

## PREFERRED INCOME FUND INCORPORATED

Dear Shareholder:

The Preferred Income Fund was a bright spot in a year that really needed some good news. For the fiscal year ended November 30, 2001, the Fund earned total returns of 17.0% on net asset value ("NAV") and 28.0% on market price. Those returns were very good by just about any measure.

The following table shows the Fund's returns on NAV over a range of time periods ending November 30, 2001. As in the past, we have compared the Fund to a Lipper composite of investment grade closed-end bond funds. Although the investment strategies used by the Fund differ significantly from those of the typical bond fund, we believe that the Preferred Income Fund provides a better way of accomplishing a similar investment objective.

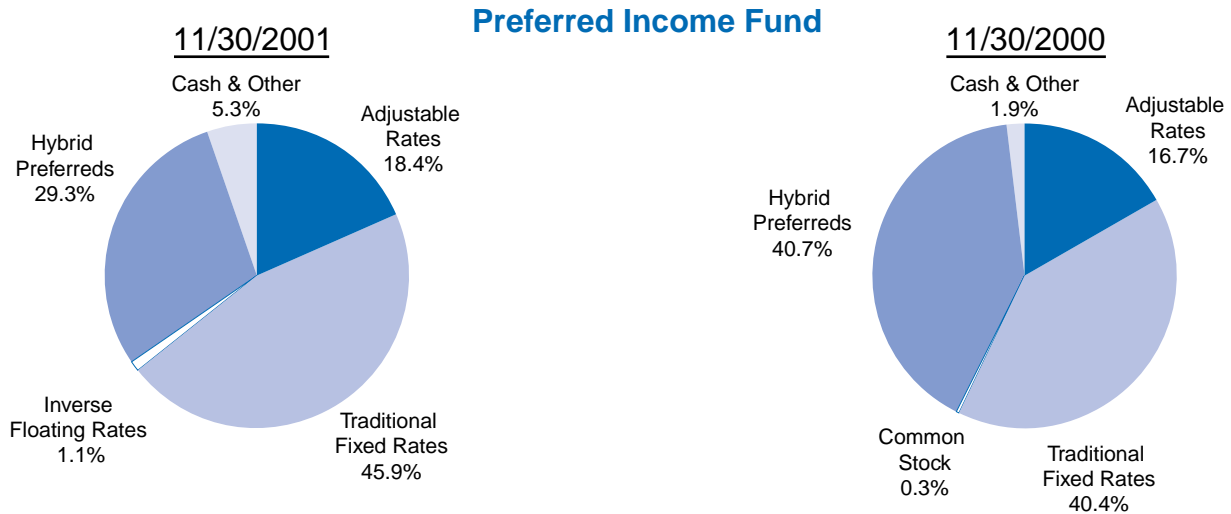
<b>TOTAL RETURN PER YEAR ON NET ASSET VALUE<sup>(1)</sup> FOR PERIODS ENDED 11/30/01</b>			
	<u>One Year</u>	<u>Five Years</u>	<u>Life of Fund<sup>(2)</sup></u>
Preferred Income Fund .....	17.0%	7.5%	12.5%
Lipper Composite of Investment Grade Bond Funds <sup>(3)</sup> .....	11.2%	6.9%	8.2%

(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.

Although the tragedies of September 11th overshadowed everything else, the main events in the markets for bonds and preferreds last year were high volatility and declining interest rates. Short-term interest rates, in particular, fell dramatically. In contrast, long-term rates showed a moderate decline for the year, partially due to a recent bounce back from their previous lows. The Fund benefited from these trends, including even the volatility.

The preferred market gave a good account of itself under these conditions. Hybrid fixed rate preferreds (which are fully taxable) led the parade with a very strong performance, followed by a very commendable showing by adjustable rate preferreds ("ARPs"). Traditional fixed rate preferreds (eligible for the Dividends Received Deduction available to corporate taxpayers) lagged behind, but still did a pretty good job of keeping up with the fixed-income markets generally. Preferreds were definitely a very good place to be in such difficult times.

The disparity in the performance of hybrid and traditional preferreds created some opportunities. As prices seemed right, we sold some of the Fund's holdings of hybrid preferreds and added to both adjustable and fixed rate traditional preferreds. This shift was a reversal in part of the increase in hybrid preferreds accomplished several years ago when hybrids were on the "bargain counter." The following pie charts illustrate the change in the composition of the Fund's portfolio over the course of the year.

