on futures contracts, options on securities and options on interest rate swaps, i.e., swaptions. As in the case of when-issued securities, the use of over-the-counter derivatives, such as interest rate swaps and swaptions, may expose the Fund to greater credit, operations, and market value risk than is the case

Preferred Income Fund Incorporated

**NOTES TO FINANCIAL STATEMENTS (Continued)**

with regulated, exchange traded futures and options. With the exception of purchasing securities on a when-issued or delayed delivery basis or lending portfolio securities, these transactions are used for hedging or other appropriate risk-management purposes or, under certain other circumstances, to increase income. As of November 30, 2000, the Fund owned put options on U.S. Treasury bond futures contracts. No assurance can be given that such transactions will achieve their desired purposes or will result in an overall reduction of risk to the Fund.

**8. Significant Shareholders**

At November 30, 2000, the Commerce Group, Inc. owned approximately 30.1% of the Fund's outstanding Common Stock, according to a Schedule 13D filing dated December 1, 2000.

**9. Subsequent Events**

As a result of the income realized by the Fund that did not qualify for the Corporate Dividends Received Deduction ("DRD"), a portion of the distributions paid to the Fund's Money Market Cumulative Preferred™ Stock Shareholders from January 1, 2000, through November 30, 2000, has been designated as being from non-DRD income, as required by Internal Revenue Service Ruling 89-81, with respect to the Internal Revenue Code of 1986, as amended. On December 18, 2000, the Fund declared an additional distribution of \$320,729, payable December 21, 2000, to Money Market Cumulative Preferred™ Stock Shareholders as required by the Fund's Articles Supplementary. (See Note 5.)

## REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders and Board of Directors of  
Preferred Income Fund Incorporated:

In our opinion, the accompanying statement of assets and liabilities, including the portfolio of investments, and the related statements of operations and of changes in net assets and the financial highlights present fairly, in all material respects, the financial position of Preferred Income Fund Incorporated (the "Fund") at November 30, 2000, the results of its operations for the year then ended, the changes in its net assets for each of the two years in the period then ended and the financial highlights for each of the five years in the period then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements and financial highlights (hereafter referred to as "financial statements") are the responsibility of the Fund's management; our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits of these financial statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits, which included confirmation of securities at November 30, 2000 by correspondence with the custodian and brokers, provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP  
Boston, Massachusetts  
January 12, 2001

Preferred Income Fund Incorporated

**TAX INFORMATION (Unaudited)**

Of the total distributions attributable to the fiscal year ended November 30, 2000, including the Additional Distribution to Money Market Cumulative Preferred™ Stock Shareholders, 58.49% qualified for the Dividends Received Deduction for eligible corporate investors. (See Note 9.)

For the calendar year ended December 31, 2000, 56.31% of all distributions paid to Common Stock Shareholders qualified for the Dividends Received Deduction for eligible corporate investors. Shareholders should refer to Form 1099 accompanying additional information and the information contained herein when preparing their tax returns to determine the appropriate tax characterization of the distributions they received from the Fund in calendar year 2000.

At November 30, 2000, the Fund had accumulated realized capital losses of \$6,014,198. These losses may be carried forward and offset against any future capital gains through the year 2008.

Preferred Income Fund Incorporated

## **ADDITIONAL INFORMATION (Unaudited)**

### **Dividend Reinvestment and Cash Purchase Plan**

Under the Fund's Dividend Reinvestment and Cash Purchase Plan (the "Plan"), a shareholder whose Common Stock is registered in his own name will have all distributions reinvested automatically by PFPC Inc. as agent under the Plan, unless the shareholder elects to receive cash. Distributions with respect to shares registered in the name of a broker-dealer or other nominee (that is, in "street name") may be reinvested by the broker or nominee in additional shares under the Plan, but only if the service is provided by the broker or nominee, unless the shareholder elects to receive distributions in cash. A shareholder who holds Common Stock registered in the name of a broker or other nominee may not be able to transfer the Common Stock to another broker or nominee and continue to participate in the Plan. Investors who own Common Stock registered in street name should consult their broker or nominee for details regarding reinvestment.

The number of shares of Common Stock distributed to participants in the Plan in lieu of a cash dividend is determined in the following manner. Whenever the market price per share of the Fund's Common Stock is equal to or exceeds the net asset value per share on the valuation date, participants in the Plan will be issued new shares valued at the higher of net asset value or 95% of the then current market value. Otherwise, PFPC Inc. will buy shares of the Fund's Common Stock in the open market, on the New York Stock Exchange or elsewhere, on or shortly after the payment date of the dividend or distribution and continuing until the ex-dividend date of the Fund's next distribution to holders of the Common Stock or until it has expended for such purchases all of the cash that would otherwise be payable to the participants. The number of purchased shares that will then be credited to the participants' accounts will be based on the average per share purchase price of the shares so purchased, including brokerage commissions. If PFPC Inc. commences purchases in the open market and the then current market price of the shares (plus any estimated brokerage commissions) subsequently exceeds their net asset value most recently determined before the completion of the purchases, PFPC Inc. will attempt to terminate purchases in the open market and cause the Fund to issue the remaining dividend or distribution in shares. In this case, the number of shares received by the participant will be based on the weighted average of prices paid for shares purchased in the open market and the price at which the Fund issues the remaining shares. These remaining shares will be issued by the Fund at the higher of net asset value or 95% of the then current market value.

Plan participants are not subject to any charge for reinvesting dividends or capital gains distributions. Each Plan participant will, however, bear a proportionate share of brokerage commissions incurred with respect to PFPC Inc.'s open market purchases in connection with the reinvestment of dividends or capital gains distributions. For the year ended November 30, 2000, \$8,248 in brokerage commissions were incurred.

The automatic reinvestment of dividends and capital gains distributions will not relieve Plan participants of any income tax that may be payable on the dividends or capital gains distributions. A participant in the Plan will be treated for Federal income tax purposes as having received, on the dividend

Preferred Income Fund Incorporated

---

**ADDITIONAL INFORMATION (Unaudited) (Continued)**

---

payment date, a dividend or distribution in an amount equal to the cash that the participant could have received instead of shares.

In addition to acquiring shares of Common Stock through the reinvestment of cash dividends and distributions, a shareholder may invest any further amounts from \$100 to \$3,000 semi-annually at the then current market price in shares purchased through the Plan. Such semi-annual investments are subject to any brokerage commission charges incurred.

A shareholder whose Common Stock is registered in his or her own name may terminate participation in the Plan at any time by notifying PFPC Inc. in writing, by completing the form on the back of the Plan account statement and forwarding it to PFPC Inc. or by calling PFPC Inc. directly. A termination will be effective immediately if notice is received by PFPC Inc. not less than 10 days before any dividend or distribution record date. Otherwise, the termination will be effective, and only with respect to any subsequent dividends or distributions, on the first day after the dividend or distribution has been credited to the participant's account in additional shares of the Fund. Upon termination and according to a participant's instructions, PFPC Inc. will either (a) issue certificates for the whole shares credited to the shareholder's Plan account and a check representing any fractional shares or (b) sell the shares in the market. Shareholders who hold Common Stock registered in the name of a broker or other nominee should consult their broker or nominee to terminate participation.

The Plan is described in more detail in the Fund's Plan brochure. Information concerning the Plan may be obtained from PFPC Inc. at 1-800-331-1710.

### Directors

Martin Brody  
Donald F. Crumrine, CFA  
Robert T. Flaherty, CFA  
David Gale  
Morgan Gust  
Robert F. Wulf, CFA

### Officers

Robert T. Flaherty, CFA  
Chairman of the Board  
and President  
Donald F. Crumrine, CFA  
Vice President  
and Secretary  
Robert M. Ettinger, CFA  
Vice President  
Peter C. Stimes, CFA  
Vice President  
and Treasurer

### Investment Adviser

Flaherty & Crumrine Incorporated  
e-mail: flaherty@fin-mail.com

### Questions concerning your shares of Preferred Income Fund?

- If your shares are held in a Brokerage Account, contact your Broker.
- If you have physical possession of your shares in certificate form, contact the Fund's Transfer Agent & Shareholder Servicing Agent —  
PFPC Inc.  
P.O. Box 1376  
Boston, MA 02104  
1-800-331-1710

**This report is sent to shareholders of Preferred Income Fund Incorporated for their information. It is not a Prospectus, circular or representation intended for use in the purchase or sale of shares of the Fund or of any securities mentioned in this report.**



## Annual Report

November 30, 2000

web site: [www.preferredincome.com](http://www.preferredincome.com)