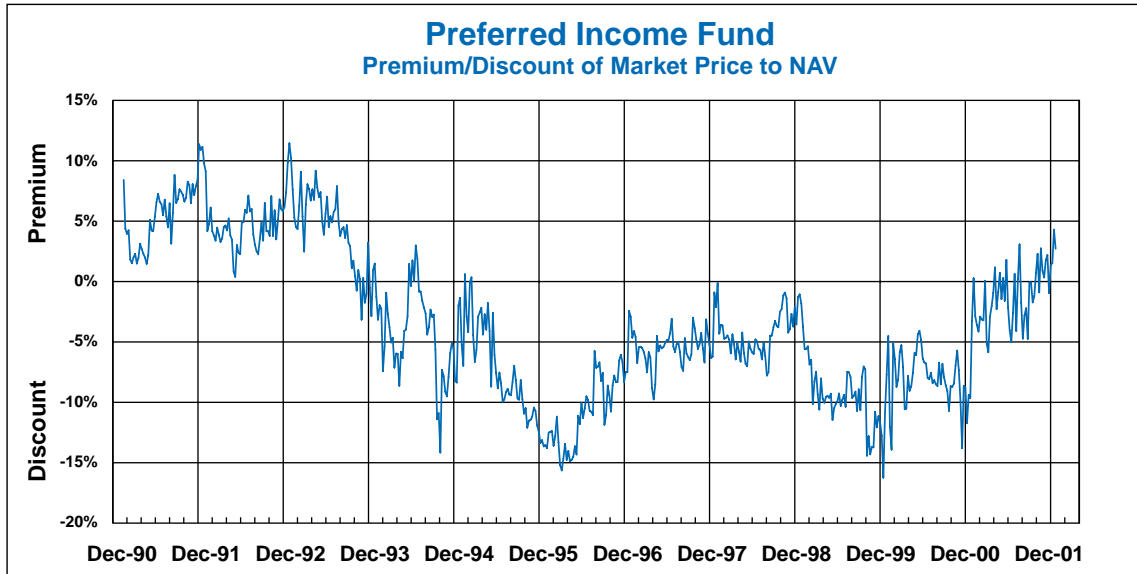


The Board of Directors recently updated the Fund's investment guidelines. The Fund is now required under normal circumstances to invest at least 80% of its total net assets in preferreds of all types, including both hybrid preferreds and traditional preferreds. In the past, the guideline was 65%. Furthermore, investments in debt securities are now limited under normal circumstances to 20% (versus 35% previously) of total net assets. As a practical matter, these revisions merely reflect more closely the Fund's actual practices. They are not expected to cause any changes in our portfolio strategies.

The Fund's leverage magnifies results, good or bad; and that was a big positive this year. Our income benefited greatly from the lower cost of the Money Market Cumulative Preferred™ shares ("MMP") issued by the Fund to create its leverage. The annualized rate paid on the MMP, which is reset every 49 days through an auction process, is approximately 1.7% currently. A year ago, it was around 5%. Beyond that, the leverage further enhanced the very good total returns earned on the Fund's preferred portfolio. It was definitely a good year to be leveraged.

A portion of the appreciation on our holdings of preferreds was offset by losses on the Fund's hedges (which consisted entirely of purchased put options on Treasury bond futures). That was to be expected in the face of declining long term interest rates. The goal in markets like this is simply to keep losses on our "safety net" hedge from eating up too much of what we make on the rest of the portfolio. On that count, we have declared victory.

The market price of the Fund's common stock has recently stayed in a fairly narrow range around the net asset value of the shares, as shown by the graph that follows. The recovery from a discount to NAV a year ago contributed to the especially attractive total returns on market value set forth in the opening paragraph of this letter.



Shareholders will see a tangible sign of the Fund's good fortunes in the form of a special year-end dividend on December 31, 2001 in the amount of 16.4 cents per share, double the regular monthly rate. This special distribution consists entirely of ordinary income. There were no distributions of realized capital gains for the year. The regular rate of 8.2 cents per share will be reinstated in January, 2002. Please see the following Question and Answer section for a more detailed discussion.

The Dividend Reinvestment Plan ("DRIP") provides our shareholders with a convenient and efficient way to increase their investments in the Fund by reinvesting regular dividends and special distributions in additional shares. More information on the DRIP is readily available. If your shares are held in a brokerage account, ask your broker if his firm is set up to participate. If you hold your shares in certificate form, or if you would just like more information, call the DRIP's agent, PFPC Inc., at 1-800-331-1710.

As described in greater detail on page 25 of this report, the Fund changed accountants during the past year. We are pleased to welcome our new auditors, KPMG LLP.

The following Q&A section explores in greater detail several key aspects of the Fund's operations. We also recommend visiting our web site at [www.preferredincome.com](http://www.preferredincome.com) for an ongoing source of current data on the Fund.

Sincerely,

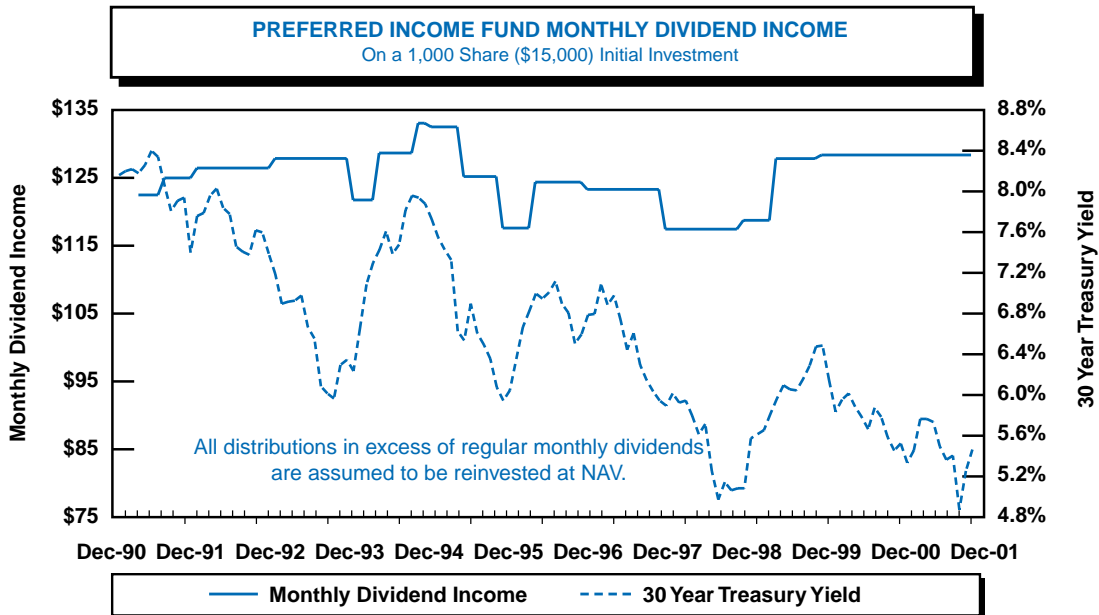
Robert T. Flaherty  
*Chairman of the Board*

December 19, 2001

## QUESTIONS & ANSWERS

### HOW DO CHANGES IN INTEREST RATES AFFECT THE FUND'S INCOME?

It's a mouthful, but here goes! Generally speaking, we expect the Fund's income to increase when interest rates rise significantly while being relatively resistant to significant declines in interest rates. As we have said many times before, this is a very ambitious mission. Nonetheless, we have achieved our goal for many years as the following graph demonstrates.



The solid blue line (measured on the left-hand scale) in the graph represents the monthly dollar income received from an original investment in 1,000 shares of the Fund. In comparison, the yields of long-term U.S. Treasury bonds are shown by the dotted line (measured on the right-hand scale). The graph assumes that the shareholder spent his or her regular monthly income from the Fund and reinvested at net asset value just the portion of each special year-end distribution that was “above and beyond” the monthly dividends.

With interest rates, particularly short-term rates, at historically very low levels now, we face many interesting opportunities and challenges in implementing our income strategies today. Read on!

### WHERE DID THE FUND GET THE MONEY TO DOUBLE ITS DIVIDEND IN DECEMBER?

Give the credit to falling short-term interest rates. The surprisingly sharp reduction in the cost of the Fund's leverage in the last six months of fiscal 2001 caused income to accumulate in excess of the regular monthly dividend rate. In a real twist on an old saying, we ran out of *year* before we ran out of *income*.

Ordinarily, a general decline in interest rates would be more likely to reduce our income than increase it. However, the savings on the cost of leverage were sufficient to offset other factors that, by themselves, would have cut income. Those included hedge losses (which must be covered by sales in the preferred portfolio) and the shift from hybrid preferreds into more traditional DRD eligible preferreds.

The Fund was not affected significantly in the last year by issuers calling their high rate preferreds for redemption, which occurs frequently when interest rates fall. We pay lots of attention to redemption risk, even to the point of giving up a little yield to help protect the Fund's income in times like this.

#### **WHY HASN'T THE FUND INCREASED ITS REGULAR MONTHLY DIVIDEND?**

The "windfall" from the current low cost of leverage may very well be temporary. As the economy ultimately recovers from the current recession, we will most likely see an increase in short-term interest rates (and probably long-term rates, too). At the present, it is unclear how effective our hedges, which are keyed to long-term rates, will be in offsetting higher leverage costs. Of course, the future is always unclear, so maybe it is just our cautious nature that is operating here.

#### **WHY MOVE MONEY FROM HYBRID PREFERREDS INTO TRADITIONAL PREFERREDS IF THAT REDUCES INCOME?**

It's not very complicated. The best way to get more income is to have more money to invest. The best way to do that is to take advantage of bargains, wherever they may be found within the preferred market.

Traditional preferreds offer one big advantage not available from hybrid preferreds. They qualify for the Dividends Received Deduction ("DRD"), which makes their dividends 70% tax-free to a qualifying corporate investor. When the market value is not properly recognizing the value of the DRD, traditional preferreds represent bargains even for fully taxable investors.

Historically, there have been times when hybrids have outperformed traditional DRD eligible preferreds and other times when traditional issues have come out on top. Over the years, we have often moved back and forth, in varying degrees, between hybrids and traditional preferreds. This has usually worked to the Fund's advantage.

Through a complicated formula, the effective cost of the Fund's leverage is also reduced when more of its income qualifies for the DRD. The resulting savings to the Fund will become even more significant if the cost of our leverage starts to rise again.

#### **WILL THE FUND'S HEDGING STRATEGIES BE DISTURBED BY THE TREASURY'S DECISION NOT TO ISSUE ANY MORE 30-YEAR BONDS?**

Although we have questions about the wisdom of the decision, it is unlikely to have a material effect on the Fund in the near-term. Not long ago, the crystal ball gazers were predicting that the Treasury would retire most of its public debt within a few short years. We were able to deal with that prospect, and eliminating new issues of 30-year Treasury bonds is less significant.

Various hedging tools are available to the Fund. Historically, it has used put options linked to long-term Treasury bonds. However, arrangements are also in place for the purchase of options on interest rate swaps ("swaptions"). We regularly compare the economics of these alternative hedge instruments.

Preferred Income Fund Incorporated

**FINANCIAL DATA****Per Share of Common Stock**

	<u>Dividends Paid</u>	<u>Net Asset Value</u>	<u>NYSE Closing Price</u>	<u>Dividend Reinvestment Price (1)</u>
December 31, 2000 .....	\$0.082	\$13.42	\$12.13	\$12.78
January 31, 2001 .....	0.082	13.68	13.00	13.29
February 28, 2001 .....	0.082	13.87	13.50	13.66
March 31, 2001 .....	0.082	13.78	13.50	13.57
April 30, 2001 .....	0.082	13.69	13.65	13.69
May 31, 2001 .....	0.082	13.83	13.88	13.83
June 30, 2001 .....	0.082	13.96	13.60	13.93
July 31, 2001 .....	0.082	14.37	14.45	14.37
August 31, 2001 .....	0.082	14.54	13.85	14.21
September 30, 2001 .....	0.082	14.22	14.05	14.36
October 31, 2001 .....	0.082	14.81	14.64	14.68
November 30, 2001 .....	0.082	14.62	14.47	14.48
<b>December 31, 2001 .....</b>	<b>0.164</b>	<b>14.46</b>	<b>14.70</b>	<b>14.46</b>

(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, 2001

Shares/\$ Par	Value (Note 1)	Shares/\$ Par	Value (Note 1)
<b>PREFERRED STOCKS AND SECURITIES — 94.7%</b>			
<b>ADJUSTABLE RATE PREFERRED STOCKS — 18.4%</b>			
<b>BANKING — 14.5%</b>			
			BancWest Corporation:
		\$4,350,000	First Hawaiian Capital I, 8.343% 7/1/27 Capital Security, Series B . . . . . \$ 4,575,765
35,000	Series Q, Adj. Rate Pfd. . . . . \$ 848,750*	300	BancWest Capital I, 9.50% 12/01/30 QUIPS . . . . . 7,958
95,250	Series R, Adj. Rate Pfd. . . . . 2,309,812*		Bank of America Corporation:
75,000	Cobank, Adj. Rate Pfd., Pvt.,144A*** . . . . . 4,011,000*	\$ 500,000	NB Capital Trust II, 7.83% 12/15/26 Capital Security . . . . . 508,948
	J.P. Morgan Chase & Co.:		BT Preferred Capital, 8.125% Pfd., Series I . . . . . 7,662
85,075	Series A, Adj. Rate Pfd. . . . . 7,444,062*	300	Citigroup Inc.:
37,775	Series L, Adj. Rate Pfd. . . . . 3,380,862*		6.231% Pfd., Series H . . . . . 180,975*
126,700	Series N, Adj. Rate Pfd. . . . . 3,104,150*		5.864% Pfd., Series M . . . . . 6,630,572*
170,850	Wells Fargo & Company, Series B, Adj. Rate Pfd. . . . . 8,328,937*	3,750	Firststar Realty LLC, 8.875% Pfd., REIT, Pvt.,144A*** . . . . . 3,219,916
	<b>TOTAL BANKING ADJUSTABLE RATE PREFERRED STOCKS . . . . .</b>	143,877	Wachovia Corporation:
	<u>29,427,573</u>	2,800	First Union Capital II, 7.95% 11/15/29 Capital Security . . . . . 1,575,180
	<b>FINANCIAL SERVICES — 0.5%</b>	\$1,500,000	First Union Institutional Capital I, 8.04% 12/1/26 Capital Security . . . . . 2,574,537
25,000	Bear Stearns Companies, Inc., Series A, Adj. Rate Pfd. . . . . 1,075,000*	\$2,500,000	First Union Institutional Capital II, 7.85% 1/1/27 Capital Security . . . . . 1,765,619
	<b>UTILITIES — 3.4%</b>	\$1,750,000	GreenPoint Financial Corporation:
	Niagara Mohawk Power Corporation:		GreenPoint Capital Trust I, 9.10% 6/1/27 Capital Security . . . . . 3,157,519
154,879	Series A, Adj. Rate Pfd. . . . . 3,833,255*	\$3,320,000	HSBC USA, Inc.:
28,747	Series B, Adj. Rate Pfd. . . . . 725,862*		\$2.8575 Pfd. . . . . 2,543,268*
88,745	Series C, Adj. Rate Pfd. . . . . 2,240,811*		Republic New York Capital II, 7.53% 12/4/26 STOPS . . . . . 2,594,869
	<b>TOTAL UTILITIES ADJUSTABLE RATE PREFERRED STOCKS . . . . .</b>	54,600	Keycorp:
	<u>6,799,928</u>	\$2,635,000	Keycorp Institutional Capital II, 6.875% 3/17/29 Capital Security . . . . . 904,475
	<b>TOTAL ADJUSTABLE RATE PREFERRED STOCKS . . . . .</b>		Keycorp Institutional Capital B, 8.25% 12/15/26 Capital Security . . . . . 1,926,773
	<u>37,302,501</u>		<b>TOTAL BANKING FIXED RATE PREFERRED STOCKS AND SECURITIES . . . . .</b>
	<b>FIXED RATE PREFERRED STOCKS AND SECURITIES — 75.2%</b>	\$1,000,000	<u>33,379,125</u>
	<b>BANKING — 16.5%</b>		
20,000	Abbey National Group, 7.375% Pfd., Series B . . . . . 502,100	\$1,870,000	
700	ABN AMRO North America, Inc., 6.46% Pfd., Pvt.,144A*** . . . . . 702,989*		

See Notes to Financial Statements.





Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)**  
**November 30, 2001**

<u>Shares/\$ Par</u>		<u>Value (Note 1)</u>		<u>Value (Note 1)</u>
<b>PREFERRED STOCKS AND SECURITIES (Continued)</b>				
<b>FIXED RATE PREFERRED STOCKS AND SECURITIES (Continued)</b>				
<b>UTILITIES — 30.0%</b>				
240,500	Alabama Power Company, 5.20% Pfd. ....	\$ 5,056,513*	8,500	Entergy Mississippi, Inc., 7.44% Pfd. ....
	Appalachian Power Company:		5,350	Florida Power & Light Company, 4.35% Pfd., Series E, Pvt. ....
76,450	8.00% QUIPS, Series B .....	1,929,216	1,810	Great Plains Energy, Inc., 4.50% Pfd. ....
100	8.25% Pfd. ....	2,536	5,000	Green Mountain Power Corporation, 7.32% Pfd., Series 1 .....
25,000	Avista Corporation, \$6.95 Sinking Fund Pfd., Series K ...	2,324,750*	20,000	Hawaiian Electric Company, Inc.: HECO Capital Trust I, 8.05% QUIPS .....
17,000	Baltimore Gas & Electric Company, 6.99% Pfd., Series 1995 .....	1,810,075*	4,530	Illinois Power Company: 4.08% Pfd., Series A .....
10,000	Boston Edison Company, 4.78% Pfd. ....	763,900*	8,960	4.42% Pfd., Series D .....
	Central Hudson Gas & Electric Corporation:		29,370	4.70% Pfd., Series E .....
5,000	4.35% Pfd., Series D, Pvt. ....	336,225*	785	7.75% Pfd. ....
750	4.96% Pfd., Series E, Pvt. ....	57,506*	10,000	Indiana Michigan Power Company, 8.00% Pfd., Series A TOPRS .....
12,450	Columbus Southern Power Company, 7.92%, Jr. Sub. Debt., Series B .....	318,222	14,500	Indianapolis Power & Light Company, 5.65% Pfd. ....
	Connecticut Light and Power Company:		5,874	Jersey Central Power & Light Company, 7.52% Sinking Fund Pfd., Series K ...
985	\$2.06 Pfd. ....	28,422*	4,500	Kentucky Energy Corporation, 6.53% Pfd. ....
5,223	\$3.24 Pfd. ....	238,404*	18,500	Monongahela Power Company, \$7.73 Pfd., Series L .....
2,000	4.50% Pfd. ....	60,950*	26,000	Montana Power Company, \$6.875 Pfd. ....
9,300	5.28% Pfd. ....	345,914*		Niagara Mohawk Power Corporation:
6,870	Dayton Power and Light Company, 3.90% Pfd., Series C .....	425,287*	3,550	4.10% Pfd. ....
	Duke Energy Corporation:		6,500	5.25% Pfd. ....
5,550	4.50% Pfd., Pvt., Series C .....	416,139*	3,500	Northern Indiana Public Service Company, 7.44% Pfd. ....
10,412	7.85% Pfd., Series S .....	1,106,483*	6,170	Ohio Edison Company, 4.44% Pfd. ....
519	7.04% Pfd., Series Y .....	55,551*		
5,000	Energy East Capital Trust I, 8.25% TOPRS .....	126,575		
	Entergy Arkansas, Inc.:			
2,800	7.32% Pfd. ....	263,298*		
11,350	7.40% Pfd. ....	1,078,988*		
1,147	7.88% Pfd. ....	119,965*		
4,440	Entergy Gulf States, Inc., 7.56% Pfd. ....	414,518*		

See Notes to Financial Statements.



Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2001

<u>Shares/\$ Par</u>	<u>Value (Note 1)</u>
<b>MONEY MARKET FUNDS — 4.6%</b>	
427,598 Provident FedFund, 2.27% .....	\$ 427,598
9,000,000 Provident TempFund, 2.28% .....	<u>9,000,000</u>
<b>TOTAL MONEY MARKET FUNDS</b>	
(Cost \$9,427,598) .....	<u>9,427,598</u>
<b>TOTAL INVESTMENTS</b> (Cost \$193,762,213**) 99.9%	202,276,002
<b>OTHER ASSETS AND LIABILITIES</b> (Net) . . . . . 0.1	<u>136,033</u>
<b>NET ASSETS</b> .....	<u>100.0%</u> <u>\$202,412,035</u>

\* Securities eligible for the Dividends Received Deduction.

\*\* Aggregate cost for federal tax purposes is \$193,872,325.

\*\*\* 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):

<b>QUIDS</b>	— Quarterly Income Debt Securities
<b>QUIPS</b>	— Quarterly Income Preferred Securities
<b>REIT</b>	— Real Estate Investment Trust
<b>STOPS</b>	— Semi-Annual Trust Originated Pass Through Securities
<b>TIPS</b>	— Trust Issued Preferred Securities
<b>TOPrS</b>	— Trust Originated Preferred Securities
<b>CorTS</b>	— Corporate Backed Trust Securities
<b>Pfd.</b>	— Preferred securities
<b>Pvt.</b>	— Private Placement 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, 2001****ASSETS:**

Investments, at value (Cost \$193,762,213) (Note 1)		
See accompanying schedule . . . . .		\$202,276,002
Dividends and interest receivable . . . . .		1,474,765
Prepaid expenses . . . . .		62,975
Total Assets . . . . .		<u>203,813,742</u>

**LIABILITIES:**

Payable for securities purchased . . . . .	\$ 1,045,500	
Dividends payable to Common Shareholders . . . . .	155,582	
Investment advisory fee payable (Note 2) . . . . .	93,828	
Professional fees payable . . . . .	52,041	
Accrued expenses and other payables . . . . .	54,756	
Total Liabilities . . . . .		<u>1,401,707</u>

**NET ASSETS** . . . . . \$202,412,035

**NET ASSETS CONSIST OF:**

Undistributed net investment income (Note 1) . . . . .	\$ 728,768	
Accumulated net realized loss on investments sold (Note 1) . . . . .	(6,982,079)	
Unrealized appreciation of investments (Note 3) . . . . .	8,513,789	
Par value of Common Stock . . . . .	98,970	
Paid-in capital in excess of par value of Common Stock . . . . .	142,552,587	
Money Market Cumulative Preferred™ Stock (Note 5) . . . . .	57,500,000	
Total Net Assets . . . . .		<u>\$202,412,035</u>

Per Share**NET ASSETS AVAILABLE TO:**

Money Market Cumulative Preferred™ Stock (575 shares outstanding) redemption value . . . . .	\$100,000.00	\$57,500,000
Accumulated undeclared dividends on Money Market Cumulative Preferred™ Stock (Note 9) . . . . .	456.30	262,372
	<u>\$100,456.30</u>	<u>57,762,372</u>
Common Stock (9,896,988 shares outstanding) . . . . .	<u>\$14.62</u>	<u>144,649,663</u>

**TOTAL NET ASSETS** . . . . . \$202,412,035

See Notes to Financial Statements.

Preferred Income Fund Incorporated

**STATEMENT OF OPERATIONS**  
For the Year Ended November 30, 2001

**INVESTMENT INCOME:**

Dividends .....	\$ 9,885,288
Interest .....	<u>4,275,815</u>
Total Investment Income .....	14,161,103

**EXPENSES:**

Investment advisory fee (Note 2) .....	\$1,103,732
Administration fee (Note 2) .....	234,896
Money Market Cumulative Preferred™ broker commissions and Auction Agent fees .....	158,665
Legal and audit fees .....	109,599
Insurance expense .....	102,001
Shareholder servicing agent fees and expenses (Note 2) .....	82,137
Directors' fees and expenses (Note 2) .....	72,354
Custodian fees and expenses (Note 2) .....	24,023
Other .....	<u>77,181</u>
Total Expenses .....	<u>1,964,588</u>

**NET INVESTMENT INCOME** ..... 12,196,515

**REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS**

(Notes 1 and 3):

Net realized loss on investments sold during the year .....	(1,300,809)
Change in net unrealized appreciation of investments during the year .....	<u>12,993,581</u>

**NET REALIZED AND UNREALIZED GAIN ON INVESTMENTS** ..... 11,692,772

**NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS** ... \$ 23,889,287

See Notes to Financial Statements.

Preferred Income Fund Incorporated

**STATEMENTS OF CHANGES IN NET ASSETS**

	<u>Year Ended November 30, 2001</u>	<u>Year Ended November 30, 2000</u>
<b>OPERATIONS:</b>		
Net investment income . . . . .	\$ 12,196,515	\$ 12,986,217
Net realized loss on investments sold during the year . . . . .	(1,300,809)	(4,274,778)
Change in net unrealized appreciation (depreciation) of investments during the year . . . . .	<u>12,993,581</u>	<u>(1,234,988)</u>
Net increase in net assets resulting from operations . . . . .	23,889,287	7,476,451
<b>DISTRIBUTIONS:</b>		
Dividends paid from net investment income to Money Market Cumulative Preferred™ Stock Shareholders (Note 5) . . . . .	(2,579,582)	(2,821,469)
Distributions paid from net realized capital gains to Money Market Cumulative Preferred™ Stock Shareholders (Note 5) . . . . .	—	(151,753)
Dividends paid from net investment income to Common Stock Shareholders . . . . .	(9,703,430)	(10,268,842)
Distributions paid from net realized capital gains to Common Stock Shareholders . . . . .	<u>—</u>	<u>(4,115,149)</u>
Total Distributions . . . . .	<u>(12,283,012)</u>	<u>(17,357,213)</u>
<b>FUND SHARE TRANSACTIONS:</b>		
Increase from Common Stock transactions (Note 4) . . . . .	<u>823,227</u>	<u>—</u>
<b>NET INCREASE (DECREASE) IN NET ASSETS FOR THE YEAR . . . . .</b>	<b>12,429,502</b>	<b>(9,880,762)</b>
<b>NET ASSETS:</b>		
Beginning of year . . . . .	<u>189,982,533</u>	<u>199,863,295</u>
End of year (including undistributed net investment income of \$728,768 and \$670,224, respectively) . . . . .	<u><u>\$202,412,035</u></u>	<u><u>\$189,982,533</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,				
	2001	2000	1999	1998	1997
<b>PER SHARE OPERATING PERFORMANCE:</b>					
Net asset value, beginning of year .....	\$ 13.41	\$ 14.41	\$ 16.43	\$ 16.71	\$ 16.50
<b>INVESTMENT OPERATIONS:</b>					
Net investment income .....	1.23	1.32	1.29	1.28	1.27
Net realized and unrealized gain/(loss) on investments .....	1.19	(0.56)	(1.35)	0.05	1.00
Total from investment operations .....	2.42	0.76	(0.06)	1.33	2.27
<b>DISTRIBUTIONS:</b>					
Dividends paid from net investment income to MMP* Shareholders .....	(0.26)	(0.29)	(0.20)	(0.17)	(0.22)
Distributions paid from net realized capital gains to MMP* Shareholders .....	—	(0.01)	(0.08)	(0.07)	(0.06)
Dividends paid from net investment income to Common Stock Shareholders .....	(0.98)	(1.04)	(1.12)	(1.05)	(1.15)
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* .....	0.03 †	(0.00) †	(0.03) †	(0.02)	0.02
Total distributions .....	(1.21)	(1.76)	(1.96)	(1.61)	(2.06)
Net asset value, end of year .....	\$ 14.62 †	\$ 13.41 †	\$ 14.41 †	\$ 16.43	\$ 16.71
Market value, end of year .....	\$ 14.470	\$ 12.125	\$ 12.750	\$ 15.938	\$ 16.188
Total investment return based on net asset value** .....	17.01%	4.55%	(1.81)%	6.91%	13.65%
Total investment return based on market value** .....	28.02%	6.88%	(10.43)%	7.05%	17.20%
<b>RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:</b>					
Operating expenses .....	1.42%	1.41%	1.37%	1.32%	1.34%
Net investment income*** .....	7.21%	7.58%	6.66%	6.13%	6.22%
<b>SUPPLEMENTAL DATA: ††</b>					
Portfolio turnover rate .....	39%	66%	65%	87%	74%
Net assets, end of year (in 000's) .....	\$202,412	\$189,983	\$199,863	\$219,398	\$221,990
Ratio of operating expenses to total average net assets .....	1.00%	0.98%	0.99%	0.97%	0.99%

\* 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 (\$0.02 per Common Share in 2001, \$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>Year Ended November 30</u>	<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>
2001	575	\$352,021	\$100,000	\$100,000
2000	575	330,404	100,000	100,000
1999	575	347,588	100,000	100,000
1998	575	381,562	100,000	100,000
1997	575	386,070	100,000	100,000

(1) Excludes accumulated undeclared dividends.

(2) See Note 5.

See Notes to Financial Statements.



**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 accounting principles generally accepted in the United States of America.

*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, except as described hereafter. In the absence of sales of listed securities and with respect to (a) securities for which the most recent sale prices are not deemed to represent fair market value and (b) 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 ("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 accrete discount on those fixed income securities, such as capital securities, that trade on an "accrued income" basis. Upon initial adoption, the Fund will be required to adjust the cost of such securities by the cumulative amount of accretion or amortization that would have been recognized had accretion or amortization been in effect from the purchase date of each

Preferred Income Fund Incorporated

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

holding. Adopting this accounting principle will not affect the Fund's net asset value, but will change the classification of certain amounts between net investment income and realized and unrealized gain/loss in the Statement of Operations. The adoption of this principle is not material to the financial statements.

*Options:* 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 capital gains 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 accounting principles generally accepted in the United States of America 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., a member of The PNC Financial Services Group, Inc. ("PNC Financial Services"), 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 paid PFPC Inc. a monthly fee at an annual rate of 0.12% of the Fund's average monthly net assets. During fiscal year 2001, effective December 1, 2001, this rate changed to 0.10%. 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.

As of April 9, 2001, PFPC Trust Company ("PFPC Trust") began serving as the Fund's Custodian. PFPC Trust is an indirect subsidiary of PNC Financial Services. As compensation for PFPC Trust's services as custodian, the Fund pays PFPC Trust a monthly fee at the annual rate of 0.01% of the Fund's average monthly net assets. Prior to April 9, 2001, Boston Safe Deposit and Trust Company ("Boston Safe"), a wholly-owned subsidiary of Mellon Bank Corporation, served as the Fund's Custodian.

**3. Purchase and Sales of Securities**

Cost of purchases and proceeds from sales of securities for the year ended November 30, 2001, excluding short-term investments, aggregated \$73,711,164 and \$83,550,031, respectively.

Preferred Income Fund Incorporated

**NOTES TO FINANCIAL STATEMENTS (Continued)**

At November 30, 2001, aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was \$12,083,462 and aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was \$3,679,785.

**4. Common Stock**

At November 30, 2001, 240,000,000 shares of \$0.01 par value Common Stock were authorized.

Common Stock transactions were as follows:

	<u>Year Ended</u> <u>11/30/01</u>	
	<u>Shares</u>	<u>Amount</u>
Issued as reinvestment of dividends under the Dividend Reinvestment and Cash Purchase Plan . . . . .	<u>58,417</u>	<u>\$823,227</u>

**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, 2001 included an accrued additional distribution of \$237,647. The amount subsequently calculated and then paid to the Money Market Cumulative Preferred™ Shareholders for fiscal 2001 was \$233,381. (See Note 9 – "Subsequent Events.")

Preferred Income Fund Incorporated

**NOTES TO FINANCIAL STATEMENTS (Continued)**

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.

At November 30, 2001, 575 shares of Money Market Cumulative Preferred™ Stock were outstanding at the annual rate of 1.72%. 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 traditional DRD-eligible preferred securities (i.e., adjustable and fixed rate preferred and preference stocks) and similar hybrid, i.e., fully taxable, preferred securities. Under normal market conditions, at least 80% of the value of the Fund's net assets will be invested in preferred securities. Also, 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 stocks and, under normal market conditions, up to 20% 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, CorTS, REIT, Capital Securities, and other similar or related investments, will be subject to the foregoing 20% limitation to the extent that, in the opinion of the Fund's Adviser, such investments are deemed to be debt-like in key characteristics. Typically, a security will not be considered debt-like (a) if an issuer can defer payment of

Preferred Income Fund Incorporated

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

income for eighteen months or more without triggering an event of default and (b) if such issue is a junior and fully subordinated liability of an issuer or its ultimate guarantor.

### **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 ("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 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, 2001, 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, 2001, the Commerce Group, Inc. and its affiliates owned approximately 30.1% of the Fund's outstanding Common Stock, according to Schedule D filings dated September 30, 2001.

### **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, 2001 through November 30, 2001 has been designated as being non-DRD income, as required by Internal Revenue Services Ruling 89-81, with respect to the Internal Revenue Code of 1986, as amended. On December 17, 2001, the Fund declared an additional distribution of \$233,381, payable December 19, 2001, to Money Market Cumulative Preferred™ Stock Shareholders as required by the Fund's Articles Supplementary. (See Note 5.)

## REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders  
Preferred Income Fund Incorporated:

We have audited the accompanying statement of assets and liabilities of Preferred Income Fund Incorporated, including the fund's portfolio of investments, as of November 30, 2001, and the related statement of operations, statement of changes in net assets and financial highlights for the year then ended. These financial statements and financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audit. The statement of changes in net assets for the year ended November 30, 2000 and financial highlights for each of the years in the four-year period ended November 30, 2000 were audited by other auditors whose report dated January 12, 2001, expressed an unqualified opinion on that financial statement and those financial highlights.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements and 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 as of November 30, 2001 by correspondence with the custodian and brokers. 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Preferred Income Fund Incorporated as of November 30, 2001, the results of its operations, changes in its net assets and financial highlights for the year then ended in conformity with accounting principles generally accepted in the United States of America.

**KPMG LLP**

Boston, Massachusetts  
January 7, 2002

---

Preferred Income Fund Incorporated

**TAX INFORMATION (Unaudited)**

---

Of the total distributions attributable to the fiscal year ended November 30, 2001, including the Additional Distribution to Money Market Cumulative Preferred™ Stock Shareholders, 65.79% qualified for the Dividends Received Deduction for eligible corporate investors. (See Note 9.)

For the calendar year ended December 31, 2001, 67.20% 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 2001.

At November 30, 2001, the Fund had accumulated realized capital losses of \$6,014,198 in 2000 and \$513,821 in 2001. These losses may be carried forward and offset against any future capital gains through 2008 and 2009, respectively.



Preferred Income Fund Incorporated

---

**ADDITIONAL INFORMATION (Unaudited)**

---

**Change in Independent Auditors**

Based on the recommendation of the Audit Committee of the Fund, the Board of Directors voted to appoint KPMG LLP as the Fund's independent auditors for the Fund's fiscal year ended November 30, 2001. On October 17, 2001, PricewaterhouseCoopers LLP ("PwC") resigned as the independent auditors of the Fund.

The reports of PwC on the Fund's financial statements for fiscal years ended in 2000 and 1999 did not contain an adverse opinion or a disclaimer of opinion, nor were such reports qualified or modified as to uncertainty, audit scope or accounting principles.

During the Fund's fiscal years ended in 2000 and 1999, and through October 17, 2001, there were no disagreements with PwC on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of PwC, would have caused them to make reference to the subject matter of the disagreement in their report on the financial statements for such years.

Preferred Income Fund Incorporated

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

### **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, 2001, \$2,609.66 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

Preferred Income Fund Incorporated

---

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

---

dividend 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.

Preferred Income Fund Incorporated

**ADDITIONAL INFORMATION (Unaudited) (Continued)****Information about Fund Directors and Officers**

The business and affairs of the Fund are managed under the direction of the Fund's Board of Directors. Information pertaining to the Directors and officers of the Fund is set forth below.

<u>Name, Address, and Age</u>	<u>Position(s) Held with Fund</u>	<u>Term of Office and Length of Time Served*</u>	<u>Principal Occupation(s) During Past Five Years</u>	<u>Number of Funds in Fund Complex Overseen by Director</u>	<u>Other Directorships Held by Director</u>
<b>NON-INTERESTED DIRECTORS:</b>					
<b>Martin Brody</b> c/o HMK Associates 30 Columbia Turnpike Florham Park, NJ 07932 Age: 80	Director	Class I Director since 1991	Retired	2	Director, Jaclyn, Inc. (luggage and accessories); Director, Smith Barney Mutual Funds (18 funds).
<b>David Gale</b> Delta Dividend Group, Inc. 301 Pine Street San Francisco, CA 94104 Age: 52	Director	Class I Director since 1997	President & CEO of Delta Dividend Group, Inc. (Investments).	2	Director, Stone Container Corporation, until Dec. 31, 2000; Director Free Real Time.com, until Feb 1, 2001.
<b>Morgan Gust†</b> Giant Industries, Inc. 23733 N. Scottsdale Road Scottsdale, AZ 85255 Age: 54	Director	Class III Director since 1991	From January 1, 1999, Executive Vice President, Giant Industries, Inc.; and, for more than five years prior thereto, Vice President, General Counsel and Vice President-Administration, Giant Industries, Inc.	2	—
<b>Robert F. Wulf</b> 3560 Deerfield Drive South Salem, OR 97302 Age: 64	Director	Class II Director since 1991	Since March 1984, Financial Consultant; Trustee, University of Oregon Foundation; Trustee, San Francisco Theological Seminary	2	—

\* The Fund's Board of Directors is divided into three classes, each class having a term of three years. Each year the term of office of one class expires and the successor or successors elected to such class serve for a three year term. The three year term for each class expires as follows:

**Class I Directors** – three year term expires at the Fund's 2002 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

**Class II Directors** – three year term expires at the Fund's 2003 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

**Class III Directors** – three year term expires at the Fund's 2004 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

† Represents holders of shares of the Fund's Money Market Cumulative Preferred™ Stock.

Preferred Income Fund Incorporated

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

<u>Name, Address, and Age</u>	<u>Position(s) Held with Fund</u>	<u>Term of Office and Length of Time Served*</u>	<u>Principal Occupation(s) During Past Five Years</u>	<u>Number of Funds in Fund Complex Overseen by Director</u>	<u>Other Directorships Held by Director</u>
<b>INTERESTED DIRECTORS:</b>					
<b>Robert T. Flaherty††</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 64	Director, Chairman of the Board, President and Chief Executive Officer	Class III Director since 1991	Prior to December 1996, President of Flaherty & Crumrine Incorporated ("Flaherty & Crumrine"); Director of Flaherty & Crumrine.	2	—
<b>Donald F. Crumrine†, ††</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 54	Director, Chief Financial Officer, Chief Accounting Officer, Vice President and Secretary	Class II Director since 1991	Chairman of the Board, since December 1996, and previously held other officerships of Flaherty & Crumrine; Director of Flaherty & Crumrine.	2	—
<b>OFFICERS:</b>					
<b>Robert M. Ettinger</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 43	Vice President and Assistant Treasurer	Since 1991	President of Flaherty & Crumrine.	—	—
<b>Peter C. Stimes</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 46	Vice President, Treasurer and Assistant Secretary	Since 1991	Vice President of Flaherty & Crumrine.	—	—

\* The Fund's Board of Directors is divided into three classes, each class having a term of three years. Each year the term of office of one class expires and the successor or successors elected to such class serve for a three year term. The three year term for each class expires as follows:

**Class I Directors** – three year term expires at the Fund's 2002 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

**Class II Directors** – three year term expires at the Fund's 2003 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

**Class III Directors** – three year term expires at the Fund's 2004 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

† Represents holders of shares of the Fund's Money Market Cumulative Preferred™ Stock.

†† "Interested person" of the Fund as defined in the Investment Company Act of 1940. Messrs. Flaherty and Crumrine are each considered an "interested person" because of their affiliation with Flaherty & Crumrine which acts as the Fund's investment adviser.

[This page intentionally left blank]

[This page intentionally left blank]

### **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, 2001**

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